Tibor Mandják:

Are business relationships institutions?¹

Abstract

The question is simple; the answer could be quite complicated. Inter-organisational marketing researchers define business relationships as interactive exchanges between two organisations. Does this mean anything for institutional economists?

A business relationship is created by weaving actor bonds, resource ties and activity links. Business relationships exist and change through time. The establishment, development, maintenance, as well as termination of a business relationship all require investments from the participating parties. A business relationship does not exist in an isolated manner, but other market and non-market actors can equally influence it. In reality, numerous other relationships and actors affect business relationships. As a result, these actors indirectly influence business relationships through the change in behaviour of one of the parties within the business relationship. These directly and indirectly affected relationships create a business network.

For an organisation business relationships have different functions. External resources needed for operation and value creation are fed by them. Value creation for the customer and value sharing with the customer take place in business relationships. They are forms of an organisation's interdependence. A business relationship is a special form of governance of the partners' mutual efforts. A business relationship has its own value for each organisation. Each organisation has several business relationships, each with different value. In business markets, where buyers are always organisations, the business relationship portfolio is the market itself. Inter-organisational marketing researchers use very different theoretical foundations to study business relationships. Modern contract law based research distinguishes about a dozen norms of behaviour in business relationships. Institutional economic-rooted studies argue that we should use the plural-forms approach (price, authority and trust must be employed together) to explain these very complex phenomena. Research using communication theory concluded that multiple periods of business negotiations were required to develop even primitive norms. The paper concludes with some elements of a possible answer to the title question.

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Introduction

Are business relationships institutions? The question is simple and also a little brutal. The answer... An economist would certainly answer, it depends. And a scientist, what would he say? Really, the first task is to see what we really mean by a business relationship and by an institution. Inter-organisational marketing researchers define business relationships as interactive exchanges between two organisations. An institution in a very broad sense means something that could influence the economic activity of actors. Therefore, at a first glance the answer could perhaps be yes. Business relationships are institutions but as we know the devil is hidden away in the details.

In this paper we present a general business market researchers' view on certain aspects of business relationships. We continue with some research results based on different institutional theories. In the conclusion we will try to find some elements to confirm whether business relationships are institutions or not. Our approach is rooted more in inter-organisational marketing and organisational theory than in the profoundness of new institutional economics. Our goal is to present a research approach and its results hoping that it could be significant or new for institutional economists.

Marketing, economics and sociology

Considering its essentials, marketing can seem simple, but in reality it deals with very complicated issues. During its development, it integrated results from numerous sciences. Amongst the social sciences, we should highlight economics and sociology as especially rich sources of thoughts/ideas and theoretical constructions (Webster 1992, Hunt 1991, Michel et al. 2000, and Baker 2000.

Economics and especially microeconomics is almost a "natural hunting area" of marketing, since marketing itself was long considered to be one of the fields of applied economics (Grönroos 1994). We could mention economic man, exchange, maximisation of profits, and utility and economic rationality as being some of the most important among the theoretical constructs to be taken over and used by marketing (Heeler and Chung 2000). Economic man makes his rational business decisions after obtaining all the necessary market information. In an exchange relationship, the producer aspires to maximise his profits (Anderson 1982), whilst the buyer will strive to maximise utility (Houston and Gassenheimer 1987). The supposition that both the producer and the consumer act as economic men and therefore try to respectively maximise profit and utility has made it possible to understand, define and forecast their behaviours as an optimisation model. This approach is especially useful in the case of individual, unique exchange transactions that are independent from each other (Heeler and Chung 2000).

Several theories have also come to marketing from the field of sociology. Consumer behaviour describes the relationship between the individual and different social groups with the help of theoretical constructions such as roles, status, norms, lifestyles or culture. Social relationships of the network describing all of these, the conflict expressing the differing interests of these social actors, or rather the theoretical construction of power, also originate from sociology. Social learning and social changes are also results of the close relationship that has been formed with sociology (Grønhaug 2000).

After defining the essentials of marketing, let us continue our thought process through an analysis of general and specific marketing.

General and specific marketing

As a general formula, we could define the basis of marketing as being the achievement and knowledge of mutually advantageous exchange relationships. Marketing is the dialectic unity of a particular way of thinking (philosophy) and an action (function). Market knowledge of marketing is based on understanding consumers and competitors. In combining market knowledge with the fundamental abilities of an organisation, it becomes possible to determine the target consumers to whom the organisation can then offer a higher level of needs satisfaction than its competitors.

