The anatomy of relationship significance: a critical realist exploration

por

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To my one and only **Alexandra**, with whom every meaningful moment is shared.

To the memory of my first, beautiful son **Tomás** (October 2nd – 4th, 2006), the only flawless undertaking I could ever have been capable of co-conceiving.

I have suffered the greatest of losses and now I am empty.

And my soul is in heaven with my beloved son Tomás.

Biography of doctoral candidate

Born the 17th of August 1977 in Oliveira de Azemeis, I attained my 'Business Informatics' degree at the *Engineering School* of the *University of Minho* in 2000. Shortly after, I took the decision to undertake a Master in 'Information Systems' at the same university, whose completion was achieved with distinction by the 15th of April 2003. My doctoral journey officially started the following day at the *Faculty of Economics* of the *University of Porto*. Since October 2005, I am a Junior Lecturer of the *Department of Management and Economics* at the *University of Madeira*. My personal webpage is available at http://www.uma.pt/filipejmsousa .

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Finally, a few heartfelt words must be given to my supervisor. First, I owe Mota de Castro his priceless encouragement and advices: to benefit from conceptual liberty and stretch the bounds of current thinking; to be wary of unquestionable knowledge and defy entrenched positions (whenever and if that is supposedly the correct thing to do); to pursue my own path and tenaciously contend my ideas; and to perfect the clarity of exposition when arguing my stance; and to constantly challenge my own reasoning. Our working relationship was built by chance and from scratch – in these circumstances, only few relationships are bound to thrive. Yet, our relationship has evolved into one that clearly surpasses the traditional professor-student or master-apprentice connection. I wonder if our similar sarcastic abilities have been determinant in the strengthening of such relationship – that may well be the case!

Abstract

The markets-as-networks theorists contend, either explicitly or tacitly, the significance of business relationships for the focal firm – that is, business relationships contribute somewhat to the focal firm's survival and growth. I do not deny the possible existence of significant business relationships but sustain, in contrast to the consensus within the Markets-as-Networks Theory, that relationship significance should not be a self-evident assumption. Significance cannot be a taken-for-granted property of each and every one of the focal firm's business relationships. Instead, the notion of relationship significance needs to be discussed and its causes thoroughly explained. Adopting a critical realist position, the relationship significance is claimed to be an event of the business world, rightly deserving a robust causal explanation. My main research question is thus the following: How is the relationship significance brought about?

All the business relationships that the focal firm establishes, develops, maintains, and terminates with counterparts (most typically its suppliers and customers) can be adequately considered as entities which exhibit structural features namely continuity, complexity, informality, and symmetry. Owing to that peculiar structure, business relationships are endowed with certain causal powers and liabilities (e.g., allow the access to and exploitation of external and complementary resources and competences). Where those powers and liabilities (i.e., functions and dysfunctions) are put to work, inevitably under certain contingencies (namely the markets and networks surrounding the focal firm), effects (i.e., benefits and sacrifices) result for the focal firm – and the relationship significance is likely to be brought about. Two of those relationship powers – the 'access' and 'innovation' ones – are especially consequential, for their activation is likely to affect the delimitation of the focal firm's vertical boundaries. The relationship significance can be brought about owing to the overall benefits in excess of sacrifices (i.e., relationship value) accruing to the focal firm as well as the dual influence that business relationships have on what the focal firm does and gets done by others. For the business relationships contribute respectively both (i) to the access to and exploitation (and on occasion the development) of the external, typically complementary competences and resources needed by the focal firm and (ii) to the creation of new, and the modification and enhancement (or impairment) of the extant, internal resources and competences of the focal firm. What the focal firm comprises

within its vertical boundaries (chiefly resources and competences) and what it does and gets done (activities) are both strongly shaped by the business relationships in which it is deeply embedded. The relationship significance can result from the influence of business relationships on the nature and scope of the focal firm.

Keywords: Markets-as-Networks Theory, relationship significance, business relationships, firms, resources, competences, activities

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1. Introduction

"*We must obviously never return to the days when research students were told not to worry their little heads with theory but to admire craft and immerse themselves in the empirical sources.*"

(Sayer 1984, p. 264)

This first chapter poses the primary question and the objective guiding my research. I am mostly interested in discussing the significance of the *vertical interfirm relations*, in particular those that display for the most part cooperation – the so-called *business relationships* are the main object of inquiry of the *Markets-as-Networks Theory*. Significance cannot be a taken-for-granted property of each and every business relationship of the focal firm. On the contrary, the *relationship significance* is argued to be an *event* of the *business world*, whose *causes* remain yet largely unidentified. The *meta-theories* to which scientists are usually committed are addressed then in a succinct manner while I declare unambiguously my meta-theoretical viewpoint, a critical realist one. The *needfulness* of the study is argued next. Lastly, the *structure* of the thesis' remainder is presented.

1.1 The research theme

1.1.1 The vertical (and horizontal) relationships of the focal firm

Like all firms, the focal firm is involved in multiple relationships with a myriad of counterparts: unavoidably *vertically connected,* upstream with suppliers and downstream with customers (via *cooperation* and *exchange*); on occasion *horizontally linked* for the most part with its competitors (through *competition* and *cooperation*). The vertical and horizontal linkages of the focal firm are its (i) business relationships (cooperation) and arm's-length relations (exchange) and (ii) inter-organisational relationships (cooperation) respectively. Each interfirm relation is describe succinctly in turn.

Arm's-length relations

Firms have the option to engage in either an arm's-length relation or a business relationship with any of its suppliers and customers. These two vertical linkages available to firms serve, of course, different purposes. While the arm's-length, purely transactional relations are merely about the acquisition, in markets, of usually standard external resources, the business relationships allow firms to access and exploit their counterparts' complementary resources and competences (e.g., a customer's reputation and a supplier's know-how in the form of a specially tailored product respectively). Instead of – and sometimes even before – the *interactions* prevalent in ongoing interfirm relationships (wherein mutual trust and commitment, reciprocity, and future interaction all matter), firms engage in *transactions*, i.e., arm's-length, purely transactional relations governed by the price mechanism. Price and quantity are the only features of these latter discrete, on-off transactions.

Business relationships

A business relationship usually denotes as any *direct* relationship that the focal firm initiates, develops, and maintains upstream with suppliers and downstream with customers (Hakansson 1982b), a vertical recurring interaction which involves the exchange of both economic and non-economic elements (e.g., money and products, and trust, commitment, or knowledge respectively) (Easton and Araujo 1992). Other vertical yet *indirect* relationships (e.g., those between the focal firm and its suppliers' suppliers or its customers' customers) are also typified as business relationships. "An indirect relationship is most simply described as the relationship between two firms which are

not directly related but which is mediated by a third firm with which they both have [direct] relationships." (Easton 1992, p. 15). As a rule, the focal firm's indirect business relationships far outnumber its direct relationships. By drawing upon Ford et al. (1986, p. 390) and Hakansson and Snehota (1995, p. 25; 2000, p. 38), business relationships are defined as *(previous and current) patterns of interaction and interdependence between two firms, both vertically connected and reciprocally committed to each other*. Such vertical interfirm relationships are typically characterised as (i) *long-lasting*, (ii) *informal* (i.e., governed by so-called implicit or incomplete contracts), (iii) *complex* (i.e., entailing a variegated inter-personal contact pattern and aiming at multiple objectives), and (iv) more or less *symmetrical* in terms of both parties' influence over, and initiative to nurture and sustain, the relationship (Hakansson and Snehota 1995).

Inter-organisational relationships

In the business world, however, other (less prevalent) types of interfirm relationships can be found: the horizontal relationships that the focal firm maintains on occasion mostly with its competitors but also with complementors[1] and third parties (e.g., universities, technological centres, or trade associations). These so-called inter-organisational relationships can take a variety of forms (e.g., alliances, consortia, interlocking directorates, joint ventures, strategic networks, and trade associations) and are (i) usually established for specific, clearly delimited purposes, (ii) formal (i.e., ruled by written, detailed, and legally enforcing contracts), and (iii) rather short-termed (Barringer and Harrison 2000).[2]

1.1.2 IMP and the Markets-as-Networks Theory

The *Industrial and Marketing Purchasing Group* (henceforth IMP) is the most prominent worldwide research community dedicated to the study of the vertical interactions and relationships established and maintained between firms. The origins of the IMP, according to one of its founding fathers (Cunningham 1980), can be traced back to the mid-1970s in Europe when several junior marketing researchers – from France (Jean Paul Valla and Michel Perrin, *Institut de Recherche de l'Entreprise* in

[1] Nalebuff and Brandenburger (1996) employ the term '*complementor*' to refer to a producer of complementary products.

[2] For an overview of the literature on horizontal interfirm relationships, see the Organization Science 9(3), 1998 and the Strategic Management Journal 21(3), 2000. This formal (horizontal) cooperation between firms is less predominant than the informal (vertical) interfirm cooperation (Hakansson and Johanson 1988).

Lyon), Germany (Michael Kutschker, *University of Munich*), Italy (Ivan Snehota, *Isvor-Fiat Institute* in Turin), Sweden (Hakan Hakansson, Lars Hallen, Jan Johanson and Bjorn Wootz, *University of Uppsala*), and the United Kingdom (Malcolm Cunningham, Elling House, and Peter Turnbull, *University of Manchester Institute of Science and Technology* and David Ford, *University of Bath*) – dissatisfied with the explanatory power of Marketing Theory (deeply rooted in Microeconomics), started to challenge the conventional view of business-to-business markets as both atomistic and faceless with the empirical findings of their research. Some seminal contributions can be easily identified, e.g., Blois (1972), Ford (1978), Hakansson (1975), Mattsson (1973), amongst others. The IMP faces a growing interest since its foundation in 1976 and can be said to currently comprise over three hundred scholars and researchers mostly from Europe, but also from Australia, Japan, and the United States of America. Hakansson and Snehota's (2000, p. 35) characterisation of the IMP is insightful: "The IMP is a prime example of what it is also studying – a flexible network organization with floating boundaries but built around some strong relationships that connect and permit cross-fertilisation of various streams of ideas and research.". The IMP's main discussion fora are its annual conference, held since 1984. For more details see the http://www.impgroup.org website.

The extensive conceptual and empirical body of knowledge developed by the IMP over the last three decades (see, for instance, Axelsson and Easton 1992) has drawn upon many other conceptual fields – *Social Exchange Theory* (Blau 1964), *Interorganisational Theory* (Negandhi 1975), *Relational Contracting Theory* (Macneil 1980), *Resource Dependence Theory* (Pfeffer and Salancik 1978), *Organisational Theory (March and Simon 1958)*, or even *Transaction Cost Economics* (Williamson 1985), just to mention a few – and can be now properly called a theory. The development of a holistic theory of business markets is presented as a challenging task for researchers in the field of Industrial Marketing and Purchasing. That theory, Melin (1989) argues, has to necessarily address the multiple ambiguities observed in interfirm relationships and networks, e.g., the coexistence of cooperation and conflict and of stability and change. This may explain why most scholars and researchers, whenever discussing or reviewing the thirty-year old body of knowledge produced by the IMP, diverge with regard to its denomination: whereas some call it *an approach* (Hakansson 1987), others see it as *a paradigm* (Easton 1992), or *an European-based research*

tradition (Johanson and Mattsson 1994), or still *a school of thought* (Araujo and Easton 1996a), not to forget *a perspective* (Turnbull et al. 1996). It is often the case that such body of knowledge is equated with a relatively new *theoretical territory* in the Marketing landscape (Easton and Hakansson 1996) or even strangely confused with *a social enterprise* (Axelsson 1992b) or *a social grouping* sharing similar interests and assumptions (Easton and Araujo 1989).

The recognition of a full-fledged Markets-as-Networks Theory, despite reluctantly assumed or promptly denied at early times (Hakansson and Snehota 2000, p. 46), seems to be tacitly shared by the majority of the IMP members (see, for instance, McLoughlin and Horan 2002). The Markets-as-Networks Theory – relatively young but appealing and robust – attempts to describe and explain the inner workings of the business networks and the interfirm relationships and interactions these overall comprise. Unsurprisingly, the '*interaction*', the '*relationship*', and the '*network*' are its main units of analysis. Though clearly not monolithic (i.e., meaning different things to different people), the Markets-as-Networks Theory features at least three major conceptual cornerstones[3]: (i) *the existence of business relationships* (Ford 1980), *as well as their connectedness* (Anderson et al. 1994) *and uniqueness* (Hakansson and Snehota 1995); (ii) *business relationships as a third type of governance structure, alternative to both firms (or hierarchies) and markets (or arm's-length, purely transactional relations between firms)* (Richardson 1972); and (iii) *the significance of business relationships for the focal firm* (henceforth the '*relationship significance*') (Gadde et al. 2003). I am exclusively concerned here with the last of these cornerstones, in particular the identification of the causes responsible for bringing about such relationship significance.

The relationship significance is made partly explicit in the pervasive contention of markets-as-networks theorists that '*business relationships are one of the most valuable resources at the focal firm's disposal*' (Easton and Araujo 1993b; Hakansson 1989, 1987). As Hakansson and Snehota (1995, p. 27) put it: "A [business] relationship is one of the resources the company can exploit and use in combination with other resources (other relationships) available to the company.".[4] Business relationships are a particular

[3] The term 'conceptual cornerstone' is borrowed from Hakansson and Snehota (2000).

[4] Interestingly, the most illustrious theorists of the so-called Competence-based Theory of the Firm – the theory whose focus is on firms' resources and competences – include business relationships either as one

kind of resource that is not unilaterally owned, but rather jointly controlled by the two parties involved, i.e., the focal firm and its counterpart (Hakansson and Snehota 1995). As resources, business relationships are (i) non-depreciable (for their utility or value does not necessarily decrease over time, in fact the contrary seems to be the case) (Hakansson and Snehota 1995) and (ii) extremely difficult to replicate or substitute (Hakansson 1989) as well as to acquire or sell across markets (Anderson et al. 2001). A business relationship, being essentially an implicit contract embedded in the identity of the involved parties without which it looses meaning (Ben-Porath 1980), can be thus seen as an *intangible and idiosyncratic (i.e., counterpart-specific) resource*, *not easily* if at all *tradable* between firms (Hakansson and Snehota 1995).

Since all firms develop and sustain business relationships between themselves, industrial marketing scholars and researchers are inclined to admit that those relationships contribute somewhat to the firms' existence or survival. This is why some markets-as-networks theorists stress the '*strategic importance*' or '*significance*' of business relationships (Gadde et al. 2003; Hakansson 1989), whereas others refer to relationships as of '*strategic status*' (Moller and Halinen 1999) and '*critical*', '*crucial*', '*good*', '*high-performing*', '*high-quality*', '*important*', '*relevant*', '*significant*', or '*valuable*' (Cunningham 1980; Ford et al. 1998; Ford and McDowell 1999; Gadde and Snehota 2000; Hakansson 1987; Hakansson and Snehota 1995; Johanson and Mattsson 1987; Kutschker 1982; Naude and Buttle 2000).[5] Very frequently '*significant business relationships*' are, more or less explicitly, likened to '*business relationships maintained with significant counterparts*' (Wiley et al. 2006, p. 5) or '*business relationships held with interesting (or value-providing) counterparts*' (Hakansson and Snehota 1995, pp. 202-3). The significance of a certain business relationship is not (and cannot be) explained by appealing to the significance of a particular firm, e.g., in terms of its internally available resources and competences – that would necessarily deny the suitableness of the network perspective on industrial markets and, just to mention one aspect, the impact of connected relationships. Only recently has the (focal) firm's significance been unequivocally recognised within the Markets-as-Networks Theory,

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of such resources (Barney 1991) or as a part of the '*strategic assets*' (Amit and Schoemaker 1993) or the '*asset position*' of the focal firm (Teece et al. 1997).

[5] Even the celebrated Edith Penrose (1959, p. 147, fn. 2), whose seminal research shed light on the limits to the growth and size of the firm presciently remarks "[t]he importance attached by firms to the maintenance of their existing business relationships (…)".

that is to say, the focal firm being as an individually significant and interdependent entity (Ford and Hakansson 2006a, p. 7). It is the relationship significance, rather than the significance of the focal firm, that is my focus of interest here. Let me briefly unpack the black-box and intricate notion of relationship significance.

1.1.3 The conventional meaning of relationship significance

The notion of 'relationship significance' is solely used throughout, understandably substituting for a variety of other, equivalent terms such as '*relationship criticality*', '*relationship importance*', or '*relationship relevance*'. It arguably denotes '*the irrefutable influence of business relationships on the focal firm's survival and/or growth*' – at least this is the signification implicitly assumed by markets-as-networks theorists as a whole. That one is sticking to the original – though mostly inferred – meaning of relationship significance, and not advancing a new one, is supported by Hakansson and Snehota's (1995, p. 267, emphasis added) words: "In order to survive and develop you *have to have* counterparts (…).". Such meaning of relationship significance is also conveyed by Ford and Hakansson (2006a, p. 22, emphasis added): "Companies can choose if and how they want to do something particular relative to a specific counterpart. But they *cannot choose whether or not* to have relations with others, including their suppliers and customers.". Blois (1998, p. 256) goes even further, by stating that "(…) it is impossible for firms not to have [vertical] relationships (…)." Contrary to what Neoclassical Economics postulates, the existence of the focal firm cannot be conceived of without business relationships – see, e.g., Schumpeter (1954) on a review of Neoclassical Economics' premises. It has been theoretically claimed and empirically documented since the mid-1970s that no existing (i.e., surviving) firm is '*an island in a sea of market relations*' (Hakansson and Snehota 1989; Richardson 1972).

The business relationships that the focal firm establishes, develops, maintains, and terminates with counterparts (most notably customers and suppliers) affect somewhat the focal firm's functioning and development, ultimately *influencing* its *survival* in business markets (Ford and McDowell 1999; Hakansson and Snehota 1995). Such business relationships are therefore *significant* for the focal firm. The focal firm, in the event of deliberately terminating its established business relationships (or instead seeing those relationships abruptly ended by the counterparts' will), is not only somehow impeded to operate and grow, but more importantly, it is surely doomed to perish

(Pfeffer and Salancik 1978). As Ford et al. (1998, p. 13) put it: "A company's relationships are important assets and without them it could not operate, or even exist.". Needless to say, the relationship significance is also acknowledged by all the counterparts with which the focal firm is connected. The counterparts (i.e., other firms) are as dependent for their survival and growth on business relationships as the focal firm is. Since I am here adopting the vantage point of the focal firm, the counterpart's perspective is left latent – albeit resembling, at least in part, the former. It seems reasonable to assume the similitude of the focal firm's and counterpart's perspectives since business relationships are usually characterised as symmetric with respect to both parties' initiative and interest in their development and maintenance (Hakansson and Snehota 1995).

1.1.4 Five distinguishing features of relationship significance: its non-determinism, continuum, changeability, connectedness, and perceptibility

Firstly, though business relationships are by and large significant for the focal firm, they *need not be so* at all times (Ford and Hakansson 2006a). While it is admissible that business relationships are in general significant for the focal firm – otherwise it would be illogical for them to exist at all – they need not be necessarily significant to some extent. Contra Ford and Hakansson (2006a, p. 11), '*business relationships are not always islands of significance in a sea of ordinariness*'. That business relationships can be sometimes *burdens* or *liabilities* for the focal firm (Hakansson and Snehota 1998) endorses my viewpoint.

Secondly, it is unlikely that all business relationships are, at a given point in time, highly significant for the focal firm. "Not all relationships are equally significant; some are more critical [for the focal firm] than others." (Hakansson and Snehota 1995, p. 125). A relationship significance *continuum*, ranging from *insignificant* business relationships through *lowly significant* and *averagely significant* to *highly significant* ones, can be thus presumed (Sousa and de Castro 2004). Ford and McDowell (1999) express what seems to be a common argument among markets-as-networks theorists when they argue that all business relationships are (continually) significant for the focal firm even though some are more than others. One can agree only with the latter of their contentions. Only a very limited number of business relationships impacts strongly

upon the focal firm's survival and/or growth. "(…) [C]ompanies are likely to have *relatively few* [highly] significant [business] relationships." (Ford and Hakansson 2006b, p. 250, emphasis added). The recurrent observation made by markets-as-networks theorists over the last thirty years wherein few suppliers and customers account for the majority of the focal firm's total purchases and sales respectively (Hakansson 1982b) – coming close to the '*Pareto's 80/20 rule*' – corroborates this point.

Thirdly, significance is surely not a fixed attribute of business relationships. Each and every business relationship is significant *to different degrees* for the focal firm over time. For example, a business relationship, currently highly significant for the focal firm, may become lowly significant in the future. The *time-varying relationship significance* is contended (Sousa and de Castro 2004).

Fourthly, the connectedness of business relationships affects the relationship significance. Connectedness needs to be taken into account when the significance of a business relationship is under assessment (Hakansson and Snehota 1995). Seemingly, the significance of a certain business relationship of the focal firm is in part related to the significance of other (directly or indirectly connected) relationships. This is but the corollary of firms, as well as their business relationships, being somehow interrelated.

Finally, it is likely that the relationship significance *cannot be objectively determined*, being instead object of the focal firm's changeable perception (Wiley et al. 2006). Of course, only the individuals within the focal firm are capable of truly perceiving such phenomena (Weick 1969). The relationship significance can – though it may not – be perceived by the focal firm's top management and other personnel directly involved in managing business relationships, namely from Marketing and Purchasing departments (Ritter 1999). For the sake of simplicity, I consider only the *anthropomorphic perception* of the focal firm concerning the significance of its business relationships (not only the extant, but also potential ones). Arguably, that perception resembles the '*subjective interpretation*' pointed out by Ford and Hakansson (2006a) in their enumeration of the core features of business interaction. The *perceived* relationship significance is bound to vary both (i) within the focal firm and (ii) over time. The individual and collective perceptions existing within the focal firm are bound to vary over time, and that owes primarily to modifications in the *real* significance of business

relationships. Even when business relationships do not change at all, the focal firm's perceptions concerning their significance can change – e.g., because of human cognitive reasons alone (Weick 1969). Plus, the same business relationship can be perceived as differently significant by the parties involved. For instance, the focal firm may perceive that business relationship to be highly significant, whilst the counterpart may take it as low in significance. This situation is probably not unusual in business markets. Of course, the relationship significance *perceived* by the focal firm needs not match exactly the *real* relationship significance. That is, the focal firm's perceptions may not represent in an accurate manner the *real* significance of all of its business relationships. Each business relationship is what it is – either highly significant, totally insignificant, or somewhere in between – *independently of* any perception held by the focal firm. For instance, the focal firm can perceive its (*de facto* highly significant) business relationship with the counterpart A as being just lowly significant. Or, on the other hand, the (indeed insignificant) business relationship with the counterpart B can be considered as averagely significant by the focal firm. Even though the focal firm's perception does not *per se* make a business relationship significant or contrariwise, the possibility that the former may have repercussions on the latter in the future should not be excluded – e.g., the focal firm can mistakenly regard a (somewhat significant) business relationship as completely insignificant and take steps to end it, thus possibly affecting the (degree of) significance of other, connected business relationships.

1.2 Scientists and their meta-theoretical commitments

The world, usually divided into the 'natural' and the 'social', predates all human beings. I stand with those that believe that the world has existed and still exists independently of scientists' or lay men's knowledge or their identification of it. While upholding the *realist* conviction – that the world as a whole is mostly *what it is* regardless of what humans choose to say, think, or write about it – one must also acknowledge the *social construction* of some parts of that world. Needless to say, as social scientist I am mostly interested in the social world. For surely the *social* world is to some degree *socially constructed* by men via their discourse and/or interpersonal conventions (e.g., rules, symbols, theories, and so forth). Contra the arguments of those espousing a strong social constructivist or *postmodernist* stance, the world is not merely a *tour de force* of mankind or the feasible aftermath of its intents and actions. A realist position – like that endorsed by other scholars and researchers in the Management field, e.g., see Ackroyd and Fleetwood (2000b) and Fleetwood and Ackroyd (2004a) – is suitable for analysing my (main and related) phenomena of interest: firstly *firms*, described here as heterogeneous bundles of resources and competences (some internally owned, others externally accessed and exploited), are *real*; secondly, the horizontal relationships that firms at times develop and maintain with their competitors – usually labelled *inter-organisational relationships* – are real as well; finally the *markets* and *networks* in which firms necessarily operate (i.e., the aggregates of *arm's-length relations* and *business relationships* vertically connecting firms respectively) are both real.[6] From these, my focus of interest is on business relationships, also referred to as *buyer-seller relationships*, *customer-supplier relationships* or *exchange relationships*.

Though this opening sentence may seems somewhat out of place for the 'Introduction' chapter of a Management thesis, I consciously reproduce it here because such a critical realist stance – that of realists which take a critical approach on their object of study – does have consequences for a less ambiguous reading of what follows. My meta-theoretical assumptions are clarified at once.

[6] In my perspective at least, business networks do not encompass both the horizontal and vertical relationships in which firms are generally engaged, in sharp contrast with the claims of scholars in the Strategic Management field (e.g., Gulati 1998; Gulati et al. 2000).

Any scientific research endeavour inevitably builds upon a particular *ontology* (i.e., a view of how the world is), *epistemology* (i.e., how the world can be known), *methodology* (i.e., what methods to use in the world' inquiry), and *aetiology* (i.e., the underlying causes of the world's events). Each and every scientist upholds such premises, commonly entitling them as his or her guiding *Philosophy of Science* or *Meta-theory*. Therefore scientists should always make their meta-theoretical commitments unambiguous, if not explicit. The objectives aimed for and the questions formulated in their research and, more importantly, the answers given are all likely to differ according to their meta-theoretical assumptions. Likewise any criticisms to scientists' works, unavoidable and desirable as they are, should be made taking the respective meta-theory into consideration.

Scientists in general, and social scientists in particular, adopt often in an implicit way one of three meta-theories in their research endeavours (Fleetwood 2007a, 2005): *Positivism*, *Postmodernism*, or *Critical Realism*. The differences between these mutually exclusive meta-theories are easily identified. Positivists envisage the world as a sensible and manipulable closed system wherein cause-effect relations (i.e., constant conjunctions of event regularities) can be empirically observed and recorded, whereas postmodernists argue that the world is fully socially constructed by humankind. For critical realists, on the contrary, (i) the world exists as an open system no matter any knowledge one may have of or develop about it (such knowledge being surely fallible) and (ii) social science should be critical of the very social world it aims to tentatively describe and explain. Moreover, Critical Realism depicts the world as composed of a myriad of *entities* and *events*, the former usually being unobservable and the latter normally confined to the realm of the observable. Such entities (necessarily or only contingently related to each other) exhibit peculiar *structures*, i.e., sets of interrelated properties which make them the kind of entities they are and not anything else. The world's entities, in virtue of their inherent structures, necessarily possess – though may not exercise – certain *causal powers and liabilities*, hence being both capable of doing some things and incapable of doing others. On the other hand, events result when the powers of entities are *de facto* activated (or, on the contrary, when entities' liabilities are somehow impeded) which, in turn, usually depend on certain *contingencies*, namely (i) the presence or absence of other entities and/or (ii) the activation or obstruction of

their own powers and liabilities (Bhaskar 1975; Sayer 1984, 2000). One example usually given to illustrate the critical realist meta-theoretical view of the world is that of human beings. Humans, by virtue of their intricate physiological, anatomical, and social make-up (e.g., brains, respiratory systems, arms, legs, status, and so on), have the outstanding powers to think, talk, listen or run, jump, and swim – powers, of course, put to work always under the restriction of spatial and temporal conditions (e.g., a man cannot speak fluently a foreign language without proper and lengthy instruction and repeated practice nor play tennis in the absence of either a court, an opponent, a racket, or a reasonable knowledge of the game).

A critical realist meta-theory is explicitly endorsed in this research. This being said, it is time to introduce the substantive theory which is the main springboard of my *conceptual* work here – the *Markets-as-Networks Theory*, also denominated *Industrial Networks Theory* or *Theory of Industrial Networks* – and present the main research question. I am particularly interested in one of the primordial conceptual cornerstones that theory: *the significance of business relationships* – that significance existing of course *in relation* to a particular entity, preferably *the focal firm*. One should absolutely oppose to the more or less dominant view across the markets-as-networks theorists that relationship significance should be considered *in and of itself*, that is, business relationships are significant by themselves and not for a specific entity, whether it is for instance the focal firm, its supplier A or customer B.[7] On the contrary, it is my contention that significance is not an absolute or given property of business relationships. A pertinent question immediately arises whenever one presumes the significance of something or someone: '*significant for whom?*'. Significance is an attribute that needs to be considered only *in relation to* at least one entity –it seems nonsensical to think of relationship significance in abstract. The focal firm's standpoint is appropriately adopted here, at least if I acknowledge that "[r]elationships are in our view an important structural dimension [of the business network] as fundamental as organisations themselves" (Ford and Hakansson 2006b, p. 252). "By definition, a network analysis means that what happens *between* companies is regarded as just as important as what happens *within* them." (Hakansson 1989, p. 171, emphasis added). However, the focal firm's viewpoint should not be equated with the '*firm-centred view*

[7] This view is pronounced, for instance, in the comments received from an anonymous referee to a paper I presented in the 22nd IMP Conference.

of the world' or the '*single-firm perspective*' so commonly found in Management theory and practice, whereby the focal firm is presumed to be an atomistic entity solely concerned with its own objectives and interests and disposing of complete discretion in its actions and long-term direction (i.e., strategy). The focal firm's viewpoint needs not be at odds with a '*relative world*' in which interfirm interaction predominates. The Markets-as-Networks Theory usually endorses the perspective of the '*focal business relationship*' or the '*focal business network*' (Easton and Hakansson 1996). This explains the difficulty of issuing managerial prescriptions and the theory's positive orientation.

1.3 The research question and objective

1.3.1 A challenge to the common foundationalism concerning the relationship significance

It is quite common to find within any existing theory some issues which are seen as unchallengeable while others, less obvious, remain greatly unexplored. Alajoutsijarvi et al.'s (2001) deconstruction and analysis of the metaphorical structure of the '*network talk*' – devised and deployed at large by the IMP – can help us understand why this also happens within the Markets-as-Networks Theory. Alajoutsijarvi et al. (2001) hint that, on account of the metaphors predominantly employed in the theoretical discourse of markets-as-networks theorists (and in its diverse sub-discourses), some aspects of business relationships and networks are inquired while others simply remain out of investigation. Those dominant metaphors guide theorists towards certain research questions and also to the acceptable answers. The relationship significance is bound to be one of the '*currently hidden aspects of business networks*' (Alajoutsijarvi et al. 2001, p. 104). Although the Markets-as-Networks Theory supposedly provides a '*general picture of the significance of business relationships*' (Ford and Hakansson 2006b, p. 251),[8] I claim that relationship significance is largely an understudied and taken-for-granted issue whose potential causes are not yet subject to a systematic and thorough analysis by the markets-as-networks theorists. To my best knowledge, Wiley et al.'s (2006; 2003) empirical research conducted in Sweden, Germany, and China on the '*sources*' of relationship significance (in their case, as *perceived* only *by suppliers*) is a meritorious exception.

Many if not all markets-as-networks theorists assert and reiterate the relationship significance (see, e.g., Ford and Hakansson 2006b) but seldom if ever *discuss* it in depth. Their foundationalist position, nevertheless, is easy to explain. For markets-as-networks theorists, all business relationships are almost *by definition* significant for the focal firm. Their reasoning is basically the following: (i) business relationships exist and somehow endure; and (ii) *if* business relationships are *de facto* deliberately initiated,

[8] The above-mentioned anonymous referee states along the same vein that all research conducted by the IMP is '*about the various ways in which business relationships are significant*'. And Blankenburg-Holm and Johanson (1992, p. 6, emphasis added) substantiate this position: "The IMP research *confirmed* the *significance* of lasting customer-supplier relationships.".

nurtured, and sustained by the focal firm – a purposive entity – *then* business relationships must have some usefulness (i.e., be to some extent significant) for the focal firm. Markets-as-networks theorists, in the empirical research conducted on business markets over the last thirty years, observe and report recurrently the focal firm as willingly related to and heavily dependent on several counterparts (Hakansson 1975). They assume therefore that the business relationships allowing such many-sided and multi-purpose interaction with counterparts *ought to be* significant to some extent for the focal firm. In sum, markets-as-networks theorists construed the pervasive existence of business relationships as a secure warrant of their significance, that is, *relationship existence* automatically implies *relationship significance*. This common taken-for-grantedness with regard to the relationship significance seems evident throughout the Markets-as-Networks Theory – see, for instance, Hakansson and Snehota (1995) who contend that the foci of interest of the markets-as-networks theorists are '*the important [vertical] relationships*' to the disfavour of '*uninteresting [and unimportant]*' ones. Hakansson and Snehota (1995, p. 330) declare business relationships, shown to have a complex substance and perform multiple functions (for the parties involved), to be *a priori* significant for the focal firm. At the same time, the other interfirm vertical relationships with either a single substance and/or a straightforward function – that is, the purely transactional relations which are objects of study in other theories (e.g., Neoclassical Economics and Transaction Cost Economics respectively) – are as a rule deemed insignificant for the focal firm. (Hakansson and Snehota 1995). One can hardly agree with this contention. Not only business relationships (and their aggregate networks) but also alternative governance structures such as hierarchies and markets (i.e., arm's-length relations between firms) can be significant to diverse degrees for the focal firm. Furthermore, each of these significances (regarding business relationships, hierarchies, and markets) may be assessed by itself or, alternatively, in comparison with one another. Relationship significance, my primary focus here, is determined either *per se* or relatively to either or both of hierarchy and market significances, and vice-versa.

I do not deny the existence of significant business relationships but argue, contra the consensus within the Markets-as-Networks Theory, that relationship significance should not be considered an axiom. One is likely to find a few markets-as-networks theorists denying fiercely the foundationalist accusation placed on them. Where that is the case,

their arguments can only be that the relationship significance is justified by the role that business relationships play for the focal firm, i.e., the relationship functions performed and the (more positive than negative) outcomes resulting – a line of reasoning similar, e.g., to that of Walter et al. (2003; 2001). The relationship significance is not a self-evident truth – for significance is surely not a property of each and every one of the focal firm's business relationships. Certainly, it is not deterministic that the existence of business relationships – and the business networks overall formed – leads to their absolute significance for the focal firm (cf. Ford and Hakansson 2006a; Ford and Hakansson 2006b). Put simply, the relationship significance (and in particular its underlying causes) needs to be discussed and thoroughly accounted for – a position endorsed by just a few, e.g., Sousa and de Castro (2006).

Surely, the relationship significance is but a potential event of the world

Critical Realism depicts the world as composed of multiple entities and events – the former, owing to their structure and powers and under certain spatial and temporal conditions, being responsible for the generation of the latter. And, of course, both entities and events exist regardless of human identification or knowledge of them. From a critical realist point of view, it is indisputable that business relationships are not necessarily significant to some extent for the focal firm. Relationship significance is something which can or cannot result, on account of certain (yet ungrasped) causes. In other words, the relationship significance is merely an event taking place, intermittently and '*here and there*', in the intricate business networks wherein the focal firm is deeply embedded – an event which is not always rightly perceived as such by the focal firm. As an illustrative example, think of two hypothetical business relationships of the focal firm: (i) its business relationship with supplier A, totally insignificant in a near past and currently highly significant; and (ii) its business relationship with customer B, at early times averagely significant, allegedly lowly significant in the future.

Bearing in mind that the relationship significance is a potential event of the business world, my main research question here is the following: '*Why is a business relationship significant to some degree for the focal firm? That is to say, how is the relationship significance brought about?*'. From this realist-inspired question, a research objective follows: to investigate the *structures* and *powers* which can be responsible for bringing about the relationship significance.

1.4 The need for the study

Business relationships are sources of both opportunities and constraints, thus being simultaneously rewarding and demanding for the focal firm. Multiple benefits accrue from the participation of the focal firm in business relationships but these do not come rapidly or freely (Blois 1999). Inescapably, some sacrifices are incurred (Ravald and Gronroos 1996). Being involved in business relationships is always resource-intensive for the focal firm, even if to varying extents (Araujo et al. 1999; Gadde and Snehota 2000). Such relationships can only be established, nurtured, maintained, and even ended by the focal firm through a large and incremental investment of resources (Hallen et al. 1991).

Given that (i) business relationships differ between themselves (and over time) in their relative degree of significance and (ii) the focal firm is endowed with limited resources (and consequently, can be highly involved with only a limited number of counterparts), "(…) there is a need for giving certain [business] relationships priority over others" (Hakansson and Snehota 1995, p. 131). "A firm has only limited resources; it must choose how much, and in what fashion, it will devote to each [business] relationship, potential or actual." (Easton 1992, p. 25). To prioritise business relationships boils down to '*single out the significant ones*' (Hakansson and Snehota 1995, p. 125). Prioritising, however, is not only about *giving* both high priorities to certain business relationships and low priorities to others. It also entails *getting* similar priorities from the corresponding counterparts with which the focal firm interacts via those business relationships (Hakansson and Snehota 1995, p. 202). The focal firm, in order to attribute such priorities to its business relationships, employs some criteria. "Companies always have, explicit or only implied, principles for giving priority between existing [business] relationships (…)." (Hakansson and Snehota 1995, p. 264). For instance, the degree of trust and commitment of the counterparts – declared or somehow inferred from their behaviour – often informs the focal firm in the decision to prioritise its business relationships, e.g., a higher priority assigned only to business relationships with trustworthy and highly committed counterparts (Hakansson and Snehota 1995, p. 265). Another very reasonable criterion which can be used by the focal firm in such prioritising task is the (mostly perceived) relationship significance, either currently or in the future.

So, the focal firm is advised to be rather selective in the development and maintenance of its business relationships. That is, different priorities are (or should be) attributed to, and attained in, differently significant business relationships. This means that the focal firm needs to effect a differentiated *relationship posture* in its diverse business relationships (Gadde and Snehota 2000). The focal firm's relationship posture describes its *degree of involvement* in a particular business relationship. A high or low degree of involvement characterises: (i) the extent of relationship-specific investments made by the focal firm; and (ii) the intensity of existing *activity links*, *resource ties*, and *actor* (i.e., interpersonal) *bonds* existing between the focal firm and its counterpart (Gadde and Snehota 2000). The focal firm knows, of course, that diverse postures (i.e., degrees of involvement) are likely to lead to substantially different relationship benefits and sacrifices. High-involvement business relationships usually require greater sacrifices yet allow the focal firm to obtain – presently or in the future – higher benefits than those captured in low-involvement ones (Araujo et al. 1999). "Increased involvement makes sense only when the consequently increased relationship costs [and overall sacrifices] are more than offset by relationship benefits." (Gadde and Snehota 2000, p. 310). The best way for the focal firm to '*make the most'* of its diverse business relationships is to adopt a combination of low- and high-involvement relationship postures, e.g., by attributing lower priorities to lowly significant business relationships and higher priorities to highly significant ones, hence committing to such relationships lesser and greater amounts of resources respectively (Gadde and Snehota 2000). The focal firm should intendedly engage in both low and high resource-demanding (i.e., lowly and highly significant) business relationships with counterparts, albeit the traditional apologia for the latter ones. In this respect, note the increasingly widespread contention throughout the Markets-as-Networks Theory that '*partnering with suppliers and customers is always beneficial*' (see, e.g., Campbell and Cooper 1999; Sheth and Sharma 1997).

