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On the relationship between economic rent and profit

Hallberg, Niklas Lars

2009

Link to publication

Citation for published version (APA):
Hallberg, N. L. (2009). *On the relationship between economic rent and profit*. (Working paper series; Vol. 2009, No. 2). Lund Institute of Economic Research.

Total number of authors:
1

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PO Box 117
221 00 Lund
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Lund Institute of Economic Research

Working Paper Series

On the relationship between economic rent and profit

2009/2

Niklas L. Hallberg

Abstract

The question of who appropriates the economic rents created by resources and capabilities has remained largely unresolved in strategic management. The aim of this paper is to highlight the problem established strategic management theory faces in explaining value appropriation, and to propose a framework that addresses how R&C affect bargaining power and value appropriation. While resource-based theory focuses on the generation and sustainability of economic rents, the appropriation factor framework presented in this paper shows that particular resources and capabilities, termed appropriation factors, affect bargaining power, and thus the possibility for economic agents of appropriating a larger share of rents. Based on this framework, it is argued that investments in heterogeneous and immobile appropriation factors that facilitate value appropriation through elevated bargaining power can constitute an alternative avenue to sustained competitive advantage.

Keywords: Appropriation factors, resource-based theory, value appropriation

Jel-code: M 10

ISSN 1103-3010

ISRN LUSADG/IFEF/WPS-009/2-SE

Economic rent and profit

Niklas L. Hallberg, Lund University, School of Economics and Management
Institute of Economic Research
PO Box 7080, SE-220 07 Lund, Sweden
Tel: +46 46 222 30 07, Fax: +46 46 222 44 37
e-mail: niklas.hallberg@fek.lu.se

Introduction

Resource-based theory (Caves, 1980; Lippman & Rumelt, 1982; Wernerfelt, 1984; Barney, 1986: Dierickx & Cool, 1989; Barney, 1991; Peteraf, 1993; Peteraf & Barney, 2003) does not acknowledge the full strategic relevance of resources and capabilities (Foss & Foss, 2004). This limits our understanding of the effect of resources and capabilities (R&C) on bargaining power and value appropriation. Resource-based theory (RBT) is an efficiency-oriented explanation of performance in that it explains the generation and sustainability of economic rents created by valuable and scarce R&C, but not how these economic rents are appropriated by different economic agents (Peteraf & Barney, 2003). R&C are conceived of as valuable to the extent that they increase perceived benefits of products sold or lower economic cost of production (Peteraf & Barney, 2003). Hence, performance differentials are attributed to R&C that have intrinsically different levels of efficiency. In equilibrium, firms with marginal R&C are assumed to perform at break-even while firms with superior R&C can earn economic rents (Peteraf, 1993).

R&C have traditionally been defined analogous to productive factors in neoclassical economic theory (see Caves, 1980). However, contrary to neoclassical economic theory, RBT states that R&C are heterogeneous and immobile (Barney, 1991), and that competition based on R&C can be subject to uncertainty (Lippman & Rumelt, 1982), for example in the form of *ex ante* and *ex post* limits to competition (Peteraf, 1993). The primary consequence of this characterization of R&C and competition is that sustainable value differentials may arise in both factor and product markets (i.e. economic rents). A second consequence, which constitutes the basis for the argument pursued in this paper, is that it will be inherently difficult to identify the nature and size of these value differentials. In other words, economic agents have to make imperfect estimations of the economic benefits and costs associated with particular R&C, and identify the most effective means, or organization, for appropriating the value differentials once they have been identified. It is therefore reasonable to assume that the exact sizes of appropriable value differentials are in most transactions indeterminate to the transacting parties. Separating appropriation attempts from non-appropriation attempts therefore becomes inherently difficult and dependent on the accuracy of the estimations being made. This allows agents to engage in appropriation attempts, which do not necessarily put the transaction and its associated value at risk. Thus, it is possible to think of competition as an process aimed at the appropriation of unprotected or hard to detect value differentials. It is argued that success in this process is dependent on the ability to estimate the size of the focal value differential and implement effective means of appropriating it. Together with the structural conditions of the bargaining situation, commonly described in terms of differentiation or switching costs, this ability is equivalent to bargaining power, which in turn determines the proportion of a given surplus that is appropriated.

While traditional productive R&C determines value creation, the R&C that enable strategically relevant *information* or greater *organizational control* are termed *appropriation factors*. Like traditional R&C, appropriation factors can, under the assumptions of heterogeneity, immobility and uncertainty, be viewed as subject to the same type of market failure or mobility barriers that allow traditional R&C within RBT to sustain their positive performance effects over time. It is argued that while the effect of differential switching costs on performance has been extensively investigated, the strategic implications of differential levels of information and organizational control are not properly accounted for. Thus, contemporary theory lacks explanatory power on two levels; (1) the effect of appropriation factors on bargaining power, and (2) the effect of bargaining power on appropriated value.

