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OF THE SIGNIFICANCE OF BUSINESS RELATIONSHIPS

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ABSTRACT

The Industrial Network Theory aims to describe and explain the business relationships and networks in which the focal firm is deeply embedded. One of its major propositions is that business relationships somehow influence, to different extents and over time, the focal firm's survival. This pertains to the *diverse and time-varying significance of business relationships for the focal firm*. It has often been implicitly sustained that such significance is strongly related to the role played by business relationships and consequently the relationship outcomes accruing to the focal firm. The logic underlying the relationship significance proposition is outwardly oriented, somewhat overlooking the focal firm's inside and in particular *the conspicuous influence of business relationships on what the focal firm does competently both within and across its vertical boundaries*. Arguably, the (predominantly 'functional') network-based arguments currently advanced represent a necessary but not sufficient condition for relationship significance. This conceptual paper tentatively suggests that there may be missing a supplementary (essentially internal) explanation supported by Competence-based Theories of the Firm.

Keywords: Industrial Network Theory, relationship significance proposition

INTRODUCTION

Still evolving, the Industrial Network Theory (vide Hakansson and Snehota, 1995, Axelsson and Easton, 1992, Hakansson, 1982, Ford et al. 1998) attempts to describe and explain the inner workings of business networks (and the business relationships and interactions between firms, these comprise). At least five major propositions may be pointed out within this theory: (i) *the existence of business relationships* (Hakansson, 1982, Ford, 1980), *as well as their connectedness* (Axelsson and Easton, 1992, Anderson et al. 1994) *and uniqueness* (Hakansson and Snehota, 1995, Ford et al. 1998); (ii) *business relationships as a third type of governance structure, alternative to hierarchies and markets* (Richardson, 1972, Hakansson and Johanson, 1993b); (iii) *knowledge development via business relationships, i.e., between firms* (Hakansson and Snehota, 1989, Ford et al. 1986, Hakansson, 1987, Hakansson and Snehota, 1995); (iv) *firm performance explained by both internal operations and exchange processes* (Hakansson and Snehota, 1989, Hakansson and Snehota, 1995, Araujo and Easton, 1996); and (v) *the significance of business relationships for the focal firm* (henceforth ‘relationship significance’)¹ (Gadde et al. 2003). Here we will be exclusively concerned with the last of these theoretical propositions. The relationship significance proposition is made partly explicit in the pervasive contention that ‘*business relationships are one of the most important resources at the focal firm’s disposal*’ (Hakansson, 1987, Hakansson, 1989, Easton and Araujo, 1993). As Hakansson and Snehota (1995 : 27) put it: “A [business] relationship is one of the resources the company can exploit and use in combination with other resources (other relationships) available to the company.”.

The business relationships that the focal firm establishes, develops, maintains, and terminates with counterparts (most notably customers and suppliers) are *significant* because they

¹ The ‘*relationship significance*’ notion is solely used throughout the paper, understandably substituting for a variety of other, equivalent terms such as ‘*relationship criticality*’, ‘*relationship importance*’, or ‘*relationship relevance*’. Arguably, this ‘black-box’ and elaborate notion denotes ‘*the irrefutable hold of business relationships on the focal firm’s survival (and growth)*’ - this is the meaning generally and implicitly assumed throughout the Industrial Network Theory. We absolutely oppose to one anonymous reviewer’s statement that relationship significance is considered in and of itself, i.e., business relationships are significant by themselves and not for a specific entity (e.g., the focal firm). Nevertheless, whenever the significance of something or someone is presumed, a pertinent question immediately arises: ‘*significant for whom?*’. Significance exists always in relation to someone - likewise, it seems nonsensical to think of relationship significance in abstract. That we are sticking to the original (though inferred) signification for relationship significance, and not advancing a new one, is supported by Hakansson and Snehota’s (1995: 267) words: “(...) In order to survive and develop you have to have counterparts (...)”. Such meaning of relationship significance is also conveyed by Ford and Hakansson (2006a: 22): “Companies can choose if and how they want to do something particular relative to a specific counterpart. But they cannot choose whether or not to have relations with others, including their suppliers and customers.”. Another anonymous reviewer has correctly argued that all the research conducted by the IMP Group is ‘*about the various ways in which business relationships are significant*’. The Industrial Network Theory surely provides a ‘*general picture of the significance of business relationships*’ (Ford and Hakansson, 2006b: 251). How is that relationship significance explained (i.e., what kind of influence is exerted by business relationships) is, in our point of view, an issue that has so far remained largely unclear within theory. This is precisely what we are trying to puzzle out with our comprehensive systematization of the underlying network-based justifications on relationship significance.

somehow affect the focal firm's functioning and development, ultimately *influencing* its *survival* in business markets (Ford and McDowell, 1999, Kalwani and Narayandas, 1995, Hakansson and Snehota, 1995). In the event of deliberately terminating its established business relationships (or seeing those abruptly ended by counterparts' will), the focal firm is not only somehow impeded to operate and grow, but more importantly, it is doomed to perish (Pfeffer and Salancik 1978).²

Contrary to what Neoclassical Economics postulates, the existence of the focal firm cannot be conceived of without business relationships (see, e.g., Schumpeter, 1954 on a review of neoclassical economics' premises). As has been theoretically claimed and empirically documented since the mid-1970s, no existing (i.e., surviving) firm is '*an island in a sea of market relations*' (Richardson, 1972, Hakansson and Snehota, 1989, Hakansson, 1982). This is why some IMP scholars and researchers stress the '*strategic importance*' or '*significance*' of business relationships (Hakansson, 1989, Gadde et al. 2003), whereas others refer to relationships of '*strategic status*' (Moller and Halinen, 1999) and to '*critical*', '*crucial*', '*good*', '*high-performing*', '*high quality*', '*important*', '*relevant*', '*significant*', or '*valuable*' business relationships (Hakansson and Snehota, 1995, Cunningham, 1980, Ford et al. 1998, Kutschker, 1982, Hakansson, 1987, Johanson and Mattsson, 1987, Gadde and Snehota, 2000, Ford and McDowell, 1999). Even Edith Penrose (1959), whose influence is conspicuously recognized across Industrial Network Theory (Hakansson and Snehota, 2000, Easton, 1992), earlier remarks "[t]he importance attached by firms to the maintenance of their existing business relationships (...)" (op. cit. : 147, fn. 2).

Business relationships are by and large significant for the focal firm (Hakansson and Snehota, 1995), though they need not be so inevitably (Ford and Hakansson, 2006a). Nevertheless, at a given point in time not all business relationships are significant to the same extent – obviously some are more significant for the focal firm than others (Ford and McDowell, 1999). Often, only a very limited number of business relationships strongly impact upon the focal firm's survival. "(...) [C]ompanies are likely to have relatively few significant [business]

² Needless to say, this also applies to the counterparts with which the focal firm develops and maintains business relationships. Since we are here adopting the vantage point of the focal firm, the counterpart's perspective is left latent (albeit resembling, at least in part, the former). It seems reasonable to assume the similitude in focal firm's and counterpart's perspectives since business relationships are usually characterized as symmetric with respect to both parties' initiative and interest in their development and maintenance (Hakansson and Snehota, 1995). The focal firm's standpoint is appropriately adopted here, at least if we acknowledge that "[r]elationships are in our view an important structural dimension [of the business network] as fundamental as organisations themselves" (Ford and Hakansson, 2006b: 252). However, the focal firm's viewpoint should not be equated with the '*firm-centred view of the world*' or the '*single-firm perspective*' so common in Management theory and practice, hence presuming the focal firm to be an atomistic entity only concerned with own goals and interests and disposing of complete free will in its actions and strategy.

relationships.” (Ford and Hakansson, 2006b: 250). Empirically confronted by IMP researchers, the recurrent observation that few suppliers and customers account for the majority of the focal firm’s total purchases and sales respectively (Hakansson, 1982) - namely Pareto’s ‘80/20 rule’ - corroborates this point. Moreover, it is likely that a certain business relationship impinges on the focal firm’s survival (i.e., is significant) to different degrees over time. That is, relationship significance is changeable *over time*. Finally, it should be stressed that relationship significance cannot be objectively determined, being instead an object of perception by the focal firm, particularly its members (Wiley et al. 2006). The *perceived* (though not necessarily *real*) relationship significance, of course, varies within the focal firm.

