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Multiple-Tie Networks, Structural Dependence, and Path-Dependency: Another Look at Hybrid Forms of Governance

Comment

by

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At least since Max Weber, we know that for purposes of bringing out essential features, it may be useful to construct contrasting ideal types. The market-hierarchy distinction of transaction cost economics is such an ideal-typical contrasting of organizational form. With all the advantages of concentrating on these pure types, there was the disadvantage of neglecting what was in between. This gap was discovered and closed by suggestions of discrete “hybrid” forms in between markets and hierarchies (WILLIAMSON [1993]). Whereas this development is a logical consequence of expanding the dichotomy and although it has generated useful insights, it also has its drawback in that it has fostered what one may call the cocktail approach to organizational study. Analyses concentrate mostly on detecting mixtures of market and hierarchy aspects (“less asset specificity than would be compatible with hierarchies, more asset specificity than would be compatible with markets” etc.). Since there are no precise break-points, the cocktail approach is often strongly *post hoc* and, more importantly, it often does not deal with the features that are most specific to the mix of contracting arrangements.

More recently, it has been suggested that the space between markets and hierarchies should have center stage attention rather than be relegated to the muddy intersection of the pure forms. The reason for this attention is the conviction that new forms of contracting develop in that space between markets and hierarchies, variously called “networks” (THORELLI [1986], POWELL [1990]) or “symbiotic contracts” (SCHANZE [1991]). Empirical studies and new theoretical leads on these phenomena are really just rolling in. MENARD’s [1996] study of the French Poultry Industry is a prominent example of this new kind of endeavor. What does it have to offer?

Menard’s study concentrates on a particular part of the French Poultry Industry, viz. the certified or LABEL chicken which must meet high quality standards. There are a number of outstanding features of this study. First of all, Menard finds different governance structures in the certified chicken industry

that function side by side and are equally efficient (p. 169). This is odd considering the market/hierarchy theory of hybrids. In theory, there can be different forms but the "right" one should have efficiency advantages. Not so, says Menard. Why, then, should there be different kinds of governance structures (integrated and hybrid) side by side and why are there no efficiency differences? Second, Menard finds most standard transaction cost conditions for hybrid forms violated. Bounded rationality does not play much of a role because there is a stabilized technology in a stable environment with continuously increasing demand. Opportunism itself is strongly constrained by observability. There is high frequency of transactions and little uncertainty. Also the usual kinds of asset specificity (regarding physical and dedicated assets, and site specificity) are virtually missing (pp. 173f.).

What is the explanation for the fact that there are integrated and hybrid forms side by side? How can the hybrid form be explained when the theoretical conditions for its existence are not satisfied? Unfortunately, Menard does not offer an answer to the first question. But for the second, he does provide an explanation. He discovered some asset specificities after all. There is the "brand name capital" (p. 174) which signals not just quality but also specified breed requirements, particular conditions of production, area of production etc. There is also temporal specificity (p. 174), which derives from the fact that the LABEL regulates freshness which pushes the market kind of coordination in the direction of integrated coordination. This coordination takes place in the institutional context of government licensing and it is based not on property rights and hierarchical fiat but on a consensual delegation of authority among the contractual partners to make binding decisions. He concludes "that the LABEL system is *neither a cartel, nor a . . . subcontracting arrangement*, but rather a *tightly coordinated network*" (p. 177).

Menard's analysis does break new ground and it provides a fine example of complex contracting. However, his analysis is still so strongly guided by the market/hierarchy distinction that he cannot really offer something new. For example, the three different governance structures he found could not be interpreted in the transaction cost mold. As a consequence, he does not address the question. Instead, he seems to be glad to have found some asset specificity to bring the analysis back into the fold, but the paper does not contain any hint how the temporal specificity induced by LABEL regulations would produce the forms observed. His point on governance by consensus seems potentially interesting, but there is little analysis how this delegation of authority works, nor is there any recognition that only one part of the overall structure has to do with governance by consensus. Finally, the label "network" adds fashionable cache but little analytical advance.

1. Structural Advantage and the Contracting Game

My suggestions would be to avoid three knee jerk tendencies in the analysis of hybrid forms. First, whereas the term “network” suggests homogeneity of relation among the partners, exactly the opposite should be assumed: that relations among contractual partners are different in kind. Some may be asymmetrical (as required by definition for symbiotic arrangements), some may be symmetric. Some may be short-term, some long-term, etc. It is better to search explicitly for multiple-tie network. Second, asset specificity is but one influence on governance. Another important determinant is structural advantage. Third, the empirical analysis of governance structures should not only concentrate on a checklist for the occurrence of hybrid forms but always also consider effects of path-dependency on governance structure.

