

**RATIONALITY AND COOPERATION BETWEEN FIRMS.
TESTING HABITUAL BEHAVIOUR IN GREEK INDUSTRIES**

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I. Objectives

The aim of this empirical research is to investigate the influence of some social factors that are actually constraining the entrepreneurial strategy. Actual decision-making and action does not follow simple maximization rules inside an exogenously determined institutional framing. Entrepreneurs act inside a concrete, ongoing system of social relations and are largely influenced by non-market social factors such as habits and rules.

Our main objective is to verify whether and to what extent the strategic behavior of Greek entrepreneurs is the result, of not only a strict rational calculation, but also the result of a ‘rule-following behavior’. In order to do so, we have focused on the social environment of entrepreneurial strategy: informal arrangements and cooperation between firms, informal relations, trust links, family links etc. The application of sociological techniques of research (personal interview guided by a questionnaire) has performed interesting empirical results. The statistical analysis of the data provides strong evidence as to the impact of cooperative habits and rules on entrepreneurial strategy. On the whole, the data concerning a developed region of Greece seem to reveal an intentional cooperative pattern of behavior of firms, based on social rules that favor self-sustaining contract enforcement and reduce transaction costs and the risks of opportunism.

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II. The Significance of Informal Institutions and arrangements

In the tradition of Classical Political Economy production of commodities was considered as a social process that takes place in a specific historical context¹. This view was taken for granted not only by the old Institutionalists like Veblen and Commons but also by some early neoclassical writers such as Alfred Marshall². It was then commonly believed that “production takes place only in society –only through the co-operation of an industrial community” [Veblen, quoted in Tabb 1999]. The meaning of this rather obvious, and yet undervalued nowadays, assertion is that all economic activities are institutionally embedded. Decision-makers operating within different institutional and social settings are therefore, reaching different decisions [Loasby 1993, 219]. Consequently, as Ronald Coase wrote [1992, 718], “it makes little sense for economists to discuss the process of exchange without specifying the institutional setting within which the trading takes place”.

According to Douglas North [1993, 245] “Institutions consist of informal constraints and formal rules, and of their enforcement characteristics”. In that sense Institutions include not only formal **organizations** (business firms, banks, corporations, local authorities, schools), and **social structures** (legal system, property rights assignment, political structures), but also all the informal **social values** (routines, habits, rules, mutual monitoring and trust) that affect human interaction and exchange [see Hodgson 1998, 179]. Both formal and informal Institutions matter greatly to economists because “they impart regularity and consistency of economic behavior over time” [Tabb 1999, 195]. They are thus responsible for what is known as the “Institutional lock-in” of the economy: economic institutions having originated through social networks are then “locked-in” into a single path dependent institutional pattern [see Smelser & Swedberg 1994, 19].

¹ Read for instance Chapter III of the Second Book of Adam Smith’s *Wealth of Nations* (1776), or the Chapter VII of the First Book of J.S. Mill’s *Principles of Political Economy* [1848].

² See Marshall [1890], Book IV, Chapter X. About the “old Institutionalism” see Perlman [1996, 227-240]. On the meaning of different forms of Institutionalism see Rutherford [1994].

Our interest here was focused on informal institutions and arrangements. The latter were defined as “an arrangement between economic units that governs the ways in which these units can cooperate and/or compete” [Davis & North, quoted in Williamson 1992, 341]. Informal institutions and arrangements encompass a whole matrix of social and moral norms, rules, habits and routines that constrain economic behavior. **Rules** are “conditional or unconditional patterns of thought or behavior which can be adopted either consciously or unconsciously by agents” [Hodgson 1997, 664]. **Habits** are impersonal rules followed unconsciously, and describe a general tendency to engage in a repetitive form of action. **Routines** are also based on past experience, but they differ from habits in the sense that they always involve a group and “serve an end in view that contributes to the continuity of the life process” [Waller 1988, 119]. Finally, **trust** although it was always recognized as a fundamental element in every transaction (See Arrow [1974, 23]; Williamson [1985, 405]), it is an ethical norm that is regularly treated in Economics in an ad hoc manner, “as a bolt-on addition to orthodox analysis” [Hodgson 1998, 250].

