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# Knowledge and Social Capabilities in the Garment Sector: A Case Study

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#### **Abstract**

This work evaluates how the innovation induces changes in the competitive dynamics of the garment sector and how social capabilities and knowledge, considered residual variables in the cognitive approach, combine to bring about the structural changes of an industrial cluster.

The relationship between knowledge and innovation is discussed in the theoretical part of the paper, as well as the social capabilities definition and characteristics. In the empirical part, we measure social capabilities, we describe their diffusion in a baby clothing cluster and we estime an innovation equation.

**Key words:** Knowledge; Social capabilities; Innovation; Baby clothing cluster

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# **INTRODUCTION**

Unlike the neoclassical production function considered exclusively traditional resources such as capital, labour and technology, the cognitive approach to production function considers social capabilities and knowledge as key variables for understanding the recent structural changes and economic growth of an industrial cluster.

The peculiarities of knowledge include social capabilities or social abilities. The former depends on the degree of cumulativeness and appropriability, which represents the capacity of new knowledge to generate yet more knowledge and innovation. The higher the degree of appropriability of knowledge, the lower the capacity of diffusion in an industrial cluster and, consequently, its growth. The peculiarity of knowledge and in particular of tacit knowledge form a crucial element in the social capabilities that are associated with enlarging knowledge learning processes and network diffusion.

The paper is organized as follows. In section two we put in evidence the role of social capabilities in knowledge diffusion and innovation and at the same time, we evidence the nature and the characteristics of the social capabilities in the literature. In section three, social capabilities is quantified in the baby clothing cluster, we describe social capabilities diffusion in this case study and we present our empirical analysis estimating an innovation equation. The last section concludes the paper.

# 1. KNOWLEDGE DIFFUSION AND INNOVATION THROUGH SOCIAL CAPABILITIES

The peculiarity of knowledge is the social capabilities or social abilities to enlarge knowledge learning process and network diffusion. The first one depends on the degree of cumulativeness, and appropriability, which represent the capacity of a new knowledge to generate more new knowledge and innovation. More is the degree of appropriability of knowledge, smaller becomes the capacity of diffusion in a cluster and the growth of it. To a higher level of knowledge corresponds a more high of innovation. The network diffusion depends on degree of cooperation and positive externalities of an industrial cluster.

Based on an extensive literature on knowledge, tacit knowledge and social capabilities, knowledge is considered to be an intangible and dynamic variable and has its origins in information. The process of knowledge

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accumulation produces innovation and, then, technical progress has in the economic development a crucial role.

According to Schumpeter (1971, 1977) innovation is a process of creative destruction or a "new combinations" of existing resources, involving the introduction of new goods and/or new production process to create a new organization, a new trade, a new form of marketing or in the access to a new supply source of raw or semi-finished materials or, still, in a new industrial organization. This technological change concerns not only the firms and the users, respectively as technology sellers and buyers, but also public institutions; each of them contributes to the technological changes with their experience. These changes according to Schumpeter lead to the development.

There are others types of innovation, one regarding SMEs operating in the traditional sectors as it is our case study-defined as "Schumpeter Mark I"-and anotherdefined as "Schumpeter Mark II"—which regards large enterprises in advanced sectors. Schumpeter Mark I industries are characterized by low entry barriers, higher rates of firm entry; innovations are generated and developed by new firms with new ideas, new products and new process. The technological competition among firms assumes the form of creative destruction (Schumpeter, 1911). Schumpeter Mark II industries are characterized by high entry barriers (Schumpeter, 1950), high economy of scope and scale, high investment in R&D. In this case industrial technological competition assumes the form of "creative accumulation" with firms introducing innovations by means of a process of progressive consolidation of their technological capabilities along well established technological paths (Malerba, 2005). High technological opportunities, low appropriability and low cumulativeness characterize Schumpeter Mark I, while Schumpeter Mark II is characterized by high appropriability and cumulativeness.

Consequently, the firm requires constant innovative actions to increase its competitiveness and maintain its market share. A process of knowledge accumulation that produces innovation is necessary (de Felice, Martucci, & Schirone, 2012).

The process leading to modern economic systems owes its existence to great discoveries and, therefore, to the inventions that, once translated into innovation by enterprises, create the evolutionary process that leads to economic growth characterized by the progress of some industries and the regress of others (Marshall, 1890; Schumpeter, 1939). Consequently, it can be stated that there is a connection between economic growth and the evolution of the industrial structure (Kuznets, 1930). This has been analyzed, according to different paradigms, by Bain (1956), Coase (1937) and Williamson (1975), among others.