But what is the network-based explanation commonly advanced for relationship significance?

Surprisingly, the determinants of relationship significance have not been subject to a systematic analysis within Industrial Network Theory.³ Tacitly shared by IMP scholars and researchers, the relationship significance assumption is taken-for-granted, often asserted and reiterated (see Ford and Hakansson, 2006b) but seldom (if ever) discussed in depth.⁴

The main (conceptual and empirical) foci of Industrial Network Theory are business relationships, i.e., those vertical interfirm relationships which are assumed to both (i) have a complex substance (i.e., entailing an intricate inter-personal contact pattern) and (ii) perform multiple functions for the focal firm (Hakansson and Snehota, 1995: 330). It seems rather undisputable that, within Industrial Network Theory, the (composite and multi-purpose) business relationships are *by definition* (highly) significant for the focal firm. Basically, the network-based reasoning on this matter is that business relationships *do exist ergo they should be* significant. Empirically the focal firm is willingly related to, and externally dependent on, counterparts; expectedly, the business relationships (that allow such multiplex interaction with counterparts) are decreed significant for the focal firm. Summing up, *relationship pervasive existence* unequivocally implies *relationship significance*. As a result, relationship

³ It is quite natural that, within any theory, some issues are taken-for-granted and others, less obvious remain greatly unexplored. We believe that Alajoutsijarvi et al.’s (2001) deconstruction and analysis of the metaphorical structure of the ‘*network talk*’ (devised and deployed at large by the IMP Group since the mid-1970s) helps to understand why this also happens within Industrial Network Theory. They hint that, owing to the dominant metaphors employed in the overall theoretical discourse (and in its diverse sub-discourses), some aspects of business networks and relationships are sure to be enquired while others are simply ruled out of investigation. Moreover, those metaphors are sure to guide scholars and researchers towards certain research questions as well as their acceptable answers. In our viewpoint, relationship significance is one of those ‘*currently hidden aspects of business networks*’ (op. cit.: 104).

⁴ To our best knowledge, Wiley et al.’s (2006, 2003) studies on *sources of relationship significance* in Sweden, Germany, and China are a meritorious exception. Such reasons (in their case, as *perceived only by suppliers*) are basically distilled from the functions, benefits and consequent value of business relationships advanced by Walter et al. (2003, 2001). Drawn upon part of the extensive IMP2 database, Wiley et al.’s (2006, 2003) empirical research suggested that (i) the prevailing reasons for relationship significance are associated with both economic and direct benefits (while indirect and non-economic ones being secondary in rankings), and (ii) no substantial differences regarding the way European and Chinese firms characterize their significant business relationships can be spotted.

significance is an unquestionable presumption of Industrial Network Theory. Blankenburg-Holm and Johanson (1992: 6, emphasis added) stress this very clearly: “The IMP research *confirmed* the *significance* of lasting customer-supplier relationships.”.

Supposedly, relationship significance is strongly associated with the role business relationships play for the focal firm (Hakansson and Snehota, 1995, Wilkinson and Young, 1994). By fulfilling that role (in the form of relationship *functions* and *dysfunctions*), relationship outcomes (typically more *benefits* than *sacrifices*, that is, *relationship value*) accrue to the focal firm (Wilson and Jantrania, 1994, Walter et al. 2003, Walter et al. 2001). Even if such relationship value does not result, relationship benefits and sacrifices may be respectively greater and/or lower than the ones expected by the focal firm or resulting from engaging in other, alternative business relationships (Anderson et al. 1994). In either or both of these situations, relationship significance is sure to be contended.⁵

This primarily ‘functional’ explanation for relationship significance is naturally related to the focal firm’s outside, in particular its context (i.e., a full-faced environment composed of a limited number of distinct, clearly identifiable, and complexly interconnected counterparts) (Hakansson and Snehota, 1989). The external focus is a logical consequence of the spatial boundaries of Industrial Network Theory, namely interaction, relationship, and network being its main units of analysis (check Bacharach, 1989 on theory’s spatial and temporal boundaries).

Building upon the theoretical and empirical research of Araujo et al. (2003) and Mota and de Castro (2004, 2005) on the strong link between business relationships, competences, and boundaries, we advocate that the predominantly functional justification seems a necessary but not sufficient condition for relationship significance.⁶ Another (internally-focused) theoretical explanation - addressing the influence of business relationships not only on what the focal firm gets done but also on what it does competently within and across its fuzzy, vertical

⁵ Industrial Network Theory is clearly not a monolithic body of knowledge, therefore meaning different things to different people (Easton, 1992, Hakansson and Snehota, 2000). Notwithstanding, with regard to the network-based justification for relationship significance, our standpoint is that a pattern can be disclosed within Industrial Network Theory. Despite knowing that we can be accused of artificially imposing such pattern, what seems really unacceptable to us is that no pattern at all can be advanced, and consequently that relationship significance is irremediably ‘*in the eyes of the beholder*’. The pattern revealed – that business relationships pay off (i.e., are valuable) per se or comparatively – cannot be reduced to a mere economic cost-benefit analysis, as that would imply all benefits and sacrifices resulting from participation in business relationships to be objectively and quantitatively measured (Broadway, 1974). That unambiguous quantification of relationship benefits and sacrifices is often unfeasible, as latter on shown.

⁶ The common network-based reasoning presumes that relationship significance derives from both the nature and role of business relationships (Hakansson and Snehota, 1995) - indirectly from the former, directly from the latter. That is, relationship role (of course, strongly related to relationship nature) and the resulting relationship value should fully justify relationship significance. Our key claim in this paper is a bit different: relationship value *only partly* explains relationship significance.

boundaries - seems to be missing. Resorting to so-called *Competence-based Theories of the Firm* (Penrose, 1959) may be, in this sense, quite apposite. According to these theories, the focal firm comprises a bundle of *direct and indirect competences*, which allow it to (know how to) *do things* by itself, as well as (know how to) *get things done* by others respectively (Nelson and Winter, 1982, Loasby, 1998).

We hold that business relationships are significant for the focal firm not just owing to the relationship value (i.e., benefits in excess of sacrifices) they allow it to co-develop and partly appropriate. Relationship significance is also explicated because business relationships permit the focal firm to (i) improve its internally existing resources and competences or develop new ones (isolatedly or jointly), and (ii) access and exploit external, complementary resources and competences (possessed by counterparts). These two rationales (in essence network- and competence-based) on relationship significance can be combined with ease - despite the latter being for the most part neglected within Industrial Network Theory.

We agree with the overall *whats* and *hows* of Industrial Network Theory (i.e., its constructs and propositions, respectively), but not completely with its *whys* (in particular, the logical reasoning underlying its relationship significance proposition) (see Whetten, 1989 on the main components of a theory). In Wilkinson's (2003) terminology, one can say that the phenomenon in question - relationship significance - is only partially explained with reference to the existing state-of-art of theory. In other words, the current network-based arguments on relationship significance do not seem to suffice. Understandably, we are not challenging the relationship significance in itself but only contesting its apparent taken-for-grantedness and the completeness of its underlying network-based arguments. Furthermore, it should be made clear that our intent is neither to question nor to evaluate the Industrial Network Theory as a whole; we are rather modestly trying to add to it. Our main suggestion is that it can be enlightening to append a competence-based reasoning on the aforementioned relationship significance proposition.

This paper is organized as follows. We start in the following section by expounding in detail the theoretical support for relationship significance, largely implicit within Industrial Network Theory. The thoroughness of such presently posited network-based arguments is then subject to an exploratory reflection. A competence-based explanation for relationship significance, still in embryonic form, is next advanced. The theoretical and practical implications of further enquiry on relationship significance are addressed in the fourth section. And lastly, we present our concluding remarks.

