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Finding good relationships – intended and realized relational governance of international fine wine exchanges

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ABSTRACT

Changes in relational governance have mainly been documented in the form of relationship building, developments and repairs related to tensions, or break-ups of otherwise strong relationships. In this paper, we take a closer look at the relational governance of long-distance international exchanges between producers and importers of fine wine. We contribute by providing evidence for several novel relational governance changes, and we document portfolio effects on governance choices. Fine wine producers and importers intend on relational governance for most of their international exchanges, but they may end up being terminated, relegated to market governance, or settle as incomplete relationships.

1. Introduction

Unlike cheap wine, which is traded primarily on market terms with price as the key exchange parameter, fine wine trading most often requires asset specific investments. Without specific investments, importers and producers cannot develop a luxury wine brand in the minds of consumers worldwide (Beverland, 2005), which is required to build sales. At the same time, fine wine is traded internationally across large distances, frequently by smaller producers and importers, who populate a highly uncertain global sector. The wine sector is truly global, with winemakers, importers, and consumers dispersed across the continents. These characteristics mean that one of the most central concerns, for managers representing international fine wine importers and producers, is to safeguard against potential opportunism by exchange partners. Given the typically smaller size of the producers and importers, combined with the need for managing many international exchanges simultaneously, relational governance is frequently preferred over contractual governance. However, unlike transaction cost economics conceptions of governance mechanisms as stable entities (Williamson, 1991), relational governance frequently changes over time (Ness, 2009; Ring & Van de Ven, 1994). Research on relational governance dynamics, frequently in the international exchange context, has provided evidence for several prevalent change types, the most important being the gradual development of close relationships (Roath & Sinkovics, 2006; Ariño, Ragozino, & Reuer, 2008; Cullen, Johnson, & Sakano, 2000, the dynamics caused by tensions and their resolution (Ariño and de la Torre, 1998; Das & Teng, 2002; Kumar & Nti, 1998), and the more recently described dissolution, despite a strong relationship between the parties (Lazzarini, Miller, & Zenger, 2008; Vanneste, Puranam, & Kretschmer, 2014). In this paper, we seek to extend this line of research and contribute by shedding light on additional relational governance change types. We investigate these changes in long-distance producer-importer exchanges, which are faced with particular *international* governance challenges:

1) Uncertainty is high in such international exchanges (Aulakh & Genctürk, 2008; Zhou & Poppo, 2010). Since asset specific investments are required, there is a need for solid governance mechanisms.
2) Given the dispersed nature of the global wine sector, the companies are faced with the need for managing a large range of international exchanges. Combined with the limited resources of these small companies, both comprehensive formal contracting and hierarchical governance are infeasible (Aulakh & Genctürk, 2008; Bello & Gilliland, 1997). Research has shown that relational governance is the dominant choice in this context (Homburg, Cannon, Krohmer, & Kiedaisch, 2009; Zhang, Cavusgil, & Roath, 2003).
3) But the same characteristics simultaneously limit the companies' possibilities for social interaction in each exchange, complicating the development and maintenance of governance through close personal ties (Roath & Sinkovics, 2006; Zhang et al., 2003).

Most of the extant research on relational governance dynamics are on closer high frequency exchanges such as alliances, technology

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partnerships or joint ventures, and frequently not in the international context. Little knowledge exists on relational governance dynamics in international producer-importer exchanges, despite the pronounced governance challenges associated with this particular exchange type. Further, the high population of such exchanges in world business signifies a strong practical reason for this research. We therefore seek to contribute in this area. Our investigation deals with the following research question: *How does relational governance of long-distance international exchanges between producers and importers change over time?*

To investigate this problem, we made an exploratory qualitative study of international fine wine trading, focusing on the long-distance exchanges between Australian producers and their international importers, including those in Denmark. Such exchanges are characterized by significant levels of uncertainty and asset specificity (Zhou & Poppo, 2010). These mainly direct, international exchanges are associated with considerable trading hazards, and therefore safeguarding is essential for firm security. Over a three-year period, we interviewed a range of Australian producers and Danish importers of fine wine, inquiring into their approach to governing their international exchanges. From these data, we analyzed 79 individual exchanges and mapped their detailed governance approaches, including changes in relational governance. Based on our findings, we develop a set of propositions that contribute to the literature on governance dynamics in international business exchanges. Specifically, we contribute by documenting several novel relational governance changes as well as portfolio effects. Our findings also have practical value, because they add to extant knowledge on the relational governance process and its dynamics, and therefore enable managers to strengthen their governance of international business exchanges. The paper is structured as follows. First, we describe the most important concepts connected to international business exchange governance and proceed to laying out the status of extant research on relational governance dynamics. Next, we describe our methodology and the data set. We then show our findings and discuss them, leading to a set of propositions. Finally, we conclude the paper and provide the reader with managerial implications.

