An integrated analysis of socioeconomic structures and actors in Indonesian industrial clusters
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2. Literature Review

This chapter introduces conceptual views that are helpful for understanding the dynamics of a cluster. The first part of this literature review contains a conceptual view on industrial clusters. This part refers mainly to the Italian district literature, which assumes a cluster to be a socioeconomic organization.

In the second part, I describe the duality theory of Giddens as a prologue of an analysis of structures and actors into one single framework. This theory argues that structures and actors are interdependent elements and should not be postulated into two separate analyses.

The third part of this review presents the main conceptual views regarding socioeconomic structures. New institutional economics (NIE) and new economic sociology are theoretical foundations that elaborate the main characteristics of structures in socioeconomic structures. The notion that economic action is embedded in a social structure has revived debates about the positive and negative effects of social relations on economic behavior.

As an extension of social embeddedness theory from the new economic sociology, the following conceptual view in the third part elaborates some theories regarding interorganizational and interpersonal trust and reciprocity. Thus, the three items are parts of relational dimensions of social embeddedness and complement the analysis of social embeddedness, as stated by Granovetter (1985, 1990), and make it possible to explore the phenomenon of social embeddedness and its relational dimensions in the context of a cluster. The fourth part of this review presents leadership approaches to explore and understand the leadership type of local actors more effectively. A cluster is a pluralistic and dynamic organization (Becattini et al., 2003), and some actors coordinate collective actions through decision-making processes in local economic institutions within a cluster (Schmitz, 1995).

This study integrates several different theories into one comprehensive conceptual framework to conceive of a cluster’s dynamics in terms of a socioeconomic structure and the roles of actors within a cluster. Finally, this chapter concludes with a literature review of firm performance, because this
study examines the effects of structures and actors on firm performance qualitatively in Chapters 5 (structures), 7 (actors), and 8 (the interplay between them) and the impact of socioeconomic structures of a cluster on firm performance quantitatively in Chapter 6.

The description unfolds in five parts. The first part presents the literature of industrial clusters (Section 2.1). Section 2.2 focuses on Giddens’ duality theory of structures and actors, which is a theoretical foundation of the interplay between structures and actors. The third part describes some theories regarding socioeconomic structures that include new institutional economics (Section 2.3.1), new economic sociology (Section 2.3.2), interpersonal and interorganizational theories (Section 2.3.3.a) and the theory of reciprocity (Section 2.3.3.b). The fourth part of this literature view focuses on the leadership types of actors by describing leadership theory (Section 2.3), while the fifth part describes a literature review on firm performance in Section 2.4. The last section concludes this chapter.

2.1 The Literature of Industrial Clusters

2.1.1 Definition of industrial clusters

There is not one overall conceptual and analytical framework that explores the functioning of regional industrial clusters. The term is used quite indiscriminately for a broad range of business arrangements. Most literature uses the term industrial district instead of industrial cluster.\(^1\) For the purposes of this study, they can be used interchangeably, but I prefer industrial cluster because this term is more well-known and mainly used by the Indonesian government as well as in the Indonesian literature. According to Schmitz (1999), an advantage in using cluster is that it refers merely to a sectoral and geographical concentration of firms. Whether specialization and cooperation develop is thus a matter for empirical research and not subsumed in the definition.

\(^1\) In Western European history, guilds have been a common phenomenon. Epstein (1998, p. 685) defines a guild as “a formal association of specialized artisans, the masters, whose authority was backed by superior political sanction; apprentices and journeymen came under guild jurisdiction but lacked membership rights.” In preindustrial Europe, guilds performed the development of learning networks that supported technological advance during the British Industrial Revolution (Mokyr, 1999). Guilds also operated as political and administrative units that protected its members from expropriation by opportunistic urban elites and rent-seeking organizations that lobbied for economic privilege from the state (Epstein, 1998; Mokyr, 1999). However, by the time of the Glorious Revolution of 1688, the craft guilds in Britain had declined and lost most of their political clout (Mokyr, 1999). Currently, modern guilds exist in different forms around the world. In many European countries guilds have had a revival as local organizations for artisans, primarily in traditional skills. They may function as forums for developing competence and are often the local units of a national employers’ organization.
According to vom Hofe and Chen (2006), there are three different industrial cluster concepts. First, industrial clusters depict local concentrations of certain economic activities, whose functioning can be explained with Marshall’s theoretical principles of localization economies. Marshall (1890) states that there are three types of external economies. The first type of external economy has intermediate input effects. Firms in a cluster will be supported by more specialized suppliers of inputs and services. The second type is based on the diffusion of technological know-how and ideas. The circulation of knowledge through face to face contact can generate economies of information and communication (Scherer, 1984). The local economic activities operate more efficiently when firms pay the costs of acquiring knowledge only once and share this acquired knowledge among one another. Other examples of this type are the creation of a collective commercial image of a district and the diffusion of a professional and managerial culture (Rabellotti, 1998).

The last type emphasizes the concentration of specialized skills. Labor pooling occurs as a result of both skills being upgraded within a cluster and skilled labor being drawn from other places that benefits both workers and firms. Pooling can benefit firms in two ways. First, companies can utilize labor at different times, and the geographic concentration allows workers to move from firm to firm as demand dictates. Although this reduces the risk of unemployment, workers may have to lower wages in exchange for stability in their overall income (Diamond and Simon, 1990; Krugman, 1991). Second, the close proximity of several structurally equivalent firms provides an additional incentive for prospective employees to invest in industry-specific skills because these skills will not lock the employee into a dependent position when there are several potential employers (Rotemberg and Saloner, 1990). Therefore, external economies are part of a common pool from which every economic actor can freely draw.

Marshall (1890/1964, p. 271) makes a point of a social effect of localization when it comes to the promotion of upgrading:

“When an industry has thus chosen a locality for itself, it is likely to stay there for a long time: so great are the advantages which people following the same skilled trade get from near neighborhood to one another. Good work is rightly appreciated, inventions and improvements in machinery, in processes and the general organization of the business have their merits promptly discussed: if one man starts a new idea, it is taken up by others and combined with suggestions of their own; and thus it becomes the source of new ideas”.

Schmitz’s (1992) study is an extension of Marshall’s theoretical principles of localization economies. Drawing from his experience on growth constraints of small industries in developing countries, Schmitz defines a
cluster as a group of enterprises belonging to the same sector and operating in close proximity to one another. He argues that incidental external economies are important in explaining the growth of contemporary industrial clusters, but there is also a deliberate force at work—namely, consciously pursued joint action. He captures these gains from clustering in the concept of collective efficiency. Joint actions can be of two types: cooperation among individual enterprises and groups of firms joining forces in business associations, producer consortia, and the like.

Recent literature in developed countries explains how the concept of collective efficiency is being used for the success of the cluster concept in developing countries (Schmitz, 1995; Nadvi, 1996; Rabellotti, 1996; Humphrey and Schmitz, 1998; Mc.Cormick, 1998). The framework of collective efficiency has been used in different ways in the literature on industrial districts. In contrast, Sato (2000) uses the framework of collective efficiency to explain clustering effects. She introduces unintended positive effects (passive externalities) and intended positive effects (active externalities) as clustering effects (Sato, 2000). Nadvi (1996) draws a similar conclusion for Pakistan by using the terms passive and active collective efficiency. He shows that in a cluster, firms obtain at least two advantages: those that fall into the producer’s lap and those that require joint effort. Thus, the collective efficiency framework helps explain the evolution of clusters. It makes sense to view cluster strength as the ability to respond to (adverse) changes in the environment.

Furthermore, different methodological perspectives have been employed in the Italian literature to analyze a cluster. Becattini et al. (2003) introduce a socioeconomic definition of an industrial district. Becattini (1990) claims that his analysis has its roots in the Marshallian concept of territorial external economies: He defines industrial districts (using the term industrial districts instead of industrial clusters) as a socioeconomic organization in which the manufacturing towns, community, and firms tend to merge. He implies that the local social system in which the specialized firms are embedded and their habit of mutual cooperation has been extended to economic relations and turned into an integral part of the industrial district itself.

The definition indicates the relationships between firms in a cluster that are characterized by both competition and cooperation. Both trust and reciprocity are important to understand the destiny of transactions (Dei Ottati, 2003). The Italian literature shows that there are some distinctive features of industrial districts that have influenced research on industrial organization and economic and social development (Becattini et al., 2003)—for example, flexibility arrangements based on product and process innovation; collaboration of the skills and competences of specialized economic agents; trust as a guiding principle of firm’s relations and a source of cluster dynamics; and an intervention of social embeddedness on market relations in the larger social
community (Becattini, et al., 2003). Thus, the economic process of the industrial district can be organized only where the development of a spirit of cooperation occurs (Dei Ottati, 1996).

The second definition of industrial cluster is mainly based on input–output forward and backward linkages that allow cluster formations of establishments that are interrelated in the production value chain and complementary relationships (Isaard et al., 1959; Czamanski and Ablas, 1979; Bergman and Feser, 1999; Iannmarino and McCann, 2005). It relies on the use of quantitative methodologies, especially on input–output tables that reveal interindustry relationships.

The third definition adds some ingredients to the basic notion of spatially concentrated firms and includes countrywide business networks. This definition and subsequent analysis follows Porter’s (1990, 1998) approach closely. He (1990) uses the term to designate a group of firms engaged in similar or related activities within a national economy. Although he believes that the relationships within an industry cluster benefit from being located near one another, he does not take geographic proximity as a defining characteristic of clusters. Porter (1998) further defines a cluster as a geographical concentration of interconnected firms and institutions in a particular sector in a national economy. His four-diamond approach of advantage deepens the concept of the cluster concept and makes it possible to identify national competitive advantage as being built on four main pillars: factor conditions, demand conditions, related and supporting industries, and firm strategy, structure, and rivalry.

### 2.1.2 The Italian district literature

Starting from the concept of the “Marshallian district,” the Florence School, which includes Giacomo Becattini (1990, 2003) and his associates (Pyke, Becattini, and Sengenber, 1990; Sforzi, 1990; Trigilia, 1992; Dei Ottati, 1996; Dei Ottati, 2003a, 2003b; Sforzi, 2003), extensively contributes to the understanding of the functioning of districts, especially in emerging economies. Becattini and his associates did intensive research in the Italian districts. They highlight some of the distinctive features of an industrial district as the model of socioeconomic organization. In their perspective, an industrial district is a socio-territorial entity characterized by the active presence of both a community of people and a population of firms in one naturally and historically bounded area (Becattini, 1990). Becattini et al. (2003) claim that the framework of their analysis has its roots in the Marshallian concept of territorial external economies (Becattini et al., 2003).

