

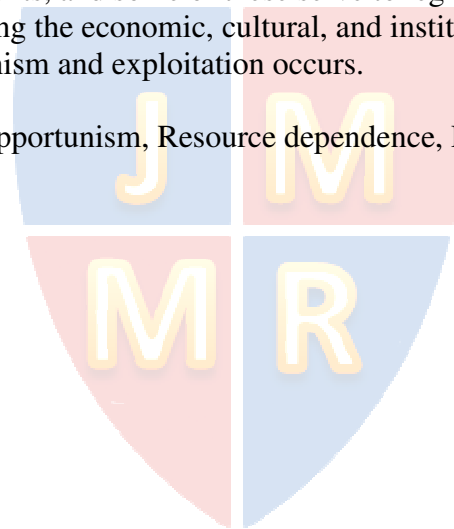
Reconsidering embeddedness: asymmetric network ties and the fate of dependent firms

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ABSTRACT

This conceptual paper reviews the literature on the social embeddedness of organizations and argues that the existing literature's focus on trust, norms of reciprocity, and cooperation among firms has led to the misspecification of the social embeddedness construct. The paper argues that social embeddedness is a broader construct and that under certain conditions, particularly those of power imbalance, social embeddedness can promote rather than prevent opportunism and exploitation among firms. The social nature of the relationship does not ensure against exploitation because social norms relating to the exercise of power differ across institutional and cultural contexts, and some of these serve to legitimate domination. The paper develops propositions regarding the economic, cultural, and institutional contexts that shape the extent to which such opportunism and exploitation occurs.

Keywords: Embeddedness, Opportunism, Resource dependence, Power imbalance, Networks, Japan



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INTRODUCTION

In his seminal piece on the social embeddedness of economic action, Granovetter (1985) argued that economic action and market exchange cannot be understood purely in terms of the actions of atomized individuals, but must be understood as embedded in and shaped by the social structures and ongoing systems of social relations in which those actions and exchanges take place. This view has informed and organized much of the literature in economic sociology and organization theory (see Dacin et al., 1999 for a review).

In particular, a rich stream of research developed around Granovetter's argument that personal and network relationships generate trust, discourage opportunism, and facilitate market exchange (Gulati, 1995a; Gulati and Singh, 1998; Gulati and Sytch, 2007; Uzzi, 1996, 1997; Uzzi and Lancaster, 2003). This stream of work details how the ongoing nature of these relationships makes actors less likely to violate trust or engage in opportunistic behaviour, either because ongoing social interaction create feelings of mutual affection that make such behaviour distasteful, or because such behaviour would jeopardize an ongoing relationship that benefits both parties.

However, by equating social embeddedness with relationships based on trust and reciprocity, this research reduces Granovetter's broader point that economic relationships are social in nature to the narrow proposition that the social nature of economic relationships generates the trust that is necessary for beneficial exchange. Such a narrow treatment of the embeddedness construct has led to its misspecification. The broader point that economic relationships are socially embedded means that these relationships take on the characteristics of social relationships generally, not simply those based on trust or those devoid of opportunism. Trust is one possible outcome, but social interaction and social structure can generate a wide variety of relationships. For example, social relationships characterized by status and power differentials can easily lead to domination and exploitation, where there is a great deal of mistrust on the part of weaker parties and opportunism on the part of stronger ones. Social relationships in which social structure reinforces domination and exploitation are no less socially embedded than those characterized by trust and reciprocity.

Researchers who focus on the trust-generating capacity of socially embedded exchange, then, cannot rely on embeddedness to explain the emergence of trust and reciprocity in socially embedded relationships. They must still explain the conditions under which social relations lead to trust versus when they lead to trust violations and opportunism. This paper seeks to address that gap in two ways. First, drawing on resource dependence theory (Pfeffer and Salancik, 1978) it argues that when power imbalance in an embedded relationship is sufficiently large, powerful actors are unlikely to experience negative consequences from their opportunism because weaker actors have few options. Instead those actors can use their power advantage to capture the same benefits that emerge in embedded relations based on trust and reciprocity while also engaging in opportunistic behaviour when it suits their needs. Second, drawing on Zukin and DiMaggio's (1990) arguments regarding political and cultural embeddedness, this paper argues that trust-violating opportunism can also emerge when political and cultural contexts legitimate extractive behaviour on the part of powerful partners and limit the options available to weaker ones. In such institutional contexts, embedded relationships characterized by opportunism may in fact be the norm.

