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## **The Network Concept of Strategic Management and Its Limitations**

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### **1. Introduction**

Over the past several years, the concept of network organizations has become one of the symbols of global change in the processes of company management on the competitive market. The essence of network structures boils down to departing from multilevel-hierarchy structures and replacing them with clusters or specialized business units in which market coordination mechanisms are substituted for mechanisms of coordination through hierarchy.

Reference books differentiate between two basic types of network structures: internal networks and interorganizational networks. It is the latter type, referring to the concept of outsourcing, which is recognized as a more reasonable scenario for the development of a company. The rising popularity of network-based organizational solutions has lead some researchers to recognize them as the dominant characteristics of the new approach to strategic management. The literature points to the validity of departure from strategic management towards the strategic “shaping of networks” (Bowman, 2000, p. 35), as well as the need to alter the branch and resource-based concept in order to understand the strategy

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as a “portfolio of interorganizational relations” (Venkatraman, Subramaniam, 2002). However, it should be pointed out that so far the validity of such postulates has not been corroborated in the light of the empirical studies.

The dynamic growth of the concept of interorganizational networks has raised a number of utterly new and insufficiently described and explained questions regarding the nature, sources of competitive advantage and conditions for the effectiveness of network structures, to be answered by management theoreticians, who used to analyze the relations between entities in dual systems.

The purpose of this study is to contribute to the discussion on the development of interorganizational network structures from the perspective of strategic management. The starting point is the presentation of various approaches to network structures, which allowed the author to derive the basic forms of network structures in the subsequent part of the study and finally to answer the question whether the network approach may be recognized as the new paradigm of the strategic management theory.

## **2. The origin of the concept of network organizations**

The concept of interorganizational network structures can hardly be recognized as a new approach in the field of management studies. The onset of the industrial revolution in the 18<sup>th</sup>-century Europe was connected with the undertakings of merchants, who in fact were the coordinators of the “spatially-dispersed production”. Various forms of interorganizational relations existed also in the first half of the 20<sup>th</sup> century, including industrial cartels set up in the interwar period.

In the 60’s of the 20<sup>th</sup> century, along with the rise of importance of international business cooperation, the problem of interorganizational solutions was often addressed in the economics and sociology literature. Authors focused on the activity of one or more entities, analyzed from the perspective of their reasons for participating in the cooperation system. Interorganizational relations were given an exceptional amount of attention in the literature on the theory of organization, however, non-profit organizations were the main subject of analyses. In the early 80’s of the 20<sup>th</sup> century, a number of studies were published, in which network forms of business activity were described in the context of the construction, filmmaking and publishing industries. R. Eccles’s publication may be recognized as a classic study within this field. The author introduced the notion of “quasi firm”, describing the relationship between the main contractor and the subcontractors, characterized by stability and durability and hardly ever established

on a “beauty contest” basis. Even though contracts in such relationships are usually concluded on a permanent-terms-of-cooperation basis, what lies at the heart of the coordinating activities is not the hierarchy but rather the cooperation based on a long-term grouping of entities and allowing the elimination of costly monitoring activities. Apart from the analysis of the solutions employed by the entities operating on the European and American markets, the relations between the companies in the groupings (kairetus) of Japanese enterprises are the topic which has long inspired discussion in the literature.

In the late 80’s of the 20<sup>th</sup> century, interorganizational relations attracted the attention of strategic management researchers. On the one hand, the solutions based on stable and long-term relations between many entities ceased to be perceived as unique organizational solutions, on the other, the survival and growth of companies in the conditions of internal and international rivalry was becoming increasingly more dependent on participation in various types of alliances, which often brought former rivals together. The first studies which attempted to define the basic features of international network structures in the context of business strategies were published in the early 80’s of the 20<sup>th</sup> century.