As it was suggested elsewhere, “effective informal institutions fundamentally influence economic development and performance, both by providing self-sustaining contract enforcement, which reduces transaction costs, and by supporting efficient third-party enforcement from the state” [Raiser 1997, 7. Cf. North 1993; Keefer & Shirley 2000]. Our research attests that firms having established long term informal relations with other competitive or non-competitive firms benefit from lower costs of making transactions enforceable³. In doing so, firms do cooperate consciously adopting thus patterns of behavior that largely exceed market arrangements [see Menard 1995, 173].

³ On the definition of the costs of transaction see Coase [1937, 1992], Williamson [1985, 1994], Menard [1990] and Radner [1992].

Moreover, informal rules and arrangements protect business firms from the hazards of opportunism. By opportunism here we incorporate not only “seeking self interest with guile”, but also the “more blatant forms, such as lying, stealing and cheating” [Williamson 1985, 47. Cf. Alchian & Woodward 1988, 66]. It was John Stuart Mill who pointed out once the “economical” outcome coming from “the advantage to mankind of being able to trust one another” [Mill, 1848, 111]. Mill had in mind both the costs of monitoring –“watching that labourers fulfill their engagements”- as well as the costs from the lack of integrity in commercial affairs, when he stressed “the substantial advantage derived in business transactions from proved trustworthiness” [1848, p.112]. In similar terms, Alfred Marshall insisted upon the positive effects coming from the “progress of trade morality”, upon the “general management of business” [Marshall 1890, 253]. As it will be seen below, in order to overcome the hazards of opportunism and minimize its costs, firms cooperate establishing between them “implicit contracts”, i.e. unwritten agreements the terms of which are only known to the two parts, without any contract engagements (see Brousseau 1996).

Before getting further to the details of the research let us give a definition that recapitulates what has been already said. “An Institution is manifested in a long-standing historically determined set of stable, abstract and impersonal rules, crystallized in traditions, customs, or laws, so as to implement and enforce patterns of behavior governing the relationships between separate social constituencies” [Menard 1995, 167].

III. The empirical research

Our research was geographically confined to the Region of Magnesia, which has seen great industrial activity for more than a century, and which manifests many economic and social indicators representative of entire Greece (income per capita, distribution of product between different sectors, social stratification etc.) [See Maloutas 1993; Petrakos 1998]. The research was limited only to industrial firms. The reason was that industrial firms present

generally a far more complete organizational structure dealing with the entire productive process, involving suppliers, workers and customers.

The questionnaire

Trained interviewers have interviewed managers of firms, using a detailed questionnaire. The final sample contained 36 out of 104 industrial firms of the region. Only 32 valid questionnaires were collected, representing a percentage of 30,76% of the total population. The completeness of the responses was very good, with almost 98% replies to most questions. The questionnaire contained 19 questions of various types (i.e. open, closed or multiple choice), divided in four sections. Section A provided background on the size and production of the firm. Section B probed into the specificity of relationship between firms. Section C has sought to understand the type of relationship between firms, the Administration and financial institutions. Finally, Section D of the questionnaire has looked into the internal organization of firms, seeking for social influences concerning the hiring procedures of personnel and the procedures of technical innovation.

Sample characteristics

The first characteristic for the classification of industrial firms was their size according to their total revenues (turn over) and the number of their employees. In the first category there was 31% firms with annual (1998) revenues less than 1,3 million \$Us; in the second category we found 48% having from to 1,3 million to less than 13 million \$ US; and finally there was 21% of firms having obtained over 13 million \$US (up to 280 millions). In the total, 75% of the firms have seen their revenues increase in the last five years. As far as the number of employees is concerned, 26% have less than 9 employees; 52% have from 10 to 99 employees; and 22% have more then 100 (up to 800) employees.

The second characteristic concerned the oldness of the firms. 11% of them were created before 1940; 35% were created from 1945 to 1974; and finally 54% were created after 1974, the year of restoration of the Democracy in Greece.

The level of internal organization was the third and the most crucial characteristic. Almost all firms (91%) possess one more department in their structure beyond the production department. Most of them possess a distinct sales department (71%) and a distinct financial department (72%). Half of the firms have an R & D department, while only one third of them has also a marketing department (34%) as well as a training department (38%). A key point about internal organization is also the existence of strong family links between on the managerial level. Almost 55% of the firms examined do have at least two family members in the managerial staff. As we will show, in the next section, internal organization differs significantly between affiliated (branch) firms and non-affiliated (independent) firms.

