ifera... RESEARCH DEVELOPMENT

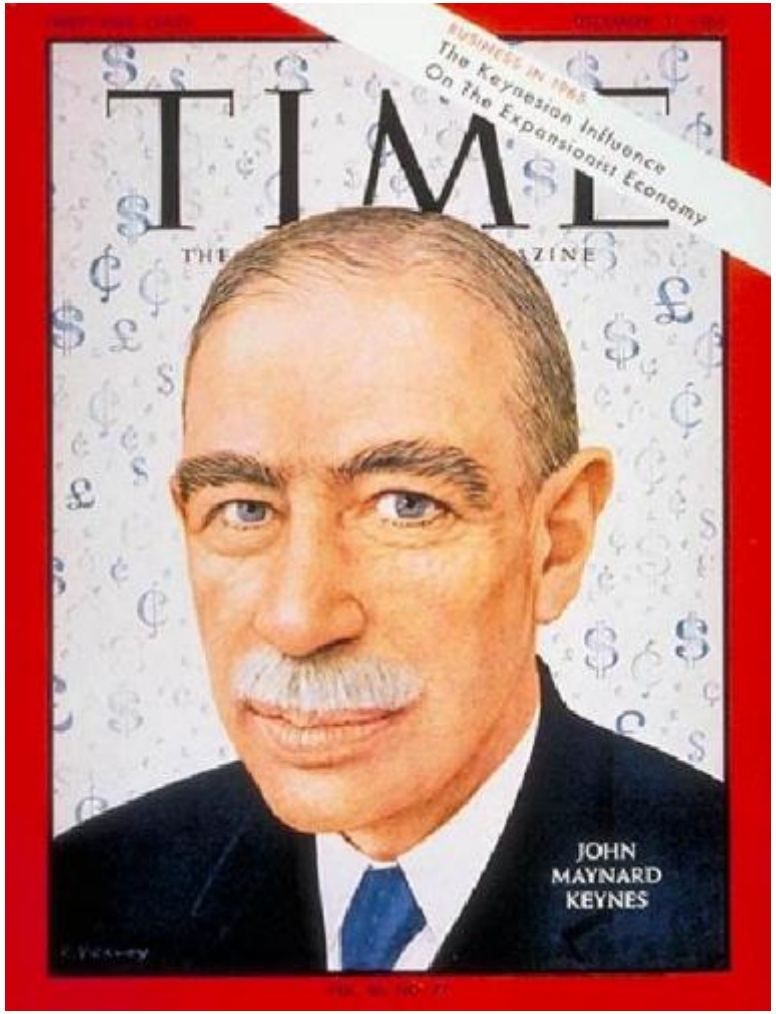
VIRTUAL PROGRAM

**WEBINAR:**
THEORY BUILDING IN FAMILY BUSINESS RESEARCH:
some reflections based on the paper "Property Rights, Owner-Management, and Value Creation" forthcoming in Academy of Management Review

**May 14, 2020**
**6.00 PM**
**(Central European Time)**
No registration required
Link to the webinar in the FB event description

# THOMAS ZELLWEGER

# Some general thoughts about why theory is important




"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood... Indeed the world is run by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences are usually the slaves of some defunct economist . . . ."

(Keynes, 1953, p. 306)

There is no innocent eye.

# What is good theory?

Good theory is **interesting**
"Interesting theories are those which deny certain assumptions of their audience, while non-interesting theories are those which affirms certain assumptions of their audience." (Murray S. Davis, 1976)

Good theory is **important**
Because it will help us see relevant problems, ones with wide societal impact in clearer ways (Laszlo Tihanyi, AMJ, 2020)

Good theory is an **abstraction and not a mirror** of reality
As Holland (1998) notes, a map of the world that is as detailed as the actual setting has no value. A theoretical construction structures attention by suggesting what factors are central, and what sets of interrelationships merit our attention." (Gavetti, Levinthal, Ocasio 2007)

# Good theory is interesting

You need to know the literature

**To reach interestingness you need to know the literature:**

- Not just the family business literature, the foundational works
- While reading, you look for incidents where established organizational theory:
  - does not hold when we expect that it should
  - or holds, when it should not
  - and authors can explain the unexpected results.
- Reading is important as it will give you:
  - A sense what people think about a certain subject (consider this to be all we know about the phenomenon)
  - Ideas about research gaps, if you engage with practice while holding the literature in your working memory
  - Make you an interesting interlocutor for practitioners if you are able to relate to the challenges they experience in a comprehensive way, beyond their own “single-case” experiences

