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HETERODOX ECONOMICS APPROACH TO BUSINESS CO-OPERATION

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Abstract

Purpose- Economics and business have evolved as sciences in order to accommodate more of 'real world' solutions for the problems approached. In many cases, both business and economics have been supported by other disciplines in order to obtain a more complete framework for the study of complex issues. The aim of this paper is to explore the contribution of three heterodox economics disciplines to the knowledge of business co-operation.

Design/methodology/approach- This approach is theoretical and it shows that many relevant aspects of business co-operation have been proposed by economic geography, institutional economics, and economic sociology.

Findings- This paper highlights the business mechanisms of co-operation, reflecting on the role of places, institution and the social context where businesses operate.

Research Implications- It contributes with a theoretical framework for the explanation of business co-operations and networks that goes beyond the traditional economics theories.

Originality/value- This paper contributes with a framework for the study of business co-operation both from an economics and management perspective. This framework embodies a number of non-quantitative issues that are critical for understanding the complex networks in which firms operate.

Conceptual paper

Keywords: Business Co-operation, Entrepreneurship, Economic Geography; Institutional Economics; Economic Sociology

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Introduction

The economics of entrepreneurial action cannot be fully explained by the orthodox economics approach because such simplistic view leaves many important insights of business uncovered. This gap has motivated academics to develop theory in order to accommodate complex non-quantitative factors into business analysis. This approach is provided by the heterodox approach to economics, business, and entrepreneurship.

> "Or, *A Tale of love Unrequited?...*back in the 1970s, economic geography hadn't been getting out much. Its monogamous relationship with neoclassical economics was no longer productive; they were hardly even talking anymore. Economics was becoming increasingly self-absorbed, and lately just wanted to spend time alone modelling. Economic geography, on the other hand, longed to get out and see more of the world, make new friends, maybe even influence them. Before long, the relationship with economics was over, and by the early 1980s economic geography was looking elsewhere for intellectual company. There were flings with Marxism, with regulation theory, and institutional economics, but they never lasted. Then, after the cultural turn, there was more reading around, and perhaps more fun, but hardly more commitment… nobody noticed it at first! For some time, economic geography had been moving in the same circles as economic sociology, they shared the same social networks. Both had reputations for being a little promiscuous, so nobody took their dalliances very seriously. But the more they got to know one another, the more, it seemed, they had in common. With time, the attraction only grew… Could this be the real thing?" Peck (2003: 1)

The aim of this paper is to review how three branches of the literature may contribute to explain the mechanisms associated to business co-operation: Economic geography; Institutional Economics; and Economic Sociology.

Economic Geography

While the orthodox economic theory often fails to adequate investigation of the 'real world' phenomenon, concerned in modelling economic/social action, economic geography has managed to lead in a different direction. One of the main critiques of mainstream economics is that the high levels of abstraction, induced by economic modelling, disregard role of places and its features in contributing with an explanation to entrepreneurial behaviour. To that extent, economic geography takes into account the role of places and sociological behaviour on board.

The new economic geography, as it is in the present, is a result of an evolutionary process. The spatial agglomeration theorists were mainly concerned (in a similar way to economics) in modelling the location of economic activity in regions where locations were just points along a linear economy, failing to address where this location will occur in particular places and not in others. This is best described by Martin (1999: 77):

> "This neglect is most obvious in the mathematical models of spatial agglomeration. Here 'regions' or 'locations' are often just points along a linear economy, or concentric circles in von Thunen-type landscape, or patterns in a Christaller-type surface. Real communities in real historical, social and cultural settings with real people, going about the 'ordinary business life' (as Marshall once described economics) are completely bypassed."

However, Martin also recognises the difficulty of including locally-varying social, cultural and institutional factors in the formal mathematical models, and admits that regional growth and convergence researchers assume the importance of these factors.