IV. Results and discussion

As stated in the introduction, the detection of social non-market factors was the main concern of our research. Such factors include cooperative patterns of behavior not only between non-competing firms –i.e. firms with client-customer relations- but also between competing firms, that is firms producing identical goods.

Descriptive analysis

We have tried to locate the presence of informal arrangements as a result of social norms and/or habits in entrepreneurial activity, by focusing on the direct relations between firms. What was found is that firms are willing to cooperate yet not through the establishment of formal contracts. Implicit contracts, suggesting the existence of a high level of trust between firms with long term relations, seem to be the canon here. The results are presented in the following six groups:

CR1. Cooperative relations between non-competing firms.

Many of the firms are oriented to the local market. 60% of industrial firms have established direct relations with other **local** non-competing firms. This number is going up to 81% as far as relations with other firms is concerned, located in Athens or Thessaloniki (Greece's 2nd largest city of 1 million Ha.). More than half of the firms also have such relations with other firms located abroad, mostly in the European Union countries (53%). What is more important here is the area and the range of those relations, as presented in Table 1 bellow.

| Area of relation | Percentage |
|-------------------------|-------------------|
| R & D | 37% |
| Sales | 37% |
| Subcontracting | 31% |
| Training | 28 % |
| Joint production | 25% |
| Marketing | 19% |
| Financial Informations | 16% |

Table 1: Positive answers to the existence of cooperative relations

CR2. Cooperative relations with suppliers.

More specifically, as far as the relations between non-competing firms is concerned, we have tried to detect more thoroughly their exact type. The results are presented in Table 2.

| Type of relation | Percentage |
|-------------------------|-------------------|
| Price bargain | 78% |
| Payment facilities | 78% |
| Price reduction | 69% |
| Quality raw materials | 68 % |
| Block-booking | 53% |

Table 2: Positive answers of cooperative relations with suppliers

These high scores are significant in the sense that they are giving a clear picture about the existence of conscious cooperative patterns of behavior between firms and their suppliers.

What is also very significant is the fact that the majority of firms (54%) take more than five years to change a supplier.

CR3. Cooperative relations with customers.

Direct relations with customers also reveal a significant cooperative pattern of behavior, as shown in Table 3 below.

| Type of relation | Percentage |
|---------------------|------------|
| Payment facilities | 81% |
| Quality of products | 75% |
| Price bargain | 66% |
| Price reduction | 66% |

Table 3: Positive answers of cooperative relations with customers

It should be underlined that not a single firm has denied having any kind of direct cooperative relations with its customers.

CR4. Cooperation between competing firms.

Although the results are here less important in absolute numbers, their theoretical relevance is far more substantial. If firms are actually establishing informal arrangements with their competitors, then they largely exceed the standard rational pattern of behavior. Exactly half of our industrial firms (16 out of 32) have established at least one credible commitment with competitors, willing thus to create what is called, “a mutual reliance relation” [Williamson 1985, 190]. The results are given in Table 4.

| Type of relation | Percentage |
|-----------------------|------------|
| Information exchange | 41% |
| Duplicative suppliers | 25% |
| Posted prices | 19% |
| Exclusive territories | 16% |
| Financial matters | 9% |

Table 4: Positive answers to the existence of credible commitments

CR5. Relations of firms with formal Institutions.

The meaning of this group of questions was to detect the eventual troubles arising from the everyday relationships between business firms and their formal institutional environment, as well as their positive or negative attitude to that. Thus, while firms with 81% of positive opinions perceive Banks very well, the same is not true about Central Administration. Their assistance has been positively perceived only by 34% of firms, while another 34% have neutral opinions about it. Things are better with local Chambers of Commerce (56% of positive opinions) and Regional Administration (44% of positive opinions). The troubles detected in those relations are presented in Table 5.

| Type of trouble | Percentage |
|-----------------|------------|
| Bureaucracy | 41% |
| Inefficiency | 35% |
| Non cooperation | 16% |
| Inefficacy | 13% |
| Corruption | 3% |

