

REAL MECHANISMS OF STRATEGIC ACTING

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ABSTRACT

This paper deals with real and contemporary ways of strategic acting in manufacturer-retailer networks. Key objective of the study is to explore and describe how organisations develop and implement strategies to achieve their objectives. Its empirical basis is defined by embedded case studies in the markets of fast moving consumer goods in Germany.

Following the epistemology of critical realism, the paper attempts to extend the perspective of the network approach by utilising the recent advances in the area of corporate finance. Based on what organisations in reality do, strategy is not seen as the ultimate concept of the company's positioning in the market but as an inventive stream of finding and doing what is possible for each organisation in its respective network. While organisations react to events as they unfold, strategic acting takes the form of creating and exercising a number of real options that best reflect the organisations' strengths and their capacities derived from network membership.

INTRODUCTION

This paper attempts to explore and describe real and contemporary ways of how organisations develop and implement strategic acting in manufacturer-retailer networks. We define strategic acting as an inventive stream of finding and doing what is possible for each organisation in its respective network. While organisations react to events as they unfold, strategic acting takes the form of creating and exercising a series of real options that best reflect the organisations' strengths and their capacities derived from network membership.

The traditional thinking and language of strategic acting is full of normative expressions borrowed from the military practice and game theory. Partly, its vocabulary sprang out of the development of microeconomics and managerial economics (Baumol, 1959) and the rise of business planning as a sensible concern for what will happen in the future. It was a strategic marketing thinking propounded by writers such as Howard, McCarthy, Levitt, Borden and Shapiro (see readings selected by Dolan, 1991) who were largely influenced by operations research, systemic or cybernetic approaches grown out of World War II logistic problems (Smith, 1966 ; Fortun & Schweber, 1993). Analytical methods such as the Boston Consulting Group's simple matrix developed in the 70s, the industry and competitive analysis in the 80s, the core competence and economic value added (EVA) in the 90s penetrated the process of making strategic decisions in large multinational companies. The end result of this managerial perspective of strategic acting was the perception of a dichotomy between the firm and its environment, and the concern with tactical aspects of competition in which the fittest firm would survive.

The finance theory of the last decades had a scant impact on corporate strategy, despite its great contribution to our understanding of how markets work and how resources are allocated and valued. Based on forecasts of key parameters like market growth, competitive dynamics, prices and costs, and drawing from five or ten years forecasts, organisations relentlessly used the tools of financial theory such as the method of discounted cash flow analysis (DCF) to calculate the net present value (NPV) of their strategies. Getting the cash flows forecasts right is extremely difficult; nevertheless, it is even trickier to decide for the right discount rate. According to the finance theory, the discount rate is the opportunity cost of capital or in other words the cost of not investing in another strategic initiative of similar systematic risk. Practically, the higher the risk of a strategic initiative, the higher its discount rate and the

lower the NPV. The implication of this financial view is that DCF often results in negative NPVs for many of the most exciting strategic opportunities.

Arguing that finance theory may have missed the boat, Myers (1999), emphasised the problem of link between today's investments and tomorrow's opportunities. He makes the cogent argument that if tomorrow's opportunities depend on today's decisions, then there is a time-series link between strategic decisions. This problem is not just another forecasting problem. The series of strategic decisions are options and conventional DCF does not value options properly. Conventional DCF approaches to the appraisal of strategic decisions, such as the standard NPV take into account the opportunity cost of capital and the projected future cash flows. Yet the theory ignores an important, though subtle, aspect of reality. Strategic acting can be implemented flexibly through deferral, abandonment, expansion or in a series of stages. Based on a longitudinal study in manufacturer-retailer networks in Germany, programmatic initiatives (Mouzas & Araujo 2000) are implemented through stages preserving the balance between change and stability. Organisations are flexible in implementing new strategic acting. They enter a stage of inertia in which they resist changes, then move on to a stage of trials in which they test new options in existing relationships, and then roll out their strategic initiatives by mobilising other organisations who diffuse the changes in their network. Traditional DCF approaches cannot adequately capture this kind of organisations' flexibility to adapt and revise strategic decisions in response to unexpected market developments and assume organisations' passive commitment to certain static operating strategy.

