

Paper to be presented at the DRUID PhD Winter Conference
Aalborg/Rebild Bakker, January 16-18, 2003

LONG LIVE THE “HYBRID”: WHAT TRANSACTION COSTS ECONOMICS LEFT UNSEEN

Tina Brandt Husman

Danish Research Unit for Industrial Dynamics (DRUID)

Department of Industrial Economics and Strategy (IVS)

Copenhagen Business School (CBS)

Howitzvej 60, 6., DK-2000 Frederiksberg, DENMARK

Phone: +45 38 15 25 37 - Fax: +45 38 15 25 40 - Mail: tbh.ivs@cbs.dk

January 2003

Comments Solicited!

Work In Progress – not to be cited or quoted

Abstract:

Inquiring into transaction costs economics' (TCE) definition of uncertainty has been pushed by insights into the organisation of activities, as they are observed for example in advertising agencies when producing advertising campaigns. A curiosity over the reasoning of the transaction costs theory regarding hybrid governance structures' ability to cope with uncertainty, and thus regarding their “survivability”, elicited an examination of Williamson's definition of uncertainty. It is argued that TCE's centre on outcomes of economic processes, rather than on processes of competence development and a detailed study of coordination of uncertainty in production, makes it difficult for the TCE to reveal coordination potentials that can be observed in some forms of hybrid governance structures, that is, in the interfirm project organisation. The production process uncertainty observed that the interfirm project organisation is proposed capable of handling, implies that there must be exceptions to when Williamson's reasoning regarding hybrids' survivability relative to the firm and the market will hold true. Where artistic and creative elements are crucial to production such as found among others in advertising, but also in other industries, such coordination of activities is required. Situations where production process uncertainty, requiring flexibly used resources, is experienced and which are not embraced by TCE's definition of uncertainty, Williamson' conclusion may be reversed: some forms of hybrid governance structures, the interfirm project organisation, may perform better than the market and the firm under such conditions.

Keywords: Hybrids, project organisation, coordination, internal organisation, uncertainty, creative industries

Acknowledgements: V. Mahnke and K. Foss's TCE insights are gratefully acknowledged. The usual disclaimer applies.

LONG LIVE THE “HYBRID”: WHAT TRANSACTION COSTS ECONOMICS LEFT UNSEEN

I: Introduction

It is in the conception of the hybrid as understood by Williamson, and especially his definition of uncertainty, this paper departs. Departing in TCE is challenging not the least from the point that Williamson himself has claimed (1985) that in terms of transaction costs economics' ability to explain decisions of vertical integration, it has beaten all-comers. Transaction costs economics indeed with its emphasis on asset specificity does provide a good explanation as to whether to internalise or externalise an activity in production processes. As Holmstrom and Milgrom (1994) notes make-or-buy decisions are one of the most studied topics in the theory of the firm. However, as will be argued in this paper, looking at production of other types of products and services of a more illusive character in terms of deciding product content *ex ante*, such as with many creative products, transaction costs theory in its current form still has leaves something unseen.

This paper argues that transaction costs economics' (TCE) orientation about outcomes of economic processes, rather than about the processes of competence development and coordination of processes, makes it difficult for the TCE to reveal benefits of coordination that can be observed in some forms of hybrid governance structures (Williamson 1990; 1991). Williamson defines hybrids as: “*various forms of long-term contracting, reciprocal trading, regulation, franchising, and the like*” (1991: 280; 1996: 104). TCE has often been subject to criticism. For example TCE has been criticised for viewing the firm as an adaptive system only that via make-or-buy decisions obtains perfect fits between the way in which transactions are organised and the surroundings of these transactions (Knudsen 1997). TCE thus has been criticised for being incomplete in only resting on functional types of explanations by focusing on the outcome of economic processes rather than on the cumulative processes of learning and new competences development over time when explaining the existence and boundaries of the firm (*ibid*: 1997). This paper recognises the contributions of TCE, among others for explaining make or buy decisions, but also the paper should be seen as adding to the criticism already put forward. It does so by pointing to a condition of uncertainty, that Williamson has not hitherto incorporated in the TCE framework, and which ultimately may lead to an inversion of Williamson's conclusion about the potential and survivability of hybrid governance structures relative to the alternatives of the firm and the market.

The interfirm project organisation, defined as *a structure of autonomous agents or firms, often co-localised, that possess complementary capabilities and temporarily cooperate to meet predefined objectives within predetermined deadlines through a non-repetitious string of complex activities* (see also Husman 2002; Dynamo), may be seen as one type of hybrid governance structure although they differ in certain aspects (see Section III). The argument is that the hybrid, the interfirm project organisation notably, possesses advantages in coordination that the governance structures of the firm and the market, as conceived by Williamson (1973; 1985), do not. The advantages in coordination of the interfirm project organisation the TCE framework has not been able to reveal since outcomes of economic process rather than the cumulative processes of competences, have been the studied object. Hybrid structures' ability to handle certain types of uncertainty associated with the production process of certain products, in particular those of advertising and other products requiring artistic elements, consequently have not been overt in a TCE framework.

The following explicates the argument in detail. Firstly, uncertainty as in the production process of an advertising campaign is discussed in Section II with the purpose of identifying and illustrating what *product content uncertainty* is. As follows in the concluding discussion it is suggested that product content uncertainty may not be unique for advertising productions, but a more general characteristic of products requiring certain creative processes to be competitive. The objective of Section II is to account for a type of uncertainty that Williamson's TCE framework left unobserved and thus not embraced in his definition of uncertainty. Following this, Williamson's TCE analysis and his assumption of uncertainty are discussed in some detail. Williamson's Figure 3 (1991:292) (see Figure 1.1a) of the transformation between the firm, the market and the hybrid is reviewed. Finally, the type of uncertainty observed in production of advertising campaigns, is suggested incorporated into Williamson's definition of uncertainty. In proposing this, the implications of the redefined assumption of uncertainty, now embracing also product content uncertainty, for TCE's transformation between governance structures are examined: some products possess *product content uncertainty* in that they are complex to plan production for *ex ante*, requiring a flexible organisation of activities; under such conditions this interfirm project organisation as a form of hybrid governance structures may be *preferred* by management to the alternative governance structures of the firm and the market, rather than be a governance structure management is forced to choose as a last resort option.