With the exception of studies investigating the impact of industry structure (Porter, 1980), intra-firm stakeholders' bargaining power (Coff, 1999; Blyler & Coff, 2003), and game-theoretic approaches (e.g. Lippman & Rumelt, 2003), little is known about the mechanisms underlying the bargaining process over economic rents and how these mechanisms relate to the main body of research in RBT. This paper highlights information and organizational control as fundamental and primary strategic dimensions, thus seeking to extend the mainstream notion of R&C beyond efficiency enhancing factors. This is not an entirely novel notion, but to the extent that these issues have been addressed within RBT, it has been from the perspective of posing supplementary conditions for the realization of other types of efficiency-related strategic advantages. For example, information has been highlighted as an important factor for identifying strategic resources (Barney, 1986; Makadok & Barney, 2001), and a well functioning organization has been suggested as a condition for valuable, rare, inimitable and non-substitutable resources to lead to sustained competitive advantage (Barney, 1994). The prime function of the R&C addressed in this paper is not to create economic value in the sense that they affect the level of perceived benefit or economic cost of output. However, they can still have an immense effect on performance, and generate a state similar to sustained competitive advantage, if they are positively related to value appropriation, and fulfill the criteria of heterogeneity, imperfect mobility, ex ante limits to competition, and ex post limits to competition (see Peteraf, 1993).

The aim of this paper is to highlight the problem established strategic management theory faces in explaining value appropriation, and to propose a framework that addresses how certain R&C, or appropriation factors, affect bargaining power and value appropriation. Based on this framework, it is argued that investments in heterogeneous and immobile appropriation factors that facilitate value appropriation through elevated bargaining power can constitute an alternative avenue to sustained competitive advantage. The paper is structured in eight parts. The next section, or section two, reviews contemporary explanations of firm performance based on their unit of analysis (independent variable) and predicted type of performance effect (dependent variable) in order to position the contribution of the appropriation factor framework relative prior research. Section three addresses the nature and limitations of economic agency, and its consequences in terms of uncertainty. A more nuanced understanding of economic agency allows for a better understanding of the bargaining process and the role played by R&C in this process. Section four develops a bargaining perspective on value appropriation based the notion of uncertainty and a review of factors highlighted in the bargaining literature. This allows for the development of an appropriation factor framework in section five, which brings together RBT's emphasis on R&C as drivers of competitive heterogeneity, economic structure in terms of switching costs, and the challenges faced under uncertainty in terms of information and organizational control. The propositions stated in the appropriation factor framework are then further elaborated on and exemplified in section six by the application of the framework to a set of bargaining situations. The paper closes with a discussion of related research, implications, further research (section seven), and a summary of the main conclusions (section eight).

Explanations of firm performance in strategic management

The field of strategic management can broadly be sorted under two general headings: strategizing and economizing (Williamson, 1991). The first appeals to power, bargaining and the ability of economic actors to appropriate economic value; the second is principally concerned with efficiency and the creation of superior economic value.

As emphasized above, RBT is an efficiency-oriented explanation of performance in that it explains the creation of economic value, but not how this value is appropriated by different economic agents (Peteraf & Barney, 2003). This stands in sharp contrast to other theoretical perspectives, such as the competitive forces framework (Porter, 1980) and game-theoretic approaches (see Shapiro, 1989). The competitive forces framework portrays firm performance as an issue of value appropriation, which is an effect of the bargaining power of different economic actors (Porter, 1991). That is, the dependent variable (profit) is primarily determined by how the firm is affected by structural industry factors external to the firm, such as internal rivalry, buyer and supplier bargaining power, substitutes and threat of entry (Porter, 1980). Thus, RBT and the competitive forces approach address value creation and value appropriation, respectively. The predominance of these two research paradigms in strategic management has linked value creation to the notion of R&C, while value appropriation has been associated with structural industry factors. Hence, explanations of firm performance cluster around the two specific research positions outlined above, which presents a theoretical gap in mainstream strategic management research. The argument is illustrated in Figure 1.

	Industry	R&C
Value creation	A. Community driven value creation	B. Resource-based theory
Value appropriation	C. Competitive forces framework	**D. Appropriation factor framework**

Figure 1 Modes of explaining firm performance.

Figure 1 displays the two main dimensions on which contemporary modes of explanation are contrasted. The horizontal axis refers to the main unit of analysis and the type of independent variable investigated. The vertical axis refers to the predicted type of performance effect and the type of dependent variable investigated. According to the two dimensions outlined above, four different positions emerge (A-D). Position A includes industry-level and efficiency-based explanations of firm performance.[1] Position B includes firm-level and efficiency-based explanations of firm performance, such as RBT. Position C includes industry-level and bargaining-based explanations of firm performance, such as the competitive forces framework. Finally, position D includes firm-

[1] Position A refers to explanations of firm performance placing the locus of value creation outside the firm. This position is not the prime focus of this paper. Examples of explanations that could fit this position are *network externalities* (Katz & Shapiro, 1985), *co-creation of value* (Thomke & von Hippel, 2002), and *community driven value creation* (Chesbrough & Appleyard, 2007).

level and bargaining-based explanations of firm performance, such as the appropriation factor framework outlined in this paper.

Due to the firm-level/value creation vs. industry-level/value appropriation dichotomy, established explanations of firm performance fail to cover important areas represented by position D. This presents a theoretical gap in strategic management research that leaves established explanations of firm performance unable to deal with important phenomena placed within the boundaries of this position. The theoretical gap outlined above raises the question of how value appropriation relates to R&C. Drawing on the suggestion of Dutta et al (2003) that firms should not only concern themselves with the type of value creating R&C normally investigated in RBT, but also consider factors affecting value appropriation, this paper addresses the question of how R&C influence bargaining power and value appropriation.