The reality of business is characterised by uncertainty and change. As organisations are continuously confronted with new information and uncertainty about market conditions and future cash flows is only gradually resolved, managers adapt or alter their initial strategy in order to capitalise on future opportunities or to mitigate existing losses. This strategic flexibility (Trigeorgis, 1999) is likened to financial options. While organisations create, build and maintain a portfolio of strategic options on the future (Williamson, 1999; Beinhocker, 1999), real options thinking provides an appropriate theoretical foundation for strategic acting and investment valuation (Luehmann, 1998). Real options had been routinely applied on trading floors long before they invaded the world of large organisations. Black and Scholes (1973) developed their option pricing model shortly after the first options exchange opened in Chicago. The so called Black-Scholes formula was further developed by Merton (Merton,

1973; Mason & Merton, 1985), who showed its broad applicability. Corporate strategists started to use their theories increasingly in the 90s to evaluate business decisions and contracts whose worth depends on the uncertain future value of an asset. In order to make intelligent strategic choices organisations consider the value of keeping their options open. In reality, organisations keep their options open to resolve a number of inherent contradictions. Elaborating on the theoretical foundation of heuristic approaches in strategy, Kogut and Kulatilaka (1999) addressed three such paradoxes.

- Organisations' strategic heuristics involve a combination of inward-looking and outward-looking analyses
- Organisations are inert and yet success depends on flexibility
- Organisations have the property of "uncertainty avoidance" and yet their growth depends upon exploration in high-risk environments

The perspective of the present study differs from the above presented views in two ways. Firstly, we are concerned with what triggers strategic acting in manufacturer-retailer relationships and how and why is this happening. Secondly, our major challenge is to gain new insights into manufacturer-retailer networks by using approaches that have been developed in the context of exchange relationships between organisations. Following the epistemology of critical realism, the paper attempts to extend the perspective of the network approach by utilising the recent advances in the area of corporate finance. The new perspective employed in this research challenges the traditional studies of strategy resulting in three significant repercussions. First the market is not seen as a faceless topology but as a network of other organisations. Thus, the new perspective transcends the abstract notions of market uncertainty employed by corporate strategy or corporate finance and attempts to identify the sources of environmental forces by investigating the pattern of relationships among organisations that constitute the environment. Secondly, networks of relationships constrain the strategic acting of organisations, and in turn are shaped by them. Third, not only history but also future matters because strategic acting is time-consuming, and at any period of time the old co-exists with the new, while the new gradually and flexibly succeeds the old to become itself old and replaceable.

METHODOLOGY

The objective of this paper is to explore and describe contemporary, real mechanisms of strategic acting, following a critical realist epistemology. Critical realism emphasises that reality is independent of the knower but is not given transparently to us – i.e. our knowledge of the world is fallible and theory laden (Sayer, 1992). Realists argue that "generality is

ascribed to the operation of causal tendencies or powers. The latter act in their normal way even when expected regularities do not occur" (Tsoukas 1989, p 551). Causal tendencies or powers differ from the deterministic or stochastic association of events. Rather, they are necessary mechanisms of acting in a set of circumstances. Here lies a crucially important characteristic of realist epistemology. Causal powers depend upon certain conditions in order to operate (Easton, 1995). This implies that the same causal mechanisms can produce quite different results and, alternatively, different causal mechanisms may produce the same results. In other words, events emerge from the interaction between causal mechanisms and necessary preconditions. In the absence of any one of the necessary preconditions or causal mechanisms, the particular event does not occur