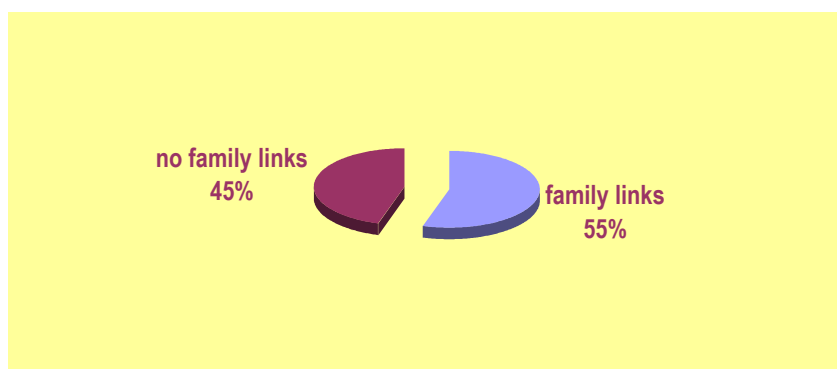
Table 5: Troubles between firms and formal Institutions

What is to be emphasized here is that more than half of those firms (53%) do persist and try to establish personal relations with servants in formal Institutions in order to overcome these problems. In other words, when conflict arises with formal organizations, firms choose “voice” instead of “exit”. “Voice involves dialogue, persuasion and sustained organization” [Williamson 1985, 257]. As in the case of interfirm relations, entrepreneurs demonstrate their willingness to bypass formal procedures and to cooperate.

CR6. Hiring procedures and Family links

Like the previous case the rationale of questioning firms about their hiring procedures of personnel was made in order to detect any eventual deviation from the usual formal

procedures. The answers did not reveal any abnormality. Greek industrial firms prefer to hire their personnel through ‘interviews’ (59%), rather than using other common formal procedures like ‘professional recommendations’ (12,5%) ‘public calls’ (09,5%), and ‘personal recommendations’ (09,4%). Where things are more expressive is that when managers are asked about the hiring of relatives in administrative positions within their firm 55% said have hired one or two members of the same family.



Graph 1

Here again habitual norms prevail over the formal ones, and managers prefer to share managerial functions with members of their family, instead of hiring, eventually, more qualified trained managers.

Testing the existence of institutional arrangements

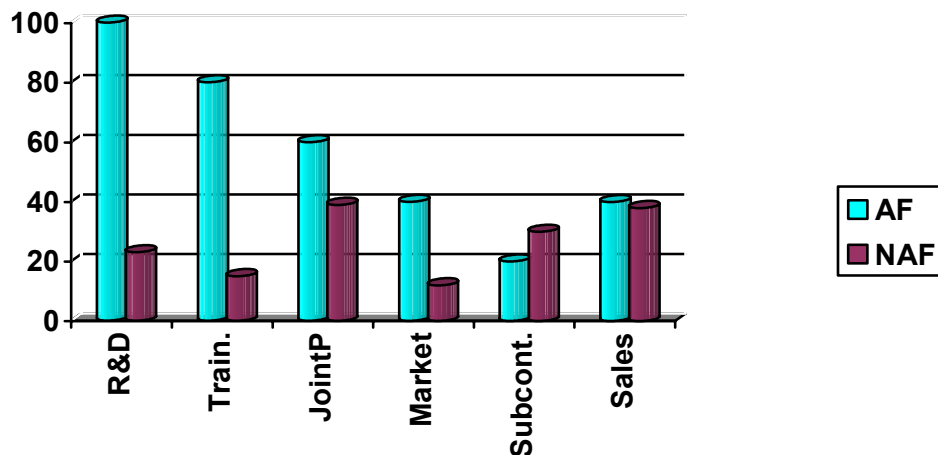
In order to test the importance of institutional influences on entrepreneurial strategy we have used the criterion of affiliation (dependence) of firms by the means of the Cross tabulation method (Chi-square test). Non Affiliated Firms (NAF) seem to be less organized and therefore less bureaucratic and more flexible than the Affiliated Firms (AF). Furthermore, Non-affiliated firms are oriented to the local market being thus more sensible to the

influences coming from the local social environment. **The Hypothesis to be tested** is whether non-affiliated firms are more sensitive to the influences of the institutional environment and more willing to establish informal arrangements and credible commitments. The lack of highly structured organization of non-affiliated firm can be easily demonstrated if we look at the degree of internal specialization. While both kinds of firms possess production and sales departments, a very small portion of non-affiliated firms has also a marketing department (NAF 23%, AF 80%. X^2 : 6,21, d.f: 1, p: 0,01). The same is also true about Training Departments (NAF 27%, AF 100%. X^2 : 9,43, d.f: 1, p.: 0,002).