RELATIONSHIP SIGNIFICANCE AND ITS UNDERLYING ARGUMENTS

Any attempt to justify relationship significance cannot bypass the centrality of one topic within Industrial Network Theory - the role that business relationships play for the focal firm as one of its multiple resources. In view of that, business relationships may be considered significant owing to their multiple purposes (and associated outcomes) for the focal firm (Hakansson and Snehota, 1995, Gadde and Snehota, 2000).

The focal firm engages in business relationships fundamentally because of appropriate 'payoff structures' that render it favourable consequences or outcomes (Axelrod, 1984). In an almost game-theoretical language, one could even claim that the payoff for cooperating exceeds that of deflecting (i.e., abandoning current cooperation with a specific partner and standing alone) (Kalwani and Narayandas, 1995). In other words, the focal firm deems both the economic and non-economic consequences resulting from participation in business relationships (i.e., benefits and sacrifices) to be, either per se or comparatively, globally satisfactory.⁷ Relationship benefits are always weighted against related sacrifices (Hakansson and Snehota, 1995) - and the former often seen to exceed the latter. In addition, both of these are compared to relationship outcomes either (i) expected (or wished for) by the focal firm or (ii) ensuing from substitute business relationships or alternative governance mechanisms (such as hierarchies and markets).⁸

It pays off for the focal firm to develop and sustain a business relationship with a specific counterpart, and consequently that business relationship should be termed *significant*, for either or both of reasons:

- (i) the relationship *benefits* (i.e., the ensuing *positive outcomes*) obtained by the focal firm exceed, to some extent, the *sacrifices* incurred (i.e., relationship *costs* plus *deleterious outcomes*) (Gadde and Snehota, 2000, Biong et al. 1997, Hakansson and Snehota, 1995, Blois, 1999);
- (ii) the relationship benefits are greater and/or relationship sacrifices are lower than benefits and sacrifices (a) *expected* by the focal firm or (b) potentially stemming from *alternatives*, that is, substitute business relationships and conventional governance

⁷ This holds true, of course, if rationality in business behaviour is overtly assumed (Cyert and March, 1963, Thompson, 1967). Demsetz (1992) further suggests that business behaviour cannot be properly understood in the absence of that presumption. Hakansson and Snehota (1995, chapter 8, fn. 1) highlight this. The rationality of the focal firm (even if bounded) seems one of the stepping stones of Industrial Network Theory.

⁸ Besides relationship outcomes, (interpretation of) parties' behaviour are also influential in the development and maintenance of the very business relationships (Hakansson and Snehota, 1995). For instance, obtaining highly favourable relationship outcomes as well as perceiving a great degree of trust and commitment in the counterpart's conduct can be both quite pivotal in the focal firm's decision to nurture and sustain a business relationship.

structures (hierarchies and markets) (Hakansson and Snehota, 1995, Anderson et al. 1994, Zajac and Olsen, 1993).

An opening distinction between the two types of outcomes resulting from engagement in business relationships - relationship benefits and sacrifices - is timely here. Relationship benefits are positive outcomes accruing to the focal firm (Anderson et al. 1994) from the fulfilment of relationship functions (Walter et al. 2001, Walter et al. 2003). Relationship sacrifices, on the other hand, encompass both the costs incurred by the focal firm (indispensable to obtain the benefits referred) (Gadde and Snehota, 2000) and the deleterious outcomes that always ensue from being involved in business relationships (Anderson et al. 1994). Deleterious outcomes normally result from relationship dysfunctions (Walter et al. 2001, Wiley et al. 2006). If deleterious outcomes accrue to the focal firm then a relationship dysfunction must have occurred; yet, we argue, deleterious outcomes can also flow from the non-fulfilment of some relationship functions (foreseen or desired by the focal firm), i.e., the non-obtainment of (anticipated or wanted) relationship benefits. In this regard, deleterious relationship outcomes include not only ensuing harmful consequences, but also the potential (yet not attained) positive outcomes. Relationship outcomes are in general highly uncertain – these can neither be totally predicted *ex ante* nor fully measured *ex post* by the focal firm (Ford and Hakansson, 2006a).

In sum, one may argue that relationship benefits comprise ‘*what is gained*’ from a business relationship (i.e., its positive outcomes), whereas sacrifices consist of ‘*what is given out*’ (i.e., its costs) plus ‘*what is lost*’ or ‘what was expected or desired to gain’ in that same relationship (i.e., its deleterious outcomes). Ford et al. (1998) put it in different terms, seeing relationship benefits and sacrifices respectively as what parties (the focal firm and its counterpart) can offer to, and demand from, each other.

The all-inclusive justification advanced within Industrial Network Theory for relationship significance – that *business relationships pay off either per se or comparatively* - can be seen indeed as two. The first explanation, which we call ‘minimal’, is about relationship benefits outweighing sacrifices; the second explanation, we label ‘differential’, holds that relationship benefits and sacrifices are respectively greater and/or lower than the potential ones produced via expectations or in alternatives.

For the purposes of this paper, we shall only take the totality of the first explanation and a part of the second one, to be the network-based argument justifying relationship significance.⁹ This (apparently odd) decision is supported by two sound motives:

- (i) the second (differential) explanation for relationship significance can only be addressed after the first (minimal) is thoroughly examined. In order to compare relationship benefits and sacrifices with the benefits and sacrifices resulting from expectations or alternatives, inevitably one must first assess the former. As one can easily see, the second appraisal begs for the results of the first one;
- (ii) however, that the first (minimal) explanation for relationship significance is always inspected before the second (differential) one should not directly lead us to the abandonment of (a part of) the latter. What is definitively more troublesome is that the evaluation underlying (a part of) the second explanation is forcefully conducive to other, distant theories. All the benefits and sacrifices from alternative governance structures (i.e., hierarchies and markets) are exhaustively detailed elsewhere – in the Property Rights Approach (Hart and Moore, 1990) and Transaction Cost Economics (Williamson, 1981) respectively. In short, we are sticking to the ‘pure’ network-based rationale, setting aside all arguments that would oblige us to survey other literatures.

Trimmed from the aforementioned overall justification, the ‘pure’ network-based rationale on relationship significance is here the following: a business relationship is significant either because its benefits exceed sacrifices (i.e., relationship value is captured by the focal firm) or the relationship benefits and sacrifices are respectively greater and/or lower than the ones expected by the focal firm or potentially resulting from engagement in other, alternative business relationships.

Let us now discuss in detail the benefits and sacrifices resulting from the focal firm’s participation in business relationships, as well as the functions and dysfunctions from which they respectively emanate (Walter et al. 2003, Wiley et al. 2006).

⁹ Only a part of the differential explanation for relationship significance is deliberately left out of the remaining discussion, in particular the one that does not categorically spring from Industrial Network Theory - related to the potential benefits and sacrifices ensuing from alternative governance structures. Our primary interest, if it needs to be recalled, lies only in Industrial Network Theory. It is outside the scope of this paper to determine all the benefits and sacrifices of vertically integrating, and of employing transactional relations with, counterparts. The thorough discussion of the differential explanation is therefore postponed, preferably becoming object of later research. This thoughtful delimitation of theoretical focus can be with considerable ease pointed out as a limitation of our study - even though it bears negligible (if any) penalties, neither impairing nor invalidating our primary claims of, in particular that a competence-based justification on relationship significance may be lacking.

Functions and dysfunctions of business relationships

Relationship (interlinked) nature and role. Business relationships can be characterized in accordance with two primary dimensions (Hakansson and Snehota, 1995, Wilkinson and Young, 1994): (i) their *nature* (or *substance*) and (ii) their *role* (or *function*). It is often argued that the latter is contingent on the former (Hakansson and Snehota, 1995). That is, some relationship substance – in the form of intense activity links, resource ties, and actor bonds - must exist if functions are to be performed. Relationship functions are effected because there exists a reasonable degree of involvement and commitment by both parties and their resources and activities are being employed and coordinated respectively (Walter et al. 2001, Walter et al. 2003). In addition, there is also some degree of mutuality (or compatibility) concerning both parties' intentions, plans, and interests (Anderson et al. 1994).