For objectives determined this way, a conscious, integrated and synergetic use of marketing tools is necessary. In this context, one can differentiate strategic marketing, which includes market knowledge and the choice of consumers, from operative or tactical marketing, essentially the application of marketing tools, based on strategic marketing which aims to achieve strategic goals (Lambin 1999).

When we place a mutually advantageous exchange in the centre of marketing, we refer to the relationship between the organisation and the market, and to the importance of this relationship. Within a market, an organisation can have relationships with its customers, its competitors and with other actors within the market (e.g. authorities, social associations, and political parties). Relationships formed this way (and within them the organisation's activity), fundamentally depend on the needs, demands, requirements, and market situation of the other party and equally on many other factors: basically on the other party's behaviour.

Inter-organisational (or business) marketing

Inter-organisational marketing is a particular field of marketing. Its fundamental peculiarity comes from the fact that in all cases the buyer is an organisation and not the individual consumer. The general coherence of marketing is also to be found in inter-organisational marketing. The diversity and heterogeneity of needs and buyers in this case also constitute the basic problem of marketing (Alderson 1958). The objective of marketing in this field is also to satisfy the buyer's needs at a higher level than competitors. Satisfying the buyers' needs is also achieved with products and/or services that constitute value for the buyers. Using Peter Drucker's words, the essentials of marketing are given by knowledge of what value means for buyers (Drucker 1980). In the long term, satisfying the customer's needs should not go against the organisation's strategic goals.

A strategic element of marketing is market knowledge: this means knowledge of the buyers and the competitors, as well as the choice of buyers based on the latter. The integrated use of marketing tools is also based on strategic marketing.

However, considering the fact that the buyer is always an organisation, the application of general marketing coherence is done in a unique manner. The fact that the buyers are organisations basically modifies the general marketing approach in three fields: purchasing behaviour, the market, and the relationship between the buyer and the seller. The market view of inter-organisational marketing is based on a network approach. Buying behaviour, or more exactly organisations' purchasing behaviour is characterised by interactivity. Exchanges between the seller and the buyer are carried out in the form of business relationships.

The business relationship: a complexity of actors, actions and processes

The analysis of organisations' purchasing behaviour, of the theoretical approach based on the <u>essentials of marketing</u> within exchanges (Bagozzi 1975), of the research results on distribution channels (Dwyer et al. 1987, Anderson and Narus 1990, Stern et ali. 1996), as well as of the increasing openness of organisations to establish stable supplier relationships, means that security due to market changes has had a considerable effect on the development of inter-organisational relationships. This process has occurred at different paces and with different emphasis among American and European researchers. Nonetheless, by the end of the 1990's the analysis of inter-organisational issues became one of the most dynamically developing fields of inter-organisational marketing (Sheth 1996, Mandják 2000).

Concerning the **essentials of business relationships** our starting point is the International Marketing and Purchasing group's (IMP) interactive model. The IMP interactive model is based on the results of empirical studies conducted at the end of the 70's using a wide-ranging international sample (Hakansson 1982). The model describes the (business) relationship between organisations through mutual (interactive) exchange episodes. The exchange episodes create exchange processes, which can have different elements and objects. We can therefore differentiate between product and/or services exchange episodes, information exchange episodes and financial exchange episodes. The fourth exchange episode is formed by the personal relationship that is created between the people taking part in the exchange (social exchange) (Hakansson 1982). Exchange episodes are the building blocks of business relationships (Hakansson and Snehota 1995). At the heart of business relationships are these various exchange episodes. The appropriate frequency of exchange episodes, on one hand, can build confidence among the participants, whilst on the other it can simplify exchange episodes carried out in the relationship through developing routines and thereby decrease related costs.

We consider business relationships as *interactive exchange relationships between two organisations*. An exchange takes place between two organisations. Organisations are manmade creations. The basis of their creation is the division of labour among people. An organisation's objective is to provide goods or services to its buyers or requestors and to receive resources as counter value for these. An organisation transforms its own resources and those it has acquired into values accepted by its clients. In all cases the organisation is embedded in its own social-economic-technical environment (Szántó 1999, Grabher 1993). The organisation, as a system, is in mutual dependency with its environment on both the input and output sides. On the input side, e.g., for production, the organisation depends on new resources (or rather the production of a new combination of resources) and on its suppliers. On the output side, it depends on the clients that need this new combination of resources, that is, on those for whom the organisation produces value.

