

Work-in-progress

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**RESHAPING THE BUSINESS NETWORKS – A STUDY OF THE EFFECTS OF REGULATIONS ON THE CO-OPERATION**

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**ABSTRACT**

This paper purports to explore how changes in regulations affect the co-operation in business networks in practice. Regulations are often used by governmental authorities as a tool to steer the market. Governmental authorities tend to strive towards perfect markets and avoid market failures by trying to influence industries through rules and regulations. For this reason, some markets can be described as more protected than other markets, i.e. they are characterised by high degree of regulations and control from the authorities. When governmental authorities are not satisfied with how markets perform new regulations or changes in existing regulations can be introduced. When the regulations are changed in an industry so are the circumstances for business activities. The question is whether governmental authorities can steer actors in existing networks or not? Extending the question above this paper seeks to explore the influence of expected and introduced changes in regulations on relationship and network development in protected industries. The results show that the effects of changes in regulations vary and are difficult to predict. It is argued that this can be explained through the translation processes taking place in the networks.

**Key words:** protected markets, networks, change, regulation, deregulation

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## Introduction

“The market, as a governance form for economic activities, is regarded as a network of actors that are directly and/or indirectly connected to each other through exchange relationships and/or as competitors” (Cook and Emerson, 1978; Mattsson 1993; Anderson, Håkansson, and Johanson, 1994; Mattsson, 2004). Markets are within IMP approach not seen as consisting of independent firms, but are instead viewed as connected through enacted ties and relationships (Snehota, 1990; Håkansson and Snehota, 1995; McLoughlin and Horan, 2002). Firms are seen as heterogeneous and dependent on other actor’s resources for their own existence. As stated by Salmi (2000) environment and markets are not seen as generalized nor standardized but rather as defined by firms’ interactions with identified counterparts. The market in this aspect is neither a structure that is anonymous nor a network structure that can be imposed on other organisations by a dominant actor. Instead, the market is viewed as an organic network where the structure evolves through enactment between autonomous actors resulting in ties and relationships (Håkansson and Snehota, 1995; Snehota, 1990; McLoughlin and Horan, 2002).

Consequently, we argue that markets are shaped and created by actors and activities. Referring to Callon (1998) one could even say that markets are not given but constructed, which means that there is no ‘a market’, or neither ‘a perfect market’. (Callon 1998; Law, 2000) However, governmental authorities tend to strive towards perfect markets and avoid market failures by trying to influence industries through rules and regulations. For this reason, some markets can be described as more protected than others. Protected markets are characterised by high degree of regulations and control from the authorities. The protectionism thereby creates distinctive features for the market and sets the frames for the actors. When governmental authorities try to change the frames new regulations can be introduced. Given the view of markets as socially constructed and enacted, what will happen when industries face changes in regulations? The purpose of this paper is to understand how expected and introduced changes in regulations affect the business networks in practice.

## Reshaping the business networks

Exchanges of resources between actors lead to co-operative behaviours that are conducive to success in relationships between companies as well as between people and individuals (Morgan and Hunt, 1994). These exchanges successively build up the contact pattern and relations. “It is important to note that information and social exchange between parts can continue over long periods without there being any exchange of products or money. Thus, development of specifications and visits between the companies may occur before the first order is placed or between timely spread individual orders.” (Ford, 1997:10). During the exchanges one or both parties make some kind of adaptation of the elements to be exchanged, or during the exchange process per se. The adaptations can span over different areas in the firm and they can be changes in the service, information or even changes within the organizational structure. Social exchange episodes are critical in the building of long-term relationships. Social interactions between the firms are important in order to decrease the uncertainty within the exchange. This is even more important if the cultural- or geographical distances are high or if the level of experience is low. Firms can through interactions learn about each other and as a result mutual trust is incrementally developed. In the exchange processes the experience and the knowledge about the exchange partner increases. Hence, relationships are investments made by firms in order to gain economic benefits, decrease costs, reach higher revenues and/or increase the control over some other part of the environment. Expectations about the roles and responsibilities with the partner become clear and the exchanges may also become routines. Within certain relationships exchanges can even become institutionalized to such a degree that neither party questions them anymore. (Ford, 1997:10)

