TRANSACTION COSTS: A LEGENDARY THEORY OF THE FIRM

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Abstract

There are three widely recognized perspectives on the organizations. They are resource dependence, efficiency, and population perspectives. The purpose of this paper is to explain the history of transaction cost theory, theory of the firm, the nature of the firm, the transaction cost economics, and the critiques for this theory. Articles in leading journals listed in EBSCO, Emerald, JSTOR, ProQuest, and ScienceDirect databases were chosen. A conceptual and relational analysis was conducted to fulfill the purpose of this paper. Results show that an acceptable theory of the firm should possess the capability to elucidate not just the reasons for the existence of firms in a market economy, but also other aspects. At the very least, it should have the capacity to clearly define and articulate the limits of a firm's activities, including what tasks are performed internally and what tasks are outsourced or delegated to others, as well as how these activities are structured and how the firm achieves growth and success. While profit-oriented organizations have long recognized the numerous advantages of inter-organizational collaboration, non-profit organizations are now beginning to understand some of these benefits, including cost savings through shared administrative expenses, enhanced value propositions, increased efficiency, strengthened programs, utilization of compatible skills and abilities, and improved leadership skills.

Keywords: Transaction Cost Theory, Efficiency Perspective, Theory of The Firm, Organization Theory

Introduction

Organization theory is a field that encompasses numerous diverse viewpoints on the subject of organizations. Three widely recognized approaches include resource dependence, efficiency, and population. Organizational success, as viewed through the lens of resource dependence perspective, is characterized by companies effectively leveraging their power to the fullest extent. From this viewpoint, companies are seen as alliances, modifying their structure and behavior patterns in order to obtain and retain necessary external resources.

The efficiency perspective is largely influenced by economics. The primary determinant of organizational performance in this perspective is efficiency, as indicated by its name. Efficiency theorists define successful organizations as those that possess the ability to effectively manage their transactions. From this perspective, organizations serve as intermediaries for economic transactions between members both within and outside the organization.

From a demographic perspective, organizational success might be described as the ability to endure and continue existing. The population perspective focuses on two interconnected aspects when examining survival: categorization and choice. It incorporates principles from biology and regards organizations as systems that are largely influenced by environmental influences. While this viewpoint recognizes the existence of individual organizations, its main emphasis is not on individual organizations themselves, but rather on the broader concept of organizational forms or populations of organizations. Organizational form refers to the arrangement, methods, and mechanisms that define individual organizations (Ulrich & Barney, 1984).

In this work, we shall not delve extensively into the topics of resource dependence and population perspectives. Instead, the focus will be on the efficiency standpoint, more specifically the transaction cost theory. The following text will provide a summary of the efficiency standpoint. This text will include explanations for history, the theory of the firm, the nature of the firm, transaction cost economics, and critiques of the transaction cost theory. Finally, this study will present previous research and future research suggestions focused on transaction costs in the field of organizational studies.

Methods

The author performed a literature review regarding efficiency perspective, especially the transaction cost theory. Articles in leading journals listed in EBSCO, Emerald, JSTOR, ProQuest, and ScienceDirect databases were selected for study and analysis. Then, the author carries out conceptual and relational analysis to meet the objectives of this paper.

Result and Discusssion

Organizational Perspectives

The primary determinant of organizational performance from an efficiency standpoint is efficiency. In other words, successful organizations are those that can effectively oversee their transactions. From this perspective, organizations serve as intermediaries in economic transactions between members both within and outside the organization. This perspective is based on several assumptions (Ulrich & Barney, 1984). First, the unit of analysis is the transaction, and economic actors are presumed to participate in activities

aimed at minimizing the costs associated with these transactions. Transactions are the act of exchanging products or services between economic entities. They can take place within an organization, involving persons or departments, or between an organization and external entities. Transaction costs occur when the parties involved in an exchange have difficulty in determining the value or other attributes of the goods or services being transferred.

Second, there are three main types of governance structures that can be employed to facilitate transactions and minimize costs: markets, bureaucracies, and clans (Barney & Ouchi, 1983; Ouchi, 1980). Markets regulate transactions by applying competitive forces to ensure that the price of an item or service appropriately reflects its qualitative and quantitative value. Bureaucracies, which are hierarchical structures, oversee transactions by implementing rules with varying degrees of accuracy. The rules inside the organization determine the expectations for what each party should contribute and receive in a transaction. These rules are implemented to ensure a sense of justice and equality among all parties involved in the trade.

Clans, which are another form of hierarchical organization, regulate trade by implementing a system of shared values. If the parties involved in an exchange can comprehend and effectively communicate their fundamental shared values in a convincing manner, it can provide them with the assurance that they are being treated fairly, even in situations where formal bureaucratic processes may fall short. The objective of organizations is to minimize transaction costs when markets fail, as suggested by these governance mechanisms (Williamson, 1975).

Third, within this paradigm, the suitability of various governance techniques is contingent upon transaction characteristics. Transactions can be classified based on their complexity, uncertainty, enforcement difficulties, purpose congruence, and investment specificity (Barney & Ouchi, 1983; Williamson, 1979). The primary goal of the efficiency viewpoint is to align governance systems with transaction characteristics in order to identify the most efficient mediators between parties involved in a transaction. Markets are efficient intermediaries for economic transactions under various circumstances. However, defining fair rates becomes challenging and expensive when the items or services being exchanged are intricate, distributed over an extended period, or traded in noncompetitive environments.

Consequently, a market is unable to effectively regulate the trade. In situations when there is uncertainty, the costs associated with using a market governance mechanism to facilitate a transaction would be too high, to the point of being unaffordable or perhaps unachievable. As a result, the transaction would not take place in the long run. In order to enhance effectiveness and reduce the expenses associated with transactions, markets can be substituted with bureaucracy.

Within a bureaucracy, established rules govern the decision-making and modification of objects involved in a trade, such as an employment contract, over an extended duration. The rules in a bureaucracy serve to reduce the necessity for constant and thorough monitoring of the transaction, in order to prevent either side from deceiving the other. This is possible because both parties involved in the transaction share a vested interest in adhering to the regulations set by the governing bureaucracy. Nevertheless, bureaucracies can also experience failure when there is a significant level of uncertainty over performance. When the expenses associated with governing behavior in a bureaucracy become too high, a clan governance mechanism may arise as a substitute.

Within a clan, both parties involved in the transaction possess a mutual value or objective. Parties involved in an exchange can have confidence in the long-term presence of fairness due to their common beliefs and objectives. Simply put, the efficiency perspective involves matching the characteristics of transactions with different governance structures to determine the conditions under which these mechanisms can effectively and fairly facilitate exchanges. Table 1 provides a concise overview of the Efficiency Perspective, which offers an alternate framework for conceptualizing organizations.

Table 1. Summary of Efficiency Perspective

Issues	Efficiency Perspectives
Organizational success	Maximize organizational efficiency
Organizational concept	Mediator between parties involved in economic transaction
Assumptions	1. Study transactions between organizations 2. Identify alternative governance mechanisms (market, bureaucracy, and clan) 3. Assess transactions characteristics 4. Match governance mechanism to transaction characteristic to get lower transaction cost
Literature	Economics
Key work	Williamson (1975, 1981) Ouchi (1980) Barney & Ouchi (1983)

Source: (Ulrich & Barney, 1984)

In his study "The Nature of the Firm", Coase (1937) initially described a corporation from an efficiency standpoint, drawing on both theoretical and empirical literature. He contended that the most suitable unit of examination for comprehending firms is the interactions between parties within it, and that the expenses

associated with these interactions influence the conduct of the firm. The individual acknowledged that the market mechanism for managing transactions is not always as effective as the firm (hierarchy) mechanism. The primary reason for the profitability of establishing a firm appears to be the existence of a cost associated with utilizing the price mechanism... Operating a market incurs expenses, but by establishing an organization and granting authority to an entrepreneur to manage resources, certain costs associated with the market can be reduced (Coase, 1937, p. 390). Coase also proposed that markets are more efficient than companies in controlling transactions under conditions of low transactional uncertainty and strong knowledge requirements for market contracting.