2. The governance of international business exchanges

Efficiently designed governance structures maximize benefits for the buyer and supplier, while simultaneously safeguarding from opportunism in the exchange (Cannon, Achrol, & Gundlach, 2000). Two exchange hazards amplify the threats from opportunism: asset specificity and uncertainty (Poppo & Zenger, 2002; Williamson, 1991) (see Table 1 for key governance related definitions).

Asset specific investments represent sunk costs if the exchange terminates prematurely, for instance due to the other party behaving opportunistically. At the same time, uncertainty, which comes in two forms, market dynamism and task ambiguity, increases the vulnerability to opportunism (Cannon et al., 2000). With the simultaneous presence of uncertainty and at least moderate levels of asset specificity, the exchange must be safeguarded by applying an appropriate governance mechanism (Ness, 2009; Williamson, 1985), such as relational governance.

Relational governance relies on close social ties between boundary spanners to safeguard the exchange (Poppo & Zenger, 2002). Here, the parties engage in social interaction and gradually generate a set of shared norms that have safeguarding properties because they provide guidelines for proper and acceptable behavior (Macneil, 1980; Ness, 2009). Expectations of continuity motivate the parties to invest in the exchange, which then adds further to the relational resistance to opportunism (Poppo & Zenger, 2002). Relational governance also promotes willingness to adapt and behave flexibly under conditions of uncertainty (Bradach & Eccles, 1989; Zhou & Xu, 2012). Looking at a cross-section of key writings in the literature, the most essential relational norms are *trust, flexibility, information exchange,* and *commitment* (Cao & Lumineau, 2015; Cullen et al., 2000; Genctürk & Aulakh, 2007; Griffith & Myers, 2005; Heide, 1994; Poppo & Zenger, 2002). Together, these relational elements provide the exchange with sufficient strength to curb opportunism.

Distant cross-national producer-importer exchanges, such as those under study in this investigation, are characterized by particularly difficult governance challenges. Some of the most researched governance challenges relate to the cross-cultural differences, differences in law systems, institutional differences, and political differences, which characterize many international exchanges (Cullen et al., 2000; Luo, 2006; Zaheer & Zaheer, 2006; Zhang et al., 2003). However, the companies in our study are from populations with relatively similar characteristics on these characteristics and such cross-national differences are therefore not our focus. The governance challenges in our study are instead caused by the sheer geographical distance between the producer and importer locations, which makes it difficult to keep a high interaction frequency, compared to domestic or regional locations (Zhang et al., 2003). In addition, producers and importers, which are often small companies, have to govern many dispersed international exchanges because they sell and buy in many locations, and this characteristic means that they have limited resources for each exchange (Aulakh & Genctürk, 2008; Bello & Gilliland, 1997; Roath & Sinkovics, 2006). The creation and maintenance of strong social relations becomes a challenge, since producers and importers rarely meet. Distance also hinders monitoring and information asymmetries are therefore exceedingly high in these exchanges (Aulakh & Genctürk, 2008), making opportunistic behavior from exchange partners more likely (Roath & Sincovics 2006). At the same time, such international exchanges are typically faced with high uncertainty, both in the forms of market dynamism and task ambiguity, while asset specific investments are required (Aulakh & Genctürk, 2008; Zhou & Poppo, 2010). Finally, the described limited resource of these companies, combined with the large ranges of international exchanges that need to be governed, make both comprehensive contracting and hierarchical governance unlikely (Aulakh & Genctürk, 2008; Bello & Gilliland, 1997). Earlier research on this type of exchange has suggested that relational governance is the more likely choice in this context (Homburg et al., 2009; Zhang et al., 2003).

Table 1
Key governance related definitions.

Governance (Williamson, 1999, p. 1090).	"*A means by which to infuse order in a relation where potential conflict threatens to undo or upset opportunities to realize mutual gains*"
Asset specificity (relationship specific adaptations) (Cannon et al., 2000, p. 181).	"*Investments made to modify processes, product technologies, or procedures to the specific needs of and/or capabilities of an exchange partner*".
Opportunism (Luo, 2006, p. 122).	"*The acts and behaviors performed by one party to seek unilateral gains at the expense of another party by breaching explicit or implicit agreements, exercising private control, withholding or distorting information withdrawing commitments or promises, shirking obligations, or grafting joint earnings*"
Market dynamism (Cannon et al., 2000, p. 181).	"*The degree of variability in a firm's supply market*" (this was a study of buying companies – hence supply market)
Task ambiguity (Cannon et al., 2000, p. 181).	*"The difficulty of obtaining or understanding information regarding a suppliers tasks or functions"* (this was a study of buying companies – hence suppliers tasks and functions)
Contract (Zhou & Poppo, 2010, p. 679)	*"Contracts, backed by legal institutions, specify the roles of both parties and the procedures as to how exchanges are to be carried out"*