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Export networking challenges and opportunities for manufacturing firms from developing countries

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Chapter 4

Theories of Inter-organisational Co-operation

4.1 Introduction

This chapter will review theories of inter-organizational co-operation: (1) to conceptualise the experiences we reviewed in chapter two and three and ultimately (2) to construct a theoretical framework for the empirical research. The framework helps us to examine and understand the export problems of footwear and textile manufacturing firms in Eritrea and the opportunities in the export markets. Although there is no universally accepted theory of inter-firm co-operation it is possible to offer a systematic overview of the main theories that contribute to our understanding of the subject. Four theories have been identified to serve for this purpose: (1) resource dependence theory, (2) transaction cost theory (3) strategic management theory, and (4) network theory.

4.2 Review of relevant theories

Each of these theories explains the motive, organisation and form of the inter-organizational relationship differently. However, all of them are useful in explaining the co-operative relationships between firms. As an extension to our analysis we will have a Section in which we are going to compare the four theories and draw the implications in the empirical research project.

4.2.1 Resource dependence theory

Building on early work in social exchange theory, resource dependence theory views inter-firm co-operation as a strategic response to conditions of uncertainty and dependence (Heide, 1994). Pfeffer (1992) mentions three key assumptions that stem from work in sociology and motivate the resource dependence perspective. First, the primary goal of organisations is to maximise power. Second, to survive organisations need to obtain resources from the environment and third, the environment of organisations is uncertain. Given the underlying assumption that few organisations are internally self-sufficient with respect to their critical resources, two potential problems are created. First, a lack of self-sufficiency creates potential dependence on parties from whom the focal resources are obtained. Second, it introduces uncertainty into a firm's decision making, to the extent that the resource flows are not subject to the firm's control, and may not be predicted accurately (Ibid.)

In line with the first problem mentioned, Pfeffer and Salancik (1978) reported three factors critical in determining the dependence of one organisation on another. First, there is the importance of the resource, the extent to which the organisation requires it for continued operation and survival. The second is the extent to which the interest group has discretion over the resource allocation and use. And third the extent to which there are few alternatives, or the extent of control over the resource by the interest group, is an important factor determining the dependence of the organisation. Dependence then can be defined as “the product of the importance of a given input or output to the organisation and the extent to which it is controlled by a relatively few organisations”(Ibid.). A resource that is not

important to the organisation cannot create situations of dependence, regardless of how concentrated control over the resource is. Also, regardless of how important the resource is, unless it is controlled by a relatively few organisations, the focal organisations will not be particularly dependent on any of them.

Research has shown that resource dependence between organisations triggers co-operative ties such as, vertical integration, and business alliances (Pfeffer and Salancik, 1978; Burt, 1983). Pfeffer and Salancik (1972) observed that the analysis of intraorganizational power strategies have pointed out the co-operative role of manoeuvres such as integrating special committees to reduce the actual constraint imposed by powerful outsiders on the strategic player. The main argument of these studies is that the actor seeks strategic allies in proportion to the intensity of constraint in a specific sector of his or her environment. As a result the main premise of resource dependence theory is that firms will seek to reduce uncertainty and manage dependence by purposely structuring their exchange relationships by means of establishing formal or semiformal links with other firms (Pennings, 1983; Ulrich and Barney, 1984). Heide (1994) claimed that the main implication of resource dependence theory is its identification of dependence and uncertainty as the key antecedent variables motivating the establishment of interorganizational relationships. However, he also criticised the theory in a sense that it offers only limited insight into the specific mechanisms that can be used to govern relationships, beyond "global" strategic alternatives like contracting and joint ventures.

The unit of analysis for resource dependence theory has varied from the organisation, to the linkages: a consideration of the set of interdependencies between organisations (Auster, 1994). Pfeffer and Salancik (1978) also mentioned that the level of analysis is primarily organisational where organisation is defined as a coalition of groups and interests, each attempting to obtain something from the co-operation by interacting with others, and each with its own goals and preferences. According to Pfeffer and Salancik the industry level is often introduced as an independent variable molding interorganizational linkages.

The standard operationalization of resource-dependence theory has neglected co-operative relations with actors on whom one has no direct dependence, since such ties are strategically inconsequential (Gargiulo, 1993). In the resource dependence literature, the motivation and rationale for interorganizational cooperation is to gain resources and power (Pfeffer and Salancik, 1978). Individual organisations make strategic choices to form or become part of a co-operative network of other organisations when it appears that the advantages to such an arrangement, especially enhanced survival capacity (Uzzi, 1996), outweigh the costs of maintaining the relationship, including any potential loss of operating and decision autonomy. Thus, much of what is known about the rationale for network involvement is based on an extension of the literature on interorganizational relations.

The resource dependence theory is relevant to our study because it is useful to evaluate the capacity of footwear and textile manufacturing firms in Eritrea and to explain how they can get access to market knowledge, financial and human resources, which are a bottleneck to the firm's participation in the international market. The theory sends a message that footwear and textile manufacturers in Eritrea can acquire the needed resources through co-operation with parties in their environment. In this respect two variables are important for our research. These are organisational capacity and opportunities for resource mobilisation. These variables will be discussed and defined in chapter five in detail.