Williamson (1975) combined Coase’s overarching framework with economic and organizational theory literature to develop a framework known as the organizational failures framework. According to Williamson, the inefficiency of economic exchanges in markets can be attributed to two factors related to individuals involved in the transactions (limited rationality and opportunistic behavior) and two factors related to the transaction environment (uncertainty/complexity and limited bargaining power due to small numbers). Markets may fail and be replaced by hierarchies as a governance mechanism due to opportunism, bounded rationality (as described by Simon in 1945), uncertainty, and small numbers bargaining. Hierarchies can promote shared aims and objectives among parties involved in transactions and enable effective monitoring of each other’s behavior through established rules. This helps to address certain challenges associated with using a market-based governance system.

Williamson’s research has been expanded to demonstrate that certain transactions can be so unclear or intricate that they cannot be effectively managed by either markets or bureaucratic bureaucracies. Prolonged and intricate transactions can result in inefficiency inside bureaucracies, perhaps leading to their replacement or the introduction of clan-based systems (Barney & Ouchi, 1983). Clans serve as an effective means of controlling exchanges in situations characterized by significant unpredictability, complexity, and a long-term expected duration of the connection.

The History

Ronald H. Coase, a Nobel Prize laureate, introduced the concept of transaction costs in his renowned work titled “The Nature of the Firm” (1937). Coase posed the question: Given the emphasis on market efficiencies in economic theory, why is there a significant amount of economic activity conducted within integrated firms? Coase’s conclusion posits that the utilization of the market incurs certain costs that can be mitigated by resorting to the firm. These are commonly referred to as transaction costs. The costs associated with measuring, information, negotiation, contracting, enforcing, and policing agreements are outlined by Pitelis (1998).

According to Oliver E. Williamson’s (1975) influential book “Markets and hierarchies: Analysis and antitrust implications”, these costs can be ascribed to limited rationality, opportunistic behavior, and asset uniqueness. Firms that incorporate (imperfect) markets internally (via hierarchies) are believed to enhance overall efficiency. Firms emerge as a consequence of a contractual agreement among the parties engaged in trade. The elimination of market inefficiency is considered both the cause and consequence of firms. The border of a firm is determined by the costs associated with its hierarchy, such as organization and management costs. It is defined as the point where an additional transaction may be carried out with equal efficiency either through market exchange or by involving another firm. Therefore, the combination of market and hierarchy exhibited leads to an improvement in total efficiency.

The phenomenon of market internalization, driven by the presence of transaction costs, can provide an explanation for the development and tactics employed by companies, particularly in terms of vertical integration, the adoption of the M-form organization, the formation of conglomerates, and the establishment of international corporations. Efforts to improve efficiency have led to the development of hybrid organizational structures, including strategic alliances, networks, and equity joint ventures. These structures represent a shift from relying solely on markets or hierarchies to a combination of both (Williamson, 1993). Essentially, the presence of firms, hybrids, and markets may be attributed to the pursuit of efficiency. Efficiency is a result of the process (Pitelis, 1998).

Following that, the author’s name is Williamson, O. E. In his 1979 paper titled “Transaction cost economics: The governance of contractual relations”, the author asserts that transaction costs play a crucial role in the field of economics. The paper also identifies the key factors that define transactions, describes the primary governance structures involved in transactions, and explains the process of matching transactions with institutions in a selective manner. His primary focus was on transactions in the intermediate-product sector.

In his 1985 book “The Economic Institutions of Capitalism”, Nobel Prize winner Oliver E. Williamson first recognized that coordination and information protection are instances of transaction costs. However, the word is typically used to refer to particular inefficiencies. Williamson (1985) provides a concise overview of his groundbreaking research on the economics of transaction costs (TCE). According to Williamson, transactions costs encompass the time and financial resources required for negotiating, drafting, and enforcing contracts. Additionally, there may be significant costs incurred when companies take advantage of incomplete contracts to pursue personal benefits at the price of the overall welfare.

Williamson's theory of transactions-costs economics primarily centers around the detrimental outcomes of opportunistic behavior and the expenses associated with attempting to mitigate them. Contract law has the potential to improve the opportunistic behavior that might occur when contracts are not fully specified, but it is improbable that it will completely eradicate it. Therefore, when contracts are not fully specified, there will definitely be additional expenses associated with doing transactions. In order to provide a more accurate explanation of the nature of these costs associated with transactions and how they can affect decisions regarding integration, there are three significant theoretical concepts from the field of transactions-costs economics: relationship-specific assets, quasi-rents, and the holdup problem (Besanko, Dranove, Shanley, & Schaefer, 2016).

The Theory of the Firm

The theory of the firm is a comprehensive field that includes various frameworks aimed at addressing several inquiries about firms. These inquiries include the reasons for their existence, the factors that determine their boundaries, the methods to reconcile the conflicting interests of owners and managers, the optimal internal organization for efficiency, and the causes of performance disparities among firms. The work in this topic encompasses various disciplines, including economics and strategic management, which are based on fundamentally distinct assumptions about organizational behavior. The theory employed has tangible ramifications for managers and policy-makers. A satisfactory theory of the firm should possess the capability to elucidate not just the reasons for the existence of firms in a market economy, but also other aspects. At the very least, it should have the capacity to clearly define and articulate the limits of a firm's activities, including what tasks are performed internally and what tasks are outsourced or delegated to others, as well as how these activities are structured and how the firm achieves growth and success (Teece, 2016).

The distinguishing attributes of firms are frequently perceived differently in the literature encompassing economics, organization theory, and strategic management. Ronald Coase (1937: 388) emphasized the role of the 'entrepreneur-coordinator' in organizing economic activity within firms, as opposed to relying on market contracting with individuals or other firms. According to Coase, markets and companies differ in their reliance on voluntary transactions and authority. Markets involve voluntary transactions between individuals, but firms rely on the authority of one party, specifically the entrepreneur, over the other party, notably the laborer. This is a potentially limited interpretation of a firm.

A firm can be defined as either a sole producer or a group of relatives or friends (partners) who work together in the production process. The firm does not necessarily have to be a hierarchical organization with several individuals, unlike the Coasean firm. From a logical standpoint, it can be argued that firms or organizations come before the market because firms engage in production activities, whereas markets may not necessarily exist without enterprises. Furthermore, one could raise the question of which came first historically: markets or hierarchies such as families and states. All of these criticisms are conventional in the literature and are not at all innovative. Pitelis (1998) emphasizes that the Coasean firm is just one of several potential definitions of the firm.

The Concept of the Firm's Existence

In an efficient market economy, transactions between individuals have the potential to be utilized for the organization of any and all activities. The inquiry into the purpose of firms is therefore complex and significant. Historically, the prevailing theory, as shown by Adam Smith's depiction of specialization in a pin factory, was technological determinism. This theory posits that firms exist because all components of the production process must be located in close proximity to one another (Teece, 2016).

The technological argument, however, lacks credibility under thorough examination, as the resources and capabilities required for production could potentially be owned by different firms or individuals, who can collaborate and achieve the required coordination through a network of contracts. Indeed, the growing utilization of outsourcing has demonstrated that the alternative scenario of contracting has some degree of truth. The inquiry pertains to the quantity or amount. Ronald H. Coase (1937), stated earlier, was among the pioneers who suggested a different method for explaining technology or internal process. Coase (1937) proposed that corporations are created to minimize the transaction costs that would be required to establish a network of contracts among independent entrepreneurs, as imagined in a market-based scenario. Coase acknowledged that organizations, like as corporations, had inherent restrictions, specifically that managers have a finite capacity to efficiently oversee a certain number of operations. By merging these two ideas, Coase determined that a firm would include (or internalize) an activity if the expense of doing so is lower than the costs the firm would incur by outsourcing the same activity to an external agency.

Oliver Williamson (1975) further developed Coase's concept of transaction costs to construct a prognostic model. He observed that when investments are made in transaction-specific locational, physical, or human capital, one or more parties to a contract become susceptible to vulnerability. The possible drawbacks arise from the transactional specificity, meaning that the investments made by one or both parties are tailored to the unique transaction and hence have significantly less value in other contexts. If Party A makes a unique investment to support a contract with Party B, then subsequently Party B takes advantage of unclear aspects of the contract (keeping in mind that no contract is completely foolproof), then the value of A's investment may decrease. Asset specificity, whether present or expected, creates a risk of decreased

value and therefore a cost for transactions, unless the activity is conducted within the company, where motivations are better aligned. Williamson's transaction cost framework believes that the alignment of interests within a corporation is superior to that in a contractual partnership. Therefore, internal organization is the most desirable organizational structure when a corporation necessitates significant capital investment that is specifically designed and dedicated to solving the economic issue at hand.

