ARTICLE IN PRESS

Industrial Marketing Management xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Industrial Marketing Management

journal homepage: www.elsevier.com/locate/indmarman

Target and position article

The varying roles of governance mechanisms on ex-post transaction costs and relationship commitment in buyer-supplier relationships

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ARTICLE INFO

Keywords:
Relationship governance mechanisms
Ex-post transaction costs
Relationship commitment
Buyer-supplier relationships
Structural equation modeling

ABSTRACT

Inter-firm relationship governance is becoming increasingly fragmented and complex in industrial marketing and management. There is a need to develop an integrative framework, which describes the nature of the relationship (complementary or substitutes) between economic and sociological governance mechanisms, and their relative effectiveness in explaining ex-post transaction costs and relationship commitment. Building on transaction cost economics (TCE) and social exchange theory (SET), we investigate the varying roles of economic (i.e., contract completeness and symmetric dependence) and sociological (i.e., trust and communication) governance mechanisms. The deductive-nomological framework is tested by employing a nonparametric technique (i.e., partial least squares - PLS) to structural equation modeling (SEM) and semi-partial correlation. The analysis of data from 170 buyer-supplier relationships established by Finnish SMEs indicates that sociological mechanisms function as substitutes with contractual governance and complementary with symmetric dependence in relation to ex-post transaction costs and relationship commitment. Further, economic governance mechanisms have a more effective role in minimizing ex-post transaction costs, whereas sociological governance mechanisms are more powerful in enhancing relationship commitment.

1. Introduction

Minimizing transaction costs and maximizing relationship commitment have become the central research phenomena in inter-firm relationship management. Transaction cost is defined by Williamson (1985) as all of the ex-ante and ex-post contracting, monitoring and enforcement costs connected with conducting exchange activities between firms (Gulbrandsen, Lambe, & Sandvik, 2017). Relationship commitment, on the other hand, is considered as a central ingredient of the relationship marketing model affecting the behavior of partners (Shi, Shi, Chan, Liu, & Fam, 2011), and involves a need to develop and maintain a stable relationship (Anderson & Weitz, 1992). However, the uncertainty of buyers and suppliers regarding the expectations whether the counterpart abandons opportunistic behavior and acts cooperatively in bargaining and negotiation is an inevitable dilemma in relationship exchange (Gorton et al., 2015). Similarly, incomplete contracts, distrust, asymmetric information sharing and interdependence, differences in objectives as well as unanticipated changes in the market are depicted as negative forces influencing transaction costs and relationship commitment.

Governance, therefore, becomes pivotal in buyer-supplier relationship development (Liu, Li, Shi, and Liu, 2017; Luo, Liu, Yang, Maksimov, & Hou, 2015). Prior inter-firm governance literature suggests that, in order to achieve joint objectives, firms need to erect appropriate governance factors, namely; economic and sociological mechanisms (e.g., Bai, Sheng, & Li, 2016; Liu, Luo, & Liu, 2009; Yang, Gao, Li, Shen, & Zheng, 2017), rooted in transaction cost economics (TCE) and social exchange theory (SET). Economic mechanisms, in line with TCE, include certain governance factors, firms emplaced to avoid transactional uncertainties through adequate structural implications. Whereas sociological mechanisms as SET factors help to govern inter-firm relationships by developing a cooperative environment between firms (Liu et al., 2009; Liu, Li, Shi, and Liu, 2017).

Although prior empirical research has extensively documented the effective roles of governance mechanisms, it remains in limited context of opportunism mitigation (e.g., Liu et al., 2009; Luo et al., 2015), relationship performance (e.g., Yang, Zhao, Yeung, & Liu, 2016; Liu, Li, et al., 2017) and conflict management (e.g., Lee et al., 2017; Lumineau & Henderson, 2012; Yang et al., 2017). A growing number of empirical studies demonstrate that economic structure of relationship exchange is

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https://doi.org/10.1016/j.indmarman.2017.12.012
Received 28 April 2017; Received in revised form 2 November 2017; Accepted 12 December 2017
0019-8501/

Please cite this article as: Shahzad, K., Industrial Marketing Management (2017), https://doi.org/10.1016/j.indmarman.2017.12.012

sociologically embedded (e.g., Dyer & Chu, 2011; Granovetter, 2005). Some past empirical studies have investigated only a few governance mechanisms i.e. trust and transaction-specific investments, their roles remained in isolation in explaining governance cost (Bharadwaj & Matsuno, 2006; Corsten & Felde, 2005; Dyer & Chu, 2003) and commitment (Chang, Wang, Chih, & Tsai, 2012; Shi et al., 2011). Moreover, several recent studies on inter-firm have called for a systematic research on distinct roles of relationship governance mechanisms in relation to transaction costs and relationship commitment in different types of buyer-supplier relationships (e.g., Burkert, Ivens, & Shan, 2012; Gulbrandsen et al., 2017; Liu, Li, et al., 2017). Therefore, researchers have different opinions as well as they found conflicting empirical results on whether these mechanisms function as complementary (Liu et al., 2009; Van der Valk, Sumo, Dul, & Schroeder, 2016) or substitutive forces (Li, Xie, Teo, & Peng, 2010; Wuyts & Geyskens, 2005). On the other hand, the relative effectiveness of these mechanisms is characterized by nuanced understanding of different transaction objectives driving governance structures, which is missing in the literature.

