# CONTENTS

	List of figures and tables	ix
	Acknowledgments	xi
1	INTRODUCTION	1
	On business institutions	1
	Overview of the theory	2
	Plan of the book	5
2	CAPABILITIES, STRATEGY AND THE FIRM	7
	Classical and neoclassical theories	8
	The "why" of firms	9
	Routines, capabilities, and organization	13
	Strategy and the boundaries of the firm	17
3	A DYNAMIC THEORY OF THE BOUNDARIES OF	
	THE FIRM	20
	The division of labor	20
	Transaction costs in the short run	27
	Transaction costs in the long run	29
	Capabilities and governance costs	30
	Transaction costs and the passage of time	32
	The sources of dynamic transaction costs	35
	Coordination and appropriability	36
	Capabilities in the long run	40
	The short- and long-run boundaries of the firm	41
	The dynamics of firm and industry evolution	43
4	VERTICAL INTEGRATION IN THE EARLY AMERICAN	
	AUTOMOBILE INDUSTRY	46
	Invention and product development	47
	Product standardization and mass production	50
	Replacement demand and model changes	58

#### **CONTENTS**

5	EXTERNAL CAPABILITIES AND MODULAR SYSTEMS	68
	The theory of modular systems	69
	Product differentiation and the product life cycle	76
	The development of high-fidelity and stereo systems	77
	The microcomputer industry	87
	Other examples of modular systems	99
6	INERTIA AND INDUSTRIAL CHANGE	101
	Introduction	101
	Institutions and inertia	102
	The role of routines and capabilities	104
	Learning and inertia	106
	The population dynamics of market dominance	108
	Four hypotheses	112
	Conclusions	118
7	INNOVATION, NETWORKS AND VERTICAL	
	INTEGRATION	120
	Introduction	120
	Networks and networks	124
	Specialization and appropriability	132
	Networks and economic change	135
	Industry structure and the scope of innovation	136
	Innovation and the product life cycle	138
	Conclusion	141
8	CONCLUSION	143
	The role of large firms in economic growth	144
	Convergence and divergence in economic development	147
	Notes	151
	Bibliography	164
	Index	178

## FIGURES AND TABLES

#### **FIGURES**

2.1	The two dimensions of integration	10
	A theory of specialization	15
3.1	Crafts production	21
3.2	Factory production	22
3.3	Parallel-series scale economies	24
3.4	The activities of a firm and their cost premium	32
	The "classical" presupposition	34
3.6	Two firms drawing on a single capability	41
3.7	The effects of spreading knowledge on the boundaries	
	of the firm	42
3.8	The convergence and divergence of industries	44
3.9	The effects of innovation and obsolescence	44
5.1	Components of the original and improved widget	71
5.2	Firms involved in the production of components of the	
	improved widget	72
5.3	Production of widgets with changing component 4	72
5.4	A core network	73
5.5	A decentralized network	74
5.6	The consumer's view of the product life cycle	77
6.1	"Harvesting" and leadership-shift among firms	111
7.1	Integration, networks and the response to innnovative	
	conditions	124
7.2	Japanese firm relationships	128
7.3	Degree of radicalness of uncertainty	136
8.1	The evolution of converging firms	148
8.2	Innovation and the diversification of converging firms	149

#### FIGURES AND TABLES

### **TABLES**

4.1	Wholesale value of American motor-vehicle output compared	
	with wholesale value of manufactured components and	
	equipment purchased from others, 1922-1926	60
4.2	Outside purchases of components by American automobile	
	manufacturers, 1926–1927	60
4.3	Index of vertical integration, 1923–1934	61