If innovation depends on the level, variety and pervasiveness of knowledge, then effectiveness of innovation and its ability to give monopoly to the firms will be positively proportional to the level of knowledge appropriability, and negatively proportional to the degree of externality within the industrial sector. Time, as we know, decreases monopoly power, allowing the potential for imitation. Consequently, the firm requires constant innovative actions to increase its competitiveness and maintain its market share. A process of knowledge accumulation that produces innovation is much needed.

Thus, we can say that the capacity of accumulation of knowledge in a firm produces innovation that is strictly connected to the acquired competences and, above all, to those acquired through the research. In a specific industrial district, the accumulation of knowledge and the innovation depend on the low level of knowledge appropriability and on inter firm relations. This is the key to strengthen knowledge commutability in a local context, where the firms can take advantage of localized externalities and geographic proximity/openness. The innovation and its different typology depend on the tacit knowledge and on social and firm networks; on the contrary, the codified knowledge depends on a formal communication or formal connection such as patents or licenses.

Innovation activity depends, therefore, on knowledge that can be classified as context-specific, tacit, complex and independent (Winter, 1987). In fact, the more changeable the knowledge, the higher the possibility to share it thanks to personal interactions. On the contrary, codified knowledge uses standard communication means like patents, licenses, and so on.

This means that a higher degree of knowledge appropriability is positively correlated with a higher degree of monopoly power, a higher concentration of production activities, and little possibility of knowledge diffusion, which can be regarded as a private property of the firm.

Vice versa, a low grade of knowledge appropriability results in a higher fragmentation of the production activities, and in a higher imitation capacity and higher possibility of creating a continuous process of knowledge diffusion with a consequent increase in innovation. The latter differs from the former in that there is a good chance for the entry of new innovative entrepreneurs who, making use of the skills available in the sectors in which they operate, allow the whole production system to keep the market shares steady and to get new ones.

It is important to take a more in-depth look at the evolution and transformation of knowledge from personal to social, firm or organizational and cluster or interorganizational knowledge. According to Nelson & Winter (1982), Nonaka & Takeuchi (1995), Grant (1996), Spender (1996) and Howells (2002) it is not only individuals that are able to create knowledge. It is necessary to distinguish between individual or personal knowledge, and social or group knowledge. However, organizational knowledge cannot exist without individuals. Initially, individual

knowledge is private, it is in the mind of the individual, and is difficult to transfer because it derives from perceptions, memory, inferences and experience allied with reason (Metcalfe & Ramlogan, 2005).

The same object can be seen through different prisms of personal knowledge; it depends on the conceptual system (Putnam, 1993). When individuals interact within the same geographical or local space or context, using a common language, personal knowledge is augmented and becomes interdependent. It becomes social knowledge that is collective, and is derived from social interactions through formal or informal meetings.

The concept of "social capabilities" is not used univocally in literature, even if this terminological confusion is not also a conceptual ambiguity. It is sometimes meant as a level of cooperation, local culture, collective resource deriving from a net of relationships which are created among individuals, so as to be assimilated to a "social capital".

In an industrial cluster, social proximity favors the formation of relational capital or intangible capital stock defined as social capital (Putnam, 1993; Coleman, 1988; Cainelli, Leoncini, & Montini, 2007; Metcalfe, 2001). At the same time, for us, industrial districts are characterized by social capabilities and tacit knowledge derived from social capacity, which is an intangible flux of knowledge or, in other words, an intangible and dynamic resource good. It is a collective or club good because it is not appropriable and it requires effort, time and high cost. It derives from the interaction between induction and deduction processes and it grows as more the groups' relations are intensive. In particular, social capital is involved in social network analysis, social capabilities are contemporary involved with social network and firm network analysis. They depend largely on the economic, political, social and institutional evolution of a society and a district. In the district, firm competitiveness depends on internal and external sources of knowledge in order to generate new knowledge and all firms benefit from knowledge externalities or knowledge spillovers if the appropriability is high, the costs are low and the firms can produce more technological knowledge.

Otherwise, social capabilities are a residual indicator, a fifth intangible factor which is usually used to explain the growth processes of a nation, or, as in this paper, of an industrial cluster.

