

## **Economic institutions and the reproduction of capital**

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### **Abstract**

The reproduction of capitalism as a socio-economic system entails production and utilisation of various forms of capital - including physical, financial, human, organisational and social capital. Although all these forms have economic value, there is a fundamental difference between the appropriable forms of capital that can be owned, traded and thus disembodied from their social context, and those that are predominantly relational and context-dependent, and can be 'owned' and 'traded' only partially and conditionally. The reproduction of the forms of capital occurs in the context of economic institutions, among which property rights, contracts, firms, markets, as well as forms of inter-firm cooperation are particularly analysed. Rather than being purely instrumental, economic institutions are pervaded by the duality between rights and obligations or constraints. Consequently, sustainable reproduction and enhancement of various forms of capital depend upon the social context that enables the existence and interpretation of such processes. Although this claim particularly pertains to the relational forms of capital, it is also applicable to the appropriable forms as well – especially given the shift towards postindustrial society. By providing conducive social relations, institutions facilitate the ongoing balancing process between production and utilisation of various forms of capital.

*Keywords: economic institutions, capital, property rights, contracts, firms, markets, inter-firm cooperation*

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## **Introduction**

The field of business is defined by its focal organisations (business firms), their stakeholders and strategies employed in the pursuit of profit, competences, legitimacy and other material and symbolic resources. Business is a set of practices - a cycle of transactions and transformations. It requires a mobilisation and use of a variety of resources in order to produce commodities valued by the market, satisfy obligations to the providers of resources, and enable another production cycle. Business is also the context of human agency, constituted and expressed through participation and enjoyment of material and non-material outcomes. The field has been traditionally revolving around economic discourses and competitive processes, which were promoted or mitigated by state interventions. Competition and state interventions have therefore traditionally been the drivers of institutionalisation of the field. Recently we have been witnessing the increased influence of epistemic communities and/or professions specialising in particular business issues, such as consultants, providers of professional services and academics engaged in business education.

Throughout history, the field of business has been organised and integrated into society via various socio-economic systems. Systems like capitalism and socialism, whose conflict has pervaded the last century, consist of particular practices, discourses and institutions. They promote particular goals, techniques, and their justifications, co-ordinate business activities and place them within wider societal contexts. Any socio-economic system deals with a central problem of reconciliation of inevitably diverse preferences and plans of many different individuals and organisations (cf. Hodgson, 1999), and with the general viability requirements of institutional systems – the abilities to attain goals and socialise actors (Offe, 1996). Reconciliation of differences requires a balance between competition, which promotes dynamism and innovation through which differences are played out, and co-operation, which enables existence of practices and institutions that are subjected to competition (e.g. the firms) and ensures the preservation of basic characteristics of the system. The interrelationship between competition and co-operation precludes the effectiveness of a socio-economic system, which includes attaining the goals built into the definition of the system and the accompanying social relations that will enable future goal attainment. In order to sustain momentum over time, socio-

economic systems need to provide flows of goods, services and relationships characterised by sufficient quantities, qualities, diversity and distribution<sup>2</sup>. Moreover, they need to socialise actors not simply into passive acceptance of the basic characteristics of the system, but, rather, into active role in its reproduction. The crucial issue here is whether system integration can secure the sufficient degree of co-operation among actors. Any socio-economic system rests on specific economic and political power structures, which seek explicit compliance of the actors – through market forces, regulatory mechanisms and organisational hierarchies. The pressures of market and/or hierarchical relationships exert powerful influence over actors, but they have limitations stemming from the margin of liberty of individual actors, social groups and their interactions, which preclude founding any socio-economic system on crude power. These limitations are most clearly distinguished in productive, learning-oriented actions and relationships, which require active participation of the actors, rather than just restraint from particular practices. Since goal attainment within socio-economic systems involves significant requirements for engagement and creativity, reproduction of facilitating social relations is inexorably based on institutionalisation. Institutions constitute power relations that enable individual actors to productively engage in social processes and realise their projects, but also, by steering their perceptions and behaviour, they serve as constraints. Consequently, instead of discerning the foundations of socio-economic systems in structures and explicit power relations that govern interactions, we propose a view that encompasses a broader relationship between power and legitimacy. In such view, social systems are eventually founded on power as a productive capacity of individual and collective actors to engender specific attitudes and behaviours, which in turn support goal attainment. Institutionalised power related to knowledge claims and normative implications that construct the ‘normal’ modes of thought and behaviour directly influence the viability of the system. However, in order to overcome any inclinations towards rationalisation of the existing social forms through invocation of the categories of power, we need to pay a closer attention to the reproduction and transformation processes through which such social entities and the power associated with their functioning arise and reproduce over time. Any socio-economic system is a social construction reproduced through the actions of individual and collective actors, rather than a determinist or evolutionary system which, having been set in motion, reproduces itself automatically.

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<sup>2</sup> Failure in any of these areas may create legitimacy problems. Historically, socialism has often been associated with the problems regarding quantity, quality, and diversity, whereas legitimisation of capitalism has been dependent on dealing with the distribution inequalities.

## **Capital(ism) and its reproduction**

Capitalism is the socio-economic system that dominates the present era. Prior to Second World War one could argue that the USA and Britain were actually the only significant capitalist economies (de Soto, 2000). Much of the last century has been marked by the struggle between capitalist and socialist economies. Capitalism nowadays may have approached ‘ultrastability’ (cf. Offe, 1996) through the failure of socialism and inclusion of possibility for reforms that do not challenge the basic characteristics of the system. Despite the views on the unchallengeable prevalence of capitalism and democracy (Fukuyama, 1992), the debates on the future and social and ecological sustainability of capitalism still exist (Hodgson, 1999; Carroll, 2001). Regardless of whether we accept the ‘ultrastability’ postulate or intuit that the economic, social or environmental risk generated by capitalist practices could jeopardise its viability, we should examine its basic characteristics, and the logic of reproduction and transformation of capital(ism), because that logic should contain the basic answers to the question of foundations of capitalism.

Capitalism is characterised by ‘generalised commodity production’ in which markets and commodity relations include not only goods and services, but also labour and capital (Hodgson, 1999: 161). Friedland and Alford (1991: 248) go even further, claiming that ‘[t]he institutional logic of capitalism is accumulation and the commodification of human activity.’ The predominance of commodity relations includes two main conditions (cf. Schutz, 2001). First, there is private ownership over the most of capital (at least, over some of its manifestations – see below). Economic assets legally belong to individuals or corporations, which are entitled to their use, disposal and the associated profits and at least some losses, given that the prevalent form of economic organisation is corporation with limited liability. Second, production is done by wage labour – individuals that give the discretion over the work processes to their employers in exchange for agreed compensation. Both of these conditions are based on individual autonomy and freedom to contract one’s resources in the pursuit of desired ends, or in reaction to economic necessity. Capitalism is characterised by a growth of economic activity and the subsequent expansion of commodity relations – social relations predominantly organised through markets and price mechanism. Expansion of economic activity and commodity relations occur through

introduction of existing products and technologies into new markets, introduction of new products and technologies, as well as through commodification of social relations that had previously been organised through other, non-market modes. Such organisational modes include the practices of self-sustenance and gift-based exchange, as well as more complex institutionalised practices that promote non-market goals or methods which have ascribed intrinsic value – pursuing science, religion, ideological goals etc (cf. Stinchcombe, 2002).

Capitalism entails the intention towards enhancement of the stock of capital through the use of markets. Dealing with the prerequisites of reproduction and growth of capitalist relations should tackle the nature of capital as a dynamic way of thinking and acting about resources. The expansion of capital over time is associated with accompanying social relations and institutions, the reproduction of which generates expansion of economic activity through production of valued goods and services, innovation, technological development and promotion of efficient use of resources. These processes are accompanied by various external effects on the societal structures within which economic activity occurs.