That the focal firm needs to have a varied degree of involvement in its business relationships over time is supported by two other reasons (Araujo et al. 1999). First, the high-involvement relationships, despite offering potentially higher benefits, are complex to manage and demand far more investments thus being more risky – not to mention that such resource-demanding relationships do not always exhibit a high degree

of significance for the focal firm (e.g., not bringing about benefits in excess of sacrifices). Secondly, a high resource-demanding business relationship necessarily requires a high degree of involvement by both parties involved – for that business relationship will not develop and endure if the focal firm or its counterpart lacks either the interest or the resources (e.g., time and money) to establish and maintain it.

The message is clear: business relationships should be managed in varied ways by the focal firm, in accordance with their (present or future) relationship significance. The focal firm must deploy a *thoughtful differentiation* in its business relationships (Ford et al. 1998). "Only a limited number of [business] relationships can be developed in a more extensive way by an actor, as developing such extensive bonds is exacting. (…) Extensive bonds can be developed only to some and not all counterparts." (Hakansson and Snehota 1995, pp. 200, 202). The focal firm is in general strongly committed to the business relationships which are (or can become) highly significant. Such relationships, usually high-involvement ones which demanded a long time and many efforts to develop, may be extremely difficult to replace (Ford et al. 1998). Even when substitute business relationships (either extant or potential) can be found, it is unlikely that these are significant for the focal firm to the same extent. Business relationships are never fully replaceable, insofar as substituting one for another is not costless. As Anderson et al. (1994, p. 9, emphasis added) put it: "In most business-to-business settings, relations are only *nearly substitutable* in that some adaptation will be needed, even though it may be rather minor (…).". A low-involvement posture, on the contrary, is likely to be adopted by the focal firm in its business relationships which are low in significance. The (actual or potential) relationship significance needs to be carefully assessed over time at least if the focal firm aims to manage its business relationships effectively as well as efficiently. The relationship and network management is, in essence, about (i) monitoring and changing (whenever necessary) the degree of involvement adopted by the focal firm in each and every of its business relationships (Gadde and Snehota 2000) and (ii) establishing new business relationships, developing, altering or terminating existing ones or change the connections between them (Mattsson and Johanson 1992). In the same vein, Hakansson and Snehota (1995, p. 125) claim that "(…) without some insight about which links [i.e., business relationships] are critical (…), management actions can become counterproductive and produce undesired effects".

The commonly urged differentiation in the relationship posture – in essence the *relationship* and *network management* (Ritter et al. 2004) – can be effected only when the focal firm is able to (i) identify *which* of its business relationships are or will be significant (and to what degree) – of course, the relationship significance is affected by the connectedness of business relationships – and (ii) more importantly understand *why* that is the case. Only by probing into the relationship significance, and being able to disclose its causes, can the focal firm acquire or improve its understanding concerning the individual and collective management of business relationships. That invaluable understanding can, for instance, compel the focal firm to (i) reinvest in a business relationship which is expected to augment its degree of significance in the near future or (ii) instead divest if that relationship is currently insignificant. The decision to divest of, or even terminate, a business relationship releases resources that the focal firm may use otherwise (e.g., to deepen an existing relationship, or establish a new one, both of which are potentially more significant). Needless to say, the focal firm is likely to face substantial opportunity costs when it chooses to maintain a lowly significant business relationship in disfavour of other highly significant one(s).

That the causes of the relationship significance are seldom (if ever) articulated within the Markets-as-Networks Theory helps to explain why the focal firm's understanding with regard to the management of its business relationships (and overall network) is yet far from perfect – probably giving rise to damaging practical consequences at the relationship and network levels. Managerial guidelines on the relationship and network management can only be rightly given to the focal firm's managers (or grasped by themselves) when the underlying causes of the relationship significance are fully and unambiguously known by the markets-as-networks theorists. This thesis aims to contribute to the understanding on the relationship significance – and indirectly to practice. Improving the practice of industrial marketing and purchasing necessarily requires an ever better conceptual comprehension of firms and their business relationships and networks. "[B]y extending and improving firms' understanding and sensitivity regarding relationship and network issues, better performing firms and networks will emerge (…)" (Wilkinson and Young 2002, p. 127).

1.5 The structure of the thesis

The thesis is organised as follows. This introductory chapter is followed by the declaration of my (critical realist) meta-theoretical point of departure. A brief outlook on the History of Science paves the way for the exposition of the ontological, epistemological, methodological, and aetiological premises of the three meta-theories that scientists normally deploy in their inquiries of the world: Positivism, Postmodernism, and Critical Realism. The theoretical basis is presented in the third chapter. The historical roots, the development, dissemination, and orientation, and the state of the art of the Markets-as-Networks Theory are expounded. The fourth chapter, the core of the thesis, features the tentative description and explanation of the causes potentially bringing about the relationship significance. Lastly, I present the concluding remarks, namely the main theoretical contributions and limitations of the study as well as the future research agenda.

2. The meta-theoretical point of departure

"*[N]othing happens without a cause. (…) [W]e continue to regard unanswered causal questions as just that – not as proven cases of indeterminacy [i.e., the absence of causality as if 'God plays dice'].*"

(Collier 1994, p. 127)

Meta-theory is seldom found in doctoral theses, the notable exception being those of Philosophy candidates. Nevertheless, this chapter intends to unequivocally disclose my main meta-theoretical assumptions (given the centrality of meta-theory here), while also paving the way for the arguments on the anatomy of the relationship significance. First, a brief history of Science is given. And then the ontological, epistemological, methodological, and aetiological premises of the three meta-theories that social scientists normally employ (knowingly or not) in their scientific endeavours are pointed out.

This chapter draws heavily upon the works of Sayer (1984; 2000) and Fleetwood (2004; 2005) and their illuminating view of the Philosophy of Social Science and particularly of Critical Realism. The clarifying meta-theoretical taxonomies aligned by Ackroyd (2004, pp. 150-1) and Fleetwood (2007a, p. 3) are of particular importance. Furthermore, Delius et al.'s (2000) overview of the History of Philosophy and the access to one of the largest online encyclopaedias (see http://www.answers.com) proved very helpful in facilitating my rapid yet interested incursions into the History and Sociology of Science. The extensive comments of Fleetwood to an early draft of this chapter are greatly appreciated.

2.1 A concise vista on the History of Science, since the Antiquity through the Middle Ages to Modernity

Science derives from the Latin word '*scientia*', broadly meaning 'knowledge'. It is commonly defined as (i) the systematic, rigorous, and time-consuming activity through which the world is both inquired and tentatively described and explained and (ii) the outcomes of such activity. That is, science denotes the production and use of scientific knowledge (theoretical and empirical) and that knowledge *per se*. The origins of Science can arguably be traced back to the sixth century B.C. when, in *Antiquity*, the Pre-Socratic philosophers (later followed by prominent others such as Socrates, Plato, and Aristotle in the fifth and fourth centuries B.C.) firstly attempted to discover the governing principles of the world – the so-called '*metaphysics*'. These Pre-Socratic Greek philosophers (amongst which one can find Thales, Anaximander, Pythagoras, Anaximenes, Heraclitus, and Parmenides) are largely responsible for the transition in Western thought from the '*myth*' to the '*logos*' (the greek term for '*reason*') – a radical shift that implied abandoning the hitherto common theological or supernatural explanations of the world and the search for and proposal of rational, logic ones. From that time, the study of the world relying purely on logical reasoning – that is to say, '*Philosophy*' or, in Greek, '*the love of wisdom*' – has been underway. And concurrently, the kindred '*logocentrism*' (i.e., the belief that the pursuit of '*pure reason*' is conducive to the discovery of the underlying substance of the world) has predominated.

The *Middle Ages*, the Western history period between those ancient (both Greek and Roman) times and our modern era, were heavily marked by a movement known as *Scholasticism*. The scholastics attempted, between the eleventh and fourteenth centuries, to combine theology and philosophy – with the most widely known of those reconciliations being the thirteenth century synthesis of the Christian faith with the Aristotelian metaphysics performed by Thomas Aquinas. The medieval inquiry of the world, in the beginning conducted at large within monasteries, expanded to other, more proper, locations – the first universities created in the late eleventh and twelfth centuries in Italy, England, and France. The total number of medieval universities founded throughout Europe amounted then to more than sixty. The first university ever founded, however, dates back to the fifth century when a learning centre of Philosophy,

Astronomy, and other subjects is created in Constantinople (currently Istanbul, Turkey). Formally founded in ninth century, this university lasts until the fourteenth century.

The post-medieval period, spanning from the sixteenth century to the present, is often labelled *Modernity*. Since the scientific method is first proposed in this period, earlier inquiries of the world are considered pre-scientific.[9] Modernity may be seen to include at least two distinct epochs: the *Ages of Reason* and *of Enlightenment* in the seventeenth and eighteenth centuries respectively.[10] The Age of Reason indisputably signals the end of the Middle Ages during which faith commands reason and imposes its scholastic stamp on the knowledge of the world. *Rationalism* (i.e., the belief expounded by prominent philosophers such as René Descartes, Baruch Spinoza, and Gottfried Leibniz, that the exercise of reason rather than experience is the primary source of knowledge) then prevails. Rationalist positions are later challenged by *Empiricism*, the distinguishing feature of the Age of Enlightenment. Leading empiricists like John Locke, George Berkeley, and David Hume claim that all that can be known results only from the human sensory experience. The basis of the empiricist philosophy is found earlier, in the beginning of the seventeenth century, when Francis Bacon proposes the *inductive method* (through which one can arrive at universal claims about the world by drawing upon multiple observations and experiments and discovering event regularities). Despite Rationalism being clearly opposed to Empiricism, the empiricist philosophers are not totally against the use of reason nor do they fail to deploy it, where necessary, in their investigations.

The nineteenth century witnesses the development of *Idealism* and *Positivism*. These two philosophies seem to be elaborations of the earlier centuries' rationalist and empiricist standpoints respectively. While the Idealism posited by Georg Hegel and others contends that the world is merely composed of ideas (i.e., the world exists primarily as human consciousness or spirit), the Positivism of Auguste Comte and John

[9] The scientific method is composed of the principles necessary for the realisation of scientific investigations, namely: (i) the observation or experimentation of the phenomena; (ii) the formulation of hypotheses concerning the phenomena, via induction (i.e., the move from the particular to the general); (iii) the tests of the proposed hypotheses to demonstrate their truth or falsity, through deduction (i.e., the move from the general to the particular); and (iv) the verification of, or the need to modify, those hypotheses. The scientific method is strongly rooted in the empiricist tradition, hence privileging the use of quantitative research methods and techniques (see the 2.2.1 section below). The scientific method, first employed and still dominant in the natural sciences, is now massively deployed by social scientists.

[10] Some historians take the Age of Reason to be an earlier part of the Age of Enlightenment, thus seeing the latter Age to include both Rationalism and Empiricism.

Stuart Mill emphasises the role of sense perceptions as the only admissible source of knowledge. It is noteworthy to say that Idealism is allegedly a reaction to the materialist position which advocates that the world is only matter, essentially physical. Materialism is formulated as early as the fourth century B.C. (when the Greek natural philosopher Democritus first proposed the Atomism, a theory arguing for the world as merely including atoms and empty space) and later renewed in the seventeenth century, e.g., by the English Philosopher Thomas Hobbes. Early in the twentieth century, Positivism undergone a period of systematic reflection driven primarily by the Vienna Circle and the Berlin Circle, two groups of philosophers and scientists (like Rudolf Carnap and Carl Gustav Hempel respectively) formed in the 1920s that met regularly to investigate the philosophy of science. Karl Popper later on criticises and extends the positivism advocated by the 'Vienna Circle'.

The scientific progress attained during Modernity (especially the nineteenth and twentieth centuries) in both natural and social sciences, at large shaped by the empiricist/positivist stance, is overwhelming. Major scientific advancements in Physics (e.g., Isaac Newton's Law of Gravitation), Chemistry (e.g., the determination of oxygen's role in combustion and respiration and the advancement of the first period table of chemical elements by Antoine Lavoisier), or Biology (e.g., the theory of evolution by natural selection put forward by Charles Darwin) are good examples of such steady and undeniable progress in the human knowledge of the world. This prolificacy seduces many social scientists into the belief that positivism does for social sciences what it has done for natural ones. And, over the years, Positivism gradually disseminates into almost all social sciences, including Management. Since the mid twentieth century, Positivism comes under challenge mostly from philosophers of science. These responses to Positivism, often globally referred to as *Post-Positivism*, are for the most part divided in two: (i) *Postmodernism* (also entitled *Post-Structuralism*, (*Strong*) *Social Constructionism* or (*Strong*) *Social Constructivism*) featured by Alexandre Koyré, Thomas Kuhn, and Paul Feyerabend; and (ii) the *Realism* of Roy Bhaskar and Rom Harré. Postmodernists and realists, whilst sharing an animosity to Positivism, differ fundamentally on the ontology presumed. Put simply, realists contend the existence of a mind-independent world whereas postmodernists claim the social (mostly discursive) construction of the world. Realism is a meta-theory whose

foundations are laid down earlier by the '*transcendental idealism*' of the 18th century German philosopher Immanuel Kant (1781 [1999]). For Kant, our experience of the world is about how it appear to us, not as the world is in and of itself. He distinguishes between the *things-in-themselves* ('*noumena*') and the human perceptions and conceptions of those things ('*phenomena*'). The world has a (more or less apprehensible) structure beyond and in fact independent of human knowledge.

2.2 Alternative philosophies of social science (or meta-theories)[11]

The world we inhabit is usually seen as divided in two: the natural and the social, i.e., nature and society. The first is studied by natural sciences, the second by social ones. Both natural and social sciences aim to develop and improve our understanding of the world, therefore reducing our ignorance and freeing us from the restricting influence of human dogmas and falsehoods (Sayer 2000). Social sciences in particular enable and encourage the emancipation of society, as Collier (1998) argues, by fostering the development of knowledge.[12] Scientists always rely on some presuppositions when conducting natural or social research. Such presuppositions, which every good scientist should be aware of and when necessary make explicit, concern: (i) the way the world is thought to be (*ontology*); (ii) how the world can be known (*epistemology*); (iii) which research methods and techniques to employ in its study (*methodology*); and (iv) what causes underlie the world (*aetiology*).[13]

Ontology relates to the nature or substance of the world, that is, the (kind of) entities that exist. Epistemology, on the other hand, is focused on how human beings can acquire or develop knowledge of the world. Methodology is focused on the methods and techniques to deploy in the world's inquiry, mostly scientific research. Finally, aetiology regards the study of the causes underlying the world's primary constituents (i.e., entities and events). Ontology is often claimed – at least by postmodernists and critical realists – to be the overriding meta-theoretical dimension for it strongly influences epistemology, methodology, and aetiology (Ackroyd and Fleetwood 2000a).

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[11] The Philosophy of Science, being one of Philosophy's diverse branches, is concerned with (i) the assumptions and implications of Science (especially ontological and epistemological ones) and (ii) how is scientific progress attained by mankind. At the outset, one must acknowledge the terminological ambiguity surrounding the lexicon of philosophers of science (see, for instance, the interchangeable use of '*entities*', '*objects*', '*events*', '*phenomena*', '*world*', and '*reality*' to denote the same thing, namely all that exists). I stick tentatively to the same terms throughout the thesis in order to avoid reproducing that terminological confusion.

[12] Alvesson and Willmott's (1992, p. 432) definition of emancipation is championed here: "Emancipation describes the process through which individuals and groups become freed from repressive social and ideological conditions, in particular those that place socially unnecessary restrictions upon the development and articulation of human consciousness.". Human emancipation, however, requires more than (new) knowledge – changes in the world's practice, often motivated by such knowledge, are naturally necessary (Sayer 2000).

[13] Ontology and epistemology are in general denoted as the *nature of being* and the *knowledge of being* respectively (see, for instance, Ackroyd and Fleetwood 2000a).

Scientists' presuppositions, that is to say, the ontological, epistemological, methodological, and aetiological commitments they inevitably embrace in their investigations of the world, constitute their *philosophies of Science* – what I prefer to denominate here as *meta-theories*. These meta-theories should not be confused with the *substantive theories* that scientists usually employ or devise in their research efforts. But it needs to be acknowledged the influence that any meta-theory has to some extent on the substantive theory adopted or created by the scientist. Fleetwood and Ackroyd (2004a) define meta-theory as what lies beyond or outside any substantive theory, empirical research or practice. The relation between meta-theory and theory in particular is loose rather than tight (Sayer 2004): having the 'right' meta-theory does not necessarily lead us to develop a 'right' or unchallengeable theory; yet, it is very unlikely to arrive at a 'right' theory when starting from a 'wrong' meta-theory – though it can happen by pure chance. Both meta-theories and theories change, notwithstanding, the latter is altered more often and sometimes radically.[14]

Meta-theory and theory are two issues infrequently discussed by Management scholars and researchers (Tsoukas 1994). While meta-theory is almost altogether neglected (Fleetwood 2007b), theory is only seldom an object of analysis within Management. To my best knowledge, worthy exceptions on meta-theory reflections include Tsoukas' (1989) and Easton's (2000) arguments in favour of the epistemological suitability of case research, the discussions promoted by Lawson (1997) and Fleetwood (1999) on the adequate meta-theoretical basis for Economics, Easton's (2002) apologia for a critical realist standpoint in the Marketing field, as well as the more recent discussions on ontological and epistemological issues in Management studies primarily from either a postmodernist or realist perspective (e.g., Jones and Bos 2007; Westwood and Clegg 2003). And on theory see, for instance, the Academy of Management Review's 1989 and 1999 fora on *theory building and testing* (e.g., Van de Ven 1989; Weick 1999) and, in the Administrative Science Quarterly, Astley (1985) and a forum on *what theory is and is not* (DiMaggio 1995; Sutton and Staw 1995; Weick 1995).

Where the meta-theoretical commitments are not made transparent or remain ambiguous or unexamined (or worse, are 'buried' within developed or espoused theories), one often finds scientists at cross-purposes, talking past one another instead of

[14] Unless mentioned otherwise, the social world is referred henceforth to as '*the world*'.

engaging in constructive and intelligible criticism. This is the case with some of the Postmodernism versus Realism debates, e.g., a heated skirmish over appropriate meta-theoretical premises taking place in the Strategic Management field (Kwan and Tsang 2001; Mir and Watson 2001, 2000). Some social scientists defend themselves on these occasions by claiming to be reproducing the ontological inconsistencies of their objects of study (e.g., lay persons). This reproduction is yet unacceptable and scientists should instead critically report those '*ontological oscillations*', that is, identify those inconsistencies clearly and comment on their possible causes and consequences (Fleetwood 2005). All scientists must be explicit about and mindful of their espoused ontology – though there is always the remote possibility that a scientist may straddle two different ontologies (Fleetwood 2007a).

Since their inception in the first decades of the 20th century, the social sciences in general and the field of Management in particular are widely dominated by Positivism. Fleetwood (2007a) correctly points out two motives for the dominance of this positivist orthodoxy: (i) most of the 'Research Methods' courses attended by postgraduates in universities draw (at least implicitly) upon Positivism, focusing exclusively on quantitative methods and techniques; and (ii) as the courses on 'Philosophy of Science' are extremely rare to find in those same universities, thus leaving absent the valuable discussion on the suitability and shortcomings of each of the available meta-theories, many social scientists are unaware of the deficiencies of Positivism and that meta-theoretical alternatives do exist. Some of those who start to challenge the predominant meta-theory, especially from the 1980s onwards, encounter or stumble upon what they take to be the only alternative to Positivism, namely Postmodernism – as if only two competing meta-theories are available to inform and guide scientific research. The common line of reasoning, as Ackroyd and Fleetwood (2000a, pp. 3-4) put it, is that either the world (i) is objectively available and capable of being easily known by the systematic application of the empirical techniques or (ii) is not known objectively at all and what is known is merely the product of human discourse. It is very common to find postmodernists wrongly treating (Critical) Realism as synonymous with or a disguise of Positivism, as if the empirical or naive realism of positivists and the critical (or qualified version of) realism are the same thing (e.g., Mir and Watson 2000, pp. 944-5). This explains why many postmodernists think that the only alternative to the spurious

'*scientificity*' of Positivism (and its useless quest for the absolute truth of knowledge) is Relativism and/or Conventionalism, i.e., that truth is relative to its proponents and/or collectively agreed upon respectively (Fleetwood and Ackroyd 2004b). What is striking is that postmodernists posit an almost *empty* or *impoverished* realism when they assume the existence of discursive or ideal entities only (Fleetwood 2005). See more on the ontology of Postmodernism (section 2.4.1). It needs to be made clear, however, that the rejection of Positivism does not mandate an allegiance to Postmodernism. There is available the (Critical) Realism alternative, arguably more appropriate to inform scientific research. Positivism and Realism, despite sharing the assumption of a mind-independent world, differ strongly with respect to the existence of observable and unobservable entities and events within the world. Positivists take observation and experimentation procedures as the primordial ways to attest their ontological claims, therefore privileging the observable over the unobservable – what is labelled the '*empiricist prejudice*' (Fleetwood 2002a). Realists, on the other hand, consider both the observables and unobservables of the world as objects of potential inquiry.

Against the commonly held position that only Positivism and Postmodernism are on offer, some social scientists root their work neither in positivist nor in postmodernist meta-theories. Of these scientists, the best known are John Commons, Friedrich Hayek, Nicholas Kaldor, John Keynes, Karl Marx, Carl Menger, George Shackle, Adam Smith, Joseph Schumpeter, Thorstein Veblen, and Max Weber all of which draw upon various forms of Realism – despite mostly not using the term 'Realism'. Contrary to what postmodernists often assume, Realism does not represent a recent meta-theoretical reaction against Postmodernism (cf. Contu and Willmott 2005; Reed 2005). There is no late '*realist turn*' in Science, natural or social (Ackroyd and Fleetwood 2000a). Yet, it is undeniable that Realism only gained prominence since the 1970s, after being carefully articulated and refined by Bhaskar and others (Bhaskar 1975; Harré and Madden 1975), in particular its sophisticated variant known as Critical Realism. Collier (1994) addresses the pivotal influence of Bhaskar on the development of Critical Realism. For incisive introductions to Critical Realism, see Archer et al. (1998) and Danermark et al. (1997). Notwithstanding the current popularity of Postmodernism among the social scientists, many of them are now increasingly prone to endorse the meta-theoretical option posed by Critical Realism. Indeed, one can find multiple examples of social

scientists who adopt (mostly in an implicit way) a realist perspective on their research topics. A large number of scientists, by acknowledging that the world includes things which exist independently of any knowledge of them, may even be called '*minimal realists*' (Sayer 2004). See, for instance, the Ackroyd and Fleetwood's (2000b) and Fleetwood and Ackroyd's (2004a) volumes as a sample of the growing number of critical realist inspired works across various sub-fields of Management (e.g., Human Resource Management, Operations Management, Industrial Marketing, and others). Plus, Realism even seems to be the orthodoxy amongst Management practitioners (Fleetwood and Ackroyd 2004b). That a realist viewpoint is in general adopted by business managers is corroborated, for instance, by Hesketh and Fleetwood's (2006) empirical work on the '*Human Resources Management-Organisational Performance*' link.

It should be stressed that the ontological, epistemological, methodological, and aetiological commitments of these three meta-theories (in part, mutually exclusive) are applied in both the natural and social sciences. The only difference being that natural scientists endorse Realism – rather than Critical Realism – insofar as they (i) do not (and often cannot) critically evaluate their objects of study and (ii) are not urged to issue guidelines in order to, for instance, change the ways of acting or the effects brought about by such objects. Scientists can take a critical realist perspective when those objects of study are subjects (naturally endowed with the possibility to change, intendedly or not). A critical evaluation is advised and sometimes not dispensable in (a realist) social research. Critical Realism is a qualified variant of Realism, sharing all of its features and only to be applied in the social sciences (Sayer 2000).

Next, I address seriatim the three meta-theories that social scientists employ (explicitly or implicitly) in their research. Both Positivism and Postmodernism are presented uncritically, along with their (allegedly unsound) views of ontology, epistemology, methodology, and aetiology. Criticisms to positivist and postmodernist standpoints are suspended until Critical Realism is introduced.

2.3 Positivism

Positivism, also often referred to, in its various versions, as Empiricism, *Foundationalism*, *Instrumentalism*, *Logicism*, *Modernism*, *Objectivism*, or *Scientism*, is the orthodox meta-theory deployed in most of the natural and social sciences. Though there are many versions of Positivism, I address here the variant in which it is conventionally depicted, or as Easton (2000, p. 212) perceptively puts it, its '*lowest common denominator version*'.

Positivists do not usually engage in discussions on meta-theory, seeing these as useless and sterile. They just '*get on with research*', taking for granted the premises of the apparently unique meta-theory available (Positivism) and ignoring the meta-theoretical alternatives (either Postmodernism or Critical Realism). As seen below, Positivism builds upon certain premises: (i) an empirical realist ontology; (ii) the equivalence of explanation and prediction; (iii) the large-scale deployment of induction and deduction; and (iv) the universality of closed systems and the conception of causality as mere cause-effect relations (resulting from the ontology and epistemology presumed). Hempel and Oppenheim's (1948) analysis of the essential characteristics of scientific explanations can be mentioned as a fine example of the positivist standpoint in science. In their paper, one encounters *passim* both explicit and implicit references to the main premises of Positivism (e.g., p. 142 on the authors' latent assumptions of the ubiquity of closed systems and constant conjunctions of events).

2.3.1 Ontology

Positivists advocate an *empirical realist* ontology. There is a world '*out there*' composed of *observable*, *perceptible*, *measurable*, and *quantifiable* entities and events, all waiting to be discovered, sensed, and explained. Entities and events, of course, exist regardless of human knowledge of them whatsoever. That is, the world predates human beings but, ontologically speaking, Positivism claims that all that exists can be known by mankind (via observations or experiments) or, in other words, what cannot be observed or experienced is unlikely to exist – at the very least, it is ruled out of scientific investigation. Positivists do not deny *a priori* the existence of what they cannot know about, but are prone to exclude it from their inquiries (Fleetwood 2001). Some of the more sophisticated empiricist philosophers (for example, Van Fraassen 2004) try to extend the scope of empiricism to include phenomena that, despite

inaccessible to the naked eye, can be observed via various instruments, e.g., microscopes or telescopes. Yet this position is not taken up by social scientists engaged in Positivism who still privilege that which can be observed and, of course, measured.

2.3.2 Epistemology

Positivists endorse Locke's (1690 [1998]) belief that the human mind is born blank – a '*tabula rasa*' or a '*blank slate*' – upon which the world begins to '*write*' through the experience of the five human senses (sight, hearing, touch, taste, and smell). Positivism presumes a clear-cut distinction between 'subject' and 'object', a distinction which Sayer (1984) argues to be strongly rooted in a set of parallel dualisms (such as 'reason-emotion', 'mind-body', 'fact-opinion', 'thought-action') in which the left-hand term is unequivocally considered as superior to the right-hand one.

Understandably, the existence of an unproblematic and largely *theory-neutral* access to the world (via observation and/or experimentation) is assumed by positivists. It is not unusual to find the empirical research conducted by positivists, during which the world's entities and events are recorded, measured and quantified, without the guidance of any substantial theoretical base (Fleetwood 2007a). All knowledge of the world results from the observation or experimentation of multiple instances of entities and events, often in the form of '*(event) regularities*'. From the application of those scientific procedures follows the inductive generalisation (from the 'sample' to the 'population' under study) and possibly the postulation of universal laws governing the world. A clear *nomothetic* or instrumentalist (i.e., law-seeking) approach reigns within Positivism. By focusing on (the occurrence of) the event regularities, positivists seemingly emphasise events to the disfavour of entities.

The quest for truth in a positivist science

Positivists pursue fiercely the '*truth*' of scientific knowledge, hence attempting desperately to make that knowledge a perfect mirror or accurate representation of the world. The truth of positivists' knowledge claims is assessed through the empirical tests of hypotheses (posited via induction). Truth is said to be established whenever verification is empirically achieved or, instead as Popper (1963; 1959) contends, whenever falsification cannot be attained. Truth is obtained relatively without problems, by following the rules of good scientific practice. Positivists can be accused of being foundationalists, for all scientific knowledge produced is normally given a character of

absolute truth (or complete objectivity or validity) in the sense that it is independent of subjectively held beliefs of scientists and/or lay persons. Simultaneously, the positivists hold in notorious disregard other kinds of human knowledge (especially lay one) – displaying what is called an '*intellectualist prejudice*'. This prejudice is probably an unintended consequence of the '*enlightenment project*' wherein Positivism fits, a project that, despite presupposing that scientific knowledge must contribute decisively to '*enlighten*' the society as a whole, benefits mostly the academic élite and deepens the intellectual-lay societal division of labour (Sayer 1984).

Positivists take a rather static view of scientific knowledge, seeing it as a product that, once developed by Science, can be easily stored, accessed, and widely disseminated. The development process of scientific knowledge is characterised by cumulative accretion and usually not an object of analysis. Positivists neglect or consider as irrelevant the Sociology of Science, that is, the conspicuous (yet not absolutely determinant) influence of the social conditions of and interrelations among scientists in the creation and assessment of scientific knowledge.

Prediction equals explanation

The main objective of Science, according to positivists, is prediction. The unequivocal criterion to evaluate the maturity of any science is its predictive power regarding the phenomenon of interest. This objective helps to reveal a striking feature of positivist science, namely that positivists, when they believe that they are capable of offering more or less 'precise' predictions about a phenomenon, they also feel capable of 'explaining' it – and, of course, when endowed with a 'sound' explanation on a phenomenon, they can also 'predict' its future occurrence. The conflation of prediction with explanation, often referred to as the '*symmetry thesis*', is in general committed within Positivism – the major difference between the two being that the former is directed towards the future occurrences of the phenomenon whilst the latter is only concerned with past ones. This is discussed at length in the epistemology of Critical Realism (see section 2.5.2 below).

2.3.3 Methodology

In general, positivists employ, some of them without acknowledging so, a version of the '*Deductive-Nomological*' (D-N) or '*Covering Law*' model by which a phenomenon is explained and/or predicted through logically deducing and/or inducing it (the

'*explanandum*') from (i) a set of antecedent conditions and (ii) the general law(s) governing such phenomenon (both of which constitute the '*explanans*') (Hempel and Oppenheim 1948, p. 138). An extensive use of induction and deduction is made by positivists in the development of their scientific explanations and predictions (D'Andrade 1986). A conspicuous preference for quantitative research techniques (e.g., variance and regression analyses, structural equation modelling) is also found within most positivist science. Such nomothetic research, also labelled as *'extensive*' by Sayer (1984; 2000), can be tested mostly via replication studies.

2.3.4 Aetiology

Whenever searching for the cause of an event (i.e., what 'produces' it), positivists presume that cause to be another event, typically the preceding one. Since all that positivists have in their ontological locker are events then, as Fleetwood (2001, pp. 206-7) puts it, "[i]f one event is observed or hypothesized, one can seek only its cause in terms of another observed or hypothesized event". Events, in spite of being considered *a priori* atomistic, are taken to be related by their successive occurrence over time. Events are assumed to be constantly conjoined and their temporal succession is equated with causality. Therefore unequivocal *cause-effect relations* are likely to be readily identified by positivists – that, for instance, the event Y is '*caused by*' the event X, also possibly expressed as $Y=f(X)$. The former event (measured or approximated in a so-called *dependent variable*, is allegedly a '*function of*' the latter event (measured or approximated in an *independent variable*) for changes in the magnitude of the independent variable account for (i.e., 'explain') changes in the magnitude of the dependent variable. At least with regard to the social phenomena, the obsession of positivists with measurement and quantification (in their attempt to facilitate the statistical manipulation of variables and perform tests of hypotheses) leads them to inadequate conceptualisations, for the mostly qualitative and multi-dimensional nature of the social world is in this way overlooked (Hesketh and Fleetwood 2006).

Causality is couched in terms of *functional relations*, thus boiling down to mere *constant conjunctions of events*, that is, *lawful or law-like event regularities* (Fleetwood 2001). For example, such *deterministic* or *stochastic laws* governing the world are styled by positivists as '*whenever event X, event Y follows*' or '*whenever events* X_1, X_2, *and* X_3, *event Y (on average or with Z probability) follows*' respectively. Such

conception of causality – often denoted as *Humean causality*, after British Enlightenment philosopher Hume (1739 [1985]) – is admissible only in a world where *closed systems* predominate. Humean causality therefore implies that the world as a whole is undoubtedly a closed system which neither contemplates endogenous change nor is subject to varying exogenous influences. According to Bhaskar (1975), a closed system necessarily entails the satisfaction of two closure conditions: (i) the absence of internal change within the system of interest (the internal closure condition) and (ii) the constancy of external influences over that system, that is to say, '*other things being equal*' (the external closure condition). An open system, on the contrary, is one where one or both of the closure conditions are not met. The realist view of open and closed systems differs from that of *Systems Theory* – a trans-disciplinary theory founded in the 1950s by the Austrian-born biologist Ludwig von Bertalanffy (1850) who studies the structure and properties of systems. The advocates of Systems Theory take each phenomenon as a structure, i.e., an ensemble composed of several interacting and interdependent parts which give rise to emergent properties (not found in its constituents alone) – in clear contrast to the classical reductionist approach focused on a single element of phenomenona. Systems theorists classify systems as open or closed in accord with the presence or absence respectively of the system's interaction with its surrounding environment, whereas critical realists add the requirement of the lack of internal change for a system to be considered closed. Arguably, systems theorists take for granted the inevitability of any system's internal change.

2.4 Postmodernism

Without a doubt, postmodernists take on positivists as their arch-rivals. Postmodernism arises in the early 1970s as a fierce and shocking reaction to the positivist orthodoxy ruling the social sciences – for instance, the theory-neutral observation claimed by Positivism is promptly rejected and an *observation-neutral theory* is instead endorsed by postmodernists (Sayer 2000). Postmodernism is also frequently called (and incorrectly equated with) *Conventionalism*, *Idealism*, *Interpretivism*, *Relativism*, (*Strong*) *Social Constructionism/Constructivism*, or *Subjectivism*. Its development is often denoted as the '*turn to discourse*' or the '*linguistic turn*' in Science. The notions of '*discourse*', '*language*', and '*rhetoric*' (and sometimes even '*thought*' and '*knowledge*') are used interchangeably by postmodernists. Since knowledge (especially scientific one) is for the most part linguistic, I adopt here preferably the first of these terms whenever referring to the postmodernist (for the most part socially constructed) view of the world.

Before addressing the postmodernists' common presumptions, it is important to note that Postmodernism (i) though not avoiding reflections upon meta-theoretical issues (particularly in its harsh criticisms of Positivism), usually overlooks the alternative of Critical Realism (see, e.g., Frankel 1986; Heller 2001; Westwood and Clegg 2003) and (ii) normally conflates the Philosophy of Science with the Sociology of Science – as if the extant social relations within and amongst scientific communities determine *per se* the ontological, epistemological, methodological, and aetiological presumptions of scientists.

2.4.1 Ontology

The ontology posited by postmodernists is difficult to ascertain because they are in general remarkably ambiguous when they elaborate on their ontological claims (Fleetwood 2005). While almost all postmodernists admit the centrality of discourse in the (social) construction of the world, some make the strong claim that the world is entirely socially constructed mostly via the discourse of both scientists and lay men (Berger and Luckman 1966). Or, in other words, the world is said to be *discursively constructed* to the extent that it '*lies in the eyes of the beholder*'. Other postmodernists, however, are unwilling to make such a strong claim and take what may be called a '*weak social constructivist*' or '*weak social constructionist*' position whereby (i) a part

(not all) of the world is socially constructed and (ii) the existence of extra-discursive phenomena is admitted. This weak version of social constructivism – no pejorative connotation intended with the adjective '*weak*' – is acceptable to critical realists. On these grounds, one faces a *concept-* or *theory-determined* world, a world which does not predate humans and may even not exist (or stop existing) if one discursively chooses so. The world is purely a '*figment of human imagination*' and insofar as '*wishful thinking*' prevails (i.e., the world corresponds to everyone's wishes for it), multiple '*realities*' are likely to exist – as many as available thoughts.

2.4.2 Epistemology

Conventionalism and relativism

Multiple knowledge claims, arrived at via human ingenuity and creativity, are conjectured by postmodernists (Kuhn 1970) – and, in a truly postmodern way, '*anything goes*' (Feyerabend 1975). The epistemic status of such claims (even scientific ones) is determined through human convention, being inter-subjectively agreed upon. Unsurprisingly, Postmodernism contends that the 'absolute' truth (strenuously pursued by positivists) is both meaningless and unachievable. On the contrary, the truth of a knowledge claim is *relative* to the extent that it boils down to a mere convention. Truth is a matter of agreement, negotiation, and collective consensus, therefore never being absolute but relative. As the truth of each knowledge claim (or theory) is always relative to its proponents and/or adherents, scepticism is likely to reign amongst postmodernists. This relativist stance can be expressed in the following way: "*As an X-ist, I believe in Z and W.*". Such stance implies that any theory is considered observation-neutral, not being susceptible to corroboration or refutation via empirical observations and experiments (Sayer 2000). Postmodernists implicitly recognise two kinds of relativism: (i) that the world can only be known in terms of our discourse (i.e., *epistemic relativism*) and (ii) that no knowledge claim can be shown to be better than any other (i.e., *judgmental relativism*).

Science and its development process

Postmodernists overemphasise the discontinuities in the scientific development process, depicting it as one marked by lengthy periods of stability on occasion interrupted by turbulent '*scientific revolutions*' (or '*paradigm shifts*'). Kuhn (1970) argues prominently that Science is essentially about 'puzzle-solving' (i.e., finding solutions to

the small problems left unsolved by the guiding 'paradigms' or theories). It is often the case that one of those problems resists solution in spite of several attempts over time to do so with the use of the ruling paradigm: a trial-and-error period is then sure to ensue, often culminating with the replacement of the extant paradigm by a new one which is capable of solving the triggering 'anomaly'. Whenever adopting such a Kuhnian perspective, postmodernists see knowledge as divided into monolithic blocks, in general mutually incommensurable and unintelligible and thereby rule out any possibility of theoretical cross-fertilisation or of settling potential inter-theory disputes.