II: The Advertising Campaign Production Process¹

The purpose of this section is to illustrate what is meant by *product content uncertainty*, a type of uncertainty present in the production process of an advertising campaign. Product content uncertainty is argued not to be embraced by Williamson's definition of uncertainty (see Section III) and thus constitute a condition of uncertainty not following the reasoning Williamson proposes about the survivability of interfirm project organisations: *when uncertainty increases, the likelihood of hybrids as being suitable governance structures decreases* (see Section III for details). This reasoning of Williamson will be inverted, that is: *when uncertainty increases, the likelihood of hybrids as being suitable governance structures increases*. Why this is the case can be seen from observing production processes in industries where artistic innovation, design, and creativity constitute both crucial inputs and processes for firms in the industry to be competitive. The theoretical implications of this are discussed in the following sections. The objective here is not to provide a comprehensive insight into advertising businesses, but merely to provide content to and illustrate what the following theoretical Sections highlight. A few words to understand what advertising means is required prior to discussing uncertainty.

II.I The Role of Advertising

Originally, advertising agencies emerged to buy and sell space in the media. Today, the activities have broadened. Advertising may be defined as paid-for communications in the media aiming to persuade, sell or inform an audience. Advertising, together with other service industries (management consulting, IT and recruiting services) have throughout the 1990s, compared to other industries, experienced growth both in employment, value added and revenue in Denmark (Ministry of Trade and Finance 2002). The last years' recession, however, has moderated the figures.

Both commercial and non-commercial clients, advertisers, such as government departments, political parties, trade unions and charities, make use of advertising agencies. Advertising activities are often outsourced to advertising agencies, as clients (advertisers) themselves do not possess the resources and capabilities to market own services and products in a satisfying manner, or because outsourcing is perceived better than having to learn the required skills themselves. Professionals external to the firm, among others, can ensure a more objective interpretation of the communication challenges, as well as, possibly contributing to selling the marketing manager's plans within the firm.

¹ This section serves only an illustrative purpose. Insights into the advertising industry stem from structured and unstructured interviews conducted with industry experts continuously since 2000, and my past in the industry.

In 1999 there were 3.984 advertising agencies in Denmark² employing 15,510 workers, 8,339 of these were full time employed (DST Company statistics). International corporations own several of the agencies. Grey, Bates, Republica and DDB account for some of the biggest agencies in Denmark. Geographically, the advertising agencies are located concentrated in in larger cities such as Copenhagen, Aalborg and Aarhus.

An advertising programme is generally referred to as a *campaign*. Campaign is defined as: *A series of military operations undertaken to achieve a large-scale objective during a war* (The American Heritage Dictionary 2000), and thus origins in a military context. Advertising campaigns possess similarities with campaigns, as they have been understood in military terms. Similar to military campaigns, an advertising campaign usually includes a series of advertisements in different media and is based on calculations of the media's *reach* and required *frequency* within the target group. Furthermore, an advertising campaign can be seen as continuously adapted to meet advertiser's competitors' attacks and counter attacks on previous campaigns. A battle takes place, and it is therefore sometimes complex to clearly determine when one campaign is over and a new takes over. These characteristics advertising campaigns have in common with military campaigns, and they have implications also for the production and organisation of activities. These are as such characteristics that require a flexible organisation where new strategies and resources (weapons) constantly should be easy to mobilise within a short time span.

Analogous made to military campaigns shows some of the characteristics that distinct the advertising industry's use of interfirm project organisations from how it is being used in other industries. For example, in industries of building or oil construction using interfirm project organisations (Stinchcombe 1985; Gann 1994; Gann and Salter 2000) is done to serve different requirements than those of for urgent responsiveness to changes in the economy and environment such as is the case in the advertising industry and often in other industries where creative and artistic elements too are crucial for business. Industries such as pop music production, news industries, film and theatre productions may provide other examples of such industries, where uncertainty can be in product content and where, some of the industries, are sensitive trends and fads are central to conduct business.

II.II Product Content Uncertainty

Alone in the comparison between hints are provided as to why the interfirm project organisation is vigorously used and a suitable governance structure for advertising agencies, their clients and their suppliers. It provides opportunities of diversity and quick adaptation to resource need, that is, provides flexibility in resource allocation.

² Including other advertising agencies and advertising mediation.

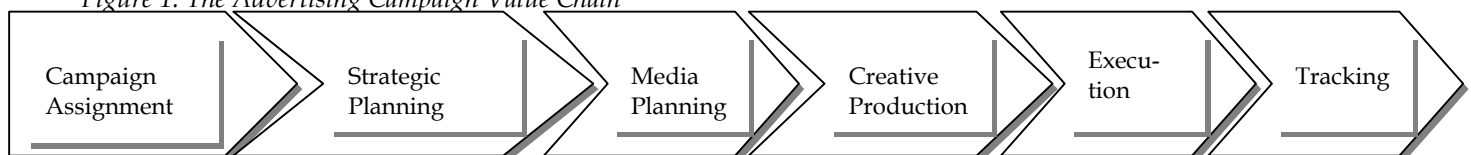
The activities, tasks and agents involved in a typical advertising campaign production process is outlined in order to provide examples of where in the production process, and in between which agents, product content uncertainty is present and thus necessitates flexible resource allocation. As the purpose is only illustrative, the only overall traits are pointed to.

II.IIa The Advertising Value Chain

Activities

Often advertising is just one component in an advertiser's marketing plan that also includes many communication efforts – public relationships, promotions, direct mail etc. Advertising runs through a production process similar to what can be illustrated the generic value chain (Porter 1985) in Figure 1. No two advertising campaigns run identical, Figure 1 depicts only a rough chronology of how advertising is typically created in a typical full service³ advertising agency. Big full service advertising agencies may offer more content in terms of media offered (both radio, web design, TV advertising, SMS, Outdoor material etc.) or pre- and post testing of advertising, influencing, for example, the creative, execution and tracking stage. The size, network and financial opportunities of big advertising agencies make such broader scope possible compared to the smaller advertising agencies. The labels in Figure 1 indicates the outcome of the activities performed in each stage, and thus the value added throughout the production process from initiation of the campaign to its execution and possible post testing of the advertising effectiveness.

Figure 1: The Advertising Campaign Value Chain



Depending on whether it is a new project for the advertising agency, that is, a new good, service or new client, the campaign assignment and strategic planning stage will take longer time. What comes more, all "stages" may not be followed in all campaign productions, as well as, the workflow of an advertising agency is not sequential and predictable. Feedback processes and changes may take place both between the different stages of the production process, as well as within the group of activities indicated in the boxes. Furthermore, to save costs clients may sometimes choose, for example, to coordinate production or make the copy write text itself.