# Good theory is important

You need to engage with practice

**To reach importance you need to engage with practice:**

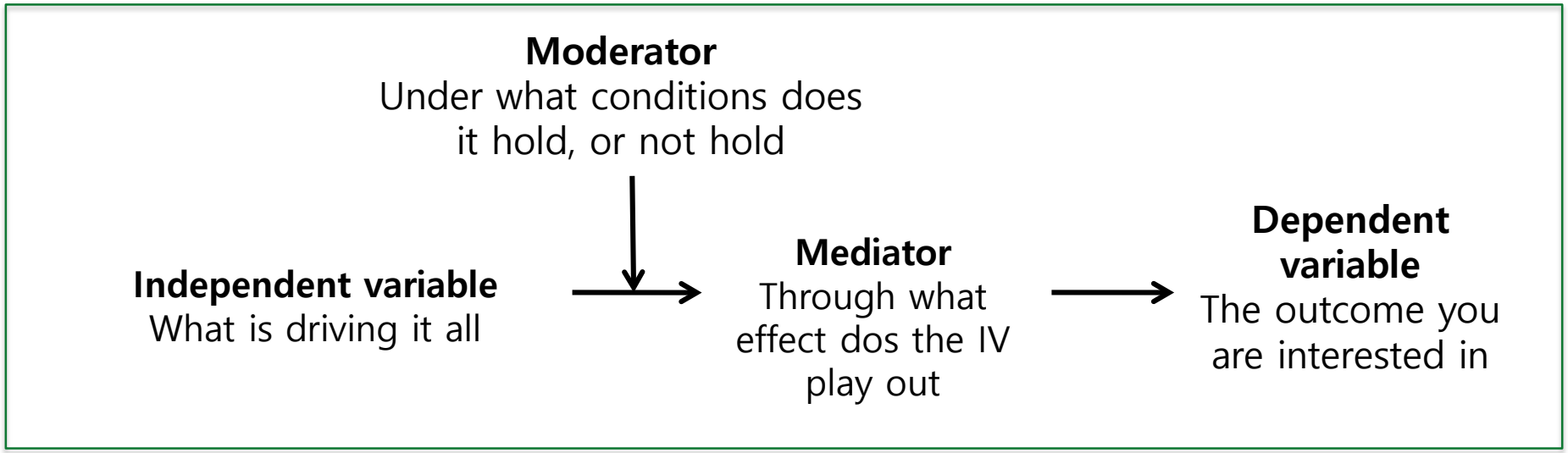
- Practice is the data, from which you derive ideas, and against which you test ideas
- Because practice is the data, practice is **right** ! Don't be sniffy vis-à-vis practitioners !
- Try to focus on topics with broad societal importance: closely-held firms are omnipresent
- Engage with practice through a theorist's eye, that is, by deliberately putting on the "glasses" (hence the views, ideas) you have taken out of the literature
- While engaging with practice, ask yourself:
  - From what I have read: what fits, and what does not fit with my observations in practice?
  - What is missing here, or what is wrong with the literature, what stands in the way of making sense of what I observe in practice?
- In doing so, focus on the assumptions, and less so on the variables

# Good theory is an abstraction and not a mirror of reality

You need to focus on the core issue

**To reach the right level of abstraction you need to focus on core issues:**

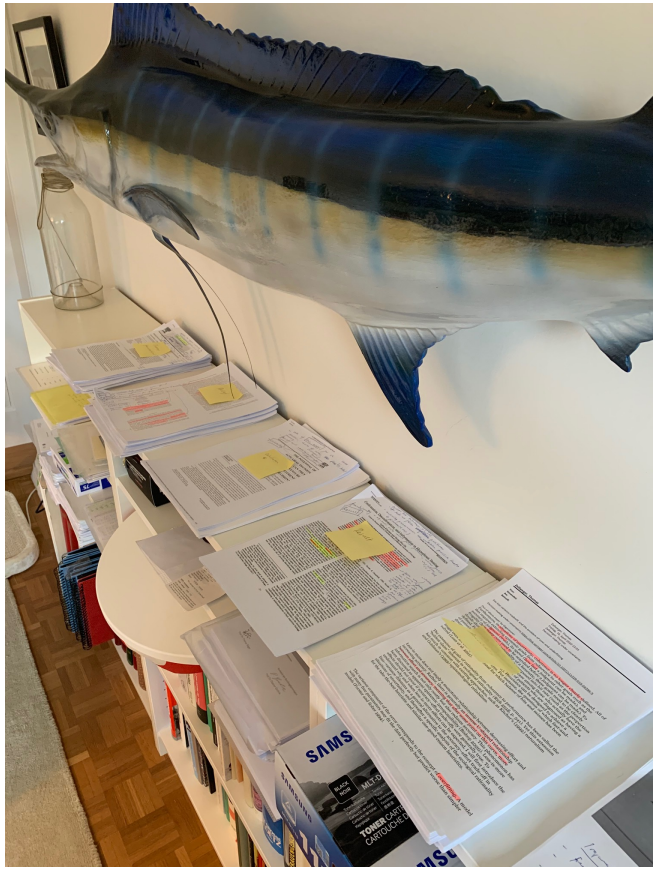
- We are not consultants ! We do not search for 1:1 solution
- We search for theory (explanations) that do not just fit 1 single case. You try to find a core mechanism that has explanatory power across multiple cases
- Hence, abstraction is needed, and at the same time a focus on the core issue, most often an IV, a DV, and a Moderator / Mediator
- If you cannot draw the conceptual model, it is probably too complex
- The boxes tend to be easier to explain than the arrows between them: focus on the Why !




**Context**: Where, when and who?

# Some tricks about reading and writing

- Read up to a feeling of saturation, while taking notes:
  - Throw your notes into a document and group them in a very rough first order (a first conceptual model)
  - I print out key papers, and create piles of papers, that all belong to a core idea or variable, inspired by the first conceptual model
- Your first document:
  - It will be messy, but try to keep some order to fill in text pieces and ideas
  - Think about using title structure in MS Word for quick navigation between different parts of the text
  - Small font, or a large screen: you want to keep an overview of the flow of arguments across large parts of the text: the story
- Work on it every day: even if it is only 10 min.



# Some reading about writing good theory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- DiMaggio, P.J. (1995). Comments on "What theory is not". *Administrative Science Quarterly 40*(3), 391-397.
- Ferraro, F., Pfeffer, J., & Sutton, R.I. (2009). How and why theories matter: A Comment on Felin and Foss (2009). *Organization Science, 20*(3), 669-675.
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- Tihanyi, L. (2020). From "That's Interesting" to "That's Important". *Academy of Management Journal*
- Weick, K.E. (1995). What theory is not, theorizing is. *Administrative Science Quarterly, 40*(3), 385-390.
- Whetten, D.A. (1989). What Constitutes a Theoretical Contribution?. *Academy of Management Review, 14*(4), 490-495.


Further readings:


- Huff, A.S. (1999). *Writing for scholarly publication*, Thousand Oaks.
- Van de Ven, A.H. (2007). *Engaged scholarship: Creating knowledge for science and practice*. Oxford.