4.2.2 Transaction cost theory

The transaction cost approach (TCA) has been used to explain the existence of the firm and has dominated economic thinking about institutions over recent years. Initially referred to by Coase (1937) as marketing costs, transaction costs have been widely incorporated into economics. The market versus hierarchy dichotomy has become an important issue in institutional economics, in the theory of the firm, and in parts of industrial organisation theory (Simon, 1959; Arrow, 1969). By confronting market and hierarchy as two fundamentally opposed allocation mechanisms, a research agenda arose in which it was tried to specify the theoretic conditions under which either of these mechanisms would be preferred. This led to valuable insights and applications of the so-called transaction cost economics (Williamson, 1989). According to the transaction cost approach a transaction is defined as the transfer of property rights of goods or services between economic actors.

Coase (1937) explained that a firm and a market are alternative means of organising economic activity, he emphasised that the use of the market place involves costs. These costs determine the market structure and shape transactions and interfirm relationships. When the cost of buying from other firms is relatively low, a firm is more likely to buy supplies from others than producing itself. Williamson (1975) argues that four basic concepts underline this analysis. These are: (1) markets and firms are alternative means for completing related sets of transactions, (2) the relative cost of using market or a firm's own resources should determine the choice, (3) the transaction cost of writing and executing complex contracts across a market "vary with the characteristics of the human decision makers who are involved with the transaction on the one hand, and the objective properties of the market on the other"; and (4) these human and environmental factors affect the transaction cost across markets and within firms.

Transaction cost theory deals with factors that explain both internal firm and industrial organisation. These are (1) bounded rationality (2) opportunism (3) uncertainty (4) asset specificity and (5) frequency (Williamson, 1985). While the first two are assumptions about human behaviour the last three factors are key dimensions that determine the transaction governance structure. Uncertainty, asset specificity and frequency are related to the manufacturer decision on distribution channels.

Uncertainty refers to "parametric changes" in exogenous forces (such as the market) compounded by unpredictability stemming from individuals limited information processing capabilities, as well as the consequences resulting from the opportunistic motives of other actors (Williamson, 1985). Opportunism is self-interest seeking with guile that include behaviours as lying and cheating as well as more subtle forms of deceit, such as violating agreements (Ibid). Simon (1957) embedded the uncertainty dimension to market choice and emphasised that in a world of great uncertainty, it may be difficult or costly to negotiate contracts that deal with all possible contingencies. As a result, firms may produce internally even though, otherwise, it would be cost effective to rely on markets. Thus, reliance on the market is more likely when there is little uncertainty; there are many firms and limited opportunities for opportunistic behaviour. When these conditions are reversed firms are more likely to produce for themselves than to rely on markets. Another dimension that determines the efficient way of organising transactions is asset specificity. In his 1985 analysis, Williamson gives more attention to asset specificity as a point of reference for choosing between transaction governance structures. Asset specificity refers to: durable investments that cannot readily be redeployed to other uses and which are made in support of particular

transactions. The commitment of such assets locks the partners concerned into the given type of transaction. For export transactions involving high asset specificity and uncertainty, it is expected that export activities can be performed more efficiently within the firm by employees in a foreign subsidiary rather than outside the firm by agents or distributors (Bello and Lohtia, 1995).

Williamson (1985) classified the frequency of transactions into occasional and recurrent (Figure 4.1). In the first case he suggests that market contracting backed by third party assistance, such as arbitration and litigation, is an appropriate mode of governance. In the second case, he suggested that relational contracting and bilateral governance should prevail. In Williamson's opinion relational contracting involves a long-term investment in building relationships between the parties. Bilateral governance, however, implies that both parties invest in specific assets, which generate mutual dependence and serve as hostages against opportunism. In this view relational contracting and bilateral governance are examples of hybrid governance structures, intermediate between markets and hierarchies. Both hybrids can be considered as networks as defined in chapter one.

Table 4.1 Transaction co-ordination mechanisms

| Frequency | Investment characteristics | | |
|------------|----------------------------|--|-----------------------------------|
| | Non-specific | Mixed | Idiosyncratic (Asset specific) |
| Occasional | Market governance | Trilateral governance (neo-classical contracting) | Unified governance governance) |
| Recurrent | (classical contracting) | Bilateral governance (relational) | |

(Source: Williamson, 1985))

Despite its well-known contribution TCA has been subject to criticism. In his examination of opportunistic behaviour in inter-firm relationships, John (1984) reaches contradictory evidence regarding the role of opportunism. He concludes that opportunism can be viewed usefully as an endogenous variable that is evoked by certain antecedents within a long-run relationship. In other words, individuals may not always behave opportunistically even if conditions permit such behaviour. Refusals to honour agreements and misrepresentation of intentions cannot be taken for granted. Rather, they are induced by certain other factors. To remedy this problem Nooteboom (1995) acknowledges the importance of trust and that a dynamic treatment of ongoing relations allows for the building of trust. Trust economises on the specification and monitoring of contracts as well as material incentives for co-operation and reduces uncertainty (Nooteboom, 1997; Powell, 1990). Therefore it is important to verify which instruments are available in a market to strengthen trust among actors. Nooteboom (1999) argues that institutions (certification, professional standards, benchmarking, and intermediaries) can produce trust. Furthermore, contracting may reduce the risk of opportunism, although detailed contracts are expensive and impossible to the extent that contingencies are complex and variable (Ibid.).