Boundaries of the Firm

The limits of the firm are often examined at two levels of examination. The focus has primarily been on the extent of outsourcing compared to in-house production. However, there is also another inquiry on the variety of industries in which a company decides to compete, known as the scope of the enterprise.

Initial examinations of corporate boundaries (e.g., Robinson, 1934) sought to address pertinent inquiries by scrutinizing the most advantageous magnitude of a solitary product enterprise. One explanation is that single product companies are unable to expand indefinitely because as they grow in size, they become slower in making decisions, resulting in negative effects on performance. This represents the financial burden of bureaucracy. As firms grow, the capacity of senior management to possess all the necessary knowledge for making good decisions is diminishing. Multidivisional (M-form) structures facilitate this process by delegating several operational choices to lower levels within the organization.

Nevertheless, individuals frequently have incentives to manipulate the information they present to higher-level executives in a manner that they believe will be advantageous to themselves, rather than to the firm as a whole (Williamson, 1985). Consequently, a corporation's decision-making process is likely to become more disconnected from actual circumstances. The customer experience declines as centralization increases and managerial hierarchies become more complex. This impact can be reduced if the organization's culture promotes the dissemination of knowledge.

Coase's (1937) essay addressed these difficulties by introducing the transaction costs associated with market interactions compared to the expenses of bureaucratic processes. In addition, he incorporated the concepts of vertical and horizontal integration into the discourse, so aligning it more closely with the contemporary comprehension of organizational limits. Managers assess activities based on their transaction costs in their methodology. The decision rule stipulated that managers should internalize transactions to the point where the marginal cost of bureaucracy is equivalent to the marginal cost of dealing in the market. Coase's analysis fails to consider the technological considerations that are distinctive to each product. For instance, certain supplementary activities require a higher level of integration compared to others, and vertical integration is more likely to be favored when there is a requirement for unstructured technical interaction between two stages of production that are not modular.

Often, complementarities can be effectively managed without the need for internalization. This phenomenon might arise due to the presence of intrinsic or manufactured modularity, which facilitates the establishment of a clear interface that enables the complementary components to evolve independently. Consolidating separate tasks under one company is typically ineffective because the administrative structure of the company cannot recreate the strong motivation provided by independent contractual agreements. While Coase's work was insightful, the model in Coase (1937) only provided an incomplete decision rule for company size. This is because it only examined marginal transaction and bureaucratic costs, without considering how these costs relate to marginal revenue.

Williamson (1981, 1985) revisited and expanded upon Coase's theory, focusing on analyzing individual transactions that a corporation may engage in. Williamson expanded upon Coase's concept of transaction costs by incorporating the notions of asset uniqueness and specific institutional characteristics of markets and hierarchies. This enhanced understanding allows for a more precise analysis of the decision-making process regarding integration. Asset specificity in a world of incomplete contracts gives rise to re-contracting dangers, as it is not possible to cover all potential situations. Managers should integrate when effective production necessitates making investments that are customized to a particular transaction.

An issue with the several transaction cost-based techniques to determining firm boundaries is that they assume, either explicitly or implicitly, that all other factors remain constant when comparing internal organization to external contracting. Production costs, on the other hand, may be influenced internally by the way organizations are structured. This scenario can occur when the demand for a component is insufficient to support its internal production by a single downstream user, but is significant enough to warrant efficient production by a supplier who can sell to multiple downstream customers.

Another limitation of transaction cost-focused theories of the company is in the implicit assumption that the sole objective is to efficiently structure firms. The dynamic capacities paradigm in strategic management acknowledges that limits are unlikely to be efficient in terms of transaction costs, as innovation and growth are equally vital as efficiency. The transaction cost approach relies on strict assumptions to make specific predictions that are valid when considered as a whole. In contrast, the dynamic capabilities approach to firm boundaries is broader and more directive, without predicting that expanding firms will inevitably optimize their boundaries solely for efficiency (Teece, 2016).

The Nature of the Firm

Nearly a century ago, an economist conceptualized the economic system as being coordinated by the price mechanism, transforming society from an organization into an organism. The prevailing belief was that the allocation of resources was orchestrated by the price system. However, in his paper "The Nature of the Firm", Coase (1937) posed a challenge regarding the necessity of organizational structure, given the prevailing argument that coordination can be achieved through the pricing mechanism. However, considering that production can be conducted without any organization if it is regulated just by price fluctuations, the question arises as to why organization is necessary.

Coase (1937) sought to investigate the underlying reasons for the existence of a firm in a specialized trade economy. He questioned the notion that the allocation of resources is determined by the price system. He contended that the distribution of resources is not accomplished directly through the price system. He stated that the primary motive for establishing a corporation appears to be the existence of a cost associated with using the price mechanism. The introduction of the firm was mostly attributed to the presence of marketing expenses. Market transactions incurred higher costs compared to transactions conducted within the firm.

In his 1937 work, Coase proposed that the most effective way to define a firm in practical terms is by examining the legal relationship commonly referred to as "master and servant" or "employer and employee". According to Coase, this relationship is characterized by two essential elements: (1) the servant is obligated to provide personal services to the master or to others on behalf of the master, distinguishing it from contracts involving the sale of goods, and (2) the master possesses the authority to direct and oversee the servant's work, either directly or through another servant or agent. The dominant characteristic in this relationship is the right of control or interference, which includes the ability to dictate the servant's working hours, assign tasks, and provide instructions on how to perform them. This distinguishes the servant from an independent contractor or someone who is employed solely to deliver the results of their work to their employer.

Coase (1937) provided potential explanations for why not all production is conducted by a single large organization. As a company grows, there is a possibility of experiencing diminishing returns to the entrepreneur function. This means that the expenses of managing new transactions within the company may increase. Eventually, there comes a point where the expenses of arranging an additional transaction within the company are equivalent to the expenses associated with conducting the transaction on the public market, or to the expenses of organizing by a different entrepreneur. Furthermore, it is possible that when the number of transactions being conducted increases, the entrepreneur may not effectively allocate the factors of production to their most valuable applications, resulting in suboptimal utilization of these factors.

Once more, it is necessary to achieve a point where the amount of resources wasted is equivalent to the marketing expenses incurred in the open market, or to the loss that would occur if the transaction were arranged by a different entrepreneur. Ultimately, the cost of acquiring one or more of the resources used in production may increase, as the benefits of being a small company outweigh those of a large company. The precise point at which the growth of the company stops may be influenced by a mix of several factors. The argument is that a company will continue to grow until the expenses of managing an additional transaction internally are equivalent to the expenses of conducting the same transaction through a market exchange or by organizing with another company. This indicates that there is a market transaction taking place between these two producers, both of whom are capable of organizing it at a cost lower than the current marketing expenses.

Assuming all else remains constant, a company will generally be larger if: (a) the costs of organizing are lower and the rate at which these costs increase with an increase in transactions organized is slower; (b) the likelihood of the entrepreneur making mistakes is lower and the rate at which mistakes increase with an increase in transactions organized is smaller; (c) the supply price of factors of production decreases (or increases at a slower rate) for larger firms. The concept of a business can provide more exact interpretations for the terms "combination" and "integration". A combination occurs when transactions that were previously separate are brought together. Integration occurs when the organization of transactions that were previously conducted between entrepreneurs on a market takes place. A company has the option to expand through either one or both of these two methods. The entire framework of the "structure of competitive industry" can be effectively analyzed using standard economic analysis techniques (Coase, 1937).

An examination of the impact of changes on the cost of internal organization and marketing expenses will shed light on why organizations have fluctuations in size. It is evident that dynamic elements play a significant role in this phenomenon. Therefore, we possess a concept of dynamic equilibrium. The above analysis has also served to elucidate the correlation between initiative or entrepreneurship and management. Initiative refers to the ability to anticipate and take action, and it is facilitated by the pricing system through the creation of new agreements. Management mostly responds to fluctuations in prices by reorganizing the resources that it oversees. The fact that the company person typically performs both roles is a clear consequence of the marketing expenses (Coase, 1937).

