How Embeddedness and Social Mechanisms Affect the Economic Performance in the Music Industry: The Case of Mescal Music

Fabrizio Montanari
SDA Bocconi School of Management

Antonio Cianfagna
Mescal Music

Fabrizio Montanari *is assistant professor at the University of Modena and Reggio Emilia and he also works at Bocconi University (Institute of Organization and Information Systems). His research interests regard the analysis of networks in the cultural industries.*

Antonio Cianfagna *graduated at Bocconi University in 2004 with a specialization in Organization Studies. Now he is working at Mescal Music in the Recording and Artistic (R&A) production Unit.*

Abstract
Like for most cultural industries, the music industry's products have a twofold nature: They are simultaneously artistic and economic products. For this and other reasons (such as high environmental uncertainty, high human asset specificity, etc.), the music industry represents a very difficult context in which to successfully compete. To face this high market complexity, two main organizational responses have emerged: On the one hand, we have few large multinational firms ('majors'); on the other hand we have a large number of smaller and loosely structured firms ('independents').
The main aim of this paper is to study the case of an Italian independent label, Mescal Music, which has achieved a relevant market share in the Italian market. In order to investigate which organizational factors have led Mescal to such a relevant success, we adopted a case study methodology combining different data collection methods: archives' analysis, interviews, questionnaires, secondary sources and direct observation.

Keywords
Embeddedness, Network governance, Social mechanisms, Music industry, Case study

Introduction

Over the last 20 years, there has been an increasingly attention for the network form of governance. Many industries increasingly are using network governance (coordination characterized by informal social systems rather than bureaucratic structures within firms and formal contractual relationships between them) to coordinate complex products or services in uncertain and competitive environments (Powell, 1990; Ring and Van de Ven, 1992).

The theory of the network form of governance comes from an integrated vision between transaction cost economics and social network theories, and basically, asserts that the network form of governance is a response to exchange conditions characterized by human asset specificity, demand uncertainty, task complexity, and frequency (Jones, Hesterly and Borgatti, 1997). These exchange conditions involve high adaptation needs, owing to changing product demand, high coordination needs, owing to integrating diverse specialists in complex tasks, and high safeguarding needs, owing to overseeing and integrating parties' interests in customized exchanges. To enhance cooperation, the network form of governance relies more heavily on social coordination and control, such as occupational socialization, collective sanctions, and reputations, than on authority or legal recourse. Under these exchange conditions, thus, the network form of governance offers comparative advantages over hierarchies and markets in simultaneously adapting, coordinating, and safeguarding exchanges.

Embeddedness is a fundamental element of this governance form, as it explains how dyadic exchanges and the overall structure of relationships can affect economic action and outcomes. Embeddedness provides the basis for understanding how social mechanisms, such as restricted access, macro-cultures, collective sanctions and reputations, coordinate and safeguard exchanges in networks

The network form of governance has been observed in many industries, such as, for example, semiconductors (Saxenian, 1990), film (Faulkner and Anderson, 1987), and fashion (Uzzi, 1996). Peterson and Berger (1971) argue that also the music industry represent a favourable context for the emerging of network governance, as it is characterized by high level of environmental uncertainty, human asset specificity, and task complexity.

To face this high market complexity, two main organizational responses have emerged: On the one hand, we have few large multinational firms (such as, for example, EMI and Sony Music), which are part of entertainment conglomerates and are referred to as the 'majors'; on the other hand, we have a large number of smaller more regionally bounded 'independents', often specialists in a particular music genre (Gander and Rieple, 2004). The 'majors' produce mass products and are characterized by a more bureaucratic organizational structure. The 'independents' are smaller and loosely structured record firms, based on stable and long lasting ties with musicians, distributors, technical suppliers and live concerts agencies.