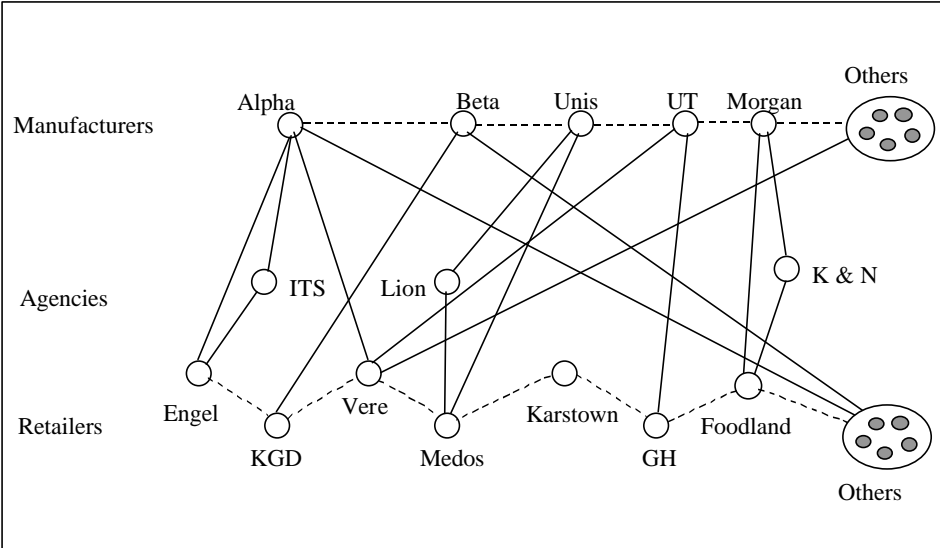
As the relationship between causal mechanisms and their outcomes is not fixed but contingent, realist epistemology would suggest the investigation of the "contextual conditioning of causal mechanisms which turns or fails to turn causal potential into a causal outcome" (Pawson and Tilley 1997, p 69). The use of Pawson and Tilley's (1997) realist formula that "Context + Mechanisms = Outcome" is based on the vision of a stratified reality. This calls the realists' attention to the understanding of human action in terms of its location within different layers of social processes. Strategic acting or programmes work by introducing new ideas or resources into a set of pre-existing processes. Causation is not understood externally by an hypothesis of cause and effect, but internally in the form of a release of underlying and often hidden causal powers. Therefore, we investigate how pre-existing causal mechanisms, which generate outcomes, are removed or countered through alternative real mechanisms introduced through human actions or programmes.

Our decision to follow a critical realist epistemology has determined to a large extent the methodological choice of multiple embedded case studies to collect, analyse and report the empirical evidence. The data collection is based on multiple sources and triangulation of data in order to maintain a chain of evidence and to develop converging lines of inquiry that increased the validity and reliability of the research constructs. Because of space constraints, in this paper we will only report a summary of the results of an embedded case study.

In this case we study a manufacturer-retailer network in the market of fast moving consumer goods -fmcgs- in Germany. This network is a web of exchange relationships. Although we are still dealing with interorganisational relationships, the fact that retailers are involved in selling

goods and services without further processing to the ultimate consumer, and the fact that manufacturer-retailer networks are embedded in pre-existing dynamics make the investigated network different compared to other interorganisational networks. Manufacturers' ability to supply retailers and retailers' ability to supply consumers does not rely entirely on their own internal assets. The relationship of manufacturers and retailers with third suppliers, agencies and banks can be seen as external resources that enable them to carry on their business. Manufacturers Alpha, Beta and Unis are multinational producers of a wide range of fmcgs and particularly strong in the area of cosmetics, laundry and cleaning products while manufacturers Morgan and UT are multinational tobacco companies. Retailers Engel, Medos, Vere and KGD are grocery retailers with a leading position in Europe. GH and Foodland are wholesalers of food products and particularly strong in the convenience channels e.g. petrol stations. These companies are direct rivals and compete for consumers and shelf space in retail outlets. Traditionally, they are highly aware of each others' moves and countermoves and their rivalry is mediated by their attempts to enrol other network actors as allies in the pursuit of their competitive strategies (see Araujo and Mouzas, 1998).

Figure 1



THE CONTEXT OF MANUFACTURER-RETAILER NETWORKS

The business network we studied is an integral part of German social, economic and cultural life. Population trends, income, legislation, technological changes and consumers' buying behaviour define the externalities that affect organisations' strategic acting. A number of developments at manufacturer-retailer network level are creating a new competitive framework in this network. Retailers and manufacturers are experiencing stagnation or decline of their sales turnover after several decades of continuous growth. Aggressive discount stores and hypermarkets are gaining market shares at the expense of smaller supermarkets. Mergers and acquisitions are consolidating the retail business while strong, global manufacturer and retailer brands are competing for shelf space.

The above trends should also not be seen in isolation. Socio-economic developments speed up or delimit network developments and vice versa. Consumers' increasing leisure time and spending combined with shorter household and time budgets at a macro, socio-economic level speed up the trend towards discount stores, hypermarkets and retailer brands at a network level. Consumers have to generate time and budget savings especially in the product categories of household, laundry and cleaning, and food and drinks to finance their travel and leisure spending. At the same time the same socio-economic phenomena speed up developments outside the manufacturer-retailer network that in turn affect our defined network. For example, increasing leisure spending and shorter time budgets set new demands for convenience products and services in convenience stores, home-services, petrol stations and other new channels that compete with the defined manufacturer-retailer networks.