A rapid growth of interest in network organizations was seen after the year 1986, in which a special issue of Business Week (1986, March 3) was published, where the costs and benefits of interorganizational network structures were described and the notion of “hollow corporation” was introduced. As a consequence of the development of network organizations, particularly those which did not pursue their own manufacturing activity, terms such as “virtual” or “modular” corporation were coined. In the early 90’s of the 20<sup>th</sup> century, the number of studies dedicated to general issues in network structures became so large, that the notion of network started to be perceived as “trendy”. On the one hand, the raising interest in network-related issues was inspired by the works of such eminent authorities in the field of management studies as P. Drucker and R. Kanter (1994), on the other, it was connected with the benefits tied to the application level of network solutions. The networking of organizations allowed the reduction of investment in the development of new products and the acceleration of the processes aimed at introducing the products to the market, it also offered opportunities for a more effective use of the limited financial resources in the processes of creating and maintaining competitive advantage. At the same time, people started to pay heed to the limited applicability of network structures, which could only be effectively employed in the context of an established mechanism of cooperation with suppliers and a correct choice of the scope of specialization.

At first, the relatively rapid growth of the number of publications dedicated to network structures did not positively correlate with the applicability of the solutions described therein to solving the actual problems of an organization and made it impossible to answer the critical – from the perspective of the theoretical level – question whether the term “network” referred to the specific features of an organization or to a special organizational form?

### **3. The concept of network-based structure in strategic management**

The current status of research on interorganizational networks is not advanced enough to confirm the thesis regarding the emergence of a new paradigm of the strategic management theory within the network concept. An analysis of the results of the studies conducted in 2000 and dedicated to the conceptualization of the strategic aspects of networks, the analysis of competitive advantages typical of networks and the studies forcing the thesis that network structures are associated with a new, important content rather than just being a new organizational form of strategic management, allows the conclusion that it is still too early to formulate a new paradigm. What is more, three limitations of the network approach may be demonstrated.

The contemporary issues in network structures attract the attention of the representatives of various disciplines. An analysis of the studies in fields such as economics, management studies, sociology, psychology of organization, or population ecology, reveals that such a wide variety of approaches makes an accurate classification very difficult.

In spite of numerous attempts, no commonly accepted definition of a network organization has been developed. C. Jones (Jones et al. 2007, p. 914) describes nine conceptions of a network organization, on the basis of which he coins his own definition, which he believes to be the most cohesive and to integrate the most important elements of all the other definitions. According to C. Jones, a network model of organization assumes the existence of a purposefully selected, permanent and structured grouping of autonomous companies, engaged in the process of goods manufacturing and service delivery, based on an implicit and open-ended agreement, which ensures flexible adaptation to the changing environment and makes use of the mechanisms of coordination and protection of exchange transactions.

By adopting a broader approach to the definition of interorganizational networks, one can describe them as mechanisms governing intercompany relations, which are different both from coordination based on hierarchy and from

coordination based on a market mechanism. According to the approach referred to above, networks may be distinguished on the basis of: 1) quasi-integrative processes, assuming the lack of control over ownership while maintaining control over the entity's assets, 2) the use of elements of cooperation on the basis of a new organization of production. What should be emphasized is the fact that the analysis of the organizational and managerial features of network structures conducted within the narrow definition of particular disciplines was criticized as early as in the 90's of the 20<sup>th</sup> century, as a result of the approach used in economic sciences and the sociology of organization. When it comes to economic sciences, little attention was given to co-operative relations and the rivalry between them within the neoclassical trend, while certain attempts were made at analyzing the fragmentary and yet important aspects of network structures within the area of transaction theory and some other non-institutional trends. When it comes to the sociology of organization, which recognized the network approach as one of the basic trends, the researchers focused on the analysis of social networks, and in particular on the distribution and exchange of information, conflict solving and building an atmosphere of trust. However, when valuating the analyzed problems, relative strategic advantages fell outside the area of interest.