Capital can thus be defined as a bundle of tangible and intangible resources, which can be put into productive use and increased over time, and which underpins the flow of goods and services. In general, capital is increased through investment and utilised or destroyed through consumption, but investments do not automatically ensure the eventual increase in the stock of capital because of inherent risks and uncertainties. The key role of capital in capitalism is realised through underpinning of the production, exchange, distribution and consumption of goods and services. Economic thinkers from Adam Smith onwards have analysed the benefits of economic specialisation, embodied in the division of labour and the subsequent market exchange, as the source of increasing productivity and the corresponding ‘wealth of nations’. This process is based upon capital as the stock of assets accumulated for productive purposes. However, rather than being inherent to the assets themselves, capital is the potentiality whose actualisation can be brought about by creative thinking about the utilisation of assets (cf. de Soto, 2000). Thus, capital is an abstract notion that captures the potentiality of generating additional economic value by the productive use of assets, which presupposes the production for the market in which surplus value can be generated.

## The forms of capital

As a dynamic stock of relatively durable structures, capital assumes various forms, which far transcend the notion of ‘financial resources saved and invested’<sup>3</sup>, thereby including any resources that are or can become objects of market (trans)actions and generators of additional economic value. Resources beyond the reach of the market, regardless how valuable (economically or otherwise) they may be, are not capital. The notion of capital traditionally included the tangibles over which property rights could be held, and which could be used for productive purposes (physical capital, which also includes financial capital). More recently, the notion of capital has been extended to the intangibles such as human capital (knowledge, skills and capabilities to learn), social capital (relationships that bond people and organisations together), organisational capital (knowledge, capabilities and resources based on the processes within an organisation and between the organisation and its environment), and even ecological capital (environmental resources). Within organisations, human and organisational capital form intellectual capital (cf. Roos et al., 1997). Not all of these forms are created intentionally, but all of them have economic implications and can be used strategically to capture economic benefits.

Although all forms of capital are subjected to the market transactions, there is a fundamental difference between the appropriable forms of capital that can be owned, traded and thus disembedded from their social context, and those that are predominantly relational and context-dependent, and thus can be ‘owned’ and ‘traded’ only partially and conditionally. Physical capital, complemented with specific aspects of organisational capital (‘intellectual property’), belongs to the former category, whereas human<sup>4</sup>, social, ecological and most aspects of organisational capital should be included in the latter. The latter forms can be economically valued, but they also have intrinsic value discernible in the processes of their creation and reproduction. They become capital by the virtue of analogy and potential economic implications.

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<sup>3</sup> It can be argued that traditional association of capital with money stems two sources. First, there is a need to express economic value of resources in monetary terms for the purposes of rational comparison and accounting. Second, money can be accumulated quasi-automatically via interest payments; unlike money, other resources have to be subjected to deliberate use to generate additional value.

<sup>4</sup> Although human capital ‘belongs’ to particular persons, it remains inherently relational. It cannot be traded directly. Its actualisation occurs only through human interaction.

Economic utilisation only partially affects the intrinsic value of learning, socialising, or a preserved natural environment. Since these forms of capital are largely public goods, which means that actors who invest in them capture only a fraction of the benefits, their reproduction and enhancement is likely to be more problematic (cf. Coleman, 1988), especially when such enhancement collides with opportunities for enhancement of the appropriable stock of capital.

The intention to enhance the stock of capital by using resources at hand for the purposes of achieving allocative and technical efficiency, as well as innovation that will support such efficiency over time, are inscribed in the idea of capitalism, which entails a continuous mobilisation of productive assets in order to create new economic value. However, since economic activity is embedded within the social structure (Granovetter, 1985), creation of economic value will also be partially depend upon the network of social relations, whose reproduction is not reducible to instrumental motives. Economic and social sustainability of capitalism is thus linked to preservation and/or enhancement of the stock of appropriable and non-appropriable forms of capital alike. System integration through capitalism entails the creation and reproduction of circumstances that enable utilisation of resources as the actors who own or manage them decide, given the particular social relations embedded in law, custom and habits. The context of the reproduction processes is formed by the economic institutions of capitalism, among which we distinguish the crucial ones - property rights, contracts, firms and markets (cf. Hodgson, 1988). Such institutions revolve around production and/or utilisation of assets, usually (but not necessarily) in the context of market transactions. Given the division of labour and the complexity of production in the modern economy, firms (rather than individuals or partnerships) are primary social mechanisms for production and commodification of assets. Property rights over the assets are exchanged through the use of contracts.

### **Property rights**

Rights entail legal or moral recognition of choices or interests of individual actors within a particular political community (cf. Reeve, 1998). Actors' different discursive standpoints and distributional conflicts make any definition of rights tentative and potentially problematic. Effective exercising of individual rights requires support by the majority (or, at least, by a

sufficiently powerful minority) of other members of the relevant political community. Rights thus both stem from and are constrained by the membership in the political community, and the corresponding political processes.

Property rights ‘define a sphere of control over scarce resources’ (Dienhart, 2000: 152). Property rights systems define the scope of and allocate property rights, protect the allocations and delineate the range of acceptable or encouraged actions regarding the resources at the actors’ disposal. That entails defining ownership relations among individual, group, corporate or state actors with respect to particular goods. All components of the ownership relation – owners, goods and the exact content of ownership rights depend upon political processes. The exact definitions of the ownership relation and property rights change in accordance with the prevailing discourses and power relations. These changes affect the allocation of property rights, the levels and forms of regulation of the use of assets, and the boundary between the public and private sectors<sup>5</sup>.

As for the owners, the debate about the merits and shortcomings of private, common and state property has pervaded the debate between capitalism and socialism, and it has been succeeded by the debates about privatisation of the public sector and private-public partnerships. Correspondingly, the nature and scope of goods subjected to ownership and exchange changes over time. Most fundamentally, we need to distinguish the scarce resources that can be subjected to economic transactions from other material (such as emergency medical care) and relational resources (e.g. friendship) or public goods (e.g. human rights, legislative processes or judicial rulings) that may have economic implications, but are, or should be, excluded from economic considerations (Walzer, 1983). Even when certain transactions are allowed, they are likely to be regulated. Finally, rather than being a unitary and abstract relationship between actors and their resources, property is a bundle of socially endorsed rights. The content of the ownership relation in mature legal systems has been analysed by Honore (1961). He characterised ownership by the rights of possession, use and management, the rights to an income, to the capital value and security from expropriation. Further ‘incidents’ of ownership include transmissibility of ownership, prohibition of harmful use, residual control, absence of term, residual control and liability to have the property taken away to satisfy owners’ debts. Such rights can be restricted

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<sup>5</sup> The latter is affected by privatisation or (now almost unimaginable) nationalisation.

when they collide with more fundamental rights, or redefined as needs and interests change (cf. Dienhart, 2000). Furthermore, changes in the characteristics of the goods and the ways of their utilisation affect the nature of property rights over them. Increased risks, complexity and the importance of symbolic and relational aspects of some goods shifts emphasis from ownership to access (cf. Rifkin, 2001). Moreover, fragmentation of ownership over the corporation has caused separation of ownership from control and endowed the managers (rather than the shareholders) a pivotal role in dealing with the complexities of resources, tasks, technologies, products, legal regulation and social legitimacy.

Economic implications of ownership and the corresponding institution of property are embedded in legal conditions. However, the emphasis moves to the processes and consequences of exercising property rights in the context of valuation and entrepreneurial recombination of resources. The institution of property is a social mechanism that enables actors to represent some assets and engage in transactions with them. Formal property systems enacted and protected by the law tackle the appropriable forms of capital, which can be precisely identified, linked to particular owners and exchanged. Property rights consist of three linked prerogatives – exclusivity, transferability and constitutional protection of ownership (Pejovich, 1998). Exclusivity entails monopoly power over utilisation of an asset and responsibility for its outcomes. Transferability means the right to transfer assets to others at mutually agreed upon conditions. Constitutional grounding of property rights results in legal protection and enforcement of actor's property rights from infringement by other societal actors, including the majority or the holders of political power.