For Postmodernists, the primary goal of Science comes down to uncover the political agendas (and the hidden power) driving the social construction of the world – see, for instance, Michel Foucault's (1980) work on the close relation between knowledge and power. Therefore, the explanations procured by postmodernists concern both (i) where the world-shaping discourses come from (i.e., whoever produces them) and (ii) why these performative discourses are collectively accepted. Predictions, on the other hand, are simply avoided. Contra to the nomothetic perspective of Positivism, postmodernists embrace an *idiographic approach* fundamentally concerned with the 'particular' (and its detailed explanation), despising the discovery of allegedly general laws.

2.4.3 Methodology

Postmodernists prefer to employ qualitative methods and techniques in their scientific endeavours (e.g., discourse analysis), probably an instinctive reaction to the obsessive preference of Positivism for quantitative research. Further, many postmodernists tacitly accept Feyerabend's (1975) *methodological anarchism* which strongly objects to any single (often empiricist) scientific method as the only pathway to the attainment of truth of knowledge. Feyerabend argues in favour of the methodological pluralism in Science, claiming that prescriptive methodological guidelines limit severely the activities of scientists and as a consequence restrict the scientific progress.

2.4.4 Aetiology

Even though postmodernists do not explicitly address aetiology in their accounts, it looks clear that discourse is (to them, at least) the fundamental cause governing the world. This said, it is perplexing to see that postmodernists, if inquired about aetiology, are likely to suggest that it is simply a social construct, hence denying causality as an objective feature of the world.

2.5 Critical Realism

As mentioned before, Critical Realism was developed by Bhaskar (1975) and others (Harré and Madden 1975) by building upon Kant's (1781 [1999]) transcendental reasoning. Critical Realism, in addition to its endorsed realist viewpoint, argues for Social Sciences that are critical of the (social) world they aim to tentatively describe and explain. Social scientists are urged to be critical in their accounts or claims (theories, conceptual frameworks, models, concepts) of their objects of study, contributing to and reinforcing the potential emancipatory role of the Social Sciences. A critical social science hence features not only (i) research on 'what is' but also (ii) criticisms on 'what is' and (iii) assessment on 'what might be' (Sayer 2000). The Social Sciences must be both positive and normative, therefore describing, explaining, and judging *what is the case* as well as issuing prescriptions about *what should be the case* (Sayer 2004). This is because the world is surely different from what one would like it to be; otherwise, prescriptions would be dispensable.

Unsurprisingly, Critical Realism is in general seen as an *underlabourer* and *occasional midwife* for a variety of substantive work in the social sciences (Sayer 1984; 2000). It is noteworthy that critical realists as a rule reflect upon meta-theory deliberately and extensively, offering several counter-arguments to both the positivist and the postmodernist worldviews.

2.5.1 Ontology

The basic assertion made by Critical Realism pertains to the existence of a by and large *mind-independent world* (Bhaskar 1975). That is to say, almost all the *entities* and *events* (as well as the *relations* within and amongst these) composing the world exist independently of our identification (or knowledge) of them. To think otherwise is to presume that the world is but a reflection of human knowledge of it – and this appears to be an intellectualist position. Fleetwood (2005, pp. 198-9) prefers the term '*identification*' to '*knowledge*' because the former comprises (i) the latter (either in a tacit or explicit form, i.e., 'know-how' and 'know-that' respectively) and (ii) other human cognitive activities such as observation, experimentation, and even conception and interpretation. I endorse his preference.

The rejection of the empirical realist view

Diverse entities and events, both of which can be observable or unobservable, co-exist in the world. In direct opposition to the empirical realism of positivists (advocating that what one can observe is all that exists), neither the entities nor the events of the world are necessarily connoted with materiality or confined to the realm of the observable. For critical realists, '*observability*' (or its closest ally, '*experimentability*') is not the definitive criterion which allows them to make ontological claims. As Fleetwood (2005, p. 199, emphasis in original) says, "God may or may not be real, but the *idea* of God is as real as mount Everest (…).". Positivists, in contrast, conflate ontology with epistemology and thus can be accused of committing the *epistemic fallacy* (Bhaskar 1975). For they reduce the world to what is (or can be) known of it via human senses.

The world's varied entities

Mind-independent existence applies to all kinds of entities of the world: *material*, *ideal*, *social*, or *artefactual* ones (Fleetwood 2004). For instance, (i) mountains and rocks, and computers and tables (i.e., material and artefactual entities respectively) exist regardless of any knowledge one may develop or have of them;[15] (ii) accounts, symbols, and beliefs (i.e., ideal entities) endure independently of their proponents' and adherents' arguments as well as the criticisms of contenders; (iii) the United Nations, and the markets and networks in which firms operate (i.e., social entities) exist independently of the individuals and groups responsible for their creation and the scientists aiming to build knowledge about them. Fleetwood (2004) refers to the material, ideal, social, and artefactual entities of the world as the four '*modes of reality*'.

Whereas material entities are not devised by mankind (and would continue to exist even if human beings were extinguished), artefactual, social, and ideal entities are dependent for their existence on the activities of men. Yet, as Fleetwood (2004) argues, *some but not all* human beings (namely scientists, lay people, none or both) and *some but not all* human activities (those related to identification are often unneeded) are involved in the reproduction and transformation of artefactual, social, and ideal entities *some but not all* the time.

[15] I address first the kinds of entities existing in the world because events are ultimately '*produced*' by entities. As claimed below, events are brought about whenever entities' powers are exercised, of course under the restriction of several contingencies (i.e., the presence or absence of other entities and/or the exercise or not of their own powers). Entities can be claimed to be the primordial component of the world's nature.

Five remarks about the world's entities deserve attention here (Fleetwood 2005). First, entities undergo change over time. Secondly, each entity needs not be of a unique kind (e.g., a theory, despite usually seen as an ideal entity but can also be considered a social entity since it is largely shaped by the long-lasting interpersonal relations that scientists establish and sustain among themselves). Thirdly, social entities, like ideal ones, are in essence immaterial. Fourthly, some postmodernists (particularly those adopting a strong social constructivist ontology) commit the mistake of merging the material, artefactual, and social entities into ideal ones, i.e., non-discursive entities into discursive ones – as if non-discursive entities are but an epiphenomena of discourse. Finally, critical realists recognise that non-discursive entities may have a discursive counterpart, that is to say, all the material, artefactual, and social entities can be a subject of discourse whereby akin ideal entities are created (e.g., a stone and the theory of its origin and structure). Of course, it is possible to find that the referent of an ideal entity is itself another ideal entity (e.g., a detailed explanation on the evolution of a particular theory) (Fleetwood 2005).

Entities' relations: the 'necessity' vs. 'contingency' distinction

Critical realists assume that two kinds of relations can be found within and between the world's entities: (i) *necessary* and (ii) *contingent* ones. Necessary relations stand for what inevitably '*must go together*' while the contingent relations represent what '*can go together*' but does not have to. The distinction between necessity and contingency is summed up as *what must* and *what can* be the case respectively (Sayer 1984).[16]

Necessity can be seen as divided in two (Harré and Madden 1998; Sayer 1984): *logical* (or *conceptual*) and *natural* (or *material*). Whereas the latter necessity pertains to relations amongst the world's material constituents, the former necessity concerns relations amongst concepts or terms (such as the '*husband-wife*' example above). It is often the case that natural necessities take the form of conceptual necessities, that is to say, the former are represented by scientists in discourse. A relation is necessary (e.g.,

[16] It is important to stress that the term '*contingent*' holds a different meaning from that usually assumed for it (which is '*to be dependent upon*'); instead, it means '*neither necessary nor impossible*' or in other words, '*potential or possible*' (Sayer 1984, 2000). The relations between entities are particularly noteworthy, though relations within them can also be identified (i.e., relations between the entities' structural features). All the entities of the world are by and large contingently related, though some necessary relations between them also exist. With regard to the world's events, the openness of the world makes the existence of necessary relations between the events unlikely to result. Events are in general contingently related, i.e., no constant conjunction of events or the so-called cause-effect relations can be identified in the world.

between the entities '*husband*' and '*wife*') in the sense that what each of those entities is depends on its standing in that relation, that is to say, each entity cannot exist without the other (and ultimately without the relation itself) – the existence of a husband necessarily presupposes a wife's existence (and the change of a husband is tied to a wife's change), and vice versa. On the contrary, when the relation is contingent then either of the connected entities can exist without the other (and the relation) – as an illustrative example, a '*man*' can exist without a '*woman*' (and a man can change without being implicated by, or implicating, a woman's change) as well as the other way around. That a relation is necessary does not mean it is more important than contingent ones (Sayer 2000). Both necessary and contingent relations can be equally important for the connected entities. For instance, the contingent relation of the entity X with the entity Y may be as important as (or even more important than) the former's necessary relation with the entity Z.

The world is sure to display four notorious relations (Sayer 1984): (i) the necessary relation between the elements composing each entity's structure; (ii) the necessary relation between the structure and powers of each and every entity; (iii) the contingent relation between an entity's powers and the effects of their exercise; and (iv) the contingent relation between an entity's powers and the surrounding contexts. One more relation can be pointed out: the necessary relation between the powers and tendencies of an entity – tendencies being the effects that powers are likely to bring about. See more on tendencies or the 'transfactuality' of powers below, this section.

Lastly, two important notes: (i) although change can happen in contingent relations (e.g., contingently related entities can 'causally' affect each other in terms of their respective powers), interdependent change is prevalent only in necessary relations (e.g., an entity's powers change when its structure is somehow modified); and (ii) some necessary relations can be *asymmetric* to the extent that one entity cannot exist without the other (and its relation with it) but the other entity can (Sayer 1984).

One can find both necessity and contingency in the world – while some entities are necessarily related, others are only contingently so. In contrast, positivists see this necessity as absolutely absent from the world (Sayer 1984, 2000). They support both the '*ontological atomism*' (i.e., the ubiquity of discrete events and the existence of

structureless, powerless, and unchangeable entities) and the kindred '*universal contingency*' (i.e., that the relations within and between entities are all contingent).

The structure (and powers) of entities

Each entity of the world has a peculiar nature, exhibiting a set of structural properties, in general interlinked (Fleetwood 2004). While all entities are composed of structures (which themselves can be often regarded as micro-entities), some of those entities are inserted into other, larger structures (i.e., meso- and macro-entities) (Sayer 2000). Consider the following example: firms (as entities) have structures of their own and by connecting them with other structures (i.e., suppliers and customers), it is likely that the interfirm relationships, nets, and networks (what can be depicted as micro-, meso-, and macro-structures) emerge.

Any entity, by virtue of its intrinsic nature (which makes it the kind of 'thing' it is and not anything else), is endowed with some (usually *emergent*) *causal powers and liabilities*, hence being both capable of doing some things and incapable of doing others (Harré and Madden 1975). Critical realists take the notion '*causal*' to mean '*bring about (any) change*' (Sayer 2004). For instance, (i) human beings have the powers to reason, talk, and invent (owing to their physiological and social features) and (ii) firms have the power to generate goods or services because of their heterogeneous resource and competence endowments. The powers of an entity are also called '*dispositions*', '*potentialities*' or '*capacities*' whereas its liabilities can be denoted as '*susceptibilities*' (Fleetwood 2001). In line with Sayer (1984), my viewpoint is that an entity's liabilities entail the absence of some of its expected and/or desired powers. For ease of exposition, '*causal powers and liabilities*' are simply referred to as '*powers*' in this chapter.

Since Critical Realism gives particular emphasis to the nature or structure of the world's entities, it is often charged with the label of *essentialism*. That is, Critical Realism is presumed 'guilty' of being focused on the discovery of a fundamental, often singular and fixed essence of entities through a theory-neutral observation and an inductive reasoning. Critical Realism, however, should not be confused with essentialism: the latter aims to identify both the *generative* and *distinguishing* properties of entities (i.e., the features which determine what an entity can and cannot do and the features which permit that entity to be clearly distinguished from another one, respectively); the former is focused only on the identification of the first of these properties while acknowledging

the possibility of their alteration over time (Sayer 2000). In addition, Critical Realism distinguishes between the *essential* (or *necessary*) and *accidental* (or *contingent*) properties of entities (Sayer 2000).

The emergence, diversity, and potential exercise of powers

The powers of an entity *emerge* mostly from (i) the powers of its individual structural constituents but also from (ii) the powers of the relations that it maintains with other entities. Nevertheless, the former powers are *irreducible to* any of (i.e., are more than the sum of) the latter two. For critical realists, not only entities have a structure and, as a consequence, powers. Some of the (necessary and/or contingent) relations that these entities establish and maintain among themselves possess a particular nature, hence being endowed with powers (Sayer 1984, pp. 104-5). Some scholars working under the sociologist 'agency-structure' framework (Giddens 1876; Parsons 1937) claim that the relational structures are naturally endowed with powers (e.g., see Elder-Vass 2006; Fleetwood 2007a). For those scholars, social structures – such as those of families, communities, or cultural groupings – pre-exist (extant) agents whereas agents draw upon, reproduce, and transform such structures over time – in sum, structures are the conditions for, and the continuous outcomes of human agency. In brief, the entities' relations can be causal. Needless to say, the powers of any relation derive at large from the powers of the involved entities (primarily the powers of the two parties directly connected via the relation but also of others indirectly connected to them). For instance, I contend further ahead (in chapter 4) that firms as well as their lasting vertical relationships (and the overall networks) are both structured and powerful entities of – or, as one may call them, causal configurations governing – the business world.

Not all entities of a given kind (endowed with a similar nature, i.e., sharing a certain set of generative properties) have the same causal powers. Understandably, similarity at one lower-level stratum of the world (e.g., chemical or biological) need not imply similarity at another higher-level stratum (e.g., social) – for instance, two individuals having the same physiological characteristics, some of which may even be unobservable or difficult to determine unambiguously (e.g., equal weight, height, and muscular and cerebral masses), may exhibit radically different cognitive and social abilities.[17] An entity's powers are not necessarily activated or exercised. They exist irrespective of

[17] The world's stratification is addressed below, this section.

ensuing effects (i.e., the result of their exercise). In other words, any power does not depend for its existence upon the effects it is capable of generating, that is, the events it can bring about (Fleetwood 2001). The tautology that an entity does something because it has the intrinsic power to do so is hence avoided. Yet, while some powers remain intact when unexercised, others are likely to deteriorate if they are not put to work, e.g., the human powers to ride a bicycle and to speak a foreign language respectively (Sayer 1984).

Contingencies affecting the exercise of powers

The powers of an entity can remain dormant to the extent that their activation depends partly on – and the ensuing effects depend heavily on – the surrounding, enabling and/or constraining, *spatial and temporal conditions* (i.e., the presence or absence of other entities and/or the exercise or inactivation of their powers over time). These conditions impact primarily upon the potential exercise of powers (and, as a consequence, the ensuing effects), but can also affect the nature of entities, e.g., contributing to their structural modification. Sayer (2000) refers to these conditions, both diverse and changeable, as *contingencies* or *contexts*.

Tendencies: the 'transfactuality' of powers

Owing to such geo-historical contingencies, the entities' powers act *transfactually* inasmuch as their exercise does not necessarily bring about the events expected to ensue (Ackroyd and Fleetwood 2000a). That is, when a certain power is exercised, its normal outcomes may be impeded by certain contingencies, namely the exercise of counteracting powers (e.g., an aircraft with the power to fly can fail to do so in the presence of severe atmospherical conditions). On the contrary, a power acts *factually* when its effects are not deflected or countervailed by (the effects brought about by) other powers, that is, when surrounding contingencies are somehow made unaltered (Fleetwood 2001) – such constancy is impossible to ensure in an open world as our social one, as seen below.

The effects resulting from the exercise of a power cannot be known *a priori*; nevertheless, scientists are usually able to identify that power's *tendency*, i.e., which effects that power tends to bring about (Sayer 1984). Consider, as an example, the power P_1 that has a tendency to E_1 and E_2, i.e., tends to bring about the events E_1 and E_2. That P_1 has a tendency to such events, however, is not tantamount to say it will

inevitably generate E_1 and E_2. A power "(…) does not always bring about certain effects, but it *always* tends to. Hence, it acts transfactually." (Fleetwood 2001, p. 212, emphasis in original). In the hypothetical situation of fixedness of particular contingencies (of course, those normally conducive to the occurrence of the events E_1 and E_2), the power P_1 would not tend to those effects but surely bring them about. Indeed, it is nonsensical to say that a power tends to a particular event *only if* certain contextual conditions are met. This conception of tendency is different from that of positivists for they often employ the term 'tendency' to connote the statistical character of certain (nearly law-like) event regularities styled, for example, as 'whenever event X, event Y *tends to* follow'.

Powers, when and if *de facto* exercised (under whichever conditions), bring about certain events. The resulting events, however, are not always the ones expected to ensue from the powers' activation (owing to the counteracting powers prevailing). For instance, power P_1, under the condition C_1 (i.e., the presence of the event E_2 owing to the activation of the power P_2), generally brings about the event E_1; however, under conditions C_2 and C_3 (i.e., the presence of the events E_3 and E_4 generated respectively by the powers P_3 and P_4, and the absence of the event E_2), that same power P_1 generates the event E_5.

Causal mechanisms and configurations co-governing the (non-deterministic) world

The world's events are typically co-determined, resulting from the convergence of countless and interconnected powers possessed and exercised by a myriad of entities, under a variety of mutable contingencies. The events and entities of the world are brought about because of several webs of interlocking '*causal mechanisms*' and '*causal configurations*' at work simultaneously.

Sayer (1984) is probably the first to define a causal mechanism, claiming it to be '*the given way of acting of a power*'. I take it to mean differently here. A causal mechanism exists whenever a few entities (in particular their internal structures and powers) are interrelated and they are as a whole responsible for bringing about certain events, under particular contingencies. Moreover, when those entities are vast in number (and the connection of their structures and powers is far more complex) and their interrelation brings about some events, under particular contingencies, one says that a causal configuration is operating. Simply put, the notion of causal mechanism is employed to

denote nothing more than an ensemble of powerful (structures of) entities. If those mechanisms are themselves complexly interrelated, the term causal configuration is more proper (see Fleetwood 2007a; Hesketh and Fleetwood 2007). The distinction between causal mechanisms and causal configurations is in essence one of number and complexity (of causal structures and powers), whilst recognising that the latter encompasses the former (i.e., a causal mechanism is merely a sub-, sub-sub or sub-sub-sub-configuration). For instance, one can look at the marketing department of a small firm (including a handful of highly competent individuals) as a causal mechanism capable of 'generating' lasting relationships with both suppliers and customers; on the other hand, a large multinational firm (endowed with an enormous amount of valuable resources and competences worldwide) can be properly considered as a causal configuration able to produce a high volume of throughput (of goods or services for customers) and profits (for its owners and/or shareholders).

It is very likely that not only can one discover interdependences between the causal mechanisms and configurations (e.g., strong and weak, strengthening and restricting), but also a hierarchy of those mechanisms and configurations can be pointed out in the co-determination of the world (Fleetwood 2007a; Sayer 1984). Causal mechanisms and configurations should not be connoted with any kind of determinism (for example, as positivists frequently do with the term 'mechanism'). See the section below on the aetiology posited by critical realists. In sum, the world is governed by (or, more properly, it is the outcome of) a diversity of co-tendencies and counter-tendencies (generated by multiple coexisting causal mechanisms and configurations), reinforcing and/or counteracting one another concurrently.

The openness of the (social) world

Since (i) causal mechanisms and configurations may be inactive and (ii) the effects of their exercise are always affected – reinforced or counteracted – by the effects generated by other mechanisms and configurations (i.e., events' occurrence is mediated by the influence of diverse contingencies), *what happens* does not exhaust *what could have happened* (Sayer 1984). For Bhaskar (1986, p. 209), "[t]he world is not just the totality of what is actually the case, but includes what might or could be (…) as well.". Or, in other words, "[t]he actual is only a part of the real world, which also consists of non-actualised possibilities and unexercised powers of the already existing structures and

mechanisms that are transfactually efficacious (…)." (Patomaki 2006, p. 9). Therefore, the world cannot be pre-determined, that is, it is not a *closed system*. Against the determinism implied in the general laws advanced by positivists (a consequence of the cause-effect relations and constant conjunctions of events they allegedly identify), the world is surely an *open system* (which includes many sub-systems). Of course, in such open system (and depending on the prevailing conditions): (i) the same causal mechanism and configuration may produce different effects, (ii) different mechanisms and configurations may generate the same effect, and (iii) event regularities, if extant at all, are at the very best transitory or spatially restricted.

Not only is the social world invariably considered to be an open system, but also the natural world is, in the same manner, taken (almost exclusively) as such (Sayer 1984). Whereas no closed systems are found in the social world, very few can be encountered in the natural world (and even those systems are often not susceptible to human manipulation or control). Nonetheless, some *quasi-closed systems* – where one or several causal mechanisms and configurations are dominant, prevailing over others – can be found in the natural and social worlds. For instance, the relative constancy of the throughput of a firm's production process over time (attained via a set of intendedly created routines and conventions) can lead us to consider that firm as a quasi-closed system. It is possible to artificially design closed systems in the experiments of some natural sciences (e.g., physics, chemistry).

The openness of the world is corroborated by the world's failure to meet the two conditions that would '*close the system*': (i) the entities and their structures and powers composing the world (or the causal mechanisms and configurations ruling it) are prone to change either gradually or radically (e.g., as humans 'internally' change via instruction and socialisation with others, so do their abilities to write, speak, learn, and invent); and (ii) the contingencies (affecting both the exercise of causal mechanisms and configurations and the ensuing effects) also change over time – this 'external' change is strongly related to the modification of the structures and powers of some entities for these constitute themselves the contingencies faced by other entities. Sayer (2000, p. 95) points out four barriers to determinism: "Firstly, whether causal powers (…) exist depends on the contingent presence of certain structures or objects [i.e., entities]. Secondly, whether these powers are ever exercised is contingent, not pre-determined.

Thirdly, if and when they are ever exercised, their consequences will depend on mediation – or neutralisation – by other contingently related phenomena. A fourth possibility is that natural and social causal powers themselves (and not merely whether and in what circumstances they are exercised) can be changed."

Positivists, despite the overwhelming evidence suggesting the openness of the world, commit – often for the sake of 'methodological convenience' – the mistake of treating it '*as if*' it is (or could be) closed. And in order to close their system of interest, they usually make unrealistic assumptions (e.g., the *ceteris paribus* or the *homo economicus* in Economics). Indeed, some critical realists even argue that (known) *falsehoods* or *fictions* are piled up by positivists allowing them to artificially engender the closure of their system of interest (Fleetwood 2002b). Apparently, those closure assumptions allow positivists to evade the possibility of their theory's falsification.

It is important to recognise that the artificial closure of systems entails performing a *fictionalisation*, not an *abstraction* as positivists claim. Surely, abstracting is not equal to fictionalising and the former by no means entails the latter (as seen in the Methodology section ahead). The ideal or fictional systems designed by positivists do not approximate the real, open ones. And the knowledge arrived at in such contrived closed systems cannot be transposed as valid into open systems (Fleetwood 2001). Doing such transposition implies committing the '*ignoratio elenchi*' fallacy because a point would be grossly neglected, namely the non-ubiquity of constant conjunctions of events in the world.

The world's stratification: the 'real', 'actual', and 'empirical' domains

In addition to this conspicuous openness, one must also note that the world is *stratified*, as three different domains or strata can be identified within it (Bhaskar 1975): (i) the *real* (or the '*deep*', as many critical realists refer to it), (ii) the *actual*, and (iii) the *empirical*. While the world's entities – and the causal mechanisms and configurations they as a whole configure – reside at the domain of the real (possibly being unreachable to the human senses), their exercise and the ensuing effects (i.e., events) can be observed or experienced at the stratum of the empirical thus being at the range of senses. These three ontological domains are contingently related to the extent that the moves from the real to the actual and from the actual to the empirical (e.g., the exercise and the manifestation of a causal mechanism respectively) are possible but not

mandatory (Ackroyd and Fleetwood 2000a). Notwithstanding, all the observations and experiences made by scientists or lay people (*at the domain of the empirical*) necessarily presuppose the exercise (*at the domain of the actual*) of causal mechanisms and configurations (residing *at the domain of the real*), under particular contingencies (again at the domain of the empirical). So, one can understand now why the operation of a causal mechanism or configuration may be difficult or even impossible to empirically identify (and its effects difficult or impossible to empirically observe or experience), when other (countervailing) mechanisms or configurations are at work and their effects impede, override and/or conceal the effects of the former. The likes of Sayer (1984, fn. 42, p. 280) notwithstanding, I do not subscribe to Bhaskar's (1975) view that the causal mechanisms and configurations need to be either unobservable or less observable than the effects they are capable of producing (i.e., the resulting events).

In sum, a *stratified*, *relational*, and *transformational* ontology is presumed by critical realists (Fleetwood 2001). Diverse and interrelated entities and heterogeneous events can be found (at different strata) within a layered, open, and evolving world. By contrast, empirical realism, the ontology professed by positivists, conflates the domain of the real with that of the empirical, hence assuming that all that exists is inevitably at the range of human senses. As a result, positivists fail to see the distinction between a causal mechanism, its exercise, and the outcomes of that exercise. A *flat* or *depthless* ontology characterises Positivism (Ackroyd and Fleetwood 2000a; Fleetwood 2001).

2.5.2 Epistemology

The concept-dependence, but not concept-determination, of the world

The world is what it is independently of our or anyone's identification of it. The relation between objects and subjects (i.e., the world's constituents and scientists respectively) is obviously contingent for objects exist regardless of any inquiry made on them by subjects. This contingency notwithstanding, the world is *concept-dependent* for one can know it at length via available discourses (both scientific and lay ones). Our access to the world is surely partial and mediated. "[W]e cannot gain access to the world independently of the concepts we use." (Fleetwood and Ackroyd 2004b, p. 3). One cannot step outside discourse if one aims to understand the world – such an *Archimedean point* is surely inaccessible. The non-material (i.e., social) world, in particular, is largely concept-dependent. Social entities and events are *intrinsically*

meaningful – what they are depend strongly on what they mean to humans (Sayer 1984). As a consequence, meaning is often claimed to be constitutive of the social world. Meaning is created, within a language. through the '*play of difference'* or the '*sense-relations'* among concepts – for instance, two terms being synonymous, antonymous, or heteronymous (Saussure 1916 [1977]). The entities and events of the natural world, on the other hand, are *intrinsically meaningless* since what they are does not depend on what their meaning is. Therefore, one is bound to have a *single* and a *double hermeneutic* in the natural and social sciences respectively (Sayer 1984). In the natural sciences, we see the construction and sharing of meaning only taking place within the scientific communities (e.g., concerning the natural entities and events studied); on the contrary, in the social sciences, meaning is developed by and shared within the communities of scientists and also within their own objects of study (e.g., the inquired social entities themselves).

That the world can be known (i.e., described and explained) at large through the use of human discourse – hence that there is no such thing as an unmediated or neutral access to the world – does not make the world a mere product of discourse. Though the world is concept-dependent, it is *not* completely *concept-determined.*

The descriptive and performative roles of knowledge (or discourse)

The world is more than discourse, contra the claims of some postmodernists. Even socially produced entities (e.g., concepts, models, or theories) have a remarkable independence from what scientists or lay people think of, or say about them. "To acknowledge that most social phenomena are concept-dependent is not to imply, in idealist fashion, that they are dependent on concepts alone, for it takes more than thinking to produce social institutions and practices." (Sayer 2004, p. 19, fn. 9).

All postmodernists who endorse a strong variant of Social Constructionism claim that discourse is all that exists (and, as a consequence, that discourse ought to be self-referential). For them, the world as a whole is collapsed into discourse. By assuming the widespread existence of wishful thinking (both individual and collective), Postmodernism equates the *construal* of the world with its *construction* (Sayer 1984). Though construals may – but need not – inform constructions (and constructions in turn may be construed differently over time), it is not the case that entities (as diverse as rocks, mountains, water or social institutions) emerge or change simply because one

chooses to create or recreate them discursively. For postmodernists, the *descriptive* (or *denotative*) function of knowledge is neglected almost in the same proportion that its *performative* (or *constructive*) role is overemphasised. Since referents are collapsed into their terms or concepts, the epistemic fallacy is again committed (Bhaskar 1975). Strangely, both positivists and postmodernists commit the fallacy of conflating the world with our knowledge of it – the only difference being somewhat in the way that conflation is effected (Sayer 2000). Positivists take the world as synonymous with what one empirically observes; for postmodernists the world is synonymous with what one socially or discursively constructs.

Though the mind-independent existence applies to both the natural and the social worlds, the latter is recognised (by critical realists) to be *in part* socially constructed by humans. Human agency is to some extent a requirement for the social world's existence; yet this does not mean the social world is merely the outcome of discursive activities of human beings (Ackroyd and Fleetwood 2000a). The world does not change simply because our discourse or knowledge of it is somehow altered (e.g., racial discrimination is not eradicated when society changes its discourse in favour of multiculturalism). Realists take this into account and are hence ready to accept a '*weak*' version of Social Constructionism.

The (partial and mediate) discursive construction of the social world

At a given point in time, however, the social world is what it is independently of humans' conception, knowledge or discourse of it. Social phenomena, though partly dependent on the *actors* who create, reproduce, and transform them, generally exist regardless of all the scientists interested in their study (Ackroyd and Fleetwood 2000a). The social world is but a partly deliberate and complete construction of mankind, being usually not in accord with what human constructors would want it to be in the first place (Sayer 2004). Social phenomena, once constructed, gain an increasing independence from (i) their original founders, (ii) the actors responsible for their reproduction over time, and (iii) the scientists who possibly inquiry them. "The social phenomena that confront us today are mostly the product of activities [both discursive and practical ones] carried out before any current observations we make, and while it is occasionally possible for researchers to influence [in the long term] what they study, the latter

phenomena are mostly *others*' constructions, and *not necessarily intended* ones at that." (Sayer 2004, p. 7, emphasis added).

The influence of human knowledge on the world is both *potential* and *mediate*, frequently occurring in the long term – something surprisingly overlooked by postmodernists. Only some knowledge claims prove influential enough to change *de facto* the world and, even when that is the case, it is mostly the *past* rather than the *contemporary* knowledge that constructs the world. Knowledge is neither powerless nor all-powerful: it is potentially causal, i.e., capable to change the world. Yet, contra the idealism of postmodernists, knowledge alone does not modify completely the world (e.g., whenever knowledge is developed or revised, a 'new' world is not created or reshaped *ipso facto*).

Critical realists recognise the *performative* role of knowledge, though noting that such performativity depends on how knowledge is related to the (extra-discursive) world, that is, the knowledge's degree of '*practical adequacy*' (Sayer 2004).[18] The existence of both *intra-* and *extra-discursive* realms within the world is acknowledged by Critical Realism, in opposition to the postmodernist and positivist standpoints that just take for granted the non-emptiness of the former and latter realms respectively (Sayer 2000).

A theory-laden observation

In spite of the unassailable mind-independence of the world (absolute in the natural world, relative in the social world), the human mind is not *world-independent*. When one looks at or perceives the world, some sort of pre-understanding (e.g., a frame of reference, conceptual framework, theory, or belief) is always present, though it is often not reflected upon or even noticed. As Kant (1781 [1999]) reasons, '*perception without conception is blind*' and '*conception without perception is empty*'. Human senses are inevitably *conceptually-tainted*. Critical realists assume that human observation is necessarily *theory-laden* or *conceptually-mediated*, instead of the *theory-neutral* observation postulated by Positivism.

Knowledge, practice, and the world: the (relative) practical adequacy of knowledge

One understands the world (and develop knowledge of it) by (i) *observing*, (ii) *experimenting*, and most importantly (iii) *practically intervening* on it. In addition to the knowledge resulting from the observation and experimentation of the world (the

[18] Practice is argued to be, to a large degree, the link between knowledge and the world (as seen below).

epistemological means privileged by positivists), a great part of knowledge is obtained through both the *practical intervention* in the world and the *interaction and communication* of humans (Sayer 1984).

The relation between knowledge and the world is not one of *correspondence* or *mirroring* involving the pursuit of an unsound notion of absolute truth. This relation is not merely *contemplative* or *passive* but rather *interactive* and characterised by (a degree of) practical adequacy. Knowledge, instead of aiming to be in a positivist fashion a mirror of the world (i.e., '*absolutely true for all time*', or '*true with a capital T*'), ought to be to some extent *practically adequate*. Knowledge, besides describing and explaining (hence enabling *the reference to*) and constructing in part the world, *informs* and *guides* the practice within it. So, the *referential, performative,* and *practical* functions of knowledge all need to be affirmed. Knowledge and practice are '*reciprocally confirming'* as they both legitimate and are legitimated by each other (Sayer 1984). Given this reciprocal confirmation, changes in knowledge and practice usually go hand in hand.

The inadmissible judgmental relativism

Despite accepting the epistemic relativism of postmodernists, Critical Realism rejects their position of judgmental relativism. Though the world is largely known via discourse (i.e., necessarily under some description, from a particular perspective), humans can still assess which accounts (in general only a few) are *more* practically adequate *than* others. For there is always to some extent a feedback from the world owing to our practical interventions within it (Sayer 2004).

The '*relativity*' of truth in general upheld by postmodernists impedes (or at the least implies the suspension of) the assessment and comparison of the practical adequacy of diverse knowledge claims and evades the possibility of their falsification. The idea that '*anything goes*' seems unsound for judging the practical adequacy of accounts. This is in agreement with that humans do inevitably all the time in their everyday life, in order to avoid undesired practical consequences, e.g., looking for cars before crossing a road (Sayer 1984). The common posture of postmodernists is to accept all knowledge as equally valid; yet some take the other available route which is to *doubt* all extant knowledge. This latter choice is mindless because, as Sayer (2004) wisely notes, to be sceptical about a knowledge claim implies accepting the truth or validity of other claims

used as grounds for that scepticism – one cannot call into question everything. Critical realists take as a fallacy the postmodernist idea that unless we have an absolutely true knowledge, we are only left with the total absence of knowledge or, in other words, complete ignorance. The critical realist argument is that humans find themselves most of the time somewhere between these two poles.

The multiplicity and (uneven) fallibility of knowledge

Theoretical pluralism is both acknowledged and fostered by critical realists. Though a single world exists, humans develop multiple (unevenly practically adequate and often contradictory) accounts of it and all of them remain open to contestation. There is no indisputable knowledge, be it scientific or lay – and these two may naturally differ (Fleetwood 2005). All knowledge is fallible, but not equally so – treating all knowledge as equally fallible would be a mistake as dangerous as that of treating all knowledge as equally true. Critical realism is clearly at odds with any kind of foundationalism or taken-for-grantedness. "It is the [common] experience of the fallibility of our knowledge, of mistaking things and being taken by surprise (…)" (Sayer 2004, p. 6) that lends weight to a realist conviction. *Ontological realism* and *epistemological fallibilism* are two sides of the same coin.

The relative fallibility of knowledge, however, is unrecognised by positivists – especially with regard to the scientific knowledge. And postmodernists implicitly take all knowledge as unerring (because of its secure performativity). Postmodernists try to distance themselves from positivists by endorsing relativist and in many cases, strong social constructionist viewpoints. But strikingly, postmodernists are prone to be as foundationalists as the ones they argue against. Firstly, if discourse exhausts completely the world (i.e., wishful thinking prevails) then human knowledge must be infallible. For it is contradictory to accept the fallibility of knowledge while simultaneously acknowledging that that knowledge is capable of constructing the world as a whole. Secondly, Relativism allegedly promotes open-mindedness, eschewing any form of absolutism. By taking all accounts as relative (i.e., equally 'true'), postmodernists have an excellent excuse to avoid any criticisms whatsoever (e.g., of an empirical character). That escape from critiques possibly contributes to the perpetuation of the *status quo*. In sum, a different kind of foundationalism can be also found within Postmodernism.

The objectives of Science

In a critical realist perspective, Science aims to understand or make sense of (that is, describe and explain) the many-sided world we inhabit. The difficulties of making Science stem not only from the multidimensionality and mind-independent existence of the world, but also from its non-perennial nature (i.e., its never-ending, usually gradual, at times drastic change).

Bhaskar (1998; 1975) sagely notes the presence of two dimensions in Science, a *transitive* and an *intransitive*. This means that Science comprises (i) its (*ontic*) objects of study and (ii) the (*epistemic*) resources it employs to inquire those objects (e.g., theories, research techniques, and so on) – the latter are likely to change continuously (sometimes even radically), while the former endure (regardless of the latter's influence) though they are not immutable. Scientists and lay people face *stable but not static* referents (i.e., the world) and develop references to (namely description and explanation of) those referents, partly via *stable but not static* terms, models, and theories.

Scientists' causal accounts of the world: descriptions, explanations, and (tendential) predictions

Adopting a realist terminology, one can say that Science strives (i) to discover the nature of world's entities as well as their powers, liabilities, and tendencies, thus being able (ii) to explain the occurrence of events (Secord 1986). Plainly, scientists aim to develop robust yet tentative theories (i.e., *causal accounts*, descriptive and especially explanatory ones) of the extant causal mechanisms and configurations at work potentially responsible for bringing about the inquired events (Fleetwood 2007a). Sayer's (2000) terminology epitomises things very clearly: critical realists attempt to develop a '*bird's-eye view*' on their phenomenon of interest, instead of the '*god's-eye view*' pursued by positivists. The scientific research performed by critical realists switches from the domains of the 'empirical' and 'actual' to the domain of the 'real', that is, from the events observed and experienced to the entities and powers (or causal mechanisms and configurations) ultimately responsible for their occurrence (Ackroyd and Fleetwood 2000a). Critical Realism stresses the need to '*go back to reality*' (Lawson 2001).

When holding sound knowledge on the world's causal mechanisms and configurations and on the contingent conditions present, scientists are often capable of (i) assessing the

causal efficacy of the co- and counter-tendencies working, hence (ii) possibly providing highly qualified predictions about the likelihood of the occurrence of certain events. Such '*tendential predictions*' about the future, though not totally accurate, are certainly not of a spurious quality (Fleetwood 2007a). The outcome of the conflux of several co- and counter-tendencies at work is impossible to predict outrightly: "[T]he future (…) is real but not yet determined and therefore consists of a multiplicity of different possibilities (…)." (Patomaki 2006, p. 29). Which of the converging or opposing tendencies are more forceful and likely to prevail is a matter to be assessed empirically by scientists (Fleetwood 2004). Against the characteristic allegations of positivists (e.g., Hempel and Oppenheim 1948), the maturity of any science is unrelated to its predictive power for the openness of the world makes highly improbable the existence of that predictive ability. The descriptive and explanatory powers (which can always be improved or extended) are much more adequate as epistemic criteria for evaluating the scientific knowledge. Positivists are only capable of offering predictions of a spurious precision and '*emaciated explanations*' at the most (Hesketh and Fleetwood 2006, 2007). The phenomenon to explain (i.e., the explanandum) is logically deduced from a universal regularity (commonly expressed in a law) and a set of initial conditions (i.e., the explanans) – review the Logicism of the Deductive-Nomological model used by positivists, section 2.3.3. Nevertheless, no explanation of what produces the phenomenon is given. Positivists confuse prediction with explanation (the so-called 'symmetry thesis'), the only difference between these two being in the occurrence of the phenomenon to be explained or predicted: explain the phenomenon after its occurrence (what may be also called '*postdiction*', that is, 'predict' the past) and predict its forthcoming occurrence respectively (Fleetwood 2002b). A prediction, even if accurate, does not constitute *per se* an explanation. Mostly non-explanatory predictions and a few non-predictive explanations are offered by positivists.