Market and Hierarchies

In his book "Markets and hierarchies: Analysis and antitrust implications" published in 1975, Williamson argued that the choice between a competitive or monopolistic model of the company in micro-theory depended on the relative size of economies of scale compared to the market. Regardless of the specific model

used, the dominant assumption is that individuals or organizations aim to maximize their profits. The firm's production and procurement decisions are typically assumed to be predetermined, while internal organizational aspects such as hierarchical structure and internal control systems are also disregarded. Indeed, instances of rivalry arising in the stock market are infrequent, and thorough investigations into such matters are even rarer. It should not be surprising that many intriguing issues related to firms and markets are overlooked or ignored by simplifying the firm to a production function with a sole focus on maximizing profits.

The industrial organization tradition, centered around the structure-conduct-performance paradigm, utilizes the established micro-theory model of the company as a foundational element. However, the primary focus of analysis is on the industry as a whole. The central focus is on the impact of market structure and inter-firm behavior on economic performance. Policy analysts of this type, particularly economists at the Federal Trade Commission, frequently attribute anticompetitive intentions to intricate or unfamiliar business processes, even when the primary objective of these techniques is really to enhance transactional efficiency. There is often a strong opposition to intricate company structures such as vertical integration, conglomerate organization, innovative financing or leasing arrangements, and similar practices (Williamson, 1975).

Williamson (1975) combined Coase's overarching framework with economic and organizational theory literature to develop a concept known as the organizational failures framework. According to Williamson, the inefficiency of economic exchanges in markets can be attributed to two factors related to the individuals involved in the transaction (limited rationality and opportunistic behavior) and two factors related to the transaction environment (uncertainty/complexity and limited bargaining power due to small numbers). Markets may fail and be replaced by hierarchies as a governance system due to opportunism, constrained rationality, uncertainty, and small numbers negotiating. Hierarchies can promote shared aims and objectives among parties involved in transactions and enable thorough supervision of each other's conduct through established norms. This helps to address certain challenges associated with using a market-based governance system.

Transaction Cost Economics (TCE)

Transaction cost economics refers to different ways of managing transactions, known as governance structures, with the goal of minimizing transaction costs. Transaction-cost economics is a multidisciplinary field that combines economics with elements of organization theory and has significant overlap with contract law. In 1979, it served as the contemporary version of institutional economics and largely depended on comparative analysis. Frictionless principles serve primarily as a point of reference. Despite its limitations in capturing all transaction-cost events, mathematical economics has faced other obstacles as well. The progress in studying transaction-cost concerns has been hindered by the absence of clear language definitions. A notable omission has been the failure to identify the crucial dimensions in which transactions vary (Williamson, 1979).

The three key aspects for describing transactions are (1) the level of uncertainty involved, (2) the frequency at which transactions occur, and (3) the extent to which durable investments related to the transaction are made. Among these three, uncertainty is commonly acknowledged as a crucial characteristic, while the significance of frequency is considered at least plausible. However, the full extent of the governance implications of neither of these factors has not been thoroughly explored, and it cannot be done so unless it is combined with the third crucial aspect: transaction-specific investments. Given that investment disparities play a significant role in the study of governance, it is necessary to provide further clarification. Williamson (1979) argues that in order to efficiently organize economic activity, it is important to match governance structures with the transactional attributes of uncertainty, frequency of exchange, and the degree to which investments are transaction-specific. Figure 1 illustrates the six categories of transactions that governance structures must align with. The cells in Figure 1 contain illustrative transactions.

		Investment Characteristics		
		Non-specific	Mixed	Idiosyncratic
Frequency	Occasional	Purchasing Standard Equipment	Purchasing Customized Equipment	Constructing a Plant
	Recurrent	Purchasing Standard Material	Purchasing Customized Material	Site-specific Transfer of Intermediate Product Across Successive Stages

Source: Williamson (1979)

Figure 1. Illustrative Commercial Transactions

There are three main categories of governance systems that will be examined: non-transaction-specific, semi-specific, and very specific. The market is a generic form of governance characterized by anonymous buyers and sellers. There is no text provided. The user's text is a single period. Let's meet. There is no text provided.to momentarily trade standardized items at prices that are in balance. In contrast, highly specialized structures are customized to meet the unique requirements of the transaction. Identity is undoubtedly significant in this context. Semi-specific structures, by definition, occupy an intermediate position. Several suggestions are thereafter proposed without delay. (1) Transactions that are highly standardized do not typically need a particular governance structure. (2) A highly specialized governance structure will only be applicable to repeated transactions. (3) While few transactions of a non-standardized nature may not justify the need for a governance framework tailored to each transaction, they nonetheless warrant special consideration.

Macneil's three-way classification of contract categorizes transactions based on their characteristics. Classical contracting encompasses all standardized transactions, regardless of their frequency. Relational contracting is applicable to recurring transactions that are non-standardized. Neoclassical contracting, on the other hand, is necessary for occasional transactions that are non-standardized. Figure 2 illustrates the alignment between governance structures and transactions that occurs as a result of efforts to economize.

		Investment Characteristics		
		Non-specific	Mixed	Idiosyncratic
Frequency	Occasional	Market Governance (Classical Contracting)	Trilateral Governance (Neoclassical Contracting)	
	Recurrent		Bilateral Governance	Unified Governance
			(Relational Contracting)	

Source: Williamson (1979)

Figure 2. Matching Governance Structure with Commercial Transactions

Market governing, often known as Classical Contracting, is the primary governing framework used for nonspecific transactions involving both infrequent and recurrent contracting. Markets are particularly effective when there are repeated transactions involved, as both parties may rely on their own past experiences to decide whether to continue trading or easily switch to another option without much cost. Given their standardization, it can be assumed that alternative buy and supply arrangements are quite simple to negotiate. Occasional transactions, although not specific, are characterized by a lack of direct experience on the part of buyers and sellers, making it more difficult to protect against opportunistic behavior. Frequently, nevertheless, one can go to rating services or the feedback from other purchasers of the same product. When the good or service is uniform, experience rating, through both formal and informal methods, will encourage parties to act properly.

Trilateral Governance (Neoclassical Contracting) is necessary for two specific types of transactions: infrequent transactions that are a combination of different elements, and highly unique transactions. Once the parties involved in such transactions have agreed to a contract, there are powerful motivations to ensure that the contract is fully executed. Specialized investments have been implemented, which have a significantly lower opportunity cost in other uses. However, transferring these assets to a new provider would be extremely challenging due to the difficulty in valuing the assets. The stakeholders have a strong vested incentive in maintaining the relationship, particularly for deals that are very unique and specific.

Specialized governance frameworks are often created for two sorts of transactions: recurring transactions and extremely idiosyncratic transactions. Relying primarily on market governance for these transactions is risky due to their lack of standardization, but the recurring nature of these transactions allows for the recovery of the costs associated with a specialized governance structure. There are two distinct types of Transaction-specific Governance structures for intermediate-production market transactions: bilateral structures, which maintain the autonomy of the parties involved, and unified structures, which remove the transaction from the market and organize it within a firm under an authority relation known as vertical integration. Bilateral structures have recently gained recognition for their importance, however their functioning remains little comprehended.

Williamson (1979) has proposed a technique that can be easily generalized for the examination of labor contracts. Furthermore, it has implications for comprehending both the regulation of public utilities and the dynamics of family relationships. A cohesive strategy for contract development materializes. It is encouraging that the general characteristics of several diverse transactions may be accommodated within the

framework. The significance of transaction costs in organizing economic activity is thus validated. However, the realm of contractual agreements is very intricate, and it is unrealistic to anticipate that the suggested uncomplicated economic framework will encompass anything beyond the fundamental aspects. Developing a framework to address micro-analytic phenomena should be possible. Expanding the scope to incorporate supplementary or alternative aspects, such as the simplicity of confirmation in capital-market transactions, can occasionally be essential.