These purposes have clear and potentially beneficial social, political and economic implications. The definition and enforcement of property rights promotes their prudent and productive use of resources in order to increase individual or group well-being (cf. Dienhart, 2000). By linking the actors to the benefits and costs of the use of resources over which they have property rights, societies also facilitate innovation and entrepreneurship while spreading the risk of such endeavours. According to de Soto (2000), property systems lead to several beneficial effects that allow economic actors to generate capital. Seemingly trivial infusion of legality into protecting property – a task that traditionally been performed by force and/or communal understandings –

has led to improved flow of communications about assets, their potential, and about their owners. By representing the crucial economical and social ‘qualities *about* the assets’ (p. 42, emphasis in original), rather than tangible aspects of the assets, formal property systems provide representations of our concepts regarding the assets, and particularly the potentiality for various options of their use. The formality of the system of property rights enables integration of dispersed information about the assets within a legal jurisdiction, (i.e. the state<sup>6</sup>), which enables the spread of such information. Consequently, it is easier to evaluate the potential of assets for producing additional value, and for exchange through which production of capital can be facilitated. Promotion of standardised representations of assets also leads to enhancing the potential for comparing and combining or dividing assets. Increased flows of information and opportunities to exchange representations, rather the assets themselves assist in protecting transactions, thus easing the generation of trust and promoting the accountability of economic actors. The risk of losing credibility and/or property thus also plays a disciplinary role. Although legal property systems have been devised to identify owners and protect holding of assets, their economic role has primarily been visible in protection of the exchanges of property rights over those assets (de Soto, 2000). Property systems enable valuation and the increase transferability of some categories of assets and protect transactions associated with them through enforcement of the accompanying contracts. The effectiveness of transactions depends upon credible representations of the assets, integration of available information about them, and transferability of ownership over them, all of which depends upon credible property systems.

Reduction of the property rights to relations between atomistic actors and assets is not sustainable (cf. Hodgson, 1988). Within non-totalitarian conditions, the definition, support and occasional enforcement of property rights systems require not only the judicial mechanisms, but also the social legitimacy that engenders sufficient recognition and support that enables productive asset utilisation (cf. de Soto, 2000). The socially grounded nature of property ontologically precedes the abstraction processes necessary for the formation of capital on the basis of assets. Its effectiveness is best achieved when the relevant actors sufficiently agree on the ownership of assets and on the rules governing their use and exchange. Any attempt to create unified property

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<sup>6</sup> It is not accidental that the current globalisation processes coupled with the increased value of intangible and symbolic assets have invoked attempts to globalise the systems of intellectual property rights.

systems without consideration of the social relations that govern existing property arrangements is likely to be futile, as examples from the developing and transition countries demonstrate (de Soto, 2000). That does not entail that the disputes about the exact content of property rights and their effects on the generation capital and distribution of resources can be concluded. However, it is preferable that these inherent components of the political process occur within an institutional framework that has social legitimacy.

## **Contracts**

Economic transactions among actors within the business field entail the exchange of resources (goods, services and money) and, except in the case of services, the accompanying transfers of property rights over resources. Contracts are legal arrangements that enable actors to engage in economic transactions, characterised by their voluntary nature and tendency toward explicitness. Contracts cannot be imposed upon the parties involved<sup>7</sup>. Specific contractual terms need to be accepted voluntarily. The expressions of intention and consent are institutionalised in culturally specific symbols and routines (Hodgson, 1988). It should also be acknowledged that power relationships, laws and customs significantly influence the negotiation process, the content of contracts, their execution and enforcement. Recognition of the voluntary nature of contractual arrangements should not efface the acknowledgement of different motivations and margins of liberty of actors based on different negotiating positions, nor the discussion of fairness of such arrangements. Some contracts are entered into because of the recognition of opportunities; others are accepted because of the lack of better options<sup>8</sup>. The tendency towards explicitness entails that significant aspects of economic transactions – the types and quantities of goods or services involved, temporal aspects and quality standards – will be defined as precisely as feasible. When any of these aspects are unfeasible to define, laws or established practices will be invoked, or a

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<sup>7</sup> Consequently, notions like social and implicit contracts are problematic. ‘Social contract’ theories - from Hobbes, Locke and Rousseau to their current versions (e.g. integrative social contract theory in business ethics - cf. Donaldson and Dunfee, 1994) - remain metaphorical interpretations of systemic relationships without much binding power. Implicit contracts entail mutual understandings whereby contractual form does not exist or has a secondary importance. For a discussion, see below.

<sup>8</sup> ‘Freedom of contract’ is only an aspect of genuine freedom. As Hodgson (1999: 83) argues: ‘Genuine freedom of choice is constrained for all if there are a limited set of institutional alternatives, and for many if they are consigned to a relatively powerless state of poverty, unemployment and social exclusion.’

hierarchical relationship that will govern the contract execution will be established (e.g. employment relationship).

From a legal viewpoint, a contract constitutes a business relationship between the contractual parties involved. Due to its voluntary nature, a contract requires preceding intention and consent of the parties (cf. Hodgson, 1988). However, this requirement also reveals its social dimension. In the practical sense, contracts are manifestations of the already negotiated business relationships. The expressive dimension of contracts is relatively less important (although still present) in formalised exchange mechanisms of standardised goods (e.g. commodity and stock exchanges) where little idiosyncratic communication or negotiation takes place and intents are instantaneously crystallised into contracts. Its importance grows with the specificity of the goods being exchanged, and with the regularity of exchange between particular partners. The case in point is relational contracting, whereby contracts are habitually renewed although alternative suppliers or substitutes of the goods being exchanged usually exist.

Contracts define an important dimension of action within the business field, but they remain essentially incomplete. Social action within the business field entails material and symbolic resources alike, and only a part of it can be subjected to explicit deliberation. Since the practices and relationships among actors also have institutional and symbolic dimensions, they are cannot be subsumed under economic transactions and their contractual manifestations. As Durkheim (1997 [1893]) has argued, although valid contracts require explicit consent of the parties involved, they are eventually based on non-negotiable elements that cannot be reduced to explicit agreement, but are assumed and have binding power. Due to the fundamental complexity and uncertainty of socio-economic environment and the social context of economic (trans)actions, all-encompassing stipulation of contractual conditions is the impossible. Even when engaging in most simple actions we habitually depend upon various habits and routines. That is even more discernible in contracts. As Hodgson (1999: 66) puts it:

‘The relevant information pertaining to the typical contract is too extensive, too complex or too inaccessible for anything more than a small part of it to be all subject to rational deliberation and contractual stipulation.’

Due to the impossibility of defining all relevant information and all possible contingencies, contracts are fundamentally incomplete. The impossibility of total contractual stipulation brings forth the ubiquitous ‘impurity’ of contracts, i.e. their eventual embeddedness in antecedent social relations, as well as relations that develop and revolve around contracts. Effectiveness of contracts, defined as facilitation of productive cooperation within firms and exchange among business actors, is rooted in a complex web of practices and institutions. In addition to actors’ rational deliberation, contracts are based on the existing laws and accumulated customs and institutions (Hodgson, 1999), and the corresponding trust<sup>9</sup> between partners (Fox, 1974; Gambetta, 1988). Some of these relations (e.g. the system of property rights) are facilitated and enforced by the state and society, whereas others develop more locally as a result of learning about the competences and credibility of particular actors within the field. Non-contractual facilitation of (trans)actions between partners is usually conceptualised in terms of trust. Although the initial willingness of actors to trust others differs, actual development, reproduction, change and possible termination of trusting relations stems from practical experience and interpretation of business interactions. Trust reinforces and sometimes even replaces explicit contracts<sup>10</sup>. The latter occurs within the groups of entrepreneurs connected either by identity (e.g. overseas Chinese) or by development of relational contracting that supersedes one-off exchange. Due to its intrinsic value, conceptualising trust in exclusively utilitarian terms is self-defeating, because it misses the social features involved in its protection and generation. Subjecting it to extensive calculation and contractual negotiation undermines its value (cf. Hodgson, 1999). Expansion of contractarian logic into social relations previously based on a degree of trust entails the marketisation of such relations. Increasing explicitness of most conditions of exchange increases their level of negotiability, which may engender short-term benefits of flexibility. Under such conditions, owners or controllers of economic resources can move them more easily to their potentially most efficient use. However,

‘instability and insecurity resulting from mobile resources can seriously impair the development of trusting, cooperative relationships upon which efficient contracting depends.’ (Jones, 1995: 431)

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<sup>9</sup> Trust involves confidence in the partner that leads to commitment despite risk. It can be developed on the basis of calculation of costs and benefits, sharing of cognitions, and sharing of personal identities between the actors (Lane, 1998).