THE SOCIAL EMBEDDEDNESS OF ECONOMIC ACTION

Granovetter's 1985 work on the embeddedness of economic action was an attempt to counter the consensus in neoclassical and new institutional economics that economic outcomes should be understood as efficient solutions that emerge when rational individuals pursue their individual self-interest. Granovetter argued instead that economic activity is embedded in social structures that constrain and shape that activity. The primary target of his critique was Williamson's (1975, 1981) transaction cost economics, which sought to explain why some activity takes place within an individual firm given that economic theory posits that the market mechanism of price is more efficient. Williamson, argued that firms are necessary because managers lack the perfect rationality of homo economicus posited in neoclassical economics, which prevents managers from knowing in advance whether an actor will engage in opportunistic behaviour. Certain types of transactions then become too costly to perform on the open market due to the malfeasance risks involved. Such transactions must be brought within the boundaries of the firm, where hierarchical control prevents malfeasance and ensures order.

Granovetter argued that Williamson's attempt to rescue neoclassical theory fails because the problem is not simply that individuals lack perfect rationality; the deeper issue is that market participants are not the atomized individuals posited in neoclassical theory because people are embedded in webs of social relationships that shape economic activity in ways not accounted for in neoclassical models. Whether malfeasance occurs depends as much on those relationships as on whether interactions takes place within a firm or on the market. Subunit loyalties or social conflict within a firm can limit the firm's ability to control internal departments or impose important decisions, therefore internalizing economic activity within the firm does not guarantee efficient outcomes. Meanwhile, individuals engaged in market transactions often develop social relationships across firm boundaries that foster trust and mitigate opportunism.

Granovetter emphasized this latter point, arguing that the social nature of economic activity often fosters rational economic outcomes that enable markets to function efficiently. The ongoing nature of social relationships provides participants information about the trustworthiness of exchange partners not otherwise available, thereby enabling transactions to occur. These inherently social relationships also provide actors with access to opportunities and resources necessary for economic action. In other words, social relations are not a friction on the market, but rather are an important source of value.

Social Embeddedness and Cooperative Relationships between Firms

Organizational scholars have elaborated and tested the various components of Granovetter's framework. Powell (1990), for example, argued that the repeated exchange that occurs within networks represents a unique economic form that is distinct from both the arms-length relations that exist in markets and the command and control relations that exist inside firms. Within these networks, firms do not seek to extract maximum value from a single exchange. Instead, they engage in a give and take that fosters trust and reciprocity. This trust enables firms to share information openly, coordinate action effectively, fulfil changing requirements from partners with a minimum of haggling and fear, and respond rapidly to opportunities while allowing for greater flexibility and innovation than is possible within a single firm.

Following Granovetter and Powell, this overwhelmingly positive characterization of socially embedded exchange is one of the defining features of the embeddedness literature. For example, Uzzi and colleagues (Uzzi, 1996, 1997, 1999; Uzzi and Gillespie, 2002; Uzzi and Lancaster, 2003) argue that individuals engaged in repeated exchange develop feelings of friendship and concern for the welfare of the exchange partner outside of the business relationship and will prioritize the preservation of the relationship over immediate economic concerns. Such a relationship follows a logic that differs fundamentally from a market logic of individual personal gain. Partners seek mutual benefits through pooling of resources, exchange of knowledge, and coordinated action. This in turn increase firm profitability, access to new opportunities, fitness, and survival.

They find support for these arguments in several empirical contexts. Managers in New York apparel firms who engaged in repeated exchanges, for example, frequently shared fine-grained and even proprietary information with exchange partners in order to boost coordination and problem solving even when doing so was inconsistent with the utility maximization assumptions of traditional economics. Moreover, firms that engaged in such embedded exchange survived at higher rates than firms engaged in more arms-length transactions (Uzzi, 1996; 1997). Similarly, a series of studies on bank lending to midmarket and small firms found that the quality and depth of the relationship between lender and borrower engendered greater trust and facilitated information exchange, thereby increasing the frequency and the profitability of lending transactions for both parties (Uzzi, 1999; Uzzi and Gillespie, 2002; Uzzi and Lancaster, 2003),

Uzzi and colleagues focused on the interpersonal nature of embedded ties, but work in the embeddedness tradition also informs more macro perspectives on organizations, particularly in the strategy literature on alliances and interorganizational relationships. Empirical studies by Gulati and colleagues find evidence that embedded ties provide an invaluable lubricant for global alliances. By creating relations of trust and reciprocity, they reduce coordination costs through increased information sharing and mutual understanding, and they reduce transaction costs by mitigating moral hazard and making opportunism more visible and costly (Gulati, 1995a, 1995b; Gulati and Gargiulo, 1999; Gulati et al., 2000; and Gulati and Singh, 1998). Similarly, repeated alliances increased the likelihood of future alliances and decreased the use of hierarchical means of governance such as equity stakes.