According to transaction cost theory (Williamson, 1979, 1986), the most effective organizational structure is one that maximizes economic efficiency by minimizing exchange costs. According to the hypothesis, every transaction type incurs coordination costs associated with monitoring, controlling, and managing the transactions. According to Williamson, transaction costs encompass the expenses associated with operating enterprises inside the economic system. He has contended that these expenses should be differentiated from the costs of producing goods and that a decision-maker might opt for either a firm structure or sourcing from the market by comparing transaction costs with internal production costs. Therefore, the cost is the main factor that determines such a selection.

According to Williamson (1979), there is a growing agreement on several factors. Firstly, opportunism is a key concept in the examination of transaction costs. Secondly, opportunism plays a significant role in economic activities that require specific investments in human and physical capital. Thirdly, the effective handling of information is an important and interconnected concept. Lastly, the evaluation of transaction costs is a comparative institutional endeavor. However, there is a lack of agreement on transaction costs beyond these broad statements.

Criticisms of the Transaction Cost Theory

Transaction Cost Economics (TCE) has gained significant prominence in the past decade as a fundamental framework for analyzing various strategic and organizational matters that hold great significance for managers. These matters include vertical integration, distribution strategy, international expansion, strategic alliances, optimal financial structure, and the design of internal incentive systems. The TCE logic has been used to derive normative implications on various applied issues, including the ones above and others. These implications are now widely discussed in popular media and are also being emphasized by top executives. Additionally, consulting firms have emerged to spread this notion to their business clients. Economists have also started incorporating transaction-cost reasoning into their teachings for both classroom settings and general business audiences. This is not just done as a positive theory of business practices, but also as a normative theory of organizational choice and design. According to several advocates, the theory's objective is not just to provide an explanation but also to have an impact on practical application (Masten, 1993).

Ghosal and Moran (1996) attempted to warn against the increasing inclination to utilize the TCE logic for normative objectives. While Williamson's theory has some appeal as a positive theory, its applicability is significantly limited due to its high assumptions and excessive stylization. While positive theory can be simplified and made forceful by approximations, normative theory cannot achieve the same level of parsimony and effectiveness. In this situation, Masten (1993) focuses mostly on the lack of relevance of positive theory when it is incorrectly used in normative fields, while Ghosal and Moran (1996) are more concerned with the potential hazards of doing so. Williamson's arguments are not only irrelevant to the majority of decision-making scenarios in companies, but if they are implemented, they are also likely to have a negative impact on their performance.

Ghosal and Moran (1996) contend that the prescriptions derived from this theory are not only incorrect but also pose a risk to business management due to the underlying assumptions and reasoning. Organizations are not simply alternatives to facilitate efficient transactions in cases when markets are unsuccessful; they have distinct advantages in controlling specific types of economic activities using a different logic than that of a market. Transaction cost economics (TCE) is considered "detrimental to practical application" due to its failure to acknowledge this distinction. Ghosal and Moran (1996) pinpoint the origins of the "organizational advantage" and advocate for the development of a distinct theory that aligns with the realities of what Simon (1991) refers to as our "organizational economy".

Ghosal and Moran (1996) provided a critical analysis of Williamson's interpretation of TCE (1975, 1985, 1993b) for specific reasons. Williamson's analysis of TCE is comprehensive and particularly suitable for "business decision makers". It is also widely adopted by scholars who study topics beyond traditional economics, making it the prevailing approach for applying TCE to managerial issues. To be more precise, TCE, which was initially formulated as a positive theory to elucidate the reasons for the existence and longevity of organizations in markets, is now being expanded to elucidate the internal organization and management practices within firms. Williamson's reasoning, namely his M-form hypothesis, is the most commonly utilized variant for this purpose.

Due to their specific focal concerns and depth of analysis, other variants of TCE have had a limited impact on the management literature. Moreover, among the various iterations of TCE, Williamson's version relies most significantly on its behavioral assumptions. Applying these assumptions and the reasoning they are based on to business actions, especially those that affect a company's internal management, might

negatively affect the "base rate" of the phenomena and therefore undermine the validity of the assumptions. Thus, Williamson's version of the theory has a larger probability of utilizing the TCE logic for normative purposes, resulting in more significant practical ramifications.

Ghosal and Moran (1996) initiated their criticisms by elucidating that a significant portion of TCE (Williamson, 1975, 1985, 1991a,b,c,d, 1992, 1993a,b,c) relies on a nearly identical set of assumptions, which might have detrimental effects on businesses whose managers consciously or unconsciously embrace its recommendations. The initial assumption pertains to the nature of human beings. Williamson's brand of TCE reasoning incorporates an opportunistic "model of humans", which refers to self-interest without moral constraints (Milgrom & Roberts, 1992). It is presumed that he lacks options since he cannot be sure in advance that his spouse would not act in a self-serving manner, and finding out afterwards can be expensive (Williamson, 1975). The second premise pertains to the necessity for achieving success. The attractiveness of the outcome is determined by the "efficiency" within the predefined rules of the game, according to Williamson (1991d).

According to Williamson's theory of Transaction Cost Economics (TCE), the rivalry between organizations and markets is expected to result in unfavorable outcomes. According to this view, organizations exist because they have better capabilities to reduce human opportunism by using hierarchical controls that cannot be accessed through markets. Nevertheless, these hierarchical restrictions do not inevitably restrict opportunistic conduct. Indeed, they are more likely to have the exact opposite impact. The belief that people would act in their own self-interest can produce a situation where opportunistic conduct grows when measures are taken to prevent it. This, in turn, leads to the necessity for more stricter and more complex measures to control such behavior.

TCE has faced criticism on various fronts. It has been accused of embodying a concealed ideology that distorts rather than clarifies (Perrow, 1986), engaging in ad-hoc theorizing that is disconnected from reality (Simon, 1991), lacking universality due to ethnocentric bias (Dore, 1983), disregarding the contextual basis of human actions, thus presenting an under-socialized perspective on human motivation and an over-socialized perspective on institutional control (Granovetter, 1985), and other alleged acts of omission and commission. Ghosal and Moran (1996) share the same concern as Pfeffer (1994) on the normative implications.

Critiques for Opportunism

Opportunism plays a crucial role in Williamson's Transaction Cost Economics (TCE) framework. Opportunism represents a more potent manifestation of the self-interest assumption, which is a widely accepted motivating principle in economics and other social science fields. The key distinction between the two is based on the extent to which individuals can consistently adhere to norms and fulfill their commitments. In the conventional perspective, self-interested behavior is believed to be limited by adherence and loyalty to commitments. Opportunism is nonexistent. It enables individuals to engage in "strategic behavior," which refers to the act of making deceptive or insincere threats and promises with the intention of gaining personal advantage (Williamson, 1975). Williamson did not provide details on the specific processes via which opportunism is generated or mitigated. Williamson posited that human nature was the exclusive determinant of its own existence.

Williamson employed the term opportunism to refer to both a mindset and a set of actions. As an illustration, he mentions the "opportunistic attitudes" (1975: 48), which he saw as one of the "basic characteristics of human nature" (1991c: 8). Simultaneously, he regarded it as a form of conduct akin to falsehood, theft, and deceit (1975, 1985) and "deliberate attempts to deceive, distort, contradict, obscure, or otherwise bewilder" (1985: 47). The unspoken differentiation between opportunism as a mindset or propensity and opportunism as a specific form of conduct or activity is nonetheless crucial for Williamson's claims. This distinction enabled him to view opportunism both as a behavioral assumption inherent in human agents and as a behavioral consequence influenced by the selection of governance mechanisms. Williamson's formal thinking lacks the differentiation between opportunism as an attitude and its actual expression in opportunistic action. Moreover, the lack of differentiation between opportunism and its expression allows his logic to remain coherent and prevents it from being ambiguous and vague. In order for his theory to be valid, opportunism must be regarded as an assumption that is not influenced by the specific circumstances, and as a result that is not predetermined.

Williamson argues that opportunistic behavior is directly influenced by the potential benefits it offers, which are mainly determined by transaction-related characteristics, particularly asset specificity. However, this behavior is limited or influenced by safeguards such as controls, fiat, monitoring, etc., which increase the costs for the individual engaging in such behavior. The linkages depicted in Figure 3 are essential for TCE to determine the optimal governance structure for a given transaction. They exhibit both the implicit fluctuation of opportunistic conduct, as well as its correlation with context (i.e., the interplay between transaction characteristics and governance).