# PROPERTY RIGHTS, OWNER-MANAGEMENT, AND ECONOMIC VALUE CREATION

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# The puzzle

- The owner-managed firm, i.e. the firm that is managed by its controlling owner
  - Traditionally depicted as most efficient type of firm (Jensen & Meckling, 1976)
  - With important advantages towards economic value creation (Foss & Klein, 2002; Hansmann 2000)
- However:
  - Most owner-managed firms are small (Demsetz, 1983)
  - Limited capacity of the owner-managed firm to attract resources to grow and create economic value (Wasserman, 2006; Hellmann, 1998)
- Owner-management as double-edged sword for economic value creation
- Research gap:
  - Need for integrated theorizing to accommodate the *benefits and costs of owner-management for value creation*

# Economic value creation in the owner-managed firm: What do we know?

- **Economic value**: economic value is the surplus between the perceived benefits gained by the purchasers of a good and the economic cost to the enterprise to produce it (Bowman & Ambrosini, 2000; Peteraf and Barney, 2003; Lepak et al., 2007).
  - Two strategies to generate economic value: 1) cost lowering, and/or 2) benefit enhancing (Porter, 1985; Pitelis, 2009)

- **Advantages** of owner-managed firms towards economic value creation:
  - *Agency theory*: cost lowering, "lean, no-nonsense institutions devoid of managerial amenities" (Demsetz, 1983; p. 377)
  - *Incomplete contracting theories* (Foss & Klein, 2002; Grossman & Hart, 1986; Hansmann, 2000):
    - Ownership should be in the hands of those stakeholders who contribute most to value creation and for whom fully specified contracts cannot be written.
    - Benefit enhancing: owner-managed firms particularly good at creating innovative new products and services that help to differentiate the focal firm and create value (Alvarez & Barney, 2007)

# Economic value creation in the owner-managed firm: what do we know?

- **Disadvantages** of owner-managed firms towards economic value creation:
  - *Economies of scale*: Smaller size leading to lower ecomomies of scale (Schumpeter, 1942; Acs & Audretsch, 1988)
  - *Resource dependence*: resource providers require control in exchange for resource provision (Villanueva, Van de Ven & Sapienza, 2012; Hellmann 1998; Kolvereid, 1992)
    - Control dilemma between the "kingdom and the throne" (Wasserman, 2017)
  - *Behavioral biases of entrepreneurs*: particular preferences, such as not to grow (Hamilton, 2000; McCann & Vroom, 2013)

- **Theoretical inconsistency:**
  - Owner-management is both seen as a source of advantage and disadvantage for value creation

# Solving the puzzle drawing from property rights theory

- Property rights theory, part of incomplete contracting theory (e.g., Klein, Crawford & Alchian, 1978; Libecap, 1989), next to transactions costs economics (Williamson, 1975)
- Property rights define the range of privileges granted to individuals to specific resources (Kim & Mahoney, 2002; 2005).

- In classical property rights terms, ownership grants three rights (Alchian & Demsetz, 1972; Libecap, 1989):
  1. ***Right to use*** the resource,
  2. ***Right to appropriate*** the residual returns from the resource, and
  3. ***Right to transfer*** these rights.

- Ownership is seen as unproblematic in agency theory, as the theory assumes complete contracts can be written
- Ownership matters in property rights theory since it is hardly possible to write complete contracts: value creating resource exchanges "*often evolve in ways that are difficult, if not impossible, to anticipate" and the related contracts "are (almost) always incomplete*" (Barney, 2018, p. 14).

# The self-incentivizing nature of property rights in the hand of the owner-manager

- Property rights vest residual rights of control in the owner-manager, which grants absolute authority to the owner-manager, to overrule decisions, revoke prior commitment, alter resource use (Coff, 1999)
- Property rights are exercised in the pursuit of enhanced owner welfare and hence in self-regarding ways, so that owners have incentive to exercise property rights until the marginal benefits are offset by the marginal costs (Barzel, 1997)
- Owner-management reduces the cost of exercising property rights, making their use attractive (Barney, 2018; Foss & Foss, 2015)

➔ Hence, exercise of use, appropriation and transfer rights by the owner-manager is self-incentivizing.

➔ **This, as we will argue in the following, explains why owner-management is a source of both benefits *and* hazards for value creation…**

# Strategic benefits from exercising use rights

Right to use: Party holding the property right is empowered to define the use of resources.

**Strategic benefits** from the concentrated property rights in the hand of the owner-manager:

- Great deal of managerial discretion, freedom from capital market oversight, superior information access, possibility to monopolize decision-making

*Possibility to formulate innovative firm-level strategies, economizing and swift implementation of thereof enhances value generating capacity of the owner-managed firm.*

# Incentive benefits from exercising appropriation rights

Right to appropriate: Party holding the property right can appropriate residual rents after fixed claimants are paid.

**Incentive benefits** from the concentrated property rights in the hand of the owner-manager:

- Being the main, most often the sole residual claimant, powerful incentive for the owner-manager to ensure efficiency, expend effort and maximize economic value
- Monetary and non-monetary rewards foster extrinsic and intrinsic motivation to create value.

