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Competitive paper

Institutional change of business networks: Russian transition revisited

By

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Abstract

Dynamics has been a key issue for investigations of business networks. This paper concentrates on rules that shape business interaction between actors: institutions. It makes an attempt to develop further the model of industrial business networks that consists of the governance structure and the production system (Johanson & Mattsson 1992) by involving institutional aspects. The aim of the paper is to analyse institutional change forces (i.e. formal and informal rules) and their influence on network structures. Institutional change of business networks is discussed in general terms, but it is investigated in particular in the Russian context: here most dramatic changes have been witnessed as new markets are being created. The paper directs attention to the dynamic forces (interplay of formal and informal rules; co-operation and competition; dyadic and network changes) and the relevance of time. The paper is mainly conceptual in character, but it summarises relevant empirical studies. The time span of more than a decade between the end of Soviet era and today's Russian market conditions allows us to make already some conclusions about the dynamics, showing major results of the interplay of formal and informal institutional rules. It is believed that the analysis of institutional change and economic transition will increase our understanding on business markets (what is a market) and their dynamics (how are markets created) more generally.

Key words:

market, institutions, formal and informal rules, market definition, network dynamics, Russia

INTRODUCTION

Dynamics has been a key issue for investigations of business networks. Analysis of interaction processes and changing connections of business relationships in industrial context form the core of IMP research tradition. This paper operates in the same area, but concentrates on rules that shape business interaction between actors: institutions. It has been argued that institutional traditions can contribute to theory development in IMP (Welch 2001). This paper makes an attempt to develop further the model of industrial business networks that consists of the governance structure and production system (Johanson & Mattsson 1992) by involving institutional aspects. Moreover, this model is applied to an empirical case of new market creation: the Russian transition process into a market economy. We have witnessed a complex and relatively slow process, which can be understood by using the tools of the network view. Simultaneously, an analysis of this contemporary and in many ways unique process is of interest for anyone concerned with the question: “what is a market”. This question, of course, has been in the core of IMP research right from the start and market definition continues to be focal issue for network research (Snehota 2003).

The aim of the paper is to analyse institutional change forces (i.e. formal and informal rules) and their influence on network structures. Institutional change of business networks is discussed in general terms, but it is investigated in particular in the Russian context: here most dramatic changes have been witnessed as new markets are being created. The paper directs attention to the dynamic forces (interplay of formal and informal rules; co-operation and competition; dyadic and network changes) and the relevance of time (legacies of past history, experiences and perceptions of today, and future expectations). The paper is mainly conceptual in character, but it summarises relevant empirical studies. The time span of more than a decade between the end of Soviet era and today’s Russian market conditions allows us to make already some conclusions about the dynamics, showing major results of the interplay of formal and informal institutional rules. It is believed that the analysis of institutional change and economic transition will increase our understanding on business markets and their dynamics more generally.

The paper is structured in the following way. The paper starts with a literature review on institutions. It then presents a view on markets that is based on the conceptual developments within the IMP Group. Next, the network approach is enriched by bringing in an institutional approach. Against this conceptual background empirical evidence is presented, discussing changes in the

transitional Russian economy. The concluding section summarises issues of institutional rules, e.g. business norms, and their effect on business networks.

INSTITUTIONS

Institution is one of those terms that are frequently used but seldom properly defined. Institutions have been identified with e.g., general and organisational environment, governance structure, and formal organisations. One way of understanding different approaches is to view institution as a relative term: what is considered as institutional depends on the analytic problem involved (Sjöstrand 1992). From the wide spectrum of institutional approaches, two dominant ones can be picked out: one that focuses on legal foundations and constructions and another that focuses on human (inter)actions and their rationales (*ibid.*). Or, put differently, we can see two main schools of thought: rationalist and sociological, which both encompass a range of perspectives (Welch 2001). In what follows, institutional developments within neo-institutional economics, sociology and organisational studies are briefly discussed.