Furthermore, Becattini was the first to introduce the term industrial district to describe the development of Tuscany, one of the industrial areas in Italy (Becattini et al., 2003). The term was used in a paper given by Giacomo
Becattini at a meeting of the Italian Economic Association on Italian Regional Development (Pisa, 1977).

According to Becattini (1990), the manufacturing town, community, and firms are located in a district where they do business and live together. In his view, the local social system is an integral part of the industrial district itself. Participating firms—mostly small ones—can become extremely efficient and perform well through collective organization and linkages. The density of trade union ties and local business association influence can be great in these small firm economies (Trigilia, 1986). Two Italian districts—Tuscany and Emilia Romagna—are evidence of the successful functioning of a district.

One of the important aspects of an industrial district is that local people are embedded in the same cultural environment. The working process in the industrial district is determined by the social context in which the specialized firms operate and cooperate on the basis of standing customs. These customs have been extended into economic relations (Dei Ottati, 2003a); the economic process can only be organized as an industrial district if customs of cooperation exist and a spirit of cooperation occurs.

Combining competition and cooperation is one of the distinctive features of the Italian industrial districts and of dynamic local production systems in general. According to Dei Ottati (2003a), in industrial districts, competition is a dynamic factor that motivates local people to obtain better results because competition will increase efficiency by saving on resources and inventing new devices. Continuous change happens when competition challenges local people to find efficient ways of manufacturing their goods or services.

Schmitz (1995) argues that clusters have moved from a commercialization strategy based on price to a highly flexible specialized form of production organization with more emphasis on high quality. In her study on Italian and Mexican footwear clusters, Rabellotti (1996) finds that although most retail chains in Mexican clusters still maintain a competition strategy based on price, some were progressively increasing their attention to quality. Most of them adopted a strategy aimed at selling a product at a lower price and a required level of quality (Rabelotti, 1996). Moreover, in his study on Nigerian clusters, Uzor (2004) concludes that a competition strategy of many firms has shifted to offer not only a better price but also an assurance of the quality of the end product.

There are at least three ways cooperation facilitates the economic process (Dei Ottati, 2003a). First, it can reduce business risks faced by economic local people in a cluster, so it maintains the dynamic economic process. For example, for those who start their own firms or decide to invest in new machinery and new products, if the business of a person collapses, he or she can always go back to being an employee at the neighboring firms or previous employer or to do subcontracting production for other firms.
Second, the custom of mutual cooperation between firms smoothes the coordination of firms with respect to the division of specialization. Consequently, manufacturing is divided up among various firms, resulting in increased production efficiency. An easy way to coordinate complementary activities is established. Third, production costs are lower because cooperation induces an efficiency of participating firms through the coordination of manufacturing. This situation enables firms in the district to take advantage of external economies as one of the natural effects of the industrial district. In fact, the productivity of single firms depends on the benefits of external economies.

Dei Ottati (2003a) introduces the “community market” as one of governance structures instead of markets and hierarchies. This kind of market stresses the blend of competition and cooperation based on local conventions typical of the district; people follow an implicit code of behavior, which is acquired by socialization. “Markets and hierarchies” refers to the theory of transaction cost economics, which points out the ideal types of mechanism governing transactions according to the information used: Markets allow local people to evaluate transactions by referring to prices, whereas hierarchies refer to explicit rules enforced by authorities with discretionary powers.

The community market as a mechanism governing transactions lies midway between the market and the community. Dei Ottati (2003a) argues that one of the advantages of using a governance mechanism of transactions based on community factors is that it considerably reduces transaction costs. Because these costs derive mostly from the need to maintain reciprocity, whenever this reciprocity is guaranteed by a social mechanism (rather than a contract or bureaucratic structure), transaction costs will be lower.

The other advantages are that in such a structure, opportunism is discouraged and solutions for uncertainty and ambiguity are lower. Opportunistic behavior is discouraged and does not require expensive hierarchical control, as in large firms. Uncertainty can be faced with flexibility and innovation, which tend to differentiate the final demand rather than standardize it, as in large corporations (Visser, 1996). Ambiguity can be overcome by dividing and distributing the manufacturing and by entrepreneurial functions as well, through the specialized unit in buying and selling, rather than by introducing bureaucratic rules and entrusting command to salaried managers.

According to Dei Ottati (1996), there are four principal features of an ideal local social system in an industrial district, which resembles a community of people. First, for people living in a naturally and historically confined area and embedded within the same cultural environment (e.g., values, ways of behaving, tastes, expectations, local dialect on), the reproduction of this culture is easier. Second, geographical closeness results in frequent direct face-to-face contact between and among people. Third, the social culture is constituted by norms of reciprocity accompanied by relevant controls like social sanctions, which discourage opportunistic participants. Last, self-help between individuals,
which is based on the rules of reciprocity, reinforces the economic dynamism of the industrial district. In fact, as much of the literature points out (Brusco and Sabel, 1981; Piore and Sabel, 1984; Pyke, Becattini and Sengenberger, 1990; Dei Ottati, 1996; Lorenz, 1992), one of the distinctive elements of a cluster’s socioeconomic organization is the reciprocal cooperation and trust within it—that is, bounding capital (Dei Ottati, 2003a).

Moreover, the economic environment also has its own principal characteristics: First, the industrial district consists of a huge number of specialized firms in one, or very few, phases or functions of the same industry or in subsidiary industries second, it demonstrates the existence of several repeated and successive transactions between the participating firms; third, the relations between local people depend on past behavior of the partners; and fourth, social controls exist for those who behave incorrectly (i.e., breaking market relations and social disapproval).

A. The role of local institutions

According to Dei Ottati (1996), social control has an important role to maintain the actual survival of the district as a model of socioeconomic organization. In this situation, trust is the important factor. However, control is only effective within a small and homogenous community (Dei Ottati, 2003b). As a consequence, some local institutions complement social control in the industrial district to guarantee conformity to the custom of mutual cooperation in support of trust (Dei Ottati, 1996).

Some examples of local institutions with general objectives are political parties and local government; those with economic objectives are local entrepreneurial associations and trade unions (Trigilia, 1986). Becattini (1990) emphasizes the role of fundamental organizations and institutions for the support of the district’s community such as the market, the firm, the family, the local authorities, and many other public and private, economic and political, cultural and charitable, religious and artistic bodies. The structure of the society and the institutions frame the environment of economic activity (Becattini, 1990).

In addition, Visser (1996) states that some local institutions have a role as benchmarks for newcomers and even the more experienced entrepreneurs in a cluster. Producers assimilate local know-how about techniques, organization, and management, which in turn has been derived from collective experience (Visser, 1996). Thus, in local economic institutions within a cluster, there are some influential actors (i.e., entrepreneurs who play a significant role in coordinating collective action), and they lead the members of a cluster community in pursuing firm performance and, in turn, the performance of a cluster.
B. Factors that affect performance of a cluster and the role of collective actions

There are at least two principal factors that affect the survival of an industrial district (Dei Ottati, 2003b). First, the firms within it should be able to acquire and maintain their performance. The performance of an industrial district, especially with respect to innovation, depends to a significant extent on the characteristics of the social context in which production is embedded. Through the performance of an industrial district, a community of firms in the district has the ability to adapt production to the changing demands of the market. Indeed, the willingness of skilled workers and entrepreneurs to cooperate and devote their different expertise to constant improvement and variation in products and processes is the most important factor in improving the range of products and services supplied, as well as in finding new markets rather than investing in research and development.

The second factor is the building and maintaining of (1) good internal social cohesion and (2) consensus among the main local interest groups to get involved in collective programs. The creativity of different skilled workers and firms is not merely the outcome of bureaucratic controls or even monetary incentives. Instead, it requires genuinely shared objectives as well as a satisfactory distribution of income among the parties involved. This consensus feeds, and is fed by, the formation and development of a widespread sense of belonging to the local community and its production system.

Considering these two factors, it is necessary to examine how one can achieve a viable compromise among the distinct interests. Performance of the district cannot come only from the market relations among local people (competition), not even when it is only supplemented by a local culture orienting behavior toward cooperation. Indeed, because of the structures of industrial districts, maintaining performance of the district requires collective actions among various participating firms in the district.

Such conscious collective actions result in a social cohesion that contributes to local development. There are three origins that explain the importance of collective actions as a local governance device. The first are actions that can stimulate firms to discuss long-term local development objectives and ways to achieve them through political and institutional establishments. This situation can unite different interests among different categories of participating firms and promotes general commitment to such objectives to strengthen a sense of belonging to the local system.

Second, actions are necessary to stimulate local collective bargaining so the relations between workers and suppliers in the districts are essentially cooperative, thereby favoring competition among district firms rather than the exploitation of one or more members. Third, actions are useful to obtain institutional solutions for joint marketing of specific collective goods, such as the organization of trade fairs to promote local products or sharing knowledge through the establishment of a technical school. Such collective goods are
important to improve the performance of the local industry. The goods produce external economies and may increase the productivity of participating firms and stimulate the creation of new firms. Collective actions only require the support of participating firms that get involved in collective bargaining if there is a problem that affects their business in the district. No one can push firms to sit together.

Dei Ottati (2003a) distinguishes between two types of collective actions: normal and extraordinary. The first one refers to collective actions of the routine production activities within a cluster such as sharing new machinery and joint marketing, whereas the second comes up in extraordinary or uncommon situations such as collective bargaining with respect to a new government regulation that may become a constraint for collective efforts to develop a cluster. Collective actions among firms need the involvement of local and nonlocal public and private institutions. This implies that actions may be created in different forms, especially with respect to the supply of collective goods as well as common problems.

Key insights for this study:

The literature indicates some different definitions of industrial clusters. Here, I refer to the definition mentioned in the first part of this review. Furthermore, the Italian district literature provides a good insight in defining a cluster as a socioeconomic organization. In this perspective, interfirm relationships within a cluster can be explained in terms of the simultaneity of competition and cooperation. Firms within a cluster compete with each other but are supported by trust and reciprocal relationships among them. The Italian literature explains the mechanisms inside Indonesian clusters as socioeconomic organizations in which the simultaneity of competition and cooperation prevails.

In addition, the Italian literature recognizes the existence of local economic institutions in coordinating collective actions among firms in a cluster and arranging roles in the game of interfirm relationships. An example of an institution is a local business association. The main function of the associations is to represent collective interests of a cluster community and determine the custom of cooperation among local people in a cluster.

2.2 A Theoretical Foundation of the Duality of Structures and Actors

Giddens’s structuration theory conceptualizes structures and actors as being one interdependent element. The agent–structure debate has become increasingly influential in social theory. The debate over dualism is relevant to all social sciences, including economics and organization theory (Jackson, 1999). Structure-based approaches to institutions emphasize the ways institutions shape the preferences actors hold, whereas actor-centered approaches typically treat preference formation as outside their domain and
focus on the ways actors’ pursuit of their goals aggregate into social outcomes (Child, 1997). Structure-based institutionalists emphasize the ways institutions help define the interests actors hold, whereas actor-centered approaches focus on the ways in which actors behave given an exogenously determined set of goals (Reed, 1997).