As a result of these discontinuities in consumer demand, manufacturers and retailers have experienced a growth limitation that revealed intrinsic and chronic weaknesses. During the years of continuous volume growth, uncertainty behind strategic acting was not a major issue. It was the first signs of stagnation in consumer demand that set alarm bells ringing. The concentration in the retail trade and shelf space limitation in stores have increased competitive pressures, putting a premium on revenue and profitability of stores for every square meter of available floor space. The drive to manage business uncertainty, to foster innovation, and to derive new valuation systems that take into account economies of speed and strategic flexibility in resource allocation has proved irresistible.

A MODEL OF STRATEGIC ACTING IN MANUFACTURER-RETAILER NETWORKS

Having reviewed the theoretical foundation of this paper, we now propose a model of strategic acting in manufacturer-retailer networks. The proposed model is an interpretation of the reality studied; it results from the conceptual frameworks of critical realism, from real options and from the incorporation of the research results. The model (see Figure 2) consists of four generative phases of strategic acting. The final outcome of the model's four generative phases is articulated in network changes, and it affects the conditions of further changes in the future.

The first phase of the model derives from the Pawson and Tilley's proposition discussed in the methodology and refers to the context as a set of pre-existing dynamics. The context includes inherent developments a) at macro level -socio-economic externalities-, b) at network level -manufacturer-retailer network- and c) at key account level -dyadic relationships-. It defines a set of contingencies that provides impetus and resistance to manufacturers' and retailers' strategic acting.

However, manufacturers' and retailers' strategic choices are not made simply because their managers receive and interpret contextual information. Managerial perceptions are constructed through the use of technologies of representation that reduce contextual information to maps, statistics, plans and control parameters (Cooper, 1992). Therefore, the second phase of the model allows actors to develop options, calculations and rhetoric that render a field of activity knowable and administrable. The mediation of technologies of representation in the way actors perceive and interpret network dynamics has three implications. First, the same contextual event will have a differential effect upon each actor. Second, the translation of contextual events into relevant real options for each actor is not instantaneous. A significant time lag often accompanies the interpretation of these events and the formulation of adequate strategic responses. Third, there are different strategic initiatives by the actors.