In 1989, Abramovitz (1989) strictly defined it, explaining the results of a long-term economic growth of different nations thanks to the natural resources, the "technological congruence" and the social capabilities, distinguishing two fundamental components: the social attitude and the economic characteristics of the population and institutions. Meant as the whole of the institutional and social-economic conditions which govern the actions, the behaviors and the relationships among the

agents of a nation, the social capabilities determine an interactive and cumulative process where the economic growth is supported and, at the same time, it favors the following strengthening. In such a way, and contrary to the convergence theory, this process explains as the development differential of the poorest countries depends on the initial endowment of the "social capabilities".

In this research, we consider the mentioned Abramovitz's definition about the social capabilities, but, we use one slightly different because it refers to the growth of an industrial district. For this reason it is integrated with some characteristics highlighted by Marshall (1890), by Penrose (1959, 1985), by Richardson (1972) and by Becattini (1981).

In fact, the planned coordination is not only of the single firm, but it may be through the cooperation of independent firms and as it is emphasized by Marshall (1890) where the relationships created amongst firms must be integrated with the relationships with suppliers, customers, providers of services. In this way the internal capabilities are combined with external ones and this may be in an industry as in an industrial district.

For Marshall, social capabilities represented the religious, political and economic elements that characterize people's history. Social forces co-operate with economic forces in an industrial organization: there are often strong friendships between employers and employed.

But, the modern industrial district is in continuous evolution, it is absent the industrial atmosphere of Marshallian memory and in the modern industrial district are not present all the characteristics of the traditional Marshallian industrial district as the analysis of the results of the Italian case studies demonstrates. The modern industrial districts are more hybrid clusters or, better still, using the Markusen (1996) classification, they have only some peculiarities of the Marshallian cluster. For this reason, we must to add other elements that characterize social capabilities that were identified in Becattini's analysis of Marshall's work. Becattini, in fact, defines an industrial district in a neo-Marshallian perspective, as a socio-territorial entity characterized by the active presence of a community of people and a population of firms in a given historical and geographical space (Becattini, 1979).

Taking into account these aspects, for the purpose of our paper, the characteristics and the elements of the social capabilities in an industrial cluster include the geographical proximity-openness for the spatial conditions; the tradition, social relationships, skills and ability, knowledge, learning for the social conditions; the innovation, human resources, organization, knowledge, markets, company relationships, internationalization for the economic conditions; the social and political institutions for the political conditions and the technological and organizational progress for the innovation.

## 3. THE MEASURE OF SOCIAL CAPABILITIES

There are few works that have estimated and measured social capabilities (SC), and studies that have constructed an indicator that measures social capabilities in an industrial cluster are unknown in the literature. SC are usually non-market and non-accounted in regional and national dataset. The only consistent way to measure the SC characteristics is by implementing survey-based approaches aimed at producing specific information by structured questionnaires.

More specifically, the analysis requires data collection through interviews designed to obtain information that permit to have the development of qualitative and quantitative indicators for studying the typology of these relations and for measuring social capabilities. We have adopted a "scoreboard approach" in which an observed phenomenon is measured using a set of indicators which grasp some of the key elements of that phenomenon. The potential indicators to be included in the analysis are identified with the help of literature and are based on the original results of a questionnaire. We have therefore devised the questionnaire to reflect the indicators that make up social capabilities and that allow us to measure them.

Considering the SC in industrial cluster, 8 indicators are identified together. Geographical space (GS) determines the spatial conditions; social networks (SN) represents the social conditions; economic conditions are represented by firm networks (FN) and knowledge exchange (KE) that is formed by the knowledge exchange connected to innovation knowledge (KE from IK) and the knowledge exchange connected to market knowledge (KE from MK); that of institutional networks (IN) determines the political conditions while innovation capabilities (IC) and marketing capabilities (MC) determine innovation (Table 1).

Table 1 Social Capabilities Indicators

| Characteristics         | Indicators                                                                                                                                                                                    | Time period questionnaire |  |
|-------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|--|
| A. Spatial conditions   | Geographical Space (GS)                                                                                                                                                                       | 2012                      |  |
| B. Social conditions    | Social Networks (SN)                                                                                                                                                                          | 2012                      |  |
| C. Economic condition   | Firm Networks (FN) and Knowledge Exchange (KE) or the Knowledge Exchange connected to Innovation Knowledge (KE from IK) and the Knowledge Exchange connected to Market Knowledge (KE from MK) | 2012                      |  |
| D. Political conditions | Institutional Networks (IN)                                                                                                                                                                   | 2012                      |  |
| E. Innovation           | Innovation Capabilities (IC) and Marketing Capabilities (MC)                                                                                                                                  | 2012                      |  |

