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# Influence of institutional and moral orientations on relational risk management in supply chains

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ABSTRACT

Inter-organizational relationships in supply chains are built, maintained, and enhanced to achieve corporate goals. However, relational risk will weaken the success of supply chains. Manufacturers must build forms of relational governance to safeguard against the relational risk of partners. For managing relational risk, this research investigates the contribution of institutional and moral orientations to relational risk management. The results of the study of 260 major manufacturing firms in Taiwan suggest that three types of relational risk—opportunistic behavior, loss of competences, and incomprehension—are significantly affected by institutional and/or moral orientations. The findings provide useful insights into how supply chain members should reinforce their institutional and moral views of relational governance and manage relational risks faced by the supply chain as a whole.



## 1. Introduction

Relational risk has increasingly become an issue of strategic importance in supply chain management (Das and Teng, 2001; Delerue, 2005; Jia and Rutherford, 2010; Nooteboom et al., 1997). It is defined as both the probability and the outcome of suboptimal cooperation (Das and Teng, 2001; Delerue, 2005). Relational risk derives from the failure to address power asymmetries between partners (Ratnasingam, 2007). To improve supply chain performance and product quality, firms often demand that their supply chain partners, including subcontractors or suppliers, implement common processes, which usually requires the management of relational risk. Standardizing firms' operations usually requires relational risk management. Specifically, to be successful in a supply chain, collaborative behavior and activities need to be promoted to manage relational risk among members (Nyaga et al., 2013).

To take full advantage of a supply chain, manufacturers must understand those factors that affect the partners' relational risk. Improving the collaboration between supply chain partners reduces uncertainty and risk (Bode et al., 2011). To reduce supplier risks that raise high management cost because of multiple suppliers, some manufacturing firms (e.g., Intercon Japan) provide their suppliers with economic incentives (Tang, 1999, 2006). In supply chains, collaborative relationships can help promote superior value and provide good interaction (Dyer, 1996; Wagner et al., 2010). Previous research has focused on modeling relational risk precursors or independent variables from the perspective of transaction costs or resource-based economics. Nooteboom et al. (1997) examined trust between supply chain partners and the results suggest that trust-related variables have significant effects on relational risk. Delerue and Simon (2009) investigated national cultural value among supply chain partners and the findings demonstrate that cultural values significantly affect manager perception of risks. Jia and Rutherford (2010) proposed cultural adaptation as the solution to mitigate the relational risk. However, little research has been conducted on the effects of the institutional and moral orientations of relational governance on inter-organizational risk management and relationships, despite the acknowledged importance of relational governance to inter-organizational behavior (Schoenherr et al., 2012). Good relationships that have the potential to ensure the success of supply chains will be highly valued (Carter and Jennings, 2002; Van de Vijver et al., 2011). Therefore, supply chain partners should aim to develop and maintain close and cooperative inter-organizational relationships, which will in turn help them to manage relational risk.

Relational governance and risk management are important strategies for preserving good relationships between supply chain partners and reducing the likelihood of relational risk (Cousins et al., 2006; Kale et al., 2000; Liu et al., 2009). Relational

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governance affects both the structure and the operation of inter-organizational relationships (Zaheer and Venkataraman, 1995). It is conducted in line with the agreed-upon values and activities associated with social relationships, especially inter-organizational exchange (Poppo and Zenger, 2002). Relational governance can promote collaboration and mitigate exchange hazards (Poppo and Zenger, 2002; Zaheer and Venkataraman, 1995). Supply chain relationships that increase the effectiveness of governance and improve the management of relational risk are fundamental to firms' long-term survival and success. The nature of an inter-organizational relationship depends on the type of collaboration involved: from simple buy-and-sell interaction to close collaborative product development (Dwyer et al., 1987; Wagner and Johnson, 2004). Therefore, firms encounter various relational risks when developing inter-organizational relationships (Delerue, 2005; Ratnasingam, 2007). Effective relational governance reduces relational risk which are intrinsically social (Poppo and Zenger, 2002). Institutional theory offers a convincing explanation of the effects of social environment on the behavior of firms in inter-organizational relationships. The behavior of organizational partners is shown to be influenced by either formal rules or laws or informal agreements (Howell and Annansingh, 2013). The behavior of supply chain partners is also influenced by the moral attitudes of their agents, which are determined by internal normative guidelines. Therefore, establishing value-based relationships that involve risk evaluation is an important component of relational governance. Our main research question is as follows. "How do institutional and moral views of relational governance help firms to manage relational risk?"

To address the important issue of relational risk mitigation in supply chains, this study investigates the influence of the inter-organizational institutional and moral orientations of supply chain partners on relational risks such as opportunistic behavior, loss of competences, and incomprehension.