This paper aims to study the case of an Italian independent label, Mescal Music, which represents a rare example of an indie being able to achieve a relevant market share in the Italian music industry. In particular, we are interested if Mescal Music has adopted coordinating mechanisms more close to the network model or to the 'major' bureaucratic model. In order to investigate which organizational factors have led Mescal to successfully compete in the Italian market, we adopted a case study methodology combining different data collection methods: archives' analysis, interviews, questionnaires, secondary sources and direct observation.

Theoretical Framework

Network Governance: Definition and Exchange Conditions

The theory of the network form of governance comes from an integrated vision between transaction cost economics (Williamson, 1975, 1981) and social network theories, and constitutes a "distinct form of coordinating economic activity" (Powell, 1990: 301), which contrasts and competes with markets and hierarchies.

Network governance involves a select, persistent and structured set of autonomous firms/actors engaged in creating products or services based on implicit and open-ended contracts to adapt to environmental contingencies and to coordinate exchanges (Jones, Hesterly and Borgatti, 1997). These contracts are socially (not legally) binding, as they use mechanisms of adapting, coordinating and safeguarding exchanges that are not derived from authority structures or from legal contracts. To enhance cooperation on shared tasks, the network form of governance relies more heavily on social coordination and control, such as occupational socialization, collective sanctions, and reputations, than on authority or legal recourse (Nohria, 1992; Ouchi, 1980; Saxenian, 1990).

Jones and colleagues (1997) identified four conditions necessary for network governance to emerge and thrive, and, thus, addressing problems of adapting, coordinating, and safeguarding exchanges more efficiently than other governance forms. These conditions are: demand uncertainty, customized exchange with high human asset specificity, complex tasks, and frequent exchanges among parties comprising the network.

Demand uncertainty refers to the inability of an individual or organization to predict future events (Milliken, 1987). Demand uncertainty can be generated by unknown and rapid shifts in consumer preferences, or by seasonality, or by rapid changes in knowledge and technology (Jones et al., 1997). Customized (or asset-specific) exchanges create dependency between parties, increasing demands for coordination and raising concerns about how to safeguard these exchanges. Task complexity refers to “the number of different specialized inputs needed to complete a product or service” (Jones et al., 1997: 921). Task complexity creates behavioral interdependence and heightens the need for coordinating activities (Pfeffer and Salancik, 1978). Frequency concerns how often specific parties exchange with one other.

These four exchange conditions involve high adaptation needs, owing to changing product demand, high coordination needs, owing to integrating diverse specialists in complex tasks, and high safeguarding needs, owing to overseeing and integrating parties’ interests in customized exchanges. The need for safeguarding and coordinating exchange inhibits parties from using market mechanisms for customized, complex tasks, and the need for adapting exchanges inhibit parties from using hierarchies. Therefore, under these conditions, the network form of governance offers comparative advantages over hierarchies and markets in adapting, coordinating, and safeguarding exchanges.

Network Governance: Social Mechanisms as Coordinating Mechanisms

The network form of governance carries out special problems of adapting, coordinating, and safeguarding exchanges, relying as it does on autonomous units operating in a setting characterized by demand uncertainty with high interdependence, owing to customized, complex tasks (Jones et al., 1997). Network governance overcomes these problems by using social mechanisms rather than authority, bureaucratic rules, standardization, or legal resources.

These social mechanisms consist of restricting access to exchange, imposing collective sanctions, and making use of social memory and cultural processes (Jones et al., 1997).

In particular, *restricted access to exchanges* in the network is “a strategic reduction in the number of exchange partners within a network” (Jones et al., 1997: 927). In network governance restricted access occurs through status maximization and relational contracting. The status maximization strategy restricts access because partners seek to avoid partners of lower status; however, since other parties also are avoiding parties of significantly lower status, the result of status maximization is exchange among units of similar status. Status is based on past demonstrations of quality or association with high-status partners (Podolny, 1994). Alternatively, relational contracting restricts access, because a party works with fewer partners more often (Bolton, Malmrose and Ouchi, 1994). Restricted access reduces coordination costs: Having fewer partners who interact more often reduces variance in expectations, skills and goals, and permits exchange partners to learn about each other and to establish routines for working together (Faulkner and Anderson, 1987). Restricted access also facilitates safeguarding exchanges: Having fewer partners, who interact more often, increases identification among parties and provides conditions for developing strong ties among those involved (Granovetter, 1973).