However, recently, some social theorists have argued that the stalemate between actor-centered and structure-based approaches to the social sciences is based on a false dichotomy (Giddens, 1979, 1984). These analysts claim that the constitution of actors and structures are not two independently given sets of phenomena, and the structural properties of social systems are both medium and outcome of practices they recursively organize (Giddens, 1984). These theorists contend that a dualistic perspective more accurately depicts the complexity of economic institutions (Jackson, 1999).

Duality forms part of Giddens’s structuration theory, which has greatly influenced recent sociology (Giddens, 1984). Giddens’s (1976, 1979, 1981, 1984) work on structuration is an attempt to articulate a process-oriented theory that treats structure as both a product of and a constraint on human action. Instead of actors and structure standing separate and opposed, they are brought together in a duality of structure: Structures can be reproduced and transformed only through actors who themselves can come into existence only within a structured environment (Giddens, 1984).²

Throughout his essays and books (1976, 1979, 1981, 1984), Giddens emphasizes that structures are enacted by what he calls “knowledgeable” actors (i.e., people who know what they are doing and how to do it), and actors act by putting into practice their necessarily structured knowledge. This concept of actors as “knowledgeable” and “enabled” implies that those actors are capable of putting their structurally formed capacities to work in creative or innovative ways. If enough people or even a few people who are powerful enough act in innovative ways, their actions could transform the very structures that gave them the capacity to act.

According to Giddens (1976), structures define both the rules guiding action and the resources empowering action: Structure is “both the medium and the outcome of the practice which constitutes social systems” (Giddens, 1981, p

² In his essays and books, Giddens does not distinguish the meaning of agents and actors, and even he uses both terms interchangeably. This study assumes that both terms are distinct and what Giddens denotes as agents are actors in this study. According to Meyer and Jepperson (2000), assumptions about actorhood are now so taken for granted and social scientists use the term actor with little reflexivity to denote people or organized groups, as if such entities are by definition actors. The actorhood of individuals is part of a system of social agency with organizations and national states. Meyer and Jepperson, 2000, p. 101) refer to agency as “legitimated representation of some legitimated principal, which may be an individual, an actual or potential organization, a nation–state, or abstract principles (like those of law or science, or more prosaically, high culture, or even etiquette)” and actors “celebrate ideals of mobilized agency and enter into the sweeping collective action that is distinctive to modern society” (p. 110).
27.). *Social systems* refer to the patterning of social relations across time and space, understood as reproduced practices. Structure exists only as memory traces, the organic basis of human knowledge ability, and as instantiated in action. By *social systems*, Giddens means empirically observable, intertwining, and relatively bounded social practices that link persons across time and space.

Giddens (1984) admits that any particular actor confronts a diversity of structures that seem quite independent of whatever they may do. He insists on a human potential to choose actions deliberately and to carry them through effectively, even in defiance of established rules and prevailing powers—in other words, this is the possibility and power of actors. At times, structure may constrain actors, but it is also pivotal to the enhancement of their powers and the development of actors (Giddens, 1984). According to Giddens (1976), action is intentional and goal directed. He relates on the production of structures and tries to examine how structures affect the production of action. Giddens (1981) argues that only by accepting a model wherein the actors reflexively monitor their actions will we be able to account for how the members of society produce their structures.

Giddens’s formulation of structuration theory contains three different but interrelated structural types: signification, legitimation, and domination (Giddens, 1984). Signification structures involve symbolic representations that provide meaning and facilitate communication. Legitimation structures relate to norms and values. Domination structures relate to power as it involves the ability to control and mobilize resources. Giddens postulates two general structural types: rules and resources (1984). Rules are associated with legitimation and signification structures, and provide the meaning and legitimacy on which organizational actions are undertaken and evaluated. Norms and values and symbolic representations are associated with legitimation and signification structures, respectively, and provide legitimacy and meaning for initiating and evaluating action. Resources, both material and human, are associated with domination structures. The allocation of resources facilitates or impedes action, and supports or retards development of signification and legitimation structures.

In addition, the concept of structuration refers to the transformation of social structures. For example, Giddens (1984) notes that modern society is characterized pre-eminently by its richness in organizations. He argues that change is now so rapid in modern societies precisely because the wide scope of contemporary organizations brings them into contradiction with so many other systems of activity (Giddens, 1984). These can be the effective instruments of collective actors. While as individuals we can do little to change the world, through purposive, reflexive organizations we can mobilize the power to transform social systems. Thus, structuration theory contends that institutions (structures) and humans are inextricably linked. Institutions influence how people communicate, enact power, and determine what behavior to sanction and
reward if institutions are encoded in actors’ stock of practical knowledge in the form of norms adapted to a particular setting (Giddens, 1979). Structuration theory theorizes the inter-relationships and interactions between local people and structure thereby providing an opportunity to theorize the influence of the actors’ skills and awareness in the process of institutionalization at the various levels (Giddens, 1979).

There are two other major theories on the duality of actors and structures. In sociology, the work of Norbert Elias and Pierre Bourdieu contains main alternatives to that of Giddens. Elias’s (1991) social theory focuses on the concept of “figuration,” which refers to actual actors and their interactions, rather than on the institutional structures found in traditional approaches. Figuration avoids the dichotomy of actors and structure by relying on the direct relations among actors. In such figuration, people can be understood only through their place in social networks, and nothing can be gained by analyzing individual people in isolation from their social context or society in isolation from individual persons (Elias, 1991).

The second theory, that of Bourdieu (1990, 2005), addresses the actor/structure issue as based on the idea of “habitus,” defined as the individual person’s stock of accumulated social knowledge and experience. According to Bourdieu (1990), habitus can explain human conduct: People’s internal dispositions derived from their past socialization ensure the constancy of social practices over time.

Thus, the duality debate can help to soften the rigidities that have marred both conventional sociological theory and neoclassical economics (Jackson, 1999). In emphasizing the interdependence of actors and structure, duality-based approaches ensure that both will be fully appreciated in social (and thus economic) theorizing.

Key insights for this study:
Duality theory gives us the perspective that structure and actors are interdependent elements. This theory is useful to design an integrative analysis of socioeconomic structures and the role of actors within a cluster. Actors have some options to constitute structures of their environment; conversely, structures affect the behavior of actors in dealing with their life problems. Structures shape people’s practices, but it is also people’s practices that constitute (and reproduce) structures. Exploring relationships between actors and structures should help theorists obtain a comprehensive picture of the dynamics of a cluster.

2.3 Theories Regarding Socioeconomic Structures of a Cluster
This section consists of three subsections that describe theories regarding socioeconomic structures of one organization. To explore conceptual views of structures, new institutional economics in section 2.3.1 helps us
understand the economic perspective of structures, and new economic sociology in section 2.3.2 postulates the social perspective of structures. The theory of both kinds of trust (interpersonal and interorganizational trust) and reciprocity in section 2.3.3 end this second part of theoretical foundations.

2.3.1 New Institutional Economics

Some studies conclude that business strategy in emerging economies is strongly influenced by institutional contexts (North, 1990; Hoskinson et al. 2000). A substantial literature on the interface between economic theory and business activity has highlighted the influence of the “rules of the game” (i.e., the reward structure of an economy on business activities). In practice, different incentive structures in different environments can result in economic activities that contribute to economic growth or they can result in rent-seeking behavior, a form of unproductive economic activities or may even lead to activities that are detrimental to economic growth (North 1990), whereas neoclassical economics sees social structures as constraints on rational individual behavior (Etzioni, 1988).

As North (1981, p. 5) states,

“From the viewpoint of the economic historian this neoclassical formulation (in mainstream economics) appears to beg all of the interesting questions. The world with which it is concerned is a frictionless one in which institutions do not exist and all change occurs through perfectly operating markets. In short, the costs of acquiring information, uncertainty, and transaction costs do not exist. But precisely because of this nonexistence, the neoclassical formula does lay bare the underlying assumptions that must be explored in order to develop a useful theory of structure and change.”

In this sense, NIE forces economists to turn their attention to the analysis of why institutions rise and persist.

North (1991, p. 97) defines institutions as “the humanly devised constraints that structure political, economic and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct), and formal rules (constitutions, laws, property rights)”. He argues that “institutions consist of a set of constraints on behavior in the form of rules and regulations; a set of procedures to detect deviations from the rules and regulations, and finally, a set of moral, ethical behavioral norms which define the contours and that constrain the way in which the rules and regulations are specified and enforcement is carried out” (North, 1986, p. 233).

Therefore, NIE differs from neoclassical economics in that it ascribes a greater importance to institutions and social structures (Hodgson, 1989). It
generally turns away from strict individualism toward a more structural outlook, in which the social and institutional context exerts a prime influence on economic activity (Rutherford, 1994).

The NIE theory typically explains the emergence and maintenance of institutions through their alleged efficiency: If an institution is efficient, it will exist (North, 1989). North and Thomas (1973) emphasize that the rapid economic growth of Western Europe was due to its efficient economic institutions. One organization can pursue the establishment of institutional arrangements and property rights when it is efficient. Then the institutional arrangements and property rights can create an incentive to channel individual economic effort into activities that bring the private rate of return close to the social rate of return (North and Thomas, 1973).

One of the strands of NIE is transaction cost economics (TCE). One variant of TCE promoted by Oliver Williamson has received widespread application (Ghoshal and Moran, 1996). It is a useful theoretical perspective to examine many facets of interfirm relationships, including their structures (Gulati, 1995), their continuity (Olk and Young, 1997), and their stability or survival (Parkhe, 1993).

According to Williamson (1985; 1991), TCE is a common framework to understand how managers graft governance arrangements. It mainly involves contractual relations governance. Its general proposition is that managers align the governance features of interorganizational relationships to match known exchange hazards, particularly those associated with specialized asset investments, difficult performance measurements, or uncertainty (Williamson 1985; 1991). In response to exchange hazards, managers may graft complex contracts that define remedies for foreseeable contingencies or specify processes for resolving unforeseeable outcomes. When such contracts are too costly to craft and enforce, managers may choose to integrate vertically (Williamson, 1991).

Williamson (2000) considers four levels of institutions: At the top is the social embeddedness level, where norms, customs, and traditions are located; the second is referred to as the institutional environment, which consists of formal rules, such as constitutions, laws, and property rights; the third level is composed of the institutions of governance in which the governance of contractual relations becomes the focus of analysis; and the last level is resource allocation and employment at an organization level.

