

STRATEGIC MANAGEMENT: A Property-rights Approach

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June 1983

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Introduction:

Strategic management is an elusive topic that has called forth a wide range of types and qualities of analysis. For some it remains a highly political process; others will build mathematical models. This paper touches on the range of theories which organization theory and business policy writers have customarily called on, sometimes implicitly, when focusing on senior management -- among which we find those responsible for the firm as a whole. Thus 'strategic' management has a head-office rather than a departmental, a new product, or a planning staff flavor. Ultimately we will see that 'strategic', like 'organization' cannot be readily defined (March & Simar 1958:1), and we get our best sense of it by superimposing a series of partial definitions which constrain rather than fix its meaning.

In Part I of the paper we accept these difficulties but, rather than despairing, we argue that we have made considerable progress towards a disciplined analysis of strategic management. We argue that our theorizing has evolved through a series of phases, like paradigm shifts. Each phase casts the problem that strategic managers solve in a new light. Each addresses practical problems ignored in its forerunner. Each restructures rather than rebuts the previous paradigms' insights. There is progress, even though it is erratic.

The most recent phase corrects an overemphasis on diversification and internal capital market management which grew up around the conglomerates of the 1960's. This resulted in a number of broad generalizations such as the BCG matrix and the SPA value-map, which are extremely difficult to apply. The recent adoption of the concepts and relative rigor of industrial organization

economics [IO] has brought strategic analysis back in contact with the realities of industrial production, administration and market behavior. This new phase probably also strikes the death knell of the strategy-structure-performance [SSP] debate which has filled our journals for a decade.

Of course, the strategic-IO paradigm has shortcomings too, which reflect its dependence on Chamberlin's theory of monopolistic competition. For the individual strategist the paradigm has much to say about protecting streams of super-normal profits with mobility barriers and so forth. It has little to say about his real problem, which is to generate these profits in the first place. Clearly this drives us back towards the blackish hole of a theory of entrepreneurship.

In Part II, we argue that we can make additional progress by shifting towards the property-rights paradigm. Actually this does not mean treading into the unknown for we are merely converging on current economic exploration of Alchian's and Demsetz's earlier insights. In brief, Alchian's firm is an integrated bundle of interacting property-rights, the results of the contracts the strategist makes (1982). The paper concludes by describing strategic management as the process of acquiring and protecting potentially useful property-rights and of integrating them into powerful operating bundles. Done well, the firm can earn and sustain super-normal profits. Done badly, these possible profits are rapidly dissipated and appropriated by the firm's competitors, suppliers, customers and, maybe, managers.

Part I: Concepts of Strategic Management:

'Strategy' turns out to be a difficult concept to pin down because our normal use of the term implies a workable concept of uncertainty. Without

uncertainty strategic management is purely instrumental. When working correctly managers are merely the instruments by which the situation's determinants, such as market forces, influence the firm. Such instrumental passivity is simply not what managers mean by 'strategic'. For the purposes of this paper, we characterize uncertainty as an incompleteness of data, that which prevents rigorous conclusion-drawing (Spender 1980:51). Given such uncertainty, strategic management means 'making good' the defective data. This can be done in a variety of ways, but simply gathering more data misses the point. Looking up a number in a telephone directory is not a strategic matter. For the purposes of this paper, therefore, we define uncertainty as applying when the missing data is not available and when its value cannot be established. Strategic managers must then draw on their personal imagination, judgment, values, risk preference and so forth to 'complete' the incomplete data and so make their analyses conclusive. In practice, a firm's situation is never wholly without relevant determining data, so the strategist is never entirely free from constraints on his imaginative plan-making. Similarly we can see that many conventional definitions of strategy, dealing with the 'long term', the 'most important' or the 'broad picture', are simply ways of pointing to the principal uncertainties that firms have to deal with overall.