Dyer and Singh (1998) elaborate the benefits of these embedded ties in their relational view of strategy, arguing that firms that develop relationship specific skills and resources within embedded networks earn relationship-based quasi-rents that generate surplus profits and competitive advantage. Investments in relationship-specific physical and human assets lead to productivity gains along the value chain due to tighter matching of supplier product to buyer needs, reduced inventory and transportation costs, and deeper, more efficient communication and collaboration across firm boundaries.

Empirical work supports this relational view of strategy. In a study of 344 supplier-automaker relationships in eight automobile manufacturers in the United States, Japan, and Korea, Dyer and Chu (2003) found that high reported levels of trust in embedded relationships decreased objective measures of transaction costs, boosted information sharing, and improved objective measures of procurement profitability. Dhanaraj et al. (2004) found that strong ties based on trust in embedded relationships boosted the transfer of tacit knowledge in a sample of 140 international joint ventures, and a meta-analysis by Geyskens et al.(2006) found a positive

performance effect for firms in embedded relationships facing hazards such as partner-specific asset investments or technological and volume uncertainty.

Independent of Granovetter, research on Japanese business firm networks echoed the social embeddedness arguments regarding trust and reciprocity with respect to the long-term relational contracting that takes place within Japanese trade and manufacturing networks. Dore (1983; 1986) argued that Confucian norms of goodwill and ethical behaviour temper the pursuit of self-interest and minimize opportunism. This allows subcontractors and central network partners both to benefit from long-term trusting relationships that provide security and ensure higher quality inputs while maintaining flexibility in the face of competition. Several scholars embraced Dore's argument, treating Japanese network forms as exemplars of trust-based economic cooperation that lowered transaction costs and improved coordination and communication (Hill, 1995; Lincoln, 1990). Empirical work on the Japanese auto industry provided support for this view, demonstrating extensive proprietary-information sharing, tight coordination of production, and extensive cooperation on pricing and investments in relationship specific assets among network firms (Dyer, 1996a, 1996b, 1997; Smitka, 1991).

POWER IN EMBEDDED RELATIONSHIPS

Despite empirical support for the proposition that embedded relationships are often based on trust and reciprocity, the relational embeddedness literature is incomplete insofar as it largely ignores the role that power plays in such relationships. A large body of sociological literature testifies to the importance of power as a construct for understanding social relations and structure (Blau, 1964; Coleman, 1990; Emerson, 1962; Pfeffer and Salancik, 1978; Weber, 1978). As Sewell notes, "any notion of structure that ignores asymmetries of power is radically incomplete" (1992, p. 9). Indeed, Granovetter himself reminds readers that attention to power relations is necessary for a full understanding of how conflict is managed in economic relationships (1985, p. 501). Yet, most of the literature on relational embeddedness describes relationships among embedded actors in which power is largely absent, and trust and mutual benefit dominate.

The Role of Social Forces in Encouraging the Exercise of Power

The idea that social relationships will be governed by norms of reciprocity that ensure against exploitation and result in mutual benefit may be true of relationships among equals, but it is clearly untrue for a host of social relationships among non-equals. The relationship between chief and villager, gang leader and gang member, or supervisor and subordinate are primarily social relationships, not market one, but their social nature does not prevent the more powerful party from taking advantage of the weaker. Indeed, it is often the social nature of the relationship itself that enables the exercise of disproportionate power by the stronger party.

Consider Weber's typology of domination. Weber (1978) distinguishes between domination based on economic power and domination based on authority. In the former case, exchange is roughly equal because the dominated comply only to the extent that it matches their interests. In the latter case, however, compliance is obtained through a socially imposed duty to obey, regardless of personal interests. This socially imposed duty may come from social norms or cultural values that legitimate the exercise of power, or it may come from institutional contexts that threaten sanction for failure to comply, but in either case the disconnect between duty to obey and personal interest enables the more powerful party to demand and receive

disproportionate benefit. The social nature of a relationship does not ensure equality in the exchange, nor does it guarantee that more powerful parties forgo the exercise of power in order to gain advantage; it may lead them to do just the opposite. Therefore, the relational embeddedness literature must pay closer attention to contextual factors such as culture and institutional forces in determining whether embedded exchange relationships are likely to be characterized by trust and mutual benefit or by opportunism and domination.