Williamson (2000) argues that the top level of institutions (i.e., social embeddedness) is taken as given by most institutional economists. For this level, North (1991, p. 111) poses this query: “What is it about informal constraints that gives them such a pervasive influence upon the long run character of economies?” Williamson (2000) admits that NIE is involved principally with the second (formal rules or institutional environment) and third (governance or play of the game) levels of institutions.
Regarding the options of governance structure, Williamson (1985; 1991) sets a research agenda by presenting the dichotomy between market and hierarchy. The leading question in his framework is this: When does a manager pursue a firm’s objectives, use the market, rely on her/his own organization, or use a mixed-mode relationship?

Williamson (1985) argues that the cost of economic transactions influences the performance of economic functions within the boundaries of hierarchical firms rather than market processes that cross these boundaries. There are combinations of three dimensions that for the most part determine the optimal governance structure; that is, transactions can be effectuated through (1) the market, (2) the internal organization, or (3) an intermediate form: the frequency with which transactions recur, the uncertainty to which the transaction are subject, and the condition of asset specificity (Williamson, 1998).

Visser (1996) maintains that the type of functional linkages between firms is influenced by institutions and institutional environments. As Williamson (2000) indicates, institutional environments prevail at a higher level of generalization than market and firm organizations do. In line with this argument, Menard (1995, p. 163) explains that the operational levels of institutions, organizations, and market are different, “with institutions being an over-arching class that subsumes both organizations and markets.” In this context, firms and markets are classified as institutional arrangements. Both are parts of operationalizations of specific institutions that make up the real-world structures in which people settle transactions (Menard, 1995).

Moreover, Menard (1995, p. 170) refers to the market as “a specific institutional arrangement consisting of rules and conventions that make possible a large number of voluntary transfer of property rights on a regular basis, these reversible transfers being implemented and enforced through a specific mechanism of regulation, the competitive price system.” Visser (1996) gives examples of market institutions such as the promotion of price competition to reduce performance ambiguity. Meanwhile, firms are “designed to make possible the conscious and deliberate coordination of activities within identifiable boundaries, in which members associate on a regular basis through a set of implicit and explicit agreements, commit themselves to collective actions for the purpose of creating and allocating resources and capabilities by a combination of command and cooperation” (Visser, 1996, p. 172). Examples of formal institutions accompanying firms are tax and labor legislation, environmental regulations, and moral codes; in contrast, informal institutions are the ones that promote internal cooperation. Therefore, firms can be differentiated from markets in which they are socially embedded (Visser, 1996).

The TCE theory is based on two behavioral assumptions about people who make inferences on the selection of a governance structure: bounded rationality and opportunism (Williamson, 1975). Bounded rationality is defined as the inability of people to anticipate properly the complex chain of
contingencies that might be relevant to long-term contracts. TCE expressly adopts Simon’s (1957) proposition that human cognition is subject to bounded rationality where this is defined as behavior that is intentionally rational but limitedly so. This behavioral assumption (bounded rationality) allows for an imperfect ability to assess all alternatives. Therefore, individuals do not maximize but only optimize with the information at their disposal (Williamson, 1998).

Opportunism is a person’s rational pursuit of his or her own advantage, with all means at his or her command, including guile and deceit (Williamson, 1975). Indeed, one of the prominent contributions of transaction cost theory is Williamson’s statement about the existence of opportunism among transaction partners: Opportunism will increase transaction costs. Every agent is looking for personal gain (opportunism); therefore, contracts must be drawn up to attempt to minimize this opportunism (Williamson and Ouchi, 1981). The cost associated with these contracts is an example of transaction costs.

Williamson (1975) defines opportunism as an effort to realize individual gains through a lack of candor or honesty in transactions. Crozier (1964, p. 194) defines “opportunism as the active tendency of the human agent to take advantage, in any circumstance, of all available means to further his own privileges.” According to Visser (1996, p. 14), opportunism creates a destructive problem in the economy: “Opportunism inflicts economic damage in combination with asset-specificity (which determines the losses to both parties in case of non-compliance), bounded rationality (which together with strategic distortion of information yields risks of adverse selection), as well as uncertainty about external factors.”

Indeed, people engage not merely in the pursuit of self-interest but also in opportunism—“self interest seeking with guile; local people who are skilled at dissembling realize transactional advantages. Economic man is thus a more subtle and devious creature than the usual self-interest seeking assumption reveals” (Williamson, 1975, p. 255). It relates to some kind of information manipulation, by both giving distorted or incomplete information and making false promises before concluding or during the execution of a transaction (Williamson, 1985).

Pfeffer and Salancik (1978) note that when a firm needs resources held by another firm, a competitive struggle often results in which only the firm that possesses or controls critical resources “wins” or gains control over the other firm. Firms that exhibit rivalrous behavior tend to perceive and structure relationships with their partner as zero-sum games, in which one firm’s gain is another firm’s loss (Jarillo, 1988). Thus, competitive behavior may encourage firms to behave opportunistically toward others (Griesinger, 1990).

The mitigation of opportunism plays a central role in TCE (Coleman, 1994). Opportunism is mitigated and constrained by authority relations and by the greater identification with transaction partners that one allegedly has when
both are contained within one corporate entity than when they face one another across the chasm of a market boundary (Williamson, 1985). In general, people protect themselves against opportunism in arm’s-length relationships (Uzzi, 1997).

Furthermore, regarding the concept of people, NIE rests on the two following principles: (1) the assumption of humans as “homo transaction cost economicus,” which implies that a person can perceive all transaction cost-minimizing arrangements beforehand, and (2) the evolution principle, in which local people at different positions in the organization can perceive competitive pressures differently; this encompasses the notion that different views may be taken to favor efficiency-enhancing measures (Buckley and Chapman, 1997).

The arguments of the first principle collide with the behavioral assumption of bounded rationality. If local people cannot cope with contracts featuring complex contingencies, it is doubtful whether they can select in advance an efficient decision-making procedure to be used in adapting to future contingencies (Dow, 1987). Moreover, people prefer energy-saving properties of acting rationally and engage in this type of behavior routinely.

The second principle relates to the adaptation of governance structures in response to pressures for survival of the organization. This principle, which causes the drive for efficiency, does not necessarily relate to the most efficient form that can be identified, but it can be limited to structural arrangements that have actually been applied (Vosselman, 2000). It is logical that competitive pressures have an important role in the functioning of TCE (Buckley and Chapman, 1997); competition drives the need for an optimal governance structure. This argument is in line with an argument Roberts and Greenwood (1997) propose: The institutional environment enables and constrains decision makers in their efforts to be as rational as possible. Williamson (1998, 2000) defines the institutional environment as formal rules of the game, especially property (polity, judiciary, and bureaucracy). The rules are important in the operationalization of organizations.

**Key insights for this study:**

The NIE theory emphasizes the rational behavior of economic agents in interfirm relationships. Agents tend to behave rationally for the sake of their self-interest. In contrast to neoclassical economics, NIE ascribes to the importance of formal and informal institutions. It recognizes social embeddedness—which consists of informal rules such as the norms, customs, and traditions—as the top level of institutions and NIE concerns on the institutional environment—including formal rules—as the second level.

The NIE theory through TCE is useful in understanding and defining the options of governance structures of institutions. There are three options: market, hierarchy, and the intermediate form of both. Each option has its own condition to prevail: Markets are achieved through prices, whereas hierarchies
are constructed by authority. In selecting these kinds of structures, economic agents are assumed to be rational. However, this behavior is limited because of uncertainty and information access. Opportunism occurs when people wish to take advantage of their partners for their personal gains through guile and deceit.

2.3.2 New Economic Sociology

Economic sociology can be defined most simply as the sociological perspective applied to economic phenomena (Weber, 1922/1978). However, Etzioni (1988) argues that social economics is an appropriate term for all social science analyses of the economy—economic theory plus economic history, economic sociology, and so on.

By demonstrating the positive role of social relationships in modern economic life, sociologists have contributed to a time-honored research program revitalized by Granovetter (1985) with his seminal essay on the social embeddedness of economic transactions. Whereas economists typically have ignored social relations or treated them as an obstacle to attain economic rationality, sociologists have shown that economic rationality actually can be enhanced by embedding transactions in social networks that facilitate trust and diminish the risk of opportunism (Granovetter and Swedberg, 1992).

According to Smelser and Swedberg (1994) in the Handbook of Economic Sociology, Harrison White (1981) initiated a renewed interest of sociologists in economic phenomena. Since the mid-1970s, he developed a sociology of markets (Smelser and Swedberg, 1994). One of White’s students, Mark Granovetter, wrote a seminal article titled “Economic Action and Social Structure: The Problem of Embeddedness,” published in 1985. This article was inspired by Polanyi’s essay “The Economy as an Instituted Process.” Granovetter (1985) argues that the economy is structurally “embedded” in networks that affect its working. This focus on networks was soon picked up by the label of the new economic sociology—a term also introduced by Granovetter (Smelser and Swedberg, 1994) which stresses the importance of networks.

Granovetter (1985) defines a network as a regular set of contacts or similar social connections among individual people or groups. An action by a member of a network is embedded because it is expressed in interaction with other people (Granovetter, 1985). He uses the concept of networks, which is especially useful in the sociological analysis of the economy as a starting point to criticize NIE. Granovetter (1985) argues that his concept is close to concrete, empirical reality. Its use prevents conceptual errors common in mainstream economics theory and NIE. He singled out the notion of “efficiency” used in NIE to explain the emergence and structure of social institutions (Granovetter, 1985).

According to Granovetter (1990), there are three key propositions in economic sociology with respect to economic institutions. First, economic action is a form of social action. In other words, the pursuit of economic goals
is accompanied by that of such noneconomic ones as sociability, approval, status, and power. Economic action can be rational, traditional, or irrationally speculative (Weber, 1922/1978).

Second, economic action is socially situated. It cannot be explained by individual motives alone and is embedded in ongoing networks of personal relations rather than carried out by local people. As a result, the concept of people focuses on the people as a socially constructed entity, as people in interaction, or as people in society. Thirdly, economic institutions are social constructions. It means that economic institutions do not arise automatically in some form made inevitable by external circumstances but are socially constructed.

In expanding the three propositions, Granovetter (1990) introduces the theory of social embeddedness. This theory provides a conceptual basis for examining the benefit of collectively agreed ties. Granovetter (1985) suggests that economic activities must be considered in terms of the social structure in which such activities are embedded. Social embeddedness means that economic action and outcomes, like all social actions and outcomes, are affected by people’s relations and by the structure of the overall networks of relations (Granovetter, 1990). People are not like atoms; rather, they behave in their social context and are embedded in concrete, ongoing systems of social relations at purposive action of people’s attempt (Granovetter, 1985).