In business networks firms are involved in many relationships at the same time. Relationships are connected to each other forming a web of relationships called a business network. Thus, changes in one relationship have effect on other relationships (cf. Cook and Emerson, 1978). The business organization is therefore not only dependent on the actors which it directly interacts with, but also on relationships

connected to their relationships through third parties (Blankenburg and Johanson, 1992). As a consequence of conducting business, the network context of a firm is continuously emerging, evolving and dissolving over time and is, thus, both seen as a structure and a process (Anderson et al, 1998; Anderson et al, 1994; Snehota, 1990). As we aim to increase our understanding of the effects of regulations in protected markets we need to go further into the structure and processes taking place in the markets.

### ***Different market practices - a matter of translation***

One stream of research that is focusing on understanding the processes affecting markets is the market practice approach. Focusing on market practices is a relatively unexplored area as pointed out in the introduction (see e.g. Callon, 1998, Helgesson et.al., 2004). According to the market practice view, markets arise as a consequence of opportunities for exchange perceived by a set of actors - actors who expect to find opportunities to engage in exchange (Snehota, 1990). Economic exchange can be seen as the core of all market practices (see e.g. Forssell and Norén, 2004; Callon 1998). According to Kirzner (1973) a market is “made up of the activities of the market participants” (Kirzner 1973; Snehota, 1990) where market practice can be defined as all activities that contribute to shape markets. Helgesson et.al. (2004) present three conceptual sub-categories for analysing market practices. These are *exchange practices* (activities related to individual economic exchanges), *representational practices* (activities that contribute to depict markets and/or how they work) and *normative practices* (activities that contribute to establish guidelines for how a market works according to the actors). The various market practices are interlinked meaning that there is a clear interdependency and interaction between the practices. In order to understand how the market practices are interlinked and how something is transformed into something else, Helgesson et.al. (2004) use the concept of translation. (See also Callon, 1998) By translation they denote the basic social process through which something – an idea, a rule, a text, a product, a technology, a truth, etc. – spreads across time and space (Kjellberg and Helgesson, 2004; Latour, 1986). The essential in the translation process is that it requires actors to act. If there is no one to pick up a message or an idea, nothing happens, i.e. actors conduct and produce market practices and markets through translations. Therefore, it is critical to understand how the actors’ translations of regulations are constructed, which leads us to the discussion of the calculative agencies.

### ***Markets and calculative agencies***

Protected markets can in many cases be described as highly institutionalised. According to Callon (1998) institutionalize organizational settings have also created institutional guidelines that are stable and that legitimate for shared expectations between the actors. Simultaneously Callon (1998) refers to the term “calculative agencies” in his research. He discusses market co-ordination between actors / agents that is based on calculative behaviour, and inter alia, a possibility to choose between different alternatives as a buyer and seller in the market. Within protected markets, however, there seems to exist somewhat specific circumstances for exchange. As the markets are protected, the amount of actors is limited and actors are controlled by rules and regulations. In other words, there seems to be a consensus of shared norms and practices between the actors as the market is influenced by protectionism.

Actors’ behaviour can be explained as a result of agents’ social interaction and information exchange and thus, agents cannot remain strangers to each other. They cannot either become strangers again once they have become entangled (Callon, 1998). According to Callon (1998:7) the underlying reasoning for co-ordination between the agents is made on the assumption of a ‘primitive’ reality without which co-ordination would not be possible. An understanding of this ultimate basis is the purpose of the notion of a social network or, more broadly, the notion of embeddedness (Callon 1998:7): “If agents can calculate their decisions, irrespective of the degree of uncertainty concerning the future, it is because they are entangled in a web of relations and connections; they do not have to open up to the world because they contain the world. Agents are actor worlds.” (Ibid.) The coordinative behaviour can also be seen as a result of shared culture, rules, procedures, routines that all together guarantee the adjustments and predictability of behaviour (ibid.). Putting it in more concise Callon (1998) argues that existing calculative

agencies are embedded<sup>2</sup> in various institutional arrangements, which creates a heterogeneous assemblage.