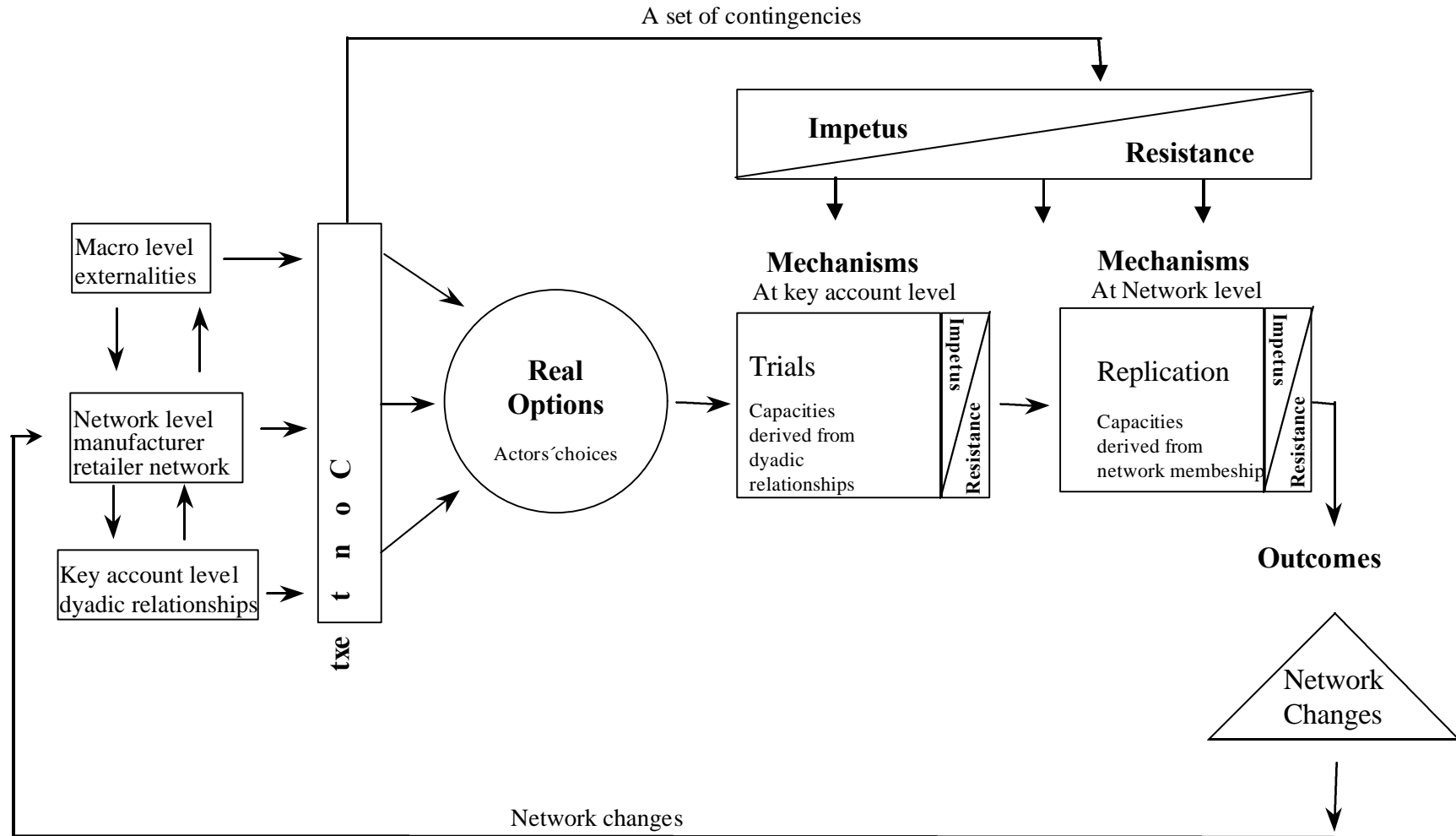
The model's third phase refers to trials in form of exercising of options through co-operation in dyadic key account relationships. Strategic initiatives emerge as co-operative pilot projects implemented in dyadic key account relationships. These pilot projects reflect the embeddedness of the strategic acting within a wider range of pre-existing relationships, and

demonstrate the emergence of new opportunities and chances. The actors test the feasibility of new ideas in vertical dyadic relationships, gain experience and compete horizontally with their rivals. If the experience is positive, then the actors capitalise on their knowledge and extend their strategic initiatives to other actors.

Thus, the fourth phase in this model refers to the replication of strategic acting. The achievement of a competitive advantage over other firms and a return on investment of the strategic initiatives in dyadic key account relationships depend crucially on the ability of manufacturers and retailers to get other actors to co-operate with their plans. This fourth phase is inextricably linked with a fascinating implication. The enrolment and mobilisation of other actors induce a diffusion of changes in the manufacturer-retailer network. However, the emergence and diffusion of changes is not an epidemic phenomenon that simply infects the manufacturer-retailer network for a period of time. Instead, changes are the outcome of an interaction process between manufacturers and retailers and interaction patterns generate both impetus and resistance processes to these changes.

Figure 2 A Model of Strategic Acting

(Organisations' inventive stream of finding and doing what is possible for them)



By context we do not simply refer to the spatial, geographic or socio-economic embeddedness of the actors but also the pre-existing set of rules, norms, processes, interrelationships and structures which define a set of contingencies that facilitate or impair the efficacy of strategic acting. Thus, the relationship between mechanisms of strategic acting and their outcomes is not fixed but contingent. This implies that the same strategic acting can produce quite different results within a different contextual conditioning. Building on the notion that mechanisms of strategic acting are about actors' choices and their capacities derived from network membership, we regard strategic initiatives as the inventive introduction of new options or resources into existing interorganisational relationships. The critical point here is that the relationship between context and actors' strategic choices is also not fixed because actors create real options by constructing the forms in which this context appears.

APPLICABILITY OF THE MODEL

Examining the applicability of the proposed model, we have asked two main questions. First, how does the model apply the empirical data of present research ? Second, how much light does the model shed on the inherent mechanisms of strategic acting ?