In order to get a flavor of what could be done with these suggestions let us go back to the French Poultry Industry. Leaning roughly on the hints provided by Menard himself, and without any claim to accuracy, one can come up with a scenario of path-dependent developments that sheds very different light on the matter. First of all we have to turn to the question: who are the major players in the contracting game?

Menard identifies the growers as “a master piece of the system” (p. 169), suggesting that they are the most important player. He supports this claim by two arguments: there are about 50 times as many growers as there are food providers and processing plants and the significant variation in productivity comes from the growing phase. Because of this prominent role of growers, he subsequently concentrates on their contracts. Why would the growers be the major player? Is it because they are so numerous? Would one not assume the opposite? And why would the variation in productivity say something about the growers’ importance as players in the contractual game? Later in the paper (p. 176), Menard identifies the “Certifying Organization” as the “pivotal force” in the LABEL system because it implements contracts, selects participants, monitors them and largely controls adjustment of quantities and price. In this organization, representatives of all kinds of firms in the industry are involved, so that this organization cannot be the same as “the growers.” This time, the reason’s given for the identification of the major player is different: it is the seemingly prominent activity. However, since the Certifying Organization has been identified by Menard himself as an organization that has only delegated authority, that depends completely on the voluntary compliance of the parties, what bite does it have as major player and what interests does it represent? There seems to be little theoretical reason in Menard’s own terms for selecting either growers or the Certifying Organization as the major player. It would probably be better to look at the structural relations between the players to see what is going on.

Imagine for the sake of argument that there was no LABEL system and that growers were operating independently. There would be a multitude of growers

(many of them small) confronted with a limited number of incubators, food providers, equipment suppliers, processing plants and distributors. Let us look at the different relationships. Given that there are no specific technologies involved and the market itself is not volatile, the relationship between the different groups of actors will be driven by considerations of *structural advantage*, specifically by three factors: *number, size, and damage potential*.¹ The basic idea is that some of the profit in an industry is distributed according to structural advantages of players vis-a-vis their contract partners. What are the circumstances favoring a group in contract negotiation vis-a-vis another group? Theory and evidence of structural effects on negotiation suggests negotiation advantages to the group that (i) is less numerous than the group of contract partners, (ii) contains larger units than the group of contract partners, and (iii) whose units experience less damage by failure to reach an agreement than the units in the group of contract partners. The growers are relatively very numerous (Menard (p. 169) states the 1992 numbers as 6,368 growers in the LABEL system confronting 57 incubators, 117 food providers and 125 processing plants). This asymmetry in numbers is enhanced by the fact that production is regionally concentrated. By and large the growers are also relatively small production units. They have supply partners and customers. Let us first look at the supply side. The incubators are fewer and have thus an advantage vis-a-vis the growers, but their product is so highly time-constrained that they would experience much damage should contract negotiations fail or substantially delay. This limits their negotiation advantage again. Similar to incubators, food suppliers have a small number advantage vis-a-vis the growers but unlike the incubators, they are less threatened by negotiation failure or delay. Equipment suppliers are in a position similar to food suppliers but since growers need equipment renewal much less frequently than they need food supply for their chicks, food suppliers will be the central player on the supply side.

On the customers' side of the growers, there are processing plants and distributors. Distributors have a numbers, size and damage potential advantage vis-a-vis the growers. They are organized into chains and do not just sell chicken. They are thus fewer, bigger and much less affected by negotiation failure. However, distributors are overwhelmed by the number of (similar) contracts with independent growers. They would favor a few contract partners. The price for this strategy is the reduction in the numbers advantage but there is a considerable saving in negotiation costs and they do not lose the damage

¹ Considering that by "numerous" I mean the number of unconnected units in a group, these conditions roughly cover the flip side of what Burt has called "constraint" (see BURT [1992], [1993]). Burt's work, partially inspired by network exchange theory (see MARKOVSKY, WILLER and PATTON [1988]), concentrates on the embedding of transactions in a corporate hierarchy (i.e. on vertical integration) where market transactions are very constrained. Although the argument I make here is quite different, since I deal with vertical integration of the *unconstrained* actors and with hybrid forms, it is nonetheless strongly inspired by the kind of analyses Burt makes of business transactions.

potential advantage. There are two possibilities: either the distributors encourage the growers to organize themselves into a union or they cut out the growers and only deal with the processing plants. Either way, the distributors would keep a strong damage potential advantage because their total product basket is so much more varied than that of the processing plant or the union of growers. Since the processing plants are already there, whereas the growers' union would still have to be formed, distributors are likely to deal with processing plants only. That leaves processing plants as the only customers for the growers.