Taking this into the network perspective, we argue that calculative agencies within a protected market, is an outcome of translation that occurs within the market. It explains the mechanism and activities for networks and actors within them. This means that actors in networks are part of various institutional arrangements where their actions are restricted by bounded rationality. This can be seen and analysed through market practices. Actors within the networks translate the rules and regulations and thus, change the market practices. The translation is a continuous process in the markets. Hence, calculative agency refers to markets as socially constructed and enacted. Referring to the market practice perspective, actors translate exchange practices, representational practices and normative practices within the protected market.

Governmental authorities aim to involve in markets through regulations as they try to steer the markets. For this purpose several regulation tools, e.g. licences can be identified. Licenses are a regulation tool that governmental authorities can utilize to steer firms and ascertain that firms will follow the rules and norms in the society. This implies that firms must justify their existence and prove that their activities will be in line with the regulations. Governmental authorities can thus to certain extents steer firms and influence the business networks through the licenses. (Persson and Steinby, forthcoming) However, there can also be other ways that governmental authorities try to influence the markets. When the existing laws and regulations are not enough to steer the market, the existing regulations can be changed or new regulations can be introduced. It is therefore interesting to study how the translation occurs when actors within protected markets face a change in the regulations.

### **Methodological concerns**

In the empirical part of the paper, changes in regulations on protected markets have been analysed by applying the case study approach. We have chosen to illustrate the studied phenomenon through two separate cases taken from the insurance industry and the pharmaceutical distribution. Analysing the effects of changing regulations, case study method is especially suitable as it enables the researcher to capture the complex and many-sided phenomena in its context. The chosen method is appropriate especially as we want to cover contextual, complex and multivariate conditions and not just isolated variables (Yin, 2003).

Two case studies, the insurance industry and the pharmaceutical industry, are presented when illustrating the effects of changes in regulations. The first case presents a situation where regulations have been changed and the second case a situation where there is a threat thereof. The period of analysis is from the beginning of the 1990's until 2004. Data has been collected in both cases through in-depth interviews with representatives within the industries, which has been complemented with secondary material (e.g. press releases, newspaper articles, journals).

### **Effects of a threatening deregulation of the market**

Life insurance companies are responsible for insuring a safe future for the individual in the case of a long life or to secure the family members left behind, and also to administrate large amounts of money. Due to this it is an industry, which is highly regulated and thus protected. A life insurance company has to apply for a license before it is allowed to start their insurance operations. Applying for a license requires that the insurance company can fulfill different requirements e.g. on reinsurance, which in many countries regulates how the insurance money are to be invested (Walcerz, 1997:28). These requirements also work as barriers to entry and have been found to have a negative effect on insurance trade (Zimmerman, 1997).

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<sup>2</sup> Embeddedness defined by Callon (1998) refers to Actor Network and is therefore different from Granovetter's (1985) definition.

Within the EU attempts have been made in order to decrease trade barriers towards insurance trade and to harmonize the laws and regulations of the European insurance industry on authorization of cross-border businesses, coordination of tax treatment of contributions and benefits on pensions and authorization of cross-border transfers of pension accumulations and rights (Giffin and Straube, 2000-2001). In January 1993 the single European market was introduced and six years later the Commission submitted a strategy for a full integration of a single financial services market, with the aim of reaching this goal by 2005 ([www.cea.assur.org](http://www.cea.assur.org)). One of the main goals with the harmonization process is to increase competition between the insurance companies and to improve the firms' possibilities to reach economies of scale and scope of operating the pension schemes for European workers.