In other words, social capabilities (1) depends on 8 indicators:

$$SC = f(GS + SN + FN + IN + KE \text{ from } IK + KE \text{ from } MK + IC + MC)$$
 (1)

where:

GS is a concentration/dispersion of firms in a localized space as an industrial cluster. It is identified by 1 variables;

SN represents the social network identified by 5 variables; of these, in turn, two are formed by 11 variables;

FN represents the firm's network identified by 4 variables;

IN represents the institutional network identified by 4 variables;

KE from IK is the knowledge exchange connected to innovation knowledge identified by 8 variables;

KE from MK is the knowledge exchange connected to market knowledge identified by 8 variables;

IC represents innovation capabilities identified by 12 variables;

MC represents market capabilities identified by 9 variables;

We have taken into consideration all the companies that responded to the questionnaire. It proved necessary to normalize (2) the indicators for each firm and we have used a composite indicator for each of the variables.

$$I_{n} = (X_{i} - X_{min})/(X_{max} - X_{min})$$
 (2)

where I is the considered indicator, n is the firm number; X is the considered variable. The result is between 0 and 1. It takes the value 1 if a company has a good performance and 0 otherwise.

After it is necessary to calculate the mean of the 8 composite indicators to obtain the social capabilities.

# 4. THE BABY CLOTHING CLUSTER: EMPIRICAL RESULTS

The case of the baby dresses is a good example of innovative and traditional/fashion categories and it reveals a certain proactive firm district on the basis of a study conducted by Censis in 2012.

The IV Report of the National Observatory of the Italian districts (2012) also evidences that, despite the crises of 2008, on 22 districts localized in the South of Italy, leaders are the clothing districts that represent the 56% of total.

Particularly in Apulia there are eight industrial districts (Istat Report, 2005), including six in textile and clothing and it is estimated that 65% of "made in Italy" children's clothing is produced in the province of Bari with 103 businesses in the baby clothing category (Infoimprese database, 2012). This is the reason of our choice. It is necessary to add the recognition of the Apulian Fashion District Production Chain in 2010 under the terms of the Regional government's resolution.

It should be noted that the year the questionnaire was addressed, 2012, corresponded to a year in which the "mortality rate" of Italian and Apulia companies was very high, so it was particularly difficult to contact and obtain information from the companies themselves. The choice to search for a sound method for obtaining responses to the questionnaire was very difficult at the beginning because very few firms.

Of the 103 firms in the sector under examinationsportswear, outerwear, ceremonial clothing and pullovers-42 responded to the questionnaire in a valid way.

Based on the Figure 1, we divide the firms belonging to the district into three groups:

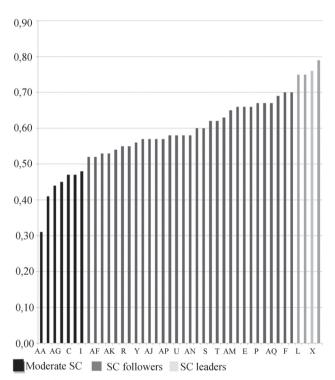


Figure 1 SC Diffusion in the Baby Clothing Cluster

• The SC **leader** group that scores more than 0.70. 9.5% of the companies belonging to the cluster can be

considered leaders for the high spread of SC within the group and within the cluster. These are the firms in the sample that have a class size from small such as 'AB', which has only 10 employees, but that, in addition to producing on its own, is also an outside contractor for the cluster, through too large for the sector in question. One ('Z') has more than 120 employees.

- The SC **follower** group, scoring more than 0.50, accounts for almost all of the cluster. 73.8% of the companies belonging to the cluster can be considered followers for the high incidence of SC within them and within the cluster.
- The **Moderate** SC group, scoring more than 0.30. 16.7% of the companies belonging to the cluster can be considered moderate for the modest diffusion of SC within them and within the cluster and belong to the micro and small class sizes.

The predominant group is therefore made up of the follower enterprises (73.8%), while the group of companies that contributes to the high spread of SC within the cluster, 9.5% of the total (first group), is small. It follows that within the cluster the spread of the SC is very high.

