Adaptation, Specialization, and the Theory of the Firm

This invaluable book provides the foundations for a new theory of the firm, drawing on Birger Wernerfelt’s landmark work on economic theory and the resource-based view of the firm. It addresses a vigorous and long-standing academic debate over what exactly a “firm” is, both in the field of management and economics. Wernerfelt revisits his classic articles, including an extensively revised “A Resource-Based View of the Firm” (1984), which have been updated and synthesized to provide precise and accessible concepts and predictions. By offering future directions for research and practice, this book will be of interest to students and scholars of management and economics alike.

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Adaptation, Specialization, and the Theory of the Firm

*Foundations of the Resource-Based View*

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For Bjoern
# Contents

List of Figures  
List of Tables  
Preface  

<table>
<thead>
<tr>
<th>List of Figures</th>
<th>page ix</th>
</tr>
</thead>
<tbody>
<tr>
<td>List of Tables</td>
<td>x</td>
</tr>
<tr>
<td>Preface</td>
<td>xiii</td>
</tr>
</tbody>
</table>

## Part I  Agenda

1 Introduction  
2 Preview: Small Forces, High Frequencies, and Large Firms  

## Part II  The Main Argument

3 Adaptation Costs in One Dimension: Firms, Contracts, and Price Lists  
4 Adaptation Costs in Three Dimensions: Firms, Markets, and Contracts  
5 All Adaptations Are Not the Same: The Scope of Firms and the Size of Markets  
6 Resources and the Scope of the Firm  

## Part III  Implications

7 The Allocation of Asset Ownership  
8 Communication within and between Firms  
9 The Power of Incentives within and between Firms  
10 Decision-Making in Large Organizations  

vii
Contents

Part IV Empirical Tests 179
11 Bargaining Costs: Existence and Sub-Additivity 181
12 Adaptation Frequency and the Boundary of the Firm 201
13 Asset Ownership and Externalities 229

Part V Foundations 251
14 Endogenously Incomplete Contracts 253
15 Multiple Equilibria and Firm Heterogeneity 272
16 On the Endogenous Amplification of Small Differences 284

Part VI Postscript 299
17 Summary and Final Reflections 301

Index 303
Figures

2.1 Most efficient mechanisms and changing needs  1  (page 18)
2.2 Most efficient mechanisms and changing needs  2  19
2.3 Most efficient mechanisms and changing needs  3  20
3.1 Most efficient mechanisms  41
4.1 Most efficient mechanisms by frequency of change and switching costs  72
4.2 Most efficient mechanisms by frequency of change and gains from service specialization  72
4.3 Most efficient mechanisms by frequency of change and number of needs  75
5.1 A two business–two service economy  90
6.1 Resource–product matrix  103
6.2 Sequential entry  107
6.3 Exploit and develop  109
6.4 Stepping stone  110
7.1 The value–depreciation frontier  117
8.1 Conditional posterior density of $c_i$ if the seller did not find the new design ($F = U$)  136
8.2 Conditional posterior densities of $c_i$ if seller found, but did not offer, new design ($F = U$)  137
8.3 Conditional posterior densities of $c_h$ if seller offered the new design ($F = U$)  139
11.1 Schematic screen-shot of the bargaining environment for the buyer  185
11.A-1 Frequency of settling times by experimental treatment  200
14.1 $\{k, r \mid \text{The buyer will cede decision } d \text{ to the seller}\}$  265
15.1 Possible linear codes when $V = 4$  276
Tables

3.1 Kendall rank correlations  
3.2 Correlation coefficients  52  
3.3 t-Values from regressions  52  
4.A-1 Components of efficiency and performance of mechanisms  79  
7.1 Questionnaire  123  
11.1 The tendency to pool for increasing costs of pooling  187  
11.2 The tendency to pool for different costs and benefits of pooling  189  
11.3 The role of time-savings in the tendency to pool  189  
11.4 The role of anonymity in the tendency to pool  190  
11.5 Number of offers in one period negotiations and pooling prices  191  
12.1 List of parts  207  
12.2 Descriptive statistics by production system  208  
12.3 Probability of pair-wise co-production by adaptation frequency  210  
12.4 Sum of internalized adaptation frequencies by production system  212  
12.5 Models of max $\sum_{i\neq j} f(i, j) [bf_{ij} + e_{ij}]$  217  
12.6 Sum of squared production system residuals (SSR) by alternative models  219  
12.7 Sum of squared firm residuals (SSR) by alternative models  220  
12.A-1 Adaptation frequencies from interviews and co-production data for production system A  224  
12.A-2 Descriptive statistics by production system  226  
12.A-3 Probability of pair-wise co-production by adaptation frequency  226  
12.A-4 Sum of internalized adaptation frequencies by production system  227
List of Tables

