THE BUSINESS ORGANIZATION IN ECONOMICS, SOCIOLOGY, AND STRATEGY RESEARCH

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This note addresses three elements: first, Sharon Oster and Harrison White's core arguments concerning their own work in industrial organization economics and economic sociology (Oster, 1982; White, 1981); second, Oster and White's comments about each other's work; and, third, suggestions about understanding strategy as a field distinct from economics and sociology.

OSTER ON OSTER AND WHITE ON WHITE

Oster on Oster

Oster's empirical estimation of strategic groups largely replicates the concept of microeconomic industry at a finer-grained level. Strategic groups in her study consist of firms with similar advertising expenditures within a product-market-based definition of industries. Different strategic groups may arise within an

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industry because firms make different initial choices, owing to different perceptions in the face of uncertain market and technical forecasts. The different choices then lead to varying degrees of lock-in. Some industries are marked by strategic groups that are quite transitory from year to year, but mobility barriers that arise from scale economies in production and advertising-intensive product differentiation in consumer markets in other industries lead to group persistence over time. This is a fine-grained restatement of the Mason-Bain-Scherer formulation of market structure, business conduct, and firm performance, with a key refinement. The largely implicit refinement that the Oster approach provides is that there is a pre-market stage of firm initial conduct in which firms make their initial investments based on projections of future buyer preferences. The initial investments by firms then influence subsequent industry structure, conduct, and performance, especially if the investments involve substantial asset specificity. Put simply, differences among firms arise because of different expectations of consumer markets, while the differences persist if more than one of the expectations are correct and if the initial investments provide substantial advantages in meeting consumer demand. At the same time, though, there will be pressures for convergence toward the strategies of the most profitable firms in an industry, as less profitable incumbents attempt to change their strategies to match more profitable competitors and as industry entrants undertake strategies similar to those of the most profitable firms.

White on White

White offers a subtly different argument concerning firms’ initial choices and evolutions, in which the differences reflect White’s disciplinary view of individual organizations that exist within social structures of many other organizations. Where Oster argues that individual firms invest in accordance with what they expect consumers to value, White argues that firms compare themselves to other firms that operate in what he refers to as “production markets” and then seek positions in which they will minimize competition from the other firms as they operate in consumer product markets. Over time, firms attempt to adjust their positions so as to both meet consumer demands and maintain differences from competitors. So long as there is sufficient differentiation in buyer demands, where the differentiation requires both different goods and services and different ways of producing the goods and services, then differences among firms will persist.

Two principal subtleties arise when comparing Oster and White’s approaches. First, in White’s view, firms explicitly seek social differentiation within networks of firms as well as product differentiation within consumer markets. While this argument might appear to be equivalent to economic game-theoretic predictions in which firms seek to optimize by taking other firms’ expected actions into account, in fact the White argument reflects substantially different assumptions concerning rationality than the game-theoretic approach. Quite simply, firms’
goals and the actions that derive from those goals arise as much from their desire to maintain their independence from other firms as from their desire to sell goods and services to consumers. The second subtle distinction, which is largely implicit in both the White and Oster arguments, arises in the source of initial differences in firms. Where Oster implicitly assumes a potentially clean slate, on which firms could chose to follow the same initial strategies but do not do so because of differing expectations about the value of different strategies, White assumes that firms begin with inherent differences, presumably owing to differing backgrounds of founders and the stocks of assets that they garner to create their businesses, so that different firms would not be able to follow identical initial strategies even if their managers wanted to do so. Therefore, firms' attempts to differentiate themselves from other firms reflect not only their social desires for independence, but also the economic rationale that they must seek to survive and profit in the face of inherent differences among firms. Thus, White's theory offers economies that start with firms and build to markets, in contrast with Oster's economies that start with markets or, at least, expectations of markets, and then build to firms.

**WHITE ON OSTER AND OSTER ON WHITE**

White on Oster

White's critique of Oster has the dominant tone of the emerging field of economic sociology. This is the tone of the challenger, which takes aim at the more entrenched field of economics and seeks to identify and exploit its limitations. White's critique is acerbic, frequently humorous, always taking issue with the underlying theory of the entrenched field of economics, explicitly seeking to deplace the incumbent and replace it with a more institutional view of economic sociology.

White's critique addresses empirical issues and conceptual limits within Oster's work. The empirical critique essentially argues that we must view Oster's results with caution, owing to several types of data limitations. The empirical cautions clearly are apt. Nonetheless, the core result of the study almost certainly would stand in any empirical analysis: in any identifiable industry, we will almost always find persistent differences in strategies and profitability over time, whether we compare industry incumbents and/or entrants. Thus, the key issue is not whether there will be differences among competitors, but why the differences exist and why they persist.

White's conceptual critique raises three focal issues, which he directs as much at industrial organization economics as at Oster's study. First, Oster's microeconomic approach emphasizes decisions as the cognitions of individual decision makers that pay little heed to their interactions with other individuals. Second,
Firm-Level Change

Both Oster and White largely are silent on the mechanisms of firm level change. In the Oster work, as in most economic analyses of industries, it is not clear whether persistence or convergence of strategies occurs because of the decisions of individual firms or whether changes occur primarily through exit of incumbents and entry of industry newcomers. To a lesser degree, the same issue arises in the White work, where it is not clear whether jockeying for differentiated positions within networks of firms primarily involves incumbents adapting to the moves of their competitors or whether adaptation tends to occur more at the population level. Yet, to even begin to understand industry dynamics, in terms of both stability and change, we need to understand business dynamics at the level of the firm.