Macro-culture is a system of widely shared assumptions and values, comprising industry-specific, occupational or professional knowledge, that guide actions and create typical behavior patterns among independent entities (Jones et al., 1997). Macro-culture is something that is shared by all participants of an industry. Macro-culture specifies roles, role-relationship and conventions-accepted approaches and solutions to problems-to be employed by participants (Becker, 1982). Thus, macro-culture coordinates interdependent activities among independent entities so that complex tasks may be completed. Macro-cultures are diffused and sustained through three institutional means: Socialization processes, trade journals or industry newsletter (e.g. *Daily Variety* for the Hollywood film industry), and industry events, such as trade shows, film festivals, and conferences (Jones et al., 1997). Macro-culture facilitates efficient exchange among parties because the ground rules do not have to be recreated for each interaction (Faulkner, 1987). Macro-culture, in fact, enhances coordination among autonomous parties by creating convergence of expectations through socialization, and by allowing for idiosyncratic language to summarize complex routines and information.

Collective sanctions involve group member punishing other members who violate norms, values or goals and range from gossip and rumors to ostracism (exclusion from the network for short periods or indefinitely) and sabotage (Jones et al., 1997). Collective sanctions safeguard exchanges, because they define and reinforce parameters of acceptable behavior by demonstrating the consequences of violating norms and values. In Maine lobster trapping, for instance, interlopers who violate fishing territories and accepted norms are sanctioned “through surreptitious destruction of their traps” (Acheson, 1985: 386). Ostracism is used often in the film industry when parties violated accepted behaviors (e.g. Michael Cimino and his movie *Heaven’s Gate*).

Reputation involves an estimation of one’s character, skills, reliability and other attributes important to exchanges. An individual’s reputation is particularly important in contexts characterised by imperfect information, in which actors have to rely on proxies or signals to make rational assumptions about the intention and future behaviours of other actors (Fombrun and Shalley, 1990). When these signals are derived from past observations, they serve as a stable basis to form rational beliefs about the actors in question. Thus, models of reputation presume a tight coupling between individuals’ past actions and future expectations (Weigelt and Camerer, 1988). The higher an individual’s reputation is, the more valuable s/he becomes in both the external or internal labour market (Kilduff and Krackhardt, 1994). In the film industry, for instance, reputation is a critical factor for careers, as “persons with successful performances and good reputations move ahead in their careers, those with only moderate reputations do not, and those with poor reputations experience employment difficulties and fail in the market” (Faulkner and Anderson, 1987, p. 881). Reputation safeguards exchanges because it relays the detection of and serves to deter deceptive behavior, which enhances cooperation (Jones et al., 1997).

A key issue in assessing the effectiveness of these social mechanisms for adapting, coordinating and safeguarding exchanges is their congruence: Congruent mechanisms reinforce one another to promote cooperation.

Embeddedness as a Foundation for Social Mechanisms

Under conditions of demand uncertainty, human asset specificity, task complexity, and frequency of exchange, organizational fields develop structural embeddedness. While relational embeddedness captures the quality and depth of a single dyadic exchange, which in other words are the extent to which exchange parties consider one another's needs and goals, structural embeddedness refers to the extent to which a "dyad's mutual contacts are connected to one other" (Granovetter, 1992: 35). This means that actors (individual or organizations) do not have relationships only with each other, but with the same third parties as well; thus, many parties are linked indirectly by third parties. Structural embeddedness, thus, refers to the network's overall structure and architecture, and is a function of how many participants interact with one another, how likely future interactions are among participants and how likely participants are to talk about these interactions (Granovetter, 1985, 1992).