<u>The business relationship is both the form and the management tool of the connections</u> <u>between the two organisations</u>. In fact, the exchange relationship between two organisations does not exist in an isolated manner, but other market and non-market actors can also influence it (Hakansson and Snehota 1989). In reality, numerous other relationships and actors affect business relationships. (Ford 1990, Axelsson and Easton 1992, Anderson et al. 1994). The focal relationship between two organisations is affected by third actors with whom one of the parties is in some kind of relationship on his own (Michel et al. 2000). As a result, these actors indirectly influence business relationships through the change in behaviour of one of the parties in the business relationship. <u>The *business network is* the totality of the focal</u> relationship and the indirect one affecting the latter (Axelsson and Easton 1992).

In inter-organisational marketing we define the market as being a group of actors that control resources and that are in a mutual exchange relationship where the market network is created and develops as a result of exchanges between the market actors (Johansson-Mattson 1992). For the organisation, the market essentially means all business relationships and the networks related to them.

There are several levels within business relationships as a result of the reality of this market. When we refer to relationship levels we mean the framework and the system of conditions of individual exchange episodes. As exchange episodes embed into the relationship, the relationship itself also *embeds* into its own network.

The relationships between the buyer and the supplier change over time and these changes can be very different. We can consider changes in business relationships over time as a sequential process, (this is, characteristic of the different relationship life-cycle theories) (Backhaus and Büschken 1997) or as a non-sequential process (Ford 1980). Most importantly we need to distinguish between individual business relationships in considering the role of time. This is of utmost importance during relationship management and evaluation.(Ford et al. 1998, Mandják 1998).

The **content of business relationships** means different connection "fibres" created by exchange episodes are the content of business relationships. These connection fibres are woven into "cloth" spun of actor bonds, resource ties and activity links. The real content of a business relationship is a particular and concrete combination of these fibres.

Resource ties

The organisation is fundamentally a total of resources. These resources give the organisation power and differentiate the organisation from other market actors. The given total of resources makes it possible for an organisation to reach its objectives, with the aim of increasing its efficiency and improving its market positions (Barney 1991). The organisation is a total of numerous internal resources (Barney 1991, Chikán 1997), but these are only used (activated) in case they are useful for other organisations and if interaction takes place with these organisations. The concrete combination of resources producing value for the client is called organisational competence or organisational capability (Grant 1991).

One part of organisational resources is fixed; these are available capacities that are the actual results of former investments or developments. These fixed resources considerably restrain the organisation's freedom of decision concerning resources and in the meantime justify the paradox that in order to be marketing oriented, an organisation must (also) be production oriented (Ford et al. 1998).

Exchange processes are influenced by both organisations' technologies – including the product's, the process's and the market's technologies (Ford 1998) – or more precisely by the relationship, the compatibility of these technologies with each other (Webster 1991). Technology does not, however, exclusively mean technical and technological knowledge, but fundamentally knowledge of resources, as well as knowledge of how and to which purposes these resources can be used, i.e., how they can be combined with each other. Product technologies enable organisations to plan some kinds of products or services. Process technologies make manufacturing products or providing services possible. By applying market technologies, the company is then able to adapt its products or services to suit market needs (Ford et al 1998).

Organisations contact each other and develop relationships in order to be able to use their own resources and to take part in values that can be created with others' resources (Ford et al

1998). An important role of the organisation's resources is to create a contact point with the partner organisations' resources. The first question concerning this is to know what kinds of resources are needed. The second is to know how the connected and thus <u>practically</u> common resources of both organisations can be efficiently used. This often happens in the framework of a longer-term co-operation agreement.

Activity links

Activities are related to resources. There are two main types of activities: the transformation and the transfer of resources. Resource transformation means creating a new combination of resources and this is what is called the value creation process. Resource transfer means to prepare, organise and carry out exchange transactions. The object of this transaction is the resource in question. This is called the value delivery process (Anderson and Narus 1999).