The recognition of these factors led to an important expansion of the scope of economic geography, incorporating ideas from diverse existing schools of thought, such as institutional economics, economic sociology and cultural theory. Moreover, economic geographers base their theories on existing concepts and develop them in a different perspective, as seen below:

> "Economic geographers have drawn freely on the concepts and perspectives of different schools of economics; but, for their part, economists have tended to accord little if any attention to the role of geography in the economic process." (Martin and Sunley, 1996:259)

To the matter of this paper, economic geography contributes with the recognition of the role of places in shaping economic action. Within the variety of sub-theories, one perspective is particularly important – the industrial district literature or the 'new Italian economic geography'. This branch of literature plays special emphasis on the region where activities are located, and regional/local culture is a vital part of business. This is well described by Sforzi (2002: 442)

> "This 'active co-presence' consists in the fact the local society exerts an influence on the organisation of production which springs from its social culture. A system if values and norms – dominated by a spirit of initiative and largely reflected in the principal aspects of life, like work, consumption, saving, attitudes to uncertainty – produces a cultural environment favourable to economic enterprise, influencing industrial relations and the activities of local government administration."

Another reason why this approach is also particularly interesting to this work is acknowledged by Martin (1999: 79-80), below:

> "The Italian industrial districts literature has encouraged economic geographers to focus on the networks of trust, co-operation, competition and governance that characterise such areas […] Rather such districts differ considerably in origin, economic structure, social regulation, institutional organisation and degree of political intervention […] Economic agents are not just locked into a particular developmental path but also into that particular place where their (path-dependent) powers can be exercised."

To that extent, the literature on industrial districts is central to the study of co-operation between SMEs, and also important in addressing the role of the local culture in promoting cohesion among the participants in the local economy. Particular characteristics of different places contribute to the construction of a particular 'culture', which influences business action and, therefore, determine the business co-operation mechanisms.

This issue, along with others of particular importance for this work, can be found in the overlap between economic geography and others schools of thought. This is the case with the institutional economics and the economic sociology, which became an interest of economic geography, but still remains as autonomous disciplines. For this reason, these theoretical frameworks explored, separately, in the subsequent sections.

Institutional Economics

Although being a very broad framework, there are four main areas in which institutional economics provides a theoretical contribution to the explanation of reality. Institutions can be looked from a social, political, historical and cultural perspective. To that extent, they contribute to the understanding of: local productive systems; individual action within the economy, economic growth; and the role of historical events on shaping the present features of societies. This section is organised accordingly.

In order to provide a clear picture of Institutional economics, some of the propositions of Hodgson (2000) on the description of institutionalism are shown below:

- Institutionalism uses psychology, sociology and anthropology as a way to derive a richer analysis of institutions and human behaviour;
- Institutions constitute a key element for any economy becoming then a task of major importance to undertake their study within any economic analysis, mainly the processes of institutional processes, innovation and change;
- The economy has to be seen as an open and evolving system, within a natural environment that is affected by technological changes and embedded in a broader set of social, cultural, political, and power relations and
- Finally, individuals are seen as affected by their institutions and cultural situation.

The latter proposition addressed the contribution of Institutional Economics to understand individual behaviour. This is particularly important in the context of SMEs as they are, usually are managed by individuals (usually being the entrepreneur the only decision maker within the firm). These individuals introduce in the firms´ behaviour the cultural and institutional context. According to Schmid (2004) organisations embody a set of institutions (human relationships) to which a group of people subscribe. Some of them are unique to the organisation, others are chosen from a set of available to the others, and some are obligatory and given as a result of a larger rule-making organisation.

The perspective used to describe the organisation can also be used as an analogy to describe the co-operative relationships taken place in networks and the institutional set that are shared. Because these institutions result from people interaction, a network (as seen the locus of inter-firm relations) develops the set of institutions that makes it unique and the source of these institutions is also the same described above for the firms. It can then be derived that firms and hence networks are embedded within an institutional context.

A different perspective regarding individual behaviour is also provided. The theory can be extended in order to provide an explanation to why each individual is unique and behaves accordingly. The individual behaviour is a result of the institutions he has been exposed to and that influences his/hers behaviour. Therefore, two individuals would be behaving equally if they were exposed to exactly the same institutions under the same conditions.

The study of institutions is also closely related to geographical proximity in what concerns to the existence of a local culture and specific local institutions that shape the business relations. The interaction between the two concepts is well presented in Pilon and DeBresson (2003), about the impacts of local culture on regional innovation systems. They agree that local traditions, local value systems, common language and human capital seem to represent the sources of dynamism in the Third Italy which, they refer, is characterised by both co-operation and competition – the so-called coopetition. Hence it can be suggested that local culture impacts similarly in the perspective of co-operative relationships and in networks where communication and local value systems play a major role as trust and behaviour are central to the networking phenomenon.