Consistent with the early work of Commons (1934), TCA's modal unit of analysis is the individual transaction. As a result, Nooteboom (1992) suggested that the tendency in previous empirical work has been to focus on how individual relationships or transactions are organised at a given point in time. This implicit tendency to focus on single transactions ignores the dynamic nature of interorganizational relationships. As Sahlins (1972) observes, "a material transaction is usually a momentary episode in a continuous social relation."

Expanding the unit of analysis beyond single transactions has important implications. First, past interactions or exchange episodes as mentioned by Hakansson and Snehota (1994) may influence how a new transaction is organised. For example, Gulati (1995) shows how the governance feature of earlier joint ventures between firms (i.e., the financial arrangements used) influences the governance of subsequent ventures. Gulati's general conclusion is that prior learning or experience with a particular exchange partner may reduce the need for more formal governance mechanisms in subsequent transactions.

Finally, in his conclusion Williamson (1991) suggested that whether transactions are conducted within the market, internalised within the firm, or conducted alternatively by an intermediate form of "obligational market contracting" will be determined by which governance mechanism that minimises transaction costs, and ultimately maximise efficiency. Based on this argument three concepts are important in determining the efficient transaction governance form for the footwear and textile manufacturers in Eritrea. These are asset specificity, uncertainty and frequency. Asset specificity is relevant in a sense that the Eritrean exporters have to be aware of the capital losses they may incur if they are to re-deploy their assets. Coping with uncertainty requires a form of organisation that is both adaptive and able to control opportunism. The greater the frequency or volume of transaction the more justifiable is a relatively expensive governance structure. These three concepts will be discussed in chapter five in detail.

4.2.3 Strategic management theory

The conceptual frame of reference of strategic management consists of a large and growing body of contributions from industrial economists (Chandler, 1962; Porter, 1980,1985), organisational theorists (Mintzberg, 1987; Pfeffer, 1982) and management theorists (Ansoff, 1965; Hoffer and Schendel, 1978).

Hymer (1972) was one of the firsts to apply market power theory to the study of co-operative strategy that distinguishes offensive from defensive coalitions. Offensive coalitions are intended to develop firm's competitive advantages and strengthen their position by diminishing other competitors' market share or by raising their production and/or distributions costs. Defensive coalitions mainly focus on raising the entry barriers to a certain market. Porter and Fuller (1986), in fact, qualified Hymer's argument by indicating that offensive coalitions can have a negative effect through reducing the competitor's adaptability in the long run. Among the factors that serve as entry barriers are economies of scale, switching costs, capital requirements, knowledge and learning, proprietary law, product design, brand identity and dense business network relationship with supplier and customers (Porter, 1998). Firms that have a weak position in the market in order to defend themselves against dominant players may also seek defensive coalitions.

Porter (1980, 1985) has made an important contribution in infusing the strategy discipline with economics and realised a greater coherence in the strategy field. In his book competitive strategy Porter (1980), argues that the relative position which firms occupy within their industry's structure determines the generic strategies, which are the most viable and profitable for them. Firms choose to enter into some kind of co-operative relationship with other firms to acquire competencies that the firm lacks: learn how to operate in new markets whether domestic or foreign, to acquire resources, to diversify into new business; to capitalise on economies of scale; or to circumvent trade or foreign investment restrictions. Porter also states a co-operative strategy might offer a mutually advantageous opportunity for

collaborating firms to modify the position, which they occupy within their industry. In other words, it may enable them to increase their market power.

Strategic approaches on inter-organisational linkages have tended to emphasise the competitive benefits of alliances in improving the firm's strategic posture within its industry. The parent firms are typically the primary unit of analysis. The two levels of analysis, which focus on the domestic research, are the firm level (parent and child) and the industry level. Porter (1985) defines the industry level, as a market, in which similar or closely related products are sold to buyers, is the highest level of analysis typically included. Porter (1998) identifies two broad types of linkages through which firms exercise co-operation with other firms. These are linkages with the value chain and vertical linkages with the value chains of suppliers and channels. "Competitive advantage frequently is derived from linkages among activities" (Porter, 1998, p.48).

Porter and Fuller (1986) used the value chain concept to distinguish between co-operative strategies according to the resources pooled by the partners. One type of strategy is for partners to bring similar resources together to generate economies of scope, rationalise capacity, transfer knowledge, or share risk. This strategy has variously been termed additive, scale, scope and symmetrical. Another type of co-operative strategy that of forming complementary alliances refers to situations where partners contribute different value chain activities, which allow them to build on their respective strengths and competitive advantages. This latter strategy links different activities to form a new value chain that realises complementarities and gives that alliance competitive advantage.