Indeed, the competitive advantages and competitive advantage rent typical of networks have recently become a popular topic in the literature on strategic management. However, even the first attempts at studying the strategic aspects of network operation suggested the existence of important theoretical problems. Not only was a discrepancy between the basic premises of managers' activity, based on managerial control teams and the necessity to operate on the basis of cooperation and negotiations in the processes of creating and managing alliances and networks, revealed (Romanowska 1997), but also the existing paradigms referring to the methods of researching company strategies turned out to be insufficient. An analysis from the position of sector structure, developed by m. Poter, was soon rejected as useless from the perspective of the reality of network structures. However, the traditional resource-based approach, in which single entities operating within the sector rather than the entire sector constitute the basic analyzed units, proved to be only partially useful. According to the resource-based concept, competitive advantages are found within the organization, while pursuant to the premises of network structures, the entities participating in the network do not attempt to hold their individual competencies and skills back from the other participants, while the assets are allocated within the boundaries of the network, with the aim of increasing the business potential through synergy.



In line with the nature of interorganizational networks, the analytical approach should take into consideration the existence of competitive advantages. In some studies, attempts were made to address this issue. R. Kanter (1994) points out that regardless of the duration and aims of an alliance, the status of a good partner becomes a key corporate asset, referred to as “collaborative advantage”, which means that the strategy is not based on what we know but rather on who we know.

In the context of the foregoing, the proposal of J. Dyer and H. Singha (2004) seems especially interesting. Using the limitations of the existing theories as a point of departure, they proposed an unique “relative” concept, the basic assumption of which is the ability of the network to develop relations leading to the creation of a stable competitive advantage. J. Dyer and H. Singh adopted dual and network relations as the subjects of their studies, as a result of which their depiction may be seen as the first conceptualization of the economic rent associated with interorganizational activity. Even though the phenomenon of relational contracts had already been analyzed within the framework of transactional theory of a company, it was the first time that the phenomenon of “relative rent” was studied within the context of company strategies, which proves that theories of a company may be formulated outside the studies in the field of strategic management.

J. Dyer and H. Singh (2004, p. 662) defined the “relative rent” as “an additional profit arising from of exchange, which could not have been made by any of the entities participating in the exchange on their own, which means that it is only generated as a result of joint, idiosyncratic efforts of specialized entities within alliances”. Assets, procedures for the joint use of knowledge, complementary resources and competencies, and an effective management of cooperation between entities, which are typical of mutual relations, are the determinants of relative rents. That being said, the resources which facilitate the creation of relative rents are beyond the control of individual entities, since they constitute the “property” of the system of network relations.

Despite the fact that the problem of networking attracts a lot of interest, the studies on the critical – from the perspective of the existence of the “relative rent” – phenomenon of trust between the participants of interorganizational relations, should be regarded as insufficient

The fact that the problem of limits to the competitive advantages of networks is sometimes overlooked is an important limitation on the critical considerations of the notion of relative rent. For the purpose of the studies on the competitiveness of network systems, researches assume that cooperation in modern business

is no longer based on typical dual alliances. Moreover, some authors point to the development of a new phenomenon, referred to as the “alliance networks” rivalry. A group of alliances is defined as a “collection of independent companies bound by cooperation agreements” (Gomes-Casseres, 2006, p. 63). The essence of the rivalry between the networks comes down to the fact that the position of the organization within a particular network provides for a final benefit resulting from the adoption of a specific form of cooperation. Therefore, the strategic positioning of a given company within and between alliance groups becomes exceptionally important.

It should be noted, that a high concentration of the advantages gained by networks is dangerous, particularly in the field of technological innovations. Managers should opt for an organizational solution model corresponding to the highest possible extent to the type of innovation created. The problem consists in ensuring harmony between two types of innovation – autonomous and systemic, and two extreme organizational structure models – network-based and vertically integrated. Network (“virtual”) structures with well-developed market mechanisms are effective in the context of technologies which do not undergo drastic change, however, they turn out to be ineffective in situations where the technological environment is dynamic, while the companies are increasingly more dependent on the internal ability to maintain a given technology. However, due to the fact that many technological innovations have a systemic nature, decentralization without the appropriate strategic control and coordination mechanisms should be regarded as a bad decision. Therefore, only large corporations are capable of ensuring the necessary conditions for the coordination of complementary innovations through the use of the scale effects and diversification of business activity. This means that the use of a network as a mechanism for creating and managing innovations proves effective in the case of autonomous innovations and in situations when the resources necessary to implement the innovations are located outside the boundaries of the company.