The relational embeddedness perspective also suffers from a one-sided view of norms of reciprocity. It treats exchange based on reciprocity as more likely to result in trust and goodwill than market exchange, but this is not necessarily the case. Polanyi (1944) argues that the principle of market exchange requires that resources of equal value change hands in every transaction, in contrast to reciprocity, where resources change hands, but equality of value is not required in every transaction. Blau (1964) describes how this lack of strict equality in a given exchange generates feelings of obligation, gratitude and trust. When one person gives a gift or renders another a service, there is a general expectation of some future return. However, the nature of this obligation is unspecified. The giver trusts the other to fulfil that obligation, but it is not assured. When the obligation is fulfilled, this engenders further trust. Blau points out that the inequality of the exchanges tends to generate a cycle of exchange. The receiver of a gift cannot return an exactly equivalent gift as this implies a rejection of the relationship. The return of a gift of greater value, however, creates an obligation from the original giver to give again, while the return of a gift of lesser value keeps the obligation to reciprocate open.

While such a system often results in trust and cycles of mutually beneficial exchange, Blau points out that power easily enters such reciprocal exchange relationships. When an exchange partner consistently receives more than they can give, the giver establishes power over the receiver, who accumulates obligations they are unable to repay. According to Blau, such people are "under pressure to defer to [the giver's] wishes and comply with his requests in repayment for his assistance. Their compliance with his demands gives him the power to utilize their resources at his discretion to further his own ends. By providing unilateral benefits to others, a person accumulates a capital of willing compliance on which he can draw whenever it is to his interest to impose his will upon others. . ." (Blau, 1964, p. 28). Moreover, because reciprocal exchange binds recipients to future obligations of an unspecified nature, it can be difficult for an indebted recipient to reject a demand, even when the timing of the demand imposes a severe hardship or when the demand exceeds any accumulated previous benefits the indebted recipient has received. What is more, when the dominant partner in this relationship makes a demand in excess of favours received, it does not necessarily end the duty of the weaker partner to comply with future demands. Superior status, once established, tends to perpetuate itself. As Blau notes, "once superior status is securely grounded in the social structure its occupant can demand unilateral services without endangering his superordinate position" (1964, p. 110).

Norms of reciprocity, then, are more complex than portrayed in the embeddedness literature. While many social relations are founded on trust and characterized by mutual affection and benefit, social embeddedness is not inherently an antidote to exploitation, opportunism, or the use of power to advantage. Although arm's length market transactions involve risks of malfeasance due to their impersonal nature, socially embedded transactions can expose participants to similar risks precisely because of their social nature. The existing relational embeddedness literature is incomplete and still needs to explain when the social nature of an embedded relationship prevents exploitation and exercises of power and when it encourages it.

Another unfounded assumption in the relational embeddedness is that the long-term advantages that come from relationships built on trust, reciprocity, and cooperation make opportunism and the exercise of power over embedded partners too costly. Though often correct, this assumption is subject to important contingencies. For two firms in an embedded relationship a large power imbalance may enable the more powerful partner to behave opportunistically and selfishly without sacrificing the benefits that are gained by maintaining a long-term relationship with the weaker firm. Consider resource dependence theory (Pfeffer and Salancik, 1978). Emerson's work on power-dependence relations (1962), posits that one party's power over another is a function of the extent to which it controls resources needed by that party. Building on this insight, Pfeffer and Salancik argue that a firm that controls the resources needed by another exercises power over that firm. This power is increased if the controlling firm is the sole source of the resource and reduced when the resource is available from other sources.

Marsden (1983) points out, however, that theoretical availability of a resource from alternate sources is insufficient to reduce the dependence of the weaker party. The social rules of a relationship may limit with whom a dependent party may transact. If a firm may only transact with a restricted set of actors for a given resource then the firm's dependence is determined by that restricted set, regardless of how many actors outside the restricted set can theoretically supply the resource. One mechanism of restriction Marsden discusses is embeddedness within a pre-existing network. Firms embedded within such networks often find it impossible to transact outside the network because they lack information to evaluate the trustworthiness of non-network firms, because they face sanctions from network partners for transacting outside the network, or because potential partners are themselves embedded in pre-existing networks and fear sanction from their partners for transacting outside the network. Thus, network embeddedness can amplify the power advantage that one firm has over another.

Power differences of this sort enable firms to behave in ways not predicted by embeddedness-based theories of network interaction. Power imbalance exacerbated by embeddedness in a restricted network relationship enables the more powerful firm to exercise significant control over the weaker party and to extract a disproportionate amount of the value created by the relationship. Powell's portrait of network forms of economic action assumes that "burdens and benefits come to be shared," that there is a "mutual orientation," or that "complementarity and accommodation" are the cornerstones of such relationships (1990, pp. 304-305), but in cases of power imbalance these assumptions are incorrect. Rather, the orientation of the relationship is towards the more powerful party, accommodation becomes the primary responsibility of the weaker firm, and the burdens and benefits, if shared at all, are shared unevenly.