Given the openness of the world (and the transfactuality of the entities' powers), the events cannot be accurately predicted although their underlying causes (i.e., causal mechanisms and configurations) can be often uncovered and illuminated by scientists. Explanation is thus likely to supplant prediction as the ultimate purpose of Science (Fleetwood 2001). And it is the explanations advanced by scientists that serve as a source for the tendential predictions about the world's phenomena.

Scientific knowledge: (varying) practically adequate, incomplete, and revisable

Science aims to develop an increasingly practically adequate knowledge of the world. Since that knowledge varies in its epistemic status (being more or less practically adequate) and is always *incomplete* and *revisable*, a great part of the time of scientists is devoted to assess and improve the degree of practical adequacy of that knowledge. Such difficult but not all-or-nothing task of scientists adds up to the '*epistemic gain*' (Sayer 2004, 1984).

The incompleteness of knowledge claims, though primarily justified by the many-sidedness and continuous modification of the world, often derives from the lack of knowledge on the possible contingencies and the way these impact upon the effects resulting from the exercise of powers – even though there may exist knowledge about the existing entities and the causal mechanisms and configurations at work. Plus, such incompleteness can even be related to the work of scientists, being either the outcome of (i) the abstractions scientists consciously make in research (i.e., what is being left out of their accounts) or (ii) the deliberate and partial trimming of those accounts (for the pre-existing stock of knowledge possessed by other scientists renders the completeness of scientific arguments unnecessary).

The social construction (or context-dependence) of scientific knowledge and the need for reflexivity

Critical realists correctly describe Science in part as a *social activity*, by and large a male-dominated one (Sayer 2000). Scientific knowledge is indeed to some extent socially constructed, being affected by the social relations scientists establish and maintain among themselves. Scientific knowledge emerges, thrives and endures on the basis of a negotiated consensus between *theory developers* and *users*, within their respective scientific communities. The Sociology of Science is acknowledged by critical realists. Of course, this is not to imply – as postmodernists claim – that scientists' interrelations are the only (or the primary) determinants in the development and evaluation of scientific knowledge. Intellectual scrutiny also features eminently in that process. All human knowledge (not only scientific one) is partly a social construction. Knowledge is always '*situated*' because it bears the marks of its social origins and is inexorably moulded by the social background of its proponents, adherents, and even of fiercest contenders (e.g., their gender, race, personality, and personal values). It is

erroneous to assume the *context-independence* of knowledge (Sayer 2000). Moreover, the *form* of the knowledge produced also impacts upon its *content*. For critical realists, the use of metaphors and analogies in scientific knowledge is unobjectionable, a use indeed taken as admissible as that of logic and even quantitative techniques.[19] Positivists, on the contrary, discard all kinds of non-logical or non-mathematical reasoning in Science.

The context-dependent character of knowledge makes reflexivity advisable, particularly with respect to the scientific knowledge (Bourdieau 2004). Reflexivity denotes all efforts to critically expose the social context in which the knowledge is created and assessed. Nevertheless, neither *ad hominem* nor *ad feminam* arguments (opposing the male or female making the knowledge claim, not the claim in and of itself) are admissible. And to admit social influences on any kind of knowledge (enabling and/or constraining ones) is not an invitation to grant any epistemic authority to the claims of an individual or group (whether dominant or oppressed).

The 'situatedness' and yet (tentative) objectivity of scientific knowledge

That scientific knowledge is situated needs not threaten its objectivity, imply the absence of its practical adequacy or signal a relativist position. Science is never value-free; yet this does not forego the possibility of scientists aiming at objectivity in their inquiries and the scientific knowledge they develop.[20] It is not the case that we can have either some 'pure', value free, objective Science or the complete absence of Science, 'purely subjective' opinion, fiction or fantasy. That our knowledge claims are epistemically relative (i.e., shaped partly by our social and cultural backgrounds) does not mean we have to accept judgemental relativism and assume that it is impossible to differentiate between better and worse (or more and less practically adequate)

[19] For example, in the field of Industrial Marketing, Easton and Araujo (1993a) and Alajoutsijarvi et al. (2001) both address the widespread use of metaphors in the Markets-as-Networks Theory. Easton and Araujo (1997) go even further by suggesting that literary criticism bears resemblances with the criticisms made by Management scientists on their own (and others') conceptual and empirical works – their position is not senseless if one reflects on the common habit of referring to a particular body of theory as '*literature*' (Massey 1996).

[20] Sayer (1984) exposes three meanings for the notions of *objectivity* and *subjectivity*: (i) the value-neutrality or value-ladenness of knowledge; (ii) the presence or absence of truth in knowledge; and (iii) that knowledge pertains to the nature of objects or to what subjects think of those objects. Scientific knowledge is both objective and subjective (in the third above-mentioned sense) for it is developed by subjects about their objects of study (i.e., scientists and the world respectively). Though scientific knowledge is (like any other knowledge) value-laden, it is not necessarily untrue or subjective. The overly subjectivist conception of values is a prominent presumption of Positivism.

knowledge claims. For instance, one might know 'something' about the significance of business relationships for the focal firm, without knowing that with absolute certainty and without being able to explain every causal mechanism and configuration possibly bringing it about. If, in this case, we take the decision to abandon what we do know (about the relationship significance) on the grounds that we know nothing at all, we would be abdicating our (mandatory) intellectual responsibility.

Scientific research at the abstract and concrete levels

The research of critical realists is conducted either at the *abstract level* (of the tentatively identified entities' structures, powers, and tendencies, or causal mechanisms and configurations) or at the *concrete level* (of the contingent conditions present and the events observed or experienced) or at both levels (Sayer 1984). At the abstract (or conceptual) level, the structures of entities as well as their powers and tendencies or the causal mechanisms and configurations these as a whole constitute are conceptually postulated. These conceptualisations may be arrived at or only tested after being heuristically posited, and corroborated or altered, via the research that scientists undertake at the concrete or empirical level. The empirical research, while not absolutely necessary for identifying the structures and powers of entities or the causal mechanisms or configurations at work, is helpful in the clarification of the effects resulting from the exercise of those causal phenomena given the presence of diverse contingencies. As mentioned earlier, critical realists substitute practical adequacy for truth as the key criterion for the evaluation of the scientific knowledge resulting from both abstract and concrete research efforts.

The assessment, extension, and improvement of (the practical adequacy of) the scientific knowledge

Contra the allegations of many anti-realists, not only positivists, the knowledge developed by critical realists is not tautological. Critical realists, whenever certain causal mechanisms and configurations are put into practice in their concrete research, cannot justify the non-occurrence of the expected events (i.e., the empirical 'manifestation' of the identified dominating tendencies) with the argument that '*some countervailing causal phenomena must be at work*'. As previously noted, to discover which of the tendencies prevail (and which do not) at a certain context and point in time is an empirical question, and not necessarily an easy one to solve. The falsification of

knowledge claims is not avoided by the appeal to counter-tendencies or counteracting causal mechanisms or configurations. If the expected events are not brought about, scientists are impelled to develop knowledge on the counteracting structures, powers, and tendencies (and why these override the allegedly prevailing tendencies, that is to say, the relative contribution of all postulated causal mechanisms and configurations to the generation of the observed or experienced events).

The empirical check of scientific knowledge is possible, yet being insufficient to verify or falsify once and for all any of it. And of course, all empirical research undertaken by scientists ought to be both *theoretically-informed* and *theoretically-informative* (Sayer 2000). In sum, critical realists endorse a spiral-like approach to theory and evidence in scientific research. The evidence accumulated by scientists is likely to react back on the initially postulated theory, possibly causing the latter's re-evaluation and as a result its modification, extension or even rejection. For instance, after positing the existence of a causal mechanism, scientists are urged to 'empirically' determine if this mechanism (i) acts the way it is supposed to act and (ii) does bring about the event to be explained.

The possibility of cross-fertilising scientific knowledge

Critical Realism does not see scientific knowledge as composed of discrete (theoretical) blocks. In fact, any theory is difficult to delimit since it is not clear where to draw its temporal and spatial boundaries of applicability. Theories are considered, in an anti-relativist position, to be *internally differentiated* but *overlapping*. Critical realists recognise the heterogeneity of scientific theories and argue that: (i) theoretical cross-fertilisation is not only possible but desirable – for alternative theories are not in general mutually exclusive, emphasising different and one-sided aspects of the world and therefore likely to overall enhance the description and explanation of the world's complex causes, i.e., the underlying causal mechanisms and configurations; and (ii) the almost endless inter-theory disputes easily found throughout Science, may be solved by drawing upon the theories' areas of agreement. The existence of strong and weak connections amongst theories and the possibility of establishing new inter-theory linkages are both acknowledged.

The standpoints of scientists as well as their espoused theories are not necessarily absolutely antagonistic or '*incommensurable*'. The incommensurability of rival theories alleged by Kuhn (1970) or his followers is an exaggeration: "[W]here theories are in

contradiction, that implies they have something in common over which they can contradict one another." (Sayer 2004, p. 8). *Synthesis*, the common outcome of cross-fertilisation, is feasible. Such eclectic understanding, instead of a (needed but insufficient) specialist one, is hence encouraged (Fleetwood and Ackroyd 2004b). And the development process of the scientific knowledge is neither wholly continuous nor discontinuous, against the claims of positivists and postmodernists respectively. Critical Realism dispenses with the *disciplinary parochialism* and its close relative *disciplinary imperialism* without reserve (Sayer 2000). And this decision seems proper inasmuch as some of the most influential scientific knowledge ever produced is in essence inter-disciplinary.

2.5.3 Methodology

Critical Realism advocates that the object of study of any science should dictate the research method to employ – while acknowledging, of course, that the primary aims to be pursued by all scientists are necessarily the (tentative) description and explanation of extant phenomena (Sayer 1984).

The need for both structural and etiological analyses

Bearing this in mind, scientists need to undertake *structural* and *etiological analyses* of the world (Sayer 1984). As a result of these analyses, (i) the structures, powers, and tendencies of the world's entities and the contingencies are described and (ii) and the ensuing events are explained by the appeal to causal mechanisms and configurations allegedly at work, respectively. Both structural and etiological analyses, typically qualitative, involve a process of *abstraction* which is on occasion supplemented by the use of quantitative techniques such as the ones favoured by positivists (e.g., variance analysis). It is worth noting that the deployment of any quantitative apparatus implies in general subscribing to the assumption, even if transitory or spatially partial, of closed systems and the Humean causality. It is thus very difficult to reconcile qualitative and quantitative research methods on the same scientific inquiry.

Abstracting (from considered irrelevant features of) the world

Critical Realism takes abstraction (defined as the isolation in thought of a one-sided feature of a particular phenomenon, recognisably multi-dimensional) as the primary research tool at the disposal of scientists. To focus on a particular characteristic of the phenomenon of interest (i.e., to *abstract from* all other, deemed inessential, features

which together constitute that phenomenon) is a proper way to inquire the complex and many-sided entities and events that compose the world. Abstraction should not be confused with *reductionism* (that is, to explain a many-sided phenomenon by considering, or reducing it to, but one of its multiple constituents). Treating the world's phenomena as unidimensional – an unfortunately regular mistake committed by scientists – is surely not tantamount to abstract (Sayer 1984). Nor should abstraction be confused with fictionalisation that, for example, dominates neoclassical economics. All the abstractions performed by scientists, what can be seen as their analytical decompositions or deconstructions of the world's entities and events, must be made very carefully (e.g., in order to avoid 'dividing' what is indivisible or creating fictions). And it needs to be recalled that the recurrent abstraction from time is counterproductive for it implies the neglect of change (e.g., taking place within structures, powers, mechanisms, or contingencies) (Sayer 2000).

Critical realists presume that the understanding of the world, via the systematic recourse to abstraction, proceeds as follows: (i) by starting from the multidimensional world (and abstracting from all but one of its features), one is likely to grasp the unidimensional; (ii) then by effecting all the necessary abstractions to fully deconstruct the world's multidimensionality, (iii) and, later on, by combining or synthesising the knowledge accruing from each of the world's one-sidedness in order to tentatively understand its many-sidedness. Put simply, *world→abstractions* and *abstractions→world*. Even when all three steps are taken, it is not certain that scientists can develop a thorough understanding of the world (in part owing to its continuous and unpredictable change).

Retroducing and retrodicting

In addition to abstraction, scientists are advised to employ in their research both *retroduction* and *retrodiction* processes, whereby (i) the causal mechanisms and configurations capable of producing the inquired event are postulated and (ii) earlier knowledge of other causal mechanisms and configurations (e.g., knowledge produced at more or less 'distant' fields of study) is brought to bear upon the issue at hand respectively (Lawson 1997; Sayer 1984). Retroduction (or '*abduction*') is a mode of inference that, starting from a phenomenon of interest, enables the postulation of a structure, power or tendency (or a causal mechanism and configuration) that may account for the occurrence of such phenomenon. Like Fleetwood, one can take

advantage of Lawson's (1997, p. 24, emphasis added) insightful description of retroduction: "If *deduction* is illustrated by the move from the *general* claim that 'all ravens are black' to the *particular* inference that the next one seen will be black, and *induction* by the move from the *particular* observation of numerous black ravens to the *general* claim that 'all ravens are black', *retroductive* or *abductive* reasoning is indicated by a move from the observation of numerous black ravens to a theory of a mechanism intrinsic (…) to ravens which disposes them to be black." Retroduction displaces induction and deduction as the preferred mode of inference. The use of induction and deduction, as heavily espoused by positivists, is considered insufficient for the development of robust scientific knowledge.

Science is in essence a creative endeavour, both individual and collective, that makes extensive use of abstraction, retroduction, and retrodiction. Scientists develop knowledge of the world by: (i) *abstracting from* (i.e., omitting) relatively unimportant aspects of their objects of study; (ii) *retrodicting to* some established scientific theories and models (in their fields of study or elsewhere) of other structures, powers, and tendencies at work, and (iii) *retroducing to* (i.e., postulating the existence of) certain causal mechanisms and configurations that can be responsible for bringing about the events to explain.

Scientific research, mostly of a qualitative character

The research endorsed by Critical Realism is entitled '*intensive*' or '*idiographic*' (Sayer 1984). The preferred test for such research is *triangulation*, that is, the simultaneous use of diverse research techniques (e.g., direct observation, interviews, documentary analysis, and action research). And the knowledge developed in that intensive research can be generalisable (e.g., to other phenomena taking place at a different space and time) – against the view of positivists that presume generalisation to be solely the property of their research outputs. Critical realists do not make an apology for the sole use of qualitative research. Primarily qualitative, but also on occasion quantitative research techniques should be employed by scientists in accord with the specificities of their objects of study. Yet, critical realists explicitly reject the widespread positivist notion that only quantitative-based science is capable to supply robust descriptions, explanations, and predictions of the world. Mathematics or the mathematical formalism, the dominant language in the positivist Science, is both *non-structural* and *non-*

etiological (Sayer 1984). It is of itself unable to provide any knowledge on the (structures and) causes of the world. As noted previously, the identification of a mathematical association (e.g., a positive correlation between two events) needs not imply any causality – or, alternatively, the absence of that association needs not entail the inexistence of causality (Fleetwood 2001). Although being totally blind to causality, mathematics has some possible applications in the scientific research – for instance, whenever scientists want or need to represent the quantitative effects ensuing from the exercise of an entity's powers. Yet causality is clearly an extra-mathematical content and on occasion is imputed by the (positivist) scientist to its mathematical model or framework. Positivists often smuggle causality into mathematics (Fleetwood 2001). If the aim of scientists is truly the (tentative) disclosure of the world's causality, then qualitative research ought to be effected. And the perils of (trying to) quantify inherently qualitative, complex, multidimensional, evolving and often subjectively understood phenomena need to be acknowledge by scientists.

2.5.4 Aetiology

Causality as (being brought about by) powers

For critical realists, the notion of causality is ultimately about the production of change. "[A] cause is whatever produces change (…)." (Sayer 2004, p. 17). By taking this into account, critical realists substitute the conception of '*causality as powers*' for '*causality as event regularities or cause-effect relations*' (Fleetwood 2001). Against the view of positivists, to explain a phenomenon is not to search for other phenomena that (temporally) precede it but to unearth the former's underlying structure, powers, and tendencies. Positivism is usually entangled in the so-called '*associational thinking*' for it assumes that what *can* go together *must* go together, thus mistaking contingency for necessity (Sayer 2000). By subscribing to spurious cause-effect relations (hence confusing temporal contiguity with causality), positivist either (i) commit the '*fallacy of affirming the consequent*' (given the occurrence of the antecedent) or (ii) enter into a '*naïve falsification*' (i.e., that the non-occurrence of the consequent implies the falsification of the postulated cause-effect relation).

Critical realists are unable to grasp how the inductive inference – that succeeding events are connected via causality – can be soundly justified. As Sayer (1984) asks, how can a positivist vindicate the assertion that the (preceding) event X is the cause of the

(following one) Y? Or, in other words, how can a positivist justify that the future will resemble exactly the past?[21] All causes can be *au fond* discovered in the nature (or structural properties) of the world's entities and need not be observable or physical (Secord 1986). Critical realists often cite, as an illustrative example, the claim that human reasons can be causes of some observed events (Sayer 1984). Reasons can drive human behaviour but not in a straightforward manner: as we know, the same reason is able to indirectly generate different events while a same effect may be brought about by a diversity of reasons (Sayer 2004). For positivists, however, neither human reasons nor discourse can be causal. Positivists can be accused of being *naturalists* and *materialists* whenever argue that (i) the social world resembles the natural world and thus can be inquired and understood in the same manner (i.e., exclusively via the application of quantitative research techniques and the inductive and deductive modes of inference) and (ii) all the world (its phenomena and causes) is physical and observable respectively. In a rather extreme reaction to this positivist position, postmodernists often embark on a crude idealism and take discourse as the unique and fundamental cause of the world, neglecting altogether the existence of extra-discursive and non-material causes (and phenomena).

In sum, Critical Realism recognises both that (i) causes can be unobservable and immaterial (hence resistant to observation, experimentation, measurement, or quantification) and (ii) an extra-material, discursive part of the world exists, hence being only in part naturalist and materialist.

The world is multiply caused

The world is an open system, being co-determined by multiple and interacting causes (review section 2.5.1 on ontology above). Unavoidably, certain entities' structures, powers, mechanisms, and tendencies somehow causally govern the observed or experienced flux of events, irrespective of (i) the prevailing contingencies and (ii) the events brought about (Fleetwood 2001). Causality is therefore *complex*, that is to say, *multi-causality* prevails in the world. This multiplex causality is difficult to unequivocally identify by scientists (or lay people) because of three main reasons (Fleetwood 2007a): (i) several causal mechanisms and configurations are at work simultaneously (and, as we acknowledge, diverse powers may bring about the same

[21] Interestingly, this so-called *problem of induction* was first put forward by Hume.

effects); (ii) some *causal priority* (or hierarchy) is likely to exist in the world for not all causes are equally relevant in its co-determination; and (iii) the world is in part subject to the exercise of human agency (though this agency is not entirely capricious and often changes). The identification of the world's causality may be further complicated by the fact that some underlying causes lie outside of the scientists' main field of inquiry or area of competence (Fleetwood 2007a). Critical Realism therefore dispenses both with the *determinism* and the *randomness* advocated by positivists and postmodernists respectively. Only extant in closed systems, determinism is dismissed owing to the openness of the world and the existence of contingency and change in it. And there is always path-dependence in the world's change, e.g., from the '*past*' and '*other places*' to the '*now*' and '*here*' (Sayer 2000). Randomness, meaning that '*anything can happen anywhere*', is also not a feature of the world. Whatever happens – needs not be what could have happened – is explained by the existing entities and their structures, powers, and tendencies (or the causal mechanisms and configurations at work) and the prevailing contingencies of the world.

2.6 Summary

All scientists, in their inquiries of the world, build (consciously or not) upon a certain set of meta-theoretical commitments concerning ontology, epistemology, methodology, and aetiology. Each and every scientist should be made aware of this and reflect on the appropriateness of such commitments, primarily by bearing in mind the object of study. For these commitments, often taken-for-granted, have a huge impact on the undertaking and especially the outcomes of research. In addition to the mainstream (positivist) conception of Science, both postmodernist and realist meta-theories are available for adoption by natural and social scientists. Whereas positivists envisage the world as a sensible and manipulable closed system wherein cause-effect relations (i.e., a constant conjunction of event regularities) can be readily identified, postmodernists argue that the world is fully constructed, via discourse and/or social actions, by humankind. In contrast, critical realists take the world to exist independently of any human knowledge of it (such knowledge being, of course, fallible) and argue that Social Science should be critical of the very social world it aims to tentatively describe and explain. Moreover, critical realism depicts reality as composed of contingently related objects that have peculiar structures (i.e., exhibit particular features). In virtue of such inherent structures, objects necessarily possess (even though they may not exercise) causal powers and liabilities, hence being both capable of doing some things and incapable of performing others. Events result when those powers are de facto activated (or liabilities somehow impeded) which, in turn, usually depend on certain conditions e.g., the presence or absence of other objects and/or the activation or obstruction of their own powers and liabilities.

3. The theoretical basis

"*We are used to thinking about competitions in which there is only one winner, competitions such as football or chess. But the world is rarely like that. In a vast range of situations mutual cooperation can be better for both sides than mutual defection. The key to doing well lies not in overcoming others, but in eliciting their cooperation.*"

(Axelrod 1984, p. 190)

My research problem – that the causes of relationship significance are yet to be set forth explicitly – is sure to be found within the Markets-as-Networks Theory. I expose the development of this theory from its formal inception in the mid 1970s until its current state of the art, *en route* presenting succinctly its historical roots.

3.1 The Markets-as-Networks Theory

3.1.1 Historical roots

Though the Markets-as-Networks Theory has without doubt flourished from the 1970s onwards (mostly owing to the prolific research of the IMP Group), the deepest of its roots can be traced back to the seminal works of Adam Smith (1776 [1999]), Allyn Young (1928), and George B. Richardson (1972) in this chronological order. My stance is that, although other scholars and researchers can be pointed out as equally influential, at least these three extraordinary economists laid some of the primordial foundations for the Markets-as-Networks Theory.

The division of labour within and among firms: the views of Smith and Young on the need for both specialisation and integration

Adam Smith, a prominent eighteenth century Scottish economist and philosopher, is unanimously considered to be, together with David Ricardo and Karl Marx, one of the primary founders of *economic theory* in general and *classical economics* in particular. Smith is the first social scientist who probed in a systematic manner into the nature and causes of the wealth of nations. His time-consuming inquiry led him to conclude that *the division of labour*, that is, the separation of a complex work (usually performed by a single worker) in a multitude of simpler tasks in the hands of different workers, is the key factor in the economic development of any country. Smith's (1776 [1999]) analysis draw heavily upon the Industrial Revolution initiated in the last decades of the eighteenth century that was responsible for the profound transformation of the agrarian economy of England into one dominated by large-scale manufactures – see, for instance, the pin-maker factory he alludes to (p. 109). For Smith, the division of labour necessarily gives rise to substantial increases in the productivity of the extant crafts and professions (the varied '*trades*' and '*businesses*' in his terminology). Such positive effects – in the form of a greater output of work and/or reductions in production costs (i.e., scale economies) – are owed to (i) an increasing dexterity, efficacy, and efficiency of workers in repeatedly performing their specific tasks over time and (ii) the technological innovations (e.g., time-saving and high-throughput machinery) often introduced by machinery producers but on occasion devised by inventors or even common factory workers (pp. 112-5).

Smith asserts that the division of labour is not the aftermath of the wisdom of men but resulted instead from (i.e., was made possibly by) the human '*power of, and disposition to, exchange one thing for another*' (p. 117). Men find it is to their own advantage to concentrate on what they are capable of producing and exchange the surplus of that production (above their consumption needs) for what they want and need, usually the product of other men's labour. The human self-interest does not seem to preclude exchanges; on the contrary, the former strongly contributes to the consummation of the latter (p. 119). Among men, the more or less dissimilar products (which are surely the outcomes of diverse human labour) are of use to no another, being exchanged whenever mutually agreed. Smith therefore argues, in opposition to the established, that the undeniable inequality concerning the talents and geniuses of men is not the primary cause of the division of labour. Such inequality is likely to be more of an effect than a cause of the division of labour and tends to widen over time as the division of labour is extended (p. 120).

Without the propensity to exchange, men would be self-sufficient. Since each and every worker would have to similarly perform the same tasks of all other workers, there would not be any telling differences in the talents and geniuses of men. In the absence of the division of labour, the equality of talents and geniuses would result. The division of labour has hence an important role in reinforcing the specialisms which in part bring it about. By taking into account that the division of labour is mostly caused by the human power of and desire to exchange, Smith (1776 [1999], p. 121) derives the well-known theorem that the degree to which that division is effected is limited by the extent of the market (that is, the overall demand for the products resulting from men undertaking the subdivided tasks). Put simply, the division of labour expands into other crafts and professions insofar as the consumer market grows (driven, for instance, by reductions in transportation costs). The British commerce with both the inland regions and foreign countries rise by the end of the eighteen century. The transportation costs were reduced (mainly owing to the substitution of water- for land-carriage) and, as a consequence, the market grows (Smith 1776 [1999], p. 123).

In sum, Smith's thesis is that the division of labour (and the increasing productivity it gives rise to) ultimately brings about wealth and, in the case of a fair society, that the wealth generated by the whole nation is distributed equally amongst men of all societal

classes (p. 115). The work of Adam Smith is extended only more than one hundred and fifty years later when Allyn Young, a twentieth American economist, provided explanations on the phenomena of increasing returns. Young (1928, p. 529) starts where Smith lefts off: unlike the crafts and professions so characteristic of the late eighteen century and on which Smith focus, Young centers his attention on the manufacturing industries which emerged at the beginning of the nineteenth century because of the Industrial Revolution. For Young (1928), the division of labour accounts for the attainment of increasing returns and economic progress – and that these latter two are likely to lead to a further division of labour. Young argues that the main outcomes accruing from such division of labour, namely the obtainment of higher outputs and/or the utilisation of lower inputs, are secured whenever high-throughput machinery is deployed in work. That is, the principal economies obtained with the division of labour – what Young (p. 531) calls '*the economies of roundabout methods of production*' – are those of "(…) using labour in roundabout or indirect ways" (p. 539) such as in "(…) Mr. Ford's methods (…)" (p. 530).

The division of labour, according to Young, triggers a series of changes (e.g., in the form of new competences, activities, or products, and even new firms and industries) which progressively propagate throughout extant firms and the industries of which they are a part (p. 533).[22] In particular, the *internal economies* of otherwise extremely large and multi-product firms give way to the internal and *external economies* of specialised and single-product firms (p. 538).[23] Therefore, firms profit from their own scale and scope economies and from those of their connected counterparts (of the same industry or of related industries). Young even seems to allude to the connectedness of firms and industries when claiming that the external economies do not add up to – in fact are greater than – the sum of all firms' internal economies (p. 528) and noting that the growth of some industries is contingent on the growth of other, ancillary industries (p.

[22] Araujo and Kerndrup (2001) recast this change (both of a qualitative and quantitative character) as a cascade of connected teaching and learning processes taking place inside as well as across firms' boundaries, while considering that business relationships are the main platforms for effecting such processes.

[23] Alfred Marshall (1890 [1997]) provides a fruitful distinction between the internal economies which the focal firm is able to enjoy (especially when operates at a large scale) and the economies which are external to it. As Young (1928, p. 528) puts it, "(…) the economies of some firms (…) figure as the external economies of other firms (…)". The Marshallian firm is a medium through which productive economies are obtained and transmitted to the market, such economies being visible in the price of products on sale. If it needs to be restated, I am adopting the focal firm's viewpoint throughout the thesis.

538). More importantly, Young (1928, p. 529) claims that the division of labour occurs not only *within* firms and industries but also *among* both of them. By recognising this, Young is able to address a usually neglected feature of the division of labour. Though the essence of the division of labour is the *specialisation* taking place inside firms and industries, the *integration* (i.e., some sort of cooperation) across them surely ensues. Adam Smith (1776 [1999], pp. 116-7) seemingly alludes to such concomitant integration when he argues that final products are the joint outcomes of a diversity of labour endeavours. Yet Piore (1992) is the first to identify in an explicit way these two distinct and indissociable characteristics of the division of labour. To the division and sub-division of activities, attempts to integrate their outcomes are opposed (Piore 1992).[24] When a complex productive process is split up in multiple and simpler tasks, the interdependence of those subdivided tasks is not simply ruled out – for the whole, as usual, is greater than the sum of parts. "What is required is that industrial operations be seen as an interrelated whole.' (Young 1928, p. 539).

The specialisation-integration duality inherent in the division of labour is captured by Young's instructive outlook: "(…) an *increasingly intricate nexus of specialised undertakings* has inserted itself between the producers of raw materials and the consumer of the final product (…)." (p. 538, emphasis added). The main effects of these two features of the division of labour can be summarised as follows. Specialisation results in: (i) a higher productive efficiency of the focal firm (Marshall 1890 [1997]; Young 1928); (ii) the potential enhancement of the focal firm's actual competences or development of new ones (Richardson 1972); and (iii) innovation (e.g., new attributes of and uses for extant resources) (Penrose 1959). Integration, on its part: (i) leads to a higher efficiency with respect to the focal firm's costs of transacting and interacting with counterparts (via arm's-length relations and business relationships respectively) (Hakansson and Snehota 1995; Williamson 1979); and (ii) allows the focal firm to access and exploit the resources and competences of its counterparts (Hakansson and Snehota 1989).

[24] The patterns of integration and disintegration occurring over time (especially at a vertical level, i.e., in both the arm's-length relations and business relationships of the focal firm with its suppliers and customers) are exposed and justified at length by Langlois and Robertson (1995). Of course, some sort of integration is also found within the focal firm: the interdependence between its departments, divisions, functions or even activities is reinforced as specialisation is underway (Piore 1992).

The firm, the market, and interfirm cooperation as three distinct governance structures: the Richardsonian insight

The conventional perspective of *self-sufficient firms competing in atomistic and faceless markets* was firstly challenged more than thirty years ago. George B. Richardson, in his 1972 path-breaking '*The organisation of industry*', alerted to the '*highly misleading account*' or '*distorted view*' (presented in the standard theories of the firm and of markets) concerning the way in which each and every industry is *de facto* organised (pp. 883, 884). It is to Richardson's enlightening argumentation that one turns to now.

The division of labour, according to such theories, is effected only between *firms* and *markets*, i.e., hierarchies and the arm's-length relations established between firms respectively. The *coordination of economic activities* is carried out either via *direction* within firms or the *invisible hand* operating spontaneously between firms.[25] Those above-mentioned theories build upon a sharp dichotomy between the firm and the market and exhibit generally two deficiencies: (i) they merely assume yet do not to provide explanations on the principle of the division of labour between firms and markets (i.e., which activities are coordinated by *directed* planning and which others are left to *spontaneous* coordination of the price mechanism); and (ii) fail to notice a pervasive phenomena – the *interfirm cooperation* – which Richardson claims to provide an alternative mode of coordinating economic activities, in addition to both firms and markets. Richardson (1972) distinguishes clearly between interfirm cooperation and pure market transactions between firms. The former cooperation, usually a vertical one, is '*close, complex and ramified*'. In such "(…) traditional links between buyers and sellers (…) found in most markets (…)" (p. 891), also labelled as '*cooperative arrangements*' (p. 886), '*reciprocal undertakings*' (p. 891) or '*business relations*' (p. 895), both parties accept the obligation of (and give implicit assurance concerning) their non-opportunistic behaviour in the future. When it comes to purely transactional relations, on the contrary, "(…) there is no continuing association, no give and take, but an isolated act of purchase and sale (…)" (Richardson 1972, p. 891).

For Richardson, the principle governing the division of labour (or, in other words, the coordination of economic activities between firms, markets, and interfirm cooperation) can be grasped only when two elements are brought into the forefront: *activities* and

[25] The *visible hand* of firms is postulated by Alfred Chandler (1977) to contrast with the invisible hand of markets in Adam Smith's (1776 [1999]) work.

competences.[26] Richardson views each industry as composed of a large number of interrelated activities (e.g., research and development, purchasing, production, marketing, and so on). These activities, of course, are only carried out by firms endowed with appropriate competences (Richardson 1972, p. 888). Economic activities fall under two types (Richardson 1972, pp. 888, 889): the *similar* and *complementary* ones. The activities demanding the same resources and competences for their undertaking are labelled similar. The so-called complementary activities, as a rule dissimilar, represent different stages of a production process and need to be coordinated in level or specification. These latter activities, when mandate a both quantitative and qualitative coordination, are entitled somewhat differently as *closely complementary* (p. 891). Firms are necessarily devoted to a certain range or scope of activities, undertaking only those for which they have the required resources and competences. That is, firms tend to specialise in certain activities for which their resources and competences (developed and/or acquired) offer some '*comparative advantage*' (p. 891). Inasmuch as firms are endowed only with limited resources and competences, it is to their own advantage to concentrate in (and possibly expand into) the activities which they are in fact capable of performing. Understandably, the activities within firms' boundaries are in general *similar* – this is not to say that firms cannot produce several products and thus compete in different product markets (pp. 888-9).

Two evident reasons impede the coordination of all economic activities to be effected within a single and necessarily self-sufficient firm. Firstly, activities exhibit both economies and diseconomies of scale and scope. The scale on which an activity is performed affects its efficiency whereby there are not constant returns to scale or, in other words, there exists an optimum production volume (i) until which increasing returns to scale (i.e., reductions in per-unit productive costs) are obtained and (ii) from it onwards decreasing returns to scale (i.e., increases in per-unit productive costs) result[27]. And secondly, activities do not always require similar competences for their undertaking.

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[26] I use here the term '*competence*' instead of the '*capability*' notion discussed by Richardson. Nevertheless, I take their meaning to be in essence the same, i.e., the focal firm's know-how to do things effectively and efficiently (Loasby 1998).

[27] Edith Penrose (1959) explicates in detail the limits to the size and growth of the focal firm, e.g., decreasing returns to management and bureaucratic costs.

In my viewpoint, Richardson (1972, pp. 890-1) offers a competence-based answer to Ronald Coase's (1937) famous questions, namely '*why do firms exist at all (if markets could in principle coordinate all activities)?*' and '*why does not exist merely one large firm?*'. Richardson (1972, p. 896) himself considers the Coasian explanation on the existence of firms – that there are substantial costs of using markets to effect the coordination of economic activities, costs that exceed those associated with the coordination within hierarchies – as consistent with and probably extending his own rationale (for he specifies the factors that affect those relative costs). The only difference between Richardson and Coase being that the former distinguishes explicitly between interfirm cooperation and market transactions as diverse governance structures (p. 896).

Understandably, it pays off to leave the coordination of some activities – especially the complementary ones (which may be dissimilar) – to the responsibility of several firms, either resorting to their purely transactional relations or to their long-lasting and complex cooperation as adequate. On occasion it is possible to rely on markets and their intrinsic '*law of large numbers*' – that owing to the presence of aggregates of suppliers and customers, supply equals demand – for carrying out the qualitative coordination of complementary activities. Whenever such activities demand not only a quantitative but also a qualitative coordination (i.e., can be properly classified as closely complementary) they should be better coordinated by interfirm cooperation. Richardson hence arrives at the *raison d'être* for the interfirm cooperation that is "(…) very commonly present, in some degree, in the relationship between buyer and seller" (p. 886) and overall "(…) the dense network of cooperation and affiliation by which firms are interrelated" (p. 883). His reasoning on the prime reason for the existence of business relationships and networks is worth quoting here at length: "They exist because of the need to coordinate closely complementary but dissimilar activities. This coordination cannot be left entirely to direction within firms because the activities are dissimilar, and cannot be left to market forces in that it requires not the balancing of the aggregate supply of something with the aggregate demand for it but rather the matching, both qualitative and quantitative, of individual enterprise plans." (Richardson 1972, p. 892).

The enlightening insight of Richardson is that the division of labour is made among firms, markets, and interfirm cooperation. That is to say, there are three alternative (yet not completely distinguishable) modes of coordinating economic activities or governance structures. Richardson (1972) posits a continuum of governance structures, ranging from *firms* through *interfirm cooperation* to *markets*. "It is important, moreover, not to draw too sharp lines of distinction between the techniques of coordination themselves. Cooperation may come close to direction when one of the parties is clearly predominant; and some degree of *ex ante* matching of plans [i.e., cooperation] is to be found in all markets in which firms place orders in advance." (Richardson 1972, p. 896). "And just as the presence of cooperation [within both interfirm cooperation and market transactions] is a matter of degree [though the cooperative element is of course minimal in the former], so also is the sovereignty [i.e., the direction] that any nominally independent firm is able to exercise on a *de facto* basis (…)." (p. 887). And with such interfirm cooperation in mind, firms should be no longer seen either as "(…) *islands* of planned coordination in a *sea* of market relations (…)" or as "(…) *autonomous* units buying and selling *at arm's-length* in markets (…)" (Richardson 1972, p. 883, emphasis added). That firms are '*islands of conscious power in an ocean of unconscious cooperation like lumps of butter coagulating in a pail of buttermilk*' (Henderson 1932, p. 85) is without doubt an unrealistic depiction of the business world.

3.1.2 Development, dissemination, and orientation

The European alternative to the dominant American view of industrial markets

Two research traditions dominate the field of Industrial Marketing and Purchasing. The first research tradition, developed in America since the 1960s, features the application (problematic, to say the least) of *consumer marketing theory* to business-to-business markets (e.g., Bonoma and Zaltman 1978; Bonoma et al. 1977; Nicosia and Wind 1977; Robinson et al. 1967; Sheth 1977; Webster and Wind 1972a; Wind 1978). The other research tradition, by and large European, is a response to the former (still prevailing) American view of seller-dominated and atomistic industrial markets wherein firms deploy certain marketing-mix parameters (i.e., product, price, distribution, and promotion) and anonymous buyers respond (either buying or not). The Markets-as-Networks Theory is the most notorious offspring of this latter research tradition.

