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Int. J. Production Economics 79 (2002) 1–14

international journal of
**production
economics**

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Filling a gap in traditional transaction cost economics: Towards transaction benefits-based analysis

K. Blomqvist^a, K. Kyläheiko^b, V.-M. Virolainen^{b,*}

^aTelecom Business Research Center, Lappeenranta University of Technology, P.O. Box 20, FIN- 53851 Lappeenranta, Finland

^bDepartment of Business Administration, Lappeenranta University of Technology, P.O. Box 20, FIN-53851 Lappeenranta, Finland

Received 12 April 2000; accepted 10 August 2000

Abstract

This paper analyzes dyadic partnership formation between asymmetric buyers and specialized suppliers. In the first part of the paper different economics of organization-based approaches are evaluated. Their basic implications concerning the rise of partnerships are derived. In the second part a dynamized transaction cost and benefit model is introduced to analyze the most critical elements of a typical partnership decision. The final part is based on insights from practice and in-depth interviews among 12 specialized suppliers and their four large incumbent partners in the Information and Telecommunications Industry. © 2002 Elsevier Science B.V. All rights reserved.

Keywords: Transaction costs and benefits; Theory of the firm; Partnership; Supply management; Trust

1. Posing the issue

According to the founders of transaction cost economics (TCE), Coase [1] and Williamson [2], markets and vertical integration (or hierarchies) are the two main governance structures, out of which a firm may choose the most efficient one. Coase did not even mention the intermediate governance structure between markets and hierarchies, called *hybrid* by Williamson. We call these hybrid governance structures *partnerships* and interpret them as individual contracts between

parties. The aim of the contract is, of course, to create the joint surplus through cooperation and share it in a way, which benefits both (all) the parties.

Rapid changes in business environments are increasingly driving the formation of strategic partnerships between companies in the world economy. Different types of partnerships are a logical and timely response to intense and rapid changes in economic activities, technologies, and globalization of world markets [3]. *Partnerships* have gained much theoretical interest in strategic literature during the last 10 years. Despite the fact that Coase skipped them altogether modern economics of organization-related approaches have managed to shed light on some factors behind the rise of partnership-based governance structures. A recent stream of resource-based view, the knowledge-based view, [4–6] analyzes organizational

* Corresponding author. Tel.: + 358-5-6212612; fax: + 358-5-621-2699.

E-mail addresses: kirsimarja.blomqvist@lut.fi (K. Blomqvist), kalevi.kylaheiko@lut.fi (K. Kyläheiko), veli-matti.virolainen@lut.fi (V.M. Virolainen).

Table 1
Typology of different explanations of inter-firm partnerships [14,17]

Focus	Temporal dimension	
	Static	Dynamic
Production & Cognition-based- > <i>Transaction & management benefits</i>	A: Resource-based view based on static capabilities and given cognitive frames [15,38] added with [18] innovation-related transaction costs	B: Dynamic capability view based on learning and changing cognitive frames [8,5]
Exchange-based- > <i>Transaction & managements costs</i>	C: Static Coasean [1] & Williamsonian [19] transaction cost economics	D: Dynamic transaction cost economics (embryos launched by [20,9,39])

capabilities and knowledge as a source for competitive advantage. The key organizational issue is whether to develop the needed competencies, capabilities and knowledge internally or whether it is rational to exploit and integrate external knowledge. Knowledge-based competition leads us to the classic questions of the modern theories of the firm concerning the crucial role of organizational boundaries. Unfortunately, these explanations are typically *static* and focused primarily on *cost-based* comparisons. Our contribution to this discussion will be the explication of the main sources of the governance benefits, which can be obtained through different kinds of inter-firm contractual arrangements.

2. On partnership explanations

We start with a survey of some theoretical results obtained so far in economics-based literature. The rise of partnerships has been studied at least from two different angles. The first one can be characterized as the *economics of organization-inspired contractual or governance approach*, which in its explanations emphasizes either the Coasean transaction costs or the ownership of non-contractible assets (i.e. the *property rights school* introduced by Grossman and Hart [7]). The alternative, more evolutionarily inspired perspective is based on the *dynamic capability or knowledge-based approach* [8,9], which, in turn, emphasizes the role of firm-specific, rare, and hard-to-imitate routines, capabilities, learning and socially embedded tacit

knowledge when creating and sustaining joint surpluses through partnerships.

For those who want to get acquainted well with the basic premises and differences between these two approaches there are many quite recent meta-theoretical comparisons available (cf. [10–12]). Here we would like to pick up only one important position which arised from recent discussions, the *integrationistic* metatheoretical point of view strongly propagated by Foss [11] (cf. also [13]). According to this view, both the seemingly rival approaches can (should) be interpreted as the complements but not as substitutes. This view that we share has important implications as to the analysis of inter-firm arrangements.

Following the *integrationist research strategy* we take seriously some parts of the knowledge-based criticism of the proponents of the dynamic capability view (e.g. [14–16]). To put it simply, these critics maintain that the governance approach at least partly neglects the *production and cognition-related* issues, such as genuinely bounded rationality and imperfect and disperse knowledge of agents, collective tacit know-how, radical uncertainty, and overemphasizes the *exchange-related* issues, such as market (in)efficiency and incentives. We interpret the tone of this critical message so that the gap between production and exchange has to be bridged by launching some additional explanatory items into the standard TCE framework.

Table 1 outlines the main differences between the two main approaches mentioned above from the *explanatory* point of view. This typology is based on

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