³ Full service ad agencies can provide all types of communication tasks from TV- and cinema advertising, radio spots, brochures, direct mail, point of sales material etc., as opposed to specialised agencies for example within promotion, direct marketing, public relations agencies or the like

The group of activities refer to:

- 1) **Campaign Assignment:** The account manager with the client details the firm's business objective and from this define the role that advertising is expected to play, that is, if both TV advertising, direct mail, promotions etc. should be included.
- 2) **Strategic Planning:** The account manager with the team of a strategic planner, an art director and copywriter do research and on basis of this make a compelling story about the product, that is, a *positioning statement*, and a unique message to guide the creative part, that is, *the creative brief*.
- 3) **Media Planning:** During the strategic planning stage, media planners do research to finalise a *media plan* based on the media profile and consumption habits identified for the target group. The client approves the media plan before the media is bought. The advertising agency makes suggestions for the use of media, but then typically hands the actual planning and buying over to separate media agencies, that then bill the client directly.
- 4) **Creative Development:** The creatives develop drafts of the ads, consult the account manager and strategic planner for fine tuning and present the final for the client who approves. Desktop publishing, that is, refinement of the creative layout, is continuously drawn upon in this stage. At this stage the advertising may be tested among consumers by an external research firm or sometimes the ad agency itself. Especially at this stage changes may be required. External production companies produce TV, radio and print material most often.
- 5) **Campaign Execution:** A traffic manager distributes finished advertising material to the media according to the media plan. TV and radio spots can be send just a few days before air, while magazine ads needs to be send one month prior to publication.
- 6) **Tracking:** Is today mostly done by big advertisers, as it is a costly activity. Changes in the target group's opinion and changes in product sales are examples of ways to do evaluate the advertising campaign's effectiveness and reveal possible further changes needed.

Most revenue is generated in the creative development stage, this is, however, also here expenses in form of salaries are greatest. Salaries to creative personal are seller's market, and for this reason small advertising agencies in particular tend to make use of freelancers more frequently than do large advertising agencies. Besides creative activities, however, rents are generated also in research activities offered.

The Agents

Figure 1 tells us nothing about where the activities are performed, that is, who generates the value added. Both inhouse agents, as well as agents external to the advertising agency, are involved. Similar to the advertiser outsourcing communication activities, the advertising agencies face outsourcing decisions. The agents typically involved in the Danish advertising campaign production process can be summarised as in Table 1 (managerial staff is not considered).

Table 1: Agents in the advertising campaign production process

INTERNAL ACTORS	EXTERNAL ACTORS
	Client
Account manager	
Creatives (Art director/graphic designer and Copywriter)	Creatives
Desktop publisher	
Strategic Planner	
	Photographer
	Media buyer and planner
	Pre-tests (focus groups)
Production Coordinator/(Traffic Manager)	
Traffic Manager	
	Interactive agencies (providing technologies for SMS, NMS, voice response, CRM/dialog marketing)
	Film producer (incl. contacts to actors, styling agency etc.)
	Radio producer
	Print production agency
	Sound production studio
	Direct marketing Agency
	Public Relations Agency
	Promotions/trade marketing/P.O.S agency
	Event marketing/Sponsoring agency
	Business Consultants
	Research agency (offering post-test and tracking)

II.IIb Examples Of Product Content Uncertainties

Product content uncertainty is complexity related to the product's content. As such it is an uncertainty that will remain part of the production process irrespective of uncertainty and disturbances in the environment.

Product content uncertainty derives from complexity of explicating content and features of the product prior to production. Advertising is one example of an industry that experiences this type of uncertainty. In advertising, uncertainty arises from the need of constantly having to produce unique products, here in form of campaigns, which differ in originality from what already is at the market. Advertising campaigns to be efficient must differ from that of other advertisers within the same line of business. The visual design, the copy writing, the media mix (should both TV and radio and newspapers be used, or should only events of product trials be planned), and timing of exposure, target group etc. are elements to differentiate. Among others to promote inspiration, idea generation and originally project teams, in line with research (e.g. the strength of weak ties Granovetter 1973), are rarely left intact for a long period of time before new teams are gathered.

A number of consequences follows when product content uncertainty is present; the *order and frequency* with which production resources are to be utilised can be hard to determine *ex ante*; with no clear conception of the product to be used it can be complicated also to for third parties *verify whether the finished product meet quality expectations* to, and

sometimes product content uncertainty implies that not even the roles the different agents are to play in production can be determined *ex ante*, making also the *contracts complex to write ex ante*.

The nature of product content uncertainties require a flexible organisational and contractual set up and agents willing, and with the suitable competences, to work under such conditions. For advertisers this flexibility must also be shown as to sudden price changes resulting from unexpected contingencies emerging. This contractual flexibility can be seen as a custom ingrained in the industry, and billing therefore is done per hourly rate. The following provides two small examples of the presence of such product content uncertainties in the production process of advertising campaigns.

Photo Shooting Activities

In new projects especially such as for example for new clients, product content uncertainty is vast as to what the advertising campaign should communicate and how the creative brief should be developed. Compared to campaigns for existing clients an overall communicative style may not have been developed. For a freelance photographer coordinating in particular with the project manager, this complexity of *ex ante* describing the product to be produced, here the campaign, implies a greater risk of having to re-shoot photos several times because the initial idea may take a different form than expected. The motif and number of photos to take, that is frequency and possibly even order, with which the photographer is involved, will sometimes differ. In addition to this, because the advertising campaign content is hard to explicit *ex ante*, the finished campaign quality has no expressed standard to be evaluated against. This is a general problem for product hard to express *ex ante*, but it is further complicated where the only alternative is a subjective evaluation of the quality and not even an industry standard or other standards have been developed for the type of product. Art for example presents such a problem. What is good or bad art is a subjective question, as individuals have not aligned preferences, experiences or personality. The photographer may be seen to be exposed to such a quality evaluation dilemma since what is good or a bad taste, what pictures associate with and which emotions may possibly awake is different in different people and thus subjective⁴. For this reason, a photographer needs sometimes to take new photos also because of such disputes about good quality⁵⁶. Photographer's

⁴ The discussion here does not look at situations where the photographer may be hired for a direct mail campaign where groceries are to be exposed to promote sales. Here the quality evaluation dilemma will be less complex as several standards to evaluate against exist, for example in competitors' direct mail campaigns.

⁵ The whole discussion may be understood partly also from Akerlof's (1970) asymmetric information and lemons discussion.