Strategic management theory emphasises that firms enter into co-operative relations in order to achieve expansion and growth as well as to secure efficiencies of the kind identified by transaction cost economics. In organisational theory and management, networking has come to be regarded as a competitive strategy. Jarillo (1988), Johanson and Mattsson (1988), and Miles and Snow (1984) all regarded networks as a mode of organisation that can be created by managers and entrepreneurs to position their firms in a favourable environment. In this framework, the competitive advantage of a firm lies in its capacity to gain access to, and exploit, valued external resources and expertise through the network. Consequently, establishing networks is regarded as an investment for future access to other firms' internal assets (Johnson and Mattson, 1988). Jarillo (1988) also focuses on investment but is more explicit in discussing the possibility of reducing transaction cost in networks via a conscious decision on the part of the entrepreneurs to invest in building mutual trust.

Strategic management theory draws attention to the external and contextual factors, which encourage co-operative strategy. In view of the firm environment interface Cavusgil and Zou (1994) provide both a theoretical basis for a model of export performance and a means of measuring export marketing strategy (see also chapter two). They define export marketing strategy as the means by which the firm responds to the interplay of internal and external forces to meet the objectives of the export venture. Their model is based on the principle that the fit between strategy and its environment has a positive impact on the performance of the firm. Exporting is seen as a strategic response by the firm to the interaction of internal and external forces. Their model implies that the internal and external forces determine the firm's decision to enter into relationship with other firms. The strategic management theory is criticised that socially organised relations are not considered as important and are often interpreted as collusion's reducing the level of competition.

The strategic management theory will help us to determine how the footwear and textile manufacturers in Eritrea can increase their competitiveness through the vertical and horizontal linkages and ultimately penetrate the foreign markets. However it is important to know that vertical linkages among the existing transacting parties in the target export markets can also be entry barriers to new comers. The variable “linkages” is important for our empirical research project to explain both aspects. This variable is defined and discussed in chapter five.

4.2.4 Network theory

Williamson (1981) emphasised the role of hierarchies where markets fail. Ouchi (1980) took a step beyond the markets/hierarchies dichotomy and introduced the "clan" as an additional pattern informing economic action under organisational conditions. More recently, organisational theorists like Thorelli (1986), Powell (1989), and Jarillo (1988) adopted networks as yet another frame for the analysis of economic organisation. Daft and Weick (1994) state that by maintaining, modifying and transforming multifaceted interorganizational relationships, organisations can construct their own environment and markets as they seek allies to which they can bond for periods of mutual benefit. Networks are seen as arrangements between “Markets and Hierarchies” (Thorelli, 1989, p.37). In this view networks are considered as the relationships of power and trust through which organisations either exchange information and resources (Thorelli, 1986), or take advantage of economic efficiencies (Jarillo, 1988). In such analysis the network has been viewed as an organisational actor, implying that strategic management of the network yields benefits to be distributed among the network members (see also the discussion in chapter one).

Powell (1988) claimed that simultaneous pressures towards efficiency and flexibility are pushing more and more firms to experiment with network arrangements. Moreover, the “networks as strategy” school mentions increased efficiency derived from networks, which enable firms to cope with flexibility in a complex environment (Miles and Snow, 1986). Webster and Frederic (1992) noted that Networks are replacing simple market based transactions and traditional bureaucratic hierarchical organisations. Compared to the traditional market analysis, the network approach is characterised by a multidisciplinary description of the behaviour of companies in a market and by its emphasis on relations of these companies with other companies (Beije and Groenewegen, 1992). The network approach views markets as “a set of actors with different role sets linked to each other by engaging in reciprocal exchange relations” (Snehota, 1990, p.117). Kamann (1993) describes the essence of networks as follows:

“(1) No actor can fulfil his dreams without the assistance of other actors: this puts him in paradoxical position: he either remains independent (and sub optimal) or he increases his dependence (and improves his performance). (2) Relations are based on mutual trust and are the subject to social cohesion. But can change into opportunistic behaviour and betrayal. (3) The result of network behaviour is a synergetic surplus. (4) The nature of a relationship between two actors influences all other relations in the network. (5) Each actor tries to maximise his share of the synergistic surplus. (6) Each actor carefully balances dependence and freedom in order to improve the perceived optimal mix of effectiveness, efficiency, profitability and continuity.”

Trust is at the centre of network management. Kamann (1993) claims that network relations are based on mutual trust and are subject to social cohesion. But he also warns that this can change into opportunistic behaviour and betrayal. Sako (1992) identifies three types of trust:

contractual, good will and competence trust. Contractual trust concerns mutual expectations that promises are kept. Suppliers normally agree to produce and deliver ordered goods on the basis of prior agreed specifications on the assumption that they will be paid later. Reliance on oral agreements rather than written ones is deemed to reflect more contractual trust. The second type trust refers to technical and managerial competence, i.e. confidence on trading partner's competence to carry out his task. Competence trust is ascertained with the inspection of the output. In goodwill trust there are no explicit promises, expected to be fulfilled. In this type of trust partners are expected to take initiatives to exploit new opportunities over and above what was promised while refraining from unfair advantage taking. According to Nooteboom (1999) good will trust (Intentional trust) comes from the existence of institutions (inspection institutions, banks, agents, courts of arbitration) that help in implementing the contract. Although the extent to which each actor may wish to rely on any of them differs from relationship to relationship, the three types of trust exist more or less in obligational contracting relations.