*High motivation for value creation enhances value generating capacity of the owner-managed firm.*

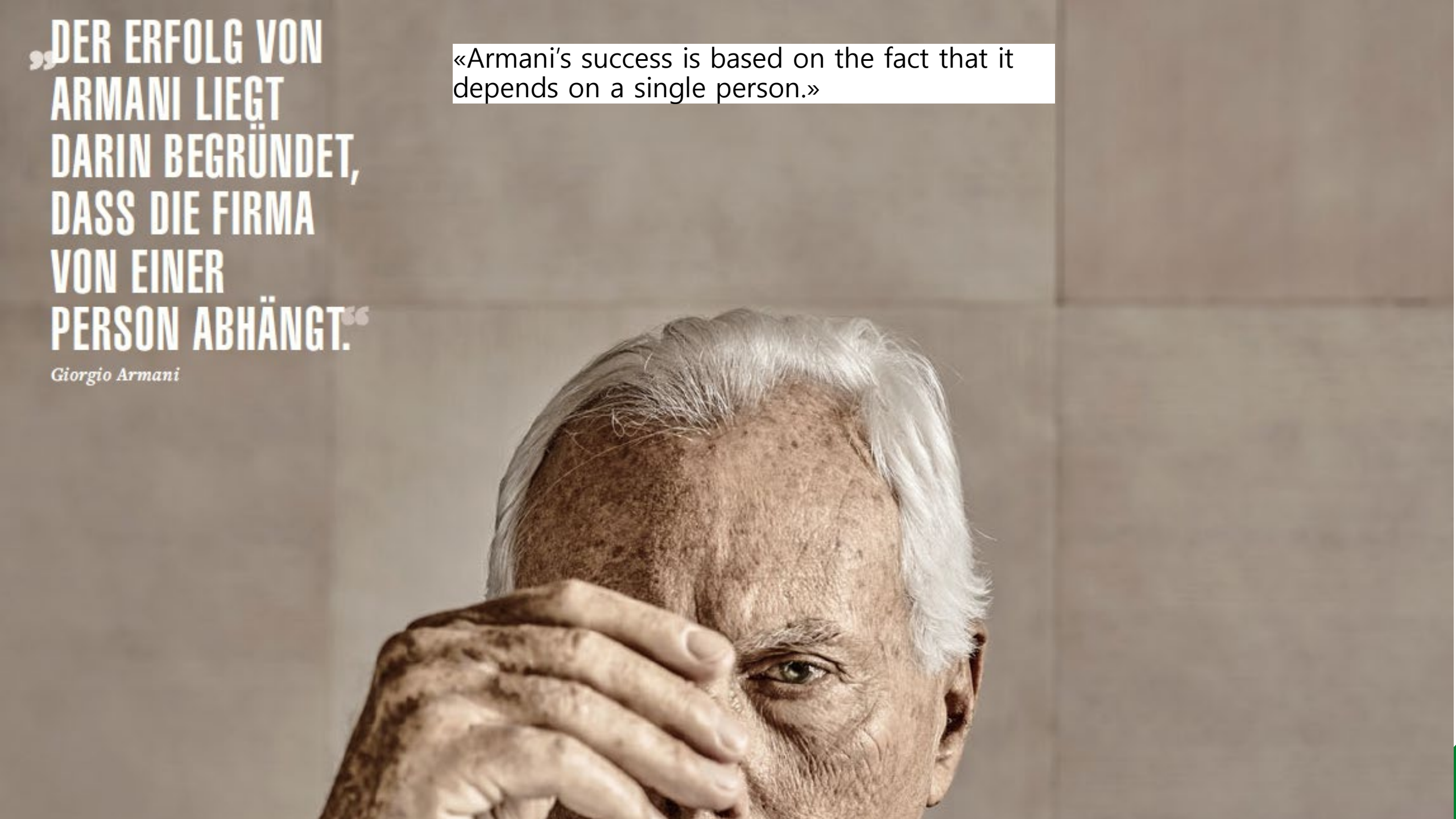
# Commitment benefits from exercising transfer rights

Right to transfer: Party holding the property right holds inalienable right to transfer right to appropriate and right to use.

**Commitment benefits** from the concentrated property rights in the hand of the owner-manager:

- Deep personal commitment to the firm, continuous involvement, accumulation of specialized experience, understanding about affordable risks for the firm (Simsek, 2007), embeddedness in ongoing social structures (Uzzi, 1996), high level of accountability for the firm - "bring honor to the firm" (Belenzon et al., 2017), dependability, capacity to engage in handshake deals, owner-manager certifies value of contracts by/to stakeholders


*Capacity to make durable commitments enhances value generating capacity of the owner-managed firm.*




«Armani's success is based on the fact that it depends on a single person.»

# The flipside of concentrated property rights in the hand of the owner-manager: the credible commitment problem

Monopolized power makes it **difficult to make credible commitments** to stakeholders, which is however required for value creation (Williamson, 1976; Barney, 2018).

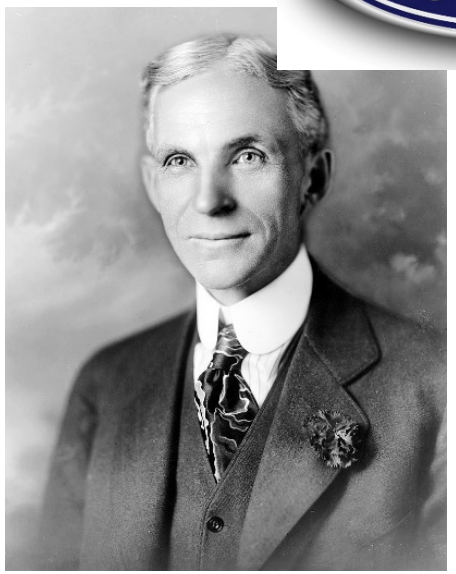
- ➔ Stakeholders fear **hold-up** and will be unwilling to commit to team efforts
- ➔ In other words, power in the hand of the owner-manager may **alienate stakeholders** and thereby undermine the capacity of the owner-managed firm to create economic value
- ➔ Note: it is **property rights in the hands of the firm's CEO who is also the controlling owner** that is at the origin of credible commitment problems (not the same as in the case of a manager of a corporation who can be sanctioned and dismissed) (Kano & Verbeke, 2012).
- ➔ The **use of thee property rights is self-reinforcing** for the owner-manager because using them is cheap for her, is possible any time she wants, and always happens with her preferences in mind.
- ➔ In colloquial terms: the hazards from dealing with the **Sun King**