Structural embeddedness allows information about third parties' actions and reputation to spread among those within the network. Thus, the more structural embeddedness there is in a network, the more information each player knows about all of the other players and the more constraints there are on each player's behavior (Burt, 1992). Embedded ties are characterized by three main features, which are mutually reinforcing and facilitate economic exchange. These features are trust, fine-grained information transfer and joint problem-solving arrangements (Uzzi, 1996). The presence of strong and long-lasting ties among parties can facilitate the development of strong social rules and reciprocal trust, which in turn encourage communication among the parties and the creation of routine, common languages and a common culture (Coleman, 1990; Nelson and Winter, 1992).

Nevertheless, too much embeddedness may create its own set of problems. Uzzi (1997) suggests that over-embeddedness (i.e. many strong ties and few weak ties) can reduce the flow of novel information into the network because of redundant ties to the same network partners. Over-reliance on strong ties tends to develop tight, relatively isolated cliques that are not well integrated with the rest of the industry. In this way, there are few or no links to outside members who can potentially contribute with new ideas and information. The optimal level of structural embeddedness in terms of overall fitness of the network may be an intermediate range, where parties are neither too tightly connected nor too loosely connected to be unaware of who needs information and has information to provide (Jones et al., 1997).

So, structural embeddedness provides the basis for social mechanisms to adapt, coordinate and safeguard exchanges as well as enhances the likelihood of the network form of governance emerging and thriving. Structural embeddedness is critical to understand how social mechanisms coordinate and safeguard exchanges in networks: It diffuses values and norms that enhance coordination among autonomous units, and it diffuses information about parties' behaviors that enhances safeguarding customized exchanges. Thus, structural embeddedness allows parties to use implicit and open-ended contracts for customized, complex exchanges under conditions of demand uncertainty, and it enables social mechanisms (restricted access, macro-culture, collective sanctions, and reputation) to coordinate and safeguard exchanges.

Structural embeddedness makes restricted access possible, because it provides information so that parties know with whom to exchange and whom to avoid. Since structural embeddedness diffuses information throughout a system, it also facilitates the development of macro-culture, because parties share perception and understandings (Pfeffer and Leblebici, 1973), and facilitates reputation to flow throughout the system. Finally, structural embeddedness allows the use of collective sanctions, since parties must know about misfeasance in order to act to condemn or ostracize perpetrators.

The Music Industry

In the music industry, like in most cultural industries, product performance has to be conceived in a multidimensional way, because cultural goods have a twofold nature: They are simultaneously artistic and economic products (Delmestri, Montanari and Usai, 2005). On the one side, creativity, innovativeness and authenticity represent cultural industries' peculiar features and the principal reason why they are able to attract people (Peterson, 1997). On the other hand, both economic efficiency and effectiveness are relevant dimensions to which cultural industries' actors are subjected, and affect how successfully they can operate.

Thus, from an economic viewpoint, recorded music is relevant, as it generates aggregate worldwide revenues of some $40 billion per year (Vogel, 1998). But, because it is the most personalized and accessible form of entertainment, it also readily pervades virtually every culture and every level of society (Vogel, 1998). Therefore, considering both its creative and economic nature, music may be considered one of the most important entertainment businesses.

From an economic point of view, the music industry represents a very competitive and difficult context, as it is characterized by high level of environmental uncertainty. This high degree of uncertainty is due to rapid and unpredictable changes in customers' preferences, which shorten product life cycles (Peterson and Berger, 1971, 1975), and to the "superstar phenomenon" (Hamlen, 1991; Rosen 1981), which lead to huge differentials in sales between those artists who are successful and those who are not (Cox, Felton and Chung, 1995).

Music production and distribution processes are very complex tasks, as they require the coordination and integration of a wide range of different specialised skills (Cillo and Soda, 2001; Gander and Rieple, 2004). Table 1 reports the activities required to bring music product to market in terms of value system chains (Porter, 1985). All these activities required to bring music product to market make music industry's transactions complex, requiring intangible knowledge and involving processes that are difficult to monitor and assess (Gander and Rieple, 2004).