Agency, uncertainty, and value appropriation

The level of rationality that can be assumed in economic behavior has been prominently addressed by Simon (1945), Penrose (1959), and Cyert & March (1963). The notion of economic behavior emerging from these accounts is that agents behave purposively to the extent that they are guided by selected goals, and rational in so far as selected alternatives or means are conducive to these goals (Simon, 1945). Rationality is not conceived of as objective or perfect, but limited by the diversity of objectives (Cyert & March, 1963), resource endowments (Penrose, 1959), habit (Simon, 1945), and standard operating procedures/routines (Cyert & March, 1963; Nelson & Winter, 1982). Economic activity is thus governed by what Penrose (1959) terms the subjective productive opportunity, which is a matter of the agent's perception of economic opportunities rather than the objective facts of the situation, and is a result of the services rendered by the endowment of R&C (in terms of knowledge, assets or routines).

The notion of economic agency outlined above presents different challenges compared to the relatively static and transparent imperfect equilibrium setting which has been widely used as the starting point for theorizing in strategic management (Mathews, 2006). Particularly, the coupling of bounded rationality and the presence of economic change produces a state of uncertainty that is central to the understanding of competition, profits, and phenomenon such as value appropriation (Knight, 1921).

It is argued that assumptions that have been partly inherited from neoclassical economic theory regarding the nature of agency and the absence of economic change have caused mainstream strategic management theory, for example in the form of RBT and the competitive forces framework, to downplay the effects of uncertainty on the competitive process. While perhaps some business phenomena can be successfully studied without consideration of the full effect of uncertainty, other phenomena are poorly or not at all captured by these explanations. Hence, without a clear and explicit concept of uncertainty, which gives rise to information and control related problems; issues related to allocation or bargaining are easily seen as unproblematic in the sense that they are viewed as predetermined by the economic structure of the situation.[2]

[2] This seems to be a result of a failure to acknowledge the localness of knowledge on different levels in the economic system. This paper captures the relevance of local knowledge on two levels; within markets (information) and within organizations/firms (organizational control). Besides Knight's (1921) seminal treatment of this issue, see Hayek (1945) for a more general discussion.

The previous section (see Figure 1) showed that contemporary explanations of firm performance fail to address the effect of R&C on value appropriation, and that this presents a theoretical gap. By (re)introducing the concept of uncertainty it is possible to account for the origin of this gap. The theoretical gap highlighted by position D in Figure 1 can be directly attributed to an inconsistent notion of agency, and thus also an inconsistent use of the concept of uncertainty. Simply put, explanations of firm performance, such as RBT, do on the one hand assume uncertainty when explaining competitive heterogeneity and its preservation over time, but on the other hand do not fully consider the consequences of uncertainty when addressing bargaining power and value appropriation.[3]

Appropriating economic value - A bargaining perspective

Adopting a view of the firm as a "legal shell" (Lippman & Rumelt, 2003), or nexus of contracts (Jensen & Meckling, 1976), with property rights to resources, economic value can be seen as generated by R&C and appropriated by stakeholders based on established property rights and bargaining (Coff, 1999). Bargaining can then be described as taking place in a two-stage game. In the first stage, economic value is distributed between firms, i.e. stakeholders acting as a coalition in bargaining with outside economic actors (inter-firm bargaining). In the second stage, internal stakeholders bargain over value captured by the focal coalition (intra-firm bargaining). Applications of the bargaining perspective on RBT have primarily addressed the second stage of intra-firm bargaining between internal stakeholders (see Coff, 1999; Blyler & Coff, 2003). The primary focus of this presentation is on the first stage of the bargaining process (inter-firm bargaining). Hence, in the first stage of this two-stage game, the agent of value appropriation is assumed to be a firm, or an organization, defined as a contractually formed coalition of individuals.

The amount of economic value appropriated by a firm in a given transaction is a result of the firm's bargaining power (Porter, 1980). The literature distinguishes three factors that determine bargaining power.

(1) *Switching costs* refers to the economic cost of exiting a transaction. Switching costs have been described in terms of structural industry factors (Porter, 1980), relationship specific (social-) ties (Michael, 2000; Blyler & Coff, 2003), and replacement costs (Coff, 1999). The switching cost is fundamental to the bargaining situation in that it reflects an alternative's differentiation in terms of economic value. Hence, switching costs define the range of potential bargaining outcomes that are acceptable to the bargaining parties (assuming a transparent bargaining situation). In this sense, switching costs constitutes a direct reflection of the level of economic value that a party brings to the transaction.

(2) *Information* refers to the focal firm's access to key information (Coff, 1999; Michael, 2000; Blyler & Coff, 2003; Dutta et al, 2003). By releasing a specific type or amount of information, it is possible to control the choice of others towards desired outcomes (Coff, 1999). Further, strategic information might allow firms to pursue transac-

[3] Knight's (1921) original treatment of the hazards of uncertainty outlines a number of methods based on which firms can deal with uncertainty. These methods highlight the economic significance of specialized social structures, technologies, and people capable of making correct estimates, as a solution to the demand and supply related uncertainties facing firms.

tions/resources with economic rents attached to them (e.g. Barney, 1986; Makadok & Barney, 2001), or systematically approach other firms with less bargaining power (Porter, 1980; Michael, 2000).

(3) *Organizational control* refers to unity of action (Coff, 1999) and the extent to which competing interests and goal conflict within a focal coalition are balanced or resolved (Dutta et al, 2003), thus inducing proper action and coordination among coalition members. Generally, the concept of organizational control has been used as a way of describing the mechanisms by which an organization and its members are managed towards the organization's objectives (Ouchi, 1979; 1980).