In examining an organisation's activities we must consider how these connect the organisation to other organisations' activities. One of the most important features is the recurrent nature of the activity. Recurrence is one of the bases of organisational thrift. Recurrence also means the stability of the organisation's activities and relationships (Hakansson and Snehota 1995).

On inter-organisational markets, organisations have to solve two closely inter-linked issues related to their activities. The first is to know who will do what, while the second is to know how the activities can be most efficiently linked. It is not enough just to examine the organisation's thrift; we also have to know how individual activities connect to those of suppliers, users and end-users. The question of who does what (and how) is the topic of the interaction between organisations. In the inter-organisational market, the success of an organisation depends on numerous different organisations' activities (Ford et al 1998).

Actor bonds

Actors are people who are involved in different business relationship activities and in decision making. They create a group of people in each organisation. On the supplier's side lies the selling centre (Bonoma and Johnston 1978). It groups together all the people who influence and act in the decision making about business relationships with the client. On the buyer's side the people who take part in the decision and those who influence it in any way constitute the buying centre (Webster and Wind 1972, Bauer and Berács 1998). The buying centre basically means the group of people involved in purchasing. Nonetheless, the people concerned with the purchasing situation may not only be members of the given organisation, but also representatives of other organisations, as in projects for example (Günter-Bonaccorsi 1996, Cova-Salle 1999, Mandják 1999, Dessinges 1990).

The effect of mutual dependence is fundamentally expressed in the interactive nature of the organisation's purchasing behaviour. The organisational buyer does not passively react to the marketing efforts of the seller, he strongly influences them (Hakansson 1982).

Those involved in business relationships also influence exchange episodes, basically through the members of the purchasing centre and the sales centre (Bonoma and Johnston 1978). More precisely, what makes the personal relationship that develops between individuals significant is that people concerned with the business relationship fulfil different roles; they take part in different exchange processes and perceive exchange episodes in different ways.

Actor bonds are of great importance to the content of business relationships. The main issues of actor bonds are how close the actors feel to each other; how they trust, appreciate and influence each other and how mutually committed they are. Actor bonds can be close or loose, and influence to varying extents what the people involved perceive as possible and feasible directions of enactment (Hakansson and Snehota 2002). How the people involved can exploit the possibilities of a business relationship is deeply dependent on the nature of actor bonds.

Processes of business relationships

The fundamental process is the exchange that occurs between two organisations, connecting the supplier to the buyer. As we have seen this exchange process occurs through different exchange episodes. Product or service exchange means delivering value, created by the supplier, for the buyer. Financial exchange generally represents payment for value received from the supplier. Information exchange may concern all the elements of the product and financial exchange processes and communication between the actors involved. Social exchange means all forms of personal communication between and among actors of the focal business relationship.

The creation of long-term business relationships depends on the frequency of exchange episodes. In the meantime, frequent exchange episodes can make it possible for exchange processes taking place in business relationship to become routines. This decreases business relationship maintenance costs for both actors. However, it can lead to an institutionalisation of the business relationship (Hakansson 1982), which means that the partners treat the relationship almost as a facility; and therefore they do not examine its utility (Thibaut-Kelley 1959, quoted by Szántó 1999).

Exchange episodes are influenced by the organisations' experiences expressed in the learning process based on results, exchange conflicts with the given partner and/or events that have occurred during exchanges conducted with other partners (Dwyer et al. 1987, Homans 1958 quoted by Szántó 1999). During this learning process, the partners' uncertainty decreases, or rather, they learn to live with a certain degree of uncertainty. The relationships evolve according to what the organisations consider they should learn from each other, what they are willing to learn and what they are able to learn (Ford at al. 1998).

The adaptation process is closely related to an interactive exchange process. One partner may adapt in order to satisfy certain of the other partner's perceived needs. Business relationships "are established, maintained, and developed by commitments, in the form of specific investments, from one firm to other. These investments (adaptations) can be viewed as a form of resource management, and are often counterpart specific and irreversible" (Seyed-Mohamed 1995:563). The establishment, development, maintenance and termination of business relationships all require efforts to be made by the parties taking part in them. This means the use of and investment in the relationship of different material and non-material resources (Ford at al 1998). Investment in the relationship can, however, risk creating resources that are specific to the relationship, that cannot (or only with some difficulty) be used in other relationships (Heide and John 1990). Business "relationships' development and their economic consequences are enactment driven" (Hakansson and Snehota 2002:517)

Considering the mutual dependence of organisations however, business relationships can be valuable resources to companies and in numerous cases it may seem that relationships are certain companies' most important capital (Ford at al. 1998).