Now, even casual observation of real business organizations makes it clear that firm level change occurs over time in surviving businesses, but in fashions that are highly constrained and shaped by firm-specific and industry-specific factors. Work that stems from Nelson and Winter's (1982) evolutionary view of economic change suggests firm and industry-level mechanisms, including internal development, discrete resource exchange, alliances, and acquisitions that sometimes allow firms to overcome constraints on change (Capron, Mitchell, & Swaminathan, 1998). The value of this work arises when we consider the seeming stability that Oster notes concerning persistence of strategic groups in the pharmaceutical and soft drink industries. If one views these sectors at the industry level, then it might appear that their has been little change in strategic identity and practice. At the firm level, however, there have been major changes in the identities and strategies of firms in these industries. The core point is that what appears to be stability when viewed at an aggregated level or along single dimensions of strategy actually masks fundamental changes by and within firms. Understanding these changes requires a different conceptualization of business organizations than the conceptualizations that arise from traditional economics and sociology.

The Concept of the Business Organization

Finally, let me turn to the issue of providing a conceptual basis for our understanding of business organizations. Williamson (forthcoming) notes that strategic management researchers have been more willing to talk about differences among firms than to conceptualize the differences and the causal mechanisms that underlie them. If we are to achieve the advances in strategic management that this publication seeks, we will need to provide a generalizable basis for what we mean when we talk of business organizations. Clearly, it is beyond the scope of this commentary to provide a full conceptual basis for the field of strategic management and, for that matter, beyond the ability of this commentator to do so. None-
theless, let me offer a few building blocks that might be useful parts of such an endeavor.

I will outline four factors that draw most closely on research in evolutionary economics and organizational ecology to provide elements of a perspective on business dynamics (Karim & Mitchell, forthcoming, provide greater detail). The four factors include behavioral assumptions, units of analysis, description, and purpose of the firm, and decision criteria.

Within this view of the business dynamics, the core behavioral assumption is that of potential self-interest by individual actors, together with bounded rationality and firm-specific foresight that arises from different firm-specific resources. These behavioral assumptions are consistent with the White and Oster arguments.

The fundamental units of analysis in this view are routines and resources. Routines are identifiable patterns of activity embodied in human or capital assets (Nelson & Winter, 1982). Several routines combine together to create particular resources that are only semi-decomposable into their underlying routines. Firms create new resources by creating new routines and by recombining existing routines in novel ways. In a real sense, routines contain much of the knowledge of what a firm is able to accomplish (Hannan & Freeman, 1989). Routines are often tacit, co-specialized with other routines, and/or embedded in broader organizational contexts. As a result, routines and the resources that they create are often imperfectly tradable among firms.

The existence of routines and resources provides a causal rationale for the strategic groups and networks of organizations that arise in Oster and White’s work. Strategic groups will tend to consist of firms that have developed similar routines or, at least, have developed parallel routines that allow them to achieve similar outcomes. Such convergence of routines will tend to occur if firms compete in similar environments, with similar suppliers and customers, so that their cognitive opportunities to create and recombine routines arise from similar sources. Moreover, the need for firms to function within the context of broader networks of firms and other social organizations arises from the imperfect treatability of resources, because firms often need to ally with or purchase other firms in order to extract value from under-utilized resources the firms’ possess. Use of such resources is central to the firms’ ability to achieve the narrow economic goals of traditional economics and to achieve the more complex set of social goals that arise in economic sociology.

In this approach, the description of the firm and the purpose of the firm involve assumptions concerning the role of the firm in governing resources. One can describe a firm as a governance structure of organizational and interorganizational resources, where governance includes protecting the value of resources, coordinating the use of existing resources, and creating new resources. Governance mechanisms will often be shaped by path dependency and local search, which arise from the tacitness, co-specialization, and organizational embeddedness of routines. In turn, the purpose of the firm has two elements: to govern the
use of current resources, including protecting their value from appropriation by others, and to govern the creation of future resources. A key implication of this approach is that production costs vary endogenously, depending on the nature of a firm’s resources and the effectiveness of the firm’s governance mechanisms. In turn, this outcome gives rise to the persistent differences in firms and industries that Oster and White identify. The protection aspect of governance arises at least implicitly in Oster’s work, and explicitly in the game-theoretic discussions of firms that Oster discusses as extensions of her work. The White approach, meanwhile, provides at least implicit recognition of the role for firm governance as to coordinate and create resources.

Finally, the decision criterion is the best available value of current and future use of routines, by which I mean that a firm will tend to seek the best available mechanisms to govern resources. Owing to firm-specific differences in routines, together with differences in foresight and ambiguity concerning the impact of possible actions, one can expect substantial ongoing variety in firms’ responses to competitive environments. So long as there is any reasonable degree of cross-sectional variation and/or inter-temporal change in market segmentation, regulatory environments, and technology, then firm-level differences will tend to persist indefinitely, again consistent with the outcomes of the Oster and White analyses.

**CONCLUSION**

I will conclude with a brief comment. The business organization is the dominant social organization of our time, with greater impact on individual lives and social outcomes than any other social institution. Despite this centrality to our lives, we have less conceptual understanding of business organizations than we do of markets and individuals. In part, the limited conceptual understanding arises from the persistent idiosyncratic differences that arise among different firms. In part, though, barriers to developing a greater conceptual understanding of business organizations arise because we often try to apply insights that have arisen in studies of other social and economic phenomena to business organizations, without accounting for key differences that arise among the units and levels of analysis. Oster and White’s studies provide critically important insights about the nature of the business organization, usefully applying and extending insights from economics and sociology. As strategy researchers, it is our job to draw on their insights, in a way that reflects and clarifies our core phenomenon of the business organization.

**REFERENCES**