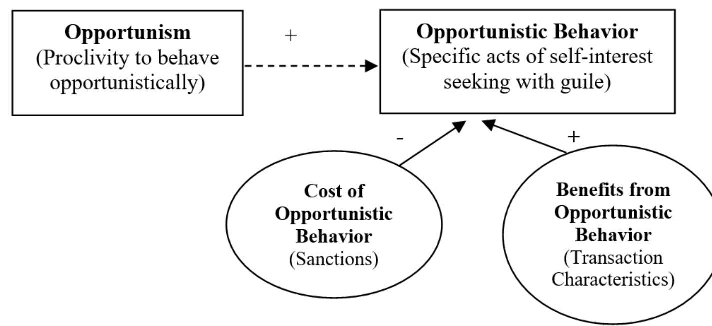

Figure 3. Williamson's Model of Opportunistic Behavior

Regarding opportunism, the Theory of Transaction Cost Economics (TCE) does not assume that all individuals are opportunistic, but rather that some individuals may exhibit opportunistic behavior at times. According to Williamson, even those who are less opportunistic still have their own motivations. Additionally, it is not feasible to determine in advance which individuals will be opportunistic and which will not be, as stated by Williamson and Ouchi in 1981. However, although the theory takes into account the presence of individuals with different characteristics (i.e., varying levels of opportunism) and their ability to display different behaviors based on their attitudes, it does not consider their tendency to change their attitudes in response to changes in time and place.

Since Williamson does not conceptually distinguish between opportunism and its behavioral expression (i.e., opportunistic behavior), we can conclude that either opportunism (i.e., the mindset) is viewed as an unchanging characteristic, unaffected by circumstances, or it is closely associated with opportunistic behavior (i.e., both factors are interconnected), with both being influenced by context in a similar manner. That is, while asset specificity may consistently influence an individual's perception of the extent to which they can engage in opportunistic behavior, and sanctions may moderate the individual's expectations regarding this behavior, it is believed that context does not independently affect the individual's attitude towards opportunism, separate from its impact on opportunistic behavior. Therefore, individuals either have a steadfast mindset towards opportunism, or their mindset and actions must synchronize in such a way that they function as a unified and cohesive notion. Alternatively, in order for Williamson's theory to effectively explain and predict the selection of governance form, it is necessary to establish a series of additional connections between opportunism and the transaction and governance characteristics, as well as how these conditions impact the interactions between opportunism and opportunistic behavior. This assumes that opportunism, as an attitude, consistently varies in relation to context, independently from opportunistic behavior.

According to Williamson and illustrated in Figure 3, opportunistic behavior is positively influenced by the benefits resulting from such behavior, as determined by transaction characteristics (relationship 'h' in Figure 4). Conversely, opportunistic behavior is negatively influenced by the cost of engaging in such behavior, as determined by the sanctions in place (relationship 'b'). In addition to the two influencers mentioned, we include a third factor that is implicit in Williamson's model and is highly supported by Ajzen and Fishbein's (1977) theory of reasoned action: opportunistic conduct is favorably affected by opportunism (relationship 'g').

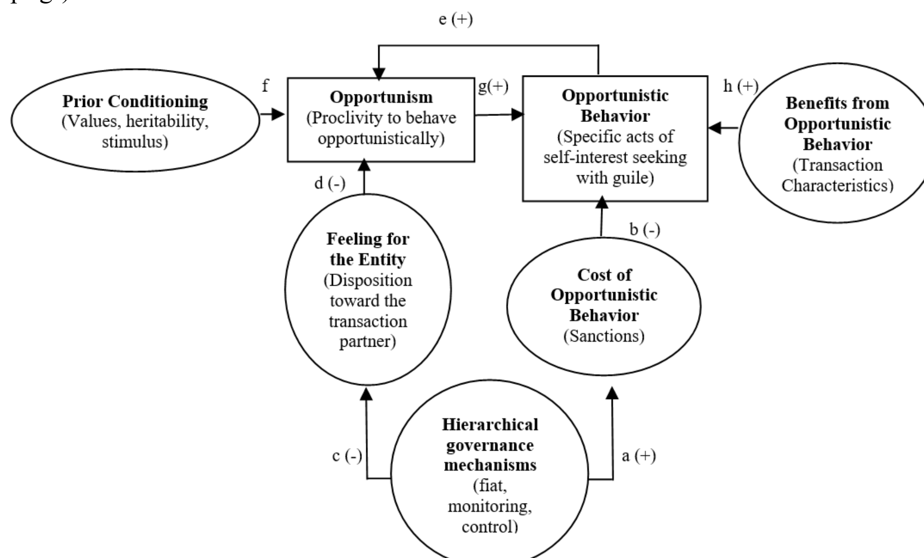

Figure 4. The Cycle of Self-Fulfilling Prophecy

Opportunism is determined by three elements. The first factor is “prior conditioning” (referred to as relationship ‘i’), which encompasses all the attitudes and values that are developed via exposure to both conscious and subliminal stimuli, and may also be influenced by hereditary variables. Additionally, opportunism is shaped by what we refer to as the “sense of the entity”, which denotes the people’ positive or negative evaluation of the particular trade partner, group, or organization. Having a favorable attitude towards the entity would decrease opportunistic behavior, whereas having a negative attitude would increase it. Hence, we have established that this variable has a detrimental impact on opportunism, specifically referred to as relationship ‘d’. Opportunistic behavior is the third factor that influences opportunism. According to dissonance theory, when there is a mismatch between someone’s attitude and their conduct, it might cause dissonance. This is especially true if the behavior was done with a strong commitment and freedom of choice. To reduce this dissonance, the person may change their attitude. The model illustrates a positive feedback loop denoted as relationship ‘e’. According to Williamson, the impact of hierarchical governance mechanisms, such as fiat, monitoring, and control, is clearly defined. These mechanisms are found to have a positive effect on reducing opportunistic behavior (relationship ‘a’). Additionally, based on the literature on motivation, they are found to have a negative effect on the overall sense of connection to the organization (relationship ‘c’).

The explicit foundation of TCE consists of relationships ‘a’, ‘b’, and ‘h’. Williamson (1975) acknowledges the existence of relationships ‘i’ and ‘g’, but does not analyze them explicitly. This is because the connections between conditioning, attitude, and behavior are perceived as direct and innate, without any room for change or variability. He disregards the dissonance lowering feedback loop ‘e’, however this relationship does not impact the core properties of the model as it only strengthens the overall impacts from the rest of the system. Williamson explicitly recognizes the existence of relationships ‘c’ and ‘d’ in his talks on the significance of “atmosphere” (1975) and the potential adverse motivational effects of monitoring (1979). However, he does not formally integrate these factors in his theoretical framework. Put simply, our deviation from Williamson’s approach is only focused on explicitly incorporating and internalizing some factors that are implied or external to his theory.

An outcome of the self-fulfilling prophesy of opportunism is the escalation of governance costs, resulting in a gradual decline in competitiveness for these firms. Ultimately, the responsibility of creating and executing these rules is one of the primary factors contributing to the accumulation of unnecessary bureaucrats and inefficient bureaucratic processes, as identified by Williamson as the root cause of inefficiency in companies. Additionally, it can augment risk-averse behavior, detrimentally impacting long-term performance; yet, there exists another less apparent consequence. Ghosal and Moran (1996) propose that enterprises, trapped in this cycle, would naturally be drawn towards specific types of businesses that are more conducive to being managed by rational control. These businesses are the type that exhibit higher efficiency features in markets and will ultimately outlast firms. To clarify, if enterprises prioritize rational control, they will end up operating in areas where they cannot compete effectively and will eventually be defeated by the market.

Critiques for Markets and Hierarchies

Organizations that rely on rational controls will attempt to implement structures and tactics that protect them from uncertainty. Organizations face two primary sources of uncertainty. The first factor pertains to the external environment and is attributed to the intricate and ever-changing nature of technologies and marketplaces. The second source of deception originates from within the organization, resulting from the discretionary actions of individuals. Hierarchies aim to minimize uncertainty by establishing a controlled and obedient atmosphere within the firm. Additionally, they tend to select external surroundings that exhibit relatively stable technology and market conditions. As time goes on, firms that are well-established and deal with a high volume of products will increasingly prefer sectors that involve operations that can be easily automated and have standardized processes. However, it is only for such enterprises that markets are likely to exhibit efficiency traits that are superior to those of organizations.