He argues that there are two dimensions of social embeddedness: structural and relational (Granovetter, 1990). Structural embeddedness is the structure of the overall network of relations defined in size, density, and diversity, and relational embeddedness is the extent to which economic actions are affected by the quality of actor’s personal relations and emphasizes socially based relationships (Granovetter, 1990). The structural dimension of social embeddedness refers to the structure of the network—that is, the impersonal configuration of linkages between people or units (Nahapiet and Ghoshal, 1998). This can contribute differently to resource acquisition. For example, it has been argued that cohesive or densely embedded structures are conducive to creating shared frames of references, which could facilitate the transfer of knowledge (Coleman, 1990).

The relational dimension focuses on characteristics such as friendships, reciprocity, and trust that people develop with one another (Uzzi, 1997). In a social relation, relational governance is the deliberate interfirm cooperative arrangement based on informal rules and unwritten codes of conduct that affect the behavior of firms when dealing with others (Poppo and Zenger, 2002). Social exchange, as well as the frequency, intensity, and reciprocity of the relation, also contributes to the building of trust and shared frames of references, which influence the ease with which information and knowledge can be communicated and assimilated (Burt, 1992).
In the same vein, Putnam (2000, p. 19) defines social capital as “norms of reciprocity and trustworthiness,” which are reproduced in personal relations. That is how communities are held together by trust (Putnam, 1993, 2000). According to Putnam (2000), there are two different consequences of trust generation in communities: bonding and bridging. On the one hand, trust stimulates communities to be exclusive, homogenous, and inward looking in that the value of communities is formed from inner-community trust. In this situation, based on Putnam’s definition, communities are held together by bonding. In the bonding communities, reciprocity and solidarity are useful to give social and psychological support to members of the communities by generating trust between the members (Putnam, 2000). An inward-looking and homogeneous culture can make local agents more vulnerable to exogenous pressures, and “strongly embedded regional networks [can] insidiously turn from ties that bind to ties that blind” (Grabher, 1993, p. 24).

On the other hand, the generation of trust by bridging means that value is created in relation with other communities (Putnam, 2000). This situation can generate broader identities for the members of the communities. Bridging is required to avoid the members falling into mutually reinforcing processes of cultural isolation and socioeconomic deprivation (Scholten and Holzhacker, 2009).

Indeed, Shaw (1998) reveals that social embeddedness can play both positive and negative roles in the development of a firm depending on network membership and on the nature of what flows through the social network. The development and maintenance of relational governance with a dense network of social ties in a cluster may involve considerable costs in terms of being isolated from external environment and creates the appearance of free riders. Embeddedness may restrict firm access to new information from external environments or the wider societal context (Uzzi, 1997; Gargiulo and Benassi, 2000). The combination of sectoral and geographical concentration as characteristics of industrial clusters can make their locality vulnerable to exogenous shifts in products and technology. A more diversified local economy can prevent this and is less vulnerable to external shocks (Uzzi, 1997; Brass and Labianca, 1999; Gargullo and Benassi, 1999).

One significant obstacle to innovation in small and medium-sized firms is weakness in collecting external information and their adaptability to increased turbulence from the external environments (Buijs, 1987; Freel, 2000; Rothwell, 1994). Particular norms that are respected within a cluster can result in over-embeddedness (Uzzi, 1997), which insulates information external to the relationship. This blindfolds a cluster for new relevant information. This cost may even be greater if the uncertainty associated with the gathering of this information and the probability of maintenance of new ties is taken into account (Poppo and Zenger, 2002).
That is why Sengenberger and Pyke (1991) stress the problem of many small manufacturers being isolated from their external environment. The ability to withdraw from social embeddedness that is no longer advantageous has often been recognized as an important factor in the adaptability of firms (Uzzi, 1997). The more intense and productive the ties with old contacts are, the more difficult it will be to end those relationships (Gargiulo and Benassi, 2000). In addition, Weber (1922/1978) states that cozy intergroup relationships of the sort frequently found in solidarity communities can give rise to a gigantic free-riding problem. Less diligent group members can enforce on successful members all types of demands backed by the same normative structure that makes the existence of trust possible.

In clusters, free riding can have a negative effect on relationships among firms because the free riders tend to exploit resources created by other more innovative firms; for example, they imitate successful products at lower costs and lower quality (Portes and Sensenbremer, 1993; Rabellotti, 1996). When the existence of free-riding behavior results from the multiple linkages of firms in clusters, unfair relationships are created (Portes and Sensenbremer, 1993). Free riders do not have to spend time and budget to create new design or products because they only imitate designs or products from other firms. Under this condition, firms that are not free riders cannot minimize their business risks and have no motivation to achieve higher levels of firm performance in terms of innovative products, technical progress, market expansion, and sales returns.

Key insights for this study:

New economic sociology indicates that economic action is socially situated. In this perspective, the rational pursuit of people joins together with social actions of people in their social system. New economic sociology introduces social embeddedness theory, which emphasizes cohesion between parties that is supported by trust and reciprocal relationships. Social embeddedness refers to the mechanisms in which economic actions of people are affected by social construction of people’s behavior.

Furthermore, this theory recognizes negative roles in the development of a dense network of social ties. It introduces the concept of bonding and bridging in communities in relation with trust generation. Embeddedness between participants in one community can be a constraint to establish contacts with external institutions, due to inter-community trust. In this situation, the communities are held together by bonding, which supports reciprocity and solidarity among the members of the communities. In addition, over-embeddedness can give rise to free-riding problems. Certain people copy what other people have done successfully without any contribution of the process in pursuing that achievement.
2.3.3 **Interorganizational trust, interpersonal trust, and reciprocal relationships**

Within organization theory, there are three theories that have been developed to explore the relational dimensions of social embeddedness: interorganizational trust, interpersonal trust, and reciprocal relationships.

The relational dimensions of social embeddedness that are based on reciprocity and mutual trust are important starting points to understand the influences of network structures on economic behavior (Podolny and Baron, 1997; Rowley, Behrens, and Krackhardt, 2000). The dimensions focus on behavior of the exchange parties—in particular, trust, confidence, and information sharing (Uzzi, 1997)—and also refer to the degree to which exchanging parties mutually consider one another’s needs and goals, defined as the quality of dyadic exchanges (Granovetter, 1992). The constructs also encompass efficient access to information in terms of the availability, competencies, and reliability of potential partners, which lower searching costs and alleviate risk of opportunism (Granovetter, 1985; Gulati, 1995).

2.3.3.1 **Trust**

The study of trust has its roots in psychology and social psychology and is intuitively an interpersonal phenomenon. Empirical studies in sociology conclude that expectation of trust ultimately resides within individual persons, but researchers in management have taken up the idea of interpersonal trust and extended it to the organizational level (Gulati, 1995; Zaheer et al., 1998). Ring and Van de Ven (1994) explain that the definition of the role of interorganizational trust is stable and enduring although the individual people within an organization may be transitory. Thus, not only is interpersonal trust necessary but also interorganizational trust may be significant within the roles and routines of the organization (Ring and Van de Ven, 1994).

However, it has been suggested that it may not be possible to study interorganizational and interpersonal trust using similar measures (Zaheer, et al., 1998). According to Zaheer et al. (1998), interpersonal trust and interorganizational trust are related but empirically and theoretically distinct. Interpersonal trust refers to “the extent of a boundary-spanning agent’s trust in her counterpart in the partner organization. In other words, interpersonal trust is the trust placed by the individual boundary spanner in her individual opposite member. Interorganizational trust is defined as the extent of trust placed in the partner organization by the members of a focal organization” (Zaheer et al., 1998, p. 142).
According to Rotter (1967), interpersonal trust is based on an expectancy held by an individual person or group that the word, promise, or verbal or written statement of another individual person or group can be relied on. Most studies that examine interpersonal trust rest on the premise that people’s trust in another party affects how they interact with the referent of the belief. Interpersonal trust refers to a personal characteristic of a partner in his or her social life. If it is believed that a person’s words are reliable and correspond with his or her deeds, he or she will be considered trustworthy.

Simply aggregating interpersonal trust as a proxy for interorganizational trust ignores the influence of social context in the form of individual people’s interactions (Coleman, 1990) and organizational rules (Sitkin and Roth, 1993) that constrain and orient its members. Nooteboom et al. (1997) acknowledge the individual person’s key role and consider that his or her propensity to trust is affected by the organizational culture. Subsequently, the authors treat trust as an individual person’s perception with respect to the partner organization, and their variables identify trust as the perception of a mutual relationship.

Indeed, many researchers on interorganizational relationships identify certain critical success factors in such relationships. Among the most common and possibly most critical ones is the role of trust in facilitating the organization and coordination of economic activities between firms. Trust studies in disciplines like psychology, social psychology, and sociology have tremendously influenced trust literature in the field of business studies (Seppanen et al., 2007). Authors typically combine different theoretical approaches to capture the multidimensional and complex nature of interorganizational trust.

Seppanen et al. (2007) review empirical studies on interorganizational trust that were published in scientific journals between 1990 and 2003 and conclude that the most common theoretical approaches behind the empirical studies were sociological and psychological. They noticed that social exchange theory was used in four studies (Ganesan, 1994; Aulakh et al., 1996; Smith and Barclay, 1997; Young-Ybarra and Wiersema, 1999), literature on marketing channels was used in three studies (Ganesan, 1994; Chow and Holden, 1997; Nooteboom et al., 1997), and transaction cost economics in three (Nooteboom et al. 1997; Young-Ybarra and Wiersema, 1999; Mollerling, 2002).

According to Seppanen et al. (2007), Sako and Helper (1998) and Young-Ybarra and Wiersema (1999) offer the most comprehensive view of the complex phenomenon of trust in interorganizational relationships. These two studies propose a combination of social, psychological and economic approaches. Sako and Helper (1998, p. 388) combine economic, sociological, and psychological theories, and their definition of trust as “an expectation held by an agent that its trading partner will behave in a mutually acceptable manner, and will act fairly when the possibility for opportunism is present” reflects the
sociopsychological expectation of reciprocity, and the economic approach to trust as prediction and economic concepts (opportunism).

According to Sako and Helper (1998, p. 396), there are three types of trust: contractual (operationalized by the statement “We prefer to have everything spelled out in detail in our contract”), competence (captured by the reverse-coded statement “The advice our customer gives us is not always useful”), and goodwill trust (operationalized by the statement “we can depend on our customer always to treat us fairly”). Their findings also supported the notion that the institutional environment may be influence the development of firm-level practices, which further influence trust.

In a similar vein, Young-Ybarra and Wiersema (1999, p. 443) combine transaction cost economics and social exchange theory in their theoretical framework, which is reflected in their definition: “Trust is based on three components: dependability (expectation that the partner will act in the alliance’s best interests), predictability (consistency of actions by the partner), and faith (the belief that the partner will not act opportunistically even in unforeseen or novel situations).” They use the vocabulary of both transaction cost economics (opportunism) and social exchange theory (expectation of reciprocity).