Powell argues that network forms are neither markets nor hierarchies. However, when power imbalance exists, they can have the characteristics of both. Granovetter is correct that hierarchy within a firm does not ensure coercive control, but it is also true that the network structure does not ensure against it. Where power imbalance in an embedded network relationship is large, that power allows a dominant partner to command compliance by dependent firms similar to fiat. Perrow (1970), for example, described how General Motors, Ford, and Chrysler demanded and received the right to audit the records of smaller suppliers in order to control supplier pricing. Currently, Walmart exercises similar fiat over its suppliers, demanding and receiving changes to supplier internal processes in order to smooth out its own supply chain.

Similarly, network relationships allow dominant partners to adopt the philosophy of the market when convenient. Under hierarchy, a firm holds much more responsibility for the

survival of its subunits. In a network such responsibility is minimized, and a dominant network partner need not protect weaker partners from the full brunt of market forces. A dominant partner may, for example, demand dramatic cost reductions from a weaker partner and threaten to take its business elsewhere if price demands are not met. Powell (1990) argues that such market-type behaviour in a network would lead a firm to be viewed as petty and untrustworthy. However, being seen as petty and untrustworthy may be a weak disincentive to a dominant partner that is the only game in town. Other firms may have no choice but to transact with the dominant firm.

In such cases the powerful firm obtains the market-based benefits that accrue from having this transaction take place outside the firm's boundaries. Had such transactions taken place internally, the cost of incorrect transfer pricing would be paid by the entire firm, not just the business unit commanded to accept a lower price, but if the transaction takes place on the market, the costs imposed by inefficient pricing are paid solely by the weaker partner. For this reason, Casciaro and Piskorski (2005) argue that resource dependence theory must account for both power imbalance and mutual dependence in predicting constraint absorption, a strategy in which dependent firm secures access to required resources by acquiring or being acquired by the firm controlling the resource. Casciaro and Piskorski point out that constraint absorption should only occur when mutual dependence is high but where power imbalance is small. When power imbalance is large, the powerful firm has no incentive to internalize the dependent firm because "such integration would . . . prevent the actor that is more powerful ex-ante from exploiting the less powerful one" (Casciaro and Piskorski, 2005, p. 194). In other words, keeping the transaction on the market benefits the stronger partner.

Finally, when power imbalance is large, the opportunistic exercise of power in the network does not prevent powerful firms from receiving the benefits of effective monitoring, fine-grained information transfer, and joint problem solving that Powell (1990) and Uzzi (1996) see as defining characteristic of trust-based relationships. Effective monitoring need not rely on trust, which would be low in relations of domination. Instead, it is fostered by dependence. The dependent party cannot risk alienating the powerful party by shirking or malfeasance because the consequences of doing so are too dire. Dominant partners can also get the benefits of fine-grained information transfer and joint problem solving (Uzzi, 1996) without relying on trust and reciprocity. Dependent partners might participate in information transfer and joint problem solving under duress, but they would still do so because compliance can be coerced through the sheer threat of retaliation or because the survival of the dependent firm itself depends upon the survival of the powerful firm. Moreover, overt coercion and threat are not always necessary. In some institutional contexts, norms relating to power relations may legitimate submission to the demands of powerful partner firms, giving them a taken-for-granted quality.

Thus, embeddedness offers no inherent protection from market exploitation in situations of power imbalance. Under such circumstance, powerful firms in embedded relations are likely to take advantage of that position of power regardless of the embedded nature of the relationship with their network partners, leading to the following propositions:

Proposition 1a: The greater the power imbalance in an embedded relationship, the more opportunistic behaviour the weaker party will face.

Proposition 1b: The greater the power imbalance in an embedded relationship, the less trust the weaker partner will report.

Proposition 1c: When power imbalance is large, embedded dependent firms will experience performance lower than non-embedded dependent firms.

Business Cycles and the Exercise of Power in Embedded Relationships

While the opportunity to exercise power over dependent embedded partners exists whenever power imbalance is large, powerful embedded partners would not automatically choose to exercise it. Trust and reciprocity may have additional benefits that cannot easily be replaced by the exercise of power. Moreover, norms of fairness may restrain firm behaviour, even if such norms are not as effective against opportunism as the embeddedness perspective suggests. However, exogenous factors can override the restraints on opportunism and the exercise of power. Conditions of scarcity are particularly conducive to the exercise of power (Pfeffer, 1981). When resources are scarce, agents are more likely to fight over them and wield whatever power they have in order to win those fights in order to protect the economic well-being or survival of the firm. Thus, opportunism and exercise of power for advantage may undermine norms of fairness and trust during downturns in the business cycle and in industries facing decline.