As markets grow and become more advanced, reaching a condition of competitive balance, they become increasingly skilled at facilitating trade. Organizations maintain an enduring edge over more complex marketplaces under three specific conditions. These conditions arise when the results of transactions are extremely unknown, when it is difficult to determine the reputations of the parties involved, and when there are significant immediate benefits from opportunistic activities. The initial state may enable opportunistic conduct to remain unnoticed, even if both the output and behavior can be quantified. The second suggests a lack of behavior or outcome quantifiability. The third suggests a work environment with a high level of discretion within the organization.

Markets and enterprises hold significant significance in Williamson’s concept as they both play crucial parts in the two fundamental processes that propel the advancement of capitalist economies: the attainment of efficiency and the adjustment to change. Both institutions are essential for optimizing resource allocation and utilization in capitalist society due to the varying effectiveness of each institution under different transaction circumstances. Williamson argues that organizations are essentially a form of contractual instrument, serving as an extension of market connections through different mechanisms (1991b). Williamson assumes that

efficiency and adaptation can be achieved through common theoretical logics. According to him, both markets and firms rely on their ability to apply the same logic, although with different methods, to transactions with varying characteristics.

Empirical evidence indicates that the distinctions between markets and companies in terms of transaction characteristics may not align with Williamson's claims. Similar transactions frequently endure for extended durations in both markets and organizations. For instance, certain firms continue to outsource the same component while others produce it internally within the same market. Additionally, both individual operators and large organizations remain sustainable in the same industry. Furthermore, both licensing and direct investment are prevalent under essentially identical economic conditions. There is no conclusive proof that in any specific type of transaction, one governance method has successfully eliminated the other, even in highly competitive situations. What sets markets and enterprises apart is their ability to attain efficiency and promote adaptability through distinct methods, guided by diverse institutional logics. The relations of one are not a continuation of the relations of the other. The relationships and their ability to conduct transactions undergo a significant change when they are moved from one institutional mode to another. The efficacy of a particular company or market in facilitating a specific activity relies on its ability to effectively execute its own institutional logic. In a transaction, a well-managed corporation has the potential to outperform many independent entrepreneurs who are working in a market with weak structure. Similarly, those independent entrepreneurs operating in a well-structured market have the potential to outperform a poorly managed organization. In order to elucidate the potential benefits of organizations compared to markets, it is essential to comprehend the disparities in the institutional logics of businesses and markets, and how these disparities impact the methods by which each can achieve efficiency and adaptation objectives. Managers of enterprises must adhere to this notion in order to get any normative mandates.

The market operates based on autonomous adaptation. Individual enterprises independently adjust their strategies in markets based on market signals. This type of autonomous adaptation occurs spontaneously as the existing supply of products and services is matched with the present level of demand. The process of independent adaptation possesses two different characteristics. In order for the "marvel of the market" to function successfully, it is necessary for prices to be either known or predictable (Simon, 1991). According to Williamson (1991d), prices need to behave as accurate indicators of transactions in order for them to adjust independently. Changes in pricing, which indicate shifts in the demand or supply of a commodity, must effectively signal to each individual participant the appropriate course of action to adopt. Furthermore, autonomous adaptation exhibits a preference for static efficiency. Autonomous adaptation plays a crucial role in optimizing the available options by reallocating resources from less efficient uses to more efficient ones. It follows an evolutionary path that is determined by the current level of efficiency, regardless of the efficiencies of future states. Put simply, a condition of great efficiency cannot be achieved through self-adjustment if it relies on less efficient states that come before it, regardless matter how efficient the final state may be.

Organizational logic refers to the deliberate and intentional modification of strategies and structures to achieve certain goals. Unlike the spontaneous, self-governing adjustment that occurs within markets, organizations have the ability to engage in what Barnard referred to as "intentional" adaptation. Barnard (1938) asserts that shared purpose is the fundamental factor that brings together a formal organization. He further argues that having a goal is essential and self-evident, as it is implied by the terms "system," "coordination," and "cooperation." While Williamson acknowledged the importance of coordination in organizational adaptation in 1991, he overlooked the significance of shared purpose in facilitating this coordination. Purpose enables the process of "coordinated adaptation" described by Williamson to go towards a certain direction, without the requirement for it to be clear or appropriate. This is achieved by using judgment in determining which market signals to heed and which to disregard. Purposive, coordinated adaptation has several advantages over undirected autonomous adaptation in markets. Firstly, intentional adaptation can occur even in situations where prices or markets are not present. Furthermore, it enables businesses to actively pursue dynamic efficiency, so generating novel possibilities and broadening the range of activities that can be efficiently coordinated beyond the capabilities of markets alone. Shared purpose ultimately changes the overall environment of institutions, where relationships exist, and thus affects the actions and preferences of individuals involved.

A Suggestion: A Theory for the Organizational Economy

Coase (1988) voiced his apprehension regarding the trajectory that TCE has followed since the release of his initial article, which served as the foundation for this particular branch of theory. He wrote,

"I consider that one of the main weaknesses of my article "The Nature of the Firm" stems from the use of the employer employee relationship as the archetype of the firm. It gives an incomplete picture of the nature of the firm. But more important, I believe it misdirects our attention . . . the way in which I presented my ideas has, I believe, led to or encouraged an undue emphasis on the role of the firm as a purchaser of the services of factors of production and on the choice of the contractual arrangements which it makes with them. As a consequence of this concentration on the firm as a purchaser of the inputs it uses, economists have tended to neglect the main activity of a firm, running a business" (1988: 37-38).

Williamson's perspective on businesses as collections of employment contracts prompted him to prioritize the study of opportunistic behavior and the implementation of safeguards to reduce the risk of one party taking advantage of another. Managers that are overly concerned with preventing opportunistic behavior, similar to the economists mentioned by Coase, are diverted from their primary responsibility of managing a corporation.

Ghosal and Moran (1996) do not argue that opportunism does not exist when they claim that Williamson's specific version of TCE is detrimental to practice. Furthermore, it is not being contended that Williamson fails to acknowledge certain consistent patterns of conduct in our society, such as the presence of locks on doors and guards at banks. If individuals were consistently non-opportunistic, this specific form of TCE may not be as detrimental in practical terms as they have contended, irrespective of its efficacy as a descriptive theory. The reason why Williamson's theory is considered detrimental to management practice is due to the frequent occurrence of opportunistic behavior, its significant negative impact, and the likelihood that management beliefs, policies, and practices can influence the factors that contribute to this threat and its consequences.

Social sciences have a unique responsibility due to the double hermeneutic process: their theories have an impact on the individuals who are the focus of study. By adopting a pessimistic outlook, this theory can elicit negative economic behavior. Williamson's reliance on opportunism as his fundamental premise prevents him from recognizing the factors that either support or undermine the credibility of this assumption. During the course of his theory, it is probable that it will inadvertently promote the same conduct that it assumes and endeavors to regulate. Hence, considering its underlying assumptions and reasoning, Williamson's version of Transaction Cost Economics (TCE) will consistently be deemed unfavorable in terms of managing firms, even when the theory becomes more accurate in predicting the behavior of individuals, groups, and organizations who rely on its recommendations.

Ghosal and Moran (1996) stressed that the theory's inability to fulfill some standards of social desirability does not necessarily discredit it. Instead, it is the theory's inability to achieve its own standards of efficiency that leads to the criticism. Based on its theory, the presence of opportunism leads to higher costs in transactions, and firms are created to reduce the risks associated with opportunism and therefore achieve efficiency improvements. The literature has identified two issues with this method. Firstly, Williamson did not provide details about how opportunism is diminished. Secondly, he overlooked the fact that the institutional framework is influenced by past events and exhibits increasing returns. In this framework, history plays a crucial role in both promoting and solidifying the persistence of inefficient and efficient activities, as informal constraints are challenging to alter.