# The flip side of use rights: **reliability hazards**

1. **Idiosyncratic strategies**
   - Monopolization of decision-making; is accountable to no one; can do as he/she wishes (Wang & Barney, 2006; Hoskisson et al., 2017; Weick, 1969)
   - Capricious, or erratic decision-making
   - Not holding promises
2. **Non-economic goals**:
   - Lifestyle firm, maintain family control, political agenda, "stay small"
   - Creates a wedge between interests of stakeholders, who count on professional – economically rational – conduct, and the interests of the owner-manager

- Examples: Walt Disney, Elon Musk
- Application to labor market problems in many owner-managed firms: Quality stakeholders (e.g. high performing employees) will either not join, decide to leave after experiencing holdup, or under-commit once inside the firm.

# The flip side of use rights: **reliability hazards**



About Henry Ford senior (Miller & Smith, 1993):

"In his later years, he proved to be stubborn, single minded, and without managerial flexibility. He "consumed" dominance over his fellow workers at the sacrifice of profit to himself. His lieutenants were disgruntled but helpless as they witnessed the decline of the company. Ford survived as the managerial leader of his company only because it was ***his*** company. Had the Ford Motor Company been a publicly held corporation, it is unlikely that he would have been allowed to indulge his taste for dominance for so long."

# A more recent example of reliability hazards: Theranos


*Use rights retained by the owner-manager engender reliability hazards that create a wedge between the interests of the owner-manager and the interests of resource-providing stakeholders, which detracts from value creation.*

# The flipside of appropration rights: **egocentrism hazards**



**Focus on narrow self-interest (Barney, 2018)**:

- Flip side of the incentive for value creation, tunnel vision
- Difficult to create win-win situations (Williamson, 1985; Mahoney & Kor, 2015; Blair & Stout, 1999)

**Capacity constraints on the part of the owner-manager**:

- To achieve value creation, the owner-manager must remain closely involved in the firm and monitor operations
- But, even heroic entrepreneurs will at some point reach capacity constraints
- Diminishing returns from owner-management, upper bound to value creation; threshold firms (Zahra & Filatotchev, 2004; Gedajlovic et al., 2004)

**Muting of initiative taking by stakeholders:**

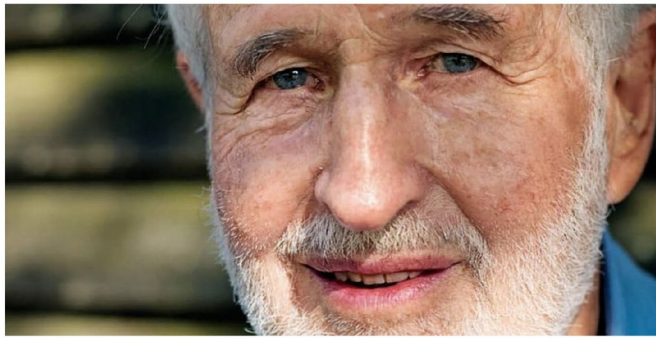
- Over-monitoring (Burkart, Gromb and Panunzi, 1997; Goranova et al., 2017)
- Colloquially: 'control freak', 'micro-manager', 'my ideas are always the best ones'

*Appropriation rights and the attendant focus on narrow self-interest on the part of the owner-manager undermines the value creation capacity of the owner-managed firm.*

# The flipside of transfer rights: succession hazards

- Departure of the owner-manager inevitable, and may engender opportunistic end-game strategies by owner-manager and stakeholders
- **Opportunistic behavior by the owner-manager**:
  - Unwillingness to let go: Attachment to their baby, overconfidence, complacency (Simsek, 2007), pleasure from exercising authority (Fehr et al., 2013)
  - Value destroying succession decisions: appoint an underqualified heir, put shares in "asset freezing" entities, such as trusts or foundations (Zellweger & Kammerlander, 2015)
- **Opportunistic behavior by stakeholders:**
  - Realize that the protection of their firm-specific investments will expire with the departure of the owner-manager: stakeholders exit, withhold effort, or engage in opportunistic behavior.

*Transfer rights may lead to succession hazards from opportunistic end-game strategies that undermine value creation.*



