



Supplier partnership and cost performance: The moderating roles of specific investments and environmental uncertainty



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ABSTRACT

Drawing on the perspective of transaction cost economics (TCE), we explain the operating contexts in which supplier partnership is likely to be an effective strategy to reduce operational costs in the manufacturing industry. We posit that supplier partnership, which falls in the category of hybrid governance, improves the operational cost performance of manufacturers and that its effectiveness is contingent on specific investments. We also posit that environmental uncertainty does not interact with specific investments to strengthen the effectiveness of supplier partnership. We apply structural equation modeling (SEM) to empirically test the model using data from 175 Hong Kong electronics manufacturers. The results show that supplier partnership is positively and significantly related to operational cost performance. We also find that the relationship between supplier partnership and operational cost performance is strengthened by specific investments. More importantly, the results reveal that the relationship between supplier partnership and operational cost performance is not strengthened by: (1) environmental uncertainty and (2) the three-way interaction among supplier partnership, specific investments, and environmental uncertainty. Our findings provide theoretical and practical insights for selecting an appropriate mode of governance structure.

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1. Introduction

As competition intensifies and the business environment is increasingly fast changing, manufacturers are under enormous pressure to enhance their operational performance. In addition to improving internal operations, many manufacturers look externally to seek competitiveness through the development of closer relationships with key suppliers (McCutcheon and Stuart, 2000; Yeung et al., 2012; Li et al., 2012; He et al., 2013; Ramanathan and Gunasekaran, 2013). Supplier partnership is widely accepted as an effective source of competitiveness among researchers, practitioners and consultants (Carr and Smeltzer, 1999; Chen et al., 2004). In this study we conceptualize supplier partnership as a long-term, mutually beneficial relationship between a buyer and a supplier, which involves the development of commitment and cooperation, and sharing of information between the two parties (Han et al., 2011; McCutcheon and Stuart, 2000).

Previous studies have found that collaborative supplier relationship provides organizations with multiple potential benefits, such as higher quality products, increased flexibility, lower inventory levels, and lower total cost. The direct performance impacts of

supplier partnership (Cannon and Homburg, 2001; Li et al., 2006; Shin et al., 2000) or its elements (e.g., Krause et al., 2007; Wong et al., 2009) are well documented. However, the operating contexts in which the partnership will operate more effectively are relatively under-investigated (Donaldson, 2001; Sousa and Voss, 2008). While specific investments (hereafter SI) and environmental uncertainty (hereafter EU) are two critical factors affecting the effectiveness of inter-firm governance structures in the literature of transaction cost economics (TCE), it is not clear whether there two factors always moderate the relationship between supplier partnership and operational cost performance (hereafter OCP) individually and jointly.

The popularity of supplier partnership in the past decades has attracted the attention of many researchers. Buyer–supplier collaborative practices are highly effective in improving delivery and quality performance (Shin et al., 2000), cost performance (Cannon and Homburg, 2001), competitive advantage and organizational performance (Cao and Zhang, 2011; Li et al., 2006). In addition, the direct performance impacts of some key elements of supplier partnerships have been explored by some researchers. Partnership elements such as cooperation, long-term commitment, and information sharing have been found to have direct and positive associations with various performance dimensions (e.g. Krause et al., 2000; Wang et al., 2011). Nonetheless, empirical findings concerning supplier partnership are not always positive (Robb et al., 2008; Stuart, 1997). Prior studies have estimated the failure

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rate of inter-firm partnerships to be around 30–50% (Anderson and Jap, 2005). Burnes and New (1997) concluded that supplier partnership may achieve successful partnering relationship only at the operational level, not at the strategic level.

These conflicting findings suggest that the management of supplier partnership should receive greater attention for offering more insights concerning the factors that could moderate the relationship's performance impact (Frazier et al., 2004; Wong et al., 2011). Specifically, given the strategic importance and the wide spread adoption of supplier partnership in practice, it is important to understand the peculiar situations in which supplier partnership is effective. (Ireland et al., 2002:414) remarked that supplier partnership is "a significant challenge and an under-investigated phenomenon" warranting further study. Although supplier partnership is well documented in other theoretical paradigms such as contingency theory (e.g. Chan et al., 2012; Jayaram et al., 2010; Wang et al., 2011), social exchange theory (e.g. Devaraj et al., 2012) and resource based view (e.g. Cao and Zhang, 2011; Yeung et al., 2012), limited investigations have been undertaken in the operations management (OM) literature through the theoretical lens of the TCE (Rindfleisch and Heide, 1997).