During economic downturns and in declining industries, opportunities for all firms operating in those environments dry up, creating conditions of scarcity. What opportunities and resources remain are likely to provoke skirmishes for access to those resources and opportunities. The embeddedness perspective suggests that embedded firms would choose to spread the harm among embedded partners in order to ensure the survival of all, but the degree of scarcity itself may make such pain-sharing difficult to achieve. When conditions are severe enough, harm-sharing alone cannot ensure the survival of all embedded partners. Partners whose very survival is at risk are unlikely to go quietly, even given norms of reciprocity and trust. One would expect that in such cases power will determine which partners survive and which do not.

Moreover, dominant partners may exercise their power even before their survival is at stake. Conditions need merely threaten an important internal constituency within the powerful firm to provoke opportunistic behaviour. Cyert and March (1963) point out that a firm must pay sufficient inducements to its members to hold together a dominant coalition. If scarcity threatens to reduce inducements to coalition members below what is needed to keep them in the coalition, those members would likely resist pain-sharing and call instead for the dominant firm to take advantage of its position of power vis a vis dependent embedded partners. For example, if pain-sharing requires major job cuts in a dominant firm where a strong union is a member of the dominant coalition, the dominant firm will likely reject pain sharing in favor of exercising power over its network partners, even when such acts result in the death of those partners.

In this situation dependent embedded firms are highly vulnerable; they often cannot turn to other trade partners to escape the demands of the dominant partner because embeddedness has led to partner specific asset investments that make switching costs too high or because their embeddedness takes the form of a restricted access networks (Marsden, 1983) which forbids them from trading with outside partners. This leads to the following proposition:

Proposition 2a: During severe economic downturns and in severely declining industries, embedded firms in networks with powerful partners will fail at greater rates than non-embedded firms.

For the more powerful firms in the embedded relationship, this is a useful situation, and the more embedded ties the dominant firm has, the more it will be able to avoid the costs of downturn and decline, leading to the following proposition:

Proposition 2b: During severe economic downturns and in severely declining industries, powerful firms with relatively more embedded ties will survive at higher rates than powerful firms with fewer embedded ties.

The benefits of exercising power in this manner will likely not be limited to ensuring the dominant firm's survival, but will also help protect its economic performance, leading to the following proposition:

Proposition 2c: During severe economic downturns and in severely declining industries powerful firms with more embedded ties will achieve higher economic performance than powerful firms with fewer embedded ties.

One important question is how firms enter such dependent relationships in the first place. Both resource dependence theory (Pfeffer and Salancik, 1978) and transaction cost economics (Williamson, 1985) argue that firms seek to avoid positions of dependence and exposure to opportunism risk whenever possible. However, avoiding those risks is not always possible. In industries organized around embedded network relations centred on powerful firms, a firm may have no choice but to embed itself within one of those networks in order to participate in that industry at all. For a small or new firm, forming an embedded relationship with a powerful partner may be the best way to ensure survival and growth in the short term, even if it leads to dependency in the long term. Thus, time horizons are important to consider. So, too, is sensitivity to business cycles and changing economic circumstances. Powerful firms may not behave opportunistically during good economic times but find it necessary to do so when they themselves face difficulties. Thus, a potentially dependent firm may enter a relationship with a powerful partner cautiously at first, but as trust builds in the relationship over time, allow itself to become increasingly dependent. When economic conditions change for the powerful partner, the dependent partner may unexpectedly find that the powerful partner is not as reliable as the dependent partner had come to expect.

Moreover, interpersonal relationships differ from interfirm ones. While Uzzi (1996, 1997) has found that individuals will develop strong personal connections to exchange partners in other firms, these individuals do not always have the authority to honour those connections. The views or interests of other stakeholders within the firm may override the perspective of individual exchange partner with whom the relationship exists. In such cases, the individual representing the more powerful firm may be forced to implement a decision that violates the trust that has developed in the relationship. Alternately, the individual representing the more powerful firm can be replaced either as one of the many casualties of economic hardship or specifically to sever a deeply embedded tie that has lost value to the more powerful partner or that can produce more value to the powerful firm by exploiting the power advantage.

Therefore, it is important that work on embeddedness look more carefully at the way embedded relationships develop over time. In particular, sensitivity to economic cycles that place pressure on embedded partners to extract value in the short term would likely enable embeddedness researchers to develop a more nuanced view of how social embeddedness affects the dynamics of interfirm relationships.