New institutional economics views institutions as efficient solutions to certain economic problems and represents the rationalist institutionalism. It is most often associated with the works by Williamson (1975). Recent 'neo-institutional' approaches see economic action as embedded in social, economic and technological structures of a network-like character (Smelser and Swedberg 1994; Granovetter 1985). The "markets-as-networks" research tradition too has developed in line with these accounts (Johanson and Mattsson 1992). While in the beginning the transaction cost approach by Williamson was considered to be one of the antecedents of the IMP Group's research (Håkansson 1982), it was later shown in many respects (e.g. assumptions, problem setting & view on dynamics) to be different from the network approach (Johanson & Mattsson 1987): so it is not developed further here.

More sociological orientations of institutional study are adopted when institutions are seen to be "basically interaction of a social kind" (Syll 1992, p. 27), and embeddedness of business behaviour (Granovetter 1985) and human interaction in business setting is stressed. If institutions concern individuals and their social context, they can be seen as 'shared typifications of habitualized actions and actors' (Berger & Luckmann 1967). Moreover, institutionalisation is the "social process by which individuals come to accept a shared definition of social reality" (Scott 1987, p. 496). Institutionalised activities acquire a rule-like status that renders them persistent and highly resistant

to change. They are then taken for granted “as defining the ‘way things are done’ and/or the ‘way things are to be done’” (ibid.).

Despite the interest in social interaction and view of institutions as social constructs, there is a need to avoid an ‘over-socialised’ view to business. Håkansson & Johanson (1993) emphasise the difference between social networks and industrial networks. The formers are dominated by actors and their social exchange relations, while activities and resources are given less attention. In the latter, in turn, the strong interdependencies between all three elements (actors, activities and resources) are important. This interdependence makes analysis of business networks different from not only sociology, but also from the organisational studies on networks (Easton & Araujo, 1994). Consequently, this study will –while focusing on actor level – consider also activities that companies conduct and their resources.

Institutional arguments have been central in organisation studies. These views focus on organisational conformity with social rules and rituals, and on legitimate organisational activities. Institutional environment of organisations (Meyer & Rowan 1977, Meyer & Scott 1983) as well as homogeneity and similarity between organisations (DiMaggio & Powell 1983) have been investigated. Moreover, there are investigations of the process of institutionalisation or analysis of organisation as institution as described by Zucker (1987). Institutionalists have largely concentrated on organisations’ passive conformity to institutional influences, but it has been argued also that interests can and should be taken into account in institutional analysis (Scott 1987, Dietz & Burns 1992). Organisational institutional arguments help to understand the activities of an individual actor (firm) in its context (a network). Institutional pressures offer both constraints and possibilities for action. However, organisational studies do not tell us much about what is happening in interaction (i.e. dyad) between the actors.

For the purposes of analysing business networks, instead of investigating institutionalised organisations or interaction between individuals, the work on economic history by Douglass North (1990, 1993) is rewarding. He analyses institutions as “the rules of the game” in a society. Thus he operates on a general level, and furthermore, explicitly separates institutions from organisations: organisations are the players of the game, who are affected by the rules but may follow their own strategies in the game. While north originally worked in the lines of a rationalist theory of institutions, his later works have rejected the efficiency explanations. Thus his “modified variant of rationalism converges with that of sociological institutionalism in many respects” (Welch 2001).

North discusses both formal and informal rules and their differing nature. Formal rules are often in written form and include the hierarchy ranging from constitutions to property rights and to specific contracts. They are present and future oriented. Informal rules can supplement, modify and reinforce formal rules. They consist of sanctions, taboos, customs traditions, i.e. the built-in codes of conduct (North 1990). Informal rules are created over time and are inherently past-oriented.

Consequently, economic activity is constrained by the interplay between the formal legislative environment and the informal, culture-specific commonly acknowledged ways of behaving. Organisations and entrepreneurs are seen to be the agents of institutional change (North 1990). Institutions may be created or they may evolve over time; typically they change incrementally. Formal rules can be changed overnight as the result of political or judicial decision, but informal rules are much more impervious to deliberate policies. Informal rules change incrementally and only as mental models of individuals change, so mental models are a central component for analysing the dynamics of institutional change.

Institutions can not be understood without their history and the concept of process is central to institutional arguments. Often, path-dependence and incremental change are stressed. Institutional change has attracted interest (Powell & DiMaggio 1991, North 1993) and e.g. strategic responses to institutional pressures have been studied (Oliver 1991), but in general terms, we can summarise that an institutional view directs attention on legitimate behaviour and relatively stable behavioural patterns.