An important contribution to the understanding of bargaining based on resource attributes has been made by Lippman & Rumelt (2003). Using the formalism of cooperative game theory, Lippman & Rumelt (2003) model value appropriation based on the relative values created by different use combinations of resources. In line with the position taken in this paper, they arrive at the conclusion that the strategy problem is one of *discovering* or *estimating* the value of these resource combinations. Although directing attention to informational and administrative problems inherent in bargaining and value appropriation, Lippman & Rumelt's (2003) formal analysis of different bargaining situations centers on the relative switching costs (in terms of differentiation or heterogeneity) of the involved actors as the single determinant of the division of surplus. Thus, Lippman & Rumelt (2003) do not, in addition to switching costs, acknowledge differential levels of information and organizational control as two prime determinants of the distribution of value among the bargaining parties. Their analysis refines neoclassical treatment of the division of surplus, but the game theoretic models used to this purpose do not question orthodox assumptions of rational and perfectly informed agents. Because the actual heterogeneity of the involved resources is downplayed by these assumptions (they only differ in inherent efficiency and complementary value) so is the uncertainty of the bargaining situation and the range of potential outcomes. Hence, while Lippman & Rumelt (2003) advance resource-based understanding of bargaining and value appropriation beyond the notion of neoclassical price competition (see Peteraf & Barney, 2003), they do not fully address the informational and organizational problems that together with issues of complementarities and switching costs enable a more complete understanding of resource heterogeneity and its impact on bargaining and value appropriation.

An appropriation factor framework

This paper highlights information and organizational control as fundamental and primary strategic dimensions, thus seeking to extend the mainstream notion of R&C beyond efficiency enhancing factors. The appropriation factors addressed in this paper are different from traditional R&C in that their primary function is not to create economic value by raising the level of perceived benefit of products sold, or by lowering the economic cost of production. However, they can still have an immense effect on firm performance, and potentially generate sustained competitive advantage, if they consistently affect value appropriation. The argument is illustrated in Figure 2.

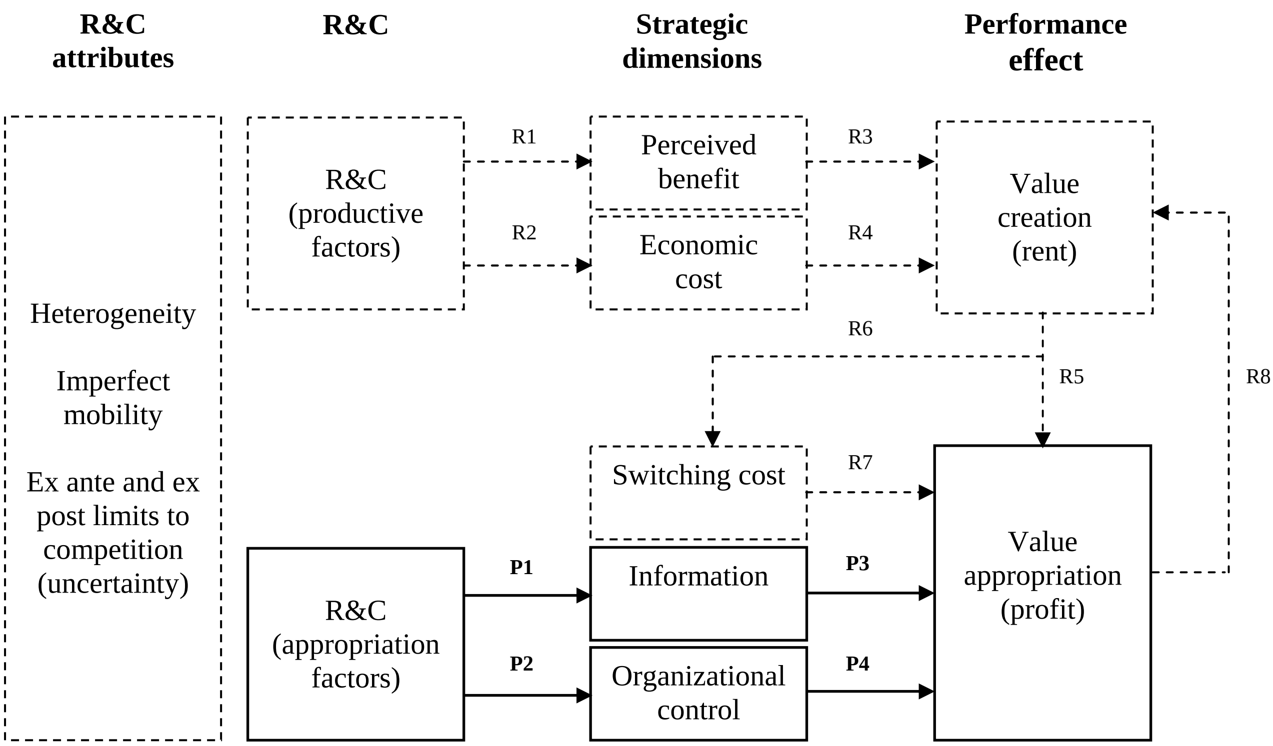

Figure 2 An appropriation factor framework within the context of resource-based theory.

Figure 2 shows how different types of R&C, such as productive factors and appropriation factors, affect performance, either by influencing value creation in terms of perceived benefit and economic cost, or by affecting bargaining power in terms of switching cost, information and organizational control, and thus the proportion of total surplus that is appropriated (profit). Key relationships in the framework correspond to relationship 1-8 and proposition 1-4. The upper half of the framework (R1-R8) constitutes a restatement of established relationships in strategic management. This is represented by the dotted boxes and arrows indicating that these concepts and relationships are not of primary concern to the appropriation factor framework (but still of importance for understanding the role played by appropriation factors in strategic management). Proposition 1-4 represent the appropriation factor framework and the focal contribution of this paper.