The present study has dealt with manufacturer-retailer networks in Germany. The term manufacturer-retailer network has been used as a metaphor to describe the inherent interdependencies between organisations selling and organisations buying in the markets of fast-moving consumer goods. The model has applied the above described context on three interrelated levels. The developments at macro level, at network level and at key account level constitute a set of contingencies that affects manufacturers and retailers. However, the affairs at macro, network and key account level are made pliable, wieldable and therefore amenable to managerial use within organisations through technologies of representation. When we talk about the effect of contextual changes, in reality we are talking about the changes in the representational construct of this context with a time lag.

The application of technologies of representation is evidenced by the shift in the approaches of strategy development and investment valuation. The great advances in information technology and the common practice of option pricing in stocks and commodity trade over the last years led to a gradual introduction of real options as investment valuation tool. This tool is now increasingly applied especially in strategic projects of high uncertainty such as R&D or new product development. Moreover, the application of real options as investment

valuation tool affected a new way of strategic thinking. The organisations' strategy is not represented as a series of static, future cash flows but as a series of available options on the future. Through the mediation of real options as technology of representation the same contextual change has a differential effect and there is a chain of translations that dictates how a particular contextual change impacts upon an actor.

Strategic acting starts with small-scale co-operative pilot projects in dyadic key account relationships. These rather cautious and reasonable attempts can be explained by the motivation of manufacturers and retailers to maintain existing relationships and exploit new strategic opportunities. This is, in fact, a subtle mixture of change and stability and underlines the embeddedness of actions within a stratified reality. In our case, manufacturer UK initiated co-operative pilot projects in its dyadic key account relationships with retailers GH and Vere. The co-operation included bold price initiatives and retailer brands. Both initiatives represented real options for a strategy that did not bring the expected results. The pilot projects were implemented only at key account level and were abandoned 18 months later. Retailers Engel and Vere co-operated with manufacturer Alpha in the areas of joint new product development, account specific distribution for relaunched products, pilot projects in electronic data interchange and continuous replenishment programmes to test new strategic options. None of these strategic initiatives remained unmodified. A number of new products were abandoned, relaunches were deferred and the projects in electronic data interchange and continuous replenishment programmes have been expanded with significant modifications. The use of existing dyadic key account relationships confirms that history matters and that continuity and stability are equally important as are changes and renewal. Manufacturers' and retailers' strategic acting inevitably carries a "history" and assumes a "future".

After the phase of trials, the phase of replication is characterised by the endeavours of manufacturers and retailers to roll out the strategic acting in their respective networks. After their first experience, the actors attempt to capitalise on existing know-how and extend the strategic initiatives to other customers and suppliers. In our case manufacturers Morgan and UK built on their strategic alliances in the area of sales and logistics by introducing general agreements and a code of conduct. Manufacturer Alpha used the trade allowances system as a lever to extend product launches and relaunches to other retailers, and retailer Vere integrated its expansion plan into other markets in the annual negotiations with manufacturers to mobilise support.

Real Mechanisms of Strategic Acting

Empirical Data

Areas of strategic acting	Key account level	Network level
Research & Development	Joint new product Development	Not applicable
Procurement/ Manufacturing	Pilot Sourcing	Mass Customisation
Launches & Relaunches	Test products/ Prototypes New / niche products	Test market Channel introduction
Distribution	Account spec. distribution Selective listing	Distribution roll-out
Price	Account specific products Retailer brands	Common price list
Marketing support	Tailor made advertising/ Key account promotion	Mass advertising Sales/ promotion drives
Service / Administration	Electronic data interchange Continuous stock replenishment	Electronic data interchange
Strategic alliances	Co-operation in logistics/ sales force	General agreement / Code of conduct

CONCLUSIONS & IMPLICATIONS

The present study on real mechanisms of strategic acting rejects a deterministic or stochastic association of observed phenomena. The identified sequence of "phases" in the proposed model of strategic acting does not imply that there is no backtracking and that all investigated outcomes go through all of the phases. It does also not imply that replication is not already a network change. The different phases –context, options, trials and replication- were introduced to employ a generative conception of causality. When we investigate the strategic acting generatively, we do not come up with a successionist view or associations of one strategic initiative with the other, but we investigate the "make up" or the how and why the association itself comes about.

The generative perspective employed builds on the "realistic evaluation" approach developed by Pawson and Tilley (1997) and adds to the models of change that already exist. For example, the model of network evolution (Håkansson, 1992) described systematic network developments as the result of a) the way actors combine and recombine activities and resources and b) the way the actors try to control the activities and resources. However, the model of network evolution raises questions in three critical areas. First, how are actors' change initiatives related to overall contextual developments ? Second, what is the actors' actual behaviour in relation to the identified evolution processes ? Third, what are the ways in which change is spread through the networks? The added value of our proposed model of strategic acting resides in its providing new insights on these critical issues.

