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Consummate cooperation in the network-firm: Theoretical insights and empirical findings

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Summary The institutional and industrial evolution of the 1980s and 1990s considerably transformed the governance structures of production through globalization, financialization and the accentuation of competitive pressures. The governance structures of inter-firm relationships have changed greatly; the modern firm is now based on cooperative vertical network organizations of production. The aim of the paper is to investigate theoretically and empirically the specificities of the inter-firm relationships that create the strong consummate cooperation that characterizes what we call the network-firm. We run an empirical study using a very large database on French inter-firm relationships, and our theoretical hypotheses that balanced inter-firm power, inter-firm relational capital and complementary organizational capabilities explain the consummate cooperation that characterizes the network-firm are confirmed.
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Introduction

Until twenty years ago, the theory of the large, vertically integrated firm à la Chandler (1962) was advocated by leading scholars in management and economics. However, the institutional evolution of the 1980s and 1990s transformed the governance structures of production through globalization, financialization and the accentuation of competitive pressures. The governance structures of inter-firm relationships have changed greatly; the modern firm is now based on network organizations of production. Complex partnership forms of vertical inter-firm relationships have replaced classical market subcontracting relationships.

Subcontracting relationships were usually trading contracts between a hub-firm and its supplier. They were strictly vertical relationships devoid of initiative, mutual commitment and cooperation. The hub-firm — the customer — requested the production of an ordinary component part to its strict specifications. The market contract between producer and customer was governed by contractual obligations: deliver the agreed-upon good at prices decided in advance. Often, these were asymmetrical relationships that were, above all, based on marketing or bargaining powers. In this type of subcontracting relationship, competences and responsibilities were strongly segmented. The period of contractualization was very short, so suppliers did not have sufficient economic and financial resources for planning specific investments and participating in the innovation process of the hub-firm.

In this paper, we focus on particular subcontracting relationships that have developed and grown since the 1980s and are based on recurrent exchange relationships between firms at different stages of the production system. These relationships are often created from a very specific demand for production of component parts or even full modules that

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is formalized and rationalized by the hub-firm and governed by both vertical and horizontal information structures. Modern subcontracting relationships based on legally independent firms rest on a foundation of strong cooperation, so, as Houssiaux (1957) was the first to show, these organizational forms can be defined as sustained and consistent exchange relationships and referred to as ''vertical quasi-integration'' (see also Blois, 1972; Eccles, 1981; Monteverde & Teece, 1982). Quasi-integration should be analyzed as an organizational form of production that aims at gaining the advantages of both the market (flexibility and powerful incentives) and the hierarchy (authority and private ordering).

Traditional forms of subcontracting have been replaced by new and more balanced relationships that are based on long-term contracts (Roberts, 2004) and relational commitments (Baker, Gibbons, & Murphy, 2002). We propose to call this new organizational form the ''network-firm,'' which is a complex governance structure that links a set of legally and vertically autonomous firms; one firm's output is the input of another firm, and so on. The firms are linked to each other and form a network. A firm that we call the ''hub-firm'' organizes this network. Finally, the network-firm — also called the ''vertical network organization'' by Baudry and Chassagnon (2012) — is a ''unified economic organization'' where intra-network exchanges are not reduced to a simple market exchange, but based on different inter-organizational coordinating mechanisms promoting a cooperative governance structure. What are the specificities of inter-firm relationships that lead to such a model? We run an empirical study using a very large dataset on French inter-firm relationships to test the theoretical hypotheses that balanced inter-firm power, inter-firm relational capital and complementary organizational capabilities explain the consummate (''strong and voluntary'') cooperation (see Williamson, 1985) that characterizes the network-firm.

The aim of the paper is to investigate theoretically and empirically the inter-firm relationships that enable vertical network cooperation. The paper is an original contribution to the organizational literature on inter-firm relationships and is organized in five sections. ''The first section'' presents the origins of the network-firm before proposing a definition of it. ''The second section'' establishes a theoretical model of the consummate cooperation of the network-firm. ''The third section'' describes the data from the French survey on inter-firm relationships, the variables and the empirical method we use to run our empirical study. ''The fourth section'' analyzes the results. ''The last section'' concludes the paper by discussing the results and the limitations of the paper that could be addressed in future research.

The network-firm: origins and definition

The model of industrial subcontracting has been strengthened in the last two decades by the development of new organizational forms. The modern firm is often organized in cooperative vertical inter-firm networks that result in more flattened and cooperative and less asymmetrical and coercive forms of subcontracting. Long-term partnership relationships have replaced classical trading contracts. This form of economic integration has gone hand in hand with strong qualitative and quantitative modifications (e.g., increased commitment durability between firms, more stable quality norms and delivery time, production of a full function by a subcontractor).

In such vertical inter-firm networks, other variables besides price, like quality, reputation, critical resources and idiosyncratic competences, are crucial. Additionally, owing to the needs for *ex ante* qualitative and quantitative coordination, these flattened relationships with subcontractors are encouraged by a cooperative organizational structure that ''unifies'' the different firms of the network through relational contracting (see Baker, Gibbons, & Murphy, 2008; Baker et al., 2002). These long-term contracts are linked to the claim developed in the 1980s that firms should concentrate on the activities for which they are best suited and outsource the activities that are far from their core competences (Bettis, Bradley, & Hamel, 1992). Thus, the governance of the modern firm should incorporate new institutional agreements, such as the development of trust and long-term relationships, with subcontracting suppliers that secure productive and organizational efficiency.

The Japanese model described in the 1980s by Aoki (1984) or Dore (1986) — who used the famous example of Toyota — contributed considerably to shedding light on questions of economic performance and the value of cooperative models of subcontracting. The main interest of this specific governance structure of inter-firm relationships is inherent to the creation of cooperative rent, often called ''relational quasi-rent'' in the managerial and organizational economics literature (e.g., Dyer & Singh, 1998). The sharing of this quasi-rent resulting from long-term cooperation between the organizational members of the network makes the latter durable and ensures ongoing business relationships that are linked to economic criteria and other informal coordinating mechanisms (e.g., Granovetter, 1995). The creation of economic value is strongly dependent on knowledge sharing and collective learning effects. In this view, Hamel (1991) analyzes these new forms of inter-firm relationships as alternatives to market and hierarchy for gaining access to valuable knowledge. In other words, these models of flattened subcontracting conform to a double logic of productive efficiency and of managing with organizational complexity.

Simon (1962) explains that, owing to the cognitive limitations of individuals, any complex product should be decomposed into simpler sub-systems. In flattened inter-firm networks, we clearly find this argument: complex final products are decomposed into complementary modules (sub-systems) and entrusted to distinct firms that specialize in a function of the complex final product. Organizational and product complexities are contained in a ''modular architecture'' (Sanchez & Mahoney, 1996) that rests on both inter-firm labor division and specialization logic. Modularity is thus defined as ''a very general set of principles for managing complexity'' (Langlois, 2002, p. 19) that combines technological design and organizational design. Modularity can be found in the aeronautics, automotive and electronics industries, where we can observe precise cases of ''flexible specialization,'' to refer to the work of Piore and Sabel (1984), in which special suppliers become very profitable and large firms. For example, in the automotive industry, equipment manufacturers generate sales comparable to those generated by the hub-firms (car manufacturers).

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