Thus the concept of strategy occupies some insecure middle-ground between a view of the firm as wholly determined by its environment and an alternative view of the firm as wholly free to pursue whatever it or, rather, its owners or entrepreneurial managers wish it to do. A theory of strategy must capture something of both. Learned et al.'s concept is the most ambitious step in this direction. They pursue the complex middle ground between what the firm might do and can do given its circumstances, what the executives want to do, and what society at large thinks it should do (1969:18). Although this view has influenced generations of Harvard BS students, it has yet to be formalized

and thus remains purely descriptive (Porter 1981:610). The resulting analysis and conclusions cannot be generalized beyond what Stigler calls that confession of analytic failure, the case-study (1958:67).

A more tractable concept of strategy is that caught between pure volition, what the entrepreneur wishes to do, and pure determinism, what its environment constrains him to do. At each extreme, strategy has no real meaning. When the situation is wholly determined, the strategist has no choice. When the situation is entirely unconstrained, there is nothing to be analyzed. Thus strategy must be defined in terms of both the constraints on, and the choices available within practical situations. First we adopt a specific theory, to frame the strategic situation, then we focus on the uncertainties which prevent that theory providing a sufficient analysis. Strategy is the strategist's way of dealing with these constrained uncertainties. Business strategy means we frame the situation with a theory which is actually our theory of the firm, albeit implicit. The evolution of business strategy can be traced by seeing different phases dominated by different theories of what the firm's parts, boundaries and processes are. Eventually each theory's inability to give managers adequate control over the firm leads to its replacement, so causing a paradigm shift. The basic concepts and language change, the analysis becomes more penetrating and strategists adopt a new theory of the firm - with extended boundaries and more sophistication. Chandler's work also makes it clear that as the senior executives' theories become more elaborate, so the firm's institutional arrangements become more complex (1962).

Phases of Strategic Theorizing:

The earliest concepts of business strategy, to think of it also as that which generates coherence and direction throughout the firm, revolve around the notions of leadership, charisma, moral character and the ability to draw

people into active cooperation (e.g. Smiles 1859). The theory of the firm is a theory of business leadership. As business outgrew the bonds of family and squirearchy, especially in the U.S., business leaders struggled for a new kind of managerial control based on a detailed understanding of the firm's functions. The writings of Taylor, Church and Fayol break up the uniqueness of the entrepreneur's idea. They establish a mechanical or scientific paradigm which stresses the functional structure of all enterprises, but one that facilitates and supports rather than replaces the charismatic entrepreneur. In this paradigm the firm's objective is to maximize efficiency - defined in engineering terms. It means (a) having better production processes, less scrap, more standardization, greater economies of scale, better tools and capital equipment and (b) achieving tighter administrative control, less lost time, better coordination, more planning, specialization and training. Strategy requires building up the knowledge-base that the organizational designer draws on and using his imagination to fill in gaps and accommodate change. Thus both Taylor and Fayol stress management's responsibility to codify and rationalize productive and administrative practice.

As unskilled industrial laboring was transformed into the operation of complex machine and factory systems, and as the skilled artisans were brought under managerial control, the impersonality of the scientific management paradigm came under increasing attack. The result of Gantt's attack on Taylor's methods, of Mary Parker Follett and others' writing is the human relations paradigm. This focuses on the community of organizational life, and on the political and psychological processes of direction and motivation. Mechanical efficiency is displaced by the larger concept of productivity, the result of the man/machine system's behavior.

To modern eyes these issues scarcely touch on strategy at all, largely because we use much more sophisticated theories of the firm, albeit unconsciously. Contemporary definitions begin with a recognition of the

constraints imposed on the firm by its environment. Actually, Gilmore argues that managements were forced to expand their ideas after the economic upheavals of the 1920's (1970:5). Now the firm's strategic possibilities are determined by the structure and behavior of the marketplaces it interacts with. The firm only survives by adapting to environmental changes, prospering by optimizing the 'fit' between its activities, products and markets. This paradigm tends to make business strategy the same as marketing strategy. But it also enfolds the previous paradigms. We see this clearly in contingency theory. Here, appropriate forms of leadership, organizational structure, and management motivations are determined by environmental circumstances.