IF MARKETS ARE NETWORKS ...

In line with the IMP research tradition, the market can be described as networks of multidimensional exchange relationships between business actors. These actors control heterogeneous, interdependent resources and conduct inter-linked activities. Co-ordination and control are needed between buyer and seller, for instance, for efficient handling of flows of goods, services, information and payments; for effective innovative behaviour; and for reduction of uncertainty.

Johanson and Mattsson (1992) propose a conceptual network model that separates the network governance from the production system. Thus they make a distinction between different levels: 1)

the exogenous, general environment (including institutions) 2) the governance structure (i.e. the network of exchange relationships between industrial actors) and 3) the production system, which consists of resources and activities.

While this model presents a general environment, it has been later argued that wider environmental, also institutional, influences are mediated through immediate network relationships of companies (Håkansson & Snehota 1995, Halinen, Salmi & Havila 1998). Thus the dyad remains as the central concept for network analysis, even if large-scale institutional change processes are under focus. Following North (1990), the institutional environment can be taken as the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution. Then it is interesting to see how this can be conceptualised within a network.

The separation between the two network levels – governance structure and production system – enables investigation of institutions' role in networks: institutional rules are humanly devised and thus operate at the level of actors.

One of the reasons for Johanson and Mattsson (1992) to separate between the two levels (network of actors/production system) is to be able to discuss strategies of actors. Moreover, when discussing connections in networks they note that connections between relationships and positions at the network level are a matter of intentions and interpretations of actors, thus being of a subjective nature. They assume that more closely connected actors have more analogous “network theories” and point out that one base for strategic action is influencing the network theories of other actors.

The concept of network theory as developed by Johanson and Mattsson clearly comes close to the discussion on institutions in networks: commonly accepted rules for legitimate behaviour affect perceptions, intentions and the way network strategies are built. The authors refer briefly to a dominant network theory, meaning that the network theories of different actors in the network could be consistent. This dominant theory would among other things express the institutional interdependencies at the actor level.

Undoubtedly, it is important to understand the complex character of business networks and pay attention on the interdependencies involved. However, in practice research on business networks has tended to focus on technological interdependencies with much less attention on the institutional interdependencies at the level of actors. It would seem relevant to carry out more analytic work at

this level. Understanding of institutional interdependencies is important for several reasons. Firstly, economic action is very much embedded in social relations (Granovetter 1985, 1992). Secondly, as business networks come into being as a consequence of interaction between individuals, the mental models will affect the structuring of networks. Thirdly, an institutional approach would seem to complement the research that has been carried out on processes of technological change, thus contributing to a more holistic view to networks.

... INSTITUTIONS PLAY A ROLE AT THE LEVEL OF ACTORS

Building on the model by Johanson and Mattsson, and adopting the definition of institutions as the rules-of-the-game in a society and the humanly devised constraints that structure interaction, I suggest that institutional formal and informal rules are to a large extent internalised by economic actors (managers). Thus the following kind of analytic model would be fruitful. (Figure 1.)

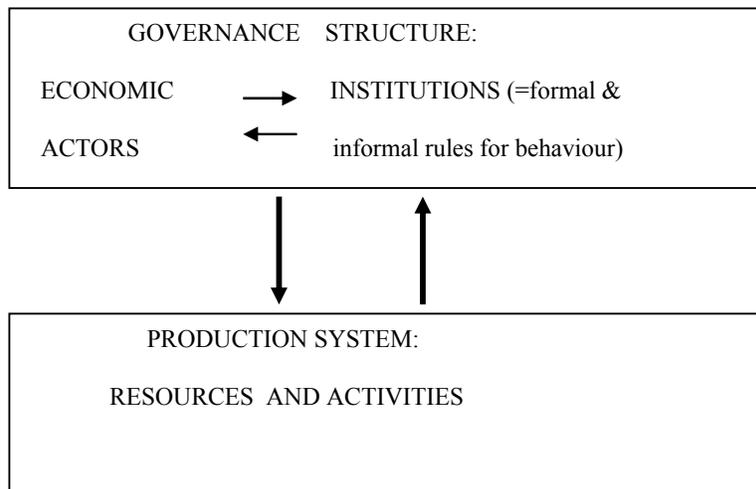


Figure 1: Institutions as an inherent feature of the business network

This analytic model argues that commonly acknowledged institutional rules for behaviour evolve in business networks. These are an inherent feature of the network and define the ‘correct’ or