Another important perspective put forward by institutional economics is the role of historical events in determining the present cultural/social and economic environment. This perspective is so important in the context of this literature that is often referred as institutional and evolutionary economics. Furthermore, this perspective is pointed out as a criticism to mainstream new economic geography, as shown below:

> "…Economic geographers have long considered the importance of history in shaping the process and patterns of uneven regional development […] Thus, while the claim that 'history matters' is certainly correct, the treatment of history in the new economic geography is more metaphorical than real and, despite the importance assigned to path dependence, this notion remains a conceptual and explanatory black box" (Martin, 1999: 71;76)

In fact, a part of a local contemporaenous culture is a reflex of historical events which have influenced people's attitudes and government action. To that extent, in order to fully understand a certain social/economic phenomenon, a historical perspective needs to be considered. History may explain why culture in two similar regions is different.

Finally, a large amount of literature is devoted to demonstrate that institutions are an important mechanism to understand economic growth. Although, this perspective is less important in the context of this research, it helps to sustain the argument that co-operative relationships may also lead to further economic development. An institutional and organisational structure is needed in order to foster economic development as done by North, (1993: 1), as follow:

> "Economic growth throughout history could only be realized by creating an institutional and organizational structure that would induce productivity enhancing activity – a supply side argument; and equally that the consequent tensions induced by the resulting societal tensions induced by the resulting societal transformation have resulted (and are continuing to result) in politically - induced fundamental changes in the institutional structure to mitigate these tensions – a demand side argument. Both the supply and demand side changes have been and continue to be fundamental influences on productivity change"

It is, now, clear that institutions are reflected in individuals' choices and that they are necessary to produce economic growth. However, these institutions may differ across regions and even sectors within the same geographical location. This constitutes the basis for the argument that networks vary according to the region they are embedded in (if they are concentrated geographically) or incorporate values from the various participants, and thus co-operative relationships too. As according to Johannisson et al. (2002), "*…it is considered that network structures may vary considerably between different entrepreneurial settings; co-operation agreements and contemporary local/global development*." The dimensions that influence each industry are then represented as follow:

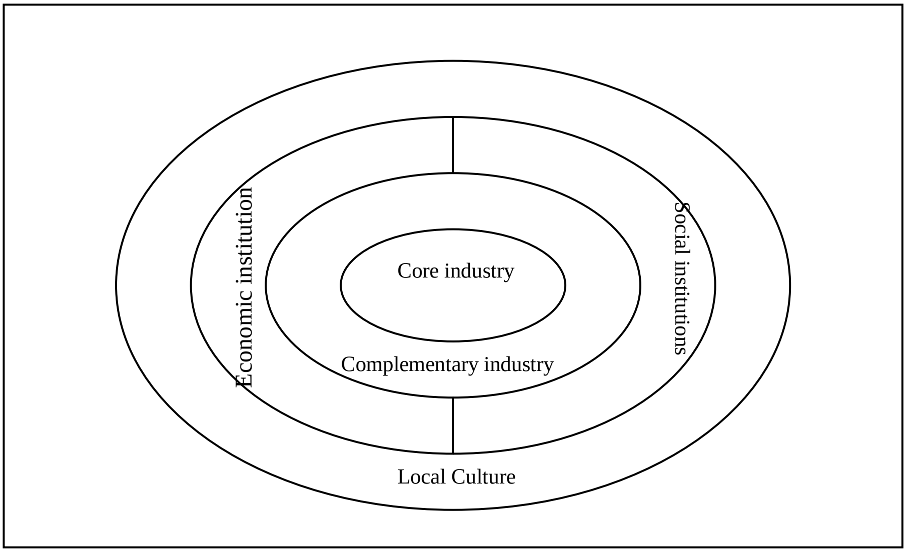

Figure 1: Economic, institutional and cultural embeddedness

Source: Johannisson et al. (2002)

Regarding the scope of this research, institutional economics contributes with insights about the role of particular social institutions as much as governmental institutions to explain entrepreneurial behaviour. Moreover, it also provides an opportunity to assess the extent to which particular phenomena may be related with historical events which have impressed longing cultural values.

