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.

1. 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 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 organisations that exist within social structures of many other organisations. 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 minimise 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 optimise 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 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.

2. 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 humourous, 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 organisation economics as at Oster’s study. First, Oster’s microeconomic approach emphasises decisions as the cognitions of individual decision makers that pay little heed to their interactions with other individuals. Second, Oster’s approach shares what White views as a critical failing of all microeconomic industrial organisation in ignoring the institutional mechanisms that shape firms’ strategic choices. Third, the dominant microeconomic approach emphasizes decisions by individual firms in isolation of the network of firms in which they function. These high level criticisms of the discipline of microeconomics speak directly to how we need to interpret Oster’s results. The core point is that the study provides only limited understanding of why differences among firms exist and persist. At the centre, White’s argument is that microeconomic theory ignores critical social phenomena that shape what firms do. Or, at the risk of over-statement, White argues that economics doesn’t explain the whole world and is wrong about much of what it thinks it explains.

Oster on White

Where White’s critique of Oster is that of the challenger, Oster’s critique of White reflects the tendency for economics to identify an underlying microeconomic rationale for all phenomena and all studies, no matter what the field. Her tone is measured and thoughtful, resonating with the entrenched leadership position of her established field.

Oster compares the studies on several dimensions, finding both similarities and differences, and, further, notes that recent economic research is exploring the key elements of those dimensions. First, Oster notes that White begins with intrinsically different firms that are aware of each others’ differences, and then allows those differences to lead to differentiated market structures. Second, Oster notes the differences in the causes of different initial choices in the two studies, with Oster’s initial differences arising from differing expectations and White’s from firms’ attempts to maintain differences from each other. Third, Oster notes that both papers explore the relative stability of market structure configurations in different competitive environments and concludes by comparing the degree to which the two studies have projected stable industry configurations. Oster notes that recent economic research concerning strategy, game theory, and network externalities has developed these arguments. Overall, Oster’s implicit core argument is that economics does incorporate social factors, such that the underlying assumptions of the now-traditional field of neoclassical economics can explain most of the important actions that we observe among firms.
3. Strategy on Oster and White

I will conclude by using the White and Oster arguments as a basis for discussing the field of strategy. My starting point is that both White and Oster offer important insights into why differences in strategy exist and persist, but that neither approach is sufficient to explain the differences, either alone or in combination. Instead, we need to develop the field of strategy research as a distinct discipline, rather than simply apply insights from economics and sociology in attempts to explain the phenomenon of business organisation.

Relevant strategy research

I start by considering relevant research that informs the Oster and White work, including strategic group research and research concerning initial conditions. Since Oster’s work in the early 1980s, a substantial body of strategic group research has emerged in strategic management and organisational ecology research. The research in part builds on the same conventions of neoclassical economics as Oster’s work, but also attempts to identify strategic dimensions and causal factors that do not devolve from mainstream economics. Several points emerge from this line of work: there unquestionably are differences on many strategic dimensions among competitors, the differences often persist for many years despite marked differences in profitability, and firm managers often recognise and respond most readily to actions by firms within their strategic groups. Among the most interesting recent approaches in this vein is the work by Margaret Peteraf and Mark Shanley (1997), in which they address the issue of why strategic groups might exist as a cognitive entity. The core point here is that the Peteraf and Shanley work, along with the strategic group research on which it builds, begins to address, dimensionalize, and model the issues of cognition and social setting that White argues are a limitation of traditional economic approaches to strategic group research. Therefore, the work helps us generate a better understanding of why initial differences can persist over long periods.

Now let me turn to the sources of differences in initial conditions, for which the most relevant body of literature arises within the resource-based view of the firm. This work ranges back to Penrose’s (1959) discussions of strategic management and even earlier in institutional sociology and economics. The basic point that is relevant here is that resource-based research provides strong conceptual and empirical evidence concerning intrinsic and persistence differences in the underlying structures and capabilities of firms that compete in similar environments (see Capron, Dussauge, Mitchell 1998 for a review). These differences how firms view the environments in which they operate and shape their ability to respond to what they see in the environments.

When we put these two points together, concerning the conceptual existence of strategic groups and the existence of firm-specific resources, we get a much richer sense of why differences among firms arise and persist than if we attempt to derive the differences primarily from differing economic expectations on the one hand or on jockeying for position in a network of social actors on the other. This work provides elements that can help us develop our understanding of the concept of the business organisation, which I will turn to after addressing the issue of firm-level change.

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 organisations 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 conceptualisation of business organisations than the conceptualisations 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 organisations. Williamson (forthcoming) notes that strategic management researchers have been more willing to talk about differences among firms than to conceptualise 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 generalisable basis for what we mean when we talk of business organisations. 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. Nonetheless, 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 organisational ecology to provide elements of a perspective on business dynamics (Karim and Mitchell, forthcoming, provide greater detail). The four factors include behavioural assumptions, units of analysis, description and purpose of the firm, and decision criteria.

Within this view of the business dynamics, the core behavioural 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 behavioural 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 and 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 and 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 organisations 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 organisations arises from the imperfect tradability 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 organisation is the dominant social organisation 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 organisations 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 organisations arise because we often try to apply insights that have arisen in studies of other social and economic phenomena to business organisations, 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 organisation, 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 organisation.

**Works cited**

White 1981
Oster 1982