The literature on networks projects itself in two directions by addressing the causes and the functions of networks. On the one hand, researchers are interested in the origins of networks, in what brings networks into existence. On the other hand, researchers ask what networks accomplish that markets and hierarchies cannot. Hakansson and Snehota (1989) in their article entitled "No Business is an Island: The Network Concept of Business Strategy" examined the position adopted by the proponents of the network model of the organisation-environment interface. The network model referred to is the outcome of a fairly broad research programme dealing primarily with the functioning of business markets, which originates in the mid 1970's at the University of Uppsala. The research programme has spread to some other research institutions mainly in Europe. Hakansson and Snehota summarised the propositions of the network model as follows:

"(1) Business organisations often operate in a context in which their behaviour is conditioned by a limited number of counterparts, each of which is unique and engaged in pushing its goals, (2) in relation to these entities, an organisation engages in continuous interactions that constitute a framework for the exchange process. Relationships make it possible to access and exploit the resources of other parties and to link the party's activities together, (3) the distinctive capabilities of an organisation develop through interactions in its relationships that it maintains with other parties. The identity of the organisation is thus created through relations with others. And (4) since the other parties to the interaction also operate under similar conditions and organisations' performance is conditioned by the totality of the network as a context, i.e. even by interdependencies among third parties."(p.141)

The upshot of the above propositions is that if a network view is adopted considerable change may be required in the way a firm allocates its resources, structures its activities and relates itself to other organisations. Concerning the advantages of economic networks, the general consensus is that they provide inter-firm co-ordination coupled with flexibility; they guarantee the effective and reliable exchange of strategic information with the network with little investment and resources from each member of the network; they minimise the risks associated with the development of resource intensive technologies and market entry; and they allow for the pooling of human resources in high demand, high skill areas (Dunning et al., 1998). While the above paragraph emphasises on the positive aspects, networks also have disadvantages. We are to discuss the disadvantages in the later part of this subsection.

Networks are lighter on their feet than hierarchies (Powell, 1989). In network modes of resource allocation, transactions occur neither through discrete exchanges nor by administrative fiat, but through networks of individuals engaged in reciprocal, preferential, mutually supportive actions. Networks can be complex: they involve neither the explicit criteria of the market, nor the familiar paternalism of the hierarchy. A basic assumption of network relationships is that one party is dependent upon resources. In essence the parties to a network agree to forge an agreement that aims at sharing the resources.

Table 4.2 Managerial representation about the importance of networks

| Importance of | | Emphasis on joint creation | |
|---------------|------|--|--|
| | | Low | High |
| Structural | Low | Social networks | Value creating networks (<i>Hybrids</i>) |
| Autonomy | High | Market based transaction (<i>Market</i>) | Vertical integration (<i>hierarchy</i>) |

(Source: Campbell and Wilson, in Iacobucci, 1996, p. 129)

Network relationships comprise both personal and organisational relationships (see also our definition in chapter one). Personal networks consist of relations between pairs of individuals, whereas the actors in interorganizational networks are autonomous organisations with their own organisation goals. Formal co-operations between organisations quite often result from previously established networks of personal, informal relations (Hakansson et al., 1988). Consequently, the decision by firms to enter into a network relationship with other firms is influenced by management's willingness to abdicate autonomy in order to acquire resources from the external environment. Campbell and Wilson (1996) postulate two dimensions along which managerial representations of networks can vary. The first dimension describes whether managers emphasise their own internal value-creation capabilities and performance, or look for external linkages to reinforce their own internal capabilities. The second dimension describes the importance to the firm to preserve its structural autonomy within its set of relationships. According to Campbell and Wilson the combination of these two dimensions yields four types of representations: (1) social networks (2) market based transactions, (3) vertical integration and (4) value creating networks. Each reflects the influence of managers' decision on firm's choice of strategy.

Market based transactions and vertical integration (hierarchy) in view of the transaction cost theory have been discussed in the previous Sections of this chapter. Here we will have a bird's eye view on the two concepts in relation to the network theory. Although Campbell and Wilson put the firm's decision to enter into networks as a function of its management's willingness to abdicate autonomy in order to acquire resources from the external environment, implicitly the two dimensions (structural autonomy and emphasis on joint creation) take the transaction cost into consideration. The manager's decision is often influenced by cost considerations. However the two theories use different dimensions to drive their conclusions.

Market-Based Transactions are observed in firms that have a low emphasis on joint value creation and attach high importance to maintaining their own autonomy (Campbell and Wilson, 1996). These firms pay little attention to the network of relationships in which they are embedded. Although it is possible for firms to conduct repeated transactions over time with the same buyers and suppliers, these relationships are conducted with high emphasis on price competitiveness. These firms depend on the market mechanism to regulate their relationship with outside firms. However, firms that recognise the potential for joint value creation but attach considerable importance to preserving their own independence are likely to vertically integrate to maintain control of the value creation process. In this classification

vertical integration represents a traditional approach to capturing value by acquiring increased control in the value chain.