Although institutional economics provides a useful theoretical framework to the three levels used in this analysis, the study of particular relationships is only indirectly addressed. At a macro-perspective, the theory considers that both national cultures and the legal/institutional system influence business co-operation. At the meso-level, regional and industry particulars are considered in the sense that the role for local institutions and industry norms and routines are also considered. Individuals are also considered to be influenced by the institutional context in which they are embedded. However, each individual characteristics are not highlighted and despite similar (convergent) behaviour are likely to be observed within a certain cultural context, individual diversity is still of vital importance. In addition to this critique, the analysis of relationships is treated similarly. Despite the contextual and macro-perspective of relationships, the inner insights about these are treated by economic sociology.

Economic Sociology

Institutions and its effects on people's behaviour need to be contextualised within a social setting. The relationship between institutions and society is so strong that institutions emerge from a society, and a society can be conceived as a set of accepted and shared institutions. In that sense, the framework developed by institutional economics and economic sociology overlap greatly. Hence, a very tiny and blurred border between the institutional perspective and the economic sociology indicates the high degree of interaction between the two schools of thought. With a number of issues being common to both, Swedberg (1991: 251) distinguishes these two approaches as follows:

> "Both economists and sociologists have helped to create this new economic sociology. Economists have developed an approach known as New Institutional Economics. The main idea here is to explain the emergence and functioning of economic institutions with the help of microeconomics. Sociologists have developed an approach to economic sociology, sometimes referred as the 'new sociology of economic life'".

The main foundation of economic sociology or of the 'new economic sociology' – as known in its present developments - is that the combination of the economic concepts, sociological issues and institutions provide an explanation to the phenomena occurring in the economy.

It is clear that economic sociology relies heavily in social institutions and social networks. This is very evident in the writings of Dobbin (2005: 27):

> "Sociological institutionalists understand economic behaviour to be regular and predictable not because it follows universal economic laws, but because it follows meaningful institutionalised scripts […] your social networks – what sociologists used to call peer groups and role models – influences your behaviour by providing concrete examples of how to behave and by enforcing sanctions of misbehaviour"

The broad framework of economic sociology provides some interesting insights for the context of this research. According to Swedberg (1997) there are three main types of concrete studies within economic sociology: Network theory; cultural sociology; and Organisation theory. It's the network theory that is central to this work.

The network theory relies heavily on the works of Granovetter on embeddedness and the study of the quality and 'strength of ties'. A concept of particular importance of the Granovetter's (1985) definition of 'business group', defined as a group of firms bounded together in some formal and/or informal ways and it differs from average conglomerate by displaying social solidarity. This definition is pertinent because it stresses out the existence of informal relationships between firm, in which there is a sort of solidarity, and hence, co-operative relationships. The network perspective also draws in the concepts of structural holes analysed in section 2.4.1.

Although Granovetter's contribution is acknowledged to be of great importance, one of the criticisms comes from the cultural sociology. Zelizer (1988) being more situated in the overlapping zone between institutional economics and the 'new economic sociology', criticises the tendency to the 'social structure absolutism', in which everything is reduced to social relations and networks. According to her, a balanced analysis would include the structural, economic and cultural factors.

The conceptual framework by Granovetter, and his over-emphasis on social structure is very much described in the following quotation:

> "The crucial point is that fundamental concepts like solidarity, power and norms cannot be understood except in relational terms; their very definition relies on social relationships, and they are produced in social networks…"

Granovetter (2001: 25)

As much as the Institutional economics approach, economic sociology does not rely on the economics' rational behaviour assumption. According to Swedberg (1997), economic sociology focuses rather on the failure of economists to incorporate social structure in the analysis of economic transactions.

Conclusions

Business co-operation is an obvious aspect of business in general. This paper has explored how three different branches of the literature contribute to the understanding of business co-operation. Economic geography emphasises the role of places and on the existence of a local culture that determines how business inter-relate. Institutional economics addresses many issues that are central to explain co-operation mechanisms: rules, norms and habits; the history and path-dependence relationships; and the local culture. Finally, economic sociology explores important issues such as ties and relationships; embeddedness; and the organisation and network theory.

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