The TCE theory provides useful conceptual tools for analyzing the role of trust in interorganizational relationships and is used by Young-Ybara and Wiersema (1999) and Sako and Helper (1998). A central concept of TCE is opportunism rather than trust. It has been referred to as “calculative trust”: Trust makes sense only if it goes beyond calculative self-interest (Williamson, 1993, p. 463). It emphasizes its risk-decreasing nature and enhances the prediction or expectation of the other actor’s future behavior. In designing the structure of organizations, the reliance on trust is seen to be too fragile as compared with devising economic safeguards against opportunism (Williamson, 1985). However, TCE argues that because people have the potential for opportunistic behavior, safeguards must be put in place to ensure trustworthy behavior (Williamson, 1993).

According to Williamson (1993), there are three kinds of trust: calculative, personal, and institutional. Calculative trust refers to a rational kind of trust caused by mutual hostages and other economic commitments. Personal trust is associated with trust from a psychological approach that exists only in personal relationships and does not depend on calculations of self-interest for its formation or continuation. Although institutional trust is calculative too, it originates from the social and organizational embeddedness.

In addition, Williamson (1993) argues that when the cost of opportunistic behavior is greater than its benefit, it will be in the rational self-interest of exchange partners to behave in a trustworthy manner. Thus, trust between partners is a result of rational decision making in their own economic interest (Williamson, 1993). This type of trustworthy behavior is emphasized in most economic models of exchange and has been referred to most commonly as
a lack of opportunistic behavior (Barney and Hansen, 1995). Therefore, TCE assumes that when an organization believes that a partner engages in opportunistic behavior, such perceptions will lead to a decreased trust.

An economic approach to trust overlooks social and ethical norms and exaggerates the influence of opportunism in organizations (Sepphanen et al., 2007). Indeed, trust in economic activities cannot be understood and explained without a constructive dialogue between the disciplines of economics and sociopsychology (Mollering, 2002). Mollering (2002, p. 157) concludes that although his study integrates the concept of trust into the theory of economic organization at the most general level, “the straightforward annexation of trust by transaction cost theory … is rejected.” This is understandable as trust has not traditionally been a focal concept in economic theories such as transaction cost economics (Williamson, 1975), even when its impact was subsequently proposed as potentially lowering transactions costs (Williamson, 1990) and increasing benefits.

In addition to limiting transaction costs, trust represents one such important social context factor and forms part of the utility of a relationship. As Granovetter (1990) explains, many attempts of rational, economic action are really “embedded” in social relations and “the role of concrete personal relations and structures of such relationships in generating trust and discouraging malfeasance” (1985, p. 490).

According to Young-Ybarra and Wiersema (1999), there are two main sources of trust in the social exchange literature: reputation and shared values. For the first source, knowledge of previous relationships or alliances that depends on the length of the attachment between the parties is the important factor (Gulati, 1995). The knowledge that an organization can be trusted is based, in part, on that organization’s reputation. Thus, trust develops between partners over time and is intimately tied to past experiences. In line with this idea, Ring and Van de Ven (1992) argue that trust occurs between two parties if they previously have had successful experiences regarding repeated transactions and both parties perceive that the partner has acted equitably.

Shared values require only current knowledge about one’s partner to the exchange and may be transmitted through the current exchange process. In this source, trust develops in part as the result of an interpretation of both exchange partners regarding his or her counterpart’s motives and intentions for the exchange goals (Morgan and Hunt, 1994). The factors affecting this second source are communication and understanding of the relationship goals of the partners.

Thus, trust is an essential component in a social exchange relationship. An individual person may be willing to establish an exchange relationship with others by voluntarily giving benefits to others first and then expecting returns in the future (Wu et al., 2009). The higher the degree of trust perceived by the
giver and the recipient, the stronger will be the social exchange relationship that exists between them (Wasko and Faraj, 2005).

2.3.3.2 Reciprocal relationships

The second dimension of relational embeddedness is reciprocity. Sociologists, social psychologists, and philosophers view it as one of the basic norms taught in all societies (see Gouldner, 1960; Thompson, 1967; Becker, 1990; Ostrom, 1997, 2003). Rindfleisch and Moorman (2001) discuss the concept of relational embeddedness as the degree of reciprocity and closeness among participating firms. Gouldner (1960) defines reciprocity as the degree of equality or comparability of the supportive actions performed for and by an individual person. Thompson (1967) refers to this as a feedback process. Such processes indicate that interdependence involves back-and-forth interactions as parties continually process new information (Thompson, 1967). Through mutual adjustment, parties jointly solve technical problems to master the development of complex new products and processes. According to Axelrod (1984) in his seminal work on two-person prisoners’ dilemma tournaments, reciprocity is an essential characteristic of strategies capable of sustaining social cooperation. Reciprocal strategies punish defection by changing the likelihood of future cooperation in response to the current defections of others, thereby reducing their vulnerability to exploitative strategies.

All reciprocity norms share the common ingredient that people tend to react to the positive actions of others with positive responses (Ostrom, 2003). The specific reciprocity norms that people learn vary from culture to culture and within a broad cultural milieu, across different types of situations that are confronted repeatedly (Ostrom, 1997).

The degree of reciprocity cannot be measured as provision of companionship. Companionship is generally beneficial to both participants in their relationships. Therefore, distinctions are made between relationships that are to the parties’ advantage (more support is received than is given), reciprocal relationships (the same amount of support is received as given), and relationships that are to the parties’ disadvantage (more support is given than is received) (Axelrod, 1984).

Thus, reciprocity can be measured as supportive actions directed from one firm to another firm maintaining bilateral relationships. When many people use reciprocity, there is an incentive to acquire a reputation for keeping promises and performing actions with short-term costs but long-term net benefits (Ostrom, 2003). Whether reciprocity is advantageous to individual people depends on the behavior of other people who are likely to use reciprocity and on an individual person’s capacity to judge the likely frequency of reciprocators in any particular situation and over time (Ostrom, 1997).
At both levels, failure to reciprocate may result in strong sanctions and significant damage to one’s reputation as a trustful contact, a damage that can be consequential for the manager’s ability to create new ties. This failure to reciprocate is precisely what people often disapprove of in the “instrumental” individual, the person who cuts the ties of obligation to the group when he or she sees no further benefit in his or her exchanges with the other members (Gargiulo and Benassi, 1999). However, when there are many others who use a form of reciprocity that always strengthens cooperation, even in one-shot situations, cooperation may lead to greater returns when a series of diverse situations is considered together (Ostrom, 1997).

In fact, reciprocity occurs in not only social embeddedness; it also happens in market linkage. According to Fafchamps (1999), market exchange is based on the concept of reciprocity. However, there is a sharp distinction between reciprocity in market exchange and social embeddedness. In the former, reciprocity is explicit: The buyer reciprocates to the seller by giving money at a specific time. In the latter, reciprocity is in an unspecified manner at some unspecified time in the future: “In market exchange, to guarantee that individuals do not get more from the community than what they contribute, one must ensure that they do not spend more than they earn” (Fafchamps, 1999, p. 4).

Reciprocity between two firms is seen as an indicator of the highest level of intimacy (Rook, 1987). Not only is the extent to which both firms receive support important; but also the extent to which support exchanges is reciprocal is significant. That support is an important factor stimulating firms to improve firm performance because it reduces the likelihood of opportunism-based conflicts. In reciprocal relationships, firms can help one another as part of a long-term mutual understanding, lending machines, labor, and knowledge sharing.

In reciprocal situations, confidence can develop when firms engage in long-term relationships, in turn, enabling firms to achieve more product innovation as well as better manufacturing and marketing performance. At the same time, firms are stimulated to obtain greater returns because reciprocity promotes negotiating efficiency. Reciprocal relationships between parties enable each party to be more flexible in granting concessions because of the expectation that the exchange partner will reciprocate in the future.

**Key insights for this study:**

The theories on trust indicate that the concepts of interpersonal trust and interorganizational trust should be distinguished. In interfirm relationships, especially those between firms within a cluster, both kinds of trust can be applied because participant firms in a cluster are located and do business in the same area. Interpersonal trust based on psychological approach refers to trust in the personal life of people, while interorganizational trust represents trust.
between and among people in their relationships with other business partners. Interorganizational trust can be based on an economic as well as a social exchange approach. An economic approach of trust is from TCE. From the TCE perspective, trust is based on a calculative process as firms observe the cooperative behavior of their partners. The social exchange approach determines trust on the basis of shared values among partners and reputation.

The concept of reciprocity explains how to measure reciprocal relationships between and among people. In this study, I apply the concept of reciprocity in embedded ties, although reciprocity can occur in either embedded ties or market relations. Reciprocal relationships are the balanced relationships in which people receive the advantage as much as what they have been given. In embedded ties, relationships are typically expected to be reciprocated in an unspecified manner at some unspecified time in the future.

2.4 A Theoretical Foundation of Leadership Types of Actors

There is a wide range of literature on the role of influential actors. It deals with the body of knowledge about leadership, which can be applied to explain the role of influential actors in a decision-making process in local economic institutions within a cluster.

Leadership has been defined by many different disciplines—for example, psychological, interpersonal and sociological concepts of leadership in behavioral sciences. Organizational theorists have provided several explanations of leadership (Yukl, 1998). Leadership has been examined from multiple perspectives, including the leader’s personal characteristics, the nature of the organizational context, and characteristics of subordinates. The definition of leadership in terms of influence, group, and goal tend to hold sway, albeit in various guises, in much of the history of leadership theory and research (Bryman, 2001).

Three elements can be discerned that are common to many leadership definitions: influence, group, and goal (Bryman, 2001). First, leadership is viewed as a process of influence whereby the leader has an impact on others by inducing them to behave in a certain way. Second, that influence process is conceptualized as taking place in a group context. Group members are invariably taken to be the leader’s subordinates and thus the persons for whom the leader has some responsibility. Third, the leader influences the behavior of group members in the direction of goals with which the group is faced. Effective leadership—the holy grail of leadership theory and research—will be that which accomplishes the group’s goal(s).

However, in subsequent research this leadership concept has not dealt with the type of decision-making context and thus has had limited applicability for decision situations (Shrivastava and Nachman, 1989). Processes by which such decisions are made become vehicles for individual people and groups to shape organizational strategies.
Organizations are composed of individual people, and they differ in behavioral characteristics (Ireland and Hitt, 1999) such as interpersonal relationships, individual orientations, goal orientation, and risk preferences. These people also differ in membership of the functional and technical subgroups or organizational units, and in levels on the authority and/or hierarchy. Each of these personal characteristics and different levels create a slightly different view of the need for change in the strategy, structure, and system of firms.