⁶ In fact this is a dilemma for the advertising industry in general. Campaign goals are sometimes to increase sales of a good, sometimes it is to brand an event or good or company etc. Quantifying for example goals of recognition of a brand into short-term campaign goals is complex as often brand building is a long-term process and multiple factors outside the campaign may affect brand building too. Thus, advertising effectiveness is a vigorously researched area where justification for the great ad spending budgets is searched for.

contractual arrangement with the agency makes room for such uncertainties of frequency and order.

The art director, copywriter and web-designer experience similar kinds of uncertainties as the photographer does. The quality evaluation dilemma may be even greater for art directing where emotions are often appealed.

Common for these agents is the creative, experimenting and explorative content in their activities contributing to the campaign. Although product content uncertainty may be particularly explicit in these processes, it may appear also in other stages of the campaign production.

Sound Production

Close interaction and feedback processes are required also for sound and film producers to perform their tasks, as the advertising agency and ultimately the advertiser demand it. Does the sound not appeal to the advertiser or to his/her expectations about its target group; sound production may need to be reproduced. The frequency with which the sound production company is to engage in the project is therefore not always to plan ex ante to starting production. The quality of the production in terms of the sound and what it associates to, not the technical production⁷, again may be source of discussion for the producers, the advertising agency and the advertiser. Similar complexity and product content uncertainty is experienced in advertising film productions. The fact that productions need to be customised to the extent they are, make the production process uncertain.

The purpose of this section was merely to provide content, and illustrate by use of a real world production processes, what is meant by product content uncertainty. The next sections return to the theoretical argumentation and review of Williamson's work on hybrid governance structures.

III: Hybrid Governance Structures: Transaction Costs Economics

Sociologists and business administration researchers (and geographers we may add) have for a while now studied transformation in economic organisation. Compared to this economists have paid little attention to this (Foss 2002). One of the few and important economists, however, who has addressed this topic is Oliver Williamson who explicated transaction costs theory (Coase 1937 ;1952 and Williamson 1975) to include also hybrid

⁷ The technical production can be compared to other advertising or sound productions in general, which thus provides an indication of standards and thus quality possible within productions. For experts such comparison should be possible.

forms of organisation. Williamson gradually acknowledged that hybrids were important and possessed their own distinctive characteristics, and thus earned attention in the transaction costs analysis framework (TCE) (1973; 1985). Williamson defines hybrid governance structures as: *"various forms of long-term contracting, reciprocal trading, regulation, franchising, and the like"* (1991: 280; 1996: 104), and can be seen as embracing equity Joint Ventures (see e.g. Hennart (1988) and Kay (1997)), but also other forms for example such as; the interfirm project organisation focal in this paper. Williamson's work on hybrid forms has since attracted other researchers' attention especially on Joint Venture research (e.g. Hennart 1988; Kay 1997; Hagedoorn and Narula 1998). The interfirm project organisation studied here distinct from joint ventures, but still possess characteristics in common with the hybrid forms (see Section III.II). The TCE has been criticised for providing a static analytical framework in leaving the internal organisation aspect, or micro coordination and process aspect, largely unexplored. As suggested this has consequences for Williamson's conclusion as to the survivability of hybrid governance structures.

Williamson's transaction costs approach to hybrid governance structures is outlined with the purpose of identifying why he reaches a different conclusion about the prospects of hybrids compared to the one proposed here, and consequently why coordination in interfirm project organisations needs to be examined for understanding the economic rationale of interfirm project organisations, and for understanding why they exist. The analysis of internal organisation or coordination in interfirm project organisation, can be seen as a relevant complement to Williamson's analysis which is criticised for still leaving such issues black boxed. Dietrich (1994) for example criticises TCE for being *"only half a theory"* because it ignores possible benefits from resource allocation in its comparative analysis of economic organisation. Likewise Grant, (1996) and Liebeskind (1996) criticise neoclassical and TCE theory for ignoring the knowledge resource and learning issues, and Kay (1997) stress how TCE and the literature on incomplete contracts are sparse on discussing internal organisation. Incomplete contract theory tells us: *"why the player is playing in the stadium, but that does not tell us much about how he is going to perform his work now he has arrived there. To see the firm as a contractual hierarchy as in Williamson's analysis, or characterised by incomplete contracts as in Jensen and Meckling's case is really to beg the question (of how resources allocation is coordinated within the firm (red.))"* (ibid. 1997:52). This study has a primary interest in studying projects, yet the coordination issues addressed may be applicable to other forms of governance structures too, and thus can be seen as contributing to addressing some of this critique of TCE. This paper acknowledges and stresses the notion of economising on transaction costs as well as TCE's approach of comparing alternative governance structures. An understanding of the advantages of interfirm project organisations, their economic rationale and reasons for existing, can only be obtained from comparing interfirm project organisations relative to alternative governance structures.

III.I The “Swollen Middle” Re-interpreted

The contribution of transaction costs economics (TCE) (Williamson 1979; 1985) largely has been to map contract law into economic organisation. After the 1970s with the New Industrial Economics (NIE) inclusive Transaction Costs economics (TCE), the conception of the firm a production function was replaced with one of the firm as a governance structure. TCE follows Common’s (1932) view of examining the transaction as the central unit of analysis. Whereas Williamson’s transaction costs theory throughout the years has had the firm and the market as primary interest, as well as it has been at the centre of contributions within organisational economics in general, this paper has its primary interest in a different unit of analysis, that of the project. Williamson early on saw cooperative forms, that is hybrids, such as the interfirm project organisation or joint ventures (JV), as infrequent and operated with a distinction between hierarchies and normal sales (market transaction) arguing that most transactions cluster around these modes (Williamson 1975). Williamson moderated this view later, however, recognising that cooperative forms are of a greater importance than initially anticipated. Among others studies by MacNeil 1974; Golberg 1976; Klein 1980; Joskow 1985; Williamon 1985, and critics of the TCE for ignoring this “*swollen middle*” (Hennart 1993) governance structure may have made Williamson recognise hybrids as different from the firm and the market (1985)⁸, and thus relevant to explicate further.

III.Ia Hybrids Versus Interfirm Project Organisations

As mentioned Williamson refers to hybrid modes as being: “*various forms of long-term contracting, reciprocal trading, regulation, franchising, and the like*” (1991: 280; 1996: 104), a definition Hennart (1988) and Kay (1997) have interpreted as embracing also equity joint venture. In effect hybrids may be seen as embracing joint venture projects, matrix organisations, licensing agreements, agreements on joining certain activities, for example co-production or co-marketing agreements, both horizontal and vertical relations may be present. The time span of these multiple cooperating forms will vary depending on the need for the activities. Most of these are referred to are intermediate agreements based on formal written agreements. Another intermediate form only to be embraced as a hybrid to the extent it is based on formal agreements, are social and industrial networks (Håkansson and Johanson 1993). The network is a long term interfirm network form that may take a formal structure related to specific activities, but it may also be related to more general activities

⁸ Hennart (1988) suggested that JV besides government restrictions on M&A, are preferred when assets are small and inseparable part of the total assets possessed by potential partners or when a total merger or acquisition increases significantly management costs.

and more informal, that is, rest primarily on trust and friendship ties. Normally such cooperation forms are referred to as social networks and industrial networks.