It goes without saying that such an approach to the nature and essence of a virtual organization is very different from the proposal to ignore them. A conscious and purposeful transfer of a part of the company’s activity outside its borders is not necessarily tantamount to losing control over some of the key competencies. However, when constructing a network, one should keep in mind that a company which constitutes the core of a dynamic network should occupy a sufficiently extensive segment of the value-creation chain, which will allow it to maintain its position on the basis of its unique competencies.

When analyzing the development of the network concept, one should note that it reflects the shaping of a new form of strategic development rather than its new content. A number of researchers believe that a new “network” paradigm of strategic management already exists. The existence of the said paradigm is often proven by pointing out that the contemporary conditions in which competition takes place make it necessary for organizations to supplement their internal competencies with a possibly large number of relations with external entities. The foregoing assumption was formulated within the concept of strategic management as a “portfolio of relations” (Venkatraman et al. 2005), which is based on the thesis concerning the qualitative difference between network relations in the knowledge economy (“age of experts”) and interorganizational relations in the industrial age, in which companies opting for outsourcing were prompted to choose such a solution due to transaction cost economics.

The concept of “portfolio of relations” may be seen as a supplement to the earlier concepts of “business portfolio” and “the portfolio of abilities”. At the same time, each of the three concepts suggests a separate source of competitive advantage – the stage of evolution, the economy of scale and diversity, and the diversification of expert knowledge, respectively (Venkatraman, Subramaniam, 2002). The concept of the economy of expert knowledge is associated with certain benefits that a company gains as a result of holding a central position in the network, giving it privileged access to the sources of knowledge created within the network. As a result, the business unit (industrial concept) or the diversified corporation (resource-based concept) are replaced by the interorganizational network as the subject of strategic management studies.

However, the creators of the concept of strategy as a “portfolio of relations” admit that so far it has not gone beyond the attempts to define its characteristic features. The basic principles for the construction of interorganizational networks have still not been laid down, there are no rules of conceptualization of the business structure incorporated into a given organizational system, the opportunities offered by this concept in terms of explaining the differences between particular companies and providing the methods for measuring the competitive advantage shaped by the networks have not been indicated (Venkatraman, Subramaniam, 2005).

The key premise of the concept, according to which no company in the knowledge economy is capable of controlling all the necessary organizational abilities within its boundaries, can hardly be regarded as a unique thesis. What is more, due to its lack of internal coherence, the said concept is devoid of comprehensiveness. Pointing out to the importance of supplementing



the organization's internal skills with the external ones (within network relations), it almost exclusively emphasizes the importance of the latter, which could easily lead to a conflict between internal organizational relations and interorganizational networks.

Several conclusions may be drawn when making a general assessment of the concept of network structures. First of all, the use of the concept of strategic networks in the theory of strategic management allows a better understanding of the strategic behaviors of modern companies. Second of all, the attempts at conceptualizing the strategic aspects of the network should be regarded as important, however, such actions have exposed the shortcomings of the narrow treatment of the problem from the perspective of particular disciplines. Third of all, what should be regarded as particularly important for the development of the network approach is the combination of the organizational and economic approach and the logic of competitive advantages and relational rent for the purpose of an analysis of interorganizational structures.