The content of business relationships has economic effects on the relationship itself, on the two partner organisations involved in it, on third parties connected with the organisations, and therefore on the business network (Hakansson and Snehota 2002). The economy of a business relationship depends on how the people involved perceive the relationship's opportunities, productivity and innovativeness. Different "connect fibres" influence different components of the perceived economy of the business relationship. Actor bonds affect perceived opportunities. The co-ordination of activities has some bearing on the perceived productivity of the business relationship. Resource adaptation shapes the innovativeness of the relationship

(Hakansson and Snehota 1995, 2002). Knowledge of a relationship's economy makes the management of a business relationship possible and its capital role necessary.

Coordination processes refer to the development and the use of mechanisms that facilitate or make controlling exchange processes possible. These governance processes include decisions, rules, and procedures concerning the physical flow of resources, as well as communication between the organisations. Role delineation, power-dependence, conflict, and trust are some of the governance mechanisms used in business relationships. Based on Stern et al. (1996) power is one partner's ability to get another partner to do what he otherwise would not have done. Conflict means a certain type of goal divergence between the parties of a focal business relationship. Conflict resolution mechanisms are also to be included when defining governance processes. Trust and confidence based on experience acquired during the relationship, as well as satisfaction provided by the relationship can play an important role in governance monitoring and evaluation are also part of this process (Möller and Wilson 1995). Discussing governance mechanisms can help us to concentrate on some institutional theory based research and its results.

Some institutional research about business relationships

Inter-organisational marketing researchers use very different theoretical principles to study business relationships. The great variety of business relationships, their aims, structures, and processes could be the main reason for this theoretical pluralism (Dwyer et al. 1995, Cova and Salle 1999). We apply markets-as-networks theory (Mattsson 1997) to understand and describe business markets as a system of relationships between economic and non-economic organisations mutually depending on each other, where the system is embedded in the social environment and in which an activity and resource exchanges take place.

Using social exchange theory (Thibaut-Kelley 1959, quoted by Szántó 1999) the interactive model supposes that organisations get into exchange relationships because they compare the expected advantages of the relationship and its costs. If they find that the relationship contributes to efficiency and thrift improvement, they get into business relationships with each other and develop behaviour patterns relevant to the relationship (Hakansson 1982, Ford 1982).

New institutional economics are widely used in distribution channel research, (Stern et al. 1996, Anderson and Narus 1990, Heide and John 1988) in buyer-seller relationship development questions, (Dwyer et al. 1987) and in sales force management referring to incentives problems (John and Weitz 1989). Transaction cost theory is applied the most. Marketing researchers have investigated the impact of the three exogenous dimensions (asset specificity, uncertainty and transactional frequency) of transaction cost analysis (Dwyer at al. 1995). However, researchers quite frequently turn towards agency theory, mainly in sales force problems (Anderson 1985, Basu et al. 1985) and less frequently to modern contract law theory (Dwyer at al. 1987). Different institutional approaches help us to understand quite a range of business relationship phenomena. They contribute to learning more about actors, resources and processes in a diverse way. Modern contract law based research distinguishes about a dozen norms of behaviour in business relationships. Institutional economic rooted studies use the plural-forms approach (price, authority and trust must employed together) to explain these very complex phenomena. Research using communication theory concluded that multiple periods of business negotiations were required to develop even primitive norms.

Some research results refer to actors' behaviour. Based on empirical research, John (1984) presents the nature and characteristics of opportunism in distribution channels. Different types

of uncertainty play an important role in the individual and collective behaviour of the actors involved. Environmental uncertainty means "the extent to which future states of the world are unpredictable" (Pfeffer and Salancik 1978:67). In studying purchasing relationships Noordewier et al. (1990) found that in the case of environmental uncertainty buyers prefer relational governance structures instead of transactional ones. Technical uncertainty has an influence on the duration of a business relationship. Empirical results of Heide and John's research (1990) show that technical uncertainty refers to the difficulty in assessing the performance of business partners. In this situation, coordination mechanisms are employed when either objective criteria or behaviours are difficult to project and enforce (John and Weitz 1989).