In principle, only high-involvement (i.e., costly, '*substantial*') business relationships are certain to perform valuable functions for the focal firm (Gadde and Snehota, 2000, Araujo et al. 1999). But that is not always the case, and therefore low-involvement ('*non-substantial*') relationships may also accomplish a role, for instance, in the future (ibid.). Multiple features of business relationships (such as high degrees of trust, commitment, and interdependence, or an extended scope of cooperation efforts and interpersonal contacts) are crucial to functions' fulfilment; unfortunately, even with a strong substance, either some (expected or desired) relationship functions are not performed at all or relationship dysfunctions are seldom avoidable (Walter et al. 2001, Wiley et al. 2006).

Empirical research has identified some relationship-specific factors as preconditions for functions' fulfilment: (i) trust, commitment, and satisfaction (i.e., relationship quality); and (ii) high degrees of adaptations (Walter and Ritter, 2003). In addition, Walter et al. (2003) empirically found that the fulfilment of (both direct and indirect) functions is a strong determinant of (perceived) relationship quality. A reciprocal, reinforcing effect between relationship function and substance thus seems to be posited. Seemingly, the role of business relationships shapes their own nature (and not just the other way around) (Araujo et al. 1999).

Relationship functions. Both *primary* and *secondary* functions are attributed to business relationships (Hakansson and Johanson, 1993a, Anderson et al. 1994). Relationship functions are labelled '*primary*', '*direct*', or '*first-order*' when relationship benefits and sacrifices are both immediately obtained by the focal firm or ensue independently of connected business relationships or other network actors. On the other hand, relationship functions are said

'secondary', 'network', 'indirect', or 'second-order' if benefits and sacrifices are only attained in the future or uniquely depend on the focal firm's connected relationships or actors (Walter et al. 2001). There is no such thing as a most advantageous type of relationship function. "(...) [I]n a given relationship, secondary functions can be as important as primary ones, or even more so" (Anderson et al. 1994: 3).

We suggest that six main functions may be set forth to group the diversity of roles that business relationships play both directly and indirectly for the focal firm (Wilkinson and Young, 1994, Araujo et al. 1999, Hakansson and Snehota, 1995, Walter et al. 2001, Walter et al. 2003, Wiley et al. 2006, Hakansson and Johanson, 1993a, Hakansson, 1987, Hakansson, 1989): (i) *access*; (ii) *control*; (iii) *efficiency*; (iv) *innovation*; (v) *stability*; and (vi) *strategy*. These are promptly described.

Access function. The focal firm is not a self-sufficient and atomistic entity, being rather deeply enmeshed in networks of relationships and largely dependent on external resources and activities for survival and growth (Thompson, 1967, Pfeffer and Salancik, 1978). Focal firm's resources and activities extend beyond its traditional ownership-delimited boundaries (Araujo and Easton, 1996). As suggested in the Actors-Resources-Activities (ARA) model (Hakansson, 1987, Hakansson, 1989, Hakansson and Johanson, 1992), business relationships allow the focal firm to access other network actors (prominently firms) and later exploit their (complementary) resources and activities. Generally, the resources possessed, and the activities performed, by the focal firm are both seen as a result of its history and only changeable slowly and at great cost (Dierickx and Cool, 1989). However, the Industrial Network Theory has shown that it is always possible (and probably faster and less costly) for the focal firm to change the resources and activities it has access to and exploits, by simultaneously disentangling from existing business relationships and initiating new ones with other actors (Ford et al. 1998).

The resources and activities of the focal firm are essentially limited, dormant, and fragmentary. Ford et al. (op. cit.: 46, emphasis in original) says this very clearly: "A company is a collection of inert resources [and activities] that are only *activated* through interaction with others and (...) acquire their value when they become useful to others. Companies interact with each other and develop relationships in order to exploit and enhance their own resources [and activities] *and to gain the benefit of those of others.*". Intra- and especially inter-firm resource and activity complementarity is a conspicuous feature of business markets (Johanson and Mattsson, 1987).

Control function. The focal firm can use its business relationships as means of influence over counterparts, thereby increasing its network control (Hakansson, 1987, Hakansson, 1989). Through business relationships, the focal firm can: (i) build new, or strengthen (i.e., preserve or alter) its existing, position(s) in the network (Mattsson and Johanson, 1992); (ii) influence counterparts (and their respective network theories); (iii) change business relationships (e.g., by ending business relationships, establishing new, or changing the substance of existing ones), consequently somewhat altering network structures, (Mattsson and Johanson, 1992); (iv) restructure the web of interdependences at the activity and resource levels (e.g., reducing its dependence on counterparts' resources and activities or increasing counterparts' dependence on its own resources and activities (Mattsson and Johanson, 1992); (v) enhance its own reputation or attractiveness as a business partner in the network (Anderson et al. 1994); and (vi) promote suitable network change or instead block undesired changes initiated elsewhere, e.g., by counterparts (Lundgren, 1992).

Efficiency function. Hakansson and Snehota (1995: 394) claim that “[f]rom the point of view of a company the benefits of relationships often consist in their positive consequences for company costs”. The focal firm’s efficiency - in performing its own activities and deploying resources - was usually regarded as an internal technical matter; however, such efficiency is to a large degree contingent on the focal firm’s established business relationships with counterparts. Efficiency gains (i.e., reducing either production costs or transaction costs or both) can be obtained by the focal firm via engagement in business relationships. By interlinking its activities with those of counterparts, the focal firm is likely to discover and attain (more) efficient ways of producing and transacting (Hakansson, 1982, Araujo et al. 1999). As Hakansson and Snehota (2000: 42) point out, “(...) relationships can be a way to reach a higher level of efficiency in the combination of production and transactions”.

Innovation function. Resource and competence development has been usually thought to occur within firms (Dierickx and Cool, 1989, Wernerfelt, 1984). Such development, however, has been empirically found to take place to a large extent between firms, i.e., via the business relationships they often maintain between themselves (Hakansson and Snehota, 1995, Hakansson, 1987). As the focal firm combines its resources and competences with those of counterparts, extant knowledge is certain to be shared and new knowledge jointly created (Penrose, 1959). By interacting, new ways of employing and combining resources and competences may be found by the focal firm (e.g., resources' recognized dimensions may be exploited differently or previously unknown dimensions discovered, and new uses and

purposes for extant resources can be advanced) and even new resources and competences may be co-developed (Araujo et al. 1999, Hakansson and Snehota, 1989).

Business relationships allow the creative leveraging of both resource and competence heterogeneity - and this heterogeneity is the outcome of both internal operations and exchange processes taking place (Hakansson, 1987, Easton and Araujo, 1993, Penrose, 1959).

Stability function. As business relationships develop over time, mutual trust and commitment are gradually increased (Ford, 1980), and interfirm teaching and learning becomes greater (Hakansson et al. 1999, Araujo et al. 1999). Business relationships are frequently used by the focal firm as information conduits or channels (Anderson et al. 1994, Hakansson, 1987), through which knowledge is shared with counterparts. By virtue of that, the focal firm is able to increase the knowledge of what is beyond its immediate network horizon (Anderson et al. 1994, Hakansson and Snehota, 1995), hence greatly reducing its environmental uncertainty (Easton, 1992).

Any business relationship always implies some degree of control by the focal firm over its counterpart and therefore, some extent of control over the environment (stability) is attained (Hakansson and Snehota, 1989). The focal firm is likely to deal better with the environmental complexity it faces (Hakansson, 1982). “Developing continuous, ‘dense’ relationships with others seems to be a way to cope with the complexities and ambiguities which any company is facing in a [business] market.” (Hakansson and Snehota, 1995: 11). By keeping both flexibility and redundancy in its business relationships (i.e., engaging in both strong and weak, similar and different relationships with counterparts), the focal firm becomes more capable to thrive in the increasingly complex and dynamic business networks in which it is deeply embedded (Araujo et al. 1999, Hakansson and Snehota, 1995).