The antecedents of the Markets-as-Networks Theory can be hence found in three streams of research: (i) the earlier studies in *distribution channels*, particularly on the issues of *power* and *control* between channel members (Bucklin 1965; El-Ansary and Stern 1972; Rosenberg and Stern 1970; Stern and Reve 1980; Webster 1976; Wilkinson 1976, 1973, 1979); (ii) the studies in *the internationalisation process of the firm* (Johanson and Vahlne 1977; Johanson and Wiedersheim-Paul 1975); and (iii) a vast array of studies in both the *industrial buying behaviour* (Blois 1970; Cunningham and Kettlewood 1976; Cunningham and White 1974a, 1973; Hakansson and Wootz 1975a, 1975b; Jarvis and Wilcox 1977; Johnston and Bonoma 1981; Luffman 1974; Pettigrew 1975; Sheth 1973; Spekman and Stern 1979; Webster 1965; Webster and Wind 1972b; Wind 1970; Woodside and Sammuel 1981) and the *industrial marketing processes* (Blois 1977; Cunningham and White 1974b; Ford 1978; Hakansson 1980; Hakansson et al. 1976; Hakansson and Ostberg 1975; Hakansson et al. 1979; Mattsson 1973; Reve and Stern 1979; Turnbull 1974).

Furthermore, the markets-as-networks theorists take advantage of more or less distant but stimulating sources of ideas on *interdependence and interfirm cooperation* (e.g., Aiken and Hage 1968; Aldrich 1976; Blau 1964; Chamberlain 1968; Dill 1958; Emerson 1962; Emery and Trist 1965; Evan 1966; Granovetter 1985; Jacobs 1974; Levine and White 1961; Lincoln 1982; Litwak and Hylton 1962; Macauley 1963; Macneil 1980; Miles et al. 1974; Negandhi 1975; Phillips 1960; Telser 1980; Van de Ven 1976; Van de Ven and Koenig 1975; Warren 1967a, 1967b; Whetten and Leung 1979).[28]

The IMP1 and IMP2 research projects and the inception of the IMP

The development process of the Markets-as-Networks Theory is easy to ascertain inasmuch as it parallels the qualitative research (mainly based on case studies) conducted by the IMP over the last three decades. Several reviews on the antecedents, evolution, basic assumptions, implications, and future research agenda of the Markets-as-Networks Theory are offered (see, e.g., Easton 1992; Ford and Hakansson 2006b; Gemunden 1997; Hakansson and Snehota 2000; Johanson and Mattsson 1994; Mattsson and Johanson 2006; Mattsson and Naert 1985; McLoughlin and Horan 2000a, 2002,

[28] Of course, there are other inspirational fountainheads I might mention. I refrain from alluding to those scattered throughout the overview of the state of the art of the Markets-as-Networks Theory.

2000b; Ritter and Gemunden 2003a; Turnbull et al. 1996; Wilkinson 2001; Wilkinson et al. 2005a; Young 2002).

The formal genesis of the Markets-as-Networks Theory (as well as the birth of the IMP Group) can be therefore traced to 1976 when the '*International/Industrial Marketing and Purchasing*' research project (latter denominated *IMP1*) is initiated. The IMP1 is born from the dissatisfaction, among about twenty junior European scholars and researchers, with the explanatory power of Marketing theory concerning industrial buying and selling (Monthoux 1975). Those scholars and researchers share the conviction that Marketing theory provides a very limited (if not unrealistic) understanding of how industrial markets really work in practice (Hakansson and Snehota 2000). In the six years that IMP1 lasted, about one thousand buyer-seller relationships – within and mostly across five European countries (France, Germany, Italy, Sweden, and UK) – are inquired by conducting structured interviews with representants of both buyers and sellers. The IMP1's methodological design and results are detailed in Cunningham (1980) and Hallen and Johanson (1989) respectively. IMP1 brings about both theoretical and empirical results. A large empirical database of buyer-seller relationships' features and in-depth case studies are generated and a conceptual framework is devised – the so-called *interaction approach* (Campbell 1985; Hakansson 1982a). Though studying only industrial markets of goods (Hakansson 1982b), those researchers presume that their conclusions are also applicable to markets where business-to-business services are produced and consumed amongst firms (e.g., Johanson and Mattsson 1987, p. 34). The interaction approach posits that (i) industrial purchasing and marketing are not merely transactions (i.e., isolated events of *action* and *reaction* respectively),[29] but rather part of a lasting pattern of *interactions* between active buyers and sellers and, as a consequence, (iii) industrial markets are neither *faceless* (i.e., featuring a large number of anonymous customers) nor *atomistic* (i.e., consisting of unconnected buyers and sellers), usually encompassing close and long-standing business relationships. As Hakansson (1982b, p. 6) puts it: "Industrial markets are characterized by stability instead of change, long lasting relationships instead of short business transactions and closeness instead of distance.".

[29] These views of industrial marketing and purchasing as discrete events are the natural consequence of academic studies of the way firms carried out their buying episodes being conducted independently of inquiries about how sellers influence that buying process to their advantage (Ford 1980).

The interdependencies between business relationships observed in the IMP1 serve as a strong motive for researchers to embark on a second project. Initiated in 1986, this project is named *IMP2*. Whereas the IMP1 focus on dyadic buyer-seller relationships, the primary units of analysis of the IMP2 are the complex networks such business relationships overall form. The IMP2 is methodologically similar to the IMP1 (with the recourse to interviews and case research) and carried out by researchers from Australia, Japan and the United States of America, in addition to most of the researchers responsible for undertaking the IMP1. The main outcomes of the IMP2 are a large empirical database of buyer-seller relationships and several in-depth case studies and, more importantly, the *Actors-Resources-Activities* (*ARA*) *model* (Hakansson 1989, 1987; Hakansson and Johanson 1992) whereby industrial markets are seen as strongly interwoven networks of actors, activities, and resources.

Books and papers as the main dissemination vehicles

The Markets-as-Networks Theory is disseminated via scientific journals, books and book chapters (as well as in the IMP annual conferences). The analytical and empirical results of the qualitative research efforts of the markets-as-networks theorists are featured in a myriad of papers: mostly in the *Industrial Marketing* field (e.g., the extinct *Industrial Marketing and Purchasing*, *European Journal of Marketing*, *IMP Journal*, *Industrial Marketing Management*, *International Journal of Research in Marketing*, *International Marketing Review*, *Journal of Business and Industrial Marketing*, *Journal of Business-to-Business Marketing*, *Journal of Marketing*, *Journal of Marketing Research*, *Journal of Marketing Management*, *Journal of Strategic Marketing*, *Marketing Theory*), and some in the *Management Science* area (e.g., the *International Business Review*, *Journal of Business Research*, *Journal of Management Studies*, *Management Learning*, *Organization*, *Scandinavian Journal of Management*, *Strategic Management Journal*). However, it is the publication of books which represent the major milestones in the development process of Markets-as-Networks theory, in particular the formal presentation of the interaction approach (Hakansson 1982b) and the first mainstream introduction to the theory itself (Axelsson and Easton 1992; Hakansson and Snehota 1995). Several other books and book chapters, e.g., Dubois (1998) and Hakansson (1993) respectively, attest to the preference of markets-as-networks theorists to publish in book format. The list of published books and book

chapters is quite extensive. For instance, on the former see Ford (2002; 1990), Ford et al. (1998), Forsgren and Johanson (1992), Gadde and Hakansson (1993; 2001), Gemunden et al. (1997), Hakansson (1989; 1987; 1975), Hakansson et al. (2004), Hakansson and Johanson (2001), Hallen and Johanson (1989), Havila et al. (2002), Laage-Hellman (1997), Lundgren (1994), Moller and Wilson (1995), Naude and Turnbull (1998), Turnbull and Cunningham (1981), Turnbull and Paliwoda (1986), and Turnbull and Valla (1986). Whereas see, on the latter, Araujo and Easton (1996a), Easton (2000), Ford et al. (1996), Hakansson and Johanson (1988; 1984; 1993b), Hakansson and Snehota (2000), Johanson and Mattsson (1994), and Mattsson (1985; 2004; 1987). Such preference is, according to McLoughlin and Horan (2002; 2000b), supported by three motives. Firstly, the Markets-as-Networks Theory is catalogued as rather peculiar if not thought-provoking (for it challenges the orthodoxy of mainstream purchasing and marketing theories). Such '*a new view of reality*', as Axelsson and Easton's (1992) edited book title puts it, adds greatly to the usual difficulties of exposing new ideas in a journal paper (and overcoming the referees' resistance to novelties). Secondly, books have a slight advantage over journals because they allow the dissemination of knowledge to a wider audience and make possible the generation of dialogues with other disciplines and related theories. Since the Markets-as-Networks Theory springs from theoretical cross-fertilisation (Hakansson and Snehota 2000), it is likely that further cross-fertilisation is searched for – and this is more easily achieved through book publication. Finally, as case research is far more employed than quantitative methods (Easton 1995), the research results tend to be more extensive and thus unsuited to publication in the relatively restricted 8000-words space of a journal paper. Easton (2000) argues for the epistemological validity of the case research in the inquiry of business relationships and networks.

A largely positive orientation

The primary purpose of the Markets-as-Networks Theory is to describe and explain the business networks and relationships in which firms are deeply embedded. Despite exhibiting a great explanatory power, the Markets-as-Networks Theory is usually charged with the allegation of an overly descriptive focus (Moller 1994; Wensley 1995). Another limitation commonly pointed to the Markets-as-Networks Theory is the neglect of the '*dark side*' of business relationships and networks, i.e., the excess of emphasis on

the relationship functions and benefits. Such limitation is compensated by recent work on the dysfunctions and sacrifices of business relationships (e.g., see Hakansson and Snehota 1998).

It is undeniable that the Markets-as-Networks Theory is inductively developed from qualitative research without any kind of prescriptive concern. Hakansson's (1987, p. 210, emphasis added) position is elucidative: "We have met many managers who have been very skilled in their way of handling networks as a result of experience of a life-time spent in networks. As a consequence we will *avoid giving detailed advice* regarding the practical handling of networks. Instead, we believe that we can be of much more help by identifying and discussing more general network issues. Thus my contribution is rather to integrate known details to a more comprehensive body of knowledge.". The positive orientation of the Markets-as-Networks Theory (Brennan and Turnbull 2002) stems from two motives. Firstly, the markets-as-networks theorists share the conviction that to improve the practice of industrial purchasing and marketing, it is needed first of all a better understanding of the interfirm relationships and networks observed in industrial markets (Wilkinson 2001). They suggest that, in principle, good theory is conducive to good practice. Secondly, the units of analysis of, and the sort of research questions posed by, the Markets-as-Networks Theory both tend not to lend themselves to the issuance of managerial prescriptions. As Easton and Hakansson (1996) correctly stress, in order to prescribe it would be necessary that the theory takes a narrower stance, e.g., adopting the focal firm's viewpoint. Plus, toolkits for network and relationship management are often difficult to formulate. Since diversity is a feature of industrial markets, best or optimal practices are not likely to apply. "Business researchers can aim to construct tools to help managers to understand their world, not tell them what decisions to take or what to do. Business researchers cannot predict the direction of development of a network, nor forecast the final effects of any network action. (…) [As] networks are built on variety [e.g., of interests, expectations, and goals] (…) the answers to managers' questions about their interactions will always depend on the specific situation and context. There are no nice neat solutions or standardized approaches to strategic network success." (Hakansson and Ford 2002, p. 138). That description is given importance to the disfavour of prescription (Gemunden 1997), is not tantamount to say that the Markets-as-Networks Theory is purely

descriptive or '*managerially empty*' (Moller and Halinen 1999). As Easton (1992) argues, normative implications flow from, but do not drive, the theory.

Since the mid-1990s, however, the concern of markets-as-networks theorists with managerial guidelines is growing. Ritter et al. (2004) argue that a shift – from understanding business relationships and networks to offering advices on to how manage them – is surely taking place within the Markets-as-Networks Theory. In the last decade, an increasingly number of works are focused on helping practitioners in their relationship and network management tasks (e.g., Ford et al. 1998; Moller and Svahn 2003). This normative turn, even if latter accomplished by theorists, is understandable. Regardless of the phenomenon under study, description always precedes prescription. That is to say, prescription *per se* is useless without some kind of previous understanding. "One cannot choose what course of action to prescribe without knowing what events each course of action will lead to." (Easton and Hakansson 1996, p. 409).

3.1.3 The state of the art

Relationship development: how are business relationships brought about

The development of any business relationship is a time-consuming and costly process. Much time and efforts must be devoted by firms if their business relationships are to be nurtured and sustained. Business relationships are constantly in need of investments for their establishment, development, maintenance, and even termination, therefore competing for firms' limited resources (Hakansson and Snehota 2000). Also, other factors are decisive in the development of a business relationship (Easton 1992): (i) the expectations held by both parties concerning the actual or potential value of the business relationship (e.g., whether relationship benefits will exceed related sacrifices)[30] and (ii) the existence of a certain complementarity or compatibility between both parties' objectives (namely, whether each party feels confident that the other will reciprocate and not be a free-rider). Some '*attraction*' between both parties (Wilkinson et al. 2005b) and the (actual or potential) relationship outcomes (Hakansson and Snehota 1995) are also pivotal in the focal firm's decision to nurture and sustain the business relationship. Mattsson (1989) claims that the focal firm's attractiveness to others depends not only on its internal endowments (e.g., resources and competences) but also on its propensity to

[30] The issue of relationship value is succinctly discussed in the following section.

cooperate (somehow deduced from its history of interaction). There is a trade-off between attractiveness and freedom of choice: the focal firm, in order to be attractive, has in part to maintain business relationships and not be totally independent. "The company that possesses no relationships is theoretically free to enter into collaboration with anyone at all, but in fact it is difficult to find anyone who is interested. The company that has already entered into a number of relationships will find it much easier to interest a partner, but its choices will be far more limited. (…) In general, established relationships are a vital condition for the initiation of [further] successful collaboration." (Hakansson 1989, p. 124).

Business relationships evolve over time as reciprocal investments are made and interdependence and mutual trust and commitment all gradually increase. Trust, commitment, and the expectation of future interaction go usually hand in hand: "Trust is a necessary condition for commitment and commitment only makes sense if tomorrow matters." (Hakansson and Snehota 1995, p. 198). Check, for example, Pressey and Matthews (2004) and Wilson and Mummaleneni (1986) respectively on the issues of trust and commitment in business relationships. Furthermore, the distance – of a social, cultural, technological, temporal or geographical basis – that normally exists between the focal firm and its counterpart at an early phase of interaction, is likely to be severely diminished as both parties gradually get to know and trust each other and to invest and, consequently, their reluctance to cooperate (partially related to the uncertainty regarding the counterpart's intentions and future behaviour) is greatly reduced. Ford (1980) and Dwyer et al. (1987) propose two models for the relationship development process according to which business relationships go through a series of (more or less similar) stages: the '*pre-relationship*', '*early*', '*development*', '*long-term*', and '*final*' stages and the '*awareness*', '*exploration*', '*expansion*', '*commitment*', and '*dissolution*' stages respectively. These models, by making an implicit or explicit use of the marriage metaphor, presume that business relationships always develop towards an ideal state – '*the successful marriage*' – characterised by a high degree of cooperation and a low degree of conflict between the parties involved. Wilkinson and Young's (1994) empirical research on more than six hundred business relationships offer strong evidences that relationship development does not follow the ideal path – from poor, highly competitive business relationships to good, totally cooperative ones – suggested

in traditional life cycle models of relationship development such as those mentioned above. Business relationships may fail to develop and are eventually terminated, at times, owing to persistent barriers to interaction. According to Cunningham (1982), the barriers to interfirm interaction may be structural (if arising from the economic, political, social and cultural features of the countries in which firms operate) or instead derive from mismatches between parties (e.g., in terms of size, organisational culture, objectives, strategy or procedures) or conflicting expectations and behaviours of the individuals involved in interfirm interaction. These barriers, in general transitory, can be removed (e.g., through deepening extant interpersonal contacts) but always at a cost (Cunningham 1982). Several other reasons for the dissolution of business relationships are offered by Biong et al. (1997): (i) the lack of relational orientation and mutual commitment by, or changed requirements of one or both parties involved and (ii) a non-positive relationship value (i.e., sacrifices more than offset, or simply equate, relationship benefits) at least for one of the parties. The development of business relationships is therefore best described, not by resorting to the marriage metaphor, but instead via deploying a *dancing* analogy featuring both leading of and following by parties (Wilkinson and Young 1994). On the termination of business relationships (and its motives and consequences), see Alajoutsijarvi et al. (2000), Giller and Matear (2001), Grounhaug et al. (1999), Halinen and Tahtinen (2002), Tahtinen and Halinen (2002), Tahtinen and Havila (2004), Tahtinen and Vaaland (2006), Tuusjarvi and Blois (2004), Vaaland (2004), Vaaland et al. (2004).

Relationship nature: what do business relationships look like

Each and every business relationship comprises multiple short-term *interaction episodes* (e.g., face-to-face meetings, negotiations via telephone or email, deliveries, and payments) in which some content is exchanged between buyer and seller (Hakansson 1982a). Of course, such interaction episodes are difficult to delimit in time for their beginning and often their end cannot be unambiguously identified (Ford and Hakansson 2006a). In general goods or services are traded for money but also knowledge and social values (i.e., trust and commitment) are often mutually exchanged. The multifarious content of business relationships is best described in terms of three dimensions (Hakansson and Snehota 2000): (i) technical (e.g., the combination of firms' resources and activities); (ii) social (e.g., the exchange of trust and commitment); and (iii)

economic (e.g., the costs of and benefits resulting from developing and maintaining business relationships). Both history and encircling structure matter in business relationships (Ford et al. 1986). Current interfirm interaction is rooted in the past and shapes future interaction. Firms interact with an eye on the future of their relationship but always remembering previous interaction episodes. As Axelrod (1981) notes, cooperation can emerge and thrive in a world of individual egoists and without the assistance of a central authority. Friendship, mutual interests and objectives, or trust may all be necessary but are not sufficient conditions for the development of cooperation. Though may at first seem counterintuitive, reciprocity – which can come close to the avoidance of retaliation or '*tit for tat*' – is the indispensable base for cooperation. Though Axelrod is focused on cooperation among self-centered individuals in society, he believes that his theory is equally applicable to the business world (Axelrod 1981, pp. 178-9). In this regard, the incentive of firms to cooperate at a given point in time (via their business relationships) comes largely from the existence of a large '*shadow of the future*' (i.e., the anticipation of mutually rewarding interactions in the future) and the history of their previous interactions (Axelrod 1984). In addition, the surrounding structure of interactions (i.e., connected business relationships) impact upon the extant interaction amongst firms, either reinforcing or hindering it.

The substance of vertical interfirm interactions and relationships is extensively discussed within the Markets-as-Networks Theory. Whereas some characteristics of business relationships (so-called *structural*) are readily perceptible at first glance, others (*process* ones) can only be discovered after an in-depth look (Hakansson and Snehota 1995). Business relationships are stable but not completely static phenomena (Easton 1992). The structural characteristics of business relationships – *continuity*, *complexity*, *symmetry*, and *informality* – give them a fair sense of stability. Yet business relationships, when looked at more carefully, turn out to be quite dynamic. Their process features are the following: *adaptations*, '*coopetition*',[31] *social interaction*, and *routinisation*. Let me address now each of these eight features in turn.

<u>*Structural features.*</u> Business relationships are long-lasting phenomena, often developed and maintained over more than ten years (Johanson and Hallen 1989), being built on intricate patterns of interpersonal contacts permeating several functions and hierarchical

[31] The notion of 'coopetition' was, to the best of my knowledge, first coined by Nalebuff and Brandenburger (1996).

levels in both parties involved (Cunningham and Turnbull 1982). The complexity of business relationships derives not only from the number of individuals involved in the contact pattern between firms (and their diverse roles, status, expectations, interests, intents, perceptions, and interpretations),[32] but also from the fact that relationships can be used for different purposes (e.g., access to and exploitation of external resources and competences).

Business relationships are more or less symmetrical in terms of both parties' initiative and interest to develop and sustain them and exhibit by and large a low degree of formalisation. It is often the case that business relationships, instead of being governed by legal contracts, rely on informal self-enforcement mechanisms such as trust, commitment, and mutuality (Hakansson and Johanson 1988). Formal contracts, unlike implicit ones, are likely to be ineffective in taking care of the conflicts and uncertainties arising between the parties over time (Macneil 1978). Despite the symmetry of parties' interests in the development and maintenance of business relationships, business relationships are often asymmetrical with respect to power and dependence issues. Dependence, of course, is inversely associated with the possession of power, for the greater the power the focal firm has in the network, the less it depends on others with whom it maintain business relationships (Emerson 1962). "The dependencies may be mutual, but are not necessarily so; in general, it may be assumed that they are more or less asymmetrical in the sense that one party is more dependent on the relationship than the other." (Johanson and Mattsson 1987, p. 39). As some firms are naturally more powerful than others (e.g., owing to the possession of valuable resources and competences or holding a dominant network position), asymmetries are likely to exist within business relationships (e.g., explaining why relationship benefits are unevenly distributed between parties). Nevertheless, relationships can never be unilaterally dominated by one of the parties, no matter how great the power of the focal firm is and no matter how great control it may exert over its counterpart (and consequently the potential dependence of the latter on the former is) (Hakansson and Snehota 1995). Though the notions of power and control are sometimes employed interchangeably, they differ *de facto*. The common position within the Markets-as-Networks Theory regarding these two notions seems to be the following: the focal firm's power in the

[32] The interpersonal and intertemporal inconsistency and ambiguity of individuals' behaviours and of their interpretations is recurrently found within business relationships (Ford et al. 1986).

network derives from (i) its control over resources, activities, and counterparts (via extant or new business relationships) and (ii) the network positions it occupies and its network identity. In short, power is a natural consequence of control.

Interfirm cooperation, like other forms of cooperation, does not require formal agreements between the parties – a large shadow of the future is sufficient (Axelrod 1984). The continuity of business relationships, therefore, contributes to their informal character.

Process features. Adaptations are the relationship-specific investments made by the focal firm and its counterpart over time to achieve fit to one another (Brennan and Canning 2002; Brennan and Turnbull 1998, 1999). Firms adjust products, production processes, scheduling routines, administrative procedures, and payment systems towards one another, thus strengthening their interdependence (and generating mutual trust and commitment) and permitting easier resolution of potential conflicts arising within their business relationships. This is also known as the '*particularity*' feature of interaction since the focal firm becomes increasingly '*particularised*' to its counterpart and vice-versa (Ford et al. 1986). The investments made by both parties to a certain business relationship often are specific to that relationship, i.e., they cannot be transferred to other relationships (they have low or zero value in alternative uses) – typifying sunk costs – and are therefore likely to involve considerable opportunity costs. Nevertheless, adaptations are always to some extent interrelated since they compete for the limited resources of both parties. Besides, adaptation in one business relationship may imply *maladaptation* in another (Ritter 1999). Many adaptations develop in an unplanned way, being invisible to (and, as a result, seldom planned or monitored by) the focal firm's top management. Adaptations are therefore likely to be known only by the personnel directly involved in the management of business relationships, i.e., of the marketing and purchasing departments. Adaptations, though often *informal* (i.e., emerging *ad hoc* to cope with issues arising as the business relationship develops), can sometimes be *formal* or formalised *ex post* if contractually agreed by parties (Ford 1980). Though mutual adaptations are the rule, adaptation is on occasion unilateral, made as a consequence of a powerful firm exerting pressure on a dependent firm and forcing it to adapt. "Partly the adaptations are made unilaterally as a consequence of imbalance in the interfirm power relation, and partly the adaptations are reciprocal

demonstrations of commitment and trust in the relationship.". (Hallen et al. 1991, p. 34). Surely, unilateral adaptations often precede mutual adaptations.

As firms have both common and conflicting interests, business relationships exhibit the cooperation and competition dimensions simultaneously. Richardson (1972) is probably the first to stress that competition and cooperation coexist within interfirm relationships. "I have sought to stress the co-operative element in business relations but by no means take the view that where there is co-operation, competition is no more." (Richardson 1972, p. 895). A kind of '*coopetition*' thrives within business relationships (Bengtsson and Kock 2000). Easton and Araujo (1992) attempt to describe the different degrees to which such diametrical different logics of interaction – namely cooperation and competition – can be found simultaneously in the atmosphere of business relationships, by hypothesising the *co-relation* dimension. This dimension is classified in terms of five categories: (i) *conflict* (i.e., both parties merely seek to destroy one another); (ii) *competition* (i.e., each party only aspires to remain ahead of its rivals); (iii) *coexistence* (i.e., parties are unaware of each other's existence or, when aware, they choose not to compete); (iv) *cooperation* (i.e., both parties collaborate in order to attain common or compatible goals); and (v) *collusion* (i.e., parties agree to cooperate with the purpose of damaging the welfare of others, e.g., customers or common competitors). A diversity of business relationships – often exhibiting cooperation but sometimes displaying coexistence, conflict or even collusion – abounds in business markets.

Business relationships encompass extensive social contacts between individuals of both parties. As Hakansson and Snehota (1995, p. 10) put it: "Machine-like relationships do not exist.". Personal contacts between firms' members – and the social bonds they establish – are undoubtedly of importance to establishing and maintaining business relationships, being capable of withstanding disruptive forces (e.g., an episode of opportunistic behaviour by one party) (Easton and Araujo 1986; Wilson and Mummaleneni 1986). It is through these social contacts that "(…) information is exchanged, adaptations are agreed, negotiations are performed, [and] crises are overcome (…)." (Turnbull et al. 1996, p. 57). In Hirschman's (1970) terminology, '*voice*' is in general preferred to '*exit*' – the former is better as a conflict-resolution mechanism than the latter (neither easy nor costless). The multiplex interpersonal contacts maintained between firms over time are responsible for the atmosphere of

business relationships, an atmosphere wherein interfirm interactions are necessarily framed. "This atmosphere can be described in terms of the power-dependence relationship which exists between the companies, the state of conflict or cooperation and overall closeness or distance of the relationship as well as by the companies' mutual expectations." (Hakansson 1982a, p. 21). Surely, the development and maintenance of business relationships is strongly dependent on the intensity and width of such interpersonal contacts.

Business relationships are characterised by mutual orientation or mutuality inasmuch as interrelated firms (i) have mutual knowledge of, and respect for, each others' strategies, interests, ambitions, and the like and (ii) are willing to refrain in part their self-interest, and fall short of merely attaining own goals, in order to pursue common objectives (Ford et al. 1986). This mutuality helps to counterbalance the conflict of interests inevitably arising between the parties to a business relationship over time, a conflict on occasion seeming insurmountable.

The routinisation of interaction episodes over time leads to the development of expectations about the roles that each party expects the other to perform – a long-term process known as *institutionalisation* (Ford et al. 1986). The rights and duties of both parties to the business relationship become informally institutionalised (i.e., self-policing and self-enforcing), materialised in norms of conduct. Institutionalisation is not without problems. On occasion, the existence of routine patterns of operation gives the wrong impression that the focal firm and its counterpart are less committed to each other, as their evolving needs and requirements are not being continually attended to (Ford 1980). In these cases, mutual commitment (despite actually being at its maximum) is perceived by both parties to be minimal.

The role of business relationships: their functions and dysfunctions, and the ensuing benefits and sacrifices

One is likely to find at the root of business relationships a '*what can you do for me? what can I do for you?*' kind of reasoning (Ford et al. 1986). That is to say, the focal firm and its counterpart enter into and sustain a business relationship because such interaction is to some extent worthwhile. The focal firm and its counterpart, via their business relationship, are able to obtain something they would or could not obtain by themselves alone – that something resembles Alchian and Demsetz's (1972) '*team*

effects'. Or, alternatively, even if both parties could obtain that something by their own efforts, it would be more costly and/or time-consuming. But what propels the focal firm and its counterpart into a business relationship? Or, as Ford et al. (1998) puts it, what can parties offer to (as well as demand from) each other?

The role of business relationships is said to be strongly dependent on their nature (Blankenburg-Holm et al. 1999; Naude and Buttle 2000; Walter and Ritter 2003). That is, only *substantial* business relationships (entailing high degrees of mutual trust, commitment, adaptations and interdependence) are likely to generate more positive than negative outcomes for the focal firm. This is not to say that the role of a business relationship has no effect on its nature (see, for example, Ulaga and Eggert 2006; Walter et al. 2003; Walter et al. 2001). It seems logical to expect that a mutually rewarding business relationship is continually nurtured and sustained by both parties. One final aspect is worthy of mention. The nature and role of business relationships can change over time owing to: (i) the internal change of the focal firm or its counterpart; (ii) the shared initiative of the parties; or (iii) the change occurring elsewhere, e.g., within the counterpart's counterparts or in connected business relationships (Hakansson and Snehota 1995).

Business relationships are established, developed, and maintained largely owing to the rewarding *functions* they perform and the positive outcomes (i.e., *benefits*) resulting for the focal firm and its counterpart; though relationship *dysfunctions* can be fulfilled and some negative outcomes (i.e., *sacrifices*) are invariably experienced by both parties.

Relationship functions. A certain business relationship can fulfil, at a given point in time, more than one relationship function for the focal firm. That same business relationship may even perform over time different relationship functions. And similar relationship functions can be performed in different business relationships of the focal firm. Sousa and de Castro (2006) suggest that six main relationship functions can be set forth: (i) the *access* function (i.e., the focal firm's access to, and exploitation of, counterparts' complementary resources and competences) (Pfeffer and Salancik 1978); (ii) the *control* function (i.e., the focal firm's increase of influence over or reduction of dependence on counterparts, and the promotion or block of relationship or network change) (Hakansson 1989); (iii) the *efficiency* function (i.e., reduction of the focal firm's production and/or transaction costs) (Hakansson and Snehota 1995); (iv) the

innovation function (i.e., the identification of previously unknown characteristics of resources and/or the discovery of new ways of using and new purposes for the extant resources and competences of the focal firm, and/or the development or co-development of new resources and competences) (Araujo et al. 1999); (v) the *stability* function (i.e., the focal firm's learning from and/or with others and the reduction of its environmental uncertainty)[33] (Hakansson et al. 1999); and (vi) the *networking* function (i.e., the focal firm's management of interdependences at the actor, resource, and activity levels)[34] (Gadde et al. 2003). Such relationship functions can be further classified as *primary* or *secondary* if relationship benefits and sacrifices (i) are immediately obtained by the focal firm and/or ensue independently of connected business relationships or counterparts or (ii) can only be attained in the future and/or depend on the focal firm's connected relationships or counterparts respectively (Hakansson and Johanson 1993a). Secondary relationship functions can be as important to the focal firm as primary ones (Anderson et al. 1994). This is corroborated by Hakansson and Snehota (1995) who argue that business relationships accomplish functions not only for each and both of the parties involved, but also for other firms directly and indirectly connected to them.

Relationship dysfunctions. A business relationship can be dysfunctional if it (i) does not fulfil some functions expected and/or desired by the focal firm or (ii) precludes the fulfilment of expected and/or desired functions in other, connected relationships. For instance, the focal firm's relationship with customer A – a business relationship which does not fulfil the pretended function '*access*' or hinders the '*control*' function in the focal firm's relationship with supplier C – is dysfunctional. In sum, relationship

[33] The focal firm, despite acquiring or developing knowledge (i.e., learning) via its business relationships, is never fully knowledgeable (Hakansson and Snehota 1995). Its environmental uncertainty can never be completely eliminated.

[34] Operating in networks (i.e., networking) is not a straightforward task for the focal firm. It entails "(…) initiating and responding, acting and reacting, leading and following, influencing and being influenced, planning and (…) improvising, forcing and adapting" (Ritter et al. 2004, p. 178). Networking requires simultaneously the combination of collaboration and confrontation and the pursuit of self and mutual interests. As Ford et al. (1998, p. 1, emphasis in original) reason, networking is about "(…) working *with* other companies, but it also involves working *against* them, *through* them and often *in spite* of them". For Hakansson and Ford (2002), networking is ultimately about the focal firm coping with paradoxes intrinsic to the nature of business networks, namely (i) exploring multiple opportunities while avoiding or minimising unavoidable threats, (ii) influencing and being influenced by counterparts, and (iii) augmenting and losing control over the network. Ford et al. (2002) elaborate on these networking tasks, contending that the focal firm needs to (i) confront or conform to the prevailing status quo in the network, (ii) consolidate extant or create new network positions, and (iii) coerce or concede to counterparts' goals and intents respectively.

dysfunctions are present in case of the absence of relationship functions (and respective benefits) expected and/or desired by the focal firm.[35]

Connectedness of relationship functions and dysfunctions. Since business relationships are (directly and/or indirectly, positively and/or negatively) connected to each other, it seems plausible that their functions and dysfunctions are interrelated (Hakansson and Snehota 1995). For instance, the '*innovation*' function carried out in the focal firm's relationship with customer A may be dependent on, as well as positively influence, the '*innovation*' functions fulfilled in both the focal firm's relationship with customer B and the customer A's relationship with supplier C (a focal firm's competitor). Alternatively, the focal firm's (dysfunctional) relationship with supplier D may preclude the '*innovation*' function in the focal firm's business relationship with supplier E. It does not seem absolutely necessary that only relationship functions and dysfunctions of the same kind are positively or negatively connected, as in the given examples. The above-mentioned '*innovation*' function of the focal firm's relationship with customer A may depend on, and affect, both the '*access*' and '*efficiency*' functions performed in the focal firm's business relationship with customer F.

Relationship benefits. Relationship benefits include all the positive outcomes accruing to the focal firm from the fulfilment of any of the referred relationship functions, e.g., the access to and exploitation of external resources and competences (Anderson et al. 1994).

Relationship sacrifices: costs plus deleterious outcomes. Relationship sacrifices encompass both (i) the *costs* incurred by the focal firm (indispensable to obtain relationship benefits) – though there is always the possibility of temporarily free-riding, i.e., benefiting without suffering any cost whatsoever – and (ii) the *deleterious outcomes* that sometimes result from being involved in business relationships. Relationship benefits and sacrifices are not unconnected: the former are not obtained automatically, easily or for free, being partly dependent on the latter's existence (Araujo et al. 1999). Much time and sacrifices (at the very least costs) are needed before relationship benefits can be harvested by the focal firm (Gadde and Snehota 2000).

[35] The term '*dysfunction*' is commonly defined as any abnormality or impairment of function. Check, for instance, the Merriam-Webster Online Dictionary available at http://www.britannica.com/dictionary. Here it is more denoted as 'non-function'.

Three relationship costs are usually borne by the focal firm (Blois 1999; Gadde and Snehota 2000): (i) *opportunity costs* (e.g., the focal firm's relationship with customer A may preclude the obtainment of benefits in the business relationship with customer B or hinder the attainment of greater benefits and/or lower sacrifices in the relationship with supplier C); (ii) *relationship handling costs* (i.e., costs of establishing, developing, maintaining, and terminating each of its business relationships); and (iii) *network handling costs* (i.e., overhead costs incurred with all of its business relationships)[36]. With regard to deleterious outcomes, at least three may be pointed out: (i) *lock-in effects* (e.g., the focal firm's established business relationships may preclude the development of other relationships) (Araujo and Harrison 2002); (ii) *the opportunistic behaviour of counterparts* (e.g., free-riding and hold-up problems) (Biong et al. 1997); and (iii) several other harmful consequences (e.g., damaging effects of the focal firm's relationship with counterpart A on the former's reputation) (Anderson et al. 1994).

Relationship benefits and sacrifices: which to emphasise? Relationship benefits and sacrifices are recognised as two sides of the same coin. The markets-as-networks theorists, however, seem to place more emphasis on benefits than on sacrifices – the latter are often left out of the theoretical discussion about business relationships (Alajoutsijarvi et al. 2001). This position is supported by the widespread notion that it is in the focal firm's best interest to be more concerned with relationship benefits than with related sacrifices. Hakansson and Snehota (1995, p. 396) convey this in clear terms: "[E]conomizing on the costs of handling relationships is important but exploiting the potential relationship benefits is even more important. It is the benefits side of relationships and not the costs [and overall sacrifices] they entail that appear to be the critical variable in a management perspective.".

Benchmarking relationship benefits and sacrifices. Relationship outcomes, namely benefits and sacrifices, can neither be totally predicted *ex ante* nor fully quantified *ex post* by the focal firm (Ford and Hakansson 2006a). "Some [relationship] consequences are quite easy to exposure, measure and quantify; others are less obvious, more indirect and more difficult to measure, but no less important." (Gadde and Snehota 2000, p. 307). As a rule, the former relationship outcomes are presumed to be sacrifices whereas the latter outcomes are benefits. Relationship benefits are only partially evident for the

[36] For instance, all the costs associated with the acquisition and use of the technological platform that permits the focal firm's communication with its suppliers and customers (e.g., internet, phone, fax).

focal firm in the short-term, becoming more clear in the future or indirectly (i.e., in connected business relationships respectively), and are mostly intangible (Gadde and Snehota 2000). Relationship sacrifices, usually immediate and direct, can be quantitatively calculated by the focal firm. Nevertheless, as Steve Fleetwood wisely reminded, the focal firm does not always know what it is sacrificing in its business relationships and cannot surely quantify this.

The division of benefits and sacrifices between the focal firm and its counterpart may be equitable or not, depending, for instance, on what is contractually agreed by or the relative power of the parties involved. Still, it is expected that, in general, the focal firm judges such relationship outcomes to be, either *per se* or *comparatively*, globally satisfactory. This makes sense, of course, if rationality in business behaviour is overtly presumed (Cyert and March 1963; Thompson 1967). Demsetz (1992) further claims that business behaviour cannot be properly understood in the absence of that presumption. The focal firm's rationality, even if bounded, seems one of the basic assumptions of the Markets-as-Networks Theory. For the markets-as-networks theorists, it is reasonable to assume that firms are or behave as intendedly rational (Wilkinson and Young 2002).

Relationship benefits are usually weighted against the sacrifices (mostly costs) needed to attain them (Hakansson and Snehota 1995). And very often, the former relationship outcomes exceed the latter – *relationship value* is thus created and appropriated by the focal firm (Wilson and Jantrania 1994). Relationship value is usually defined as the positive, mostly perceived, trade-off between all the benefits and sacrifices accruing from participation in a business relationship, whatever those might be (Anderson 1995; Wilson and Jantrania 1994). The subjective character of relationship value is justified with the incommensurability of both the relationship benefits and sacrifices (Blois 2004, 1999, 2003). I am not referring here to the overall value of a business relationship (co-created by, and somehow distributed between, the parties involved), but rather concerned with the 'slice' of relationship value captured by the focal firm. The notion of relationship value is not addressed in depth here. How is the relationship value co-produced and afterward distributed within the business relationship as well as how it can be assessed or measured, remain objects of heated dissension among the markets-as-networks theorists and no deliberate attempt is made here to shed light on those matters. On relationship value, see for instance the Industrial Marketing Management,

30(4), 2001. Furthermore, the relationship benefits and sacrifices can be compared by the focal firm to: (i) its *comparison level* (CL) and/or *comparison level for alternatives* (CL_{alt}), i.e., the expected relationship benefits and sacrifices (by taking into account the focal firm's experience with similar business relationships in the past) and the benefits and sacrifices potentially available in next-best substitute business relationships respectively (Anderson et al. 1994);[37] and (ii) the *benefits and sacrifices potentially obtainable in alternative governance structures* such as hierarchies and markets, i.e., if the focal firm decides to vertically integrate, or engage in an arm's-length relation with, counterparts respectively (Zajac and Olsen 1993).