legitimate network structures and processes. To some extent these rules are formal, and to some extent they are informal. For an individual actor in the network, the generally accepted rules form constraints to behaviour and the framework for action. Basically, actors accept and follow these institutional rules, but on the basis of their strategic decisions they can also act against the rules or try to change them. For the latter, mobilisation of other actors is usually needed as well.

Institutional interdependencies in networks bring about stability and resistance to change. This is because rules, especially informal ones, have their own history and are difficult to change. Iyer and Masters have pointed out that the operations of markets, in terms of observable negotiations and exchanges, often conceal the complex institutional environment from which they derive their support (1999, p. 14). More specifically, it is not only the formal and explicit rules, laws and regulations, but in addition, the informal, even 'tacit' knowledge, of the actors involved that makes the market operations come about. Also, the mental models, learning and skills of entrepreneurs and their organisations become key issues in network dynamics. The institutional approach thus explains stickiness and inertia in network (market) behaviour.

The second important implication of the model concerns technological interdependencies. It is not my intention to reduce investigation into the actor level only. Economic actions are dependent on established or potential linkages of resources and activities in the production system, and these interdependencies are difficult to change in the short term. The markets-as-networks view offers an analytic approach that allows us to investigate the constraints and the sets of opportunities available to economic actors (companies) both from the governance (rule creation) and production (technology) point of view. Most importantly, the focus on business activities provides a holistic view of an economic actor.

TRANSITION INTO A MARKET ECONOMY MEANS CHANGING INSTITUTIONAL RULES

In order to see in practice what the presented model can mean for an analysis of business networks, let us investigate development of markets in an extreme situation: in Russian transition into a market economy. As the process started in the early 1990s, expectations of a rapid emergence of a brave new market economy in Russia were common. In practice, we have witnessed a very difficult process: a decline in production and income, corruption and bribes, both entry and withdrawal by foreign investors, economic crisis in 1998, flight of capital, and industrial enterprises in dire straits.

Simultaneously, the strong market presence of a few multinational companies, a gradually strengthening small business sector, improvements in certain local production facilities together with recent minor growth in production figures all indicate on-going business activity. These developments can be understood if we look at the interplay of different institutional rules.

Institutional legacies from the planned system

The planned economy was based on hierarchies. In simple terms, the system can be described as follows. Companies (or as usually called, enterprises) interacted with the planners and planning system, not with each other. And they were certainly disconnected from foreign companies, as special Foreign trade organisations were responsible for external trade relations. Companies received annual production targets from planners, and in principle all required resources were to be delivered from their (not necessarily known) suppliers. Similarly companies sent their end products further according to orders and did not need to worry about marketing of the goods. Johanson (2001) notes that the stable and hierarchical networks caused anonymity between the firms. Shortages characterised the planned system. Like the entire economy, companies had a hierarchical structure where major responsibilities and decision making power resided by the top managers.

Thus, economic transactions (i.e. one-way transfers of goods) largely took place between enterprises through formal distribution links fixed by planners. One way of describing the relations is to note that they were partial – i.e. being on either an exchange level or a use level – rather than full-fledged relations involving both levels, as is typical in a market economy (Johanson 2001). In practice, formal transactions between companies were aided and extended through social relations, as managers resorted to *tolkach* (informal expeditors and networkers), and also *blat*, i.e. the practice of circumventing formal procedures by using personal contacts. This is one example showing that the planned system did not function as formally presented. Attention has been paid to the unofficial economy in the Soviet era and in transition (Grossman 1994), and to the informal side of Soviet enterprises (Berliner 1957, Clarke 1995). Resorting to e.g. personal contacts was a generally well known but ‘hidden’ behaviour in the planned economy, and this has only recently been openly and empirically analysed (Klimova and Dunaevskii 1993, Ledeneva 1996).