As far as resources are concerned the most important contribution of institutional based research has been to highlight characteristics of specific assets. Some studies also show the connections between specific assets and actors bonds. Anderson (1985) illustrates that sales representatives' product knowledge and possession of confidential information are specific assets. In studying distribution channels, Heide and John (1988) found that sales agents' investments in building strong relationships with some manufacturers could be considered as specific assets.

A fair amount of research has been conducted concerning the different processes in business relationships. The types and roles of behavioural norms in the bilateral governance process are the focus of these investigations (Dwyer at al. 1987, Heide and John 1992, Dwyer and Gassenheimer 1992). Norms safeguard asset specific investments. Without a normative structure, specific investments increase strategic dependence on a business partner. Relational ties enable buyers making specific investments to obtain upstream control of supplier operations (Heide and John 1992). Dwyer and Gassenheimer (1992) compare relational and transactional supply systems from the point of view of power and influence processes. They have found that relational supply systems feature more power and influence processes than transactional ones. Bradach and Eccles (1989) investigated the three control mechanisms (market, hierarchy and relational contracting) of transaction cost theory. They argue that price (market), authority (hierarchy) and trust (relational contracting) are different control mechanisms in business relationships. They are independent mechanisms and can be combined in a variety of ways. While price and authority mechanisms tend to be played off against each other within the organisation, price and trust are complements used between firms (Bradach and Eccles 1989).

Although applying new institutional theories is very useful and effective, some criticisms could also be made. Dwyer at al. (1995) make an interesting remark concerning ways of using these theories. "Although the exogenous components of transaction cost and agency theory are sociopsychological and economic, the endogenous exchange relationships have been characterized primarily for their monetary utility" (Dwyer at al. 1995:82). Another criticism comes from new economic sociology. In his famous article Granovetter (1985) emphasises that the unitary focus on the economic value of transactions also oversimplifies the nature of interactions and overstates the socialisation of members of a hierarchy.

After this quick presentation of some findings it is time to go back to our initial question, whether business relationships are institutions.

Conclusions, trying to answer

For an organisation business relationships have different functions. <u>External resources needed</u> for operation and value creation are fed by them. Value creation for the customer and value sharing with the customer are obtained in business relationships. They are a form of organisation interdependence. A business relationship is a special form of governance of the partners' mutual efforts. A business relationship has its own value for each organisation. Each organisation has several business relationships each with different value. In business markets, where buyers are always organisations, the business relationship portfolio is the market itself. The business relationship is a temporal connection between the people involved, the resources and the activities of two organisations. This connection influences each organisation's behaviour, internal processes and performance.

In business markets organisations strive both for economic fitness, which emphasises the competition for scare resources and underlines the <u>importance</u> of the task environment, and social fitness, which stresses the pursuit of legitimacy in the eyes of an important societal environment (DiMaggio and Powell 1983, Oliver 1991). Economic and social fitness is achieved in, and thanks to, business relationships. Business relationships have important economic and social dimensions and consequences. They are embedded in their economic and social environment and formed by their own history as a result of interactions between the organisations involved. They seem to be <u>real institutions</u>.

However, the use of this expression is quite broad. Rules, norms, behavioural patterns accepted and legalized by and in economic and social life could be considered as institutions (Bara and Szabó 2001). Institutions are generally known and accepted forms of regulations. Many institutions are the results of institutional processes. "The institutions that result from institutional processes (such as the formation of rules, laws, certification, accreditation, prevalence, and precedence) have two underlying characteristics: (1) they can be identified in terms of patterns (Jepperson 1991), and (2) they have the ability to recur by reproducing themselves (Friedland and Alford 1991). Most institutions arise in response to pressures and conditions of a particular era. Some of the pressures and conditions (such as regulatory agencies, professional associations, or habits) are in place, they tend to change slowly and incrementally." (Grewal and Dharwadkar 2002:84-5)

In view of these institution characteristics our answer could be a little bit finer. Business relationships, however complex and embedded they are, cannot be considered as institutions. We can mainly argue that they are exposed to different institutions, like regulations, industry rules or commercial habits. On the other hand, they can influence, change, support or perhaps establish some types of institutions.

Finally, the big question is how can institutions or disturb the interactive exchange process between two organisations? Or, in other words, how can they influence business relationships?

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