In the 1940's, analysts such as Holden, Fish & Smith and Newman noted that as companies grew both in size and complexity, they saw the value of building a portfolio of subsidiary operations. This reduces their exposure to uncertainty and is a distinct strategy. The risks involved in expecting particular businesses to adapt and prosper, bearing in mind the influence of the uncertain environment, are diversified away. Chandler set the SSP debate in motion with the contingency notion that, to sustain 'fit'; diversifying companies needed to divisionalize. This particular version of environmental determinism is enriched in two ways. First, the Marshallian biological analogies are used to make the concepts of both firm and environment more dynamic [life-cycles and experience curves]. Second, the relationship between structural evolution, fit and performance is explored. The SSP paradigm dominates the empirical work in our field, explaining enough of the variances for us to recognize the power of these models; but still leaving the major part of the problem to the practicing strategist.

Despite its successes, the SSP paradigm has many obvious weaknesses. First, its view of the passive instrumentality of managers as they make the organization adapt to environmental change is inadequate. Management may

decide to force the environment to adapt instead, or they may move the firm to a more advantageous environment. Bower shows that such moves reflect management's interests. Similarly Child argues that the dominant-coalition's political processes influence the firm's response. The argument is that management, in one way or another, mediates actively between the environment and the firm and may reverse the SSP paradigm's implicit causality. Thus the paradigm does not adequately describe the constraints on the strategist. This is partly because the idea of an identifiable boundary between the firm and its environment is bearing too much of the analytic burden. We merely compound this by defining the environment tautologically as that which the firm cannot control. Finally the paradigm has been developed with such generalized variables that the practical strategist finds it difficult to know what lessons to draw. The uncertainties of bounding and classifying environments and of measuring corporate structure rob it of much of its relevance. Certainly, our notion of uncertainty as data-failure has nothing in common with those environmental determinists who treat it as a measurable feature of the environment (Aldrich 1979:126). Of course, the failure to formalize any rigorous theories of entrepreneurship -- which are, after all, theories of business strategy under extreme uncertainty -- indicates how difficult it is to work with this data-failure notion.

The IO Paradigm:

Paradigms are shifted by showing how, when a subject's central problems are reconstructed in a new language, new insights emerge and new lines of enquiry open up. Business strategy is now being reconstructed within the language of industrial organizations economics [IO]. IO itself emerges in the middle ground between an essentially determinist position [pure competition] and an essentially volitionist position [pure monopoly]. Hay and Morris argue

that Chamberlin's theory of monopolistic competition, albeit theoretically flawed and empirically ambiguous, facilitated new connections between economic theorizing and available industry data (1979:17).

For strategy theorists, Chamberlin's important contribution is the 'competitive group' (1962:81). This introduces two notions. First, that firms experience market features which retard the tendency of competitive forces to erode super-normal profits. This makes product differentiation, protection, and some degree of persistent monopolistic profit available. The market environment that this implies is a patchwork of finite heterogeneous domains. Each is a market for a differentiated product for which there are, in the short run, only imperfect substitutes. Second, firms investing in productive factors actually obtain resources which are specialized to particular uses. When these two features are taken together, we can see how a number of firms might have similarly specialized resources and, applying them in the same domain, so come into an unprotected competitive relationship. They compete among themselves most effectively, and maximize their profitability, when their relatively immobile resources 'fit' their chosen domain. If these firms' relatively specialized resources are also in limited supply they may, as a group, be able to resist competitive pressures, raise entry barriers and gain sustainable super-normal profits by exercising monopolistic power over their suppliers and customers. The group as a whole competes imperfectly with groups operating in other domains. When these features are present, taking advantage of them will be revealed by the group's concentration, the degree of the member firms' vertical integration, diversification, capital intensity, R&D and advertising behavior etc. These are the dimensions of the group's 'market structure'. Further development by Mason and, later, Bain, made the paradigm hugely important for its anti-trust and economic policy implications.