We turn first to RBT and relationships directly derived from this theory. RBT attributes performance differentials to immobile and heterogeneous R&C that have intrinsically different levels of efficiency (Peteraf, 1993). Hence, some R&C are superior to others in that they allow the firm to produce at a lower economic cost or provide products with a higher perceived benefit (Peteraf & Barney, 2003). Firms with marginal factors will perform at break-even while superior R&C can earn economic rent (Peteraf, 2003). More specifically, the resource-based logic recapitulated above can be described as four relationships (R1-R4), which outline effect of differential endowment of R&C on the level of perceived benefit and economic cost of output, the difference between which is equivalent to value creation (rent).

RBT is a theory of economic rents and their sustainability over time (Amit & Schoemaker, 1993). Thus, RBT explains the creation of economic rents attributable to superior R&C, but not how this value is appropriated by different economic agents (Peteraf & Barney, 2003). This emphasizes the importance of separating economic value creation from value appropriation (profit).[4] However, as shown in Figure 2, although value creation and value appropriation are treated as separate in this paper, the amount of value created significantly affects the amount that can be appropriated by the involved agents. This effect takes two paths. First, value creation affects value appropriation by determining the size of the total surplus to be divided, and thus the size of fixed fractions of the total surplus. Secondly, value creation affects value appropriation by determining differentiation relative alternatives, and thus the switching costs experienced by the involved parties. The effect of value creation on value appropriation (profit) can be illustrated in the form of three relationships (R5-R7).

The final relationship derived from established theory represents the assertion that bargaining and value appropriation might influence the total amount of value created negatively when value appropriation is perceived as illegitimate or unacceptable by the other party to a transaction; either by cancelling out certain transactions (as in the case of monopoly pricing) or by raising the costs of completing transactions (R8).

Having explicated the causal relationships depicted in the upper half of Figure 2 (R1-R8), which are normally associated with (or implicitly assumed by) RBT, we now turn to the propositions that are specific to the appropriation factor framework outlined in this paper. As stated in the previous section, the fundamental argument is that particular R&C, termed appropriation factors, determine the availability of transaction relevant information and the level of organizational control that can be exercised. Together with the switching costs of the transacting parties, these factors determine the proportion of created value that is appropriated by an agent. More specifically, this argument can be formulated as four individual propositions (P1-P4) stating the effect of appropriation factors on information and organizational control, and the effect of information and organizational control on value appropriation.

It is conjectured that appropriation factors are subject to heterogeneity in the sense that some appropriation factors are more effective than others in securing transaction relevant information and organizational control. Because the more effective appropriation factors are limited or inelastic in supply, inferior appropriation factors are brought into use. This gives rise to differential levels of information and organizational control, which is attributable to the inherent effectiveness of appropriation factors. Hence, appropriation factors that are more effective in the process of identifying, collecting, categorizing, and disseminating information will enable a more accurate estimation of transaction relevant information.

Proposition 1. The more effective endowment of appropriation factors, the more transaction relevant information will be available to the firm.

The heterogeneity of appropriation factors go beyond their effectiveness for the identification, collection, categorization, and dissemination of information. Thus, appropriation factors that enable a more effective or coherent use of information in the execution of

[4] This distinction is commonly circumvented in RBT by implicitly assuming that firms lack market power and act as price takers in relevant markets.

transactions will enable organizational control in terms of goal congruence and alignment of competing interests.

Proposition 2. The more effective endowment of appropriation factors, the more organizational control can be exercised by the firm in transactions.

It is further conjectured that the differential information and organizational control enabled by appropriation factors will have a significant affect on the proportion of created value that is appropriated. More accurate information concerning the supply and demand conditions of individual transactions will allow firms to make proper trade-offs between transactions with differential attractiveness, secure attractive transactions, avoid unattractive transactions, and bargain successfully in individual transactions.

Proposition 3. The more transaction relevant information available to the firm, the more value will be appropriated by the firm.

While the problem of information poses an integral aspect of the bargaining situation, high levels of organizational control exercised in transactions will allow the firm to pursue action that is congruent with available information. Hence, the bargaining situation can be further extended from making transaction relevant information available to also aligning competing interests and goal conflict in order to induce proper action aimed at value appropriation.

Proposition 4. The more organizational control exercised in transactions, the more value will be appropriated by the firm.

Application of the appropriation factor framework to potential bargaining situations

This section provides eight examples or scenarios that illustrate the logic behind the propositions stated in the appropriation factor framework. For the purpose of transparency, the examples are built on delimited bargaining situations that only involve the distribution of value between a focal firm and a buyer (with competition present or non-present). The examples are outlined considering the focal firm as subject to either differential levels of information or organizational control, under the condition of competitive advantage or no competitive advantage.