Ghosal and Moran (1996) propose that, based on Williamson's behavioral assumptions (which, according to Williamson himself, differentiate his theory from others with similar goals), firms that follow his recommendation of exclusive or primarily rational controls are more likely to experience an increase in opportunistic behavior. This behavior involves sacrificing long-term economic efficiency in order to pursue short-term gains that are not sustainable. Achieving economic advancement necessitates the simultaneous optimization of both static and dynamic efficiencies.

The process of autonomous adaptation in markets already include first-order economizing as a key element. Enforcing first-order economizing as the primary goal of organizations and as a fundamental criterion for the creation of their borders, structures, and procedures, however, is ineffective. While the pursuit of static efficiency can generate the necessary resources for making investments to achieve dynamic efficiency, it is unlikely to determine the direction of those expenditures. In addition, due to the complexity of measuring dynamic efficiency compared to static efficiency, organizations that adhere to Williamson's reasoning may overlook the former while focusing on securing the latter. Williamson overlooked the capacity of organizations to shape economic growth and individuals' motivation to participate to and benefit from it by focusing solely on first-order efficiency when addressing the issue of adaptation. Nevertheless, it is not solely organizations and their members who suffer negative consequences from this normative implementation of TCE. On a larger and potentially more significant scale, societies that adhere to this specific logic of Transaction Cost Economics (TCE) risk losing the potential energy of a significant contributor to their economic growth and the contentment of their members—the intentional organization.

The advantage of organizations compared to markets may not be in addressing human flaws through hierarchy, but in utilizing human capacity for initiative, cooperation, and learning. It also relies on harnessing the organization's internalized purpose and diversity to improve both learning and its application in generating innovations and purposeful adaptation. Organizations experience failure when they are incapable of establishing the social environment required to foster the trust and dedication necessary for sustaining collaboration. Within a theory of organizations and markets, the concepts of learning and trust may replace the roles typically attributed to efficiency and opportunism in the theory of markets and hierarchies. Similarly, purpose may substitute price as a central factor. This approach may also produce divergent conclusions about organizational diversification, control, and governance. The emergence of such a theory is improbable without substantial work by researchers specializing in strategy and organization, who possess a deeper understanding of what we have referred to as the organizational logic. It is therefore necessary for these scholars to cease relying on theories of organizations that continue to uphold the belief in the market

economy, and instead begin anew by constructing an alternative theory that recognizes the actuality of the organizational economy.

Transaction-Cost Based Research

There is much research that utilizes transaction costs as a fundamental framework. These studies encompass a variety of themes and types of research. Shelanski and Klein (1995) have compiled a list of empirical studies that cover various topics, including comparative contracting (such as vertical integration, complex contracting, hybrid modes, price adjustment in long term contracts, multinational corporations, and the structure of foreign trade) and the effects of organizational form (such as the effects of vertical integration, comparative studies of organizational form, firm ownership, and governance). Notable scholars in this field include Butler and Carney (1983), Caves and Bradburd (1988), Harigan (1986), Levy (1985), MacDonald (1985), Macmillan, Hambrick, and Pennings (1986), Mahoney (1992), and Weiss (1992), among others (see to Shelanski & Klein, 1995).

According to Robins (1987), there has been a significant increase in the level of interest in economics among students studying organizations. The emergence of the new institutional economics, as coined by Williamson in 1979, has revitalized interest in key inquiries within organization theory. Economists have recently focused on analyzing vertical integration, which has led to a renewed interest in defining organizational boundaries. Their research has had a significant influence on the subject of organization studies. However, it is important to consider certain observations regarding the application of transaction-cost theory in the examination of organizations. It has facilitated the tendency to borrow ideas without caution, which has been recognized as a fundamental problem in organizational research. Certain research in the field of organization studies demonstrates this limitation. There is an increasing amount of research that has tried to use ideas taken from fields like the economics of law or economics of industrial organization to study the origins and structure of complex organizations (Williamson, 1975; Ouchi, 1980). The unquestioning application of market models has resulted in significant logical and empirical deficiencies in a substantial portion of this research.

The use of transaction-cost theory for causal analysis likely has more significant consequences than a defective economic historiography. The failure to seize opportunities to acquire fresh understanding of the relationship between an organization and its surroundings may pose a more significant disadvantage of this strategy. The transaction-cost theory aims to integrate key research in organization studies and industrial organization economics, providing a comprehensive analysis of how organizational structure is influenced by the challenges of thriving in competitive environments (Robins, 1987).

This perspective on transaction-cost economics proposes a systematic investigation that concentrates on how firms adapt their organizational structure in reaction to shifts in the competitive landscape of industries over a period of time. In this style of research, the various organizational structures used by companies would be seen as collections of formal and informal agreements with distinct incentive and information-sharing characteristics that may be examined using behavioral research methods. The transaction-cost theory offers a framework to comprehend the economic or strategic consequences of these behavioral observations and connect them to the competitive conditions encountered by the organization in its industry. Utilizing transaction-cost analysis in this manner can be a highly effective strategy. The limitations of its current applicability to organization studies suggest a misunderstanding of the theory's scope rather than any inherent problems in the theory. The examination of transaction costs must be situated within a wider theoretical framework - it cannot be used as the foundation for a broader historical or strategic analysis. By comprehending the extent of transaction-cost analysis in this way, it is possible to utilize this approach effectively for important objectives in the field of organization studies. As a supplement to a broader theory on the function of organizations in the economy and society, it can be useful in offering a unified framework for explaining the trade processes that occur inside and across organizations. By employing transaction cost theory in such a manner, it is possible to significantly contribute to the endeavor of reconciling social and economic viewpoints and developing a comprehensive understanding of organizations (Robins, 1987).

For instance, a study conducted by Klaas, Clendon, and Gainey (1999) titled “HR outsourcing and its impact: The role of transaction costs” investigated the influence of organizational-level factors on the relationship between the extent of HR outsourcing and the perceived benefits derived from outsourcing, using a Transaction Cost Economics approach. A moderated regression analysis was conducted utilizing data from more than 300 HR executives. The analysis examined the relationship between outsourcing levels, organizational characteristics, and the perceived impact of outsourcing. Evidence was discovered that supports several transaction cost assumptions concerning the influence of organizational factors. The perceived benefits gained by outsourcing were influenced by several factors, including reliance on unique HR practices, uncertainty, business size, and cost pressures. No evidence was found to support the hypotheses regarding the moderating effect of wage level, general outsourcing emphasis, or strategic participation by HR.

In order to address the need for studying how companies adapt to changes in industry competition, future research based on transaction costs could examine the N-form corporations proposed by Hedlund (1994). The N-form is distinct from the M-form (Multidivisional form) as described by Williamson (1991), and it

signifies a hierarchical organizational structure. One of the distinguishing factors between M-form and N-form is their fundamental organizational structure. The M-form utilizes a hierarchical structure, whereas the N-form employs a heterarchical structure. Heterarchy is characterized by a network structure rather than a bureaucratic one, and it is more organic in nature rather than mechanical. A heterarchy is distinguished from a hierarchy by the presence of extended pathways that connect intermediate levels in both upward and downward directions, as well as by the occurrence of lateral interactions. The ascending and descending channels provide direct communication between higher-level systems and lower levels, in addition to the indirect route through intermediate levels. Lateral exchanges facilitate enhanced integration within tiers.

Conclusion

An acceptable theory of the firm should possess the capability to elucidate not just the reasons for the existence of firms in a market economy, but also other aspects. At the very least, it should have the capacity to clearly define and articulate the limits of a firm's activities, including what tasks are performed internally and what tasks are outsourced or delegated to others, as well as how these activities are structured and how the firm achieves growth and success. Transaction-cost theory can be used to analyze the economic and strategic consequences of the organizational structure adopted by enterprises and how it relates to the competitive environment of the industry. Both profit-oriented and non-profit organizations have acknowledged the significance of partnerships. Profit-oriented organizations have long recognized the numerous advantages of inter-organizational collaboration. Nonprofits are now beginning to understand some of these benefits, including cost savings through shared administrative expenses, enhanced value propositions, increased efficiency, strengthened programs, utilization of compatible skills and abilities, and improved leadership skills. Given the growing demand for collaboration and co-creation in contemporary business matters, it might be worthwhile for future research to explore a fundamental question: why do organizations exist together (co-exist)?

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