The IO paradigm allows us to pose strategic questions which cannot be posed within the previous paradigms. The most fundamental arise from the lumpiness and stickiness of the environment, the finite size of the market domains and of their entry and exit barriers. Remembering that this paradigm enfolds the previous ones, we can see that market domains will differ not only according to their profitability but also in their position in the life-cycle, their rate of technological change, their turbulence and so forth. Research within the SSP paradigm still continues to draw samples from different domains and so confounds any organization structure - performance effects with these differentially distributed market structure - conduct - performance effects.

As Hay and Morris make clear, the competitive group approach is crucially dependent on 'uniformity' within the group (1979:11). Under Bain's influence the competitive group became identified with the 'industry' and with the SIC market segmentation scheme within which industrial data is collected. The paradigm became of much greater interest to strategists when Hunt (1972) and Newman (1979) showed that strategic managers perceive significant sub-groupings within industries. Hunt dubbed these 'strategic groups' (1972:15). The term, of course, really defines a market sub-domain or 'niche'. Firms that are similar but do not compete in the same niche are not in the same strategic group. In addition, while strategic groups within some industries may contain a number of competing firms, others may contain only one, or indeed, may be empty. The framework offers an element of strategic choice in allowing firms to move to different niches within an industry 'fit' bring an assumed objective in each case.

Porter's text is a comprehensive statement of the strategist's version of the IO paradigm (1980). But Chamberlin's inability to define the competitive group remains a complicating factor. Both Hay and Morris (1979:21) and Porter

(1981:615) argue it leads to a two-level (group and firm) analysis. Thus strategic groups are described loosely, by their market structure as well as by the specialized resources firms apply within them. Strategic maps are drawn with exceedingly problematic dimensions (1980:131). Nevertheless the strategist can distinguish inter-group competition from competition within the group. Porter brings these two levels together by considering the 'degree of rivalry' firms experience overall. The group structure, coherence, concentration, cost structure, position in the life cycle etc. is one determinant of this. But the extent to which the group is in equilibrium with, or under monopolistic pressure from other groups is also another. Porter then argues that rivalry reduces the group's profit potential (1980:3).

The strategic I-O paradigm, enfolding the old, still sees strategy as the process of relating the firm to its environment. But it changes the strategist's options by redefining the environment as heterogeneous. Within the SSP paradigm the strategist makes the firm, especially its structure, adapt. The environment is given, either static or evolving along with the corporate life cycle. Within the IO paradigm, Porter argues, strategy boils down to choosing which strategic group to compete in (1980:149). The firm has options of staying in its initial niche which it might seek to make more secure, moving to another niche, or of creating a new niche (1980:150).

Weaknesses in the Strategic-IO Paradigm:

From the strategist's perspective an obvious weakness of the strategic-IO paradigm is in the way the two levels of analysis are joined, in the implication that the determinants of the group's profitability also determine the firm's profitability. Since the strategist's objective is to maximize profits we can argue that strategy should really be focused on the uncertainty of this

link and on the strategic choices it offers to increase the intra-group profitability variance and position the firm at the upper end of the resulting distributions. This view is reinforced by casual inspection of corporate financial data which suggests substantially greater profit variance within competitive groups than between them. A second weakness is that strategic-IO writers such as Porter and Harrigan base their analyses on the paradigm's principal notions, such as entry barriers, life cycles, and market-share effects, quite uncritically. Economists, on the other hand, are in considerable disagreement about their theoretical soundness and empirical significance. The literature here is huge, Scherer's text providing an excellent overview (1980).

But, for the strategist, a more fundamental weakness grows out of a basic contradiction between the idea of specialized resources, which gives the strategic group concept its force, and the idea of inter-niche mobility. Far from focusing on particular niches, the analysis needs to clarify the inter-niche differences which the firm will see as a mobility barrier (Caves & Porter 1977). Instead of deciding which group to compete in, the firm is really faced with trying to compare the relative certainties of staying put with the relative uncertainties of moving specialized resources to other uses. As the niches are probably qualitatively different (Caves & Porter 1977:252), it is not clear how the strategist is supposed to make this comparison. Here the strategic-IO paradigm merely reexamines Ansoff's earlier analysis of diversification risk from a market structure rather than a resource perspective. Ansoff tries to compare his firm's 'competence profile' with the 'competitive profile' of the successful firms in the target industry (1965:100).