T1. Cooperative relations between non-competing firms.

Both kinds of firms, NAF and AF, have geographically oriented their trade to the metropolitan areas of Athens and Thessaloniki (NAF: 88%, AF: 75%, X^2 : 5,72, d.f.: 1, p: 0,016). This is due to the fact that these two economic centers concentrate the biggest part of the national economic activity [Maloutas 2000]. The low percentage of cooperative relations between non-competing firms presented in Table 1 above explains the low scores in cross tabulation. So, only 23% of NAF does have a cooperative relation in the area of R&D (X^2 : 10,83, d.f.: 1, p: 0,00); 15% of NAF does cooperate in the field of personnel training (X^2 : 9,14, d.f.: 1, p: 0,002); and 39% of NAF does promote common projects in joint production, with 60% of AF (X^2 : 3,64, d.f.: 1, p: 0,05). Percentages concerning cooperation in the areas of marketing, subcontracting and sales promotion are comparably low (11,5%, 31% and 39% respectively).

The same results are presented in the graph 2 below, which shows the areas of cooperation for both AF and NAF (e.g. 60% of AF does participate in joint production projects, while



only 39% of NAF). What is demonstrated here is that Non Affiliated Firms seem less inclined to cooperate officially. Nevertheless, the fact that they actually do cooperate, as it will be seen herein after proves that they prefer to cooperate unofficially, i.e. through implicit contracts.

T2. Cooperation between competing firms.

Analysis concerning the cooperative behavior between antagonistic Non Affiliated Firms revealed a high score of 54% (with only 40% for AF). Although less important, the results presented in Table 6, are not insignificant.

| Type of relation | Percentage |
|-----------------------|------------|
| Information exchange | 46,2% |
| Duplicative suppliers | 26,9% |
| Posted prices | 19,2% |
| Exclusive territories | 19,2% |
| Financial matters | 7,7% |

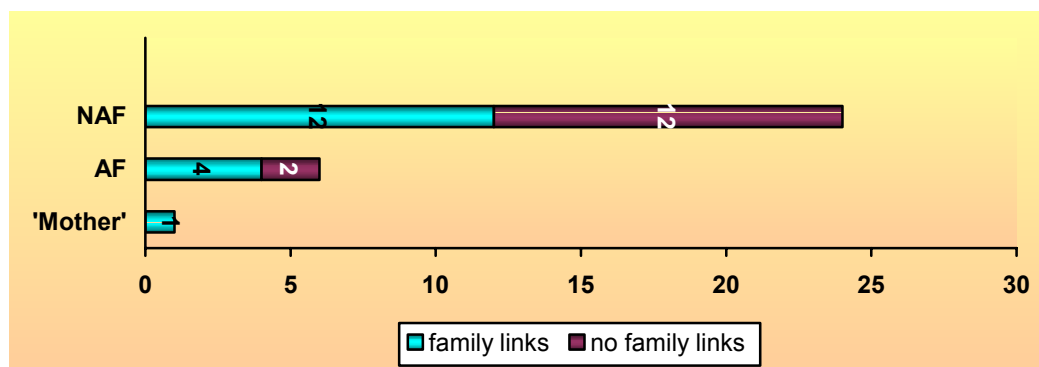
Table 6: Credible commitments between NAF

They demonstrate a clear tendency of NAF to cooperate with their competitors, far more substantial than their tendency to cooperate with non-competing firms.

T3. Affiliation and 'family business'

An interesting association can be made if we combine the data from affiliation links with family links. Graph 3, shows the results of this association.

Graph 3:



From 17 firms that are having persons with family links in the managerial level there are 12 NAF out of 24, 4 AF out of 6, and the single 'Mother Company' of the region. The fact that family links are spread in every form of affiliation proves the strengthens of those links and partly explains their sensibility to social norms. The last is also confirmed from the fact that firms with family links among the managerial staff demonstrate themselves to be far more cooperative with suppliers as well with other antagonistic firms in two matters: price bargain and payment facilities. 87,5% of firms with family links does cooperate with suppliers in order to bargain prices of raw or semi-finished materials, while almost all of them, 92,9%, cooperates to obtain payment facilities (X^2 3.480, df 1, p .062). Results are equally revealing as far as cooperation with other competitors is concerned: all –100%- firms with family links in the managerial level, cooperate directly with competitors in order to obtain a 'fair price' and some kind of payment facility. The results differ greatly for firms having no family links: only 64,5% of those firms does cooperate in such matters (X^2 6.127, df 1, p .013).