One possible explanation is that TCE does not articulate clearly the impact on firms' operational performance under different combinations of interactions among supplier partnership, SI and EU. In many cases where TCE predicts one governance structure, e.g. hierarchy, we find other kinds of governance structures, particularly hybrid, are considered more viable in many firms (Powell, 1990). Through this influential theoretical framework (Grover and Malhotra, 2003), we study two moderators, namely, asset specificity (hereafter AS) and EU, with respect to their roles on the performance impact of supplier partnerships rigorously. A moderator could be a qualitative (e.g., sex, race, class) or quantitative (e.g., level of reward) variable that affects the direction and/or strength of the relation between an independent or predictor variable and a dependent or criterion variable (Baron and Kenny, 1986:1174). Moderators are important to study, perhaps even as a requirement that they be studied, in psychological research (Frazier et al., 2004; Wong et al., 2011). We develop a research model grounded in the literature of supplier partnership and TCE, and take Mathieu et al. (1992) approach to test the model by applying structural equation modeling (SEM) to empirical data collected from a survey of 175 firms in Hong Kong's electronics industry.

Specifically, our research objective is to study the relationship between supplier partnership and OCP and the moderating effects of SI and EU on this relationship by answering the following research questions: (1) is there any relationship between supplier partnership and OCP? (2) Does SI strengthen the relationship between supplier partnership and OCP? (3) Does EU strengthen the relationship between supplier partnership and OCP? (4) Does the three-way interaction among supplier partnership, SI, and EU strengthen the relationship between supplier partnership and OCP? This study extends some important work in the OM literature such as Kroes and Ghosh (2010) and Wong et al. (2011) by plugging a gap in the fit between supplier partnership and firm environment.

This study makes contributions to both the OM and strategic management literature. First, we provide a nuanced understanding of the peculiar situations in which supplier partnership (or hybrid governance) can be more effective. We contribute to the strategic management literature by offering the plausible reasons for the success and failure in the interaction among firms (e.g., Anderson and Jap, 2005). Second, we offer practical insights to firms on employing supplier partnership to deal with issues relating to an uncertain environment (Bracker, 1980). Third, we contribute to the TCE literature by offering theoretical reasoning

and empirical evidence of the moderating roles of SI and EU in the linkage between supplier partnership and firm cost performance. Previous TCE-based studies in the OM literature discuss the possible effects of these factors but offer limited empirical analysis with sufficient statistical power. Clarification of the roles of SI and EU helps understand the means to achieve OCP and facilitate the application of TCE in the OM context. This study underscores SI as an important moderator that decision makers should consider when managing supplier relationship in the real world.

Finally, extending the work of Kroes and Ghosh (2010), we believe we are the first researchers to use SEM to test three-way interactions in an OM research context. Of the different TCE-based empirical studies, the analysis of the simultaneous effects of SI and EU as key moderators on the performance impact of supplier partnership is novel. Such an analysis approach can be applied to a wide range of similar empirical studies (Kroes and Ghosh, 2010). We also extend the work of Wong et al. (2011) through the consideration of the potential interactions and combined performance impacts among different factors.

The rest of the paper is organized as follows: in Section 2 we provide the research background, review the literature, and develop the research hypotheses. In Section 3 we introduce the research methodology, describe the data collection method, and discuss the development of the measurement scales. Then we present an analysis of the results in Section 4. In Section 5 we discuss the research findings and their implications, conclude the paper, and suggest topics for future research.

2. Theoretical background and hypothesis development

2.1. Transaction cost economics and supplier partnership

Transaction cost economics (TCE) (Coase, 1960; Williamson, 1975) specifies the situations in which firms should perform certain activities in-house (i.e., forming a hierarchy), as well as the situations in which certain operations should be outsourced (i.e., resorting to a market). TCE is based on two assumptions that can be summarized as bounded rationality and opportunism (Grover and Malhotra, 2003). Bounded rationality is the assumption that the decisions of individuals have constraints on their cognitive capabilities and limits on their rationality. It becomes problematic in uncertain environments because the environmental contingencies cannot be specified accurately in the contract and the performance of the business partner cannot be easily verified during the exchange (Williamson 1985).

Opportunism is the assumption that individuals tend to make decisions that unscrupulously seek to serve their self-interests, and that it is difficult for a firm to assess if its business partner is trustworthy or not. Opportunism is a critical concern for a firm when there are supplier-related specific assets that have limited use outside the focal relationship. These assumptions give rise to the challenges of managing inter-firm relationships. The early work of Williamson (1975) suggests that by judiciously adopting either a hierarchy or a market as the mechanism of governance for exchanges, firms can minimize the transaction costs (relating to searching, planning, negotiating, writing, monitoring, and enforcing) (Blomqvist et al., 2002; Ireland et al., 2002). Simply put an appropriate alignment of transactions with the corresponding governance structure that can reduce cost.

Williamson (1985, 1991) later extended the hard "market and hierarchy" polarity to embrace the existence of "hybrid governance". The structure of "hybrid governance" pertains to the use of complex contracts and other forms of strategic alliances, including supplier partnership, to manage an exchange. The basic premise of TCE is the following: First, organizations should match simple

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