Imagine a firm (Alfa) entering negotiation with a customer who requires a specific product that can only be made and sold by a limited number of suppliers. For this specific product and customer, Alfa creates a value of 100 $ per unit sold (200 $ perceived benefit and 100 $ cost). How would this surplus be divided between Alfa and the customer? Given that Alfa has full access to information regarding how the customer values the product and the costs associated with supplying it, and acts in an economically rational way, it would appropriate a surplus in the interval [0,100]. If no competition were present, it would in principle be possible for Alfa to charge a price of 200 $, and thus appropriate the full surplus. If equally efficient competition was present and entry was unrestricted, new firms would enter until the whole surplus was appropriated by the customer. If competition were present, but restricted to small number of incumbents, Alfa would, depending on the type of bargaining solution, appropriate a surplus in the interval of [0,100]. All these scenarios share the characteristic that value appropriation (profit) is solely determined by the amount of value associated with Alfa's product (R5 in Figure 2), which in the given example corresponds to 100 $, and the amount of value associated with alternatives (R6-R7 in Figure 2), which in the given example corresponds to the switching cost experienced by Alfa and the customer if the transaction is cancelled.

Bargaining with a competitive advantage

What outcome would be expected if Alfa were bidding for the customer's business together with a second firm (Beta) over which Alfa has an efficiency (or resource-based) advantage (R1-R4 in Figure 2). Thus, Beta realizes a value of 50 $ per unit sold (200 $ perceived benefit and 150 $ cost). The type of cooperative game theory solution to these types of bargaining situations that are examined by Lippman & Rumelt (2003) suggest that Alfa would get the deal based on its advantage over Beta and that the price would end up in the range [100,150]. Hence, competition between Alfa and Beta first drives the price down to the level of Beta's unit cost of 150 $. If the price were set at this level, Alfa would appropriate the full value of its advantage relative the competition (Beta). However, it is also a possible solution that the rent attributable to Alfa's advantage would be shared in some way between Alfa and the customer so that Alfa appropriates a surplus in the range of [0, 50], for example by having the two parties split the surplus equally at a price of 125 $ (Nash bargaining solution, see Nash, 1953).

What is common to all these scenarios is that Alfa, Beta and the customer are assumed to have perfect information regarding; (A) the perceived benefit of products, and (B) the cost of production. Further, it is assumed that the actions of the involved agents are perfectly implemented in a way congruent with profit maximization. For example, in the bargaining situation described above it is assumed that Alfa and Beta are able to accurately determine the perceived benefit (200; 200) and costs (100; 150) of the two competing products. Under such circumstances, the relative values of the competing offers are sufficient to identify how the surplus can be distributed, for example by using cooperative game theory (see Lippman & Rumelt, 2003). However, as highlighted by the appropriation factors framework (P1-P4), if these assumptions are challenged, the range of potential outcomes changes.

Information

One simple way to begin to explore the potential outcomes discussed above is to consider the effect of differential levels of information in the bargaining situation (P3 in Figure 2). For example, if Alfa because of a less effective information system were unable to measure the true size of its cost advantage over Beta, consequently estimating its costs to be 70 $ (instead of the true cost of 100 $), the range of potential prices would change from [100, 150] to [70, 150]. Assuming that the perceived surplus is equally split between Alfa and the customer, the price would change from 125 $ to 110 $ and the amount of value appropriated (actual profit per unit) by Alfa would change from 25 $ to 10 $ (corresponding to a 60 % decrease in profits). Thus, *a seller's underestimation of its costs will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*

If instead Alfa once again because of less effective information systems were unable to measure the true size of its cost advantage over Beta, but this time estimating its costs to be 130 $ (instead of the true cost of 100 $), the range of potential prices would change from [100, 150] to [130, 150]. Assuming that the perceived surplus is equally split between Alfa and the customer, the price would change from 125 $ to 140 $ and the amount of value appropriated (actual profit per unit) by Alfa would change from 25 $ to 40 $ (corresponding to an 60 % increase in profits). Thus, under the condition that the estimation is within the range of an efficiency advantage over competition, *a seller's overestimation of its costs will have a positive effect on that seller's bargaining power and the level of value appropriation (profit).*

Organizational control

A second way to explore the potential outcomes of the appropriation factors framework is to consider effect of differential levels of organizational control in the bargaining situation (P4 in Figure 2). Suppose that Alfa because of lack of authority and less effective incentive systems is organizationally unable to prevent its sales force from engaging in cost-plus profit pricing, consequently setting price at 110 $ (with 10 % mark-up on costs). Being prepared to pay up to 125 $, the customer would agree to these terms and the amount of value appropriated (actual profit per unit) by Alfa would change from 25 $ to 10 $ (corresponding to a 60 % decrease in profits). Thus, *a seller's inability to organizationally control internal forces working for a reduction of price will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*

Suppose instead that Alfa is organizationally unable to prevent its sales force from setting a too high price at 130 $ (with a 30 % mark-up on costs). Being prepared only to pay a price up to 125 $, the customer would reject these terms and the amount of value appropriated (actual profit per unit) by Alfa would change from 25 $ to 0 $. Not only would Alfa's value appropriation (profit) decrease to zero, but the cancelation of the transaction would also reduce Alfa's value creation to zero (R8 in Figure 2).[5] Thus, *a seller's inability to organizationally control internal forces working for an increase of price beyond levels acceptable to the buyer will have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.*

Bargaining without a competitive advantage

In the situations described above, the focal firm is assumed to have a competitive advantage in terms of a lower cost per unit. If we instead assume a situation were Alfa and Beta are equally efficient and both creating a value of 100 $ per unit sold (200 $ perceived benefit and 100 $ cost), how would these new conditions effect the different scenarios considered above?