Selecting the strategy and design of the structure and systems cannot be done individually because of the great complexity of the selection process; it must be the result of a coordinated and integrate group effort, despite the complexity of organizations (Daily et al., 2002). To bring about this integrated and coordinated group effort, an effective decision making process is vital (Denis, Lamothe and Langley, 2001). Leadership that emerges in processes of strategic decision making is called strategic leadership (Shrivastava and Nachman (1989); Ireland and Hitt (1999); Denis, Lamothe and Langley (2001)). Indeed, Daily et al. (2002) conclude that in the case of small to medium-sized enterprises, leaders tend to occupy a position of serving as the focus of decision making.

Summer (1980) presents strategic leadership as a multifaceted concept that involves such functions as the integration of societal ethics with organizational ethics; the alignment of philosophies regarding the roles of leader, society, and organizational constituents and the enactment of those philosophies; and the alignment of the organization with respect to influence and power in society. The current study challenges the assumption that only chief executives provide strategic leadership in organizations: Strategic decisions can emerge out of complex negotiations between internal and external stakeholders (Shrivastava and Nachman, 1989).

As a social process, strategic decision making involves multiple partisan members who must interact over extended periods of time to reach semiconsensual decisions (Mintzberg, 1983). Strategic decision making entails sub-processes of technical puzzle solving, social adjustment, political bargaining and negotiations, and organizationwide communications. A variety of environmental factors also influence strategic decision processes such as technology, suppliers, markets, and regulatory agencies (Ireland and Hitt, 1999). Daily et al. (2002) suggest that a satisfactory study of community leadership must involve a detailed examination of the whole decision-making process as it is exhibited over a range of issues.

In their study on pluralistic and dynamic organizations, Denis, Lamothe, and Langley (2001) view strategic leadership as a collective phenomenon to which different people can contribute in different ways. Such organizations consist of people from many firms within a cluster who differ in several behavioral characteristics or dimensions, such as interpersonal relationships.
(formal vs. informal), individual orientations (tasks vs. people), risk preferences (low vs. high), time orientation (short vs. long), uncertainty tolerance (minimal to complete), goal orientation (corporate vs. individual), and problem solving style (intuitive vs. analytical).

These people also differ in memberships of functional and technical subgroups or organizational units and in levels on the authority hierarchy, from cluster level to sub-unit of production at the firm level. Each of these personal characteristics, group memberships, and hierarchical levels create a slightly different view of the need for interventions or change in strategy, structure, and system.

In addition, in such organizations, the selection of the strategy and the design of the structure and systems cannot be done individually because of the great complexity of the business process in a cluster; it must be the result of a coordinated and integrated group effort. Despite the variety of personal interests, behavioral characteristics, group memberships, and hierarchical levels among the members of a cluster, leading actors must promote a joint perspective. Thus, to bring about this integrated and coordinated group effort, strategic leaders are necessary (Denis, Lamothe and Longley, 2001).

Shrivastava and Nachman (1989) define seven facets of strategic leaderships: (1) embodiment of leadership (whether strategic leadership is a function of groups of leaders, personal traits, or authority structure); (2) sources of influence (whether the leaders use personality and charisma or official rules or expertise knowledge); (3) leader-member relationships (the leaders exert direct controls or have collegial relationships with the members); (4) leadership role orientation (whether the leader makes rules or takes on organizational predefined rules); (5) unit of analysis (individual level or industry level); (6) leadership system orientation (a closed or open perspective); and (7) structuring of the leadership act (bounded by formal rules, creating new rules, or interpreting rules on the basis of the situation). These facets as reflected in strategic decision processes are a way to analyze how strategic leadership is enacted within an organization (Shrivastava and Nachman, 1989).

In line with Shrivastava and Nachman’s (1989) facets, especially the first, fourth, sixth, and seventh, Denis, Lamothe, and Longley (2001) define four views of strategic leadership within a pluralistic and dynamic organization context. The first view is leadership as a collective phenomenon to which different actors can contribute in different ways. It is an attempt to determine whether leadership emerges as a result of one person, several persons, and/or from the situation that any group member could enact a prescribed rule in a particular situation. Although the popular business press still tends to give inordinate attention to the individual leader, researchers have recently stressed that leadership requires the contributions of more than a single person. For example, Hambrick and Mason (1984) and Eisenhardt (1989) focus on top
management teams, and Pettigrew and Whipp (1991) emphasize that change leadership in large firms they studied often involved many people.

A group of people collectively may possess the necessary skills and behavior to design and carry out a major organizational change. In some cases, collective leadership is indeed explicitly formalized within an organization's structure, leading to a variety of possible divisions of roles (Stewart, 1991). Ireland and Hitt (1999) conclude that a strategy of selection and translation and a process of implementation cannot be performed by one person. No single person can impose his or her vision and preferences on an organization and bring about substantive change (Denis, Lamotche, and Langley (2001). Groups of multitalented and diversified people could be the answer to strategic planning and change for the future (Manz and Sims, 1987).

The second view is strategic leadership as a process phenomenon. This view focuses primarily on what leaders do to mobilize others in a system of interrelationships rather than on who they are. This leads to the question of whether leaders are involved in rule-taking or rule-making (Graen, 1976). In the latter orientation, the leaders define rules (for themselves, the group, and/or the organization) and allocate task responsibility and resources toward the accomplishment of personally identified goals. In the rule-taking orientation, the leaders, group, and/or organization adopt predefined rules or assume rules that are a consequence of emergent task requirements, which are guided by the larger social system (Shrivastava and Nachman, 1989).

Therefore, actors can control an entire cycle by setting the boundary conditions for production and marketing of the final product (Knorringa, 1994). According to Knorringa (1999), through superior access to information and resources, local actors can determine product specifications and set price ranges in accordance with selected market segments. Actors decide whether and when to use distinct categories of small enterprises. They can select suitable small enterprises and incorporate them into their industrial networks and exert control over them by fixing standards for inputs and outputs (Knorringa, 1994).

The third view involves strategy that is viewed as a dynamic phenomenon in which participants, roles, and influences evolve over time. In this view, there are three types of leaders' actions: symbolic, substantive, and political:

Symbolic consequences refer to changes in an organization’s dominant strategic frame or interpretative scheme which is the set of accepted ideas about what the organization’s role and strategy should be. Substantive consequences relate to the effects of leaders' actions on resource allocations, organizational structures and realized strategies; political consequences indicate effects in terms of the distribution of formal and informal power and the evolution of leadership roles within a leadership constellation (Denis, Lamonthe and Langley, 2001, p. 811).
The last view is the willingness of leaders to initiate networking with external environments. It represents strategic leadership as a supra-organizational phenomenon. This third viewpoint leads to the question whether an open or closed perspective is taken by the leadership of a cluster organization (Shrivastava and Nachman, 1989). A closed systems orientation toward the organization and the environment is associated with concerns that are localized and confined to the internal operations of the organization rather than to the environment. An open perspective is orientated toward maintaining a positive balance of exchanges between the organization and the environment. Institutional theorists argue that the more an open perspective is taken by the leadership of the organization, the more likely leaders are to respond to external demands for change (Denis, Lamothe, and Langley, 2001). Accordingly, leadership mobilizes support and manages relationships not only within the organization but also outside the organization.

**Empirical research about the role of actors and local business associations in clusters**

Some studies show that clusters were usually stimulated by social networks among local people and could be seen as the context wherein local economic actors specify goals, make decisions, and realize activities (Visser, 1996; Nadvi, 1999a; Sato, 2000). By using local business associations, local actors coordinate interpersonal relationships that consist of people with a diverse range of characteristics and goal orientations (Nadvi, 1999a). Krugman (1991) argues that the growth of clusters is the outcome of a self-reinforcing cycle within a cluster, especially with the support of local public and private institutions. Thus, local economic actors establish collective strategies through a formal local business association and/or some informal small group of clustered firms.

Doner and Schneider (1998, as quoted by Nadvi [1999b]) detail the various ways by which business associations can contribute to enhanced economic performance of members, supporting them with a range of market complementing functions. Both local business associations and some informal groups of firms can represent collective interests of the cluster. They can also provide a range of key services to local firms, regulate local competition, and mobilize cooperation (Nadvi, 1999b). All these activities are essential for the coordinating role of local actors in a cluster.

Local firms have an important role in generating support for the implementation of common action plans. Some leading firms have a significant role in identifying cluster issues for the realization of a successful cluster strategy. Schmitz (1995, 1999) concludes that clustering in developing countries has not been the outcome of a planned intervention by the state but has emerged from within the business community. This lends credence to the view that, as in the European industrial districts, the competitive advantage of
clusters based on the economic and social activities of a community is not created from above but developed through an endogenous process. Government or other external institutions (e.g., universities and/or nongovernmental organizations) may identify emerging or existing clusters through their studies of the economy, but without active involvement and actions from local firms to pursue a common cluster growth, it does not create an industrial cluster (Sforzi, 2003). Indeed, in most rural areas in developing countries, the self-identification of clusters is both expected and encouraged (Weijland, 1999).

According to Doner and Schneider (1998, as quoted by Nadvi [1999b]), business associations may have a positive impact on economic performance. Yamawaki (2001) emphasizes that in some industrial clusters in Japan, some local institutions (e.g., local trade associations, wholesalers associations, local chambers of commerce) that coordinate member firms’ activities facilitated communications between them and disseminated technological and product information. Meyer-Stamer and Empreender (1996) find in their study about regional and local policies in ceramics and textiles clusters of Santa Catarina (Brazil) that business associations have an active role in stimulating exchange, including technological exchange among firms. In these associations, local actors formulate and implement measures to create local advantages and also have an important role in shaping the supporting environment.

Accordingly, in a cluster, local actors organize a clustering community to graft business strategies for marketing, an export plan, or any other business strategy and to implement such strategies through local formal and informal institutions. Through local business associations, actors coordinate local collective bargaining, which controls the members of their own category and ensures that agreements are respected not only to the letter but also in spirit. (Dei Ottati, 2003b). They can also provide a range of key services to local firms and undertake the function of regulating local competition and mobilizing cooperation (Nadvi, 1999b).

In the early findings of their research, Wolfe and Gertler (2004) describe the key role of civic entrepreneurs in catalyzing the development of new and emerging industries in Canada, such as telecom equipment in Ottawa, wireless equipment in Calgary, and the emerging multimedia sector in Nova Scotia’s Cape Breton Island. The community leaders—who are more often than not from the private sector—helped to animate local processes of strategic visioning, galvanize socially organized activities to upgrade the innovative capabilities of local firms, and represent the common, collective interest of firms in the industry when required (Wolfe and Gertler 2004).

**Key insights for this study:**

Theories on leadership indicate that there are many definitions of leadership. In a pluralistic organization like a cluster, often that there is no person who can influence other persons with his or her personal traits or
charisma. However, decision-making processes in such a setting can be improved by identifying influential actors who lead to create decisions for the sake of collective interest in that organization. Leadership provides primarily strategic leadership theory to explore the role of influential actors in such situations.