12.A-5 Models of max $\sum \phi_{ij}(\beta) [\beta f_{ij} + e_{ij}]$ 227
12.A-6 Sum of squared production system residuals (SSR) by alternative models 228
12.A-7 Sum of squared firm residuals (SSR) by alternative models 228
13.1 Summary statistics 240
13.2 Rank-order correlation of the measures 245
13.3 Multivariate analysis 245
13.4 Modified multivariate analysis 248
15.1 Number of rounds when one member uses code A and the other uses code B 278
15.2 Number of rounds when both members use code A 278
15.3 Number of rounds when both members use code B 278
Preface

This book is based on fifteen papers written over a thirty-year period. Two of them, “A Resource-Based View of the Firm” (proposing what is now called the RBV) and “On the Nature and Scope of the Firm” (proposing what is here called the “Adaptation Cost,” or just AC, theory of the firm) were written a few years apart in the 1980s. While both papers aim to characterize the sets of activities that should and should not be undertaken by firms, I long considered them incompatible. One was about excess capacity of certain productive assets and the other was about the costs of adapting contracts. Only when writing what is now Chapter 4 did I realize that the sub-additive bargaining costs underlying the AC theory could make productive assets de facto indivisible and capable of existing in excess capacity, thus taking me directly to the RBV.

The main purpose of the book is to clarify the AC–RBV relationship and this is done in two steps. In “Adaptation Costs in Three Dimensions: Firms, Markets, and Contracts,” I derive the AC theory under gains from specialization, and in “All Adaptations Are Not the Same: The Scope of Firms and the Size of Markets,” I develop the resulting theory of the scope of the firm and compare it to the RBV. To make the linkage as clear as possible, the four key chapters have been placed in sequence at the start of the book. The remaining eleven chapters look, theoretically and empirically, at important implications and foundations of the AC/RBV.

Most chapters have their basis in a single stand-alone paper, some published several years ago. All have been rewritten for consistency of notation and terminology and updated to reflect other literature published between their original publication date and now. I do not flag the parts that are most extensively rewritten, but the reader should be aware that there may be significant differences between the original

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1 In its first incarnation, the theory was, at the suggestion of a referee, labelled the “Adjustment Cost” Theory. However, that term is also used in the macro literature where it denotes a different phenomenon.

xiii
articles and the versions found here. It should also be mentioned that the introductions to individual chapters may repeat a bit of material covered in earlier chapters. This is done to make each chapter almost self-contained and thus allow readers to skip one or more chapters. The title page before each part contains a note about the extent to which the chapters depend on each other.

Since the ideas in the book have been developed over such a long time, I have benefited from a very large number of colleagues, readers, seminar audiences, referees, and editors. The most important and consistent of these have been Bob Gibbons, Oliver Hart, and Steve Tadelis. I have learned a lot from them and the work is profoundly influenced by their willingness to repeatedly discuss on my premises. I would also like to thank Tore Ellingsen, Nicolai Foss, Drew Fudenberg, Bengt Holmstrom, Patrick Legros, Jin Li, Niko Matouschek, Roger Myerson, Mike Powell, Peter Norman Soerensen, Jean Tirole, Mike Whinston, and Oliver Williamson for one or more discussions, questions, or comments that ended up being important to some of the ideas presented here. More generally, I would like to thank everybody who has been a member of the vibrant Organizational Economics community in Cambridge at any point during the last twenty-five years.

Three of the chapters are based on papers coauthored with colleagues and I would like to acknowledge the collaborations of Boris Maciejovsky, Sharon Novak, and Duncan Simester. A couple of papers would not have been possible without the help of research assistants and I particularly want to thank Carol Meyers for her help with what is now Chapter 12. In the later stages of the manuscript preparation, Xinyu Cao provided excellent proofreading and checking assistance.

As mentioned above, most of the Chapters are based on previously published work. Chapter 2 is based on “Small Forces and Large Firms: Foundations of the RBV” (Strategic Management Journal, 34, no. 6, pp. 635–43, 2013); Chapter 3 is based on “On the Nature and Scope of the Firm” (Journal of Business, 70, no. 4, pp. 489–514, 1997); Chapter 4 is based on “The Comparative Advantages of Firms, Markets, and Contracts” (Economica, 82, no. 236, pp. 350–67, 2015); Chapter 6 is based on “A Resource-Based View of the Firm” (Strategic Management Journal, 5, no. 2, pp. 171–80, 1984); Chapter 7 is based on “Why Should the Boss Own the Assets?” (Journal of Economics and Management Strategy, 11, no. 3, pp. 473–85, 2002); Chapter 8 is based on “Bargaining Before or After Communication?” (Journal of Institutional and Theoretical Economics, 164, no. 2, pp. 211–29, 2008); Chapter 9 is based on “Robust Incentive Contracts” (Journal of Institutional and Theoretical Economics, 160, no. 4, pp. 545–54, 2004); Chapter 10 is based on “Delegation,
Preface


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