Interfirm project organisations focal in this paper as the definition⁹ indicates are better understood as non-equity collaboration entities, that is, sunk costs in terms of relation-specific asset investments are limited, if at all, existing. What comes more, the interfirm project organisation differs from Williamson's hybrids in that they are not based on long-term formal contracts; just as often interfirm project organisation of the type examined here are characterised by long-term *informal* contracts combined with short time formal contracts. This fact implies that interfirm project organisations cannot be understood without too understanding networks and institutions in which the interfirm project organisations are embedded. Considerations should thus be included in the theoretical framework designed for the study of coordination in interfirm project organisation.

Despite of this crucial difference between the hybrid, and the interfirm project organisation, the challenges, economic reasoning and framework of the hybrid as understood by Williamson makes relevance to discuss as an overall point of departure, since the interfirm project organisation and Williamson's hybrid also have similarities. Williamson (1991) makes it clear that he discusses only hybrids that are of an equilibrium kind, and not those possibly designed to give a respite. Interfirm project organisations studied here too are not designed to give a respite, although they may indeed be of a temporary kind. The assumption is exactly that interfirm project organisation are designed by intent and proactively used because of its advantages, compared to the firm and the market. Interfirm project organisations thus also are an economically viable governance structures that seek efficiency and aim for equilibrium for the firm adopting it. The argument is here that hybrids are cost efficient governance modes in certain situations, that is, where certain characteristics of industry and products are present it possess coordination opportunities that the market and the firm does not. Williamson seems to suggest something similar, that is, that hybrids at times are viable governance structures. However, because Williamson's uncertainty definition is incomprehensive in leaving unseen uncertainty about product content, different conclusions about the survivability of the interfirm project organisation is arrived at.

⁹ As the definition of the interfirm project organisation makes clear, the interfirm project organisation is seen as a distinct form of governance such as do Williamson (1991;1996). The definition embraces different forms of interfirm project organisation since different types of interfirm collaboration can take place. Just as Williamson saw the hybrid as a residual of the firm and the market, the interfirm project organisation refers to a category of different types as interfirm project organisation.

III.Ib *Hybrids – The Last Resort Option?*

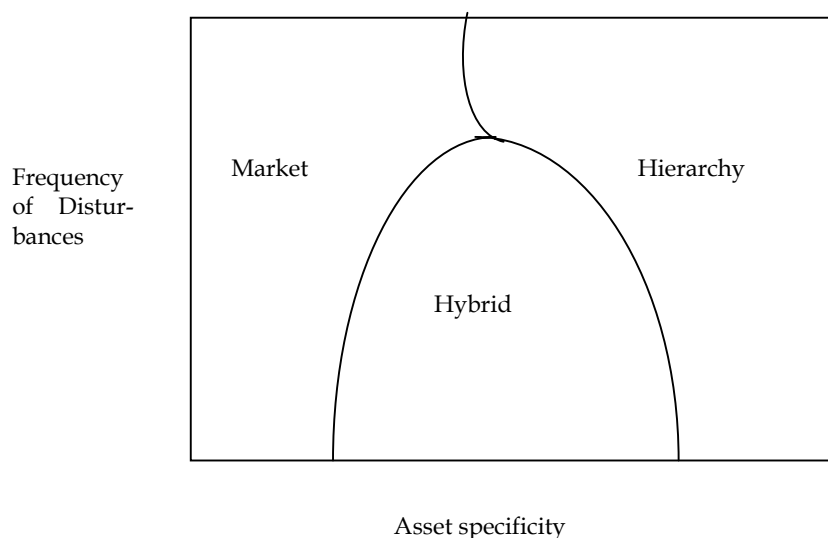
Williamson (1990) regards the hybrid as *last resort option* agents are forced into using although preferences are for the governance structures of the firm and the market. In his view hybrids are associated with more disadvantages, such as compromised incentive intensity, compared to in the market and the firm (Williamson 1991: 281 and 292). Williamson characterises hybrids as mixed forms of firms and market. This conception has been criticised by Kay (1997), however, as being misplaced. Kay (1997; 1999) looking in particular at the JV highlights what implications of this view are. Hybrids become costly and thus last resort options because they, conceived this way, carry the burdens of both the firm and the market: “..the idea that joint ventures occupy some intermediate point in some organizational form spectrum is misplaced...the joint venture carries the burden of both hierarchical and contractual arrangements, and indeed the respective market or hierarchy costs may be greater than in the corresponding pure form; for example it is difficult to see how the complicated dual control hierarchy of joint venture could be more efficient than the simpler conventional structures associated with the wholly owned alternative.” (Kay 1997: 188). Kay suggests that the JV is an extension of the hierarchy triggered when the natural evolution of firms and industries block for simpler hierarchical modes, and that they be studied on their own premises and not as a fusion of markets and hierarchy (ibid.).

The point to be deduced from Williamson (1991; 1996) is that when uncertainty gets too enormous, the hybrid is limited efficient for organising economic activity, since a transformation towards either the firm or the market will take place, he states: “Although the efficacy of all forms of governance may deteriorate in the face of more frequent disturbances, they hybrid mode is arguably the most susceptible. That is because hybrid adaptations cannot be made unilaterally (as with market governance) or by fiat (as with hierarchy) but require mutual consent. Consent, however, takes time. If a hybrid mode is negotiating an adjustment to one disturbance only to be hit by another, failures of adaptation predictably obtain (Ashby, 1960). An increase in market and hierarchy and a decrease in hybrid will thus be associated with an (above threshold) increase in the frequency of disturbances. As shown in Figure ..., the hybrid mode could well become nonviable when the frequency of disturbances reaches high levels” (Williamson 1991: 291). Williamson’s Figure 3 (1991:292) (recapped in Figure 1.1a) thus illustrates how the hybrid form is non-existing when the frequency of disturbances (uncertainty) is high (the vertical axis) and when asset specificity between the parties is either very low or very high (the horizontal axis). The illustrative point of Williamson’s figure is unambiguous. Williamson’s definition of uncertainty, however, may be questioned; an essential source of uncertainty seems not to be embraced in his definition. This ultimately affects his reasoning in the opposite direction than is suggested in this paper; namely that the hybrid in industries with high product content uncertainty handles uncertainty better than do the firm and the market.