V. Conclusions

The neoclassical assumption of rational economic behavior has received in the last sixty years or so, several fundamental methodological criticisms indicating its lack of empirical relevance⁴. The idea of independent self-interest seeking rational maximizers has also received strong arguments from the sociological perspective [Smelser & Swedberg 1994]. Recently there has been also added a sharp critique from the field of Evolutionary Psychology, suggesting that human mind often “performs in a manner that is better than rational”, being more powerful and intelligent than economists have postulated it was so far [Cosmides & Tooby 1994, 329].

New-Institutionalist Economists like Coase, North and Williamson achieved to strengthen the realistic character of the behavioral assumptions of economic analysis by broadening the notion of rationality and taking into account many of the social and institutional factors that have been left out in Neoclassical Theory. Our findings provide strong support as to the fundamental behavioral assumptions of Transaction Cost Economics. As we have seen industrial firms in Greece are willing to cooperate and to establish stable implicit contracts, trying to reduce transaction costs and the costs of opportunism. This is true about non-competing firms (suppliers or customers) who have developed in that direction a nexus of diverse long term strategies (price bargain, payment facilities, price reductions, block-booking etc.). But the same is also true among competing firms. As we have seen, there are significant proofs of credible commitments between competitors willing to reduce the risks of opportunism (posted prices, exclusive territories, duplicative suppliers etc.). Results in other empirical researches [Goldberg & Erickson 1987, Lyons 1994, Saussier 2000], confirm the role of long-term contracts where many variables cannot be observed by a

⁴ Recent critical reviews are made in Conlisk [1996], Vriend [1996] and Zouboulakis [1996].

third party, in minimizing transaction costs originated from bounded rationality and opportunism.

In all cases the standard rational maximization behavior is largely exceeded by long term informal arrangements between firms. The empirical evidence shows not only that informal rules matter, but also that such “informal rules have frequently outlived formal rules”⁵. The same pattern of behavior was detected during the measurement of attitude of firms vis-à-vis their formal institutional environment, particularly as far as their strategy to persist and to dialogue when trouble arises is concerned. The presence of informal arrangements and the willingness of firms to cooperate through implicit contracts testify the influence of social norms and/or habits and the existence of a high level of trust between firms. Because of their non-reflective, non-rational character, it is correctly said, “habitual behavior is a fatal blow to the assumption of maximizing agents” [Waller 1988, 118].

Nevertheless, it should be recognized that the inverse influence is also true. As Mark Granovetter [1985, 486] has observed, the sum of social norms that characterize a particular culture “not only shapes its members but it is also shaped by them, in part for their strategic reasons”. In other words, markets do frame individual values since they “induce self-regarding behavior...Markets affect ‘nice traits’ i.e. behaviors which in social interactions confer benefits on others” [Bowles 1998, 92]. Social norms and values like trustworthiness, honesty, loyalty, generosity and reputation, although they are considered as necessary condition to every economic transaction, are in a way competitive to the strict economic calculation of the maximizing opportunistic behavior⁶. As the market expands in new social fields and geographical territories, “the field of egotistic behavior expands also” since the status of individuals as maximizing subjects strengthens as well [Tsakalotos, 1999, 116]. Our

⁵ See Pejovich 1995, 32] for additional historical evidence as to the validity of informal rules. For more on the concept of ‘rule following behavior’, see Vanberg [1993].

⁶ However, Casson [1993], defines culture in a way that is compatible with individualistic optimization.

research tends to confirm this antagonism between market and non-market values. Still, the influence of habits and rules here detected clearly indicates the continual presence of “the ineradicable social element in the economy” [Arrow 1994, 2]. In every institutional framework there are social values that encompass individual motivations and strategies, making thus urgent, in our view, the reconsideration of the whole individualistic program of NIE, as some sociological critiques suggest [Granovetter 1985, Smelser & Swedberg 1994, Ingham 1996].

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