In order to cope with this high market complexity, record companies have employed different organizational responses. On the one hand, we have few large multinational firms, which are part of entertainment conglomerates and are referred to as the 'majors'; on the other hand, we have a large number of smaller more regionally bounded 'independents', often specialists in a particular music genre (Gander and Rieple, 2004). The 'majors' (Universal Music Group, Warner Music Group, Sony BMG Music Entertainment and EMI) have such a range and depth of economic resources, skills and knowledge (both technical and creative), that they are able to dominate the market with mass products and an integrated organizational structure. With one exception, "they are divisions of multinational entertainment conglomerates and have a combined global market share of 76%" (Gander and Rieple, 2004: 58). The 'independents' are smaller, locally specific and loosely structured record firms, which have not relevant market shares and produce niche music records. Such indies are, for the most part, owned and managed by the individuals who set them up, and are, due to this and their smaller size, less bureaucratic than the majors. The independents are characterized by a very informal organizational structure, based on stable and long lasting ties with musicians, distributors, technical suppliers and live concerts agencies.

Table 1:
Value Generating Activities and Assets Involved in the Creation, Identification, Development and Exploitation of Music Product

Assets involved	Value generating activities
Product initiation stage	
Music composing skills	Creation of a music score
Writing ability	Writing of lyrics
Product sourcing and development stage	
Insight to future music trends	Distinguishing promising new acts
Credibility and acceptability	Gaining access to and signing promising new acts
Music and artist development skills	The creation of commercialized product
Product exploitation stage	
Marketing planning procedures and practices	Creating a marketing plan
Budget management policies and skills	Providing contingent financial support
Distribution network	Ensuring widespread availability of the music product
Promotional competences and contacts	Delivering a timely and coordinated promotion of the artist(s) and their product across a variety of media

Source: adapted from Gander and Rieple, 2004: 59.

In the next paragraph, we will analyze the case of an Italian independent label, Mescal Music, which represents a rare example of an independent being able to achieve a relevant market share in the Italian music industry. In order to investigate which organizational factors have led Mescal to such a relevant success, we adopted a case study methodology combining different data collection methods: archives' analysis, interviews, questionnaires, secondary sources and direct observation.

The Case of Mescal Music

Mescal Music was created in 1993 by Valerio Soave (a copyright lawyer) and Ligabue (a famous Italian rock singer) with the main goal of producing and developing young breakthrough artists. At the beginning Mescal Music was a small loosely structured company. In 1997, when Ligabue quit the company, Mescal started its organizational development. Mescal decided to focus on a small number of unknown artists, with whom majors refused to sign contracts.

Majors, in fact, thought these artists did not have any potential commercial appealing due to the kind of music they performed.

Mescal's strategic decision regarded the idea to develop not a product, but an artistic project. Thus, Mescal decided to manage a small number of artists (7-8) with a long run orientation: Soave started to tightly collaborate with the artists in order to develop together an artistic project focused on artists' core characteristics. In Soave's idea, the artists' weaknesses had to become their strengths. The idea was to develop artists performing music strongly differentiated from the mainstream music, so that audience could easily identify them. Beside the music peculiarity and innovativeness, Mescal's artists were also great live performers. Thus, the communication strategy was focused on live shows, in order to get them known by audience through the word of mouth. The results were surprising: In only eight months, *Subsonica* sold 30,000 copies, *Bluvertigo* 22,000 (and 100,000 in one year), *Afterhours* 25,000 and *Cristina Donà* 17,000.

Nowadays, Mescal Music is the most important indie company in the Italian market (in 2004 it had revenues for over 2.5 Million Euros) and some of its artists, such as, for example, *Subsonica*, are one of the most well reputed singers in Italy.