Vis-a-vis the growers, the processing plants have a clear advantage on two fronts: numbers and size, and maybe a small advantage with regard to damage potential. They are thus a major player. Since they control access to the distributors, they should be in a slightly stronger position than the major player on the supply side (the food suppliers). Menard had pointed to two different players as being the central ones (the growers and the Certifying Organization) for reasons unrelated to the contracting game. Interestingly enough, when he describes the complex web of contracts (p. 175) he states that there is an explicit hierarchy of contracts with a clearly identified prime contractor (similar to the situation in the construction industry). In the French Poultry Industry, he states, this prime contractor is most of the time a processing plant. This confirms the interpretation offered here.

We now have a three-actor chain with a relatively strong supply side player, a relatively weak group of growers in the middle, and a relatively very strong customer player. Still, both major players at either end have a problem. They have to deal with a large number of small contract units. Unlike the distributors, they would lose a great deal of their advantage if they gave up the numbers and size advantage vis-a-vis the growers, by encouraging formation of a growers union or cooperative. What can they do? *They could keep the negotiation advantage vis-a-vis the unified growers if they linked up or even integrated.* Then the growers would be boxed in from either side, and the contracts would basically be a putting out system in which an integrated firm would supply the chicks from the incubators, supply food an equipment and process the grown chicken. That firm would also contract with the distributors. Observe that the vertical integration here is not an answer to the standard situation. Here, the integration or semi-integration is meant to preserve the negotiation advantage *after* transaction concerns would favor giving up the advantage of numbers and size. Menard himself observes (p. 168) that the (semi-)integrated firm ARRIVEE had encouraged the organization of growers into a union. Clearly then, the firm's integration was not a response to the growers' union.

If it was an easy matter to get the independent growers together, these growers would have combined long ago and recaptured the rent left in negotiations to the central players. Since this did not happen long ago, it is clearly not easy to organize the French poultry growers. How did ARRIVEE get the union to come into existence? Seemingly, they enticed the growers by letting their

union buy into the firm (with one third of the firm's capital). This is an incentive to form a union and it provides interest alignment by creating an interest of the union in the profitability of the integrated firm.

We now have the original situation with independent players and a later situation, in which food suppliers and processing plants are (semi-)integrated and also deal with incubators, and in which growers have formed a union. So far, we have not even introduced the extra complication brought in by the creation of a certified chicken.

What developments could have produced still other forms of governance? Let us consider the following "fictional" scenario. It does not pretend to retell blow by blow what really happened but it pretends to bring out possible path-dependencies that show how there can be different structures side by side *without* each having an *independent* cause. Some time in the past, when many growers were still independent, some growers analyzed this situation and concluded that they could control prices better by coordinating against the major players. But since it is not easy to organize the French poultry growers, they had to think of a special trick to get this organization off the ground. Their plan was to reinforce a growing public sentiment against "battery-reared chicken" by suggesting a LABEL plan for quality controlled chicken in analogy to a pattern that was well known in France: quality controlled wine. They formed a small union of growers. The government responded positively and the LABEL plan came into existence. However, the success was very limited because the grip the integrated firms had on the contractual arrangements was too strong and the public response too limited.

Things changed only after the public outcry about factory-reared chickens became so strong that supermarkets decided to try LABEL chicken, which, in turn, got some integrated firms to adopt the LABEL system and make arrangements with supermarkets as distributors. The system began to work and the market began to grow so fast that the integrated firms lost some of their damage potential advantage vis-a-vis the growers. As a consequence, the small existing LABEL system with a growers' union expanded as well. The committee running the union took itself initiative in setting up contracts with distributors, food providers, and processing plants. It had to pry incubators and food suppliers away from the integrated firms and it did so by offering incubators a longer term contract (three years instead of one year that is standard in the industry) and by offering certain food suppliers similarly three year contracts and special access to growers (by forcing growers to buy only from these suppliers) in exchange for price ceilings. Notice that the kinds of contracts with suppliers are means of getting them away from other partners rather than any specific symbiotic arrangements. The position of the processing plants was considerably weakened by the fact that the union negotiated directly with distributors. All this was initially helped by the fact that the union also played an important role in the organization that certified the chicken (something that changed later to an independent authority). In Menard's account, this form of