It follows that actual inter-organisational *exchange* relationships, as they exist in market economies, were in fact lacking in the planned system. Each enterprise concentrated on fulfilling internally the production target and on negotiating as low targets as possible. It did not design itself what

activities to conduct, but followed the plans and tried to get all necessary resources via the official or unofficial links; this led to hoarding and big inventories of different materials. Despite this internal focus efficiency or productivity was not an issue for the enterprise.

Important legacies from this system were thus focus on production, informal activities, resorting to personal relations for fighting shortages, and concentration of power to the top managers.

Formal rules: Transition policies

Economic transition policies (e.g. new legislation) mean a change in formal rule that governs exchange relationships. Soviet transition started with such major economic policies as liberalisation, stabilisation and privatisation, and these were followed by the second phase: structural reform. In very simple terms, “first generation economic policies were about creating a market economy, second generation policies about the kind of the market economy preferred” (Sutela 2003, p. 107). Speed was highly ranked among first reformers, as an idea of Window of Opportunity prevailed (ibid.). In practise, the transition has been slow and complex process. The issues of structural reform, in particular, are slow movers and based on long term development; not to mention the behavioural change of actors that has followed.

During the past decade economists, among others, have tried to measure the progress of the reforms and proposed different kinds of transition indicators, the best known of which are provided by the EBRD (European Bank for Reconstruction and Development). The first published indicators reflected the first generation transition issues, while the more recent ones show reconstruction; e.g. concerning infrastructural reform. (Sutela 2003, p. 110). This shows both that policies and attention have now been directed more towards the company level, and also, that we now know more what is happening in and between Russian companies. E.g. the EBRD (1999) study discusses functioning of the judiciary, corruption, street crime, and organised crime.

Generally acknowledged problems with the new formal rules relate to slow process of new legislation, contradictory regulations and enforcement problems. Especially foreign managers are still complaining about unclear and changing legislation; e.g. ownership of land and property have been problematic issues. All in all, the absence of rule of law has imposed a high transition cost upon the Russian people (Linz 2002). It is not necessary here to go in detail into the formal transition process. (Sutela (2003) gives good discussion on this development and interplay with e.g.

politics). Instead, the following sections discuss the developments in the network and at the company level: this will illustrate what has happened in practice and in inter-firm interaction, and in particular shows the role of informal rules.

Changing network and informal rules

Transition meant that the existing organisational structures were broken and enterprises themselves became responsible for establishing relations with suppliers and customers. Thus there was a need to start analysing resources and activities of other actors and establishing the necessary connections. Critical questions were how to continue, where to find business partners and how to establish relations with them.

In order to continue operations, existing resources were first to be used. It is known that in the beginning of transition Russia's capital stock was outdated and infrastructure underdeveloped. Existing enterprises needed to restructure operations and renovate production facilities. Given the worn-out and obsolete industrial base, companies are struggling for new investments. In addition, there was a need for new firms, which would play new roles in the network and provide e.g. distribution, information and financial services – all lacking in the socialist economy. Low investment in Russia has been a hindrance to both activities: capital flight from Russia has been estimated by the billions of dollars yearly. Property protection has turned out to be an important explaining factor for low reinvestment of profits by Russian firms (Linz 2002). It seems that certain sectors have been more advancing: in comparison with heavy industry firms, firms involved in the processing and distribution of food products and firms involved in services report reinvesting a significantly greater percentage of profits (*ibid.*). Food industry was also one gaining from the economic crisis of 1998; for many food companies this became a successful period for fighting foreign competition and investing in own production.

When we look at the recent evidence from Russian companies about their search for suitable business partners and establishment of relations, the following issues come up. Firstly, natural criteria concern geographical distance; secondly, foreign investments are still needed; thirdly, existing partners have been resorted to; and finally, there is evidence that Russian enterprises vary according to their attitude and activity concerning adoption of new market-based rules. All in all, companies still seem to resort a lot to old practices and norms.