The views linking short-term benefits of utilitarian deliberation with systemic risks of its cumulative effects have a long tradition within the discussions on the foundations of capitalism. Similar intuitions were expressed by Schumpeter (1987 [1942]), who claimed that social systems cannot function if based exclusively on contracts between actors guided solely by their short-term utilitarian motives, and was later followed by various theorists dealing with social or ethical preconditions of capitalism, notably Etzioni (1988) and Hodgson (1988, 1999). The latter, echoing the views of Hirschman (1982), attributed the resilience of capitalism to combining

‘...fluidity and incentives of property exchange with sufficient moral cohesion and moral obligation to keep the contract system going in a complex environment.’

(Hodgson, 1999: 68)

The interdependence of efficient exchange and social cohesion becomes more obvious when we extend the notion of contract. So far the concept has been applied to cases that involve exchange of goods or services between partners. However, economic and management theory often uses the notion of contract more widely, as a metaphor of the relationships that constitute the firm and its interactions with particular stakeholders. Examples of this approach can be found in various perspectives, including transaction cost economics (Williamson, 1985), agency theory (Eisenhardt, 1989) and stakeholder theory (Jones 1995). Although this view is often used to rationalise (rather than examine) existing power relationships via extensive invocation of ‘implicit contracts’, its basic logic has a wider potential. First, implicitness of contracts should also cover the aspects of explicitly contractual relationships that are not subjected to explicit deliberation – institutional and cultural aspects that involve material and symbolic resources alike. In other words, we need to acknowledge the social foundations of explicit business contracts. Implicit *aspects* of contracts thus become ubiquitous. Implicit *contracts* can be discerned only when there is mutual understanding between partners regarding their obligations and where contractual form either has secondary importance (e.g. cases of relational contracting) or does not exist at all (some relationships between the firm and its stakeholders - cf. Jones, 1995). The requirement of mutual understanding entails the need for a degree of interactive

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<sup>10</sup> There is significant literature arguing that formal contracts undermine trust. Other views claim that the contracts and trust are complements rather than substitutes (Poppo and Zenger, 2002).

coordination among stakeholders even when there are no explicit contracts between them. That is particularly pertinent in the cases of economic, social or environmental externalities.

## **Firms**

Rather than individuals or partnerships, firms are the crucial actors within the business field, through which the practice of business is exercised and institutionalised<sup>11</sup>. The existence of firms, as open systems, is dependent upon material and symbolic links to the environment. Ubiquity of incompleteness and implicit dimensions of contracts is not only discernible in external relationships. It is crucial for the internal organisation of the firm. The functioning of firms engaged in complex activities requires the division of labour among workers, which is in most cases based on the employment relationship and the corresponding contracts. Theoretical speculation and occasional experience allow the existence of configurations of independent contractors trading (un)finished goods or services among themselves, or entrepreneurs forming ‘virtual organisations’ whereby all activities are outsourced to external contractors. However, in practice most firms hire employees and organise their work efforts within organisational hierarchies that facilitate communication and cooperation among workers and ensure the necessary flexibility of work practices. Although employment contracts are eventually subjected to performance evaluation and the labour market, their execution makes them fundamentally different from contracts for services, and emphasises the centrality of the implicit aspects. Instead of obliging themselves to deliver products specified in advance, as in the case of contract for services, employees transfer the control of the manner of work to their employers (Hodgson, 1999). This control is far from absolute, because utilisation of the employees’ productive capacities requires partial autonomy (cf. Fox, 1974). This margin of liberty cannot be totally alleviated through disciplinary measures. As Clegg (2002: 301) puts it:

‘Always, because of embodiment, the people hired as labour power retain ultimate discretion over themselves, what they do, how they do it.’

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<sup>11</sup> The firm is an integrated organisation of people and other assets, acting as a ‘legal person’, set up for the purpose of producing or trading in goods or services, with the facility to sell or hire them to customers, and with associated and recognised corporate legal entitlements and liabilities (cf. Hodgson, 1999).

Hodgson (1999) argues that the employment relationship, i.e. the difference between employment and self-employment, is central to the distinction between firms and markets. Within their boundaries, firms eliminate explicit price mechanism in favour of allocation of resources by administrative command, which is based on the employment relationship. Here we encounter the issue of the existence of firms, first tackled by Coase (1937). His explanation, later elaborated by Williamson (1975), is that firms enable economising on transaction costs – the costs of obtaining relevant information, the costs of bargaining and decision-making, and the costs of contract policing and enforcement. All of these costs are related to the lack of information (Dahlman, 1979, in Hodgson, 1988). However, such costs can often be reduced through the use of markets – by using market research agencies, consultants and pooling information regarding reliability of market participants, which means that they cannot satisfactorily explain the existence of firms. Moreover, relevant information is a specific resource that cannot be treated as a readily available commodity and whose interpretation is straightforward, rather than dependent on actors and their institutionally conditioned conceptual frameworks (cf. Hodgson, 1988). These issues point to fundamental uncertainty<sup>12</sup> of socio-economic processes, which only can be stabilised by practical consciousness and knowledge of human actors (Lawson, 1997), which are inextricably related to conventions and institutions and their expectation-generating capabilities. But the means of uncertainty reduction in firms and markets are fundamentally different. According to Hodgson (1988), market processes involve interaction of relatively autonomous actors typically not committed to each other, and thus enable rapid adaptation based on price mechanism<sup>13</sup>, which enables rational calculation of (transaction) costs. Firms are social institutions whereby price mechanism is much less feasible and uncertainty reduction is performed through institutionalisation that revolves around authority relations and roles; rather than minimising transaction costs, firms provide institutional frameworks that considerably supersede cost calculations.

The difference between firms and markets is based on the crucial distinction between exchange and production. Exchange is an instantaneous or temporally fixed (e.g. option, futures and

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<sup>12</sup> Uncertainty, unlike risk, cannot be resolved by probabilistic calculus, because it stems from the lack of information on the key aspects of the problem, relevant mechanisms and possible outcomes. The difference was first emphasised by Knight (1957 [1921]).

forward contracts) process whose outcome depends upon currently available resources and preferences of its participants. Production has marked dynamic and innovative aspects; its effectiveness depends upon individual and collective learning processes that reshape actors' capabilities, preferences and conceptual frameworks. Such processes require time, which makes them logically connected to firms - relatively durable social entities that enable accumulation of skills, competences and other resources that develop through intra-organisational processes and interactions with the environment. As a complex cooperative activity, production also requires trust, which is enabled by the employment relationship (cf. Fox, 1974). Effective and efficient utilisation of resources within the firm is primarily based on communication and co-operation, which enable leveraging the human ability for taking initiative and learning to cope with complex and evolving problems. Effective organizations create social contexts conducive to building trust and commitment upon which co-operation depends (Ghoshal and Moran, 1996). Excessive competition and exchange within the firm can be potentially damaging for the habits and routines upon which production and learning depend (Hodgson, 1988). Consequently, organizational practices, duties and rights are regularly infused with value that transcends instrumental and opportunistic considerations.