My examination of benefits and sacrifices resulting from hierarchies and markets is succinct and, of course, incomplete. Such benefits and sacrifices (of vertically integrating, and of employing transactional relations with, counterparts) are exhaustively detailed in the Property Rights Approach (Grossman and Hart 1986; Hart and Moore 1990) and Transaction Cost Economics (Coase 1937; Williamson 1985, 1981) respectively. The '*costs of using the price mechanism*' (i.e., '*the costs of discovering what the relevant prices are*' and '*the costs of negotiating, making, and concluding a separate contract for the supply of each article or service*') are presciently discovered by Coase (1937, pp. 390-1). These costs, also labelled '*marketing costs*' and claimed by Coase to be the crucial factor explaining the existence of the firm, are later reworded '*costs of transacting*' (Demsetz 1968) and '*transaction costs*' (Williamson 1981). With regard to the benefits associated with engaging in purely transactional relations with counterparts, the reduction of transaction costs is frequently stressed (at least when asset specificity and uncertainty are both low and the transaction is rather infrequent) (Williamson 1981). The benefits of employing hierarchies often comprise (Grossman and Hart 1986): (i) the provision of incentives' alignment, hence mitigating hold-up problems (and other potential opportunistic behaviour); (ii) the reduction of transaction costs (in the face of highly specific assets); and (iii) the minimisation of *ex post* losses related to *ex ante* investment distortions (owing to contract incompleteness). The sacrifices of vertically integrating counterparts are the following: (i) diseconomies

[37] Diverse benefits and sacrifices are typically expected in different business relationships (Wiley et al. 2006). The benefits obtained and the sacrifices incurred depend on the substance of the business relationship, which is in turn contingent upon the posture adopted by (i.e., the degree of involvement of) the focal firm. Different relationship postures are likely to be conducive to dissimilar benefits and sacrifices.

of scale and scope (e.g., diminishing returns to management); (ii) internal governance costs (e.g., deriving from individuals pursuing their own self-interest); and (iii) incentives' impairment (mostly for the party acquired) and consequently the need for monitoring costs on behalf of the acquiring firm (Grossman and Hart 1986). To my best knowledge, the benefits and sacrifices of employing hierarchies and markets are only explicitly contrasted in Phelan and Lewin's (2000) paper.

The network view of industrial markets

Generalised connectedness. One of the basic claims of the Markets-as-Networks Theory is that industrial markets are not atomistic and faceless, that is to say, firms do establish, develop, and maintain business relationships with one another. Besides the *interrelatedness of firms*, the *connectedness of business relationships* themselves is also contended (Blankenburg-Holm and Johanson 1992; Ritter 2000). That connectedness implies that what happens inside each business relationship affects and is affected by what happened and is happening inside other relationships with which the former is, in some way, connected. In other words, the focal firm's development is influenced and influences, to a large degree, the development process of its counterparts – a feature of industrial networks known as '*co-evolution*' (Ford et al. 1998). Business relationships are somehow connected, *directly* or *indirectly*, *positively* or *negatively* (Easton 1992). Two business relationships are directly connected when their connection is not mediated by a third relationship; when that mediation exists, those business relationships are indirectly connected. And two business relationships are positively connected when exchange in each of those relationships is dependent upon the exchange in the other; their negative connection, on the contrary, implies that the exchange in each relationship depends upon non-exchange in the other one (Cook and Emerson 1978).

The structure and development of networks. Owing to the generalised connectedness of business relationships, industrial markets are frequently referred to as *industrial systems* or *industrial networks* and described as *intricate and heterogeneous networks composed of* a myriad of *actor bonds, resource ties, and activity links*. This view of industrial markets – with its constitutive business relationships including actor bonds, resource ties, and activity links as three substance layers – is explicitly postulated by the ARA Model (Hakansson and Johanson 1992). The ARA model draws upon Cyert and March's (1963) behavioural theory (e.g., that actors are boundedly rational) while

retaining a strong Richardsonian (1972) and Penrosian (1959) flavour on the view of activities and resources respectively. Its main premise is that actors – usually meant to denote firms but also including firms' individuals, groups, and departments or even groups of firms – perform activities via the deployment of resources (Hakansson 1989, 1987). Activities are sets of human or machine-based actions which are more or less interconnected and executed either sequentially or in parallel. Activities are performed more or less efficiently through the use of varied resources in order to generate the firms' outputs, either goods or services. Resources are the heterogeneous and interdependent inputs to activities. Inasmuch as resources have multiple attributes, they can be deployed in several ways and for distinct purposes. Resources are 'not given' for it is always possible to discover new features of resources or use their extant features in novel manners or with distinct objectives in mind – these processes are known as *exploitation* and *exploration* (March 1991) respectively. Resource heterogeneity is a condition for and the outcome of firms' resource ties. The control of resources can be direct or indirect, i.e., through ownership or via business relationships with the actor directly controlling the resource respectively. The strengthening of actor bonds is conducive to stronger activity links and resource ties, and vice-versa. Simply put, the ARA Model postulates that firms are (i) *collective and purposeful actors*, (ii) *resource collections*, and (iii) *activity structures* which are deeply embedded in networks, i.e., (i) *webs of actors*, (ii) *resource constellations*, and (iii) *activity patterns or chains*.

Networks displays two prominent features (Hakansson and Johanson 1993b): (i) they are not designed by a single firm and imposed on others, being instead formed and modified through firms' interaction; and (ii) they are opaque as firms are likely to have unclear – and not necessarily similar – views of their own and others' bonds, links and ties and of the network's overall structure. It seems logical that networks are non-transparent since their major constituents (namely, business relationships) are themselves non-transparent: "(…) it is difficult or even impossible to form a comprehensive picture of a relationship [or a network] without taking part of it." (Johanson and Hallen 1989, p. xx). Understandably, industrial networks do not have a centre (for instance, the focal firm serving as a network captain or hub) nor clearly defined boundaries. Drawing the boundaries of a network can be done in multiple ways as many dimensions can be used (e.g., technology, country, product type, focal firm).

Network boundaries are in general arbitrary, resulting from diverse perspectives, intentions and interpretations (Hakansson and Johanson 1988). In fact, networks are unbounded as they can extend without limits owing to the connectedness of business relationships.

Industrial networks are structures wherein stability coexists with change (Hakansson and Snehota 1995). Within networks, patterns of *structuring* and *hierarchisation* (stability) are counterbalanced by waves of *heterogenising* and *externalisation* (change) and vice-versa. Hakansson (1992) describes these network processes as follows: (i) structuring as the improved use of known resource dimensions; (ii) heterogenising as the exploitation of new resource dimensions or use of known dimensions in novel ways; (iii) hierarchisation as the increase of control over resources; (iv) and externalisation, also called *extrication*, as a decrease in that control. Stability results from the institutionalisation taking place within business relationships through which reciprocal norms of conduct are agreed by parties. Stability – sometimes even inertia – is also justified by the usually high costs of change faced by firms in their business relationships (e.g., the switching costs involved in the termination of the focal firm's business relationship with supplier A and the initiation of a new relationship with supplier B). "Because [business] relationships are *substantial*, they are not easy to change quickly and changes are likely to incur significant costs, both in disruption and in developing new relationships. This tends to make business markets rather stable." (Ford et al. 1998, p. 43, emphasis in original). Surely, facilitating or blocking a change is always costly and typically requires the mobilisation of other firms and of their resources (Lundgren 1992). Unless mobilising other firms and resources (through existing relationships), the focal firm will face enormous costs of change and inertia probably prevails – this is referred to as the *heaviness* of the network (Hakansson and Ford 2002). The stability of networks, however, is only apparent insofar as incessant change within firms and their business relationships can be seen. Stability and change are seen as interdependent in networks (Lundgren 1992). Stability is a prerequisite to change. Stability (e.g., in actor bonds) reduces the uncertainties of firms, thereby increasing their propensity to participate actively in the production and promotion of change. Paradoxically, change is usually vital for stability. For instance, a change in certain activity links at a given point in time can be crucial for the stability of some

actor bonds in the future. For instance, at a given point in time, one can witness some business relationships being altered and others being established, nurtured and terminated. Network change is usually incremental and strongly related to the past, i.e., path-dependent (Araujo and Harrison 2002; Hakansson and Waluszewski 2002), though on occasion can be of a disruptive or revolutionary kind. The connectedness of business relationships implies that any change – occurring at the firm or relationship levels – is propagated in a non-deterministic chain effect throughout the network (Hertz 1998). The propagation of change does not ensue in a pre-ordered way, e.g., one determined by a powerful firm. Change can be simply absorbed or reflected instead of transmitted to others. Easton and Lundgren (1992) depict industrial networks as sets of nodes through which change flows somehow, i.e., is reflected, adapted to, absorbed, transmitted, or transformed. Easton and Lundgren (1992) see firms are both sources and recipients of change, discussing five alternative propagation modes for that change: (i) *reflection* presumes that the change initiated by the focal firm is nullified (i.e., reflected) by its counterpart; (ii) *adaptation* means that the change remains only within a certain dyad (i.e., does not affect other firms), being modified in bilateral negotiations; (iii) *absorption* occurs when the focal firm accepts the change only within its boundaries, not transmitting it to others; (iv) *transmission* implies that the focal firm simply transmits the received change (with minimal or no alteration) to the rest of the network; and (v) *transmutation* occurs when the focal firm transforms the change and then propagates it to other firms. The behaviour of the focal firm towards a certain change (e.g., its reflection or absorption) differs according to (i) the relation of the change to its interest and ambitions and (ii) the atmosphere of the relationship with the initiator of the change. Industrial networks are presumably composed of different types of nodes, therefore reflecting, adapting to, absorbing, transmitting and transforming change. The existence of only one type of these nodes (e.g., reflecting or transforming ones) would make networks either totally unchangeable or very unstable respectively. Industrial networks are neither fixed nor chaotic structures (Wilkinson and Young 2002).

Managing in networks. Industrial networks are co-produced, self-organising, and adaptive systems wherein cooperation predominates despite power being unevenly distributed amongst firms (Wilkinson and Young 2002). Networks are characterised by the prevalence of 'political' processes whereby firms strive with one another and seek

support for their own interests and objectives. Needless to say, all firms have limited control over their counterparts and consequently no single firm controls unilaterally the network. One of the main goals of firms is to increase control over the surrounding network. As a result, networks are characterised by a fierce struggle for network control. That struggle takes place not only between firms but also within them – multiple actors exist at different organisational levels. "Network control is reached through control over resources and/or activities. Increased control over resources is a matter of increasing the control of resources directly, of increasing the indirect control over other resources via relationships, and of reducing indirect control [of resources] by other actors through relationships, that is increasing autonomy. Control of activities is a matter of control over resources and [possession of] knowledge." (Hakansson and Johanson 1992, p. 29). An increase in the network control of the focal firm is in general achieved at the expense of other firms' control but that needs not be always the case. Indeed, "(…) the increased control of one actor may (…) lead to an increased control of some other actors in the network" (Hakansson and Johanson 1992, p. 30). One should not conflate the 'lobbying' actions of firms with the influence of political entities on the development of the relationships and networks that those firms develop and maintain among themselves over time (see, e.g., Hadjikhani and Hakansson 1996; Welch and Wilkinson 2004 on the latter).

The evolution of networks is continually shaped by a collective networking process, beyond any firm's control or intents. Networks evolve as multiplex interfirm interaction takes place. An undirected process is at work through which network (macro) order is determined by dyadic (micro) interaction (Wilkinson and Young 2002). There is no possibility for firms to influence that self-organising process to their own advantage. Industrial networks cannot be unilaterally commanded by any firm or coalition of firms. If achieved, the full control over a network would render it a extremely large hierarchy (i.e., a firm), probably inflexible and less responsive to change (Hakansson and Ford 2002). Accordingly, it is more appropriate to talk about management *in*, and not *of*, networks (Ritter et al. 2004). "*No-one manages the network*, but many have to try to manage *in it*." (Ford et al. 1998, p. 270, emphasis in original). The focal firm is but one of many firms having partial influence on both the structure and functioning of the network.

The embedded firm: its boundaries, context, and strategy

Empirical studies of the markets-as-networks theorists demonstrate that the focal firm is not an isolated and totally independent entity operating only at arm's-length, i.e., in atomistic and faceless markets. Instead, the focal firm is seen to be semi-autonomous and deeply embedded in a variegated texture of interdependences, mostly of an economic, social, and technical kind. Interestingly, the focal firm itself is nothing more than a *network of internal relationships* (across diverse hierarchical levels, departments or functions) more or less purposefully designed to bring about outputs, either goods or services (Krackhart and Hanson 1993). This is acknowledged by some markets-as-networks theorists, e.g., Ritter et al. (2004).

The focal firm is endowed with only limited resources and competences, thus being in need of external – often complementary – resources and competences to survive and develop. The heterogeneity of the focal firm is both a result of and the motive for its conspicuous connectedness (Hakansson and Snehota 1989). Whereas some of the needed resources and competences are acquired in markets, others are accessed and exploited in networks. In other words, the resource and competence base of the focal firm can be expanded (or contracted) via the purely transactional relations and the business relationships it establishes with counterparts respectively.[38] In this sense, the focal firm should not be seen as a *unilateral decision-maker* and *resource controller* (Ford et al. 1986). Instead of a mere *production function*, the focal firm needs to be taken as an *interaction-oriented* unit (Hakansson and Snehota 1989).

A context, not an environment. The focal firm does not operate in a fully hostile and uncontrollable environment existing somewhere '*out there*' and comprising primarily a large number of macro-forces (such as political, economical, technological, and social ones) which exert a strong influence on it. Instead of this broad and faceless environment (which is argued to last independently of the focal firm's will or existence), it is often more appropriate to refer to a *context* (Hakansson and Snehota 1989). The focal firm is surrounded by a context, i.e., a finite set of distinct counterparts with which it interacts over time, via business relationships (especially suppliers, customers, suppliers' suppliers, customers' customers, and so forth). Such context is, without doubt, co-created and shaped to some extent by the focal firm.

[38] Of course, such resource and competence base can also be extended or contracted through the focal firm's inter-organisational relationships.

Before the notion of context was first employed by Hakansson and Snehota (1989), the markets-as-networks theorists referred to '*an interacted environment*' of the focal firm (Ford et al. 1986). It is noteworthy to say that the focal firm's context can be said to include other entities with which it is connected via horizontal relationships, i.e., its competitors. Each context is unique though firms' contexts can be partly overlapped (for instance, the supplier A and the customer B can be both a part of the contexts of the focal firm and of its counterpart C).

Fuzzy boundaries. Traditionally, the boundaries of the focal firm are said to be drawn by the hierarchical control of resources and competences. I am only focused here on the vertical boundaries of the focal firm, namely the boundaries separating it upward from suppliers and downward from customers. The focal firm's horizontal boundaries, demarcating it from its competitors, remain outside this discussion.

Ownership, defined by property rights, delimitates the focal firm's boundaries (Hart and Moore 1990). In this conventional view, a clear-cut line separates the focal firm from its surrounding environment. The dividing line between the focal firm and its environment is supposedly one of *cooperation-competition*: cooperation only taking place within, and competition only occurring outside, the focal firm. Two reasons allow one to denunciate the unrealism of this atomistic view: (i) though cooperative efforts abound within the focal firm, intra-firm political struggles are also frequently witnessed (e.g., Mintzberg 1985; Pettigrew 1973); and (ii) cooperation necessarily thrives outside the focal firm (for instance, in the business relationships that its competitors maintain with own suppliers and customers). It is therefore senseless to depict the focal firm as a fully autonomous and clearly bounded entity surrounded by a wider environment over which it has but a smaller influence. On the contrary, the focal firm is a networked unit without rigid boundaries since it is '*constituted*' to a large degree by the resources and competences owned by all the counterparts existing in its context (Hakansson and Snehota 1995). The focal firm's boundaries are not fixed once and for all, being instead *blurring* (owing to the great importance of external resources and competences) and *changeable* (for those boundaries are continually shaped via the focal firm's interaction with other entities). Some markets-as-networks theorists go even further by claiming that the focal firm is boundaryless (e.g., Hakansson and Snehota 1989). Resources and competences, both internal and external, are critical to the focal firm's survival and

growth. The borderline between internal and external resources and competences is increasingly fuzzy inasmuch as interdependences prevail. The internally owned resources and competences are partly out of the focal firm's control, while external resources and competences (accessed and exploited through business relationships) are subject in part to its influence.

Network competences. To operate in its context, the focal firm needs to possess certain competences – what are called *relational* or *network competences* (Ritter and Gemunden 2003b). Such competences, found within all firms to a greater or lesser degree, are divided into *relationship-specific* (i.e., dyadic) and *cross-relational* (i.e., portfolio and net) competences (Ritter 1999). That is to say, network competences are deployed at different levels, enabling the focal firm to manage (i) each of its business relationships in isolation (and their constitutive interaction episodes) and (ii) the *portfolio* and/or *net* of such relationships.[39] Moller and Halinen (1999) argue for the existence of four types of network competences: (i) *relationship management competences* to establish, develop, maintain and terminate each of the focal firm's business relationships with counterparts, thus helping it to build, protect or alter its positions[40] in the network; (ii) *portfolio management competences* to manage (non-optimally, of course) the customer and supplier portfolios of the focal firm; (iii) *net management competences* necessary to mobilise counterparts (e.g., to promote a desired network change); and (iv) *network visioning competences* permit the focal firm to develop valid knowledge of the network and its evolution (i.e., constructing and revising *network pictures*),[41] hence possibly extending the focal firm's *network*

[39] The notions of 'net' and 'portfolio' can be easily distinguished from one another. The former notion concerns all of the business relationships the focal firm is directly involved in; the latter denotes only the focal firm's relationships which are similar among themselves, typically the supplier and customer relationship portfolios (Ritter and Gemunden 2003a).

[40] The focal firm holds a particular position in the network (e.g., central or peripheral) – though often it can be said to occupy several network positions according to the diverse vantage point adopted by an outside observer or network actor. Network positions result from lengthy, costly, cumulative, and interdependent investment processes (Mattsson 1989). Firms' network positions are surely interrelated. Not only a change in the focal firm's network position is likely to have repercussions on the network positions of counterparts but also its network positions (past and current) restrict as well as offer chances for developing future network positions and new business relationships. A network position is defined by the multiple business relationships maintained with counterparts (and the nature of these relationships and the network position of those entities), setting limits on the focal firm's behaviour and enforcing its rights and obligations in the network both in the present and future (Henders 1992). In addition, the network position supplies the focal firm with a peculiar identity and network theory.

[41] The focal firm has but a limited knowledge of the surrounding network in which it is deeply embedded. The limited knowledge is accounted for by the positions and consequent horizon of the focal firm in the

horizon[42] and contributing to the continuous upgrading of its *network theory*[43] and the reinforcement or change of its *network identity*[44]. Finally, it is worth noting that network competences, like any other competences of the focal firm, erode over time. Network competences need to be nurtured, for instance, via (i) investments on internal resources devoted to the management of business relationships (e.g., up-to-date information technology, highly qualified personnel) and (ii) continuous efforts to open the focal firm's culture (e.g., empowerment of workers) (Ritter 1999).

Strategising in networks. The mainstream theories on Strategic Management – e.g., Porter's (1980; 1979a) model of competitive positioning – suggest that strategy is fundamentally about winning, i.e., '*one against all*'. Taking the self-centered atomistic firm as their point of departure, these theories focus only on interfirm competition and presume a zero-sum game wherein if one wins, others have necessarily to lose.

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network, both of which can change over time. Moller and Halinen (1999, p. 417) emphasise that knowledge generation about networks is problematic for the focal firm, while claiming that in-depth knowledge can only can be generated by taking part of the network or through having relationships with knowledgeable counterparts. Nevertheless, the focal firm is able to make sense of the business network via its network pictures (Ford and Redwood 2005). Subjectively devised by managers and more or less 'realistic', network pictures are usually pictorial representations of the focal firm's context and what is beyond its network horizon, i.e., a part or the overall surrounding network (Henneberg et al. 2006). The richer network pictures are necessarily myopic, addressing mostly the focal firm's network horizon (and context). Multiple network pictures can be found within the focal firm whereas there can be an overlap between the network pictures of multiple firms. Network pictures are undoubtedly an important input in the decision-making underlying the focal firm's networking processes (op. cit.).

[42] The network horizon denotes "(…) the part of the network that a firm is aware of and thereby can take into account" (Holmen and Pedersen 2003, p. 409). The focal firm's is necessarily myopic and thus its network horizon is more or less narrow. A network horizon is capable of being extended or diminished, however, with the increase or decrease of the focal firm's experience in the network (e.g., reinforcing extant or developing new actor bonds, resource ties, and activity links). The concept of network horizon is arguably mingled with that of the context: "The part of the network within the horizon that the actor considers relevant is the actor's network context (…)." (Anderson et al. 1994, p. 4). My viewpoint on the network context, as seen earlier, is contrasting for a context can include several counterparts of which the focal firm is unaware of but which affect it in some way. I take the focal firm's context to be usually far more comprehensive than its network horizon (i.e., the counterparts and business relationships it knows about or merely acknowledges).

[43] Based to a large extent on information channelled through business relationships, the focal firm's network theory comprises its perceptions, expectations, and intentions regarding existing and potential business relationships (Mattsson and Johanson 1992). This network theory can be used to (a) influence the network theories of counterparts (e.g., by changing their perceptions about whether, and to what extent, certain business relationships are complementary or competing), or (ii) create a new, or redefine the prevailing, dominant network theory (shared to some degree by all firms in the network). The network theory drives at large the focal firm's actions in the network.

[44] The focal firm has an identity of its own in the network in which it operates. Developed through interaction with counterparts, such identity "(…) refers to the views – both inside and outside the [focal] firm – about the [focal] firm's role and position in relation to other firms in the industrial network" (Hakansson and Johanson 1988, p. 373). Alternatively, Anderson et al. (1994) define network identity as the perceived attractiveness or repulsiveness of the focal firm as a business partner, that perception being of the focal firm itself and of other firms (e.g., potential counterparts).

However, the focal firm is an interdependent entity operating in a full-face and 'coopetitive' context where 'co-evolution' is the norm. Accordingly, its strategy is much less competitive in focus, shifting from pursuing victory over others to somehow making it together with them. "Strategy in business markets is not just about the company acting *against* others, but also often acting *with*, or *through* them." (Ford et al. 1998, p. 274, emphasis in original).

In the mainstream, predominant view of strategy – where firms, independent units in a hostile environment, compete fiercely with each other in the quest of competitive advantages (i.e., advantages over competitors) (Porter 1985) – strategy is argued to be all about the (*focal firm-environment*) *fit*. The oft-expressed '*strategy as fit*' view, first posited by Learned et al. (1965) but made widely known by Andrews (1971), implies that firms need to match their internal attributes (i.e., strengths and weaknesses) to its surrounding environment (namely, opportunities and threats). In short, the focal firm is advised to capitalise on its strengths and minimise weaknesses while taking advantage of environmental opportunities and avoiding threats. The fit to the environment is achieved by the focal firm continually *adapting*, in a passive and/or reactive way, to the environment in which it operates through the effective and efficient deployment of proprietary resources and competences. Ownership of resources and competences (probably rare, imperfectly mobile and difficult-to-imitate ones) is supposedly the unique route to attain a competitive advantage. The focal firm can, whenever necessary, either develop internally needed resources and competences or acquire them in factor markets via arm's-length relations with counterparts – the traditional make-or-buy decision (Barney 1999). This so-called resource-based standpoint (e.g., see Barney 1996; Grant 1991; Mahoney and Pandian 1992; Peteraf 1993; Wernerfelt 1984) neglects the fact that the focal firm is both a resource user and a resource provider in relation to both its suppliers and customers, not to mention other entities (e.g., competitors). Sousa and de Castro (2004) contrast the premises of resource- and network-based viewpoints of strategy. See also Baraldi et al.'s (2007) comparative analysis of the five most important approaches to strategy found in the Strategic Management field in terms of, e.g., key message and concepts, unit of analysis, theoretical heritage and assumptions, and preferred orientation.

Since the focal firm is deeply embedded in an enmeshed network of business relationships, its strategy can never be merely about fit. Instead of *adapting to* an all-encompassing environment, the focal firm proactively *interrelates with* its nearby context. Strategy content changes "(…) from the way the organization allocates and structures its internal resources and processes towards the way it relates its own activities and resources to those of the other parties that constitute its context" (Hakansson and Snehota 1989, p. 159). Axelsson (1992a) takes this network-based view of strategy as a 'missing' one within the field of Strategic Management. Regardless of the adopted view (i.e., conventional or network-based), I take the definition of strategy to be that of Johnson and Scholes (1999), namely the focal firm's *long-term 'direction'*. This direction, in accord with Ansoff's (1965) seminal work, is materialised into one or several of four *product-market* combinations: (i) *withdrawal*, *consolidation* or *penetration* (i.e., current products in current markets); (ii) *product development* (i.e., new products in current markets); (iii) *market development* (i.e., current products in new markets); and (iv) *diversification* (i.e., new products in new markets). Any of these 'directions' can be attained through one or several of three *methods*: (i) *internal development*, (ii) *mergers and/or acquisitions*, and (iii) *joint development* (i.e., either business relationships or inter-organisational relationships). See Johnson and Scholes (1999, pp. 307-51) on the *strategic options* of the focal firm, i.e., its available directions and methods.

Strategy development is an emergent and interactive process, rather than strategy being independently formulated and then implemented (Ford et al. 1998). This is in line with Mintzberg's (1978) depiction of strategy as an emergent pattern of decisions and actions taken over time by the focal firm. In sum, strategy encompasses a large number of *a priori* unplanned decisions and actions, decisions and actions which are seen *a posteriori* to converge on a given 'direction' (Mintzberg and Waters 1985). Strategy is the outcome of not only the focal firm's behaviour but also of the moves of its counterparts and many other actors, some of them beyond the focal firm's network horizon. Understandably, the strategy of the focal firm restricts and is restricted by the strategies of its counterparts, not only directly but also indirectly connected to it. The strategic autonomy of the focal firm is limited: its strategic moves (e.g., build or consolidate a favourable network position, increase its network power and reinforce its

identity in the network) are partly conditioned by – and condition as well – the strategic moves of counterparts (Araujo and Easton 1996b). Often, one can even speak of a *collective strategy* in the network (Astley 1984; Astley and Fombrun 1985).

Owing to the focal firm's embeddedness, the strategy development process is somewhere between the *strategic choice* (Child 1972) and the *environmental determinism* (Aldrich 1979; Hannan and Freeman 1977), i.e., the focal firm is not an autonomous unit with total freedom of choice nor it is subject to the intractable influence of a variety of exogenous environmental forces respectively. The focal firm has some discretion, not being governed by its counterparts' or the overall network's will. The focal firm devises and puts in practice its strategy *with* and mostly *through* the business relationships that it establishes, develops, maintains, and terminates with counterparts. "[S]trategy development in business markets [in part] centres on, is affected by, and is implemented through relationships." (Ford et al. 1998, p. 75). Clearly, business relationships are one of the main instruments (if not the primary one) that the focal firm deploys in order to effect its strategy.

Finally, one needs to emphasise that the notorious embeddedness of the focal firm has consequences at the level of its performance. The performance of the focal firm is traditionally regarded as an internal technical matter (i.e., a function of how the focal firm autonomously exploits its given set of resources and competences); in a network view, however, that performance derives partly from how multiple interdependences are systematically handled by the focal firm. The focal firm's performance (i) is not simply the result of its productive efficiency but (ii) ensues from its effectiveness in relating with counterparts and (iii) is even affected by the performance of directly and indirectly connected counterparts (Hakansson and Snehota 1989).

3.2 Summary

Given that Adam Smith, Allyn Young, and George Richardson are amongst the first scholars who contend the need for both specialization and integration, they can be considered as precursors of the Markets-as-Networks Theory. This theory arose formally in the mid 1970s as a European-based reaction to the prevailing American view of business markets and marketing. Its dissemination has proceeded mostly through books but also papers. The Markets-as-Networks Theory, largely descriptive, posits the focal firm as an interdependent entity with blurring and changeable vertical boundaries, embedded in intricate networks of connected business relationships. These vertical relationships exhibit in general a set of distinctive features such as continuity, complexity, symmetry, and informality. Moreover, multiple adaptations, coopetition, social interaction, and routinisation characterise the substance of business relationships. Business relationships are thus capable to fulfil a diversity of functions and dysfunctions (e.g., ‘access’, ‘control’, ‘efficiency’, ‘innovation’, ‘stability’, and ‘networking’), allowing the focal firm to obtain often benefits in excess of sacrifices (i.e., relationship value).

4. The anatomy of relationship significance

"*I have puzzled over ways of delimiting the notion of 'direct interaction' to something less than all instances where there is some interaction not adequately signalled by price. (…) I'm inclined, rather, to drop the attempt to use 'direct interaction' as an explanation of market failure; it is best used, if at all, as yet another synonym for such failure.*"

(Bator 1958, p. 362, fn. 9)

The *business world*, for sure a part of the *social world* we inhabit, is composed of a multiplicity of *entities* and *events*, amongst which *firms* and their *business relationships*, and the *relationship significance* figure prominently, respectively. I address in detail the *structures* and *powers* of firms and, more importantly, of business relationships – structures and powers which are likely to be *strongly interrelated*. By keeping these powers in mind, I am able to advance a tentative explanation of the causes potentially bringing about the relationship significance, an event so notorious that it is often taken for granted. Simply put, this chapter aims at the anatomy of the relationship significance.

4.1 Firms and their business relationships as entities of the business world[45]

By adopting a critical realist standpoint, I acknowledge that the world exists independently of what I may think, say, or write about it, for the world's entities and events endure regardless of human identification of them. Of course, I also recognise that the part of the world I am mostly interested in – the social world in general and the business world in particular – is to some extent a social construction of mankind (e.g., theories and concepts).

The first chapter of my thesis features, in addition to some traits of my meta-theoretical position, the research theme I address here: the significance of business relationships for the focal firm or, in other words, the contribution of the former to the latter's survival and growth. The research question and objective guiding this research were advanced in the introductory chapter. First, I called into question the recurrent foundationalist position of the markets-as-networks theorists with regard to the relationship significance. For them the relationship significance is a self-evident truth, that is to say, business relationships are inevitably significant to some degree for the focal firm. I disagree strongly with this kind of foundationalism for it presumes a determinism with which critical realists cannot agree, namely that significance is a mandatory feature of all extant business relationships of the focal firm. This determinism can be translated into something like '*since business relationships exist, then they must be more or less significant for the focal firm*', as if the existence of business relationships implies automatically their (relative) significance for the focal firm. The main reason for disputing the taken-for-grantedness commonly found within the Markets-as-Networks Theory is the fundamental non-deterministic character of the world I inhabit, both natural and social. For no linear and easily inquirable cause-effect relations are ready to be discovered, let alone unambiguously identified in the world by scientists; on the

[45] I deliberately leave out of this discussion the horizontal interfirm relationships – the so-called inter-organisational relationships. This decision is accounted for by my primary research question being that of disclosing the causes potentially responsible for bringing about the relationship significance, an issue which is not directly related to those horizontal relationships. Needless to say, the interfirm horizontal relationships are also entities of the business world exhibiting a certain structure (i.e., governed by formal contracts agreed by both parties, aimed at a clear purpose, and short-lived) and having as a result some powers and liabilities (e.g., the ability to develop new technologies and the possibility of free-riding by the partner, respectively) – see more on the former and latter issues, for instance, in Gulati and Gargiulo (1999), and Barringer and Harrison (2000) and Gulati (1998).

other hand, I need to bear in mind that the world is what it is and not socially or discursively constructed by human (lay and/or scientific) endeavours. Put simply, I start with the belief that the world is not as positivists or postmodernists think or claim it is – the world is real!

4.1.1 The business world is composed of multiple entities and events

By standing on a realist springboard, one can only leap into the real. And, taking into account my research theme, (i) *firms* and, on the one hand, the *business relationships* that they usually establish, develop, maintain, and terminate with suppliers and customers, and on the other hand, the *arm's-length relations* in which they also engage themselves – and the *business networks* and *markets* that such vertical interfirm transactions and interactions respectively constitute on aggregate – are all real, and they make part of the business world;[46] (ii) likewise, the relationship significance is one of the business world's events, an *event* that, like others, is only potential and brought about whenever certain causes are at work. These two contentions are warranted by the discussion that follows.

Firms are complexly structured, powerful, and interrelated entities

Firms are more or less interrelated entities, being deeply embedded in enmeshed networks (of connected business relationships) as well as undertaking instant exchanges in markets (of arm's-length relations). Each firm exhibits a complex structure, composed of a myriad of (internally owned and controlled and externally accessed and exploited) resources and competences, a number of routinely performed activities, and several degrees of authority and empowerment, hierarchical levels, communication channels, rites, explicit rules, tacit conventions, and so forth, and it is, as a result, potentially endowed with certain powers and liabilities. Thus it is able to generate, e.g., goods or services, cash-flows, profits). Its powers and liabilities are exercised under several spatial and temporal contextual conditions, especially the surrounding networks and to a smaller extent the markets. Owing to the (mostly vertical but also horizontal) interrelatedness of firms, their complex structures and consequential powers and liabilities are themselves connected. For instance, the structure of the focal firm affects

[46] The *business relationship* (or *interfirm interaction*) is a basic constituent of the *network* like the purely *transactional* (or *arm's-length relation* or *interfirm transaction*) is of the *market*. Whereas the firms and their business relationships and networks, and markets are all entities of the business world, the interfirm arm's-length relations are mere events.

and is affected by the structure of its counterparts (directly and/or indirectly connected) and the powers and liabilities of the former are enhanced and/or impaired by the powers and liabilities of the latter entities. It is noteworthy to say that the powers and liabilities of each and every firm affect and are affected by, to varying extents, (i) the powers and liabilities of connected firms (i.e., counterparts, directly and indirectly connected to it) and (ii) the powers and liabilities of its business relationships, both direct and indirect.

Markets are entities, though the interfirm transactional relations are events

Whereas firms and business relationships (and the networks in the aggregate) are all entities of the business world, the interfirm transactional relations are but on-off (and naturally *structureless* and *powerless*) events governed by price and quantity issues, i.e., *the price mechanism*. In essence, a transactional relation is a fleeting event that comes about whenever at least two firms demonstrate the will to and agree in bringing to completion a transaction (or exchange) that is almost instantly initiated and terminated. While it is more or less easy to point out the beginning and the end of an arm's-length relation, that task can hardly (or unequivocally) be done in the case of a business relationship. The view of interfirm transactional relations as potential events is commonly endorsed by economists, e.g., Marshall (1890 [1997], p. 182, emphasis added): "An exchange is an event (…) it is something that happens. A market is a setting within which exchange *may* take place (…).". Yet, economists are prone to neglect grossly the existence of some prominent entities of the business world, in particular the business relationships and overall networks. Business relationships are ongoing and long-lived entities, surely not transitory events.

Somewhat awkwardly, economists fail to acknowledge that the markets (that transactional relations form as a whole) are themselves entities, or as usually referred to, '*markets as institutions* (constructed, reproduced, and transformed by firms)' (Araujo 2007; Callon 1998; Loasby 2000). Markets comprise *inter alia* all the intermittent events constituting (or taking place in) them, i.e., the global set of transactional relations instantly linking firms. A large number of physical spaces (marketplaces), legal or contractual rules, cultural conventions, and technologies which are to some extent indispensable for framing and governing the undertaking of such arm's-length relations are also included in markets.

The relationship significance as a potential event

Let us now first look in detail at the *structure* and *powers and liabilities* of some of those entities, mostly the business relationships and to a smaller extent the firms and afterwards delve into the *anatomy* of the relationship significance (i.e., the *causes* potentially responsible for generating such event).

4.2 The nature and role of business relationships: their structure and powers and liabilities

Business relationships require much time and a large amount of mutual investments to be initiated, nurtured, sustained, and even terminated. As business relationships evolve incrementally over time, i.e., as the focal firm and its counterpart learn to 'dance' with one another, with each party both leading and following the other, their reciprocal commitment and trust increase and the 'shadow' of the future becomes greater.

4.2.1 The structure of business relationships

Business relationships, on account of their lengthy and costly development process, are likely to exhibit a peculiar and changeable nature or *structure*.[47] The features of business relationships, more or less easily perceptible, include (i) continuity, (ii) complexity, (iii) symmetry, and (iv) informality as well as (v) adaptations, (vi) coopetition, (vii) social interaction, and (viii) routinisation. That is to say, business relationships (i) are long-lasting, (ii) entail a multiplex interpersonal contact pattern between firms and can be deployed to pursue different objectives, (iii) are symmetrical in terms of both parties' interest to develop and sustain them, and (iv) are ruled by implicit and incomplete contracts, and (v) involve large relationship-specific investments, (vi) display both cooperative and competitive facets, (vii) involve a myriad of extensive and connected social bonds between individuals and groups of firms, and (viii) give rise to norms of mutual conduct and institutionalised rights and duties.

4.2.2 The powers and liabilities of business relationships, and the resulting effects

Business relationships are powerful and thus causal

Owing at large to that intricate structure (and to a smaller extent to their notorious connectedness), business relationships are endowed with several (emergent) *causal powers and liabilities*. So, business relationships are – like any other structured and powerful entity of the world – '*causally efficacious*' entities: they have the potential to be causal, that is, are capable of producing change anywhere in the business world,

[47] Business relationships do not change on their own. Firms, directly and/or indirectly connected, are the only entities capable of effecting changes in the structure of their business relationships (e.g., by increasing the mutual adaptations, reducing the extent of social interaction episodes, and so forth).

including (i) themselves and (ii) other entities (e.g., business relationships and firms) and (iii) transitory events, notably transactional relations. By virtue of their aforementioned structure, business relationships exhibit a sixfold set of powers and liabilities, being capable to *fulfil functions and dysfunctions* for the focal firm and thus *deliver benefits and sacrifices* (Sousa and de Castro 2006; Walter et al. 2003; Walter et al. 2001).

Powers as functions

Business relationships are likely to have six main functions, namely *access*, *control*, *efficiency*, *innovation*, *stability*, and *networking*. Business relationships have the power to provide the focal firm with, respectively: (i) the access to, and exploitation of, counterparts' complementary resources and competences; (ii) the increase of influence over or reduction of dependence on counterparts, and the promotion or block of relationship or network change; (iii) a reduction of the production and/or transaction costs; (iv) the identification of previously unknown characteristics of resources, discovery of new uses for extant resources and competences, and (stand-alone or co-) development of new resources and competences; (v) learning and the reduction of environmental uncertainty; and (vi) the management of interdependences at the actor, resource, and activity levels.