Lacking infrastructure, logistical issues and long distances of course influence companies' chances of establishing relations with distant partners. Inter-organisational relations are developing fastest in the main growth areas (e.g. Moscow, St Petersburg, and the Leningrad area). Conditions are totally different in remote areas, where it is a case of trying to survive and where companies mainly have resorted to passive adaptation. These areas do not attract foreign investors either. Regional authorities play a role here: some are more active than others in enhancing local networking, providing business opportunities and in reaching out for external actors, e.g. attracting foreign investors (for an analysis of Samara, see Hanson 1997).

So far, foreign investors have been cautious. But there are some, especially large multinational, companies that have invested in Russia and are strategically committed to building long-term exchange relationships with their customers and suppliers. For instance, in order to ensure high-quality supplies, McDonald's has been active in integrating and controlling its local supply chain in Russia, beginning with careful selection and education of potato farmers and meat producers. Thus foreign investors play a central role in building up the new networks. But they are important also as integrators of global production networks (Meyer 1999). Close interaction between foreign and local managers involves mutual teaching and learning, where business norms are gradually transferred and created (Törnroos and Nieminen 1999). However, this seems to be a long process, as foreign companies are still complaining about lacking management skills and efficiency of Russian companies (Karhunen, Kosonen and Leivonen, 2003).

Informal interaction at the level of personal relations seems to be still prevalent in Russia. When building up exchange relations during the very early transition years, companies resorted to existing relations and especially personal contacts. An important reason for this was that when organisational structures broke down, individuals involved in the business remained the same, and the trust necessary for business was based on relations between individuals (Salmi, 1995). Russian companies sought new business partners on the basis of reputation (i.e. large, well-known firms) or personal contacts (Dolgopiatova 1995, p. 141). Moreover, as the tradition of one-man management has largely prevailed, general managers often have relationships and information that are specific to them. In the transition context, obtaining orders and/or extensions of debt rest more on informal personal ties than on arms-length negotiations, which show the positive aspects of embeddedness (Hendley 1998). A study of 264 firms in four different regions of Russia in 2001 reported that it was common to borrow funds from other firms instead of banks, and 20-25% of retail shops used barter

(Linz 2002). These activities show that existing inter-firm relations are used in many ways; the same study notes also that 48-98% of the companies was paying bribes.

Duality in managerial responses to reform can be seen in a study of Russian business networks, which examined managerial goals: rent seeking or profit-orientation (Huber and Wörgötter, 1998). Accordingly, 'survival networks', which tend to be closed and hierarchical, were argued to predominate in Russia, but in the long run, competitive forces may help 'entrepreneurial networks' to proliferate. As of the beginning of the new millennium, there is more and more evidence of two types of managers and firms; those representing the old generation and those adopting new ways for business; as time goes on, the latter are increasing in number. There are also studies that provide more fine-grained analysis of different reaction modes. One of these was carried out in a Russian city Vyborg.

This empirical study of 40 companies, interviewed between 1995 and 2002, investigated how local companies have survived and adapted to the reform (Kosonen, 2002). The study ends up with six types of enterprises that have evolved in Russia alongside the economic reform. Enterprises were classified according to how they combine the new and old thinking in their governance efforts, how embedded are their governance mechanisms locally, and what kind of impact their governance practices have on the local socio-economic and political coherence. The six types included (ranging from market-economy thinking to the socialist thinking) opportunists, neutrals, disputing constructors, constructors, strugglers and reactionaries (ibid. p. 202) The typology indicates that no enterprise has relied solely on old legacies, nor on only novel forms of co-ordination. Both Russian and foreign-owned enterprises have had to adapt to the post-socialist environment. Interesting for network development are especially constructors, which are innovative in combining old and new thinking. They have built relatively strong (social) links which are used in bargaining with the state, provision of social benefits to labour force and involvement with other enterprises. The group of neutrals, in turn, represent market-like business thinking in its purest local form. These companies take care of their formal responsibilities and resort to social bargaining only occasionally.

Thus we can see that there is variation among the firms as comes to how willing and able they have been to change their activities towards market economy behaviour. This is a prime example of the interplay of strategies and rules of the game: companies have been able to choose their own strategies in adapting to the reform, although the institutional rules are the same for all actors. Moreover, Kosonen (2002) shows that over time there has been development: the category of

reactionaries has declined and those of constructors and neutrals increased. This illustrates the slow movement towards a market economy.