EU has developed the harmonizing of rules in steps and use what is called directives, which are minimum regulations where the different member countries have to follow the directives but are allowed to have stricter legislation (Hörngren and Viotti, 1994:219). The first generation directive on life and non-life insurance was taken into force in 1979. The third generation life directive regulates the establishment of life insurance business within the EU. According to this directive it is the home market's authorities, which are responsible for the supervision. Thus, the principle is that there should only be one authorization, which is the home market's supervisory authorities and the license to operate as a life insurance company in the home market is also valid in all other EU countries on the condition that the local supervisory authorities in the foreign market has been notified. ([www.forsakringsforbundet.com](http://www.forsakringsforbundet.com); Howell, 1998:12) The changing EU regulations can be viewed as de-regulations of the insurance market.

De-regulations are often predicted to be followed by increased competition but the consequences may be the opposite. The new law that was to enable insurance companies to start operations in other EU countries without applying for a separate license in each country, was a step towards opening up the EU for the free movement of services and increase competition. In Sweden insurance companies started to take actions in order to secure their position within the insurance markets. One of these insurance companies was Trygg-Hansa, a medium-sized insurance company. In 1990 Trygg-Hansa made an agreement with another insurance company on coordinating insurance operations. Through the agreement Trygg-Hansa wanted to protect its market shares and be one of the four largest insurance companies in Sweden. Furthermore, Trygg-Hansa started to invest in the American insurance market by taking over the tenth largest American insurance company within the industry insurance. The take-over was motivated as a way to handle the competition and to overcome the effects of the expected deregulation of EU's insurance market. The expected deregulation of the European market was very important for Trygg-Hansa. In one way it would open up for expansion, however, at the same time the expansion was seen as a necessary strategy to handle the expected effects of the deregulation. (DN, 920103) Many small and medium-sized insurance companies took actions such as alliance formations and acquisitions in order to strengthen their position. Hence, the expected deregulation was to be introduced in order to open up for competition in the markets but the consequence of de-regulation was a consolidation of the market.

### **Effects of a threatening deregulation of the market**

The ethics and responsibility for good practice of medicine are strongly anchored to the distribution of pharmaceuticals. This has also reflected strongly in the development of the Finnish pharmacy retailing. It has many times been more important to have efficient distribution channel and to provide customers with correct medication than to improve the business. Pharmacies have gained a quite comfortable position even from the business point of view, because there has been almost no competition between the pharmacies. Pharmacies are privately owned entities except from two university owned pharmacies. Pharmacists have been able to practice their profession sheltered from the outside world within their protected business field.

Although the pharmacy business in Finland is protected, it does not imply that it could not be touched and changed. The discussion of pharmacies position and the structure of medical distribution has been going on since the end of 1980's when the debate about distribution structure in European countries was raised.

Governmental authorities in Finland have discussed the existing single distribution channel in several occasions and it has been compared to the multiple channel structure used in most of the European countries. The Finnish structure has been criticised by e.g. the European Union and the Finnish competition authority because it resembles a monopoly market with internal rules and regulations set by the actors themselves in the network. However, all European countries have created their own systems to cover the distribution sector and therefore it is difficult to create one distribution system that could be applied in all countries.

The situation in Finland is not as urgent from the governmental perspective as can be found in other European countries. The geographically closest example can be found in Sweden, where change towards open competition in the markets is forced to take place in the future, based on the decision by EU authorities in Spring 2005. There is no direct pressure to change the pharmacy system and legislation in Finland from the EU authorities, but the deregulation of pharmaceutical distribution system in other countries, e.g. Norway, has created certain uneasiness among pharmacists.

When there has been discussion of changing the pharmaceutical distribution, it has often been stated as the need for deregulate the business meaning that pharmacy privileges would be changed from personal license to corporate license. Examples of deregulation processes from other countries, e.g. Norway, have created certain uneasiness and pressure for changes in the distribution channel structure in Finland. In Norway this kind of change has resulted in that the wholesalers have bought private owned pharmacies and taken over the pharmacy retailing as well. Thus, fast moving consumers good companies and wholesalers would like take over the distribution of medicines also in Finland.