Information

We return to the effect of differential levels of information in the bargaining situation (P3 in Figure 2) where Alfa because of a less effective information system is unable to measure the true size of its costs, consequently estimating its costs to be 70 $ instead of the true cost of 100 $. In this situation, competition between Alfa and Beta drives the price down to 100 $. Consequently, Alfa gets the customer's business at a price in the interval [70, 100]. Assuming that the perceived surplus of 30 $ is equally split between Alfa and the customer, the price is set at 85 $. At this price, Alfa realizes a loss of 15 $ per unit sold. Similar to the case discussed above where Alfa enjoyed a competitive

[5] Naturally, this would mean that Beta gets the order instead. Because Alfa is a more efficient producer than Beta, this would also reduce total wealth creation by 50 $.

advantage over Beta, the underestimation of costs will cause a decrease in Alfa's profitability. Thus, *a seller's underestimation of its costs will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*

If instead Alfa estimated its costs to be 130 $ (instead of the true cost of 100 $), competition between Alfa and Beta drives the price down to Alfa's perceived unit cost of 130 $ and Beta gets the customer's business at a price in the interval [100, 130]. Alfa's value appropriation (profit) would decrease to zero and the cancellation of the transaction would also reduce Alfa's value creation to zero (R8 in Figure 2). Thus, *a seller's overestimation of its costs will, under the condition that an advantage is lacking, have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.*

Organizational control
As a final scenario to consider we now turn to the effect of differential levels of organizational control (P4 in Figure 2) where Alfa because of lack of authority and less effective incentive systems is organizationally unable to prevent its sales force from granting too extensive rebates, consequently setting price at 90 $. Being prepared to pay up to 100 $, the customer agrees to these terms and Alfa realizes a loss of 10 $ per unit sold. Similar to the case discussed above where Alfa enjoyed a competitive advantage over Beta, the inability of Alfa to organizationally control its sales force causes a decrease in Alfa's profitability. Thus, *a seller's inability to organizationally control internal forces working for a reduction of price will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*

Suppose instead that Alfa because of its lack of authority and less effective incentive systems is organizationally unable to prevent its sales force from engaging in cost-plus profit pricing, thus setting price at 110 $ (with 10 % mark-up on costs). Because of competition from Beta, this offer will be rejected by the customer. Consequently, Beta gets the business at a price in the interval [100, 110]. Alfa's value appropriation (profit) decreases to zero and the cancellation of the transaction also reduce Alfa's value creation to zero (R8 in Figure 2). Thus, *a seller's inability to organizationally control internal forces working for an increase of price beyond levels acceptable to the buyer will have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.*

This section has addressed eight different situations that illustrate how appropriation factors might influence value appropriation (profit) by enabling differential levels of information and organizational control. These eight bargaining situations are summarized in Table 1.

	Competitive advantage	No competitive advantage
Information		
Underestimation of costs	A seller's underestimation of its costs will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).	A seller's underestimation of its costs will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).
Overestimation of costs	A seller's overestimation of its costs will have a positive effect on that seller's bargaining power and the level of value appropriation (profit).	A seller's overestimation of its costs will, under the condition that an advantage is lacking, have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.
Organizational control		
Price reductions	*A seller's inability to organizationally control internal forces working for a reduction of price will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*	*A seller's inability to organizationally control internal forces working for a reduction of price will have a negative effect on that seller's bargaining power and the level of value appropriation (profit).*
Price increases	A seller's inability to organizationally control internal forces working for an increase of price beyond levels acceptable to the buyer will have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.	A seller's inability to organizationally control internal forces working for an increase of price beyond levels acceptable to the buyer will have a negative effect on that seller's bargaining power, the level of value appropriation (profit), and value creation.

Table 1 Summary of scenarios illustrating the effect of differential levels of information and organizational control on value appropriation.

The examples presented above are admittedly simplistic, both with regards to their formal structure and level of detail or realism. However, the point is neither to present a formal model nor to present detailed real world cases, but rather to open up a new perspective on bargaining and value appropriation that is applicable to a particular set of empirical phenomena that have been neglected in contemporary strategic management theory. As shown in Table 1, the effect of differential levels of information and organizational control on value appropriation are, with one exception, similar across situations.[6] Hence, in all situations, except the situation concerning the overestimation of costs when the focal firm has a competitive advantage, misjudging information or conducting the transaction with insufficient organizational control lead to a negative effect on value appropriation (profit). Interestingly, the situation involving overestimation of costs when the focal firm has a competitive advantage indicated a completely different tendency. In this situation, it seems to be beneficial for the focal firm to overestimate its

[6] It should be pointed out that the situations accounted for reflect a simplified picture in that the variation in one factor is considered in isolation and that only one firm (Alfa) is subject to differential levels of information and organizational control.

costs.[7] However, despite this, the tendency across situations is that accurate information and high levels of organizational control are positively related to value appropriation (profit).