#### **4. Instead of a conclusion - in search of a new paradigm of the theory of strategic management**

Even though network structures have become an important mechanism for the shaping of effective strategies in the knowledge economy, it is hardly a convincing proof supporting the thesis that the network concept should be regarded as a new paradigm of strategic management. However, the postulates to recognize the validity of taking the network approach into consideration when studying the various aspects of the strategies employed by modern companies are well-founded. Having said the above, it should be emphasized that the network concept of strategic management indicating the need to change the subject of the analysis from a single company to interorganizational relations, does not contradict the other concepts of strategic management, including, in particular, the resources-based approach. What is more, it may be seen as an expansion of this approach.

The theory of strategic management is in fact "the science of change" (Mintzberg et al. 2000, p. 250). Trying to prove the correctness of the foregoing conclusion, one could point to the dynamic nature of the subject studied by the management theory, the pace of the processes of change in a business environment and the changeability of the sources of competitive advantages. As a consequence of the drastic change in the economic environment seen at the turn of the 21<sup>st</sup> century, as well as in the approach to competition and the

mechanisms used by companies, some authors point to the emerging crisis of the theory of strategic management.

C. Prahalad and G. Hamel (1994) were the first ones to attempt a systemic diagnosis of the condition of the theory of strategic management in the light of the new business conditions in the mid 90's. They suggested that there was a need for strategic thinking. C Prahalad and G. Hamel were also the editors of a special issue of the Strategic Management Journal, dedicated to the pioneering attempts to study the "new paradigm" of strategic management. B. Lowendahl and O.Revang (1998) took a step further by proving that by adopting the perspective of the post-industrial society for the purpose of analyzing the processes of strategic management, one is forced to resign from contrasting the internal and external aspects of the companies' activity in an explicit way. Moreover, such a perspective calls for the reevaluation of the meaning of some concepts which are key to the strategy, such as e.g. the concept of industry. As a consequence, the initial premises and the boundaries of the concept of strategic management should be discussed.

Publications have appeared in recent years, presenting some radical diagnoses of the imminent "end of strategic management" or "death of competition" (Moore 1996). Leaving such apocalyptic visions without a comment, one should give heed to those approaches which suggest that the term "strategic management" has aged and advocate the use of other terms which are more appropriate for the conditions in which modern companies operate. B. Taylor, the editor-in-chief of the Long Range Planning journal, introduced the notion of "strategic leadership", understood as "the management of radical change to achieve a dramatic improvement in the organization's performance" (Taylor, 1995, p. 71). H. Volberda (2003) , too, suggested an alternative approach to strategic management - the concept of "strategic flexibility". The literature on the subject presents opinions, according to which the concept of strategic management, which stems from the long-term planning and strategic planning approach, should be replaced with the notion of "strategic entrepreneurship", as a result of its evolution.

Undoubtedly, all these new ideas are consistent with the times they were conceive in, however, when analyzing their premises from the perspective of the other concepts of strategic management, one could hardly conclude that they are coherent and important enough to have a significant impact on the evolution of strategic development research.

## Summary

### **The Network Concept of Strategic Management and Its Limitations**

The purpose of the article is to contribute to the discussion on the network concept of strategic management and the limitations thereof. The article opens with a presentation of the origin of the concept of network organizations, which further on allows the author to discuss the concept of networks in strategic management, pinpoint its limitations and assess the validity of the assumption that a new paradigm of the strategic management theory is emerging.

**Key words:** *the concept of network organization, strategic management.*

## Streszczenie

### **Sieciowa koncepcja zarządzania strategicznego i jej ograniczenia**

Celem artykułu jest włączenie się w dyskusję nad sieciową koncepcją zarządzania strategicznego i jej ograniczeniami. Punktem wyjścia w artykule uczyniono zarysowanie genezy koncepcji organizacji sieciowych, co w dalszej części pozwoliło na podjęcie dyskusji nad koncepcją sieciowości w zarządzaniu strategicznym, wskazanie jej ograniczeń oraz na ocenę zasadności wnioskowania o wyłanianiu się nowego paradygmatu teorii zarządzania strategicznego.

## Słowa

**kluczowe:** *koncepcja organizacji sieciowej, zarządzanie strategiczne.*

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