Lungren, (1995) defines social networks as a social system of interconnected relationships. Organisations recognise the value of having relationships in which individuals are spontaneously motivated to go beyond prescribed roles and perform above and beyond the call of duty. The sociological approach to networks refutes an old school of economic development and modernisation, associated with Parsons, that the embeddedness of economic action in non-economic relations is a barrier to economic development (Granovetter, 1990). The social embeddedness of economic exchange as mentioned by Granovetter (1985) implies that individuals may have an effective attachment to each other for its own sake. In a socially developed network, firms act for the benefit of each other because of the loyalty and involvement developed through friendship and strong personal ties. Socially developed networks provide the basis for parties to develop confidence in the stability of their relationships.

Value creating networks describe the purposeful co-operation between independent firms along a value-added chain to create strategic advantage for the entire group (Campbell and Wilson, 1996). Firms with this orientation recognise the potential for synergy in developing capabilities that reinforce rather than minimise their dependence on outside firms and create value to the customer. The key concept that derives value-creating networks is the delivery of superior customer value (Ibid.). Value creation can be seen as the dual of transaction and production cost minimisation. Accordingly, value creation, refers to the process by which the capabilities of the partners are combined so that the competitive advantage of either the network or one or more of the partners is improved. Thus value creation is a joint effect that occurs after the network is formed. Basic for the relevance of networks, in an economic sense, is that each participant acquires more than it puts into the network. The network must be more efficient than, or at least as efficient as, alternative organisational forms in the market. It must create value added greater in sum than when each of the participants operates on its own and it must deal with the division of costs and profits among the participants (Beije and Groenewegen, 1992).

While the total pattern of business networks appears relatively stable, new relationships develop and old decays overtime and, above all, the existing relationships between companies' change in content and strength (Hakansson and Snehota, 1995). However, the major task of management is to decide on how to assess and interpret the change, whether the company is to observe or promote change, and how to handle for its own advantage. Whether a company is striving to stabilise a certain situation or attempting to change it, the outcome of its efforts will depend on how its counterparts react and adjust. While the perceptions and interpretations of the individuals differ they are developed in some kind of common ground of shared understanding, or else the co-ordination of activities and mobilisation of resources would not be possible. Changes in network relationship could also be a source of conflict.

Ford et al. (1986) mentioned that conflict among the cooperating parties may arise from absence of mutuality because of changes in the objectives of either party or because of the processes of exchange are not being managed to the satisfaction of one or both parties (Easton, 1997). As a result, Ahor (1991) indicated that new organisations have to establish an alternative to litigation, arbitration, and bargaining/negotiation for adjudicating disputes without subjecting parties to adversarial positions. They will need to evolve quasi-judicial system within the firm. Gulati et al (2000), call the quasi-judicial system "tie modality"

which refers to the set of institutionalised rules and norms that govern appropriate behaviour in the network. While these are sometimes spelled out in formal contracts most often they are simply understandings that evolve within the dyad and the network.

The network theory is conceptually rich and its attention to the details makes it relatively strong with respect to the empirical picture it paints of the relationships between the actors in the market. However being empirically strong the weakness of the network theory is its lack of ability to provide normative implications for managerial actions (Belenker et al., 1997). Norms are legitimate commonly shared guidelines to accepted and expected behaviour (Birenbaum and Sagarin, 1976). Compared to other forms of research and analysis, the development of normative theories of networks has been relatively neglected. Normative issues have been addressed to some extent from the perspective of the individual actor in the network: relationship development and management, investments in relationships, and managing a firm' position in a network (Contractor and Lorange, 1988; Hakansson and Snehota, 1989). However, the move to consider networks as specific organisational forms raises the possibility of formulating normative models for handling different business issues in the context of business networks (Hakansson, 1997). Moreover although the structural approaches describe the network structure and its impact on actors rather well, given the patterns of relationships with actors with certain attributes they do not explain how this structure and the nature of the attributes come into being (Kamann, 1998).

The network theory has also been criticised that management in network structures lacks the close control of manufacturing operations. Furthermore, innovations under the direction of management in another organisation are difficult to control and considered susceptible to being ripped off (Robbins, 1990).

In this study the network theory will be used to design a network relationship among the footwear and textile manufacturers, suppliers and buyers in Eritrea, the Netherlands and Uganda. To design the network structure we will draw a map of relationships and ultimately the type of network organisation that fits to our purpose. Moreover as argued by Gulati et al. (2000), the footwear and textile manufacturers, suppliers and buyers have to develop institutionalised rules and norms that govern appropriate behaviour in the network. Consequently, our study takes the contract enforcement institutions as a critical variable in the network development process. For detailed discussion on this variable the reader is referred to chapter five.