The pressure for restructuring the business from governmental authorities via deregulations has nevertheless already resulted in changes in the pharmacy retailing. The threat of deregulation can be seen in the pace that the pharmacy business is changing its nature. Hence, competition over customers is a relatively new phenomenon as well as the idea of building networks with competitors within the field. As a result of the threat of deregulation, the private owned pharmacies have now started cooperating with each other. New pharmacy chains have started to develop. Separate pharmacies are becoming more and more dependent on each other, which has not been the practice before. The development of pharmacy chains in Finland is still quite young and chain building is very much in progress. At the moment there can be identified in total four pharmacy chains that fulfil some criteria of strategic networks. Only two of the organisations have though a clear chain structure. The university owned pharmacy chain has gone furthest in chain development but it has not reached the same maturity as for example chain structures within the FMCG industry. The private owned pharmacies have started chain structuring first after 1996 when the first pharmacy chain constructed of private owned pharmacies was established. The benefit from a large scale in business has become a necessity for pharmacies to survive economically after the pressure in many different forms from governmental authorities has increased.

## **Discussion**

The question we have raised in the introduction is what the effect on networks will be when protected industries face changes in regulations. The purpose of this question has been to explore how regulations affect the business networks in practice.

In the empirical part of this paper we found that governmental authorities have attempted to change the markets by introducing or changing the market practice. However, the effects of these changes have not been predictable. One explanation for the unpredicted outcome is to be found in the concept of translation. Markets, as we define them, are constructed through market practices and translation. When authorities introduce new laws they tend to overlook the translation processes in their decisions. They see regulations as transactions that can be implemented directly within the market. They do not consider market practices and the effect of them in the implementation process. Market practices, defined by Helgesson et.al.(2004), are intertwined and cannot be separated. Market practices are results of long-term relationships and long traditions of exchange. Therefore, it is difficult to change markets through external regulations that are not endorsed by the business actors.

As we have been able to see, changes in regulations are a result of governmental authorities' desire to protect and regulate markets. Regulations can be changed either by introducing new regulations or in the opposite form of de-regulations. However, as illustrated in the empirical material, the market practices have an important role in the outcome of the changed regulations. It is observable in the cases as the actors have reacted to possible future changes in regulations. Thus, only a threat of deregulation has had an impact on the networks. The business actors adapt their activities to the changed regulations and thereby to the changed institutional arrangements. The regulations are translated by the actors and consequently, there is an adaptation of the translation into their activities. This all has an effect on market practices that are interlinked and influenced by different actions. The changes in market practices can be seen as a transformation of regulations as the translation is a continuous process.

When authorities change regulations, business actors start a translation process. In this process regulations are translated and transformed. However, actors can also interpret possible changes in the market. The outcome of the complex translation process can in some cases lead to a situation that is unwanted from the governmental authorities' perspective. The governmental authorities then find it necessary to once again intervene by changing the regulations. Through translations changes in regulations can even become re-regulations. We argue that the effect of the changes in regulations can be related to the reasons behind them. Sometimes business actors and governmental authorities can have a common view of that regulations need to be modernised. In these situations authorities change regulations with an agreement from the business actors' side. In these situations translations will not change the market practices as much as in the cases where governmental authorities aim to intervene in the market and force actors into new practices. Both presented cases provide examples of the latter scenario, although the changes in regulations in the cases are on very different levels. Consequently, we have been able to observe how the translation has had a great effect on the business networks. Studying the changing regulations within the insurance industry as well as the pharmaceutical industry we have found that the effects of the deregulations and the threat of deregulation have strengthened the relationships between the actors and created new forms of cooperation between the actors. Thus, the markets have become consolidated.

## Conclusions

As we have been able to learn, actors create and shape the markets. Changes in a regulation will be transformed by actors' translation processes. Even though business actors' aim at acting according to the rules and regulation, they will translate the regulations and their action will be a result of the translation process. Hence, a change in the regulation will have an impact on market practices but it needs to be translated and integrated by the actors. We thus argue that actors adapt to the changes but simultaneously they reshape them fitting to their activities. As a consequence of this also market practices change and so do the networks and relationships. Due to the translation processes taking place, the governmental authorities will find it difficult to steer the market. Changes in regulations have in this study led to increased co-operation and strengthened relationships.

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