Liabilities as dysfunctions (or the non-exercise of functions)

Business relationships display likewise six liabilities: those of *access*, *control*, *efficiency*, *innovation*, *stability*, and *networking*. Such liabilities follow whenever some powers – expected and/or desired by the focal firm to be put into practice in a given business relationship or in other, connected relationships, at a given point in time – are left unexercised.

Connectedness (and the statics and dynamics) of powers, liabilities, and resulting effects

Inasmuch as business relationships are connected to one another in multiple ways (directly and/or indirectly, positively and/or negatively), their structures and powers and liabilities, and the positive and negative effects resulting from exercising these, are likely to be complexly interrelated. For instance: (i) the exercise of the access power (and the resulting effect) of the focal firm's business relationship with supplier A may affect and be affected – *directly and positively* – by the exercise of both the access and

innovation powers (and the resulting effects) of the focal firm's relationships with supplier B and customer C respectively; and (ii) the incapacity or failure to put to work the control power (and the non-resulting effect) in the focal firm's business relationship with customer D – *indirectly* – affects and is affected by the incapacity or failure to put to work the stability power (and the non-resulting effect) in the focal firm's relationship with E, a supplier of A. I stressed previously the connectedness of firms and business relationships and of their respective powers and liabilities as well. So, the powers and liabilities of business relationships affect and are affected by, to varying extents, (i) the powers and liabilities (and the effects resulting from their respective exercise) of business relationships, and (ii) the powers and liabilities of firms.

A certain business relationship may be endowed with and may put into practice different powers and liabilities over time. Also, at a given point in time, several powers and liabilities (of one or more business relationships) may be at work simultaneously, whilst others may remain dormant – only to be, if ever, put into practice later on – owing to the prevalence of certain obstructing contingencies (e.g., other powers presently exercised). That is probably why business relationships are often said to be prolific sources of *possibilities*, i.e., they are in general capable of producing more positive than negative outcomes for the involved firms. The focal firm's top managers are likely to appeal to such latent, variegated '*potentialities*' (not necessarily '*actualities*') as the prime reason for their decision to develop and sustain a particular business relationship, e.g., with supplier A.

Contingencies affecting powers, liabilities, and their effects

Business relationships are heterogeneous entities facing diverse contingencies. The powers and liabilities of each and every business relationship are put to work under (and its structure is likely to be altered by) a myriad of different spatial and temporal surrounding conditions, namely connected business relationships and firms. In brief, the generalised connectedness of business relationships and the interrelatedness of firms constitute the contingencies necessarily confronted by business relationships.

As mentioned previously, the powers of entities act transfactually for they do not necessarily generate the events that, in general, are brought about whenever put to work. For instance, when a certain power of a business relationship is exercised at some point, there is the possibility that its 'usual' effects are not brought to be (i.e., its tendency

remains unfulfilled) owing to other, countervailing powers being at work simultaneously in that business relationship or in connected relationships. The heterogeneity of extant geo-historical contingencies and their possible mutation over time explain why the effects produced by the exercise of powers and/or liabilities cannot be identified unequivocally *ex ante*. Though the effects commonly brought about by exercising the powers and liabilities of entities can be tentatively advanced, e.g., via the observation of multiples instances of their exercise, this is not the same as saying that those expected effects (tendencies) are the necessary ones. The next time those powers and liabilities are put into practice, effects may be deflected or countervailed by other, more or equally powerful ones.

The effects resulting from the exercise of the powers and liabilities of business relationships: diverse, direct and indirect, mediate and immediate, positive and negative, yet mostly incommensurable

The effects or outcomes brought about by the exercise of business relationships' powers are benefits. Likewise, those ensuing from the exercise of relationship liabilities are sacrifices. Such positive and negative effects, such as the access to and exploration of external resources and competences and the inability to reduce production and/or transaction costs respectively, are bound to differ according to the structure of the business relationship in question and, thus, the powers and liabilities put to work. The effects resulting from the exercise of powers and liabilities are either (i) immediately obtained by the focal firm and/or ensue independently of connected business relationships or firms or (ii) only attained in the future and/or depend on connected business relationships or firms (Hakansson and Johanson 1993a).

Positive effects in part require and often exceed the negative ones – or rather the exercise of the powers and liabilities of business relationships *tend to* generate more positive than negative effects. In other words, one can say that business relationships tend to create relationship value. The trade-off between the relationship benefits and sacrifices is positive and in general is appropriated unevenly by (i) the focal firm and its counterpart or even by (ii) other parties, directly or indirectly connected to each or both of them (Wilson and Jantrania 1994). The effects ensuing from the exercise of business relationships' powers and liabilities are likely not to be all easily perceived or objectively estimated *a posteriori* by any of the parties directly or indirectly involved,

which can be explained by the intangible and incommensurable character of many resulting effects, primarily relationship benefits (Blois 1999).

The outcomes expected by the focal firm and/or the outcomes potentially accruing from the alternatives to business relationships, namely substitute business relationships and alternative governance structures

In addition to (or sometimes, instead of) the effects resulting from the exercise of relationship powers and liabilities being estimated and compared to each other, the focal firm can contrast them with: (i) the expected effects, by bearing in mind the positive and negative effects brought about in similar business relationships in the past, and/or the effects potentially generated in next-best substitute relationships, which is referred to as the comparison level and the comparison level for alternatives, i.e., CL and CL_{alt} respectively; and (ii) the positive and negative effects likely to emerge in the event of engagement in alternative governance structures such as hierarchies and markets, that is, whenever the focal firm vertically integrates or establishes purely transactional relations with counterparts respectively.

4.2.3 Relationship benefits and sacrifices overall as potential causes generating the relationship significance

So far, I addressed in depth the business relationships and the intricate networks that they overall compose as notorious entities of the business world, entities which certainly coexist with others, namely all the firms co-responsible for the initiation, development, maintenance, and ending of both relationships and networks. In contrast, the interfirm transactional relations were seen to be mere transient events in that same world.

This begs that I describe the structure and tentatively identify the powers and liabilities, and hence the tendencies, of business relationships. The outcomes of exercising those powers and liabilities, I recognise, are alluded to (at large implicitly) by the markets-as-networks theorists in their vague attempts to justify the ubiquitous relationship significance. Of course, that the relationship significance is commonly taken to be self-evident (see, e.g., Ford and Hakansson 2006a; Ford and Hakansson 2006b) helps to explain why its causes are left enshrouded or not made explicit within the Markets-as-Networks Theory.

The relationship significance is allegedly brought about by either or both of causes: (i) the *functions and dysfunctions of business relationships are performed*, whence

relationship benefits and sacrifices accrue and, inasmuch as the former outweigh the latter, the *relationship value is captured by the focal firm* (Biong et al. 1997; Blois 1999; Gadde and Snehota 2000; Hakansson and Snehota 1995); and/or (ii) the *relationship benefits are greater* and/or the *relationship sacrifices are lower* than the *benefits and sacrifices* (a) *expected by the focal firm* (when its past experience with similar business relationships is taken into account) or (b) *potentially stemming from alternatives* to the business relationship in question, i.e., substitute business relationships and/or conventional governance structures such as hierarchies and markets (Anderson et al. 1994; Hakansson and Snehota 1995; Zajac and Olsen 1993). Such alternatives can be easily approached. Consider, for instance, the focal firm's business relationship with supplier A: the focal firm can (i) substitute the new business relationship with supplier B for that previously extant business relationship with supplier A and/or (ii) vertically integrate the supplier B (hence putting an end to the extant business relationship) or (iii) intendedly terminate the business relationship with supplier A and engage with that supplier on an arm's-length basis. The reasons for taking any of these decisions are primarily related to the (perceived as negative) trade-off between the actual relationship benefits and sacrifices and the benefits and sacrifices expected or potentially attainable (in other business relationships, within the focal firm, or in transactional relations).

I do agree with this common '*functional*' view on business relationships (i.e., that *relationship functions and dysfunctions are performed and therefore benefits and sacrifices are generated and appropriated by the focal firm*), and consequently with the claim that *the relationship benefits and sacrifices (either per se or comparatively) are potential causes bringing about the relationship significance*. I contend, however, that *other* causes can also produce the relationship significance – by drawing upon my current scientific knowledge on '*the Firm'* (particularly its *raison d'être*, *nature*, and *scale* and *scope*) (see, e.g., Coase 1937; Penrose 1959). Interestingly, those causes (so far left buried within the Markets-as-Networks Theory) are likely to be brought to notice when one scrutinises the above-mentioned causes. The neglect of causes may result from the spatial boundaries of the Markets-as-Networks Theory, i.e., its main units of analysis being the 'interaction', the 'relationship', and the 'network' (review section 1.1.2). The accounts of scientists (e.g., theories, frameworks, models) are

necessarily bounded in space and time – for there are some spatial and temporal conditions under which the account is argued to hold (Bacharach 1989). This myopia of the markets-as-networks theorists is hence justifiable in part by the *externally-oriented focus* of their conceptual and empirical research efforts.

4.3 The influence of business relationships on the focal firm's nature and scope: largely uncovered powers at work

I noted above that the powers and liabilities of business relationships are sixfold, to wit the *access*, *control*, *efficiency*, *innovation*, *stability*, and *networking*. Although I do not wish to advance a hierarchy of these powers and liabilities, it seems that two of them (access and innovation) are more consequential than others inasmuch as those powers and liabilities exert a strong influence on the focal firm's *heterogeneous* nature and scope, that is to say, its peculiar endowments of *resources* and *competences*, and *activities* respectively.

4.3.1 Unfolding the 'access' and 'innovation' powers of business relationships

The 'access' and the 'innovation' powers and liabilities supply the focal firm with, respectively: (i) *the access to and exploitation of external, needed and often complementary resources and competences* and (ii) *the identification of formerly unrecognised features of the extant resources and competences and/or the discovery of new ways of deploying or novel uses for those extant resources and competences, and/or the stand-alone or co-development of new resources and competences*. These two powers and liabilities of business relationships, and more importantly, the effects resulting from their exercise, shape to a considerable extent the resources and competences, and activities of the focal firm (both internal and external, actual and potential), that is to say, what the focal firm *does* and *gets done by others* at present and in the future. Before addressing further these causes of the relationship significance, I deem useful to concisely recall upon two issues: the *nature* and *scope* of the firm.

The firm's nature and scope

The '*firm*' is often argued to be the primary unit of analysis in the Management studies. Needless to say, the focus of interest concerning the 'firm' naturally differs in accord with the Management's sub-field of study: for instance, the field of Strategic Management aims at the understanding of the strategic decisions and actions undertaken by firms (Rumelt et al. 1994) whereas the Industrial Marketing field is primarily focused on the substance, role, and significance of the business relationships, i.e., the embeddedness of firms (Hakansson and Snehota 1995).

Management scholars and researchers are necessarily compelled to offer multiple and tentative answers for a few grand questions regarding the firm: (i) '*why does the firm exists (or what is its raison d'être)?*'; (ii) '*which are the firm's basic constituents and why is the firm an heterogeneous entity?*'; (iii) '*why does the firm exhibits its horizontal and vertical boundaries (i.e., what explains its scale and scope, respectively)?*'; (iv) '*how does the firm behave and why?*'; and (v) '*what justifies the firm's performance (e.g., survival, growth, stagnation, decline, or death)?*'. In sum, Management scholars and researchers provide fallible descriptions of and explanations for the firm's *existence* and heterogeneous *nature*, *scale and scope*, *behaviour*, and *performance*. Different, and not necessarily compatible, descriptions and explanations are provided chiefly by the so-called *Theories of the Firm* (e.g., the Property Rights Theory, Agency Theory, Transaction Cost Economics, Behavioural Theory, and so on) and to a smaller extent by other theoretical bodies focused upon units of analysis other than the firm (e.g., the Markets-as-Networks Theory, Price Theory, Industrial Organization, amongst others).

The prominence of activities and the significance of resources and competences. When the topic under discussion is the nature and scope of the firm, three of its primary components come rapidly to mind: *resources* and *competences*, and *activities*. In my viewpoint, these notorious components – resources and competences, and activities – are the primordial constituents of the firm, defining by and large its nature and scope respectively. In addition, I could mention all the hierarchical levels, communication channels, rites, explicit rules, and tacit conventions which *inter alia* constitute the firm.

The resources and/or competences of the firm are inputs indispensable to the performance of its activities (I address all them thoroughly below). The significance of resources and competences notwithstanding,[48] I claim that the firm's activities can be considered as the basic units of analysis in Management because the performance of activities, implying always the deployment of multiple resources and/or competences in their performance, enables ultimately the generation of the firm's output, i.e., products (whether goods or services). In the hypothetical absence of outputs, the wants of both *families* (and the *individual consumers* these comprise) and firms remain inevitably unsatisfied. In order to bring about such outputs wanted by both firms and families –

[48] The notion of 'significance' is here taken to mean the usual, that is, the contribution of resources and competences to the survival and growth of the firm. Without resources and/or competences, the focal firm is unable to survive and grow and thus its death is sure to follow.

made available to them across *industrial* and *consumer markets*, i.e., *business-to-business* and *business-to-consumer markets,* respectively – some activities need to be performed and this commonly requires that a multitude of resources and/or competences is somehow deployed.

Given the prominence of activities, one can claim that the firm's *raison d'être* is the performance of diverse and surely interrelated activities and, as a consequence, the satisfaction of multifarious wants. My position does not seem fully incompatible with the Richardsonian and Coasian insights that the prime reason for the firm's existence is (i) the coordination of similar activities (i.e., those activities which demand the very same resources and competences for their undertaking) and (ii) the high costs of using the price mechanism in markets (i.e., interfirm transaction costs), respectively. This claim, in fact heavily shaped by the views of both Richardson (1972) and Coase (1937), does not add to my main reasoning here and has understandably no pretension of triggering such a cumbersome discussion as that of the firm's raison d'être. I address now in turn the activities, and the resources and competences of the firm.

Activities. By now, I acknowledge that the firm performs some activities (through the use of resources and/or competences) for bringing about its intended outputs (i.e., by-products and/or final products). Though the overused notion of activity lacks a clear definition, I suggest that it frequently denotes '*a set of human or machine-based actions which are (i) to some extent interconnected and (ii) more or less routinely performed, sequentially and/or in parallel, with greater or lesser effectiveness and efficiency*'. That is, as a rule: (i) absolutely independent activities are unlikely to be found both within and between firms (i.e., the outputs of some activities are often used as inputs by other activities);[49] and (ii) the performance of activities attains the desired purposes and requires the deployment to varying degrees of resources and/or competences, respectively (Penrose 1959). One can cite, as examples of activities, the research and development, purchasing, production, marketing, and so on.

[49] For instance, the common fact that the *productive* activities of the firm are altogether mentioned as a '*production system*' (instead of a '*production process*') alludes seemingly to the interdependence of those particular activities. The firm is but a system of (productive and other) activities. The complementarity of activities, however, is not only prevalent within the firm but also between firms. That is to say, the outputs of some of the firm's activities serve usually as inputs to the activities of counterparts and vice-versa. That firms' activities are in general interconnected is an issue recurrently stressed (e.g., see Richardson 1972).

Activities are usually subject to diverse taxonomies (Porter 1980; Richardson 1972). Some basic categorisations for activities include as follows: (i) *internal* vs. *external* (depending on their location); (ii) *similar* vs. *dissimilar* (hinging upon their requirement of the same or diverse resources and/or competences for undertaking); and (iii) *primary* vs. *support* (in accord with their contribution for the generation of outputs being direct or not). Firstly, there are internal and external activities for some activities are housed within the firm whereas others are located outside the firm, that is, within the boundaries of other entities, respectively. Secondly, different activities can require for their performance the use of the same resources and/or competences (the so-called similar activities); on the contrary, different activities may imply the deployment of a diversity of resources and/or competences – these activities, labelled dissimilar, are for the most part (more or less closely) complementary thus needing to be coordinated with each other (Richardson 1972). Finally, the firm's activities can be sub-divided in primary and support ones, namely those which must be executed if the firm's output is to be generated and those which assist the execution of the former activities, respectively (Porter 1985, 1980). Moreover, Porter (1985; 1980) distinguishes between the '*value-added*' and the '*waste*' activities. The former include both the primary and support activities of the firm whilst the latter encompass all the other remaining activities (e.g., delay ones). For Porter (1985; 1980), the firm is a '*value chain*' composed mostly of value-added activities and linked to the value chains of suppliers and customers. This set of interlinked value chains is referred to as a '*value system*'.

On the grounds that activities are pivotal for the generation of the firm's output, it is mandatory that they are managed or coordinated painstakingly. The coordination of activities entails, of course, the execution of a series of operations over them (such as the development, modification, improvement, or mere performance of activities), bearing in mind at all times both (i) their interdependence and complementarity and (ii) the varying complexity which underlies their performance. The coordination of each and every activity is effected via one of three alternative modes or governance structures (Hagg and Wiedersheim-Paul 1984; Hakansson and Johanson 1993b; Powell 1990; Richardson 1972; Thorelli 1986): (i) the firm, (ii) the interfirm transaction, or (iii) the interfirm interaction. In sum, hierarchies, markets, and networks are the three

governance structures coexisting in the business world and effecting the coordination of activities.

Different costs of coordinating activities are likely to be incurred, depending on the governance structure chosen for putting that coordination to work. For different modes of coordination in general involve different coordination costs. Coase (1937) and Richardson (1972) are amongst the first scholars addressing those costs in detail. The costs of coordinating activities through the market (i.e., via engaging in transactional interfirm relations) – labelled '*marketing costs*' (Coase 1937) and later reworded '*costs of transacting*' (Demsetz 1968) and '*transaction costs*' (Williamson 1981) – are likely to explain the emergence of the firm. "It can, I think, be assumed that the distinguishing mark of the firm is the supersession of the price mechanism." (Coase 1937, p. 389). So, the decision in favour of the coordination of an activity within the hierarchy – in essence, the primordial question of '*why are there firms?*' – can be explained because of the positive trade-off between those hierarchical coordination costs and the potential costs of coordinating that same activity in alternative governance structures (i.e., the market and/or the network). That some activities are often coordinated within the firm owes to the costs of employing the hierarchy being lower than those of playing the market and/or entering into business relationships. Furthermore, Richardson (1972, p. 889) alludes indirectly to the hierarchical coordination costs (and explicitly to related benefits) when suggesting that those costs rise with the increase in the activities' degree of dissimilarity: "(…) the principle that it will pay most firms for most of the time to [specialise in activities and] expand into areas of activity for which their particular capabilities lend them comparative advantage.". This discussion of coordination costs for different governance structures is, however, more complex than the one presented here and related to that of benefits attained in hierarchies, markets, and/or networks. It remains surely outside the scope of this thesis.

The firm is sure to encompass a set of interdependent activities, which are more or less routinely performed, sequentially and/or in parallel, via the deployment of several sorts of resources and/or competences. The inputs to the firm's activities comprise necessarily far more than what they are often thought to include (e.g., in Economics), namely *land*, *labour*, and *capital* – inputs which are also referred to as '*factors of production*' (Samuelson 1947). In other words, the resources and competences of the

firm comprise more than the sum of all (i) the natural resources (e.g., soil), (ii) the human efforts (specialised to different degrees), and (iii) the man-made means of production (e.g., machinery, tools, buildings) potentially employed, respectively. The firm is not a *production function* (and *a price-and-output decision maker*) that, after mustering some inputs, is automatically capable of the unproblematic generation of a certain output (contrary to what Economics in general and Microeconomics in particular both argue). For instance, Leijonhufvud (1986, p. 203, emphasis added) criticises this conventional black-box view of the firm which portrays it in such culinarily a fashion: "(…) like a *recipe* for *bouillabaisse* where all the *ingredients* are *dumped in* a *pot*, (K, L), *heated up*, f(·), and the output, X, is *ready*.". As Penrose (1959, p. 14) argues, the firm needs to be seen as having "(…) many more attributes than those [it] possessed in the [neoclassical] theory of the firm.". This view of '*the firm as a production function*' is expressed generally in a stylised mathematical form – in Microeconomics, e.g., roughly as $Q=f(K, L, W)$ where Q means 'quantity of output' and K, L, and W are the factors of production somehow employed in generating that output, i.e., capital, land, and labour respectively – and is challenged heavily by Management scholars and researchers since it, for one, abstracts from the sequential character of the firm's production process, that is, the ordered performance of its interdependent productive activities (Leijonhufvud 1986).

As a rule, the Management scholars and researchers acknowledge and overvalue only some of the inputs to the firm's activities (as well as the components of the firm itself), namely the resources, whereas neglect and/or undervalue almost in the same proportion the competences of the firm. I address first the former and turn then to the latter.

Resources. The manifold nature of the resources of the firm is the main subject of inquiry by some Management scholars and researchers – to my best knowledge, the most prominent and prolific being the proponents of and adherents to the so-called *Resource-based Theory of the Firm*. Many features of resources are detailed extensively in this theory developed formally in the mid-1980s (see, e.g., Barney 1986; Lippman and Rumelt 1982; Rumelt 1984; Wernerfelt 1984) and positing a view of the firm as '*a bundle of resources*' (Penrose 1959). This theory is focused on the firm's internal attributes that are allegedly the primary reasons accounting for the firm's performance. It emerges as a reaction against the *Industry Analysis*, devised largely by Porter and

colleagues (Caves and Porter 1977; Porter 1979b) and emanated from the '*structure-conduct-performance*' paradigm of the Industrial Organization field. The widely known '*five competitive forces*' model (Porter 1985, 1980, 1979a) argues for (i) the bargaining power of suppliers, (ii) the bargaining power of customers, (iii) the threat of new entrants, (iv) the threat of substitute products, and (v) the intensity of rivalry within the industry as the primary causes for the firms' differences in performance. With the emergence of the Resource-based Theory of the Firm, the explanation of the performance differentials – until then rooted on the structural conditions of industries, i.e., their overall attractiveness – changes towards the internal features of firms, more concretely the deployment of their resources. One important difference distinguishes the two theories: the Industry Analysis presumes the homogeneity of firms within industries (i.e., all firms in an industry are essentially alike), though acknowledging the firms' heterogeneity across industries (i.e., firms are naturally different to the extent that they belong to disparate industries); the Resource-based Theory of the Firm, on the contrary, takes the firms' heterogeneity as an indisputable starting point (i.e., firms are heterogeneous entities possessing distinct resource endowments) (Mahoney and Pandian 1992).

The conceptual roots of the Resource-based Theory of the Firm are attributed to Penrose's work (Best and Garnsey 1999; Kor and Mahoney 2004, 2000; Rugman and Verbeke 2002) and discussed at large in the *Journal of Management Studies*, 41(1), 2004. It is noteworthy to stress the basic (and criticisable) premises of this resource-oriented theory, primarily its (i) focus on the *interfirm competition* and the obtainment of *competitive advantages* (i.e., some form of advantage over competitors such as greater sales or lower production costs), and (ii) view of the firm as an independent entity operating only in a fully hostile and uncontrollable environment (i.e., faceless markets), hence neglecting the interfirm cooperation (notably vertical), and as a consequence the access to and exploitation of external resources (Sousa and de Castro 2004). The Resource-based Theory of the Firm exhibits conspicuously some flaws, particularly its: (i) neglect of the possibility of accessing to and exploiting external resources and of their connectedness with internal ones (i.e., interfirm resource complementarity) – resources are defined by the '*ownership and control*' criterion (i.e., the internal resources are delimited unequivocally by the firm's property rights); and (ii)

overly static approach for it is chiefly concerned with the end-states of (earlier) processes of resource development and fails to address the lengthy, path-dependent (i.e., cumulative), costly, and complex development process of resources – the notable exceptions being Amit and Schoemaker (1993), Dierickx and Cool (1989), and Penrose (1959). The premises and flaws of this theory are discussed in detail by Foss (1998; 1997a; 1997b).

The firm's resources are of varied sorts, exhibiting typically some notorious dimensions: (i) *tangibility* in the forefront as well as many others, e.g., (ii) *complementarity*, (iii) *durability,* (iv) *exchangeability*, (v) *imitability*, (vi) *indivisibility*, (vii) *interchangeability*, (viii) *scarcity*, (ix) *substitutability*, and (x) *versatility* (Barney 1991, 1986; Conner 1991; Dierickx and Cool 1989; Easton and Araujo 1993b; Grant 1991; Peteraf 1993; Wernerfelt 1984). In a word, *heterogeneity* (i.e., *firm-specificity*) is the distinguishing mark of the resources at the firm's disposal (Nelson 1991; Penrose 1959; Teece 1986). The development and deployment of resources is effected via the multiple authoritative decisions of the firm (i.e., of its top managers who exhibit surely a variable bounded rationality) (Amit and Schoemaker 1993; Penrose 1959). That there are discretionary, non-optimal managerial decisions concerning the development and deployment of resources explains – together with the resources' diversity (in dimensions, manners of use, and purposes) and the environmental uncertainty – the heterogeneity of the firm (Nelson 1991).

Multiple resources are normally made available across markets. However, some resources – especially the intangible ones, e.g., the firm's product brand, organisational culture, or its reputation over suppliers and customers – cannot be found in those markets. Instead, such '*immobile*' resources or '*imperfectly mobile*' resources – as Barney (1991, p. 105) calls them – need to be developed internally over time by the firm (Dierickx and Cool 1989). Markets are said to be '*incomplete*' for not all resources are available for acquisition and/or sale (Dierickx and Cool 1989). Many resources are naturally owned and controlled by the firm, thus remaining within its vertical and horizontal boundaries (i.e., *internal* resources). Penrose (1959) calls the firm's internal resources as '*inherited*' ones. However, there are also resources outside the firm, that is, within the boundaries of other entities with which it interrelates (notably suppliers and customers). The external resources are in general accessed and exploited by the firm via

its business relationships with suppliers and/or customers – though those resources can be acquired and/or sold across markets (i.e., through arm's-length relations with those same entities). In addition, some of the external resources accessed and exploited by the firm can be those owned and controlled by its competitors. In this case, the access to and exploitation of external resources are both effected via the firm's interorganisational relationships. When, on the contrary, the acquisition or sale of resources is preferred to their access and exploitation, the previously external resources become part of the firm's internal resources or vice-versa. Even in the case of the needed resources being available *de facto* across markets, the firm may find more suitable to develop internally those resources. For instance, the firm develops a resource (which could be bought) because its acquisition cost is (i) extremely expensive or (ii) exceeds the costs of internal development.

In sum, the firm can enlarge its resource base by (i) the internal development of resources, (ii) the acquisition of resources (via arm's-length relations), and (iii) the access to and exploitation of external resources (primarily via business relationships but also via its interorganisational relationships). The firm is at least in part a bundle of resources, some which are internally owned and controlled, others but externally accessed and exploited (for these are owned and controlled by counterparts). Of course, the firm's resources can be deployed in different ways and for diverse purposes over time. Penrose (1959) labels the purposes of resources as '*services*', therefore claiming that the firm should be seen as '*a collection of [actual and potential] services*', not merely a bundle of resources. I broaden the Penrosian conception of services for Penrose (1959, p. 67) considers primarily the '*productive services*', i.e., "(…) the contribution resources can make to the productive operations of the firm.". My stance is that the resources' services can be denoted as the contribution that resources make (and can make) to each and every activity of the firm. Penrose (1959, p. 48) gives particular emphasis to the role of human resources (particularly the firm's managers) in the time-consuming generation of these services. Of all the services at the firm's disposal, those provided by managers (i.e., managerial services) are taken as the most relevant ones on the grounds that they affect heavily the services rendered (actually and potentially) by all the other resources. The generation of resources' services is not straightforward: "(…) the possibilities of using services change with changes in knowledge. More

services become available, previously unused services become employed and employed services become unused as knowledge increases (…)." (Penrose 1959, p. 76). Both '*used*' and '*idle*' services can always be found within the firm – Penrose suggests that (i) the existence of the latter is the incentive for the firm to grow and (ii) the diversity of those services attests the firm's heterogeneity or, as she puts it, its '*unique character*'.

Competences. Competences are the primordial focus of interest for some of the Management scholars and researchers, in particular those that argue for the *Competence-based Theory of the Firm*. Exhibiting a clear emphasis on the interfirm cooperation, this theory conceives the firm as a bundle of competences (and resources) and an interdependent unit operating in both networks and markets (Nelson and Winter 1982; Penrose 1959; Richardson 1972). For Dosi et al. (2000), *to be competent* (at something) is *to be able to bring about that something as a result of intended yet frequently unarticulated action(s)*. Competences "(…) fill the gap between intention and outcome, and they fill in such a way that the outcome bears a definite resemblance to what was intended."(Dosi et al. 2000, p. 2). The notion of '*competence*' is often used interchangeably with that of '*capability*', '*capacity*', '*ability*' or '*skill*'. I have no problem to acknowledge the interchangeability of these terms but stick to the first of them. This terminological inconsistency is notoriously sensed within the Competence-based Theory of the Firm – see, e.g., Dosi et al.'s (2000, pp. 3-5) discussion of the varied notions employed by competence-based theorists. On the basic premises of this theory, see for instance the *Organization Science* 7(5), 1996 and the *Strategic Management Journal* 17, 1996.

Though the firm is commonly considered to be a competent entity on its own, it is noteworthy to stress that its competences reside ultimately within its multiple individuals and groups. Each and every competence of the firm is underpinned by *tacit knowledge* (i.e., *know-how*) – knowledge which is necessarily possessed (individually and/or collectively) by its *human resources* (Richardson 1972; Winter 1987). Ryle (1949) is probably the first to distinguish between two kinds of human knowledge: (i) the *tacit* or *implicit knowledge* (so-called *know-how*) and (ii) the *explicit knowledge* (so-called *know-that*). Penrose (1959) alludes ten years later to these two types of knowledge, labelling them differently: '*personal experience*' and '*objective*' or '*transmissible*' knowledge, respectively. The tacit knowledge in particular is addressed

by Polanyi (1962; 1966) who argues that '*individuals know more than they tell (or can tell)*' – individuals know to diverse extents how to do certain things (i.e., have and develop knowledge within limited domains) but find themselves unable to say how they know what they know or how they do what they do. Tacit knowledge is often highly personal, though it can also be collective (Prahalad and Hamel 1990), and difficult to articulate and codify – such knowledge is 'sticky' and therefore difficult to transfer to others (Szulanski 1996, 2003). Explicit knowledge, on the contrary, is formally expressed and as a consequence easy to disseminate. Loasby (1998) takes the know-how vs. know-that distinction as akin to that of '*science*' and '*technology*'. Nonaka and Takeuchi (1995) identify four conversion processes for human knowledge: (i) from tacit to tacit (i.e., *socialisation*), (ii) from tacit to explicit (i.e., *externalisation*), (iii) from explicit to tacit (i.e., *internalisation*), and (iv) from explicit to explicit (i.e., *combination*). Competences are in essence a distinctive feature of (some, not necessarily all) the firm's human resources, being possessed by them to varying degrees – for one is likely to find highly competent, averagely competent, lowly competent, and even incompetent individuals and groups within the firm. Competences, in spite of demanding for their existence, at the very least, human resources endowed with peculiar and interconnected (cognitive and physical) skills, often require also the combined deployment of several other resources (e.g., machinery and organisational culture) (Teece et al. 1997).

The firm exhibits typically a limited set of competences: some called *direct*, others labelled *indirect* (Loasby 1998; Nelson and Winter 1982). This means that the firm in general knows both (i) how to do certain things and (ii) how to get certain things done by others, respectively – the latter competences are as significant (to the firm's survival and growth) as the former. The direct and indirect competences of the firm are distinguished promptly.

Firstly, the firm is for sure particularly competent at doing some things. According to Johnson and Scholes (1999), the firm knows how to do one or both of two things: (i) knows how to *perform activities* (e.g., research and development, supply, production, marketing, and so forth) and/or (ii) knows how to *manage the linkages between those (usually interdependent) activities*. In this respect, the firm is likely to be endowed with two distinct and changeable types of direct competences: the '*distinctive*' (or '*core*')

and the '*ancillary*' (or '*background*') competences (Langlois and Robertson 1995; Patel and Pavitt 1997).[50] Whereas the former competences are in general idiosyncratic, synergistic, inimitable, and non-tradable, the latter competences are not necessarily unique to the firm.

The firm is often *multi-competent*, being endowed with competences (i) in its main core fields (i.e., competences which allow the firm to generate its outputs) and (ii) outside those core fields, i.e., in related and more or less distant fields (Grandstrand et al. 1997; Patel and Pavitt 1997). For instance, a chemical firm has competences mostly in its core business (i.e., the chemical field) and partly in non-electrical fields while a computer firm exhibits competences mostly in its core business (i.e., the electrical field) and partly in the non-electrical and chemical fields. Both Patel and Pavitt (1997) and Grandstrand et al. (1997) employ the notion of *multi-technology*, instead of multi-competent, to refer to the firm possessing both core and background competences. Two reasons are given by Grandstrand et al. (1997) and Patel and Pavitt (1997) to justify the prevalence of the multi-competent firm (i.e., for the firm being endowed with multi-field competences): (i) the interdependence of competences, because the background competences are indispensable for the firm to make the best use of external competences owned by counterparts which the firm accesses via business relationships, i.e., suppliers and customers;[51] and (ii) the possibility of some or all background competences of the firm becoming core ones in the future, for example, competences in computing, at present background competences of automobile firms, can possibly come to be core.[52] I may add a third reason justifying the multi-competence nature of the firm when considering the potential interdependence of its core and background competences. By entertaining this possibility, it seems likely that (i) enhancements in

[50] Selznick (1957) is the first to point out the notion of the firm's *distinctive competence* to denote '*what the firm does particularly well*'.

[51] "[F]or example, a large automobile firm may not make either the window glass or the tyres that it uses, but it will need (at the very least) to have its own [background] technical capacity in these fields to judge whether its suppliers can be expected to provide (say) more streamlined glass shapes and higher quality tires, as complements to its own [core] development of more powerful internal combustion engines." (Patel and Pavitt 1997, p. 148). The background competences of the firm can also be denoted as '*absorptive*' ones for they constitute essentially '*prior related knowledge*' which the firm do not intends to put to practice but which confers it with the ability to assimilate and exploit external knowledge (Cohen and Levinthal 1990, 1989).

[52] This argument derives seemingly from Tushman and Anderson's (1986) discussion of the (*competence-enhancing* or *competence-destroying*) impact of technological breakthroughs (initiated by incumbents or new entrants respectively) in the firm's competences.

the background competences of the firm can be conducive to improvements in its core competences and/or (ii) impairments in the former competences can lead to deteriorations in the latter ones. As a rule the firm '*knows more than it makes*', i.e., has know-how in excess of what it needs for do what it does competently (Brusoni et al. 2001). Nonetheless, there is '*not much variety*' within the specialism of the firm for its core and background competences are accumulated via a complex but path-dependent, as well as expensive and never-ending development process which is discussed below (Patel and Pavitt 1997). The variety of competences, despite being low within the firm (inasmuch as its core and background competences are always interrelated to some extent), is naturally greater across firms (Patel and Pavitt 1997).

Secondly, the firm, in addition to direct competences, has necessarily indirect competences or in other words, it shows competence not at doing particular things but at getting some things done. Inasmuch as there are necessarily some things at which the firm is competent, there are always things that the firm is unable to do competently (or can only do incompetently). As Loasby (1998, p. 153) puts it, '*the observe of competence is incompetence*'. That the firm is not competent at doing all sorts of things explains why it needs to get some things done – things typically resulting from deploying the competences of others, notably suppliers and customers. The firm is endowed with only a limited set of core and background competences, therefore demanding mandatorily the *access to* and *exploitation of* some external competences (namely, the core competences of counterparts with which the firm is related to, for the most part vertically via business relationships). Understandably, the firm needs to possess know-how concerning who the (most or highly) competent counterparts are, for only those entities can supply it with the external, typically complementary competences it requires.

The indirect competences enable primarily the firm to access and exploit the needed external competences (Ritter 1999) – when such competences exist of course. The indirect competences offer the firm the possibility to erect what Marshall (1890 [1997]) calls '*an external organisation*', that is, a set of external competences which can be accessed and exploited and which complement its direct competences. As mentioned earlier, that exploitation of external competences is more effective when the firm is endowed with background competences somewhat related to the former competences

and is thus able to make the best use of them. Nelson and Winter (1982, p. 87) seem to make this same point. However, it is often the case that the needed external competences cannot be found anywhere and the firm finds suitable to influence others – surely at a cost – with regard to the development of such competences (Langlois 1992). Indirect competences can thus serve a different but significant objective: allow the firm to influence (to its advantage) the development of the needed yet inexistent external competences in order to access and exploit those at a later point in time. Sometimes, the focal firm needs competences that it does not have in-house nor can acquire in the market or access and exploit via business relationships. In the absence of needed external competences, the firm may either (i) choose to internally develop those competences or (ii) convince others (thought to be potentially more competent) to develop them. The latter solution is likely to be preferred when the firm incurs low *dynamic transaction costs* – these costs are but '*the costs of not having the competences you need (when you need them)*', that is, '*the costs of persuading, negotiating, coordinating with, and teaching others [to develop the needed yet inexistent external competences]*' (Langlois 1992, p. 113). Indirect competences, no matter their actual purpose, are the result of the firm's endeavours over time in the complex management of its multiple relationships with counterparts, mostly of business relationships with suppliers and customers (Ford et al. 1986; Hakansson and Ford 2002). Unsurprisingly, as Araujo et al. (2003) argue, the indirect competences of the firm are brought about owing to its *counterpart-specific* competences in performing a particular set of activities, in particular the supply and marketing ones – the so-called '*relational*' (Lorenzoni and Lipparini 1999) or '*network*' competences (Ritter and Gemunden 2003b; Ritter et al. 2002) or, in other words, the firm's know-how concerning the individual and collective management of its business relationships. The firm is surely endowed to varying extents with *counterpart-specific* competences to manage effectively the varied vertical and horizontal relationships in which it chooses to be engaged in, i.e., its business relationships and inter-organisational relationships respectively. In addition, the firm has probably *generic* competences to deal effectively with its arm's-length relations with suppliers and customers (i.e., it knows how to both place bids and reply to asks in markets). The core competences of others (e.g., suppliers, customers, and/or competitors) – in general what the firm aspires to – can only be

accessed and exploited via its business relationships and/or inter-organisational relationships. The remaining alternative – of arm's-length relations (i.e., markets) – can only provide the firm with the outputs generated by counterparts with the deployment of such external competences. I need of course to recognise that the competences somehow embodied in products may be all that the firm wants on occasion (e.g., high-quality printers or premium software applications).