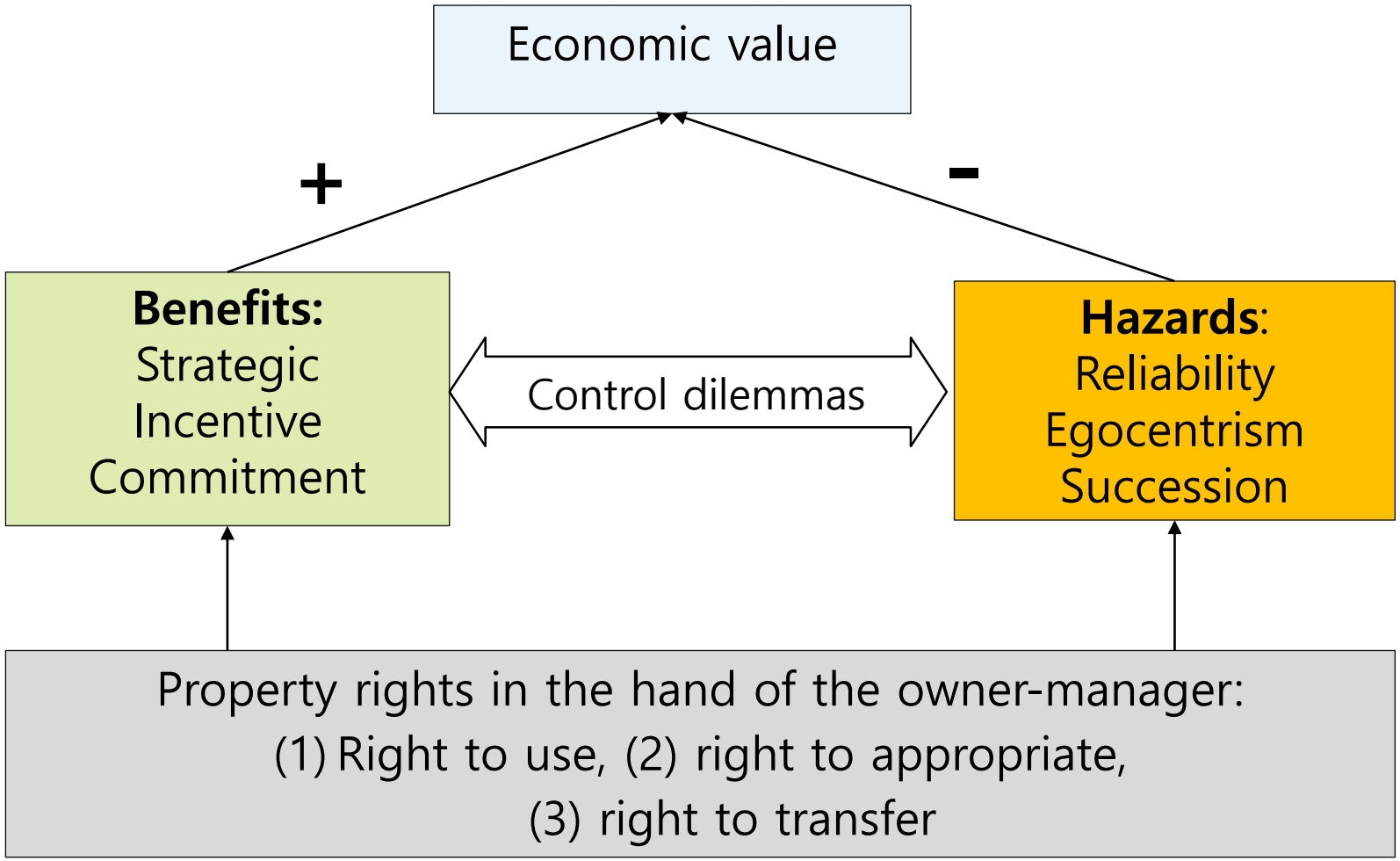
*«Ich habe Vertrauen in die Familie»: Patron Villiger.*

Heinrich Villiger

**«Meine Nachfolge plant der liebe Gott»**

Weil es mit dem CEO nicht klappte, steht Heinrich Villiger mit 88 Jahren erneut an

# Control dilemmas of the owner-manager: Property rights as sources of benefits *and* hazards for value creation



# Control dilemmas in the case of founders: the case of Elon Musk

# Control dilemmas in family firms versus non-family firms

**Reliability hazards**
- Higher voluntary employee turnover

**Succession hazards**
- Adverse selection of successors?

**Incentive benefits:**
- Higher Capex
- Lower dividends

**Commitment benefits:**
- Higher risk tolerance

Data on all private firms over 19 years; Data from the Belgian National Bank
Neckebrouck, Schulze and Zellweger, 2018

# Governance in the owner-managed firms: overcoming the credible commitment problem

- **Nobody can curb the control hazards besides the owner him-/herself.**
- Governance of the private firm thus concerned with the mitigation of **self-control problems**, whereby self-control problems refer to "actions that people take that harm themselves as well as those around them" (Jensen 1998, p. 48).
  - Self-control problems originate from intrapersonal conflict in consequence to '**dealing with oneself**', and that in doing so individuals are not protected from failure, i.e. they behave contrary to their own rational self-interest (Bazerman, Tenbrunsel & Wade-Benzoni, 1998; Loewenstein, 1996).
- Thaler & Shefrin (1981): people have an incentive to engage in self-control and thus **surrender some of their power** to move from being myopic, impulsive and caring only about their own immediate gratification, to being more far-sighted, sophisticated and other-regarding.

# Governance in the owner-managed firms: overcoming the credible commitment problem

- The governance of the owner-managed firms is essentially concerned with overcoming the credible commitment problem,
- Governance and self-control required:
  - Simple governance likely not be seen as credible enough
  - Governance without self-control, e.g. disregarding board advice, not very effective
  - Need to "walk the talk": install governance and comply to it.

**The fundamental dilemma of installing governance in the owner-managed firm:**
Owner-managers cannot create value without the cooperation of stakeholders, but making credible commitments to enlist these stakeholders requires owner-managers to limit their authority in ways that confines the free exercise of property rights and hence constrains their ability to create value.

➔ Installing governance in the owner-managed firm is a double-edged sword …

# Four governance mechanisms in the private firm: they are double-edged swords

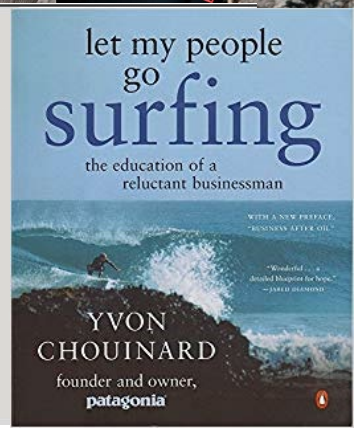
| | | Impact on control benefits | | | Impact on control hazards | | |
|---|---|---|---|---|---|---|---|
| | | ***Strategic benefits*** | ***Incentive benefits*** | ***Commitment benefits*** | ***Reliability hazards*** | ***Egocentrism hazards*** | ***Succession hazards*** |
| **Submission to social control** | Community ↓ Owner-manager | Partly reduced | Unchanged | Reduced | Reduced | Reduced | Partly reduced |
| **Delegation of authority to managers** | Owner-manager ↓ Management | Reduced | Partly reduced | Partly reduced | Reduced | Reduced | Partly reduced |
| **Submission to the hierarchy of a board** | Board ↓ Owner-manager | Partly reduced | Unchanged | Unchanged | Reduced | Unchanged | Reduced |
| **Partial allocation of ownership to stake-holders** | Owner-manager ← Stakeholders as co-owners | Reduced | Reduced | Reduced | Reduced | Reduced | Reduced |