4.3 Summary of theories of inter-organisational co-operation

Through the four theories we have reviewed in this chapter we observed that inter-organizational relationships are important for developing the capabilities of the co-operating parties and for the possibility to achieve a better performance. To summarise the orientation and contributions of the four theories of inter-organizational co-operation we will use the following dimensions⁶: (1) key assumptions of the perspective, (2) key research questions; (3) reasons why linkages were created (4) basic assumptions; (5) primary unit of analysis;

⁶ Auster (1994) used five out of the eight dimensions

Table 4.3 Summary of theories of inter-organizational co-operation

| Dimensions for Comparison | Transaction cost theory | Resource dependence theory | Network theory | Strategic management theory |
|---------------------------------|--|---|--|--|
| Key assumptions derived by | <ul style="list-style-type: none"> -Industrial organisation -Sociology -Economics | <ul style="list-style-type: none"> -Organizational sociology -Political science -Management science | <ul style="list-style-type: none"> -Organisational sociology -Anthropology -Management science | <ul style="list-style-type: none"> -Industrial organization -Management theory |
| Key questions | <ul style="list-style-type: none"> -How do characteristics such as asset specificity, uncertainty, and frequency affect the transaction costs associated with engaging in different forms of inter-organizational linkages? | <ul style="list-style-type: none"> -How does the formation of inter-organizational linkages help an organisation acquire resources and manage uncertainty? | <ul style="list-style-type: none"> -What are the interplay's relationships between activity, resource and actor layers in business relationships, and how do network firms interact and adapt to changes? | <ul style="list-style-type: none"> -What are the competitive benefits of creating alliances? |
| Reason why linkages are created | <ul style="list-style-type: none"> -To reduce transaction costs | <ul style="list-style-type: none"> -Maximise power to obtain resources and manage uncertainty | <ul style="list-style-type: none"> -Resource and knowledge acquisition motivated by social relationship, effectiveness and efficiency | <ul style="list-style-type: none"> -To maximise profit and improve strategic posture (Competitive advantage). -Access to competencies and or capabilities -Knowledge acquisition and learning |
| Basic assumptions | <ul style="list-style-type: none"> -Bounded rationality -Opportunistic behaviour | <ul style="list-style-type: none"> - No organisation is self contained -The primary goal of organisations is to maximise power -The Environments of an organisation is uncertain | <ul style="list-style-type: none"> -Transactions are embedded within networks of social relationships -One party is dependent on resources controlled by another | <ul style="list-style-type: none"> -Systematic and stable differences across firms exist in the extent to which they control resources and influence strategic behaviour -Differences in firms resource endowments cause performance differences -Firms seek to maximise their economic performance |

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| Dimensions for comparison | Transaction cost theory | Resource dependence theory | Network theory | Strategic management theory |
|----------------------------------|--|--|--|--|
| Unit of Analysis | -Transaction | -Inter-organizational linkage -Interdependencies | -Network | -A dyadic relationship |
| Examples of relevant literature | -Coase (1937) -Williamson (1975, 1980) | -Pfeffer and Salancik (1978) | -Burt (1980) -Nohria ((1992) -Johansson (1986) | -Porter (1980, 1985) -Rumelet (1974) -Wernefelt (1984) -Mahoney (1992) -Hamel and Prahalad (1990) |
| Main contribution | -Answers the fundamental question why firms exist. -Opened a new approach for organisation theorists -Useful in choosing a governance structure for a specific transaction. -Introduced hybrid relationships as a governance structure for specific type of transactions | -Resources are important in determining firms behaviour -Shows the importance of dependence and its consequences. | -Has broader unit of analysis -Useful in designing and analysing network relationships - A tool for managing relationships | - Infused strategy into economics and realised a greater coherence in the strategy field -Shows how cooperation leads to competitive advantage |
| Main criticisms | -Focuses on cost minimisation -It neglects the role of social relationships in economic transactions. -Individuals may not always behave opportunistically even if conditions permit such behaviour - Learning and experience with a particular exchange partner can reduce the need for more governance mechanisms in subsequent transactions. | -Neglects co-operative ties with actors one have no direct dependence. -Neglects the influence of bargaining power | -Normative theories of networks have been neglected -Ambiguity in the concept used -Difficult in setting the boundaries of the network | -There is often more heterogeneity in the performance of firms within a single industry than there is heterogeneity in the performance of firms across industries. -Socially organised relations are not considered as important and are often interpreted as collusion reducing the level of competition |

(Source: Extracted from the literature)

(6) examples of relevant literature, (7) main contribution, and (8) main criticisms. The aforementioned dimensions are useful to identify the similarity and differences among the theories. Table 4.1 provides a comparison of the four views. The first impression from the literature review is that the different perspectives tend to use different concepts and this leads to confusion. Commonly used labels such as coalitions, strategic alliances, collaborative agreements, industrial co-operation, and co-operation can be misleading because all the terms focus on partners working together toward mutually shared goals. This implies, there is a need for conceptual clarity and rigorous operational definitions, and movement toward consistency across perspectives.