The firm's competences, like its resources, are in general complexly interrelated. Competences "(…) are often difficult to disentangle from each other" (Barney 1999, p. 143). Interdependences can be found not only within the direct competences of the firm (i.e., between the core and background competences), but also between its direct and indirect competences. The direct and indirect competences of the firm enable it (i) to specialise – mostly in its core, but also in background activities – and (ii) to access and exploit the specialisms of others, respectively – it is important to stress that the direct competences compel necessarily the firm to create and improve indirect competences, whereas the latter in turn contribute somewhat to the development and upgrade of the former competences. The specialisation and integration are both accomplished via the direct and indirect competences of the firm, respectively – and they are reinforcing for the existence, improvement, and renewal of each specialism requires inevitably the existence, improvement, and renewal of others, more or less related specialisms. Specialisation requires and contributes to further integration (review my previous arguments in section 3.1.1). The direct and indirect competences of the firm are likely to co-evolve, influencing each other over time (Mota and de Castro 2004). Both direct and indirect competences reside within the vertical and horizontal boundaries of the firm, constituting its so-called *internal* competences. The *external* competences, on the other hand, are found outside the firm or in other words, within the vertical and horizontal boundaries of the counterparts with which the firm is (for the most part vertically) connected.

Competences are developed mostly through specialisation and to a smaller extent through integration – for it is difficult (if not impossible) to acquire ready-made competences in markets. They can be either internally developed in isolation by the firm – this is often the case – or instead brought about as a (intended or unexpected) result of the vertical and/or horizontal cooperation of the firm with counterparts (i.e., its business

relationships and inter-organisational relationships respectively). Simply put, the competences are a knowledge-based, at large proprietary *by-product* of the firm's past practice in both doing things and getting things done (Loasby 1998). Owing to their tacit nature, competences remain sometimes unidentified and exempt from formal assessment even by the firm owning and controlling them. These difficulties in identification and evaluation notwithstanding, some competences are often found as *embodied* in the firm's final products (Prahalad and Hamel 1990).

Competences are rooted in the firm's '*traditional way of doing things*' (i.e., routines), being developed in general through '*learning by doing*' and '*learning by using*', that is to say, lengthy, incremental, path-dependent, idiosyncratic, and trial-and-error learning processes taking place mostly within the firm (Arrow 1962; Nelson and Winter 1982; Patel and Pavitt 1997; Penrose 1959; Rosenberg 1982). Competences are likely to undergo an evolutionary process (of variation, selection, and retention) (Nelson and Winter 1982), a process which is guided by the iterative phases of exploration and exploitation of knowledge (Zollo and Winter 2002). The corollary of such a cumbersome development process is that competences are only slowly – and often at a high cost – created, modified, extended, improved, and renewed by the firm (Barney 1999, p. 144).

The firm needs therefore to be competent not only at combining and deploying its extant (direct and indirect) competences, but also at improving and renewing those competences and even at developing new ones. The firm needs to have some sort of *dynamic competences*, i.e., know how to do (i) the combination, deployment, improvement and renewal of existing competences and (ii) the development of new competences. On such competences, usually referred to as '*dynamic capabilities*', see Teece and Pisano (1994), Teece et al. (1997), Eisenhardt and Martin (2000), Zollo and Winter (2002), Winter (2003), and Helfat et al. (2007). Without such dynamic competences, the existing competences become over time useless for the firm and give rise to '*rigidities*' (Leonard-Barton 1992).

One senseless argument about competences is that, unlike resources, they do not wear down by usage – and in fact the opposite may occur. Nevertheless, competences necessarily erode over time (Nelson 2003), thus needing to be nurtured via deliberate, extensive, and costly investments of the firm on three interconnected learning

mechanisms (namely, the *accumulation*, *articulation*, and *codification* of knowledge) (Zollo and Winter 2002). In the same vein, Nonaka and Takeuchi (1995) argue that '*a continuous spiral of knowledge interaction (between tacit and explicit knowledge)*' within the firm is crucial if it wants to create new competences as well as enhance and upgrade the existing competences. This knowledge interaction is not done without problems. First, the complete articulation of tacit knowledge (e.g., the know-how which underlies an individual competence at performing a particular activity) is extremely difficult, let alone its codification. Secondly, even where the daunting tasks of articulating and codifying knowledge are accomplished (e.g., by the competent individual or an observer), it is not axiomatic that the created (explicit) knowledge is conducive to a new (tacit) knowledge of others. In Ryle's (1949) terms, know-how is not sure to emerge even in the presence of the corresponding know-that. Competences cannot be easily transmitted and learnt by others for the underlying tacit knowledge is only in part and imperfectly articulated and codified (Nonaka 1994).

I define competences in essence as know-how – primarily idiosyncratic, and difficult to articulate and codify – without which the firm is incapable of doing things and getting things done. Another view of competences portrays them as encompassing *possibilities*. Understandably, competences are amongst the reserves that the firm can accumulate in order to cope with the (partly inescapable) environmental uncertainty (Alchian 1950), for the most part forthcoming events which are not accurately predictable and therefore whose occurrence is impossible to prevent. As Loasby (1998, p. 152) points out, the varied competences of the firm are surely oriented towards a particular, probably ill-defined set of possibilities. For each competence, whether direct or indirect, is often multi-purpose and thus "(…) gives [the firm] the power to act effectively in a particular range of possible future circumstances (…)" (Loasby 1998, p. 145).

In sum, the firm is *a specialised system* of direct and indirect competences (Loasby 1998) – a system which is necessarily embedded in intricate networks of external (direct and indirect) competences, and employs its business relationships (and possibly inter-organisational relationships) as means to access and exploit and/or, what can be equally important, to influence the development of those external competences (Araujo et al. 2003; Mota and de Castro 2004).

4.3.2 The contribution of business relationships to what the focal firm does and gets done: other potential causes producing the relationship significance

Above I sought to clarify my understanding of the nature and scope of the focal firm. The focal firm is but an ensemble of (strongly and complexly interrelated) activities, and resources and competences – some of which it owns and controls internally, others (being owned and controlled by counterparts, mostly suppliers and customers, and competitors) it accesses and exploits externally. The focal firm's nature impacts decisively upon its *scale and scope* for the (internal) activities of the focal firm are performed (and/or their linkages are managed) necessarily via the deployment of (internal and external) resources and competences. The *amount* of resources and competences (both internal and external) at the focal firm's disposal impacts upon its scale of activities. On the other hand, the *diversity* of resources and competences (both internal and external) at the focal firm's disposal reflects and is reflected on the range or scope of activities performed.

The scale and scope of the focal firm (and its clear-cut horizontal boundaries and blurring vertical boundaries)

The focal firm has a certain scale of activities, thus being capable to generate a certain amount of output and possibly enjoying scale economies in the performance of certain activities (e.g., production, supply, research and development, marketing). The focal firm's activities are very much like those of its competitors – a senseful point given that the focal firm and its competitors produce a similar output, that is, clearly substitute products (Chandler 1990). The activities residing within the focal firm are, as Richardson (1972) argue, both similar and closely complementary (i.e., require the same resources and competences for their performance and demand careful coordination, respectively). In contrast, the scope (of activities) of the focal firm is different from that of its suppliers and customers. The (internal) activities performed by the focal firm are inevitably different to those (external) activities performed by its suppliers and customers and as a result, the outputs generated surely differ.

The scale and scope of the focal firm are largely defined by its *horizontal and vertical boundaries*. Put simply, those boundaries separate the focal firm both from its (i) competitors and from (ii) suppliers and customers. Whereas the horizontal boundaries

of the focal firm are clear-cut, its vertical boundaries are usually blurred or fuzzy (Hakansson and Snehota 1989). Though it is often easy to see '*where' the focal firm 'ends' and 'where' its competitors 'begin*', it is difficult to trace '*where' the focal firm 'ends' and 'where' its suppliers and customers 'begin*'. That the delimitation of the vertical boundaries is in general ambiguous is justified for the most part by the varied business relationships that the focal firm establishes, develops, sustains, and terminates with both suppliers and customers. Two other, yet related motives add to the fuzziness of the focal firm's vertical boundaries (Araujo et al. 1999): (i) the significance of the external resources and competences – owned and controlled by suppliers and customers – for the focal firm, and (ii) the significance of the focal firm's internal resources and competences for its suppliers and customers. While the external resources and competences (of suppliers and customers) are accessed and exploited (and controlled in part) by the focal firm, the internal resources and competences of the focal firm are themselves accessed and exploited (and controlled in part) by suppliers and customers. This partial, mutual control over resources and competences (and even activities) presumes naturally that the focal firm is vertically connected to its suppliers and customers via business relationships. Surely, when the focal firm is linked to those counterparts through arm's-length relations (i.e., '*playing the market*') then the question of the control being incomplete and shared does not apply.

The *dichotomy* between the '*internal*' and the '*external*' – concerning the resources and competences, and activities *within* and *outside* the focal firm, respectively – fades irremediably. There is no distinct *dividing line* between the firm (and its internal resources and competences, and even activities) and its suppliers and customers (and their own resources and competences, and activities) (Axelsson 1992a; Hakansson and Snehota 1989). Araujo et al. (2003) build on Thompson's (1967) insights and claim that the vertical boundaries both *bridge* the focal firm *to* and *buffer* it *from* suppliers and customers. For sure, the vertical boundaries *separate* as well as *join* the focal firm to its suppliers and customers.

In sum, the focal firm is an interdependent entity with (i) *blurring vertical boundaries* and (ii) *clear-cut horizontal boundaries*. And the nature and scope of the focal firm, owing to its intricate embeddedness (i.e., participation in multiple business

relationships), is surely connected to the nature and scope of suppliers and customers and vice-versa.

The impact of business relationships on the evolution of the focal firm's vertical boundaries

The focal firm's boundaries separate, though not in a clear manner, its internal resources and competences, and activities from the external ones. Within the focal firm's horizontal and vertical boundaries, the (internal) resources and competences are developed, deployed, combined, modified, or honed in many ways, and the (internal) activities are somehow performed. The external resources and competences, and activities are found outside those boundaries, i.e., within the horizontal and vertical boundaries of counterparts with which the focal firm is connected, primarily via vertical relationships (suppliers and customers) but also on occasion through horizontal relationships (competitors). I contend further ahead that the former (i.e., business relationships and/or arm's-length relations) and the latter relationships (i.e., inter-organisational relationships) have some impact upon respectively the vertical and horizontal boundaries of the focal firm.

Whichever the horizontal and vertical boundaries of the focal firm are, it is important to stress that they are not absolutely fixed and therefore *can* or *could* be different. And both boundaries are liable to contraction and/or expansion. The focal firm can, for instance, expand its scale (and thus being able to perform an increased volume of similar activities and generate an increased amount of output and, e.g., enjoy scale economies) by: (i) internally developing resources and competences; (ii) acquiring external resources and competences through (agreed upon) mergers with or (friendly or hostile) acquisitions of the competitors as a whole; and/or (iii) accessing and exploiting the resources and competences of competitors via the engagement in inter-organisational relationships. Or the focal firm can decrease its scale (hence producing a lower volume of activities and amount of output and, e.g., putting an end to scale diseconomies) by: (i) divesting internal resources and competences, previously developed; (ii) divesting internal resources and competences, previously horizontally integrated; and/or (ii) ending the access to and exploitation of competitors' resources and competences through the termination of the currently established inter-organisational relationships. Likewise, the focal firm's scope can be subject to

expansion or contraction (Teece 1980). The focal firm can, for instance, expand its scope (and thus being able to perform an increased volume of dissimilar activities and generate an increased amount of diverse outputs and, e.g., enjoy scope economies) by: (i) internally developing resources and competences; (ii) acquiring, through arm's-length relations, external resources and competences (of suppliers or customers) or even vertically integrating those suppliers or customers as a whole; and/or (iii) accessing and exploiting the resources and competences of suppliers or customers via business relationships. Or the focal firm can decrease its scope (hence producing a lower volume of dissimilar activities and amount of diverse outputs and, e.g., ending scope diseconomies) by: (i) divesting internal resources and competences, previously developed; (ii) divesting internal resources and competences, previously acquired in markets or vertically disintegrate the suppliers or customers earlier integrated; and/or (ii) terminating the currently established business relationships (and ending the access to and exploitation of the suppliers' or customers' resources and competences).

The horizontal and vertical boundaries can be contracted or expanded according to the so-called '*make-or-buy*' *decisions* taken by the focal firm. For the focal firm necessarily decides about both (i) which resources and competences, and activities *reside* (or *are brought*) *within* its boundaries and, as a consequence, (ii) which resources and competences, and activities are *left outside* boundaries – the latter, whenever needed, can be accessed and exploited via vertical and/or horizontal relationships with counterparts.[53] Different theories issue different guidelines on how the focal firm should effect its make-or-buy decisions and hence delimit its horizontal and vertical boundaries.[54] Different, not necessarily convergent answers to the make-or-buy questions are provided by different theories – and there is probably no best or definitive answer. Transaction Cost Economics, in the forefront of those theories, suggest that the focal firm should opt for the '*hierarchy*' instead of the '*market*' – that is, internally develop the needed resources and competences – if the costs of internal development

[53] For the sake of simplification, I refer henceforth to the '*resources and competences, and activities*' of the focal firm as simply the '*resources and competences*'. I acknowledge *passim* that the resources and competences are indispensable inputs to the performance of activities. Since the focal firm is both (i) endowed with (internal) resources and competences and (ii) accesses and exploits (external) resources and competences via business relationships and/or inter-organisational relationships, it is capable of performing its (internal) activities.

[54] The make-or-buy decisions are in general thought to affect only the vertical boundaries (and scope) of the focal firm (Ford et al. 1993). And it is this influence that I am mostly interested in here.

(i.e., '*make*') are lower than those presumed to be incurred in the alternative of acquisition or internalisation of externally extant resources and competences ('*buy*') (Williamson 2005). The structure generating the lowest costs of coordination or '*governance*' of resources and competences (either the *hierarchical* or the *market* governance) should be preferred by the focal firm.

I endorse here Loasby's (1998) view that the focal firm is a specialised system of internal resources and competences (both direct and indirect), embedded in a wider network of external resources and competences (both direct and indirect). The focal firm has necessarily a limited set of internal resources and competences – by and large direct competences, namely core and background ones – thus knowing how to do only a limited number of things. Though the focal firm is expected to attain specialisation gains (when opts to do only a limited number of things), it is inevitably in need of possessing indirect competences for it demands also to get some things done by others. The continuous establishment, development, and sustenance of business relationships (with both suppliers and customers) is in this sense mandatory for the focal firm in order to secure the access to and exploitation of the needed external resources and competences – both typically dissimilar and closely complementary to those it internally owns and controls (Richardson 1972). The focal firm's *specialisation* requires and propels its *integration* (i.e., cooperation with counterparts). That the focal firm possesses but limited resources and competences, explains at large its proneness to cooperation, mostly vertical but also sometimes horizontal. Of course, the focal firm has also the possibility of getting things done via arm's-length relations with its suppliers and customers. Though the focal firm can get things done in either or both of ways, the business relationships and the arm's-length relations do not fulfil the same role. The *access to and exploitation of external resources and competences* is only accomplished in the former of these vertical interfirm linkages. The latter offers a different route, namely the *internalisation of external resources* and/or the *exploitation of competences as embodied in final products*. That the focal firm engages in purely transactional relations with suppliers and customers is likely to be a consequence of the fact that the focal firm is *unable* of, or rather *decides not to* access and exploit the needed external resources and competences through business relationships. Moreover, the business relationships presently developed and sustained with suppliers and customers are often

preceded by the focal firm's engagement in arm's-length relations with those same counterparts in the past.

The focal firm gets things done at present and in the future because of its participation on business relationships (*current* and *upcoming*) and, to a smaller extent, its engagement in arm's-length relations (*current* and *upcoming*). *What the focal firm gets done* by others (in particular the external resources and competences which are object of its access and exploitation) is *at large* inextricably linked to the business relationships it is *able* and de facto *chooses to* initiate, develop, and sustain with several counterparts (Sousa and de Castro 2006). It is advisable to distinguish clearly between the business relationships which the focal firm is *able* and *chooses to* develop and sustain with suppliers and customers and those it *chooses not to*. Not always is the focal firm able to establish a business relationship, for one or a variety of reasons: for instance, because the focal firm does not possess the necessary relational or network competences, does not know a potential and competent counterpart, is not endowed with the resources indispensable to initiate and nurture such relationship, or because the counterpart lacks interest and motivation in the development of the relationship (Biong et al. 1997). Moreover, even where the focal firm is fully capable of initiating the business relationship, it may prefer instead to engage in an arm's-length relation with the counterpart (e.g., by virtue of facing significant opportunity costs in that business relationship or perhaps because that decision would be perceived by one of its current counterparts as a threat to their established cooperation).

Conversely, *what the focal firm does* – on account for the most part of its internal resources and competences but also of the resources and competences externally accessed and exploited – is bound to be a direct reflection of the business relationships (and to a smaller extent, the purely transactional relations) it is *unable* or, if capable, *decides not to* engage in (Araujo et al. 1999). What the focal firm does by itself and what it gets done by others are likely to be interrelated. The focal firm does necessarily the things which it is – of course capable of doing and – unable to get done. However, there are some things which the focal firm needs and which are found external to its boundaries. In such cases, the focal firm chooses often to get those things done via business relationships and/or via arm's-length relations. Assume, for instance, that (i) the focal firm needs a particular set of resources and competences which are dissimilar

and closely complementary to those it owns and controls internally and (ii) this set of resources and competences is externally available. Why should the focal firm internalise those resources and competences or instead develop them internally? The costliness of acquiring resources and competences and/or of developing them needs to be recognised by the focal firm and in many cases it exceeds the costs of the access and exploitation via business relationships (Barney 1999). Therefore, there seems to be no '*comparative advantage*', as Richardson (1972) puts it, for those resources and competences being brought within the focal firm's boundaries – or in other words, the benefits and sacrifices of employing the hierarchical or market governance structures are respectively lower than and greater than the ones attained in the relational governance structure.

The *dual influence* of business relationships on *what the focal firm does* and *gets done* is naturally implied in the *exercise of* (and the *outcomes resulting from*) the '*access*' and '*innovation*' powers and liabilities alluded to in the beginning of this section. In this regard, the business relationships contribute respectively both (i) to *the access to and exploitation (and on occasion the development) of the external, typically complementary competences and resources needed by the focal firm* and (ii) to *the creation of new, and the modification and enhancement (or impairment) of the extant, internal resources and competences of the focal firm*. Understandably, the business relationships play an outstanding impact over the focal firm's vertical boundaries – an impact which is corroborated by the theoretical and empirical research conducted by the markets-as-networks theorists (Araujo et al. 2003; Mota and de Castro 2004, 2005) and elsewhere (e.g., Barney 1999; Langlois and Robertson 1995). Keeping this impact of business relationships in mind, the make-or-buy decisions of the focal firm are somewhat transformed. The delimitation of the vertical boundaries of the focal firm cannot be resumed to a series of discrete make-or-buy decisions. Contrary to what is traditionally assumed (Williamson 1975), such decisions are not *static*, *independent*, and *dichotomous*. The make-or-buy decisions of the focal firm are closely connected to each other over time – e.g., the decision to '*make X*' may imply the decision of not to '*buy Y*' later on – and, more importantly, incorporate a third option (the '*access*') (Gibbons 2001a, 2001b). Consider, for instance, that the focal firm's decision to vertically integrate its supplier A may have negative and null repercussions respectively on its

business relationship with supplier B and on its arm's-length relation with customer C. The focal firm is not always obliged to either *develop* or *internalise* all the external resources and competences it needs – to do the things it does – for there is usually the possibility of *accessing and exploiting* those resources and competences (whenever they exist beyond its boundaries) via business relationships with suppliers and/or customers.

The boundary decisions of the focal firm are hence about '*making*' or '*buying*' or '*accessing*', that is to say, (i) *internally developing* (the resources and competences, and activities) or (ii) *vertically integrating* or *engaging in arm's-length relations with* or (iii) *developing business relationships with* counterparts respectively. It is noteworthy to recognise that the alternative to the conventional '*make*' or '*buy*', namely of the *access to* and *exploitation of* external resources and competences (via business relationships and/or inter-organisational relationships), allows the possibility to extend respectively the scope and scale (of activities) of the focal firm but leaves *unaltered* its (vertical and horizontal) boundaries. Wherever the '*access*' option is chosen, the focal firm is sure to retain its current vertical and horizontal boundaries even while expands or contracts its scale and/or scope (e.g., via a merger with competitor A and/or the vertical integration of supplier B, respectively). The scale and scope of the focal firm are not unequivocally defined by its horizontal and vertical boundaries (for, e.g., its scope and scope can be both enlarged while preserving the actual vertical and horizontal boundaries) but reflect largely the outcome of its multiple '*make-or-buy-or-access*' decisions taken over time.

Simply put, I claim that the things which the focal firm does (competently) and the things which the focal firm gets done (competently) are both likely to be influenced to a great extent by its business relationships established, nurtured, and maintained with varied suppliers and customers. This notorious yet largely unrecognised influence of business relationships on the *delimitation of the (blurring and changeable) vertical boundaries* of the focal firm *over time* constitutes in itself *another potential cause* of the *relationship significance* – in addition to the '*functional*' cause above-mentioned, giving emphasis to the functions and dysfunctions, and the benefits and sacrifices (i.e., the powers and liabilities and the respective outcomes) of business relationships.

4.4 Summary

Business relationships, and the intricate networks these overall compose, are notorious entities of the business world. And the relationship significance is merely an event which may take place, surely not a given property of those vertical interfirm relationships. Business relationships are entities with a complex structure and are therefore endowed with certain powers as well as liabilities (e.g., enabling or impeding the focal firm to access and exploit external resources and competences). The relationship significance is likely to be brought about whenever the powers of business relationships are *de facto* put to work and more positive than negative effects (i.e., relationship value) ensue for the focal firm. More importantly, the relationship significance can result from the influence of business relationships on what the focal firm does and gets done by others, that is, its nature and scope.

5. Concluding remarks

"*Ideas, whether those of art or science, or those embodied in practical appliances, are the most 'real' of the gifts that each generation receives from its predecessors.*"

(Marshall 1890 [1997], p. 780)

In the final chapter, I point out the key theoretical contributions of my research as well as its major limitations, and present the future research agenda.

5.1 Theoretical contributions

Built upon a critical realist meta-theory, this thesis is a piece of qualitative research that resulted from a lengthy succession of analytical endeavours. One therefore acknowledges: (i) the largely mind-independent existence and the openness, stratification, and concept-dependence of the world – a world composed of multiple structures and powers – or in other words, causal mechanisms and configurations – which are at work, and under varied contingencies, may bring about particular events (ontology); and (ii) the varying fallibility and practical adequacy of the knowledge of such world and its situatedness, incompleteness, and descriptive and performative roles – the scientific knowledge in particular aims at description and explanation (epistemology). I sought to perform a realist-inspired exploration into the causes of the relationship significance, a conspicuous event of the business world. That my main contributions here are theoretical does not imply that I do not intend to improve the (degree of) practical adequacy of the causal accounts concerning the relationship significance. This thesis attempts to contribute directly to a more robust (i.e., more practically adequate) knowledge, and indirectly to a more effective and efficient management of the business relationships and networks in which the focal firm is deeply embedded (review the section 1.4). The key insights of the thesis are now briefly summarised.

5.1.1 The multiple entities and events of the business world

The business world is composed of a variety of entities as well as events. Firms are at the forefront of those entities but they are certainly not alone. Firms are structured and powerful entities, probably the most prominent of the entities existing in the business world for they are responsible for bringing into existence other entities and some events (e.g., the markets and the networks and their constitutive arm's-length relations and business relationships respectively). The horizontal relationships which firms sometimes develop, mostly with their competitors but also with complementors and third parties, are also notorious entities of the business world. As stressed before, such short-lived entities – as well as their structures and powers – are left out of my main arguments here.

The (connected) structure and powers of firms

Firms are structures composed of multiple resources and competences, and activities. All of these three components are strongly and complexly interrelated within and across firms, with the activities being performed and/or their linkages managed via the deployment of internal and external resources and competences. As a consequence of having intricate structures and also because they include within their boundaries diverse elements such as degrees of authority and empowerment, hierarchical levels, communication channels, rites, rules, conventions and so on, firms are endowed with certain powers (and liabilities), being capable for instance of producing goods or services, cash flows, and profits. Of course, these powers and liabilities are always put to work under certain contexts, namely the particular arm's-length relations and business relationships (that is, the markets and networks respectively) and the inter-organisational relationships that inevitably connect firms to one another. These firm-specific contingencies that affect the exercise of firms' powers result from their limitedness concerning resources and competences. Since firms are endowed with limited resources and competences, they are prone to cooperate (or at the very least effect exchanges) with other entities, namely suppliers and customers, and even competitors. The interrelatedness of firms – mostly vertical but also horizontal – is irrefutable. Firms are inevitably connected to their suppliers and customers, for the most part via business relationships but also through arm's-length relations, and are on occasion linked with their competitors through inter-organisational relationships. Therefore, the structures and powers of firms affect and are affected to diverse degrees by the structures and powers of directly and/or indirectly connected firms and, more importantly, the structures and powers of their business relationships.

Markets and their constitutive arm's-length relations

Firms often engage in transactional relations with suppliers and/or customers, thus buying inputs and selling outputs at arm's-length distance. These interfirm arm's-length relations are mere on-off events of the business world, ruled by the price mechanism. Somewhat paradoxically, these fleeting events constitute, together with other elements which frame and govern them (e.g., technologies, marketplaces, contractual rules), peculiar entities: the markets.

Networks and their constitutive business relationships

Firms often find advantageous to develop and sustain business relationships with their suppliers and customers. Such vertical interfirm relationships and the networks that they overall form are also distinctive entities of the business world, entities with a particular structure and exhibiting, as a consequence, several powers and liabilities. Networks are in essence entangled sets of interrelated structures and powers (of both firms and business relationships). Owing to their distinguishing features (e.g., continuity, informality, complexity, symmetry), business relationships are capable of fulfilling functions and dysfunctions for the focal firm, namely: access, control, efficiency, innovation, stability, and networking. Diverse effects accrue to the focal firm from exercising these sixfold powers and liabilities, i.e., benefits and sacrifices. Such effects are always mediated by other effects that result from the exercise of the powers and liabilities of other, connected business relationships.

5.1.2 The relationship significance: non-deterministic, changing, and connected

The significance of business relationships for the focal firm – what I refer throughout as the 'relationship significance' – allegedly denotes the influence that the former have on the latter's survival and/or growth. The relationship significance exists necessarily *in relation to* at least one entity, preferably the focal firm (but also its counterpart or even another firm, directly or indirectly connected to them). Of course, the relationship significance *is what it is* (i.e., it exists or not) independently of being correctly or wrongly perceived by the focal firm. The relationship significance is implicitly or explicitly contended by all the markets-as-networks theorists who generally take it as an axiom. Those theorists are likely to endorse such a foundationalist position on the grounds of two related motives: (i) the ubiquity of business relationships in the business world (which urges the conventional view of firms as atomistic units competing only in faceless markets, posited for instance by Neoclassical Economics, to be promptly discarded); and (ii) the instinctive inference that given the indisputability of (i), then business relationships must be significant because they contribute to some extent to the survival and/or growth of the firms responsible for their initiation, development, and maintenance. In fact, some scholars and researchers seem to take uncritically the relationship significance as a corollary of the existence of business relationships, e.g.,

Hakansson and Snehota (1995, pp. 379-81). This inference, however, deserves to be deconstructed. The existence of business relationships does not mandate automatically their significance for the focal firm. In spite of the business relationships (developed and sustained with counterparts) being in general significant for the focal firm, *not all* of them are so. Significance is certainly not a given attribute of each and every business relationship of the focal firm. The relationship significance is not a regularity of the business world, being instead a *potential event* which is brought about by certain causes and which persists regardless of any entity's perception or knowledge of it (even that of the focal firm). One often depicts the notion of the relationship significance as a black box on the grounds that its potential causes are still left unidentified (section 1.3.1). Scholars and researchers are therefore urged to 'open up' in a tentative manner that black box, by delving into (i.e., describing and explaining) the structures and powers potentially responsible for bringing about the relationship significance. Yet the relationship significance is for the most part a *continuum* rather than a *dichotomy* for one finds in the business world a diversity of business relationships, ranging from lowly significant through averagely significant to highly significant ones – though there is also some business relationships which are absolutely insignificant.

Finally, it is worth noting that the relationship significance is likely to vary over time (e.g., the business relationship with supplier A, a relationship which is significant to some extent for the focal firm, may lose its significance and the lowly significant business relationship with customer B can become highly significant in a near future). And all the changes concerning the degree of relationship significance are bound to be connected with one another, owing to the generalised connectedness of business relationships. For the significance of each business relationship of the focal firm is somewhat affected (i.e., augmented or reduced) by the significance of directly and/or indirectly connected business relationships.

The causes of the relationship significance

Where the powers and liabilities of business relationships are put to work, and under the inevitable mediation of (i) the connected business relationships (and the exercise of their own powers and liabilities) and (ii) the powers and liabilities of the (directly interrelated and connected) firms, the relationship significance may result. Business relationships have powers and liabilities (functions and dysfunctions) which are

exercised and give rise to positive and negative effects (benefits and sacrifices) for the focal firm, respectively. Potentially, (i) the benefits exceed the sacrifices (i.e., relationship value accrues to the focal firm) and/or (ii) the benefits are greater than and/or the sacrifices are lower than the benefits and sacrifices expected by the focal firm or eventually resulting from alternatives (i.e., substitute business relationships and/or alternative governance structures such as hierarchies and markets). In either or both of these cases, the relationship significance is brought about.

Though the relationship significance can be brought about by these 'generic' causes (namely, the fulfilment of relationship functions and dysfunctions, the delivery of relationship benefits and sacrifices, and the appropriation of relationship value by the focal firm), other causes need to be explicitly recognised. Business relationships are significant not only because of the effects resulting from the exercise of their powers and liabilities, i.e., the benefits and sacrifices accruing as a whole to the focal firm – with the former exceeding in general the latter. The relationship significance is further generated via the influence of business relationships on the evolution of the focal firm's nature and scope. What the focal firm comprises within its vertical boundaries (chiefly resources and competences) and what it does and gets done (activities) are both strongly shaped by the business relationships in which it is deeply embedded. Business relationships (and the exercise of their powers and liabilities and the ensuing effects) can help the focal firm to (i) alter its own structure (i.e., change the internal and external resources and competences at its disposal) and as a result (ii) alter its powers and liabilities (i.e., improve the powers and liabilities it is currently endowed with and/or develop new ones). These changes, to diverse degrees, in the focal firm's structure and powers and liabilities result from the exercise (and the effects) of the 'access' and 'innovation' powers and liabilities of business relationships, that is, (i) the access to and exploitation of (and sometimes the development) of external resources and competences and (ii) the development of new, and/or the enhancement of existing, internal resources and competences respectively.

5.2 Limitations and future research

5.2.1 No empirical research

The primary limitation which is likely to be pointed out to this thesis concerns the absence of empirical research and findings. Junior researchers in Management studies are often expected to immerse in empirical sources and corroborate or refute a postulated hypothesis or theory, via the employment of case studies, surveys, or any other methodological tools. But they are usually not urged to devise, extend, or improve the current state of the art of knowledge by using conceptualisation. Contrary to the common (i.e., positivist) conception of Science, a pure conceptual analysis is not absolutely sterile. Such analysis – such as the one done here – can be proficuous and help to shed light on matters of interest.

My contribution is uniquely of a conceptual kind. The indisputability of the relationship significance is called into question and a causal account of its potential causes is provided. The main objectives of this work are description and explanation, not prediction. I only intended to answer a major research question: '*why are business relationships significant (to some extent) for the focal firm*?' or, in other words, '*how is the relationship significance brought about?*'. For sure, I do not provide definitive answers to questions such as '*which business relationships are in general significant for the focal firm? to what extent?*' or '*is the business relationship with counterpart X highly significant for the focal firm at present? when is that degree of significance expected to change?*'. Since the causes of the relationship significance are tentatively advanced here, it is likely that tentative answers to these questions may be given. As mentioned earlier (section 2.5.2), the causal knowledge of the world (i.e., the mechanisms and configurations at work) can give us the ability to offer tendential predictions about the future occurrence of events (e.g., is it likely that X is brought about?) or to issue normative guidelines if those are needed or can be issued (e.g., what needs to change in order that Y and Z generate W?).

5.2.2 The inescapable incompleteness

No matter how thorough scientists are in their research efforts, there are always some issues which are unconsciously neglected or intendedly set aside by them. Much is necessarily left unaddressed in any piece of research, and I recognise that this work is

no exception. Time and other resources available play a crucial role in the incompleteness of research as does the usually restricted focus of interest of the researcher. It is hereby acknowledged that some issues were somewhat overlooked or only briefly discussed. That was the case of the two issues mentioned next.

The influence of the focal firm's powers on the powers of business relationships

The powers of the focal firm as a whole (and of its multiple constituents, in particular individuals and teams) were only implicitly acknowledged in section 4.1.1 but not discussed at length. The structure and powers of business relationships are heavily influenced by the structure and powers of the firms responsible for their establishment, development, and maintenance, that is, the focal firm and its counterpart. Although the powers of the focal firm derive largely from its manifold structure, they also come about in part owing to the structure and powers of the diverse relations that the focal firm develops and sustains with counterparts, both the business relationships and the inter-organisational relationships. For instance, the structure of the business relationship with supplier A is further consolidated by deliberate and recurrent efforts of the focal firm like relationship-specific investments that can be extended along with increases in the focal firm's resource and competence endowments. Those costly and time-consuming efforts aim at greater or new benefits, which may result from enhanced or new powers of business relationships, e.g., efficiency gains.

The influence of the powers of the inter-organisational relationships of the focal firm on the powers of business relationships

The horizontal and vertical relationships of the focal firm serve different purposes. In general, the former allow access and exploitation of similar powers, those of competitors, whereas the latter permit *inter alia* the access to and exploitation of dissimilar powers, namely the ones exhibited by suppliers and customers. These two types of interfirm relationships are necessarily interrelated to some extent: despite being sought for diverse motives, the inter-organisational relationships and the business relationships compete inevitably for the limited resources and competences of the focal firm, in particular the resources and competences dedicated to effecting cooperation relations with counterparts. The complex interconnections between the inter-organisational relationships and business relationships of the focal firm and between its arm's-length relations and business relationships are not here given the attention they

deserve. For instance, the development of the focal firm's business relationship with supplier A may preclude its engagement in the inter-organisational relationship with competitor B. And the establishment of the business relationship with supplier A may make unneeded the arm's-length relation with supplier B. Simply put, the interaction between (i) the structures and powers of firms and (i) the structures and powers of interfirm relationships (both horizontal and vertical) demands a thoughtful discussion. The potential influence of the inter-organisational relationships and the business relationships, and the arm's-length relations of the focal firm on its structure and powers (e.g., the influence on its scale and scope of activities respectively) needs to be addressed in detailed.

5.2.3 An ongoing research

The relationship significance: a theme on need of further research

The division of labour between theorists and empirical researchers exists both within and across the scientific communities (Sayer 1984). While theorists engage themselves primarily in almost endless analytical discussions over matters of interest, the empirical researchers spend most of their time delving into the world and gathering evidences aiming for the corroboration or dispute of the extant accounts (often postulated earlier by theorists). Although some scholars are found performing both of tasks, I take myself to be a theorist. My thesis is fundamentally '*up in the clouds*', making heavy use of abstraction and featuring the analytical conceptualisation of the relationship significance and its primary causes.[55] I expect that this thesis can trigger some heated discussion over the (usually taken-for-granted) relationship significance and that the near future contemplates both conceptual and empirical research. First, it is desirable that other conceptual works on the relationship significance are carried out. The present work is only a starting point. Hopefully, it will draw enough interest to be analytically reviewed, criticised, modified, or extended (e.g., by resorting to other bodies of knowledge).

The subject also seems to be ripe for empirical investigations, for instance, concerning (i) the contingencies faced by the focal firm (namely the enmeshed networks of business relationships and the faceless markets of arm's-length relations) and (ii) the interaction over time of these contingencies with the potential causes of the relationship significance (i.e., the overall powers of business relationships and in particular their

[55] I take advantage of Tsoukas's (1989, p. 558) 'up in the clouds' and 'down to earth' analogies.

influence on the nature and scope of the focal firm). A diversity of research questions may guide such '*down to earth*' endeavours: (i) '*in what ways do the prevailing contingent conditions (e.g., the relationship connectedness) impact on the significance of the focal firm's business relationship with customer A*?'; (ii) '*what are the dominant powers presently at work bringing about the significance of the business relationship with supplier B*?'; (iii) '*what enhances or impairs the exercise of the 'networking' power of the business relationship with supplier C*?'; or (iv) '*how do the 'access' and 'control' powers (of the business relationship with customer D) interact over time?*'.

The 'topography' of the business world

My future research will aim mostly at a thorough and robust conceptualisation of the business world. The guiding vision will be the mapping of the 'topography' of (i.e., the diverse 'terrains' found in) the 'business landscape', in particular the coexisting firms, markets, and networks. The main interest lies on inquiring *the firm*, in particular its (i) *raison d'être*, (ii) *nature*, (iii) *scale* and *scope*, and (iv) *strategy*. That is to say, : (i) why the firm exists; (ii) which main constituents it includes within boundaries; (iii) in what ways do the horizontal and vertical relationships of the focal firm affect the delimitation of its vertical and horizontal boundaries; and (iv) how it devises and implements its strategy.

A main goal is to devise an encompassing account of the causes for the evolution of the hierarchical boundaries, capable of offering tentative explanations regarding the focal firm's decisions to expand and/or contract its vertical and horizontal boundaries via: (i) stand-alone, organic development; (ii) vertical integration and/or disintegration; (iii) development of business relationships and/or engagement in arm's-length relations with suppliers and/or customers, (iv) mergers with and/or acquisitions; and/or (v) development of inter-organisational relationships with competitors. Such an account (if ever arrived at) would prove helpful in the understanding of a related issue, namely the evolution of governance structures in the business world: (i) *why do new firms emerge and extant ones die?*; (ii) *why do new arm's-length relations arise and new business relationships and inter-organisational relationships are developed (and extant ones are terminated) between firms?*; (iii) *why does the substitution of arm's-length relations for business relationships take place (and vice versa)*?; (iv) *why are business relationships replaced by vertical disintegration (and vice versa)?*; (v) *why are inter-organisational*

relationships ended, and merger and/or acquisition ensues (and vice versa)?; and so forth. The combination of different bodies of knowledge, e.g., Microeconomics, Industrial Economics, and the Property Rights Approach (accounting for firms), the Price Theory (accounting for markets), and the Markets-as-Networks Theory (accounting for networks) just to name a few, is likely to be of great help in the development of such an account. I believe that no theory needs to be both the starting and ending point of scholars and researchers and that the theoretical cross-fertilisation rather than '*cross-sterilisation*' may follow from research – this latter notion is borrowed from Schumpeter (1954). For the theories are not '*self-encapsulating wholes*' and insights can be gained from different theoretical perspectives or even from playing theories against one another (Poole and Van de Ven 1989).

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