Explanations of emergence, boundaries and relative efficiency of firms should thus be primarily sought within the perspectives that focus on generation and reproduction of resources and competences/capabilities through firms. Organisations have specific capabilities to collectively create, share and utilise knowledge, which gives them advantages over markets (cf. Nahapiet and Ghoshal, 1998). The predecessors of resource- and competence-based views include Adam Smith and Karl Marx, who emphasised the crucial role of division and management of labour in the development of skills and providing foundations for the firm (Hodgson, 1998). Later on, Knight (1957 [1921]) denied the possibility of a complete market for all entrepreneurial and managerial skills and viewed the firm as a means of coping with uncertainty. Penrose (1995 [1959]) viewed the firm as a pool of productive resources whose use is subjected to administrative decisions. She stressed the role of shared experience, learning by doing, and tacit knowledge in the enhancement of the firm's competences and based the growth of the firm on such enhancement. However, she

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<sup>13</sup> Hodgson (1988) emphasises the conventional dimension of price formation, based on variation within certain ranges and/or around focal points.

restricted the applicability of her framework to managerial teamwork, and failed to take into account the capabilities and learning of non-managerial employees (O’Sullivan, 2000). Nelson and Winter (1982) developed an evolutionary theory of the firm. They claimed that habits and routines function as depositories of organisational knowledge and skills and applied evolutionary arguments to the process of selection of routines within the firm. From the 1980s onwards the resource- and competence-based theories of the firm and their applications in strategic management have risen to prominence through the contributions of Wernerfelt (1984), Rumelt (1986) Barney (1986, 1991) etc.

Resources and competences include all attributes that enable a firm to strategise and thus confront the uncertain environment. Initially, they have been divided into the following categories (Barney, 1996):

- a) financial capital, including both debt and equity sources;
- b) physical capital, including the physical technology used in a firm, its geographic location and access to raw materials (Williamson, 1975);
- c) human capital, including training, experience, judgement, intelligence, relationships, and insight of individual managers and workers (Becker, 1964);
- d) organisational capital, including a firm’s formal reporting structure, its formal and informal planning, controlling and co-ordinating systems, its culture, reputation, knowledge and informal relations among groups within a firm and those in its environment (Tomer, 1987)<sup>14</sup>.

Since resources and competences should be valuable, rare, imperfectly imitable and non-substitutable (Barney, 1991), they also delineate the boundary between the core and the periphery of an organisation. Idiosyncratic ‘core competences’ (cf. Prahalad and Hamel, 1994) and organisational subunits associated with them assume the central role within the organisation, its strategy and identity. Many ancillary competences, which are more contestable, and the accompanying subunits, are becoming increasingly likely to be outsourced to subcontractors. Many manufacturers of consumer goods nowadays redesign themselves by focusing on product development and marketing. However, these operations have limits. With the exception of

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<sup>14</sup> As noted above, some changes in the taxonomy of resources have occurred meanwhile. The category of physical capital now often includes financial capital. Organisational capital has been subsumed under intellectual capital, and social capital has been tackled.

financial resources, effective utilisation of all other resources requires time and learning. It also has to be preceded by development or acquisition of such resources. Only appropriable forms of capital can be acquired, and not even they automatically engender the tacit knowledge necessary for their efficient utilisation. More importantly, the competences required for the selection of the most appropriate resource combinations and their alterations over time cannot be readily purchased; they require idiosyncratic managerial judgement developed through experience. Regardless of the available resources and opportunities for diversification and growth through mergers and acquisitions of firms or technologies, the organic component of such processes - the development of organisational competences over time - retains its pivotal role. For example, mergers and acquisitions often do not engender satisfactory economic performance of the company engaging in them. Correspondingly, acquisition of seemingly valuable technological resources does not automatically transfer into competitive advantage (cf. Teece and Pisano, 1994). The treatment of the strategic utilisation of resources needs to be complemented by dealing with the processes of their generation, which are path-dependent, causally ambiguous, and socially complex (cf. Barney, 1991). Consequently, the dynamic aspects of competences should be emphasised, and their social embeddedness should not be overlooked. The dynamic nature of competences is rooted in their interrelationship with the uncertain and changing nature of the environment they are addressing through adaptation, integration and reconfiguration of organisational skills, resources and functional competences (Teece and Pisano, 1994). Recent developments have included more comprehensive views, i.e. a shift from value appropriation to value creation (Moran and Ghoshal, 1996), which meant that the organisational knowledge becomes the focus of theorising about the firm (Spender, 1996). The roles of relational resources in the creation of competitive advantages have also been tackled, mainly through the issues of intellectual and social capital (Roos et al., 1997; Nahapiet and Ghoshal, 1998). Resource-based view of the firm tends towards dynamism and process-orientation (cf. Hodgson, 1998), which facilitates its linkages with wider theories of social contextualisation of business. By linking internal processes and external relations of firms such theories implicitly point to their social foundations and enable conceptualisation of the interrelationships within the business field, including both its cooperative and competitive tendencies. Despite possible criticisms (cf. Priem and Butler, 2001; Barney, 2001), resource-based view can provide theories of the firm existence and behaviour consistent with the institutional foundations of firms and organisational fields.

Some of the main contributors explicitly advocate a broad research agenda that includes the issues of corporate governance and institutional environment and has important implications for the study of organisational behaviour, business ethics and corporate social responsibility (cf. Barney, Wright and Ketchen, 2001).

## **Markets**

Markets revolve around transaction and exchange processes, including the transfer of property rights. Economic theory often views markets simply as price-making and resource-allocating mechanisms (Swedberg, 1994), while neglecting the discussion of the market itself (Coase, 1988), and particularly the distinction between any exchange between operationally autonomous actors and organised and institutionalised exchange entailed by actual markets (cf. Hodgson, 1988)<sup>15</sup>. The first concept enables an abstract view of markets as aggregations of individual preferences disembodied from their institutional contexts, leading to view of institutions as constraints to such market-based individual choice. However, that not only ignores the existence of non-market exchange of goods and services (e.g. relational contracting and gifts), but also the very mechanism through which the benefits of markets are achieved. By acting as a pool of resources providing variety (Langlois, 1992), markets are expected to reduce transaction costs of particular exchanges<sup>16</sup> when compared to firms<sup>17</sup> (Coase, 1937). Analogous reasoning regarding transaction cost advantages would favour institutionalised markets, rather than fragmented exchange (Hodgson, 1988). Institutional and conventional characteristics of markets shape actors' expectations, influence behaviour and can serve as a basis of trust. They include the definition of products, formation and publication of prices, establishing contacts among actors, definition of bargaining conventions, standardisation of contracts, norms, codes of conduct and

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<sup>15</sup> This distinction rests on the difference between the market as a meta-institutional discursive construct and the market as an institution. The former entails an abstract concept of unencumbered exchange among autonomous agents, whereas the latter examines the conditions of possibility of the existing markets.

<sup>16</sup> In opposition to inherent association of markets with efficiency, which is prevalent in mainstream economics, economic neoinstitutionalist North (1990: 69) admits that the market is a 'mixed bag of institutions; some increase efficiency and some decrease efficiency.'