Strategy function. To some degree, business relationships impinge on the focal firm’s strategy in the business markets in which it operates (Ford et al. 1998). The focal firm devises and puts in practice its strategy, *with* and mostly *through* the business relationships that it establishes, develops, maintains, and terminates with counterparts. “(...) [S]trategy development in business markets centres on, is affected by, and is implemented through relationships” (op. cit.: 75). Clearly, business relationships are one of the main instruments that the focal firm musters to effect its network strategy (if not the primary one), i.e., the way the focal firm: (i) *relates to its changing context* (Hakansson and Snehota, 1989); (ii) *manages interdependences at actor, resource, and activity levels* (Gadde et al. 2003); and (iii) *deals*

with the paradoxes inherent in business markets (e.g., influencing, and being influenced by, counterparts) (Hakansson and Ford, 2002).

Two final aspects are worthy of comment. Firstly, relationship functions may be fulfilled at diverse levels (Anderson et al. 1994, Hakansson and Snehota, 1995). Put differently, the outcomes of functions' fulfilment (i.e., relationship benefits) are sensed by the focal firm at actor, resource, or activity levels. With respect to the six major functions of business relationships here identified, the *Access*, *Control*, and *Strategy* functions are fulfilled at all levels, whereas *Stability*, *Innovation*, and *Efficiency* functions are respectively performed at actor, resource, and activity levels (see Table 1 below).

		Main functions of business relationships					
Levels of fulfilment	of	<i>Access</i>	<i>Control</i>	<i>Efficiency</i>	<i>Innovation</i>	<i>Stability</i>	<i>Strategy</i>
<i>Actor</i>							
<i>Resource</i>							
<i>Activity</i>							

Table 1 - Levels at which main relationship functions are fulfilled

Source: Own authorship, inferred from Walter et al. (2003, 2001)

Secondly, at a given point in time, at least one (but not necessarily all) of these six functions are accomplished in every business relationship that the focal firm is engaged in (Walter et al. 2003). If participation in business relationships can be justified with diverse motives, more than one relationship function is likely to be fulfilled at some point in time. Moreover, the fulfilment of relationship functions is likely to vary over time. For example, as the focal firm's relationship with customer A evolves, the (previously accomplished) *Access* function may be replaced by *Innovation*. Inasmuch as it is very unlikely that a business relationship fulfils (at least in a certain point in time) all functions expected or desired by the focal firm (Walter et al. 2003, Wiley et al. 2006), one might refer to the *non-fulfilment of functions* and partly, to *dysfunctions*.

Relationship dysfunctions. A business relationship may be labelled *dysfunctional* if it either (i) does not fulfil some functions (expected or desired by the focal firm) or (ii) precludes the fulfilment of (expected or desired) functions in other, connected relationships. For instance, since the focal firm's relationship with customer A does not permit the access to customer B (i.e., not fulfils the *Access* function) or hinders *Innovation* in its relationship with supplier C, it is deemed dysfunctional. In short, if some sacrifices are borne by the focal firm (i.e., the

existence of deleterious outcomes or the absence of positive outcomes, expected or desired), then a relationship dysfunction must have occurred (Wiley et al. 2006). But what relationship functions can be identified? And how or why do they occur?

Our stance is that for each relationship function fulfilled, it is very likely that a dysfunction follows. For instance, as the focal firm obtains a higher degree of control in the network (through fulfilment of the relationship *Control* function), there is a high likelihood that its counterparts also enhance their network control (partly at the expense of the former). That is, the focal firm does not gain the total network control it potentially could – some of that control is necessarily given to its counterparts. Or, as the focal firm copes better with the surrounding environmental complexity (via the relationship *Stability* function), some of its own stability is necessarily ‘lost’ (i.e., ‘given’ to counterparts). The same thing may happen for each other main function potentially carried out in business relationships. Hence we may allude to six major relationship dysfunctions: (i) *access*; (ii) *control*; (iii) *efficiency*; (iv) *innovation*; (v) *stability*; and (vi) *strategy*.

In sum, relationship functions and dysfunctions are concomitant elements, concurrently performed in business relationships. The focal firm benefits from being involved in business relationships, but in return it has to cede (i.e., allowing or fostering its counterparts’ gains). In business markets, it is not just a matter of receiving: one has forcefully to give out, at least if it truly wants to profit. This resembles Hakansson and Ford’s (2002) reasoning on the network paradoxes.

Connectedness of relationship functions and dysfunctions. Since business relationships are directly and indirectly connected to each other, it seems plausible that their functions and dysfunctions are interrelated (see Hakansson and Snehota, 1995). For instance, the *Innovation* function carried out in the focal firm’s relationship with customer A may be dependent on, as well as positively influence, the *Innovation* functions fulfilled in both the former’s relationship with customer B and the latter’s relationship with supplier C (a focal firm’s competitor). Alternatively, the mere existence of the focal firm’s (supposedly dysfunctional) business relationship with supplier D may preclude the *Innovation* function in its relationship with supplier E. It does not seem absolutely necessary that only relationship functions and dysfunctions of the same kind are positively or negatively connected, as in the given examples. The mentioned *Innovation* function of the focal firm’s relationship with A may depend on, and affect, both the *Access* and *Efficiency* functions in its business relationships with B.

Benefits and sacrifices from participating in business relationships

As mentioned earlier, relationship benefits are the positive outcomes resulting from the fulfilment of relationship functions. Relationship sacrifices, conversely, comprise the costs incurred to attain such benefits plus the negative outcomes stemming from either relationship dysfunctions or the mere non-fulfilment of relationship functions. Plainly, benefits propel the focal firm into business relationships whilst sacrifices may be seen as factors inhibiting their formation (Biong et al. 1997).

Relationship benefits. Six primary positive outcomes for the focal firm, from fulfilling main relationship functions, may be advanced: (i) accessing other actors in the network, and potentially exploiting their resources and activities (complementary to those it internally possesses and performs) (Hakansson and Snehota, 1989, Johanson and Mattsson, 1987, Hakansson, 1989, Hakansson, 1982); (ii) exercising and/or augmenting its influence and control in the network (e.g., altering or reinforcing its network position, changing the dominant network theory, restructuring interdependences at activity and resource levels to its own advantage, enhancing its own reputation and attractiveness, or promoting and blocking network change) (Hakansson and Johanson, 1992, Johanson and Mattsson, 1987, Anderson et al. 1994); (iii) attaining efficiency gains (i.e., reducing its production and transaction costs) (Hakansson, 1982, Hakansson, 1989, Johanson and Mattsson, 1987); (iv) innovating (i.e., improving the existing use of resources, discovering new uses for extant resources, or even developing new resources and competences) (Hakansson and Snehota, 2000, Hakansson, 1987); (v) learning (i.e., coping better with, or reducing, the surrounding environmental uncertainty) (Hakansson, 1987, Hakansson, 1989, Hakansson, 1982); and (vi) strategizing (i.e., devising and putting into practice its network strategy) (Gadde et al. 2003, Hakansson and Snehota, 1989).

Relationship sacrifices: costs plus deleterious outcomes. Three relationship costs are usually born by the focal firm: (i) opportunity costs related to its established business relationships, in particular the adaptations made within these (Gadde and Snehota, 2000, Hakansson, 1982); (ii) relationship handling costs (i.e., costs of establishing, developing, maintaining, and terminating each of its business relationships) (Hakansson and Snehota, 1995, Blois, 1999, Gadde and Snehota, 2000); and (iii) network handling costs (i.e., overhead costs incurred with all of its business relationships) (Hakansson and Snehota, 1995, Gadde and Snehota, 2000).

With respect to deleterious outcomes accruing to the focal firm because of its engagement in business relationships, one may point out at least three: (i) lock-in effects (e.g., the focal firm's established business relationships may preclude the development of other relationships) (Araujo and Harrison, 2002, Mota and de Castro, 2005, Hakansson and Snehota, 1995); (ii) being more subject to the opportunistic behaviour of counterparts (e.g., free-riding and hold-up problems), in parallel with its growing dependency on others and the resulting loss of own autonomy (Hakansson, 1982, Biong et al. 1997); and (iii) various others harmful consequences (e.g., damaging effects of the focal firm's relationship with a certain counterpart on its positions, reputation, and attractiveness in the network) (Anderson et al. 1994, Mattsson, 1989).