The remainder of this paper is organized as follows. Section 2 provides a brief overview of relational governance and risk management in supply chains. Section 3 presents the theoretical framework and hypothesis development, and the data-collection method and research design are described in Section 4. The study's findings are presented in Section 5. The results are discussed in Section 6, and Section 7 concludes the paper and offers directions for future research.

## 2. Relational governance and risk management in supply chains

Inter-organizational relationships can be enhanced to reduce relational risks in supply chains. Relational risks comprise both risks associated with cooperation and risks associated with partners' behavior (Delerue, 2005). Opportunistic behavior, loss of competences, and incomprehension are useful measures of relational risk (Cheng, 2011; Delerue, 2005). Opportunism describes a wide range of possible behavior (Wathne and Heide, 2000). Within the transaction cost framework, opportunistic behavior is defined as the pursuit of self-interest by guile, leading to the deceit-oriented violation of implicit or explicit promises (Morgan and Hunt, 1994; Williamson, 1975). Loss of competences and incomprehension are measures of the risk of uncontrolled disclosure in relationships and the risk of a lack of understanding between partners, respectively. Manufacturing firms may be reluctant to share valuable capabilities or resources with their supply chain partners, especially if they regard their partners as potential competitors and/or a threat to their core capabilities or resources due to relational risk. It is essential for all parties involved to evaluate their relationships and implement appropriate strategies to control the likelihood of relational risk.

Relational governance, which involves the maintenance of inter-organizational relationships in supply chains, strives to solve exchange problems and enhance performance (Heide and John, 1988; Wang and Wei, 2007). Cooperative relationships are particularly valuable when exchange opportunities between partners exist (Poppo and Zenger, 2002). It is the most important strategy used by supply chain partners to manage relational risks (Lee and Johnson, 2010; Szczepański and Światowiec-Szczepańska, 2012; Wallenburg and Schäffler, 2014). Relational risk is often governed by formal contracts. However, no contract has complete coverage (Wang and Wei, 2007). Moral consciousness is also required to flexibly manage inter-organizational relational risk (Sim and Brinkmann, 2003). Inter-organizational relationships in a supply chain that are subject to appropriate forms of relational governance enhance the competitive advantages of the supply chain as a whole (Holland, 1995).

Several prevailing theories have shown that relational governance is an effective means of managing relational risk in supply chains (Delerue and Simon, 2009; Jia and Rutherford, 2010; Nooteboom et al., 1997). Institutional theory is a non-economic motivation theory according to which the desire for legitimacy and recognition drives partners to form inter-organizational relationships in supply chains (Liu et al., 2010; McFarland et al., 2008). Researchers have contended that integrating institutional and moral frameworks of relational governance can improve understanding of inter-organizational relational exchange (Li et al., 2010). Institutional norms alone cannot fully elucidate all of the forms and processes of inter-organizational governance. According to the moral perspective, moral orientation may lead partners to maintain proper standards of behavior (Ferrell and Gresham, 1985), which in turn mitigate inter-organizational relational risks. The institutional and moral perspectives both emphasize specific relationships in the social environment, which are measured by the value they add to organizations. Consequently, the institutional theory of relational governance, supplemented by the moral theory, is used in this study to examine the ways in which value-based relationships manage relational risks in supply chains.

Institutional theory describes the pressure placed on organizations by environmental factors; organizations are assumed to enter into inter-organizational relationships governed by unwritten rules of proper social conduct to gain legitimacy or recognition within society (Liu et al., 2010; McFarland et al., 2008; Zhu and Sarkis, 2007). According to institutional theory, the behavior of institutionally oriented firms is driven by strong social influences or aims, and firms in an institutionally oriented supply chain gradually become homogeneous via institutional isomorphism (DiMaggio and Powell, 1983; Ketchen and Hult, 2007; North, 1990). Contravening formal and/or informal guidelines for intra-organizational conduct in a supply chain may cast doubt on a firm's legitimacy and thus reduce its access to resources and social support. Therefore, firms with a strong institutional orientation behave in accordance with norms and seek to reduce inter-organizational relational risks. In a supply chain with a strong institutional orientation, firms work to sustain productive relationships with their partners.

In addition to institutional orientation, moral orientation plays an important role in shaping the commercial activities of supply chain partners. The concept of moral orientation is a science in practice; it is concerned with identifying and establishing rules for right and wrong actions (Small, 2002; Winquist and Taylor, 2001). Moral orientation describes individual behavior as determined by principles of right and wrong, and generally leads individuals to follow a morally correct course of action (Small, 2002; Winquist and Taylor, 2001). Partners with similar moral standards are able to collaborate harmoniously, which eliminates tension and