Different governance structures are required for different transaction objectives in governing relationship exchange (Burkert et al., 2012). Better understanding of relationship outcomes and collaboration goals drive managers to analyze which governance mechanism is more crucial for a particular task (Yang et al., 2016). Therefore, the varying roles of economic and sociological governance mechanisms in minimizing ex-post transaction costs and maximizing relationship commitment has yet to be addressed. Such mixed evidence and conflicting views on complementary-substitutive perspective and relative effectiveness of governance mechanisms, therefore, necessitates further investigation of the phenomenon. Thus, an interesting question now is concerned with whether sociological governance mechanisms function as complementary or substitutes with contractual governance and symmetric dependence respectively in minimizing ex-post transaction costs and fostering relationship commitment.

To fill these gaps and provide further insights, this study aims to address the concerns mentioned above. Therefore, this study contributes to the industrial marketing and management literature by portraying a comprehensive picture of relative effectiveness, as well as the joint use of both economic (i.e., contract completeness and symmetric dependence) and sociological (i.e., trust and communication) governance mechanisms influencing ex-post transaction costs and relationship commitment. Further, it develops and empirically tests a nomological framework by employing a nonparametric technique (i.e., PLS) to SEM and semi-partial correlation. The empirically comparative investigation in concurrent examination of these two effects alongside will support us in understanding the relative influence of varying governance mechanisms in order to manage successful buyer-supplier relationships. Such techniques provide firms the opportunities to evaluate the relative effectiveness of various governance mechanisms (Yang et al., 2016). The study's findings generally support our argument that economic mechanisms are relatively more effective at minimizing ex-post transaction costs, while sociological governance mechanisms are more effective at maximizing relationship commitment. Further, when sociological mechanisms interact with contract completeness and symmetric dependence, interesting findings emerge related to their complementary and substitutive nature.

2. Theoretical background and hypotheses

2.1. Governance mechanisms in buyer-supplier relationships

Governing successful buyer-supplier relationships in a systematic way is found to be pivotal in enhancing beneficial outcomes and stability (Liu et al., 2009; Liu, Li, et al., 2017, Liu, Luo, Huang, and Yang, 2017). The main question, therefore, is how to design an effective governance structure where both parties are fully devoted to fulfilling their common business objectives (Luo et al., 2015). For this reason, several recent studies have highlighted the significance of multiple governance mechanisms (e.g., Bai et al., 2016; Liu et al., 2009; Yang et al., 2017). These mechanisms are mainly found embedded in both economic and sociological mechanisms (Liu, Li, et al., 2017, Liu, Luo, et al., 2017).

2.1.1. Economic governance mechanisms

Economic governance mechanisms are explained in terms of economic rational organizational measures, which support managing, monitoring and harmonizing partners' behaviors in relationship exchange (Liu et al., 2009; Williamson, 1985). Contract completeness and symmetric dependence, as economic mechanisms, demonstrate mutually specified contractual clauses and relationship specific investments (Brown, Dev, & Lee, 2000; Liu, Luo, et al., 2017). Contractual governance is albeit ubiquitous and offers an institutional framework regulating course of relationship exchange (Luo, 2009; Liu, Luo, et al., 2017), it varies in the level of completeness, complexities (Crocker & Reynolds, 1993), rigidity, and flexibility (Sande & Haugland, 2015). Several researchers have maintained that contracts will always be incomplete due to inevitable unpredictability (Crocker & Reynolds, 1993; Luo, 2009). Therefore, a relatively complete contract minimizes the boundary spanners' uncertainty and risks of opportunisms. A well-defined contract is considered as a comprehensive instrument (i.e., explaining rules and regulations, rights and obligations of both parties) for safeguarding specific assets against opportunism (Luo, 2009; Liu, Luo, et al., 2017). Moreover, the level of completeness in a contract stipulates the extent to which contractual terms and future contingencies are specific and detailed. Term specificity highlights each partner' rights, duties and responsibilities in order to organize and manage the relationship whereas contingency adaptability concerns the contractual response to future problems, conflicts and contingencies (Luo, 2002; Reuer & Ariño, 2007). Hence, this level of contact completeness delineate exchange substance and structure resulting in maximum pay-off.

Whereas symmetric dependence entails both relationship partners to invest idiosyncratically in physical and human assets that are less valuable to alternative uses (Ali & Larimo, 2016; Khalid & Ali, 2017; Kumar, Scheer, & Steenkamp, 1995). These co-specialized investments create interdependence between partners, prior research, therefore argued that symmetric interdependence is a product of both partners' equal dependence on each other by investing jointly in a relationship (e.g., Kumar et al., 1995; Wu & Wu, 2015). On the other hand, asymmetric dependence effects on coercive power of less dependent partner to exploit, and creates prospects for opportunism and conflict (Liu, Luo, et al., 2017; Shen, Wang, & Teng, 2017). Therefore, high level of symmetric dependence enhances the joint motivation of forbearance and relational embeddedness between partners, and discourages individual private goal seeking by binding and locking firms to a particular course of action (Schmitz, Schweiger, & Daft, 2016; Young-Ybarra & Wiersema, 1999).

2.1.2. Sociological governance mechanisms

Sociological governance mechanisms are defined as socially embedded organizational measures in economic activities, which help in managing, monitoring and organizing relationship exchange (Granovetter, 2005; Liu, Luo, et al., 2017). Based on existing research, we categorize two sociological governance mechanisms (i.e., trust and communication), which underlie the impact of relational ties between buyer and supplier. Trust is a non-contractual mechanism and defined as the willingness to trust or confidence that a partner holds about the other partner's reliability, benevolence, and integrity (Zaheer, McEvily, & Perrone, 1998). Prior research on relationship trust has distinguished different conceptualization and presented influential perspectives. Such as, Dyer and Chu (2011) highlighted trust as the level of confidence of a relationship partner for other partner's fair behavior of not exploiting its