Most models of change acknowledge the role of managerial perceptions and cognition as a mediating construct between contextual developments and their interpretation within the firm (Weick, 1995; Johanson and Mattsson, 1992). The subtle point in our model of strategic acting is that these managerial perceptions are not simply idiosyncratic or even socially constructed in the sense of being shared through dialogue and socialisation patterns. They are also constructed through technologies of representation that reduce these contextual developments to administrable entities and render the field of activities knowable. The actors do not simply recombine or control activities and resources, and the resulted changes are not diffused automatically because one activity is part of several activity cycles. Instead, actors create and exercise options in dyadic key account relationships to test the attractiveness and feasibility of new propositions and attempt to mobilise other actors in their strategic acting, thus diffusing the changes in the network.

The present research contributes to the body of knowledge in five areas. First, the conceptualisation of strategic acting as the organisations' inventive stream of finding and doing what is possible for them in their respective network has been proven a valid and fruitful way of gaining qualitative insights into the reality of manufacturer-retailer networks. The framework presented provides a good platform to capture changes in manufacturer-retailer networks and rests on solid ontological and epistemological foundations.

Second, the notion that environmental information, such as socio-economic, network or key account developments, is not translated directly by organisations into strategic initiatives but is processed through technologies of representation, has been confirmed empirically. This

makes the logic of representation more fundamental to the study of strategic acting than the traditional more limited logic of management information systems widely used in the theory of management. The recognition that representation comes first shifts the attention of theory from the environmental/internal analysis (Aaker, 1992) towards the construction of forms in which information is synthesised. Real options is not just another investment valuation tool. It provides a powerful technology of representation that reshapes conventional ways of strategic thinking.

Third, the centrality of organisations' practice has been developed conceptually and confirmed empirically. Behind the organisations' practice lie their capacity to generate new options and establish exchange processes. It is often the case that managers or researchers fail to take seriously the practice of exchange and like to think about strategy as the ultimate or superior concept of the company's positioning in the market. However, manufacturer-retailer networks reveal that strategies are not ingenious programmes that work and produce results. Strategic acting starts as an introduction of new options or resources into existing interorganisational relationships. The success of strategic acting depends on its execution and it is triggered only in conducive circumstances. This means that organisations' acting takes the form of providing the rationales and resources to other organisations to act. It is an indirect mechanism that brings us to the essence of strategy which is to find unique or better ways to deliver and capture value in exchange relationships. Notwithstanding the centrality of practice, we should clearly distinguish between the organisations' strategic acting and the context as a set of pre-existing dynamics that provides impetus and resistance to organisations' acting. Organisations do not create their context, but through their acting they impact on it, reproduce it and transform it.

Forth, strategic acting is inextricably linked with innovation. Innovation does not refer only to new innovative products and services. Innovation includes the development of business processes, organisational structures and interorganisational relationships. Organisations' creative, original, unique and often asymmetric strategic actions are among the most difficult to imitate. For this reason strategy researchers should not only look at regularities of recurrent practices but also at the generality ascribed to the operation of mechanisms of strategic acting.

Fifth, the ontological foundation of strategic acting rests on wholeness, coherence and virtue. The implication of this ontology is that organisations' strategic acting requires the integration

of contextual potentials and internal capabilities, the synchronisation of short-term and long-term acting, the co-existence of co-operation and competition, the harmonisation of the general and the specific, and the symbiosis of history and future.

Having described the conclusions and implications, we would like provide directions for further research. Learning from the perspective of the present study, researchers can free themselves from static thinking in terms of dependent-independent variables, (i.e. free themselves from thinking that certain mechanisms cause certain outcomes) and can establish interorganisational exchange relationships at the heart of their considerations. Thus, researchers would not investigate strategies that produce outcomes, but would study organisations' options, choices and their capacities derived from membership in networks of exchange relationships. Researchers can look at this mechanism of acting and investigate how organisations manage to balance the exploitation of new opportunities with the maintenance of existing exchange relationships. Further research in the area of strategy development and execution could create a new framework that provides a better explanation of how real mechanisms of strategic acting interact with contexts to achieve the rich range of organisations' objectives.

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