Additionally, as we have stressed before, deleterious outcomes may include the non-attainment of positive relationship outcomes (either predicted or wanted) by the focal firm, i.e., what it loses in counterparts' favour (Wiley et al. 2006). The benefits ensuing from participation in a business relationship are somehow divided between the parties involved (Wilson and Jantrania, 1994). On some occasions, the focal firm gets less relationship benefits than the ones it expected or desired to obtain. In a sense, deleterious outcomes may include the relationship benefits obtained by counterparts, at the focal firm's expense. For example, *Efficiency* and *Innovation* benefits captured by counterpart A (to the disfavour of the focal firm) can be considered, from the latter's perspective, to be relationship sacrifices.

Relatedness of relationship benefits and sacrifices. There is always a certain degree of uncertainty (and ambiguity) about the overall sacrifices and benefits actually accruing from a business relationship (Ford, 1980). That uncertainty, more prominent concerning relationship sacrifices than benefits, stems from two aspects. Firstly, relationship benefits and sacrifices are in general difficult to identify, let alone accurately calculate (Hakansson and Snehota, 1995). And secondly, relationship benefits and sacrifices are both likely to vary across the parties to a business relationship (Hakansson and Snehota, 1995). That is, a business relationship may bear more or different benefits (or sacrifices) for the focal firm than for its counterpart, or vice-versa.

Diverse benefits and sacrifices are typically expected in different business relationships (Wiley et al. 2006). Previously, we claimed that the benefits obtained and the sacrifices incurred depend on the substance of the business relationship (Hakansson and Snehota, 1995), which is in turn contingent upon the posture adopted by, and consequently the input of, the

focal firm (Gadde and Snehota, 2000, Araujo et al. 1999). Different relationship postures (i.e., degrees of involvement) are sure to be conducive to contrasting benefits and sacrifices (ibid.). Relationship benefits and sacrifices are not unconnected (Gadde and Snehota, 2000); the former are not obtained automatically, easily or for free (op. cit.), being partly dependent on the latter's existence (Blois, 1999, Araujo et al. 1999). Much time and sacrifices (at least costs) are needed, before relationship benefits can be reaped by the focal firm (Hakansson and Snehota, 1995, Blois, 1999). Attaining benefits often requires a high degree of involvement by the focal firm in the corresponding business relationship. It is not axiomatic, however, that only high-involvement business relationships lead to large benefits and entail low sacrifices (e.g., consider the case in which the counterpart lacks motivation and interest in maintaining the relationship) (Gadde and Snehota, 2000, Araujo et al. 1999). On the other hand, a low-involvement business relationship may permit (at least theoretically) the focal firm to attain a great deal of benefits, while incurring only reduced sacrifices (ibid.). The possibility of temporary free-riding (i.e., obtaining benefits without sacrificing) can never be, of course, ruled out. Different amounts of sacrifices may contribute to similar relationship benefits whilst equivalent relationship sacrifices may imply diverse benefits (Hakansson and Snehota, 1995).

Lastly, it should be stressed that the benefits and sacrifices of a certain business relationship hinge upon the substance of, and role fulfilled by, other connected business relationships (Hakansson and Snehota, 1995). That is, relationship benefits and sacrifices (like the relationship functions and dysfunctions from which they originate) are affected by the connectedness of business relationships.

Relationship benefits and sacrifices: which to emphasize? Relationship benefits and sacrifices are recognized as two sides of the same coin (Hakansson and Snehota, 2000). Industrial Network Theory, however, seems to place more emphasis on the benefits than on relationship sacrifices – the ‘dark side’, ‘burden’, or ‘liability’ of business relationships (Hakansson and Snehota, 1998, Ford et al. 1998) is commonly left out of the theoretical discussion (Alajoutsijarvi et al. 2001). Both benefits ensuing from, and the functions fulfilled by, business relationships are largely addressed within Industrial Network Theory (Walter et al. 2003, Walter et al. 2001). By contrast, relationship sacrifices and dysfunctions are, almost in the same proportion, overlooked (Walter et al. 2001). This reinforces the widespread notion that the benefit side of business relationships is more important than their sacrifice side (Hakansson and Snehota, 1995).

That Industrial Network Theory does not give too much emphasis to the deleterious outcomes potentially resulting from being engaged in business relationships (e.g., dependency and opportunistic behaviour problems), is probably because such outcomes are invariably ‘*part of the game*’ – exactly what Hakansson and Ford’s (2002) network paradoxes suggest. It is in the focal firm’s best interest to be more concerned with relationship benefits than with related sacrifices. Hakansson and Snehota (1995: 396) convey this in clear terms: “(...) [E]conomizing on the costs of handling relationships is important but exploiting the potential relationship benefits is even more important. It is the benefits side of relationships and not the costs [and overall sacrifices] they entail that appear to be the critical variable in a management perspective.”.

Relationship significance: diverse, changeable, and connected

Before advancing to the key point of our paper, a few remarks need to be made about the statics and dynamics, and connectedness of relationship significance. At a given point in time, it is unlikely that two business relationships are equally significant for the focal firm – a *relationship significance continuum*, ranging from ‘insignificant’ business relationships through ‘lowly significant’ and ‘averagely significant’ to ‘highly significant ones, may be thus presumed (Sousa and de Castro, 2004). In addition, each business relationship is bound to see its significance for the focal firm vary over time. The *time-varying* (i.e., *actual vs. potential*) *relationship significance* is contended (op. cit.).

In view of our preceding contentions, the network-based justification for relationship significance can be directly traced to the role played by, and the outcomes resulting from, business relationships. Either because (i) ensuing relationship benefits exceed sacrifices (i.e., relationship value is co-created and partly captured by the focal firm) or (ii) relationship benefits and sacrifices are respectively greater and/or lower than the ones expected by the focal firm or resulting from substitute business relationships, relationship significance follows.

Some relationship outcomes - in particular the non-economic, mediate, and indirect ones - are difficult, if not impossible, to quantify or measure fairly. At most, these outcomes can be subjectively estimated by the focal firm (Hakansson and Snehota, 1995). Even if all relationship benefits and sacrifices were totally quantifiable, the perceptual, rationally limited character of the individual actors assessing them within the focal firm (Weick, 1969, Weick,

1995, Cyert and March, 1963) would, as a consequence, lead forcefully to personal and different valuations (Blois, 1999). The dual ownership of business relationships, and consequently the troublesome division of their ensuing value between the parties involved (i.e., which benefits and sacrifices ensue to the focal firm and which leftover ones accrue to its counterpart), also add to the difficulty of quantifying relationship outcomes (Hakansson and Snehota, 1995). By virtue of the great intangibility of relationship outcomes, relationship significance can only be *perceived* by the focal firm, instead of objectively determined. Accordingly, business relationships are sensed by the focal firm to be more or less significant, or not significant at all.

The final point to make is that relationship connectedness also bears upon relationship significance. Therefore, connectedness always needs to be taken into account when assessing the relationship significance (Hakansson and Snehota, 1995). Seemingly, the significance of a focal firm's specific relationship is often related to the significance of its other (directly or indirectly connected) business relationships. This is but the corollary of relationship benefits and sacrifices, as well as the functions and dysfunctions from which they originate, being allegedly somehow interrelated. For example, the benefits (from functions' fulfilment) in excess of sacrifices (accruing either from dysfunctions' fulfilment, non-fulfilment of functions, or both) attained by the focal firm in its business relationship with customer A may be strongly associated with the benefits and sacrifices derived (and hence with the functions and dysfunctions performed) in its connected relationships with other counterparts (e.g., customer B and supplier C).

IS RELATIONSHIP SIGNIFICANCE SUFFICIENTLY EXPLAINED?

According to the above-mentioned network-based rationale, either (i) relationship benefits exceeding sacrifices (i.e., relationship value is appropriated by the focal firm) or (ii) relationship benefits and sacrifices being respectively greater and/or lower than the ones expected or resulting from engaging in alternative business relationships are implicitly claimed *sine qua non* for relationship significance. In our viewpoint, these arguments set a minimum, i.e., constitute a *necessary but not sufficient condition* for advocating relationship significance. As an illustrative example, one may think of the business relationship that the focal firm holds with counterpart A (one of its suppliers). Such business relationship may be perceived as highly significant by the focal firm even though accruing sacrifices far outweigh attained benefits (i.e., relationship value is only captured by A) or relationship benefits and sacrifices are respectively lower and/or greater than the ones expected or resulting from engagement in substitute business relationships. In this case, the focal firm's perception of significance concerning its business relationship with A is surely supported by other motives.