<sup>17</sup> Transaction cost argument tends to be applied quite liberally. Stiglitz (1986) claims that the state intervention is necessitated when private sector (including both markets and firms) fails due to high transaction costs. Finally, Pitelis' (1993) speculates that the transaction cost failure of the state can also occur, therefore stimulating the return to the firm or the market.

contract enforcement procedures<sup>18</sup>. The absence of such elements does not necessarily preclude exchange from taking place, but it burdens the strategising processes of the actors and it is likely to increase costs of such fragmented exchange; its external impacts may also be difficult to discern. The conditions where fragmented exchange prevails within the business fields are linked to the specificity of the exchanged resources and/or emergence or paradigmatic technological or institutional shifts within the field. These include idiosyncratic one-off exchanges (e.g. privatisation of electricity transmission within a region), introduction of new technological paradigms<sup>19</sup> (cf. Dosi, 1982), and underdevelopment or significant reforms of socio-economic systems (e.g. the introduction of capitalism). The exchange of standardised goods (e.g. shares and commodities) tends to be highly organised; at the other end of the spectrum are highly specific goods or insufficiently defined goods (e.g. technologies) where such arrangements are impossible. When the market for particular technologies or products cannot be established (or is only emerging), there is fundamental uncertainty, which limits actors' strategic abilities due to limits of available information and the ability to interpret it, which lead to non-existing or inadequate behavioural expectations and patterns regarding performance or prices. When the technological paradigms shift, given the fundamental uncertainty, the possibilities for comparing various outcomes *ex ante* barely exist, so external economic, technological and institutional factors play a role (Dosi, 1982). The exchanges taking place are likely to stem from fragmented bargaining between the parties, which may over time evolve into systemically integrated markets, if particular market and non-market institutions emerge or are created and appropriated by actors. Although the objects of exchange in these cases are problematic, exchange processes and post-contract issues can be institutionalised on the basis of custom and laws that generally govern exchange processes within a field. However, even these fundamental institutions can be underdeveloped or contradictory; the lack of independent institutions tends to engender rampant versions of capitalism characterised by serious social and/or economic tensions. That often occurs in the initial or turbulent stages of capitalist development, as examples such as early 19<sup>th</sup> century in England and mid- to late 19<sup>th</sup> century ('robber-baron capitalism') in America demonstrate (cf.

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<sup>18</sup> Straightforward association of increased institutionalisation with decreases in transaction costs would be far-fetched. Institutionalisation is often facilitated by regulation, whose extensiveness and complexity can result in higher (transaction) costs.

<sup>19</sup> '[A] "technological paradigm is "model" and "pattern" of solution of *selected* technological problems, based on *selected* principles derived from natural sciences and on *selected* material technologies.' (Dosi, 1982: 152; emphasis in original). Paradigms encapsulate various 'technological trajectories' or 'normal' problem-solving activities.

Cameron, 1997; de Soto, 2000). The lack of credible institutions problems following the (re)introduction of capitalism in the countries of Central and Eastern Europe in the 1990s has been exacerbated by the contradiction between the old and the new institutional orders (cf. Offe, 1996), which also engendered underdeveloped markets and the corresponding fragmentation of exchange.

Consequently, markets can be viewed as a mediating institutional mode for execution of business transactions, which falls between fragmented exchange and organisational hierarchy of the firm. Underdevelopment or collapse of institutional systems result in fragmented exchange, whereas the predominance of institutional considerations entails transactions within organisational hierarchies. Developed markets entail interactive coordination among their participants, which is based on the price mechanism and negotiating power mediated by institutions. In addition to conventions and institutions that enable the existence of markets, further institutional considerations that may be embedded in the norms of conduct within the market or interfere with the market processes include rights, relationships and own or systemic long-term interests of the actors and their stakeholders (Dienhart, 2000). Institutionalisation of business has voluntary and compulsory dimensions and includes various laws, guidelines, codes and practices. Consequently, actors own interests/strategies and relationships are constituted through action within the business field, whereas rights and broader systemic issues are addressed through the political means and intervention at nation-state, regional or global levels. Since markets are not just allocative mechanisms but also institutionally specific cultural systems for generating and measuring value (Friedland and Alford, 1991), their institutional characteristics influence the quality of the measurement process, which is constituted through competition and institutionalisation alike. Moreover, instantiation of competition itself (or some of its effects) can require political and/or judiciary action. Private monopolies tend to be regulated. The relations between oligopolists are subjected to antitrust regulation. Finally, both regulation and deregulation, as politically enacted tools, can be used to encourage competition.

The results of the tension between market governance and institutionalisation mirror the dynamics of resource utilisation and context building. There are both divergent and convergent tendencies. One dimension may temporarily prevail, but market competition and

institutionalisation can also reinforce each other. Competitive pressures or opportunism often temporarily elude regulation and institutionalisation, whereas institutionalisation sometimes creates power relations that discourage innovation and competition. However, barely competitive markets often occur when independent institutions are underdeveloped, as the experiences of transitional countries demonstrate, whereas some highly competitive markets are among the most regulated ones (e.g. stock exchange). When competitive and institutional dimensions of markets are both developed and interconnected, the resulting complexity can steer the business field towards interactive governance (cf. Jessop, 1997).

### **Circumventing markets: inter-firm cooperation**

In terms of governance of transactions, market is only the loosest institutional mode between fragmented exchange and organisational hierarchy. Institutionalisation of relationships between firms can modify or circumvent market exchange without turning into an organisational hierarchy. Cooperative arrangements, i.e. collaboration and non-market exchange between firms, challenge the traditional assumption about the ubiquity of markets outside firms (cf. Mariti and Smiley, 1983; Hodgson, 1999). Cooperative strategies are not an alternative to competitive or corporate strategies. They extend the range of policy options, enabling firms to compete more effectively (Child and Faulkner, 1998). Firms share risks and/or pool resources through partnerships referred to as strategic alliances<sup>20</sup>. According to Child and Faulkner (1998), although such links are formed instrumentally and developed in direct response to major challenges or opportunities the partner firms confront, they depend upon the development of commitment, trust and effective alignment of the partners' organisational cultures. The main alliance forms (joint ventures, collaborations and consortia) revolve around organisational learning, i.e. development of resources and capabilities in the pursuit of cooperative projects. Instead of focusing on production, inter-firm cooperation can revolve around exchange, i.e. utilisation of existing resources<sup>21</sup>. Before focusing on different relationships that develop in such situations, let us briefly examine their logic. In his analysis of coordination of complementary activities within an industry, Richardson (1972) distinguished between *market transactions* (i.e. spontaneous

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<sup>20</sup> An excellent overview of cooperative strategy analysis is provided by Faulkner and de Rond (2001).

<sup>21</sup> Regardless of the form of cooperation between firms, further interest alignment of their interests can be achieved through (cross-)shareholdings.

coordination), *co-operation* between independent organisations that match their production strategies in advance, and *direction* (i.e. hierarchical control). In his view, markets are appropriate for *ex post* coordination of complementary but dissimilar activities. Firms excel at *ex ante* coordination of complementary and similar activities, especially when they can achieve scale economies and specialised organisational capabilities. Cooperation within networks based on relational contracting is particularly feasible for closely complementary but dissimilar activities whereby inputs have highly specific purposes. Hereby coordination is not predominantly quantitative, as in the case of markets, but also qualitative. Dissimilarity of activities makes the coordination within a single firm difficult in securing sufficient flexibility and variety of resource/capability requirements.