# Submission to social control

- Owner-manager's willingness to commit to socially legitimized normative order
  - Publicly committing to value system
  - Create transparency: about strategy, financials and succession
  - Create accountability: link personal name to company «we are a family business»


Partly reduced reliability, egocentrism, and succession hazards

Reduced strategic and commitment benefits



HiPP
The best from nature.
The best for nature.

# Delegation of authority to managers

- Even most heroic owner-manager must depend on subordinates, with knowledge of particular circumstances and time and places (Hayek, 1945)
  - Budgets (in financial terms), strategic plans, goals, transparency
  - De-personalization of the firm
  - Removed capacity constraints

Partly reduced reliability, egocentrism, and succession hazards

Reduced strategic, incentive and commitment benefits

Empirical evidence for net positive effect of installation of management team for value creation, see Durand & Vargas, 2003

# Submission to the hierarchy of a board

- Assures accountability, reduces biases of the owner-manager
- May serve as a mediator between stakeholder interests, facilitating team production (Blair & Stout, 1999; Machold, Huse, Minichilli & Nordqvist, 2011)
- Appoints top-management, including CEO
- But: e.g. lacks the tools to counter over-control; may slow down decision-making

Reduced reliability and succession hazards

Partly reduced strategic benefits

Empirical evidence for net positive effect of appointment of a board, see Villalonga et al., 2018

# Partial allocation of ownership to stakeholders


- Stakeholders with a true say in setting the strategic direction of firm
- Formal claim on residual income: rent sharing with stakeholders
- But also: dilution of ownership, undermined incentives and strategic agility

Reduced reliability, egocentrism and succession hazards

Partly reduced strategic, incentive and commitment benefits

# Discussion and Contribution

- Integrated, parsimonious theorizing about benefits *and* costs of private firm's heterogeneous capacity to generate economic value
- Provides a micro foundation about control dilemma between "kingdom and throne" addressed by Wasserman (2006)
- New light on costs tied to owner-management, challenging/complementing agency theory
- Governance of the private firm required to solve team production problems
  - Needed, in the form of self-control by owner-manager, "tie your hand"
  - But doing so undermines the inherent advantages of owner-managed firms
  - Concur with Schulze et al. (2001) that for enhanced value creation private firms need to partly adopt the governance mechanisms of the corporation.
  - Dilemma of the entrepreneur: his own success breeds his demise.
- Suggests a tradeoff between control costs ←→ agency cost:
  - Positive reason for the emergence of agency costs
  - Agency costs: inevitable price to be paid for the creation of economic value