After the construction of the Social Capabilities indicator and the description of its diffusion in the baby clothing cluster, we estimated the following regression using a robust estimator for the Probit model (3):

INNi, 
$$t = 1$$
 if INNi,  $t = \beta 0 + \beta 1$ SCi,  $t + \beta 2$ IndR&D,  
Di,  $t + \beta 3$ Xi,  $t + \epsilon i$ ,  $t$  (3)  
INNi,  $t=0$  otherwise

vhere:

- INNi, t is a binary variable taking the value 1 whether the firm i introduced technological innovations in the year 2012, 0 otherwise;
- SCi, t represent the social capabilities of firm i in period t given by function (1);
- IndR&S, Di, t is the investment in R&D and Design expenditure indicator of firm i in period t. As the literature have shown this variable is an input for the innovation output;
- Xi, t includes a set of control variables as size, age, firm's typology, and export propensity, which we included to better specify the vector of innovation inputs. For measuring the firm size we consider the log of labor number, for measuring the firm's typology we consider a dummy. This dummy takes the value 1 if the firm is capital companies, the value 0 if it is individual businesses;
  - $\varepsilon i$ , t is the error term.

#### 4.2 Empirical Results

The econometric results based on the Probit model reporting the marginal effects, are presented in Table 2.

Table 2 Probit Estimate

| Estimation Method  Dependent variables |         |        | Probit |                  |         |
|----------------------------------------|---------|--------|--------|------------------|---------|
|                                        |         | INN    |        |                  |         |
|                                        | Coeff.  | Z      | P > z  | Robust Std. Err. | dF/dx   |
| SC                                     | - 0.362 | - 0.11 | 0.909  | 3.170            | - 0.015 |
| R&D, design                            | 3.627   | 2.24   | 0.025  | 1.616            | 0.155   |
| X                                      | 3.295   | 2.57   | 0.010  | 1.282            | 0.141   |
| cons                                   | - 2.890 | - 1.79 | 0.074  | 1.618            |         |
| N. of obs.                             |         |        | 42     |                  |         |
| Pseudo Rsquared                        |         |        | 0.3891 |                  |         |
| Obs. P                                 |         |        | 0.857  |                  |         |
| Pred. P                                |         |        | 0.892  |                  |         |

The results show some interesting evidence with regard to the impacts that the social capabilities, the R&D, design expenditure and the X variable have on innovation in the baby clothing cluster with a good value of pseudo-R2. The social capabilities variables is not significant such as its marginal effect. The expenditure R&D and Design and the X variables are instead significant and important but their marginal effects are not very high, in terms of incremental innovation and with regard to demand-driven innovation. In this case a direct connection exists between the investment in R&D and Design and enterprise size. In other words, it is confirmed the Schumpeterian thesis according to which larger firms invest more in innovation and design, because they maintain their competitive advantages over the long term. But, as we have highlighted in section 2, SMEs operating in the traditional sectors such as clothing, introduce typologies of innovation, defined as "Schumpeter Mark I", characterized by low entry barriers, by firm entry higher rates, and innovations are generated and developed by new firms with new ideas, new products and new processes. The low appropriability and the low cumulativeness that characterize "Schumpeter Mark I" give the possibility to diffuse innovation through the cluster.

The X variable is important as it is expected because the internationalization is not limited to the export oriented in this category. The internationalization, for example in Albania, Thailand, China and Turkey, includes not only licenses and delocalization of production process but also subcontracting agreements as consumers are often not willing to buy clothes that are too expensive. But the strategy of producing abroad was driven not only to reduce costs, but it is driven by the need to move production closer to the consumption market, avoiding the currency exchange risk, and to use cheaper local raw materials (Crestanello & Tattara, 2011). It is the case of

China and Turkey that are suppliers and at the same time in these Countries subcontracting agreements are entered.

### CONCLUSION

The results of the case study show that the firms in our sample represent the organization where knowledge is not produced through a process of the integration of learning and formal research, but represent places of specific competences and capacities. On the other hand, the issue of training leads neatly on to the characterization of an industrial cluster, as tacit knowledge is transmitted through learning by doing. In fact, the relationship between knowledge and innovation does not only involve large enterprises but small and medium-sized businesses as well. In this latter innovation is to be understood not only as an investment in research and development and in the adoption of new technologies, but also as the gradual change of types of product, adapting to constant changes in consumer tastes, implementing new organizational methods, both internally and in their relationship with other companies, customers and suppliers. In addition the survey shows that the performance, class size and the strategic choices in the sector examined is different even though the firms are located in the same area. This reflects the presence of a range of enterprises characterized by specific features, high flexibility and adaptability to demand for which they are able to create market niches given the specific nature of the product.

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