Also other recent studies show that many of the behaviours of planned system are still prevailing in companies. For instance, in one study 404 middle-sized and large manufacturing firms from 40 Russian regions were interviewed in 2003. The data revealed that enterprises are still engaged heavily in social service provision: e.g. 56 % have their own housing or support local housing, and 73 % have recreation facilities or support employee's recreation activities (Haaparanta *et al.* 2004). Thus companies tend to play same roles in their local economy as earlier.

We can summarise that Russian enterprises have relied both on market-economy thinking and on old familiar practices inherited from the socialist era. It seems that past legacies are seen also in Russian companies' interaction with foreign partners: interviewed managers on both sides often express same concerns on behavioural patterns as earlier. Gradually, however, exchange relations develop, and along this interaction, also the identity-building of formerly anonymous Russian companies (Johanson 2001) takes place.

New rules for behaviour

Russian enterprises still make little use of the law and legal institutions in structuring exchange relations and a large proportion of transactions appear to be based on business ties inherited from Soviet times. Inter-organisational relations seem to be gradually evolving on the basis of earlier personal and other ties. This shows that although formal rules have changed (evidently, not as much or quickly as needed, as seen e.g. in property rights problems), the informal institutional norms are not necessarily changing automatically as a result. The mental and behavioural models of the business actors are slow to change, and inertia prevails. Thus, while informal institutions facilitate economic exchange by supporting self-enforcing rules of the game and by fostering trust in third-party enforcement through the state (Raiser 1997), they may also hinder the adoption of new rules and progress. Furthermore, social norms will not necessarily evolve efficiently.

How individual Russian companies arrange their external relationships is bound to affect the way the economy develops; dyadic and network changes are in many ways interrelated, and these interrelations create the dynamics of the markets. New rules at different levels for economic interaction are needed. Specific rules will emerge over time in individual relationships between

partners. In addition, common rules for the Russian context more generally are needed. Of course, rules are always specific to the market area; thus there are no overwhelming “Western” rules that could easily be adopted. Rather, rules are gradually changing and developing, as economic actors are learning and teaching each other. In fact, evolutionary approach would suggest that enterprise management might first change its behaviour in external relations, despite the slow and incremental change in internal corporate cultures (Hendley 1998, p. 112). Put bluntly, a major part of Russian companies emerging from old enterprise structures are still focusing on production and technological issues. For them, more attention on marketing and customer needs is required. Others, in turn, take advantage of transition in monetary terms and are more active in rent-seeking behaviour than production. Both represent survival strategies, which should be replaced by more active, profit-oriented and co-operative behaviour.

One way for bringing in a new type of thinking is via new actors, such as privately owned companies in the small business sector. The number of these is increasing, but in total volume their weight will be small for quite some time – in 1997 SMEs produced about 10 % of GDP, and their share of the total number of companies was about 30 % (Dolgopiatova 1999). This sector, however, plays an important role in transformation due to its particular characteristics and strategies. On the positive side, small business is demand-oriented and diversified, operating in the flexible and consumer-friendly industries of trade, public catering and services. On the negative side are operations in the shadowy economy; according to estimates, SMEs manage to conceal about one third of their activities.

Another influence comes from foreign companies. Interaction between business partners where one is located in an economy under transition and the other in a market economy will have an effect on informal institutions. For example, interaction between companies may switch the norms concerning the role of interpersonal relationships from being primary to being secondary. Thus, foreign companies in the Russian market can exert an influence by their role model behaviour and thus help in the adoption of new business rules. In addition, foreign direct investments where local production and activities are established are even more important in bringing in new practices and norms. It seems, however, that as inter-organisational interaction is based on two-way influences, learning and adaptation is needed from both sides, and also, that earlier behavioural patterns are persistent (Törnroos and Nieminen 1999; Karhunen, Kosonen and Leivonen 2003). So, interaction still in many ways reminds of East-West business traditions. This raises the issue of cultural

legacies: some parts of business negotiations and interaction of course will always reflect the specific features of Russian culture, rather than leftovers of the planned system.