Mescal Music's Organizational Structure

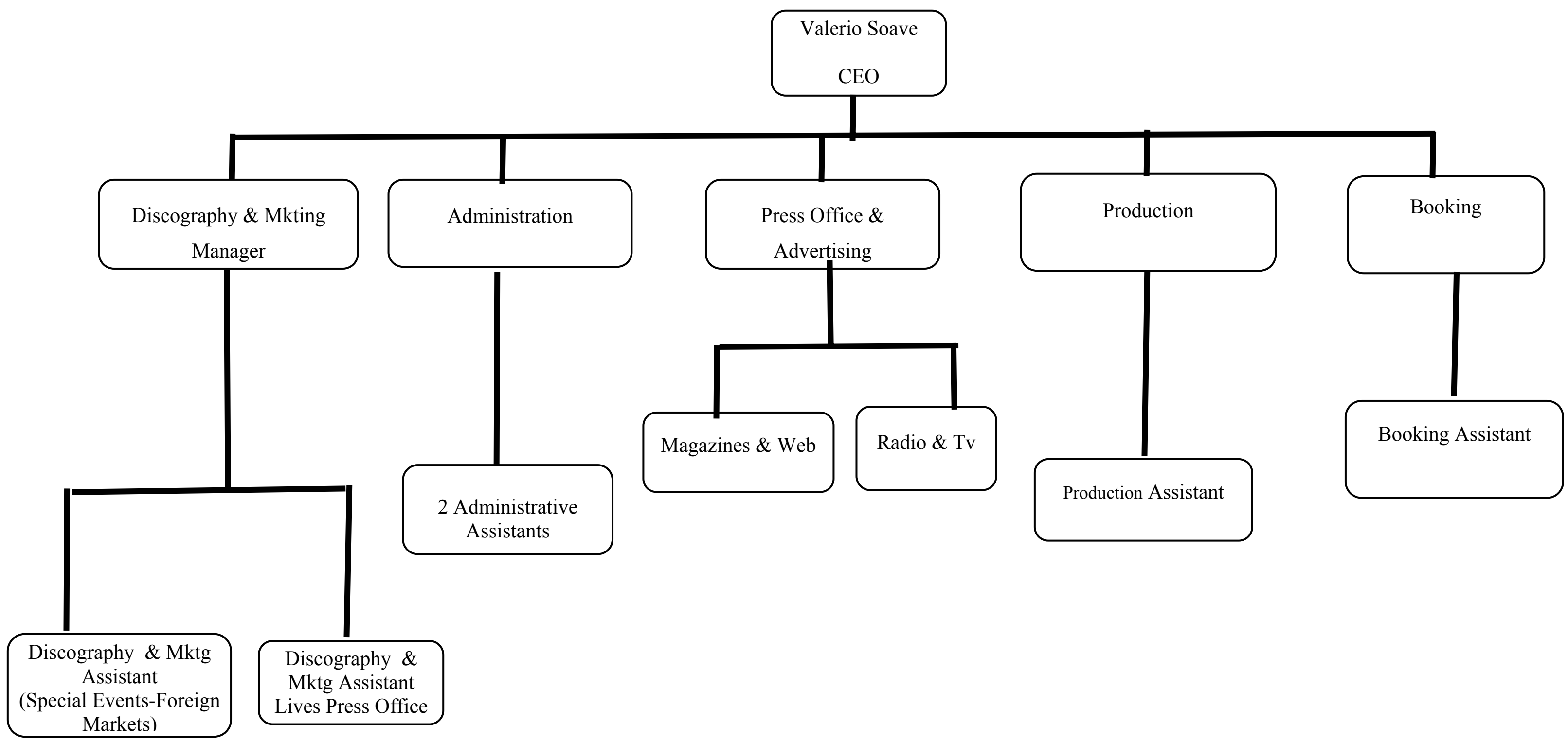
The reasons of Mescal's success could be found in its particular ability to combine organizational elements typical of both majors and independents. Mescal Music, in fact, represents a 'borderline' firm, because it is not strictly an independent label and not even a major, but a sort of hybrid organization.