At present, the dominant theoretical justification underlying the relationship significance proposition is (i) functional – primarily addressing actual and potential relationship benefits and sacrifices – and, more importantly, (ii) 'externally oriented', i.e., essentially focused on the focal firm's (interaction with its) context (see, e.g., Hakansson and Snehota, 1989). This external, or interfirm, orientation derives directly from the spatial assumptions of Industrial Network Theory, i.e., its main units of analysis being interaction, relationship, and network. An 'internally-oriented' (intrafirm) theoretical explanation for relationship significance seems to be lacking.

By drawing on the novel, both theoretical and empirical works of Araujo et al. (2003) and Mota and Castro (2004, 2005) – that address the link between business relationships and the focal firm's competences and vertical boundaries – we contend that the impact of business relationships on the focal firm's resources and competences (internally and externally available) and consequently on the delimitation over time of its blurring, vertical boundaries needs to be explicitly recognized as a possible condition for relationship significance. So far, this 'competence-based' justification has not been much addressed by IMP scholars and researchers.

Competence-based Theories of the Firm (Penrose, 1959, Nelson and Winter, 1982) postulate the focal firm as a set of internal competences (direct and indirect), profoundly enmeshed in a

wider network of external competences (direct and indirect). “A [focal] firm’s capabilities and resources are seen as embodied in evolving networks of interdependence both within the firm and within the network structure in which it is embedded.” (Araujo and Easton, 1996: 376).

The focal firm has necessarily limited direct competences (i.e., knows how to do a limited number things due to specialization) and, consequently, needs to possess indirect competences (i.e., knows how to get things done by others) (Loasby, 1998). In this sense, continually establishing, nurturing, and maintaining business relationships to access and exploit needed (external, complementary) competences is fundamental for the focal firm.

Likewise, the Industrial Network Theory recurrently advocates that all external resources and competences accessed and exploited by the focal firm are inextricably related to its potential and actual business relationships, i.e., the business relationships it is capable of (and *de facto* chooses to) establish, develop, and sustain with several counterparts (Hakansson, 1987, Hakansson, 1989).¹⁰ In a knowledge-based terminology (Nelson and Winter, 1982, Loasby, 1998), one may claim that what the focal firm *gets done by others* is (at least in part) determined by its current business relationships.¹¹ On the other hand, we may contend the following: what the focal firm *does* competently within and across its vertical boundaries - its *core* and *relational* or *network* competences (Prahalad and Hamel, 1990, Ritter, 1999, Lorenzoni and Lipparini, 1999) - is bound to be largely a consequence of the business relationships and purely transactional relations it is *unable* or, if capable, *decides not to* engage in (Araujo et al. 1999).

The emerging competence-based explanation for relationship significance

Sousa and de Castro (2004) suggest that the focal firm (i) comprises a bundle of *internal competences, assets, and dynamic capabilities*, whilst (ii) being deeply embroiled in its environment (hence relying, via business relationships, on *external competences and resources*) (Barney, 1986, Dierickx and Cool, 1989, Teece et al. 1997, Langlois and

¹⁰ The partial influence of business relationships on what the focal firm gets done by others is somehow incorporated in the arguments currently advanced within Industrial Network Theory to explain the relationship significance, under the guise of ‘*access to, and exploitation of, external resources and activities*’ (the *Access* function earlier described). We thank Hakan Hakansson and Lars Mikkelsen for pointing this out.

¹¹ The focal firm also gets things done via arm’s-length relations with counterparts. What the focal firm gets done by others is a direct reflection of the business relationships (as well as the purely transactional relations) it is *able* and *chooses to* initiate, develop, and sustain with several counterparts. Furthermore, the resources and competences subcontracted by the focal firm across the market (i.e., accessed and exploited via arm’s-length relations) are themselves likely to be a consequence of what it is unable of, or rather chooses not to, access and exploit through business relationships.

Robertson, 1995). Looking at their tentative competence-based framework (op. cit.: 15), two sound questions immediately crop up:

- (i) *Do business relationships contribute to the development, maintenance, and renewal of the focal firm's internal competences and assets?*
- (ii) *Do business relationships contribute to the access, exploitation, and creation of the focal firm's needed (external, complementary) competences and resources?*¹²

If the answer to both these questions is a 'yes' - as theoretical and empirical research conducted within Industrial Network Theory and elsewhere seems to corroborate (Araujo et al. 2003, Mota and de Castro, 2004, Mota and de Castro, 2005, Langlois and Robertson, 1995, Barney, 1999) - then relationship significance is strongly associated with (i) what the focal firm does competently by itself and (ii) what it gets done competently by others, particularly via business relationships. In short, relationship significance may be justified by the notorious (yet unuttered) role that business relationships play on defining over time the vertical boundaries of the focal firm. The focal firm's vertical boundaries bridge it to, and buffer it from, both suppliers (upstream) and customers (downstream) (Araujo et al. 2003, Thompson, 1967). Basically, these boundaries separate what the focal firm does from what it gets done by others (via business relationships, or purely transactional relations, with counterparts).

The delimitation of the shifting and fuzzy vertical boundaries of the focal firm cannot be resumed to a series of discrete 'make-or-buy' decisions. Albeit usually seen as static, independent, and dichotomous (Williamson, 1975), a network-based vantage point suggests that such decisions are closely connected to each other over time and, more importantly, incorporate a third option ('access') (Gibbons, 2001a, Gibbons, 2001b). Boundary decisions are hence about *making*, *buying*, or *accessing*, i.e., vertically integrating, engaging in arm's-length relations with, or developing business relationships with, counterparts respectively.

In addition to the network-based rationale alluded to before (to wit, *appropriation of relationship value by the focal firm or relationship benefits and sacrifices being respectively greater and/or lower than the ones expected or ensuing from substitute business relationships*), the relationship significance proposition of Industrial Network Theory may be theoretically and empirically supported by *the influence that business relationships demonstrate on what the focal firm competently does and gets done, i.e., on the evolution of*

¹² This question is one clearly put forward (and positively answered) by Industrial Network Theory, in particular its ARA Model (Hakansson, 1987, Hakansson, 1989, Hakansson and Johanson, 1992).

its blurring and changeable vertical boundaries (Araujo et al. 2003, Mota and de Castro, 2004).¹³

¹³ The liaison between the competences and vertical boundaries of the focal firm has been object of intense theoretical and empirical research (see, e.g., Langlois and Robertson, 1995). Owing to the costliness of developing competences by oneself, these play a key role in determining focal firm's boundaries (Barney, 1999). An additional conceptual link – from focal firm's *business relationships* through its *competences* to its *vertical boundaries* - seems to be propounded (Araujo et al. 2003).

THEORETICAL AND PRACTICAL IMPLICATIONS OF ENQUIRYING RELATIONSHIP SIGNIFICANCE

Business relationships are sources of both opportunities and constraints, thus being simultaneously rewarding and demanding for the focal firm (Hakansson and Snehota, 1995). Multiple benefits accrue from the participation of the focal firm in business relationships but these do not come rapidly or freely (Blois, 1999). Inescapably, some sacrifices must be incurred (Ravald and Gronroos, 1996). Being involved in business relationships is always resource-intensive, even if to varying extents (Gadde and Snehota, 2000, Araujo et al. 1999).

Relationship benefits and sacrifices are both of them unavoidable (Walter et al. 2001, Walter et al. 2003). Relationship benefits are often sensed to outweigh sacrifices, and relationship value is thus co-created and partially appropriated by the focal firm (Wilson and Jantrania, 1994, Ravald and Gronroos, 1996) – in such cases, business relationships are seen as (more or less) significant. Business relationships may be significant still, when ensuing sacrifices exceed (or are seen as roughly equal to) benefits, if those benefits and sacrifices are respectively greater and/or lower than the ones resulting from the focal firm's expectations or alternatives (i.e., substitute business relationships, hierarchies, or markets). Otherwise, business relationships may be deemed insignificant (or worthless) for the focal firm.