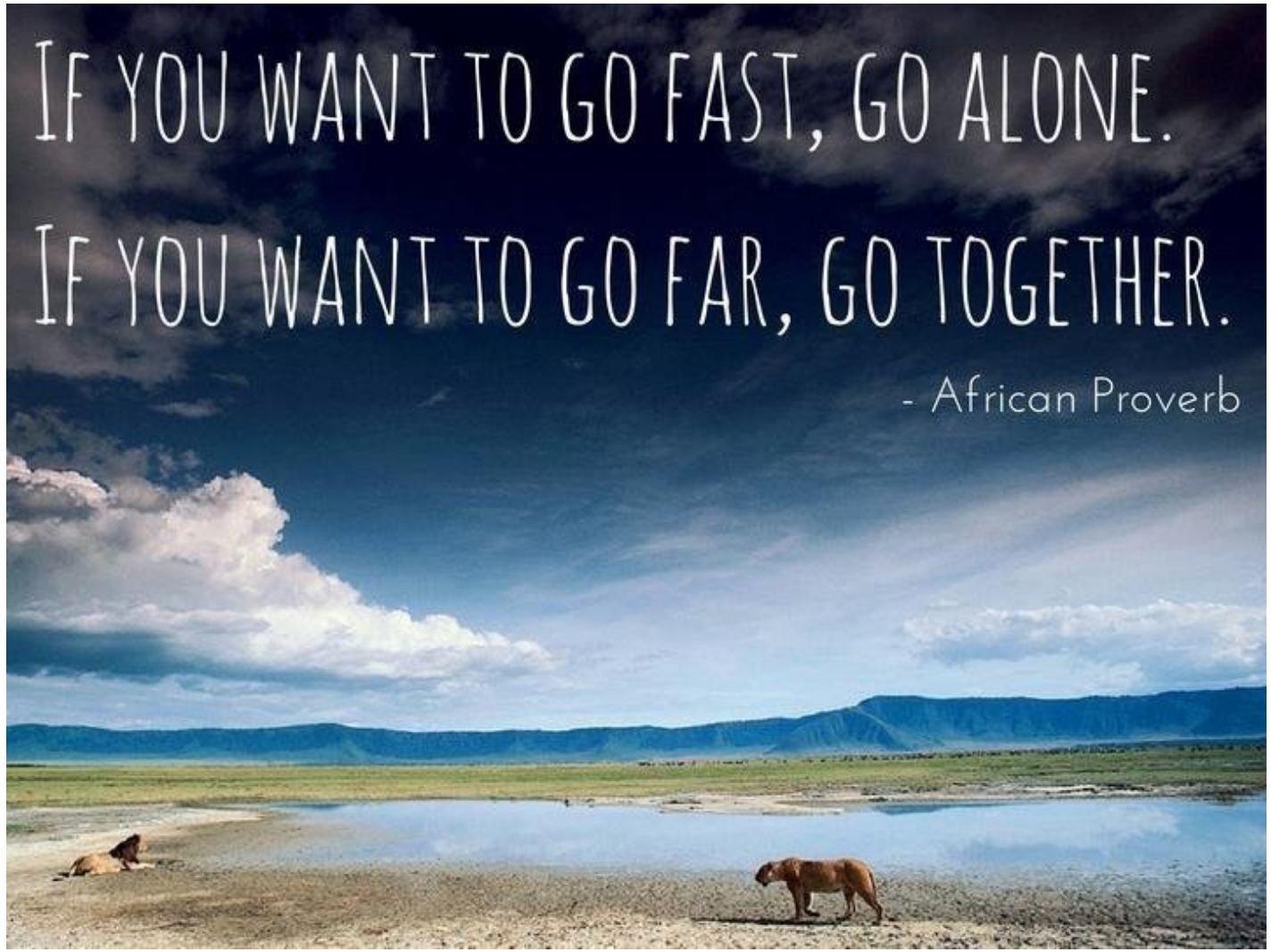
# Discussion and Contribution

- Contributes to literature on malfeasance inflicted by owners (e.g., Goranova & Zajac, 2015; Anabtawi & Stout, 2008)
- Contribution to property rights literature and stakeholder literature (Hoskisson et al., 2017; Barney, 2007; Kano & Verbeke, 2015): property rights not only problematic because of unreliability, but also because of appropriation and succession hazards
- Points at generic strengths and weaknesses of owner-managed firms
  - Strengths: strategic, incentive, and commitment benefits
  - Weaknesses: reliability, egocentrism, succession hazards
    … and what can be done about them … (see governance mechanisms)
- Contribution to work on management dilemmas and paradoxical leader behavior (Zhang, Waldman, Han & Li, 2015; Miller & Sardais, 2015): provide a micro-foundation for the paradoxical demands of the entrepreneur's job in terms of control versus delegation:
  - Dilemma 1: exploitation of and limits to individual freedom
  - Dilemma 2: self- versus other centeredness
  - Dilemma 3: pursuit of continuity in light of one's finiteness

# Future research

- Heterogeneity among private firms:
  - Success of founder firms: marked strategic benefits and succession hazards
  - Success of family firms: marked commitment benefits and reliability hazards
- Contingencies:
  - Tenure and age of the owner-manager
  - Firm age: life cycle effects
  - Industry: owner-managed firm at advantage in industries where there is need for little combined investments and coordinated effort from multiple parties (Alchian & Demsetz, 1972)
  - Riskiness of firm-level strategy: property rights particular valuable under uncertainty; but role of risk mitigation strategy, such as entrepreneur's wealth?
- Dynamic evolution of governance mechanisms
- Combination and order of deployment of various governance mechanisms

# Thank you for your attention



# Backup

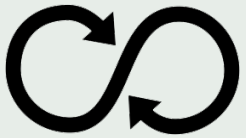
# Exercize of property rights theory and potential for economic value creation depending on those who have power

High bargaining power of the owner-manager (Coff, 1999):

1. High capacity of unified action: no collective action problems, can monopolize decision-making
2. Privileged access to key information: increases bargaining power vis-à-vis stakeholders (e.g. exaggerating financial difficulties to pay less or demand more)
3. High replacement cost of owner-manager: high firm-specific investments; the only person who can replace the owner-manager is the owner-manager himself; infinite replacement costs
4. High exit costs to the owner-manager: undiversified income, wealth and social identity.

Consequence: the property rights of the owner-manager are particularly secure and thus decisive for value creation.

Sidenote: higher bargaining power of the owner-manager than the CEO of the corporation.

| Property right | Description of property right | Benefit for value creation | Costs for value creation |
|---|---|---|---|
| | | ← Value creation dilemmas → | |
| **Right to appropriate** | Party holding the property right can appropriate residual rents after fixed claimants are paid. | **Incentive advantage**<br>Incentive to exercise control, expend effort, commit own resource in firm-specific ways  | **Appropriation hazard**<br>Focus on narrow self-interest and limited monitoring capacity on the part of the owner-manager, just as the muting of initiative taking by stakeholders   |
| **Right to use** | Party holding the property right is empowered to define the use of resources. | **Strategic advantage**<br>Managerial discretion to formulate innovative firm-level strategies, economizing and swift implementation thereof  | **Reliability hazard**<br>Misaligned goals of owner-manager and stakeholders, just as behavioral uncertainty of owner manager lead to adverse selection and morally hazardous behavior of stakeholders  |
| **Right to transfer** | Party holding the property right holds inalienable right to transfer right to appropriate and right to use. | **Continuity advantage**<br>Accumulation of firm-specific resources, embeddedness advantages, accountability of leadership  | **Succession hazard**<br>High replacement costs of owner-manager and unwillingness to depart because of over-attachment to the firm  |

# Advantages from exercize of property rights in the hand of the owner-manager for value creation

| Property right | Description of property right | Benefit of property right in the hand of the owner-manager for value creation |
|---|---|---|
| **Right to use** | Party holding the property right is empowered to define the use of resources. | **Strategic advantage** Managerial discretion to formulate innovative firm-level strategies, economizing and swift implementation of thereof |
| **Right to appropriate** | Party holding the property right can appropriate residual rents after fixed claimants are paid. | **Incentive advantage** Incentive to exercise control, expend effort, commit own resource in firm-specific ways |
| **Right to transfer** | Party holding the property right holds inalienable right to transfer right to appropriate and right to use. | **Continuity advantage** Accumulation of firm-specific resources, embeddedness advantages, accountability of leadership |