Child and Faulkner (1998) develop a typology of cooperative relationships that crosses the path between markets and hierarchies. The loosest form is *equal-partner network*, whereby firms engage in reciprocal, but non-exclusive relationships based on trust and reputation (Powell, 1991). However, equality of partners may be unsustainable because of different patterns of growth and building of competences and market power. *Unilateral agreements* entail the regular provision of specific services (consultancy, technology transfer, relational subcontracting) by one firm to another in exchange for money. The relationship between the partners is fairly close, but its pecuniary nature ensures their eventual independence. *Dominated network* involves a web of interconnected firms with a defined centre. Asymmetric power relationships prevail in such arrangements. The existence of alternative partners in the market may serve disciplining purposes towards the current ones, but the position of a firm within ‘the network enterprise’ (Castells, 1996) actually defines its degree of autonomy in changing the cooperation terms or choosing alternative partners. Then we reach the crucial threshold between dominated networks (e.g. Japanese *keiretsu*), whereby long-term relational arrangements facilitate trust and include non-instrumental considerations that often supersede negotiating positions of the partners (Dore, 1983; Shipman, 1999), and *virtual corporations/organisations*. The latter are loosely coupled enterprises coordinated through information technology, which are created as a transitional stage towards complete hierarchy or as a compilation of specialist functions coordinated by one firm

and created to exploit a market opportunity<sup>22</sup> (Child and Faulkner, 1998). Instrumental orientation based on the ‘core-periphery’ divide and loose coupling of components turn virtual organisation into a sophisticated form of outsourcing. Its potential strengths revolve around exploitation of existing capabilities not held by the firm, whereas its weaknesses stem from neglect of tacit knowledge and human dimensions of organisations, which makes emergence of capabilities and systemic innovations unlikely (cf. Chesbrough and Teece 1994, in Child and Faulkner, 1998), and may lead towards dehumanisation. Consequently, when balanced by relational considerations, virtual corporation may be a viable strategy for spin-outs and spin-offs, but it is largely unfeasible as a redesign strategy directed at existing organizations (cf. Child and Faulkner, 1998). Virtual corporations involve interactivity insufficiently supported by institutions, which leads to relationships based on simple negotiating power. Due to the autonomy of peripheral partners, core partners do not assume responsibility for the relationships with them (as in the case of hierarchy). However, peripheral partners may not have the negotiating power sufficient to secure their interests. Virtual corporation is predominantly a discursive construct with political implications, rather than an extensively viable concept of cooperative relations.

### **The duality of economic institutions**

The institutional duality between license and constraint (cf. Offe, 1996) pervades economic institutions, and helps us discern their social, political and ethical foundations. It can schematically be presented as follows:

**The duality of economic institutions**

<b>Institutions</b>	<b>License</b>	<b>Constraint</b>
<i>Property rights</i>	disposal	stewardship
<i>Contracts</i>	engagement	honouring
<i>Firms</i>	strategies	relationships
<i>Markets</i>	competition	regulation

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<sup>22</sup> As purposively created and controlled entities, virtual corporations should be distinguished from virtual ‘networks’ or ‘communities’ of loosely interconnected actors sharing a particular interest and/or working on a common problem.

The institution of property rights juxtaposes disposal and stewardship. The owner of an asset is entitled to its use, as well as responsible for the consequences. Apart from profits or losses, this provision, at the basic level, involves the issue of externalities, i.e. the consequences of a (trans)action to non-contractual parties. Attempts to promote individualistic ‘internalisation of externalities’ seek improvements structure of incentives and sanctions, coupled with simultaneous expulsion of governmental and social regulation. Following the tradition of classical liberalism, proponents of the Property Rights School (cf. Demsetz, 1967) argued in favour of extension and legal protection of individualised property rights through litigation. This would be futile even if we bracket the impossibility of total assignation of property rights<sup>23</sup>. It would only transfer the area of social influence from legislation to litigation (cf. Hodgson, 1988). Responsibilities for the use of assets within society are usually perceived more broadly. They cover economic, as well as social and environmental issues best encapsulated in the notion of stewardship – the claim that actors which own, control or influence material and symbolic resources bear certain responsibilities both for the preservation and/or enhancement of those resources, as well as for the consequences of their actions on the environment<sup>24</sup>. Stewardship signifies a dynamic balance and long-term orientation that may mitigate the economic and political problems often associated with the distribution of resources<sup>25</sup>.

Contracts display the duality of rights to engage in a contractual relations, and the obligations to honour contractual commitments – even if the initial conditions and assumptions under which contract has been made change. Due to the role of uncertainty and change, and the importance of timing, the threat of eventual legal enforcement can never be sufficient to ensure honouring of

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<sup>23</sup> Coase (1960) demonstrated that private bargaining based on assignation of property rights can deal with externalities only when transaction costs are negligible, which is an unrealistic assumption.

<sup>24</sup> The control over resources may be temporally fixed and separated from property rights. Although various loan and rental agreements do not involve transfer of property rights, actors wanting to maximise flexibility and minimise costs may actually prefer access to ownership (cf. Rifkin, 2001). This does not change the underlying logic of responsibility for the use of resources, but it makes accountability processes more complex.

<sup>25</sup> Based on the experiences of Central and Eastern Europe, it can even be argued that stewardship is ontologically more important than property rights. Namely, most of the transition economies experienced some forms of ‘primitive accumulation’ – primarily through problematic privatisation, which is usually impossible to rectify due to the passage of time and the transactions conducted meanwhile. However, the attitudes of the new owners have differed; some of them focused on asset stripping, others started developing viable businesses. It can be argued that, although

contracts that enables the effortless flow of (trans)actions required for an effective capitalist economy. What is required is a degree of institutionalisation – widespread acceptance of the intrinsic value of the relationships and contracts, which has to correspond with the sufficient level of observed contract viability<sup>26</sup>. Just like contracts themselves, honouring of contracts also has implicit dimensions, which correspond to the institutional and cultural features of relationships that embed the contracts. The less specific the explicit contract is, the more important its social contextualisation becomes. A paradigmatic example is the employment contract, whose definition, interpretation and implications are among the crucial elements of the systems of industrial relations and corporate governance within a jurisdiction. The level of social contextualisation of contracts may vary. Its erosion facilitates the integration of business activities across time and space. Importance of property systems and contracts in the creation of capital demonstrates that such creation requires a degree of rationalisation and abstraction from assets themselves, and from social understandings that define control over assets. The representative nature of property rights enables this abstraction, and the accompanying transcendence of the local boundaries of business transactions through explicit stipulation of the main conditions of a particular exchange through legally enforceable contracts. Although necessary for the production of capital, abstraction of property and explicit stipulation of contracts remain socially grounded processes. Insufficient contextualisation and institutionalisation imply low trust among partners. That can either impede transactions among strangers, especially when judicial system is underdeveloped (Fukuyama, 1995) or lead to extensive contractual formulation of business transactions and relationships, and high legal and litigation costs.

The duality that pervades firms is based on the tension between exercising strategies and building relationships. As deliberate creations with partially prescribed purposes, organisations tend to display propensity towards goal-orientation. That is exemplified through strategising. Defining and pursuing goals depends upon institutionalisation of appropriate practices and roles by

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initial distribution of resources may have been problematic, the quality of stewardship over the acquired resources makes a significant difference and may even rectify the doubtful ways of acquisition of the resources.

<sup>26</sup> The latter aspect is problematic in many economies of Central and Eastern Europe, which is reflected in high uncertainties and transaction costs. One way of looking at these problems is emphasising the contract enforcement issues because of poor legislation or ineffectiveness of the judiciary institutions. However, such views revert the causal order. The lack of institutionalisation precedes ineffective contract enforcement.

organisational members, but also a network of relationships with stakeholders (cf. Jones, 1995). The tension between strategising and relationship-building is transferred into the sphere of resource building and utilisation. Frequency and complexity of internal processes and interactions with the environment engender a tension between the use of material and symbolic resources to satisfy immediate goals, and development of resources (including relationships) that could enable future effectiveness. Their integration is captured in the notion of satisficing, which demonstrates the inability of profit maximisation, as the dominant resource-utilising discourse to provide the foundations for a firm's action. To be applicable, abstract principles need to be interwoven into larger configurations of reconciled values (Hampden-Turner, 1994). Instead of maximising any single structure of objectives, actors within firms satisfice the ever-changing multiple objectives and influences. Satisficing was originally (Simon, 1976 [1945]) understood as a characteristic of administrative behaviour stemming from cognitive limits of bounded rationality, which prevents maximisation. Drucker (1980) extended the concept by including the political dimension – the relative strength of constituencies. Finally, the stakeholder theory addresses ethical implications of business decisions in the context of multiple constituencies. Being a complex of economic, political and ethical dimensions (Nielsen and Bartunek, 1996), satisficing is an ethically desirable process, rather than an obstacle to profit maximisation imposed by cognitive limits or negotiating realities. Satisficing stems from empirically determined balancing of the constituencies within particular firms and institutional environments. It includes an instrumental dimension embedded in organisational hierarchies and dominant discourses, which can ensure the necessary efficiency and prevent the collapse of intraorganisational processes into unsustainable distributional conflicts. But it also affirms the firm as a social entity whereby strategising and relationship-building are integrated. Satisficing also redefines the notion of stewardship as a relation of interdependence. Multiple material and symbolic resources required for effective business are preserved and enhanced through satisficing processes. Despite the differences in importance, excessive orientation towards any particular resource may jeopardise the attainment of other necessary assets. Moreover, the patterns of use of resources are constrained by the power of stakeholders, including both those directly affected, and the members of relevant political communities that can use explicit regulatory mechanisms and various forms of social pressure to influence the modes of using of those resources. The affected or interested parties may have different abilities to respond to one's actions. Nevertheless, legitimacy, relationships with

stakeholders and the ability of actors to accomplish their projects partially depend upon the perceived effects of their previous actions and their systemic consequences. The importance of social contextualisation of the use of resources via stakeholder influences increases, as the resources and modes of their utilisation become more complex and therefore interdependent with the environmental influences.