Two comments should be stressed here: Williamson (1985) does suggest, however, that there are exceptions to this reasoning of much uncertainty leading to the hybrid fleeing to either the market or the hierarchy: *"sometimes, however, it will be feasible to devise non-standard contracts... Where that is done... bilateral contracting relations between nominally autonomous contracting agents can often survive the stresses of greater uncertainty"* (1985: 80). The exceptions he refers to (Chapter 7 and 8 in 1985), however, are those of non-trivial investments in specific assets and of a different kind than the type of hybrid and products focal in this survey. Williamson takes little account of the uncertainty experienced in the production process as it is found, for example, in industries as those examined in this paper.

Another striking comment by Williamson is his admission that rapid innovative regime complicates the use of TCE: *"the introduction of innovation, plainly complicates the earlier-described assignment of transactions to markets and hierarchies based entirely on an examination of their asset specificity qualities. Indeed, the study of economic organization in a regime of rapid innovation poses much more difficult issues than those addressed here"* (Williamson 1985: 143), that is, Williamson acknowledges the limitation of TCE when it comes to addressing certain type of uncertainties. This statement is not addressed specifically to his work on hybrids, but will affect it in being an exception of the TCE in general. It is not clear, however, what is meant by innovation here. Should innovation be understood as uncertainties in the environment, as process or product innovation and as such maybe embracing uncertainty as the product content kind examined here. It also is not clear from this in what ways introduction of innovation will affect TCE, and the work on hybrids in particular. It is, interesting that he years later proposes his Figure on transformation between governance structure as a transformation illustrative and comprehensive for all types of activities and transactions. But would innovative activities such as R&D in many cases not be conducted in hybrid governance structures. The relation between his Figure 3 (1991:292) and these statements on innovation is crucial, but left open by Williamson.

Figure 1.1a Williamson 1991: Organisation form responses to changes in frequency (1991:292)



III.Ib *Hybrids – The First Resort Option: Redefining Uncertainty*

Returning to Williamson's Figure on uncertainty he concludes that market and hierarchy will take over when uncertainty gets too enormous. As mentioned already this may be discussed. When examining production processes in industries focal here. The type of uncertainty at stake in these industries and products comes from *not being able to explicit ex ante the exact content and thus order and frequency of use of resources to perform the activities necessary for producing*. Expressed differently, this implies an uncertainty in the production process where the parties prior to contracting and the start of production cannot explicit the product to be produced in a manner that makes it possible for third parties to verify whether the product fully meets the quality intended by the contracting parties¹⁰¹¹. In yet other creative industries, contracting may sometimes be of a nature where none of the parties, which are to contribute to the production, know how to *plan* the production and what role they are to play in the production, implying that a contract ex ante specifying the agents' role cannot be designed.

Incorporating the type of uncertainty in the production process argued for here, the exact opposite reasoning than that of Williamson can eventually result: *where uncertainty is high, the propensity of a hybrid form of organisation being utilised increases*. The difference lies in the definition of uncertainty. Williamson understands uncertainty as the *frequency of disturbances, or change, in the environment* (1991: 291). An example of Williamson's type of uncertainty is the situation where it is not possible to predict ex ante what exogenous factors influence prices, time of delivery, quality and the functionality of the product. In such situations Williamson recommends the use of incomplete contracts. As Sanchez (2000) notes Williamson concentrates on uncertainty on the supply side. The firm and the market lack competences for coping with this uncertainty, as it requires a high diversity in resources and activities required for producing the specific type of goods and services. What this implies is that Williamson's figure does not, as Williamson seems to propose, hold true for all types of transactions and products. (Williamson's empirical insight derived from companies like General Motors and he was concerned more with manufacturing, and not the type of industries as those here).

Especially in goods where unique, artistic and creative processes are crucial input to the production of the finished good or service product content uncertainty of this kind is present. What all this suggests is that content uncertainty should be incorporated in

¹⁰ Oliver Hart (1995) however addresses production process issues uncertainty of this manner.

¹¹ Especially when it comes to contracting of creative content production such as art directing, copy writing and photographing this type of uncertainty is present in advertising industries.

Williamson's definition, and the relative influence of *different types of uncertainty* associated with activities and transactions on the mode of governance should be considered.

Including this *product content uncertainty* in Williamson's definition may change the conclusion otherwise reached by Williamson, as to the survivability of the hybrid governance structure. Williamson's focus on outcomes of production processes while black boxing the production process, that is the internal organisation and competence formation perspective, hitherto has made it difficult to reveal the type of product content uncertainty. The current form of TCE could thus not identify the advantages of coordination in the interfirm project organisation, which the firm and the market do not possess. Which, however, ultimately contributes to explaining the efficiency of the interfirm project organisation as a governance structure; this paper identifies this need of not ignoring coordination and thus is the initial step to contribute to untangling this black box.

Acknowledging such production process or content uncertainty that require highly diverse resources as an additional source of uncertainty, the argument can be pushed further: *whereas Williamson (1991) suggests increased uncertainty results in decreased use of hybrid forms, that is, an increased use of the market or the firm, incorporating uncertainty in the production process requiring highly diverse resources, implies increased uncertainty, which causes a shift toward the hybrid forms, such as the interfirm project organisation, away from the firm and the market.*

With the revised definition of uncertainty, we may revise Figure 1.1.a of when different governance structures are adopted to match two revised axis shown in Figure 1.1.b. of demand (content) uncertainty (Y) and reuse of assets (X) respectively. Reuse of assets in effect then refers to Richardson's (1972) notion of complementary assets as necessary for economic growth. Richardson suggests that firms tend to possess groups of similar activities and thus similar capabilities. Firms can therefore be specialists only within a narrow range of activities, and therefore firms and agents need to coordinate own activities with those performed by other firms and agents. Underlying this argument of Richardson (1972) is the rule of the division of labour (Smith 1776) and knowledge (Hayek 1945).