To explore the role of influential actors in the decision-making process in a cluster organization, this research applies seven facets of strategic leadership. It can be combined with the three views of leadership applied in a pluralistic and dynamic organization.

2.5 Firm Performance

The important role of business performance in most branches of management, including strategic management, warrants close attention to measuring business performance (Venkatraman and Ramanujam, 1986). The professional literature has suggested that managers should design new performance measurement systems that include financial and nonfinancial measures (Gosselin, 2005). Financial measures are sometimes insufficient for decision making; nonfinancial measures give more weight to customers and internal processes in their performance measurement systems (Jusoh et al. 2008). Some studies have shown how nonfinancial performance measures can be best combined with financial measures to obtain the best measurement in a competitive environment (e.g., Shields, 1997; Hoque and James, 2000; Jusoh et al. 2008).

In most strategy research, financial performance is the most frequent indicator of business performance (Hofer, 1983; Venkatraman and Ramanujam, 1986). This approach is the narrowest conception of business performance: It centers on the use of simple outcome-based financial indicators that are assumed to reflect the fulfillment of the economic goals of the firm. Some examples of indicators of this approach are the growth of sales, profitability (reflected by ratios such as return on investment, return on sales, and return on equity), and earnings per share (Venkatraman and Ramanujam, 1986).

A broader conceptualization of business performance would include emphasis on indicators of operational performance (Venkatraman and Ramanujam, 1986). Some examples of this approach are market share, new product introduction, product quality, marketing effectiveness, manufacturing value added, and other measures of technological efficiency within the domain of business performance. O’Farrell and Hitchins (1988, p. 400) argue that production issues (e.g., design, quality control, correct use of machinery) in small manufacturing firms should be taken into account when considering performance and small firms’ growth because “getting production right is always a necessary condition of growth in all firms.”

Following the resource-based view literature, Rangone (1999) states that there are three categories of key performance that depend on the capability
to which they are principally related: new product development performance, manufacturing performance, and marketing performance. New product development performance comes from a company’s innovation capability to develop new products and processes and achieve superior technological and/or management performance (e.g., development cost, time to market); manufacturing performance refers to production capability, which is the ability of a company to produce and deliver products to customers while ensuring competitive priorities such as quality, flexibility, lead time, cost, and dependability; marketing performance results from market management ability and reflects a company’s ability to market and sell its products effectively and efficiently.

A resource-based view of strategic management examines the resources and capabilities of firms that enable them to generate above-normal rates of return (Amit and Schoemaker, 1993). This view proposes that resource selection and accumulation are a function of both intrafirm decision making and external strategic factors (DiMaggio and Powell, 1991). Intrafirm managerial choices are guided by economic rationality and motives of efficiency, effectiveness, and profitability, whereas external influences are strategic industry factors that affect the firm, including buyer and supplier power, intensity of competition and industry, and product market structure. These factors influence which resources are selected as well as how they are selected and deployed (DiMaggio and Powell, 1991).

In this view, interfirm relationships are critical determinants affecting resource choices and firm capabilities. However, not all resources possessed by a firm would be considered. The focus is on critical or strategic resources that are classified as the basis of the firm’s sustainable competitive advantage. In addition, the key implication of this view is that a firm’s ability to generate income from resources and this capability will depend primarily on the firm’s effectiveness in managing its resources. Capabilities are to coordinate and deploy resources to perform tasks (Amit and Schoemaker, 1993; Rao, 1994), and resources are input factors controlled and used by firms to develop and implement their strategies.

In the resource-based view, the innovation capability is a part of valued resources and capabilities of the firm. A key aspect of the cohesion in a cluster is the ability to adapt to the neighbor firm’s needs and requirements. It entails flexibility to changes of partner’s behavior and adoption of new ideas (Visser, 1996). Interfirm relationships provide possibilities for firms to imitate what other firms have created or designed and improve their production process or the quality of their products. From a strategic perspective, imitation is a rational alternative to innovation when the risks and development costs of pioneering are high.

Innovation is a product, service, or a manufacturing process that is new or perceived as new by its customers at markets (Van de Ven et al., 1999). It
manifests itself in new products or services (e.g., improved quality; new ways of production; Panayides, 2006). Khan and Manopichetwattana (1989) emphasize that most studies focus on two kinds of innovation that can improve the development of small firms: process and product innovation. Process innovation refers to a change in the way products are made (Tushman and Nadler, 1986, p. 76), whereas product innovation is defined as any new product introduced by a firm to a market (Knight, 1967). Thus, innovation capability refers to a continuous improvement of the overall capability of firms to generate innovation by developing new ways of production and products to meet market needs. Both kinds of innovation can be built by a firm’s own efforts or in cooperation with neighbor firms within clusters (Sandee, 1995; Visser, 1996).

In addition, some studies consistently argue that manufacturing capabilities should have an important role in how firms compete in product markets and that firms must continually develop these capabilities (Hayes and Pisano, 1994; Hayes and Upton, 1998). These studies establish the role of manufacturing processes as a potential resource. Another line of manufacturing strategy research links capabilities to the ability of the firms to achieve low costs, high flexibility, dependability, and quality (Hill, 1989; Vickery, Droge, and Markland, 1993). According to Rangone (1999), production capability that results in manufacturing performance depends on critical resources possessed by the company such as good machinery, specialization, production process competence, and production workforce or labor skills.

In resource-based empirical studies, Hansen and Wernerfelt (1989) find that human resource factors explained greater proportions of performance variance than strategy and economic factors. To establish production capability, a firm must adapt to changing customer and strategic needs by establishing internal structures and processes that influence its employees/skilled laborers to create firm-specific competencies. Thus, human resources are often skill based and involve expertise in designing, producing, distributing, and/or servicing the products or services of a firm. Employees/skilled laborers become a critical resource for sustainable performance (Hansen and Wernerfelt, 1989).

With respect to market management capability, according to Srivastava, Shervani, and Fahey (1999), marketing capability has a central role in winning and retaining customers, ensuring business growth and renewal, developing sustainable competitive advantages, and driving firm performance. Marketing actions such as advertising, service improvements, and new product launches can help build long-term assets like brand equity and customer equity (Srivastava, Shervani, and Fahey, 1999). These assets can be leveraged to deliver short-term profitability because brand equity influences the firm’s market share and sales. Superior brands lead to higher levels of customer satisfaction and perceived value of the firm’s offering (Ambler, 2000).
Key insights for this study:

The theories involving the measurements of firm performance indicate that there are at least two main measurements of firm performance: financial and operational performance. The literature of resource-based views provides an understanding of key performances of a firm that consists of new product development, manufacturing, and marketing performances. The key performances depend on critical resources and capabilities of a firm that relate to innovation, production, and market management capability.

2.6 Conclusion

The literature review shows that the Italian district literature is relevant for understanding the operation of a cluster as a socioeconomic organization including the role of local economic institutions in collective bargaining among the members of a cluster community. This literature identifies the existence of market relations and competition, which are combined with a custom of mutual cooperation between firms. The reasons mutual cooperation is needed to accompany market relations are proposed by the proponents of the Italian district literature. The Italian literature gives a foundation to define a cluster that is appropriate with the objectives of this study.

Before exploring conceptual views on structures and actors, this literature review presents the duality theory of Giddens as a prelude to an analysis of structures and actors into one integrative analysis. Next, NIE and new economic sociology deliver a concept of structures and actors in different perspectives. The NIE theory explains the interactions between structures and actors, whereas new economic sociology does the same from a social perspective. Reconciling both theories leads to an understanding of the concept of structures and actors in socioeconomic perspectives.

The social embeddedness theory of Granovetter stresses the relational dimensions of social embeddedness, which consist of trust and reciprocity. Theories on trust conclude that one must draw a distinction between the concept of interpersonal and interorganizational trust. The economic approach from TCE should be complemented by other social and psychological approach to give a more comprehensive analysis on trust in interfirm relationships. Reciprocity theory explains how one partner values his or her relationships with other partners: whether the relationships are over-benefiting, reciprocal, or under-benefiting relationships within one organization or among organizations. The contribution of each partner is not clearly defined. It is different from reciprocity in market exchanges in which the contribution of each partner is defined as money giving after buyer and seller have agreed to trade at a specific price and quantity.
<table>
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<th>Theory</th>
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| The Italian District literature            | - A cluster is influenced by socioeconomic structures.  
                        - In a cluster, market relations are accompanied by mutual cooperation between firms.  
                        - Cluster performance results from collective actions and the effects of external economies.                                                                                                     | - Local actors have a role in collective actions in local economic institutions such as workers' union, producers' union or others business organizations. |
| Duality Theory on Structures and Actors    | - Structures and actors are interdependent elements.  
                        - Structures can be reproduced and transformed only through actors.                                                                                                                         | - Actors can come into existence only within a structured environment.     |
| New Institutional Economics                | - The market and the economy are the basic reference; society is a given.  
                        - The emergence and maintenance of institutions is typically explained through their alleged efficiency.                                                                                     | - All economic actions are assumed to be rational and pursuing the efficiency.  
                        - The behavior of economic actors: bounded rationality and opportunism.                                                                                                                        |
| New Economic Sociology                     | - The economy is seen as an integral part of society.  
                        - Social embeddedness among people in a community that are influenced by trust and reciprocal relationships.                                                                                   | - Economic actors are socially embedded in local social system.            |
| Interpersonal and interorganizational trust, reciprocal relationships | - Interpersonal and interorganizational trust is different.  
                        - Economic approach on trust.  
                        - Social and psychological approach on trust.  
                        - The clear concept and implication of reciprocal relationships in social embeddedness.                                                                                                       |                                                                            |
| Leadership Theory                          |                                                                                                                                                |                                                                            | - Seven facets of strategic leadership.  
                        - Four views of strategic leadership in a pluralistic and dynamic organization.                                                                                                                       |
| Theories on Firm Performance               | Two measurements of firm performance:  
                        - Financial performance  
                        - Operational performance  
                        Key performance:  
                        - New product development,  
                        - Manufacturing, and  
                        - Marketing performance  
| Strategic Management                       |                                                                                                                                                |                                                                            |
| Resource-Based Views                       |                                                                                                                                                |                                                                            |
The literature review on leadership theory points to the importance of strategic leadership in decision-making processes in an organization. There are seven facets and four views on strategic leadership essential for a pluralistic and dynamic organization like in a cluster. Theories on performance of companies conclude that financial outcome and operational performance are commonly used as indicators of firm performance; the resource-based view introduces the following performance indicators: new product development, manufacturing, and marketing performance. The contributions of the eight theories to this study are summarized in Table 2.1.