Embeddedness of markets within societal systems (cf. Jessop, 1997) defines their duality between competition and regulation. Markets are seemingly built upon arm's length relationships whereby efficiency-seeking overrides cooperative behaviour. However, they also presuppose an evolving network of implied and explicit understandings or agreements, shared rituals, trust, and some underlying system of evaluation (Solomon, 1992). Their competitive nature is enabled by cooperation within particular organisations, as well as through reproduction and transformation of the market processes and structures, which are (re)constituted through actions of their participants. The cooperative dimensions within markets correspond to unintended self-regulation of market participants. Unlike fragmented exchange systems, where obtaining relevant information is difficult, institutionalised markets promote the reduction of transaction costs and increase accountability of their participants through conventions, norms, codes of conduct and legal institutions. Legally and professionally defensible practices can be established and defended more easily when the information on the actors' behaviour can be juxtaposed to some standards. Economically, socially or environmentally unsustainable practices are more easily disputed in markets than in fragmented exchange systems. However, given the markets often fail to resolve economic issues (notably in the cases of externalities, public goods, information asymmetry, technological advancements etc.) and may facilitate socially questionable outcomes, there is also a need for external regulatory intervention through political and judicial means. Self-regulation within markets defines basic conventional and institutional preconditions of market processes, whereas external regulation defines further patterns of integration of markets into wider societal systems. Namely, being a result of a complex and chaotic learning process, accountability promoted by the market is admittedly partial. Responsible practices may result in higher costs (at least in the short term) or discursive disadvantages towards powerful stakeholders, which may impede their spreading across the business field. The pressures from the media, consumers, non-

governmental organisations or institutional investors can be chaotic and without sufficient attention to systematic issues.

### **Balancing resource utilisation and context-building**

Despite revolving around utilisation of resources in the context of market transactions, property rights, contracts, firms and markets require a societal context that enables such instrumental utilisation. However, this context is not simply superimposed on the market domain through political or social constraints. Rather, the contextual elements are interdependent with market and non-market transactions within capitalism and are partially reflected in them. By reproducing capitalist institutions (or failing to do so) via market and non-market transactions, actors help create and reproduce particular societal contexts that are likely to enable and constrain them and/or other affected actors in their future functioning. The systemic interrelationship between resource utilisation and context building can be conceptualised as seeking a balance that enables utilisation, preservation and enhancement of productive and creative capacities of actors and resources, including relationships. Neither the resources nor the contexts in which they are perceived, developed and utilised can reach stability. They are prone to ‘creative destruction’ engendered by environmental change, brought about by the multiplicity of actors’ interventions into the business field, including competition that includes developing and offering innovative products, technologies, management or governance arrangements. The processes of capturing effects of the productive use of resources can take place only within a context that enables the existence and interpretation of such processes. Consequently, we can restate the necessity of balancing resource utilisation and context building. Balancing between resource utilisation and context-building is an ongoing process through which the dynamism of capitalism is exercised, and which cannot achieve an end state (let alone an ‘end of history’).

When strategising, individual actors and firms utilise material and symbolic resources under their control i.e. whatever is encapsulated by the current usage of the term ‘capital’ - knowledge, money, technology, institutional environment, relationships etc. However, on closer look we can see that instrumental approach towards these varieties of capital has ambiguities and limits, which stem from time and social complexity. With the exception of financial resources, effective

utilisation of all other resources requires time and learning and usually needs to be preceded by building or acquisition of such resources. For instance, capacities to use technologies or networks of suppliers and customers have to be developed. Firms may attempt to shorten the time horizon and speed up the necessary learning processes. They do so by acquiring new technologies, engaging consultants, hiring employees with specific competences, or by engaging in mergers, acquisitions or strategic alliances aimed at increasing the productive capabilities or strengthening of one's market position. However, these processes do not automatically transfer into generation of the necessary tacit knowledge. They may only partially alleviate the effects of time, social complexity and uncertainty. And they often fail. Moreover, they are more likely to succeed when the pool of available material and symbolic resources in their environments is larger and more diverse. Hereby we encounter the interrelationship between actors and their environments, i.e. their mutual constitution. As for economic actors (and firms in particular), their actions facilitate the constitution of particular environments - by exercising certain practices and discouraging others, by building particular kinds of relationships and avoiding others, by demanding particular resources and ignoring others. Eventually, it is highly likely that groups of economic actors in particular localities and sectors will be somewhat structurally enabled or constrained by the outcomes of their past actions. The appropriate level of realisation of geographical or sector effects may be difficult to discern. There is a time lag between actions and the feedback received through the system. Actors may attempt to deny, minimise or totally avoid the consequences of their actions through the use of social and market power (including the possibilities of relocation). But these constraints will be insufficient to totally sever the links of mutual constitution between actors and structures, especially when viewed in the current interconnected and media-saturated world. Contextual aspects of business (trans)actions require inclusion of social and relational concerns whose intrinsic value is recognised. By extrapolating Hodgson's (1999) claims regarding trust, we can claim that conceptualising contextual phenomena in exclusively utilitarian terms is self-defeating, because it misses the social features involved in their protection and generation<sup>27</sup>.

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<sup>27</sup> This is particularly visible in transition countries whose stock of non-appropriable forms of capital has to be built in order to be utilised. Unmitigated focus on resource utilisation in such contexts can be particularly self-defeating for the system as a whole, because the social and political mediation mechanisms that should moderate the pursuit of resource utilisation are weak. In such circumstances, the balance between capturing the effects of the existing resources and building up a context that will enable formation of beneficial relationships, future capturing of effects and facilitate social legitimacy of the capitalism, becomes indispensable.

The argument for socially unrestrained capitalism is based on the assumption of separation of economic sphere, whereby human preferences are 'merely exercised', and other spheres where such preferences are created. Therefore, as the argument goes, placing social restrictions on the scope of exchanges merely reduces consumers' choice (and prevents them from bearing the associated costs), whereas free market does not make people moral, but it raises the cost of unethical behaviour (cf. Pejovich, 1998). The problem with this argument is that the abstraction of economy from society is partial and conditional. Since capitalist economy and society are interlinked, their interrelationship requires interpretation. Moreover, the mutual influencing processes become subject of public discussion and policy, which may result in leaning towards free-market, corporatist or other modalities of capitalism. The areas where capitalism exists in underdeveloped or malignant forms do not differ in profit seeking by individual and collective economic actors. The main difference comes exactly from the degree of social 'satisficing' that takes place and controls the excesses of profit seeking that aim to transgress legally or socially prescribed boundaries. Where such balancing influences fail to steer people and firms to participate in the building of facilitating contexts, this failure may result in problems to reproduce or build economically or socially viable socio-economic systems. Satisficing processes in the business field are constituted through relationships of firms with stakeholders, institutional frameworks, systems of corporate governance and national business systems.

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