Culture, Institutional Context and Power in Embedded Relationships

In addition to economic context, the institutional and cultural contexts are also likely to shape how embeddedness within social relationships impacts the degree to which embedded partners resort to opportunism and exploitation. As noted above, much of the literature on

Japanese business networks focused on trust and reciprocity (Dore, 1983; 1986; Dyer, 1996a, 1996b, 1997; Hill, 1995; Lincoln, 1990; Smitka, 1991) in ways consistent with the positive tilt of the embeddedness literature. However, political economists have called into question such one-sided views. Ibata-Arens' (2005), for example, documented how powerful vertical keiretsu partners have been relentless in dominating small and medium-sized dependent firms. This domination includes pressuring dependent partners to grant drastic price reductions, absorb inventory costs so that large firms can benefit from Japan's much-lauded Just in Time inventory system, and even surrender control over their intellectual property rights.

One reason these dominant partners are successful in applying such pressure is that both history and government policy in Japan have encouraged the structuring of industrial relations into restricted access networks. Such policies enabled government officials to exercise more control over economic activity in order to further national goals for economic growth (Johnson, 1982). One result has been a high level of dependence of smaller firms upon large and powerful network partners. Opportunities to participate in the economy outside these networks is limited, increasing the power that dominant partners can exercise over smaller firms in the network. The banking system in Japan provides a useful example. During efforts to rebuild Japan's economy following the second world war, government finance officials promulgated a series of rules encouraging banks to own non-finance firms that concentrated industrial organization around a few large banks, thereby ensuring that the finance ministry could intervene in the broader economy (Johnson, 1982). One result of this policy was that smaller firms faced intense capital scarcity because banks were less willing to lend to firms outside of their networks, making it hard for smaller firms to escape dependence upon bank-centred industrial networks. Intellectual property regimes have a similar effect. Japanese courts routinely dismiss patent infringement claims by small firms against large network partners because the government believes it is in the nation's best interests to allow the larger firm to exploit that patent in the international market, something which the smaller firm is less able to do (Ibata-Arens, 2005).

Aside from political context there are culturally embedded reasons for why Japanese firms are more likely to exploit power in embedded relations. Japan is widely considered a collectivist culture (Hofstede, 2001; Lebra, 1976; Markus and Kitayama, 1991), defined here as a culture that places greater value on group identity and interdependence than on autonomy and individual initiative (Hofstede, 2001). Collectivist cultures have much stronger norms regarding differential treatment of in-group members (the group with which an individual identifies) versus out-group members (Triandis, 1989) and also tend to distrust outsiders (Triandis, 1972). This makes it much harder for Japanese firms not already operating within a network to establish ties to members of that group. Moreover, loyalty to one's group is given a greater premium in collectivist cultures (Hofstede, 2001; Triandis, 1989), which places strong constraints on the ability of a dependent partner to exit a network and search for new partners. Gargiulo and Benassi (1999) have noted the tendency of strong ties to trap managers within existing networks and prevent them from forming new ties they may need. Within the context of a collectivist culture that places particular emphasis on loyalty, this tendency is exacerbated. Once a firm forms strong relationships with a network of other firms, exit from that network becomes particularly difficult.

In-group/out-group distinctions also make it difficult for firms in Japan to seek contacts outside the country. Zaheer and Zaheer (2006) point out that trust can be particularly difficult to maintain across borders, and this is especially true in Japan, where the distinction between fellow countrymen and foreigner is a particularly salient form of in-group/out-group distinction (Lebra,

1976). Thus, Japanese firms often find it difficult to seek contacts outside the country, often the only potential trade partners not locked within the existing vertical supply chain systems.

Finally, beliefs and values regarding power and status differences common in high power distance cultures (Hofstede, 2001) reinforce the notion that it is natural and right for dependent firms to be sacrificed for the sake of more powerful high-status firms. The sense of obligation and duty of compliance on the part of inferiors towards superiors is particularly potent in Japan (Lebra, 1976; Nakane, 1970). Moreover, the particular way that hierarchical values combine with collectivism in Japan justifies the appropriation of value from subordinates by superiors. Within the logic of Japanese collectivism, any value created by an individual within a collective is to be enjoyed by the collective. However, the logic of Japanese hierarchical relationship means that superiors are taken as the embodiment of the collective (Nakane, 1970). For this reason, the value created by an individual tends to be seen as belonging to the superior as the representative of that collective. Nakane has argued that such dynamics are not limited to the interpersonal level. Rather, they reflect a general organizing principle of Japanese society, with hierarchical norms characterizing the relationships among various forms of collective entities, including organizations and business enterprises. An example of this is the practice common in Japan of more powerful firms transferring employees to weaker partner firms both as a mechanism of control and as a means of reducing headcount (Gerlach, 1992; Inagami and Whittaker, 2005). Thus, both cultural and institutional factors exacerbate the impact of power imbalance within the context of Japan. For this reason, the impact of power imbalance upon firms within embedded networks would likely be higher in Japanese firms than in Western firms for all the situations outlined above, leading to the following additional propositions:

Proposition 3a: The difference in failure rates during economic downturns and in declining industries between dependent embedded firms in networks with powerful partners and non-embedded firms will be greater in Japan than in the United States, and these differences are attributable to the dissimilarity in collectivism, power distance, and institutional context between Japan and the United States.