governance was represented by the union LOUE with its efficient committee CAFEL (p. 167). For the individual grower, the change to LOUE and CAFEL was mainly symbolic because instead of having to buy chicks, food and equipment from the integrated firm, he is now required to buy these from his own union committee. Still, this symbolic advantage does create the basis of a solidaristic kind of governance *within* the union, a form stressed by Menard (p. 176) as a very special form of authority, and well worth getting more attention in the overall story.

The growth of the LABEL-chicken market also attracted new entrants. They copied what they saw has worked. That is to say they (semi-)integrated, at least with regard to processing and food supply. But new entrants had to think of something special to pry growers away from the two already existing arrangements. There are not so many possibilities left. What they could do is to offer the growers much more say in the (semi-)integrated firm. They pried individual growers loose by offering them individually co-ownership in this firm. This gives an incentive to the individual grower and allows the firm a uniform and renewable deal with its co-owners, at relatively low transaction costs with a loose union of growers (rather than atomized growers or a strong union). In Menard's account (p. 167), this form of governance is exemplified by the cooperative arrangement CANA, a late entry into the industry (end of the Seventies).

Since there are no technological differences involved, and since transaction costs are similarly reduced in all three arrangements, there should be no efficiency advantage of any one of the arrangements. Initially, the profit of the integrated firm should be larger than that found in the decentralized structure. But over time, profit difference should be very small between the three arrangements because they compete with each other and what they offer in order to get the growers into their arrangement largely eats up the profit advantage from the structural position. Thus, after a while the situation stabilizes into the three arrangements, none of which has much to do with the standard uncertainty and flexibility conditions for symbiotic contracts.

The logic of this alternative interpretation is mainly based on looking for differences in structural negotiation advantages where the technology is standard and the market is not volatile. In such a situation, we expect governance structures to arise on the basis of distributional consideration of profit and of strategic consideration for entering a market, in addition to transaction cost considerations that arise from number, size and damage potential. Thus path-dependency will be very important in helping to explain why, say, the contract with incubators is one year in one case and three years in another. Note also that in the analysis offered here there is no "tightly integrated network" of relations. Rather, there are different kinds of ties between the players, each forged by the specific structural condition and the path-dependency effects. First, there are classical contract ties (between integrated firms and incubators, between processing plants and distributors, and between the growers union

committee and suppliers and customers), most of them short-term, some of them longer-term.² Second, there are special ties between the integrated firms and growers. They are putting out contracts (“contrats à façon”) that are short-term, incomplete and that provide a framework for tacit renewal with yearly price adjustments of the “cost-plus” kind. Some of these contracts are with individual growers, some are collective contracts. These ties approximate symbiotic ties but are still different from the standard symbiotic arrangement. Third, there are the ties of the union committee of growers with the growers themselves. These ties are not symbiotic at all, but rather symmetrical and solidaristic (as they would be in any group that shares production and/or consumption, see LINDENBERG [1982]). Due to the competition of arrangements, some integrated firms did offer a kind of solidaristic tie to growers as well, but only after the growers’ union became a viable alternative.

Menard rightly mentions the licensing institutions as playing a part. They probably stabilize the existing arrangements. But judging from our reconstruction, it is doubtful whether they play as important a role as Menard thinks they do.

2. Conclusion

We have learned a lot from transaction cost economics but with regard to certain governance arrangements, it would be better to analyze them in their own right rather than as mixtures of some market and some hierarchy aspects. Menard’s paper on the French Poultry Industry tries to do just that, and he uncovers many interesting aspects that do not fit the standard transaction cost account. However, he cannot quite free himself from forcing the material into a standard mold. Thereby he fails to look at a number of important aspects and he finds no explanation for the simultaneous existence of different governance structures. In an alternative analysis, attention is being drawn to the importance of consideration of structural advantage and path-dependency under conditions of standard technology and non-volatile markets.

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² Really long term contracts seemingly exist only where transaction cost economics would expect them: with very large growers who invested heavily in buildings and equipment. Such contracts guarantee that a minimum of chicken will be bought.

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