The focal firm needs to prioritize its business relationships (Gadde et al. 2003, Hakansson and Snehota, 1995), since these (i) differ between themselves, and over time, in their relative degree of significance and (ii) can only be established, nurtured, maintained, and even ended through large and incremental investment of resources (i.e., adaptations) (Hakansson, 1982). As business relationships are not equally significant (neither presently nor over time) and the focal firm is endowed with limited resources (and consequently, can be highly involved with only a limited number of counterparts), “(...) there is a need for giving certain relationships priority over others” (Hakansson and Snehota, 1995: 131).¹⁴ Different priorities should be assigned to (and attained in) differently significant business relationships. That is to say, the focal firm has to be selective in the development and sustenance of its business relationships.

¹⁴ Prioritize business relationships boils down to ‘*single out the significant ones*’ (Hakansson and Snehota, 1995: 125). Prioritizing, however, is not only about *giving* both high priorities to certain business relationships and low priorities to others. It also entails *getting* equal priorities from the corresponding counterparts with which the focal firm interacts in those relationships (op. cit.: 202). In order to attribute such priorities, the focal firm employs some criteria. “Companies always have, explicit or only implied, principles for giving priority between existing relationships (...).” (op. cit.: 264). The ‘*degree of trust and commitment exhibited by the counterpart*’ - somehow inferred from its behaviour - can guide the focal firm in the decision to prioritize business relationships (for instance, a higher priority assigned to relationships with trustworthy and committed counterparts) (op. cit.: 265). In our opinion, one very reasonable criterion used by the focal firm can be the ‘*perceived relationship significance*’ (either actual or potential).

Accordingly, a *mixed relationship posture*¹⁵ must be effected (Gadde and Snehota, 2000). In this respect, adopting a combination of low- and high-involvement relationship postures (i.e., attributing lower priorities to lowly significant business relationships and higher priorities to highly significant ones, hence committing to these lesser and greater amounts of resources respectively) is advocated as the best way for the focal firm to ‘*make the most*’ of its diverse business relationships (op. cit.). Araujo et al. (1999) also argue that the focal firm should intendedly engage in both low and high resource-demanding business relationships with counterparts, albeit the recent apologia for the latter ones - note the increasingly widespread contention that ‘*partnering (with suppliers and customers) is always beneficial*’ (see, e.g., Sheth and Sharma, 1997, Campbell and Cooper, 1999). The message is clear: business relationships should be handled in varied ways, according to their (actual or potential) significance for the focal firm, i.e., *relationship differentiation* is often advised (Ford et al. 1998).

Typically the focal firm is strongly committed to those business relationships it considers as being highly significant (currently or in the future). Such relationships, usually high-involvement ones, are sure to have taken a long time and many efforts to develop and, consequently they may be extremely difficult to replace (Ford et al. 1998, Hakansson and Snehota, 1995). Even if substitute business relationships (either actual or potential) do exist, these are probably not significant to the same extent (e.g., because their benefits are perceived as comparatively lower or sacrifices greater). A low-involvement posture, on the contrary, is likely to be adopted by the focal firm in those business relationships judged low in significance.

Notoriously, (both actual and potential) relationship significance must be continually and deliberately assessed if the focal firm aims to manage effectively and efficiently its business relationships (Hakansson and Snehota, 1995). Differentiation with regard to relationship posture - essentially *network management* (Ritter et al. 2004) - can only be achieved if the focal firm understands which of its business relationships currently are (or will be, in the future) significant, to what degree, and more importantly why.

¹⁵ The focal firm’s relationship posture (i.e., its degree of involvement in a business relationship) may be expressed as high or low, according to (i) the extent of adaptations made and (ii) the intensity of existing activity links, resource ties, and actor (individual) bonds (Gadde and Snehota, 2000). “Increased involvement makes sense only when the consequently increased relationship costs [and overall sacrifices] are more than offset by relationship benefits.” (op. cit.: 310). Diverse degrees of involvement are likely to lead to different relationship benefits and sacrifices (Gadde and Snehota, 2000, Araujo et al. 1999). Despite surely requiring greater sacrifices, high-involvement business relationships typically allow the focal firm to obtain (currently or in the future) higher benefits than those captured in low-involvement ones (Araujo et al. 1999).

Only by disclosing the determinants of relationship significance, will emerge the indispensable understanding concerning the (individual and collective) management of business relationships. That the former is seldom (if ever) completely articulated helps to explain why the latter is yet, within Industrial Network Theory, far from perfect. That invaluable understanding can, for instance, compel the focal firm to reinvest in a business relationship expected to become even more significant in a near future or instead divest if that relationship is perceived as being currently insignificant. We believe that managerial guidelines on relationship and network management can only be rightly given when the underlying reasons for relationship significance are fully known and grasped. In a similar vein, Hakansson and Snehota (1995: 125) claim that “(...) without some insight about which links [i.e., business relationships] are critical (...), management actions can become counterproductive and produce undesired effects”.

This paper probes into relationship significance. Its main intent is both (i) to make explicit the largely inarticulated network-based rationale on relationship significance and (ii) to tentatively reflect upon the thoroughness of the arguments comprising such rationale. In doing this, we aim to be contributing something to understanding and indirectly to practice, since the improvement of the practice of industrial marketing and purchasing requires a better theoretical grasp of business firms, relationships, and markets (Wilkinson, 2001). Wilkinson and Young (2002: 127) assert that “(...) by extending and improving firms’ understanding and sensitivity regarding relationship and network issues, better performing firms and networks will emerge (...)”.

CONCLUDING REMARKS

We have here articulated the presently dominant albeit largely implicit network-based arguments on relationship significance. And the completeness of these arguments was afterward the object of a tentative cogitation using a (deemed appropriate) competence-based viewpoint.

Our main points are the following. Arguably, the sufficient conditions supporting the relationship significance proposition have not been yet outlined. As a result, relationship significance is not thoroughly explained by the current state-of-art of Industrial Network Theory. The fact that the focal firm appropriates relationship value and the fact that relationship benefits and sacrifices are respectively greater and/or lower than the ones expected or ensuing from alternative business relationships, both seem but necessary conditions for relationship significance.

The pure network-based arguments underlying relationship significance do not contemplate the (partly overlooked) inside of the focal firm, in particular the impact of business relationships on what it competently does within and across vertical boundaries, because they are naturally concerned with the focal firm's outside (especially its context), and consequently only with the influence on what it gets done by others of business relationships (Hakansson and Johanson, 1992). We conjecture that the network-based rationale on the relationship significance should be supplemented with arguments borrowed from Competence-based Theories of the Firm (Penrose, 1959, Loasby, 1998). Still, no claim for the completeness of justifications on relationship significance can logically be made, even with those supplementary arguments. Nevertheless, a contribution towards such completeness is here, at least in our view, incipiently attempted.

This paper pretends to contribute to the extension of Industrial Network Theory. We expect future empirical research to provide clear evidence of relationship significance justified by competence-related reasons, thus corroborating our main contentions.

The endless quest for better theory is a basic instinct in every researcher and scholar, whatever its field of study is (Van de Ven, 1989). Instead of being merely theory users, researchers and scholars should assume the key role of theory developers. In this respect, the current state-of-art of any theory should always be challenged, rather than simply (re)asserted (Whetten, 1989). Professor Hakan Hakansson, one of the founders and most prominent fledge-bearers of Industrial Network Theory, has vigorously contended: "*As researchers, we*

need to believe that we can be wrong. (...) Challenging, instead of accepting, can be an enthusiastic route. It makes you move on (...)".¹⁶ Proposing solutions is an inherent responsibility of those who raise criticisms to theory (Whetten, 1989). We tried to provide a possible solution here. Like many other researchers, our ultimate objective is to contribute to an even better Industrial Network Theory.

¹⁶ An assertion proffered during a discussion period following one of the presentations made in the 1st IMP Doctoral Consortium that took place at Odense, Denmark (31th of August and 1st of September, 2004), attended by the first author.

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