Like majors, Mescal has the direct control on all the production processes, from the conceiving to the distribution of a record. Mescal has a complex structure, as it comprises all the most important music organizational functions: Mescal is recording maker, publisher (*S4 Music*), and recording agency and it also is the manager of some external musicians. All these functions are not typical of an independent label, which usually only produces and sells records. Mescal has also a long-lasting agreement with Sony Music Italy for the products distribution. In this way, Mescal can exploit the Sony capabilities in products capillary distributing all over the Italian market.

On the other hand, like independents, Mescal has not a very formalized and bureaucratic structure, but rather an organic and flexible one, in which individual behaviors' control is not based on hierarchical or market like coordinating mechanisms, but on social ones. These coordinating mechanisms are very close to those typical of a network/clan model: Occupational socialization, collective sanctions, reciprocal trust and reputation (Ouchi, 1980). Mescal, in fact, has always supported and developed a stable and thick network both outside (with the distributor, the promoting agencies, live music bars, etc.) and inside (with musicians, employees, technicians, etc.) the organization. The presence of such strong and long lasting ties constitutes the Mescal's most valuable resource, because it has favored the development of strong social rules and reciprocal trust, the creation of common and shared languages among the different actors, and the reduction of the potential for opportunistic behaviors.

Therefore, Mescal Music's organization structure (see also Figure 1) is an organic structure characterized by low degrees of formalization, vertical differentiation and centralization. Thus, in Mescal team-working is a common practice and workers are encouraged to get involved and committed to the organization's life. In Mescal, people can work autonomously and are responsible for their results. Organizational control mechanisms, thus, are not based on hierarchical elements (such as standardization, formalization, rules, etc.), but rather on social ones, such as culture (people share a broad range of values and beliefs), trust, reciprocity and identification with the organization. Mescal's organization is characterized by widespread and straightforward informal communication system, which allows the fast transfer of knowledge and information throughout the entire organization. Mescal's environment is very informal. As the artists are not considered products, but human beings, so the workers are considered from a human standpoint. Valerio Soave himself is formally the CEO, but he acts more as an advisor: He replaces the hierarchical authority with a charismatic leadership. Thus, he is the first enhancing people participation in organization's life because he thinks only through the free and voluntary participation of all workers, Mescal should become a favorable field for the generation of new ideas. In this way, if an outsider visits Mescal, s/he can immediately perceive the feeling of a strong community.

Figure 1:
Mescal Music's Organizational Chart.



Conclusions

Mescal Music is the most important independent company in the Italian market: In the last three years it conceived revenues of about 3 Million Euros each year and some of its artists are one of the most well reputed musicians in Italy. According to the results of our case study, we can argue that the reasons of Mescal's success could be found in its particular ability to combine organizational elements typical of the two typical organization types operating in the music industry: the 'majors' and the 'indies'. On the one hand, Mescal, like majors, has the direct control on all the production processes and comprises all the most important music organizational functions. On the other hand, like independents, such control is not based on hierarchical or market like coordinating mechanisms, but on social ones such as occupational socialization, collective sanctions, reciprocal trust and reputation, which are typical of a network governance form. Mescal, in fact, has always supported and developed a stable and thick network both outside (with the distributor, the promoting agencies, live music bars, etc.) and inside (with musicians, employees, technicians, etc.) the organization. The presence of such strong and long lasting ties constitutes the Mescal's most valuable resource, because it has favored the development of strong social rules and reciprocal trust, the creation of common and shared languages among the different actors, and the reduction of the potential for opportunistic behaviors. Therefore, the study's results confirm the idea suggested by network theory that the peculiar network of relationships existing within a firm could constitute a valuable resource for gaining a competitive advantage in turbulent, competitive and complex industries.

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