Proposition 3b The difference in failure rates during economic downturns and in declining industries between powerful firms with more embedded ties and powerful firms with fewer embedded ties will be greater in Japan than in the United States, and these differences are attributable to the dissimilarity in collectivism, power distance, and institutional context between Japan and the United States.

Proposition 3c: The difference in economic performance during economic downturns and in declining industries between powerful firms with more embedded ties and powerful firms with fewer embedded ties will be greater in Japan than in the United States, and these differences are attributable to the dissimilarity in collectivism, power distance, and institutional context between Japan and the United States.

One might ask whether such conclusions are justified given the extensive literature on the benevolent and mutually beneficial nature of Japanese network business relations. The answer to that question is yes. A closer look at literature supporting the notion of benevolent relationships in Japan reveals an important limitation in the sample upon which this conclusion is based. With the exception of Dore's work on textile manufacturers (1983; 1986), nearly every study on Japanese buyer-supplier relationships has looked only at the relationship between leading consumer-facing manufacturers and their first tier suppliers (Clark and Fujimori, 1991; Cusumano and Takeishi, 1991; Dyer, 1996a, 1997; Dyer and Chu, 2000, 2003; Dyer and Ouchi, 1993; Helper and Sako, 1995; Lincoln et al., 1998; Smitka, 1991).

This narrow sample provides a biased view of buyer-supplier relationships in Japan. Kamath and Liker (1994) have argued that Japanese consumer-facing manufacturers treat only a handful of their most important suppliers as equal partners. These top suppliers tend to be large and technologically sophisticated enterprises supplying complex critical subsystems not readily available elsewhere. Consumer-facing manufacturing firms are typically highly dependent upon these suppliers, providing a significant measure of balance to the relationship. Outside of these few relationships at the very top, however, the arrangements are more hierarchical, with suppliers receiving orders from buyers and accountable to fulfil them exactly as specified (Kamath and Liker, 1994), an arrangement that is more reflective of the broader picture of Japanese buyer-supplier relationships. Farther down the production chain, relationships between buyers and suppliers become progressively more hierarchical, with small and medium sized suppliers typically locked into highly subservient positions (Ibata-Arens, 2005). Such an arrangement would explain why embeddedness studies that look only at relationships at the top of the production chain would find results so different from those proposed in this paper. At the top of the chain, power balance between elite suppliers and consumer-facing manufacturers helps to foster relationships characterized by cooperation, trust, and reciprocity. For the rest of the firms in the Japanese economy, however, power imbalance likely leads to the types of relationships of domination proposed in this piece.

CONCLUSION

This paper has argued that the embeddedness literature has presented an overly optimistic view of embedded relationships because it has ignored the way that power imbalance within an embedded relationship can expose weaker parties to malfeasance and opportunism by stronger parties. It has called for a heightened sensitivity to power imbalance within embedded relationships in order to more completely specify when embeddedness leads to trust and mutual benefit and when it leads to opportunism and exploitation. Granovetter's embeddedness framework has played a key role in spurring strategy researchers and organization theorists to demonstrate the many ways that social structure and social relations affect and organize economic life. The body of work that developed in the wake of Granovetter's piece made an invaluable contribution to understanding of economic action and helped organizational scholars reclaim theoretical ground previously ceded to economists. Few now accept that economic action can be treated independently of social structure. Yet, despite this contribution, there remains a critical gap in the embeddedness literature. Its concern with the way that ongoing social relations support trust, promote reciprocity, and constrain malfeasance may have been overdrawn in that it neglects the key role that power plays in social relations. A wide body of work in social theory has made clear that power is a fundamental aspect of social reality. The social nature of a relationship is no guarantee against the exercise of power, and may in fact encourage it. Power is a fundamental aspect of social structure and network relationships. Yet, discussions of power have been surprisingly rare in the embeddedness literature. This paper has attempted to reintegrate the issue of power into the discussion of embeddedness. It argues that the power inherent in social relations and network structures continue to play a key role even in embedded relations generally based on trust and reciprocity. An important task for the embeddedness perspective is to define appropriate scope conditions for explaining when the exercise of power in embedded relations is likely to take precedent over trust and reciprocity. This paper has suggested several places scholars can begin to look.

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