With all different new actors, the key issue is how to spread change from individual actors and relationships into larger nets and networks (e.g. from profit-oriented to survival networks). Small nets easily become small communities, which are detached from the rest of the economy, but their activities, and norms should be spread nation-wide. Moreover, Russia is in many ways a large country, and therefore, for instance, the impact of foreign companies can only be marginal. Interplay of formal and informal rules is one factor enhancing spread of new norms. For instance, the fact that Russia is now included in the international investigations of corruption (ranked 86th among 113 countries in 2003, i.e. being highly corrupted according to the study by Transparency International) shows that there are general macro-level forces that help new norm formation in individual relations and nets as well.

CONCLUSIONS: INSTITUTIONS PLAY AN IMPORTANT ROLE IN NETWORKS

The empirical discussion has shown the inertia and stickiness that informal rules for behaviour have caused to the Russian transition, despite the fact that new formal rules have been established. While ties between enterprises in the planned economy consisted of one-way deliveries of goods, which were supported by informal interactions, economic relationships in the 1990s in Russia have been tightly linked to individuals. This 'over-socialised' situation has led not only to trust building and information provision, but has also enhanced illegal activities and corruption. The key challenge for Russia's future is the development of genuine, mutually satisfying exchange relationships between organisations which can provide a platform for co-operation without keeping out competitive forces. It is difficult to create (new) markets.

It is easy to understand these experiences and the slow development of transition if we consider the institutional model presented earlier. However, the model can be applied to other contexts as well. Another contemporary example of changing rules is adoption of *ethical codes* in business-to-business context. They have been adopted during the past few years, e.g. due to pressures from ILO (Conventions for Labor Rights) and UN (Universal Declaration of Human Rights), although their usage is various and not necessarily seen as appropriate at the relationship level where long-term

trust has been developed (Lindfelt, 2004). In general, companies seem to have been quick in adopting new ethical jargon and policies, but we do not yet know how these affect networks and relations. Interesting questions are such as, how is the influence of general new norms triggering into inter-firm relations?, or how and when does norm formation at the level of actors influence also activities and resources; e.g. production system? This is one example showing that institutional rule formation between actors may influence the development of a business network, and therefore it deserves more attention by analysts as well.

To summarise, this paper has argued that commonly acknowledged *institutional rules for behaviour evolve in business networks*. These are an inherent feature of the network and define the legitimate network structures and processes. To some extent these rules are formal and to some extent informal. The institutional rules affect the network theories of the actors and especially lead to more consistent dominant theories.

For an individual actor in the network, the generally accepted rules form constraints for behaviour as well as the framework for action. In principle, actors accept and follow these rules, but they may also on the basis of their strategic decisions, act against the rules or even try to change them. For the latter, usually mobilisation of other actors is needed as well, since it is difficult for any individual actor to change the commonly accepted rules.

The institutional approach has certain implications for *analysis of networks*. The network approach stresses subjective perceptions and individual contents of relations. Institutional analysis in turn would look for a mid-way between subjective and objective reality. It would look for typical behaviour, typical actors and activities (Berger & Luckmann 1967) and non-personal/objective aspects that are not tied to particular actors or situations (Zucker 1987, p.444). Institutions can in this sense be seen to form more 'objective' views about networks and the general features view on which are shared by several actors. Simultaneously, institutional analysis emphasises behaviour and roles in networks that are relatively stable over time.

Network analysis deals not only with the present but also with the past and the future: it recognises that network interpretations of the actor are influenced by both memories of the past and expectations for the future. Institutional approach is valuable for understanding network dynamics. Formal rules concern present and future actions, while informal rules are past-oriented. Institutional interdependencies in networks cause stability and resistance to change. This is because rules,

especially the informal ones, have their own history and may be difficult to change. Institutional approach thus explains stickiness and inertia in network behaviour, actors adopt new roles and new norms for behaviour only when their mental model change, that is, new formal and informal rules are accepted and adopted. Separation of institutions (rules) from organisations (players and actors) makes it possible to include agents of change and strategies in an institutional analysis. There is still room for interests and strategies, even if the commonly accepted rules are seen to constrain network behaviour. Finally the view adopted here allows for inclusion of individuals and their mental models in the analysis of macro-level networks. This makes learning and skills of entrepreneurs and their organisations key issue in understanding network dynamics.

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