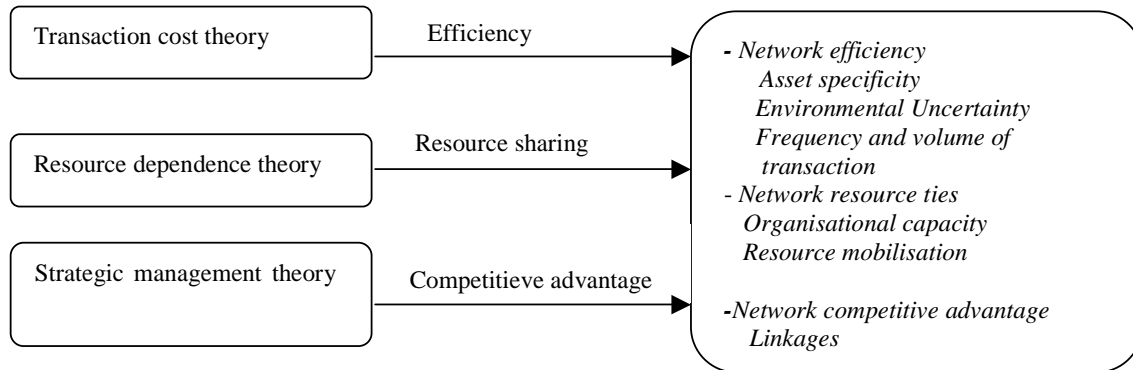
The literature review shows some of the theories that address co-operative relationships but the explanation why firms are entering into such a relationship seems to vary. Besides, the unit of analysis varies across the theories. While the transaction cost theory focuses on a specific transaction, the network theory focuses on the whole population in the network. According to the network theory, any relationship has to be analysed in relation to the whole set of relationships in which each partner is engaged. This variation in the unit of analysis creates limitations to the comparison between the findings from the different theories of inter-organisational co-operation. Another observation is that although the network theory assumes the past relationships are important in networks little attention has been devoted to a more longitudinal, dynamic, evolutionary view of inter-organisational relationships.

Longitudinal analysis is useful to understand, the evolution of inter-organisational linkages, history of the principal actors, the internal and external forces that derive them into linkages, and to explore the history of past relationships. There is a need to extend the time frame of analysis. Although most of the perspectives focus on dyad relationships, networks are important in broadening the unit of analysis. Networks define all relationships in a system and expand the unit of analysis even further. This has a reorienting effect on inter-organisational study. However, setting the boundaries of the system is critical for analysis and has to be properly defined. It can be defined by the researcher (normative approach) or socially constructed by those involved (realist approach) (Laumann et al., 1983; Welch et al., 1996). In Networks internal dispute resolution mechanism is preferred and the variable availability of contract enforcing institutions is one of the factors that influence the level uncertainty in the exchange process.

4.4. Conclusion and implications to the empirical research project

Although the theories that have been discussed above adopt different perspectives all are useful to our study. Each perspective has virtues. In our proposition, stated in chapter one, we explained that the footwear and textile-manufacturing firms in Eritrea could not embark export marketing operations individually because they have lack of knowledge, skilled human power, and financial resources. The resource dependence theory is useful to explain how Eritrean footwear and textile manufactures could acquire these scarce resources. Besides, the transaction cost theory helps us to identify the efficient type of governance structure to coordinate exchange between firms. The network theory is also useful for understanding the history of inter-organizational co-operation of the potential partners and to identify and design the future relationships. The inter-organizational network is viewed as a strategic mechanism to improve a firm's competitive advantage through cost minimisation while maintaining flexibility. Finally, the strategic management approach is useful to understand the internal and external factors that shape the co-operative strategy and increase the firms competitive advantage.

Figure 4.1 Nurturing network theory: drivers of co-operation



From the literature review in chapter three, we learned that firms, governments and international organisations often use the network approach to encounter export problems. Besides the benefits from the network approach also comprise the benefits that could be derived from the resource dependence theory, transaction cost theory and the strategic management theory. Thus we conclude that firms develop and participate in networks for transaction cost motives, resource dependence and strategic considerations (Figure, 4.1). This implies that we can borrow some concepts from the three theories to design a business network relationship among the cotton, and leather suppliers, footwear and textile manufacturers and buyers. This argument is consistent with Araujo's (1989) argument that network theory is not only built on the interaction model, but is also integrated with organisational and interorganizational theories. Therefore attempting to enrich the discussion of the nature of network relationships, it is important to integrate the ideas and relevant findings of the various theoretical streams that elaborate the specific nature of inter-organisational relationships.

Figure 4.1 is in line with Miles and Snow (1994) argument that networks are established to acquire efficiency from the functionally structured defender firm, flexibility and responsiveness from the prospector firm and ability to shift resources laterally from the analyser firm. The important aspect of business network relationships is the change and improvement in resource use, in the scope of activities and in the knowledge and capacity of actors. According to the Network approach relationships can compete to deliver value there by creating a competitive advantage for its members. The distinguishing features of these value-creating networks are a priori value vision and the use of integrative relationships to accomplish the goals of the network. The analysis suggests that the distinctive capabilities within the network create value for the final customer: trust and co-operation are not enough. We need to identify the value creation abilities of networks and determine what capabilities are required to develop purposeful value creating networks. Basic for the relevance of networks, in an economic sense is that each participant acquires more than it puts into the network. The network must be more efficient than, or at least as efficient as, alternative organisational forms in the market. Finally, although it has been emphasised that network members should contribute complementary resources, partners could also contribute similar resources to realise economies of scale and scope. In this view, companies are better off by acting in combination than separately.