Discussion

It is clearly the case that the notion of appropriation factors can be linked to the problems raised in economic organization (Coase, 1937; Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Klein, Crawford, & Alchian, 1978) and transaction cost economics (TCE) (Williamson, 1971; 1975; 1985; 1996). The theoretical framework presented in this paper is, like the TCE and the organizational failures framework, built on the notions of bounded rationality, uncertainty/complexity, opportunism, small number, information impactedness, atmosphere, and the bargaining situations that follow from these conditions. However, as should be clear from the treatment of these questions in this paper, there are important differences in perspective. The argument posed in this paper takes on a resource-based and strategizing perspective on the bargaining situation. Hence, rather than addressing the presence of bargaining and appropriation attempts as an inefficiency of the economic system (i.e. something that gives rise to transaction costs), this paper highlights the strategic advantage that can be gained by systematically leveraging these types of situations based on superior information and organizational control enabled by heterogeneous and immobile appropriation factors. Although the appropriation factor framework makes similar assumptions regarding the human and institutional context as does the TCE, it differs in its account of the consequences of these assumptions. While TCE states incomplete contracting (and thus ex post bargaining costs in an equilibrium oriented game) as the main implication of uncertainty, the appropriation factor framework emphasizes firms' inherent heterogeneity with regards to coping with this uncertainty in terms of effective governance structures and safeguarding mechanisms (i.e. the investment in appropriation factors). Further, whereas TCE assume perfect mobility of effective governance structures and safeguarding mechanisms, the appropriation factor framework emphasizes the fact that assumptions of heterogeneity and uncertainty lead to isolating mechanisms that sustain differences in the effectiveness of the governance structures and safeguarding mechanisms (see Liebeskind, 1996; Argyres & Liebeskind, 1999).

An important practical implication of the appropriation factors framework outlined in this paper is that investments in traditional productive factors and appropriation factors should be balanced against each other. This paper directs attention to the fact that sustained advantages do not just involve beating competition in terms of efficiency, but also how well the firm is able to reap the benefits of its existing strengths and protect against the potentially detrimental effects of its weaknesses. This perspective is not novel in its emphasis on the strategizing efforts of firms. The novelty consists in how it couples strategizing with the notion of heterogeneous and immobile R&C. Hence, the appropriation factor framework developed in this paper portrays R&C, referred to as appropriation factors, as being of direct and fundamental importance to successful strategizing. This suggests that firms planning to engage in strategizing activities should first consider their ability of doing so successfully by assessing their current endowment of appropriation factors. Secondly, this also suggests that firms that have been able to

[7] See Hallberg (2008) for similar empirical result.

accumulate superior appropriation factors whose benefits are not subject to competitor duplication can earn sustainable above normal profits due to these appropriation factors.

The notion of appropriation factors outlined in this paper presents several avenues for future research. First, the concept of appropriation factors, which was developed in this paper in order to understand the potentially strategic implications of R&C that are not directly addressed by the traditional RBT, requires further conceptual development and formalization. Other studies addressing similar topics have suggested that this might be accomplished by a formal integration of RBT with transaction cost and property rights economics (see Foss & Foss, 2004; 2005; Argyres & Mayer, 2007). Others have argued that further development of RBT would be best served by keeping (and perhaps even reinforcing) its delimited attention to traditional productive resources and their rent earning capacity (Peteraf & Barney, 2003). This debate has so far not provided an answer to the question of how strategy scholars are to account for phenomena, which are unproductive in the sense that they do not necessary increase the perceived benefits of products sold nor decrease the economic cost of producing these products, but still exhibit characteristics of heterogeneity and immobility. Hopefully, a beginning of the answer to this question has been outlined in this paper.

Beyond the theoretical issues discussed above, the more empirical question of to what extent value creation and value appropriation explain profit differentials also remains largely unanswered. Extending this line of reasoning, one might ask to what extent value appropriation is determined by the type of appropriation factors developed in this paper and to what extent these outcomes are explained by external factors, for example as suggested by Porter's (1980) competitive forces framework (the notion of industry structure determining the distribution of industry surplus). The question raised above highlights the need to formalize, operationalize, and test concepts and relationships suggested in this paper.

Conclusion

The appropriation factor framework presented in this paper shares basic attributes with RBT in its emphasis on heterogeneity, immobility and uncertainty. However, the appropriation factor framework also extends the RBT notion of heterogeneity by stating that R&C do not only differ in terms of economic efficiency, but also in their effectiveness in securing strategic information and organizational control. Analogous to the reasoning in the RBT, this leads to sustained differences in firm bargaining power and the proportion of economic value that is appropriated.

In the beginning of this paper, RBT was contrasted with Porter's (1980) competitive forces framework. The comparison highlighted two dimensions on which contemporary modes of explaining firm performance could be contrasted; the main unit of analysis and the type of independent variable investigated (represented by industry and firm R&C), and the predicted type of performance effect and the type of dependent variable investigated (represented by value creation and value appropriation). This produced four different positions (A-D): (A) industry level and efficiency-based explanations of firm performance (community driven value creation), (B) firm level and efficiency-based explanations of firm performance (RBT), (C) industry level and bargaining-based explanations of firm performance (competitive forces framework), and finally, (D) the position developed in this paper of firm level and bargaining-based explanations of firm performance (appropriation factors). One important contribution of this paper has been to clarify how value appropriation is affected by the internal endowment of particular R&C termed appropriation factors.

Viewing value appropriation as being at least partly driven by distinctly internal factors provides an important complement to established explanations of firm performance. The particular function of the concept of appropriation factors should be seen as providing a means of broadening the scope of strategic analysis to areas that have so far been overlooked by other types of explanations. Hence, the notion of appropriation factors should not primarily be seen as an attempt to question the relevance of RBT, but rather to provide an extension of established theory that is applicable to a new set of phenomena. This is accomplished by expanding the traditional conception of R&C in a new direction, which is genuinely sensitive to the fundamental effects of bounded rationality and uncertainty on competition.

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Elsbeth Andersson
Institute of Economic Research
P.O. Box 7080
SE-220 07 Lund, Sweden
Tel: +46 46-222 7824,
Fax +46 46-222 44 37

E-mail: Elsbeth.Andersson@fek.lu.se
http://www.lri.lu.se