Figure 1.1.b: Williamson 1991: Organisation form responses to changes in frequency (1991:292)

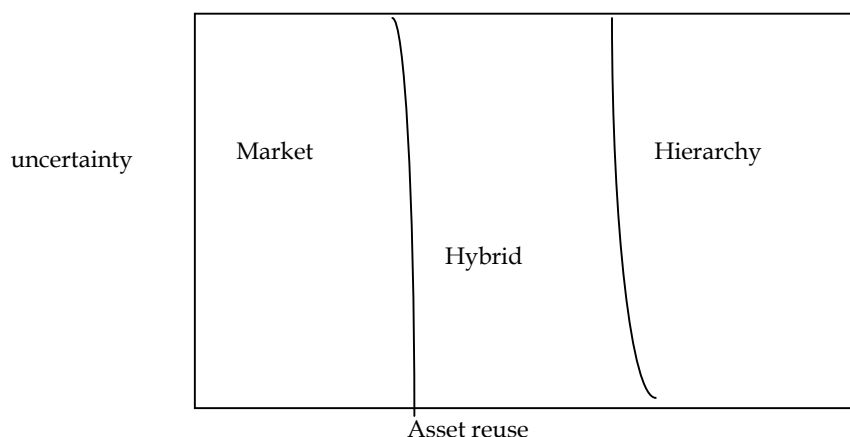


Figure 1.1.b shows that increased uncertainty needs not reduce the use of the hybrid, but rather increase its use because of its special competence of reusing assets. It is argued in the following chapters that agents in interfirm project organisations possess particular coordinative competences that ensure interfirm project organisations are efficient governance structures possessing advantages compared to the firm and the market. The hybrid does not reuse resources to the same extent as do the firm, and not as little as do the market. This argument suggests that hybrids are not used as last resort options, but proactively *in situations of product uncertainty and complexity*.

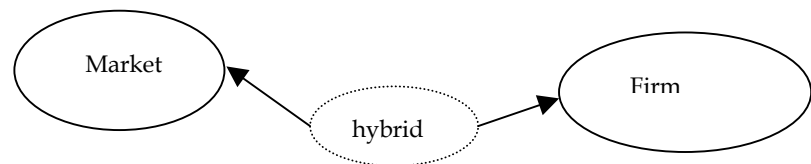
As mentioned this uncertainty type is especially found in creative industries with a high need for artistic, creative and innovative performance from time to time, but also in other industries we may find needs for such production process flexibility. There are traits in the economy today, driven among others both by opportunities derived from technological advancement and an increasingly globalised economy, where once closed economies have opened, and now compete on markets with firms from developed economies, for example NIC, that pushes the complexity of product content in the direction of customisation and modularisation in general, and that more and more industries are forced to respond to these product and demand complexities. As in creative industries such industries can benefit from using highly diverse and flexible resource use, that is draw in specialist skills when they are in demand, as it is found in interfirm project organisations. In this way the economy may be said to move towards a type of product uncertainty in general increasing the use of the interfirm project organisation as a first resort option in its special coordination opportunities shown in this paper.

In addition to this, we may find hybrid forms such as interfirm project organisation will be used in mature industries, where the benefits accruing to internal organisation is likely to decline because in the long run capabilities and knowledge spread out and become accessible to an increasing number of firms, leading firms to disintegrate as more suppliers eventually emerge (Langlois and Robertson 1995; Maskell 2001). Williamson (1985) too observes this.

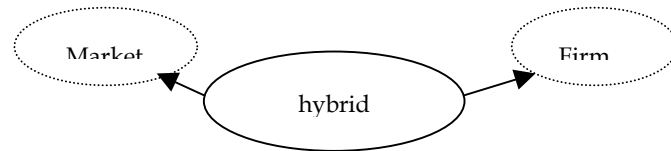
Where Williamson suggests that the firm and the market in certain situations take over the hybrid, it is here suggested that the hybrid takes over the firm and the market in certain situations. Pushing this further it suggests that firms with complex product needs (not necessary of the need for new resources from each task solved as is often required in the interfirm project organisation) in many industries will opt for the interfirm project organisation as a governance structure rather than for the firm and the market. The argument can be pushed to stating that of under certain circumstances the hybrid rather takes of the hierarchy and the market, and a project orientation of the economy can be found. Figure 1.1.c illustrates this.

Figure 1.1.c: Dominating Governance Structures (Oliver Williamson Vs. the view presented here)

Williamson



Husman



Despite the here suggested revision of the assumptions of the TCE, it still provides inspiration for departing when wishing to understand hybrids. Hybrids are less costly than Williamson's use of the TCE suggests, and hybrids are not a last resort option, but proactively used by firms to better meet today's competitive challenges. The interfirm project organisation possess coordinative advantages compared to the market and the firm for certain types of goods and services in particular, which in general is required with an increased product complexity affecting many industries, and that *these coordinative advantages help us to understand the economic rationale of the interfirm project organisation and why it exist as a distinct governance structure*. Meeting such content uncertainty necessitates diverse resources. Aoki (1998) has pointed to the importance of this for production outcome. Interfirm project organisation is a governance structure that can handle diversity because it is capable of coordinating their different sources. Interfirm project organisation's reason for existing is to be found in *its coordinative opportunities*.

IV: Conclusion & Discussion

This paper suggests that for several reasons, among others in the insistence on conducting comparative studies of governance structures and in the make-buy decision-making insights, TCE remain a relevant point of departure for studying economic organisation. Interfirm project organisations possess certain characteristics in common with Williamson's hybrid governance structures, which make the TCE's approach to the study of hybrids necessary to review. A comparative study of the interfirm project organisation relative to alternative governance structures is necessary to make should interfirm project organisations' potential be explained. There are, however, limitations to TCE's explanatory potential. One such shortcoming is pointed to: TCE have difficulties in explaining the interfirm project organisation's superior coordination competence relative to that of the firm and the market. When it comes to uncertainty in the production process, more specifically to coordination and product content uncertainty, TCE comes to short. The current form of TCE does not open for an identification of the coordinative capability, shaped by agents'

competencies superior in the interfirm project organisation compared to in the firm and the market. This coordinative capability, however, ultimately contributes to justifying efficiency and the economic rationale of the interfirm project organisation as a governance structure; this paper identifies consequences of leaving out a process orientation, thereby explains why a process orientation is needed. Stating this the paper can be seen as an initial step to untangling the black box of process analysis, and creating a theoretical framework for studying interfirm project organisations. With this observation on product content uncertainty in first of all the advertising industry, an exception to the general applicability to all types and activities and transactions, such as seems implicit in Williamson's TCE analysis on hybrids, may need to be recognised.

Is Product Content Uncertainty General for Creative productions?