At this point we can recollect our premise that practical strategy-making occupies uneasy middle ground between determinism and unconstrained volition. So what seems to be a weakness in the deterministic model may, in fact, be a

powerful way of framing the most classic concept of entrepreneurship - the innovative application of resources to new uses (Schumpeter 1934:137). Crossing a mobility barrier entails a more fundamental kind of uncertainty than that above, between the strategic group and the individual firm.

Since entry, mobility and exit barriers are all of the same type (Caves & Porter 1977:241) we can abandon the mixed two-level analysis of the IO paradigm and focus directly on the firm and the specialization and mobility of its resources. The IO paradigm requires a group level of analysis. The member firms' super-normal profits, which are the phenomenon to be explained by monopolistic competition theory, only persist because of the inter-firm arrangements. Oligopolistic interdependence requires more than each firm's monopolistic power. Thus Caves & Porter note that entry barriers can be viewed as a collective capital good on which the members earn a rent (1977:247). Chamberlin's theory is about protecting rents, whose origin is unspecified, under competitive conditions -- which is why it is so often described as collusive. The rent sources remain unclear. Williamson argues they follow when uncertainty causes a breakdown in the self-policing properties of markets (1975:208). Caves & Porter argue they follow from random initial differences in the firms' relative preferences and assets (1977:253). Thus the business strategist, who is at the level of the firm and wants to address the Schumpeterian problem and generate rents, finds the strategic-IO paradigm wanting.

Part II - The Property-rights Paradigm:

Property-rights notions grow out of the interaction of economic and legal analyses of commercial activity. The perfect rationality assumptions of economic theory seem to imply a perfect concept of property. This vests an owner with absolute control over a property's use and disposal, subject only

to the market's behavior. In practice, one of the law's functions is to ensure that ownership is legitimately constrained by the social system as well, whether by royal or feudal prerogative, statute, common law or simple custom and practice. Indeed the concept of private property is necessarily two handed, both giving use and disposal rights to owners and denying them to non-owners. Thus Coase remarks: "A system in which the rights of individuals were unlimited would be one in which there were no rights to acquire" (1972: 171).

The property-rights literature is complicated by being gathered around three related, but nevertheless distinguishable, points. Each tends to generate its own language and problems and three distinct paradigms may well develop in due course. Currently there is extensive overlap. We note that:

- (i) Commercial transactions involves exchanging bundles of property-rights. Each right expresses one bound of the total envelope of uses and constraints which are attached to a good or service. Since what is being exchanged is not absolute but complexly constrained, the bundles are frequently difficult and costly to define. They are exchanged under various forms of contract which can be costly to frame, negotiate and monitor.
- (ii) Since these contracts are not for absolute rights, but for difficult-to-define constrained bundles, they are seldom completely tidy. Because of uncertainty, the exchanges have unforeseen and unintended consequences. One important topic is the relationship between principal and agent, where uncertain specification may let the agent work in his own rather than in his principal's interest. When the contract has finite duration (is long-term as opposed to spot) incomplete specification may invite opportunism by either party.

- (iii) These contracts are not carried out in a vacuum, but in a complex functioning society. Incomplete specification may lead to people other than the contracting parties being affected by its execution. The law's ability to control externalities and costs or benefits affects the value of the contract to the contracting parties.

Contracts and the Exchange and Enforcement of Property-rights:

These points, of course, raise a multitude of questions for the business strategist, bearing in mind the view of the firm as a legal fiction which serves as a nexus for a set of contracting relationships among individuals (Jensen and Meckling (1976)), or as a bundle of contracts among the factors of production (Fama 1980:289). One concerns the nature of the contracts that businessmen make. These are discussed by Cheung (1969), Williamson (1979) and Klein & Leffler (1981), among others. Thus society's institutions form a legal environment which, to a considerable extent, delimits the businessman's freedom to contract. Klein & Leffler suggest these basic forms of contract (1981:635):

- (a) explicit contract, with third party enforcement. The underlying concept is that the parties will attempt complete specification. Subsequent mis-specification will be resolved impartially, either by the courts or by arbitration (Williamson 1979:238).
- (b) implicit contract, with direct enforcement by the contracting parties. Here we recognize that direct enforcement can work satisfactorily for a wide variety of reasons -- from the parties' mutual commitment and trust in each other, to each acting purely in his self-interest.

- (c) explicit "one-party" contracts such as the authority relations operating within organizations or between vertically integrated operations.

It may be helpful to see, given a belief in the efficiency of market forces, that (b), the 2-party contract, is the 'natural' self-equilibrating form of economic activity. The 3-party and 1-party forms can be seen as social responses (assuming they are legitimated individual responses) to 'market failures'. By this we mean the failure of individual self-interest to 'police' the transaction and maximize social welfare (Coase 1937:392, Williamson 1971: 114, 1975:5). Although much of the subsequent 'transaction cost' literature treats these as directly comparable and thus alternative forms of organization, it is clear that this overlooks the essence of the property-rights paradigm, i.e. that all forms of property are contingent and determined by their social context (Alchian and Demsetz 1973). In practice, these three types of contract are nested within each other; just as in Coase's illustration (1937:402). Administrative direction is bounded by the market transaction between firm and employee and that, in turn, is bounded by social and legal norms. As Loasby remarks, the failure to recognize that 'decisions' at these three levels are not comparable has led to widespread misunderstanding of Coase's work (1971: 881). Because of this, although Coase explores the idea quite explicitly, it seems clear that his work cannot be treated as a simple extension of the marginalist paradigm (1937:395).

Contracting in uncertain circumstances:

The question of alternative forms certainly does arise when we consider mis-specification of the basic 2-person contract, whether it occurs because of costliness, immeasurability, deceit or any other source of uncertainty. This inability to fit the contract as conceived to what eventually happens opens up

the possibility of residuals (Alchian and Demsetz 1972:782) or quasi-rents (Alchian 1982:14). As Marshall makes clear, quasi-rents are not necessarily positive; when the contract is complete the conclusions may be surprising either way. Since they are not covered by the contract, the allocation of these residuals and quasi-rents (RQ's) presents a problem. Plainly, it can be solved in a variety of alternative ways, which suggests the usefulness of alternative forms of contract and, indeed, the possibility of mixed forms. Thus we can imagine a straightforward contract to grow corn on a piece of land, the farmer paying the going market price for the labor, with a contingency or sub-contract that any excess produce over a certain amount be allocated by a third party.

But mis-specification also creates opportunities for the parties to vary their performance. Motivated by self-interest, they may behave opportunistically. Thus the laborers in the preceding example may carry off sufficient of the crop immediately before harvest to eliminate any chance of not getting all of the excess. The farmer may respond by employing inspectors which, increasing costs, reduces the residual to be distributed. The problem to be solved by the transaction cost argument is that when the allocation of the residuals begins to dominate the contract relationship, the 2-party contract fails.

While the problem may be clear, it is less clear how the contracting parties can best deal with it. One answer is to bring both parties into some joint administrative or hierarchical framework, of which the firm is but one example. There is a certain circularity in both Coase's and Williamson's treatment of why the parties would do this without demanding an initial payment which is equivalent to the fruits of their opportunism.

There are two kinds of argument which carry beyond this point. Both imply placing the contract and its problems, in a larger framework and, in

effect, implying the 3-level model we outlined earlier. One line appeals to further market forces. Thus the 'agency problem' literature argues that managers' opportunism is policed, without cost to the shareholders, because there are markets for managerial services within and without the firm (Jensen & Meckling 1976, Fama 1980, Alchian 1982, Fama & Jensen 1982). But, plainly, this argument fails if, as most organization theorists argue, there is both uncertainty and systematic distortion of information about managerial performance within the firm. This argument can be recast between firms by saying that the expectation of a long-term trading relationship polices opportunism within each particular transaction (Klein, Crawford & Alchian 1978, Klein & Leffler 1981). Again the argument fails whenever either party is able to disguise its opportunism -- for instance, by hiding excess profits under unproductive managerial indulgences.

The general theoretical approach, assuming the failure of the 2-party 'natural' contract, is to find another set of market forces. Although these operate at another level of the system, they embrace and thus costlessly police the failed market. The thrust of Klein et al.'s analysis is to establish the forms of contract which facilitate rather than impede this interaction of levels. The argument has much in common with analyzing the internal arrangements which enable a vertically integrated organization to use their monopolistic power in one market to strengthen their position in another.

A quite different line of attack is explicit in Alchian and Demsetz's assertion that firms are economic organizations formed to facilitate cooperation (1972, Alchian 1982). Rephrasing Ansoff's earlier definition of synergy (1965:75) they argue that firms exist because of 'team production'. This is activity in which a union or joint use of inputs yields a larger output than the sum of the products of the separately used inputs (1972:794). They then

argue that, so long as there is an unambiguous residual claimant, he has an incentive to act as an employer and monitor the team members for opportunism or shirking. The employees, too, have an incentive to enter into this arrangement, because they cannot otherwise have any chance to share in the marginal (synergistic) product of the team. Alchian later re-structures this argument calling the inputs 'interspecific' so long as their quasi-rent potential depends on some other resource (1982:14). The firm is thus an efficient, privately owned market in which factor owners interact in pursuit of the inter-specific quasi-rents. These are allocated by a privately-owned hierarchy which is quite separate from the broader socio-legal context.

While the property-rights paradigm enables us to address the detail of the firm's arrangements in terms of the interaction of two contracting parties, it also deals with two special cases. First, the 3-party contract is an apparatus by which the social costs and benefits, the contract's effects on parties other than the principals, can be brought to bear. Thus the state, in the interests of protecting these parties, may influence the market in which the basic 2-party contracts are being formed. Second, a special set of situations arises when operating at the interface of the private and public domains, when property rights are being established for the first time (Demsetz 1967). Although by definition, these 'contracts with nature' are unpoliced they can achieve equilibrium because of the contradictions among the actor's self-interests; when, for instance, the marginal utility of further acquisition drops. The detailed structure of these emerging property rights is likely to reflect the technology of their use as well as the actors' social structures. The two cases combine, of course, in regulation and raise questions about when 'natural' regulation, relying on market forces, is more efficient than state regulation.

Strategy in the Property-rights Paradigm:

The paradigm restates the strategist's problem in two ways. First the organization/environment dichotomy disappears and the firm is reconceptualized as an interaction between those with property rights over the various 'factors of production'. [Here we include demand for goods and services along with the classic factors.] Second, the pattern of interaction is asymmetric, reflecting the private interests of those with rights over the residuals. Here we disagree directly with Fama when we argue that the ownership of the firm is important [1980:290]. His argument carries, of course, when there is no uncertainty and, therefore, no residuals.

The paradigm pay attention to those whose interests bear on contract-making for the factors of production extending beyond the immediate and potential customers and suppliers to 'nature', to those affected only indirectly and to those who arbitrate or adjudicate. Most important, however, is the paradigm's focus on the RQ's. There is no question that the strategist must direct his attention to the uncertainties which prevent equilibrium conditions and so make RQ's possible. This merely restates the old idea that business is about the pursuit of rents and quasi-rents [Walker 1887]. These can arise in two distinct ways:

- (a) as residuals in contracts with any factor-sources.
- (b) as inter-specific quasi-rents.

Without an identifiable organization, it is not immediately clear who are the parties to the contracts we have been discussing. The firm is now merely a channel facilitating the interaction between factor-sources. Thus, conceptually at least, the firm makes no 'one-sided' contracts. It does not just acquire a specialized resource. It strives for a balanced portfolio of contracts which anticipate the transformation of this resource back into unspecialized resources, i.e., cash. The contracts we imagine here are both 'in'

and 'out', both 'buy' and 'sell', albeit separated by time, by qualitative changes of substance and, of course, uncertainty. The firm is simply a middleman of no substance deal-making a complex of contracts. His interest is limited to the residuals alone as he becomes the 'extra' party to any contract.

The strategist can pursue RQ's in three main ways. In 2-principal contracts, with advantageous negotiation, he can tilt the effects of uncertainty preferentially in his direction, treating the situation as a zerosum game for the residuals. Since he makes no investment and is being opportunistic in 'introducing' the principals he can benefit from what Alchian calls a 'bargain' (1982:15). Plainly, in a long-term trading relationship, the size of his 'cut' must be limited, otherwise the principals will bypass his 'firm'. We might call these residuals the rewards for good trading. He can also provide the 'private market' coordinating function which joins together the two parts of the contract. He represents the buyer when dealing with the seller, and vice versa. While he may charge a factor return for their service, he is able to gather residuals to the extent that he can sustain a less-than-perfect market. These will be the residuals for good management. Alternatively, the strategist can focus on the interspecific quasirents which are generated when two or more contracts interact under his management. These will be the rewards for good entrepreneurship. While these activities are distinguishable in a stable going concern, they will clearly coalesce when the business or the industry or the economy is just emerging.

Strategic management:

By breaking the firm up into a bundle of contracts, the property-rights paradigm bring us into direct contact with the RQ's that are the source firm's economic profits. Managing them can be roughly separated into four areas.

- (i) Insight
- (ii) Positioning
- (iii) Direction
- (iv) Husbandry.

Insight means seeing the possibility of residuals or quasi-rents. Positioning means establishing the contractual position which generates rights over the residuals. Direction means ensuring the completion of these contracts. Husbandry means sustaining the value of these contracts which, as Williamson argues, are generally either long-term or imply a long-term trading relationship.

Insight is the essential foundation of the entrepreneurial act, seeing the possibility of new contractual arrangements. The Schumpeterian search for new uses for existing resources is but one of the more general set of possibilities. The property rights literature discusses a number of cases in which there is insight into the failure of the government to assign property rights in a 'natural' way, so opening up structural opportunities for opportunism. Thus treating oil and lumber as 'fugitive' goods creates incentives to overwork them (Libecap & Johnson 1974, Alchian 1982:248). The way property rights are assigned can make 'natural' 2-party contracts virtually impossible to produce, the 'apex-theory' in copper-mine legislation being one example (Glasscock 1935:152). Thus the strategist must ground his thinking in the structural and behavioral specifics of the markets in which he looks for factor contracts. Ultimately the constraints on his imagination are his inability to achieve interspecific quasirents as his contracts become less and less related. Thus resource mobility is not defined 'externally', as in the strategic-IO paradigm, but 'internally' in terms of the contractual interrelations.

We have discussed positioning at some length. It is the design phase of the strategic management problem. In addition to creating the possibility of RQ's, the strategist must also prevent their dissipation through detailed attention to appropriation, shirking, agency-problems etc. Directing is the control and implementation phase and this requires data. Thus the strategist needs to design with the detail of the measurement possibilities in mind (Barzel 1982). Husbandry will be necessary to protect the RQ's from imitation, replication etc. and patents and trademarks achieve this to some extent (Mansfield et al. 1981). But it will also be necessary to make up for any tendency for the RQ's to become obsolete, through natural causes or others' R&D.

Summary:

In this paper we look at the evolution of strategic theorizing. We argue it has passed through a series of paradigmatic phases, each reflecting a set of social concerns about the way business is conducted and forcing managers towards richer 'theories of the firm'. The importance of the strategic-I0 paradigm cannot be disconnected from the anti-trust activity which Chamberlin's idea helped focus. Similarly today's widespread concern with managerial behavior, government intervention and corporate social responsibility are forcing another set of changes. The property-right paradigm can help strategic managers and theorists alike broaden and deepen their understanding of commercial activity in a sophisticated property-owning democracy.