The product content uncertainty experienced in advertising is unlikely to be a unique case. Product content uncertainty of this kind may be seen as a general characteristic of products and their production processes as they take place in many so-called creative industries. Creative industries are here understood as "industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property. This includes advertising, architecture, the art and antiques market, crafts, design, designer fashion, film and video, interactive leisure software, music, the performing arts, publishing, software and computer services, television and radio (DCMS 2002)¹². A parallel with the, from advertising, very different type of product, the theatre production, may be made. Theatre productions can be well planned by strictly following a clear-cut manuscript, it may, however, also evolve as the rehearsal with the actors takes place. If actors are allowed to improvise they inspire one another and the play gets its own life. The intended order and frequency of using the different actors, and the support staff on the theatre may change compared to what the director initially expected. Quality can here too be assessed on the technical parts such as on the performance of the actors, of the light, sound, clothing etc., but the quality in terms of the theme and the experience gained from watching it again is subjective and hard to agree upon. Similar uncertainties may be identified in other productions involving creative processes.

When product content is complex to determine ex ante, and when production subsequently is too to plan, one example of an alternative ex ante feature to guide production may be one of expressing statements about the *functionality* to be expected of the end product. That is, functionality can be expressed without setting requirements and

¹² A discussion of what creativity is and how it relates to concepts of innovation, services, entertainment and art is critical, and necessary for distinguishing what industries "qualify" as being creative and which do not. However, such a discussion requires more space than this paper allows for, why this question, controversial and provocative as it may seem, is abstracted from for now.

detailed planning statements for how this functionality is obtained, that is, how the end product is arrived at need not be set requirements for. For advertising campaigns, advertising agencies struggle with setting expectations about functionality by use of the advertisements' effectiveness for selling, creating brand recognition etc. as one of the functionality features of the advertising campaign. In theatre productions the effect a play has on its audience in terms of emotions to affect can be made expectations about, as well as, there may be made estimations over number of visitors for a play etc.

Because of the here suggested uncertainty in production processes of products in some types of industries, a more detailed focus on coordination of activities' interdependencies and internal organisation issues in general may be a relevant complement to TCE, to make it a more complete theory.

Literature

- Akerlof, G. A. (1970): The Market for "Lemons": Quality Uncertainty and the Market Mechanism, *The Quarterly Journal of Economics*, 84,3:488-500
- Aoki (1998) The evolution of organisational conventions and gains from diversity, *Industrial and Corporate Change*, 7, 3: 399
- Coase, Ronald (1937): The Nature of The Firm. *Economica*, New Series, 4, 16 :386-405
- Coase, Ronald (1952):
- Common's (1932):
- Dietrich, M (1994) : Transaction cost economics and beyond : Towards a new economics of the firm, Routledge: London
- Foss, Nicolai J. (2000): Whither economic organisation, WP CBS
- Freathy, Tim; Rippon, Anne; Anwar, Yasmin (2002) Creative industries fact file, DCMS
- Gann 1994;
- Gann, D.M. and Salter, A. (1998): Learning and Innovation Management in Project-Based, service-enhancing firms, *International Journal of Innovation Management*, 2, 4 :431-454
- Golberg (1976)
- Granovetter, M. (1973): The Strength of Weak Ties, *American Journal of Sociology*, 78/6: 1360-1380
- Grant, Ronert (1996): Toward a knowledge-based theory of the firm,
- Narula, R. and Hagedoorn, J. (1998): Innovating through strategic alliances: moving towards international partnerships and contractual agreements, *Technovation*, 19: 283-294
- Hart, O. (1995): *Firms, Contracts and Financial Structures*, Clarendon Press, Oxford
- Hayek, F.A. (1945): The Use of Knowledge in Society. *The American Economic Review*, xxxv(number four):519-530.
- Hennart, J-F (1988): A Transaction Costs Theory of Equity Joint Ventures, *Strategic Management Journal*, 9
- Hennart, J-F (1993): Explaining the Swollen Middle: Why most transactions are a mix of "Market" and "Hierarchy", *Organization Science*, 4, 4, 529-547
- Håkansson and Johanson (1993): The network as a governance structure: interfirm cooperation beyond markets and hierarchies, in *The Embedded firm*, Grabher, Gernot (ed.) (1993)

- Holmstrom and Milgrom (1994) The Firm as an incentive system, *The American Economic Review*, 84, 4: 972-991
- Husman, T.B (2002a): *The Existence, Boundaries and Internal Organisation of Project organisations*, Paper presented at the DRUID Winter Conference, January 17-19, 2002
- Joskow 1985
- Kay, Neil M. (1997) Joint Venture, chapt 9 in *Pattern in Corporate Evolution*, Kay, Neil M. (1997), Oxford University Press, NYC
- Kay, Neil M. (1999): Collaborative Strategies of Firms, in *The Boundaries of the firm*, St. Martin's Press
- Klein, Peter (1980);
- Knudsen, Christian (1997): *Økonomisk metodologi*, Jurist- og Økonomiforbundets Forlag
- Langlois and Robertson (1995): *Firms, markets and economic change*, Routledge, London
- Liebeskind, J P (1996): *Knowledge, Strategy, and the theory of the firm*
- Maskell, P. (2001): Towards a Knowledge-Based Theory of the Geographical Cluster, *Industrial Corporate Change*, 10, 4
- MacNeil 1974
- Porter (1985):
- Richardson, G.B. (1972): The Organisation of Industry, *The Economic Journal*, 82, 2: 883-896
- Schumpeter, J.A. (1934): *The Theory of Economic Development*, Cambridge, Mass.: Harvard University Press
- Sanchez, Ron (2000): Demand uncertainty and asset flexibility: incorporating strategic options in the theory of the firm, in *Competence, Governance, and Entrepreneurship*, Foss, N. J. and Mahnke, V. (2000)
- Smith, A. ([1776]/1986): *The Wealth of Nations* Books I-III, London: Penguin Classics (reprint)
- Stinchcombe, A. L. and Heimer, C.A. (1985): *Organization Theory and Project Management, Administering Uncertainty in Norwegian Offshore Oil*, Oslo: Norwegian University Press
- Williamson, O. E. (1975): *Markets and hierarchies*, New York: The Free Press.
- Williamson, O. E. (1985): *The economic institutions of capitalism*, New York: The Free Press.
- Williamson, O. E. (1990): *Transaction-Cost Economics: The Governance of Contractual Relations*, in *The Firm as a Nexus of Treaties* by Aoki, M., Gustaffson, B. and Williamson, O.E. (eds), London: Sage

Williamson, O. E. (1991): Comparative Economic Organization: The Analysis of Discrete Structural Alternatives, *The Administrative Science Quarterly*, 36: 269-296

Williamson 1996: