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Exploring the governance mechanisms of quasi-integration in buyer–supplier relationships ☆

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ABSTRACT

This article deals with quasi-integration governance mechanisms in the context of business-to-business buyer–seller relationships. Based on transaction cost analysis and resource dependence theory, the authors identify four key elements of quasi-integration: legal contract, joint problem solving, joint planning, and collaborative communication. From the perspective of resource dependence theory, the authors examine the effects of interdependence on these four elements. Empirical evidence derived from a study of 398 Chinese companies indicates that (1) the four governance mechanisms of quasi-integration are driven by inter-firm dependence; and that (2) legal contract serves as an important foundation of joint problem solving. In addition, the authors examine the distinct effects of the four elements on two critical exchange outcomes: supplier performance and buyer commitment. Their analysis shows that legal contract, joint planning, and collaborative communication positively affect supplier's performance, while joint problem solving and collaborative communication significantly enhance the buyer's commitment to the relationship.

1. Introduction

In recent years, researchers have shown increasing interest in quasi-integration. The initial claims of transaction cost analysis (TCA) argue that market and hierarchy (or vertical integration) are two polar extremes of governance (Williamson, 1975). Recent studies, however, suggest that there exist intermediate governance modes such as quasi-integration, which falls somewhere between these two polar extremes (McCutcheon and Stuart, 2000; Zaheer and Venkatraman, 1995). It is argued that quasi-integration serves as an alternative governance structure to vertical integration (Zaheer and Venkatraman, 1995). In this paper, we take the view that quasi-integration is a hybrid form of governance, and define it based on TCA and resource dependence theory (RDT).

In the logic of TCA, like vertical integration, quasi-integration should protect specific assets, adapt to uncertainty, and enable efficient transactions (Heide, 1994; Williamson, 1985). RDT, on the other hand, suggests that the governance between organizations should allow them to obtain resources from other parties and reduce risks associated with uncertainty (Heide, 1994; Pfeffer and Salancik, 1978). By combining these two perspectives, we define quasi-integration as a hybrid governance mechanism that enables two organizations to protect specific assets, adapt to uncertainty, obtain resources, and efficiently coordinate transaction and interaction between them (Cousins and Menguc, 2006; Das et al., 2006; Frohlich and Westbrook, 2001).

Even with the significant body of prior literature addressing quasi-integration, there remain three essential issues incompletely analyzed. First, it remains unclear what elements comprise the major governance mechanisms of quasi-integration. Most particularly, since quasi-integration is a collaborative relationship between two organizations, it inevitably involves two common inter-organizational governance mechanisms: legal contract and relational governances (Poppo and Zenger, 2002). While legal contract governance has been clearly defined in prior literature, there is a lack of consensus of the elements of relational governance. Previous studies usually propose various sets of key relational governance elements, but do not provide a theoretical explanation as to why these elements have been selected.

Second, most prior studies have adopted the TCA paradigm to explain the formation of quasi-integration (e.g., Buvik and Gronhaug, 2000; Parker and Anderson, 2002; Zaheer and Venkatraman, 1995). However, other theoretical perspectives could also be utilized for this purpose. In this paper, we adopt one such paradigm, RDT. The RDT theory suggests that an organization's environment is inherently unstable and thus it has to develop governance mechanisms to deal with it (Handfield, 1993; Pfeffer and Salancik, 1978). The theory provides a rich predictive framework for explaining how organizations can make their supply environment more stable and efficient (Handfield, 1993). As

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such, compared to TCA, it provides an alternative perspective that could be utilized for explaining the formation of inter-organizational governance mechanisms such as quasi-integration.

Finally, when it comes to the effects of quasi-integration on exchange outcomes, most prior studies have concentrated on the firm's performance (Cousins and Menguc, 2006; Das et al., 2006; Droge et al., 2004; Narasimhan and Das, 2001). Here we maintain that in addition to performance, commitment should also be considered, since it reflects the effectiveness of quasi-integration in maintaining the relationship.

Therefore, the main purpose of this study is to examine the process through which quasi-integration exerts governing effects on the buyer–supplier relationship by addressing the following three questions: (1) What are the key elements of quasi-integration governance mechanisms? (2) To what extent does interdependence affects these key elements? and (3) To what extent do these key elements affect exchange outcomes, such as supplier performance and buyer's commitment?

2. Literature review and research model

2.1. The key elements of quasi-integration governance mechanisms

Arguably, quasi-integration as a governance mechanism should provide firms with advantages that they cannot obtain from an arms-length market relationship. As a result, firms are willing to commit to the integrated relationship on the condition that specific control mechanisms promote and generate these advantages. These control mechanisms could be regarded, therefore, as the key governance mechanisms of quasi-integration. To identify the key elements of quasi-integration governance mechanisms, we take the perspectives of both TCA and RDT to address two prominent problems: (1) what are the advantages of quasi-integration? and (2) what are the underlying control mechanisms that offer such advantages?

In the logic of TCA, the most critical factor that distinguishes different relationships is the presence of transaction specific investments (TSIs). TSIs are those human and physical assets dedicated by a company to a particular relationship, which involve sunk costs that would be unrecoverable should the relationship be terminated (Grover and Malhotra, 2003; Heide and John, 1992). TCA suggests that such investments could be exploited by trading partners' opportunistic behaviors, such as lying, cheating, or violation of agreements (Randfleisch and Heide, 1997). Thus certain types of safeguards are required to protect TSIs. Williamson (1981) suggests that there are three advantages of hierarchy over market in harmonizing bilateral exchange and protecting TSIs: (1) reduction of sub-optimization through common ownership, (2) easier resolution of difference through fiat, and (3) easier and more complete access to relevant information. Since quasi-integration may serve as a substitute of hierarchy when complete integration is not feasible or desirable (Heide and John, 1990; McCutcheon and Stuart, 2000), we could expect that the governing mechanisms of quasi-integration offer advantages similar to hierarchy.

On the other hand, RDT focuses on the supply and demand of resources between organizations. From the RDT perspective, organizations are coalitions which alter their structures and patterns of behaviors to acquire and maintain needed external resources (Pfeffer and Salancik, 1978; Ulrich and Barney, 1984). Organizations depend on reliable input and output resources to fulfill their goals (Buvik and Gronhaug, 2000). Most critically, companies need to obtain technological capabilities to support their innovation initiatives. Such knowledge is difficult to obtain from an arms-length market relationship, and, thus, is often acquired through either vertical integration or alliance with other companies (Bouty, 2000; Vanhaverbeke et al., 2002). To ensure the stable supply of resources from other parties, an organization needs to establish formal or informal linkages with them to reduce uncertainty associated with dependence on them (Bouty, 2000; Heide, 1994). Obviously, these linkages could be regarded as quasi-integration mechanisms. From an RDT perspective, the purpose of these quasi-integration mechanisms is mainly to allow organizations to access resources from one another, stabilize outcomes, and avert environmental controls (Handfield, 1993).

In sum, TCA and RDT suggest that quasi-integration between organizations should allow them to (1) access various resources from one another, including information and knowledge, to support transaction and innovation; (2) resolve differences between two parties; (3) coordinate activities of two parties to handle environmental uncertainty, improve performance, and promote innovation; and (4) protect TSIs. This provides answers to our first question.

For the second question, we argue that, as an inter-organizational phenomenon, quasi-integration involves both relational governance and legal contract, which offer advantages similar to those of hierarchy. Based on the above-mentioned advantages of quasi-integration, we maintain that joint planning, joint problem solving, and collaborative communication, are the three most important elements of relational governance in a quasi-integrated relationship.

First, while common ownership is generally not available in quasi-integration, joint planning allows two parties to design their business process for better coordination between them, thereby avoiding sub-optimization of individual parties' business processes (Porter, 1985). Furthermore, joint planning allows companies to negotiate the terms and conditions that regulate resource sharing. By doing so, companies can protect the TSIs that they are going to commit to the relationship. Moreover, joint planning could enhance innovation by providing opportunities for shared learning, technology transfer, and resource exchange (Goes and Park, 1997; Handfield and Ragatz, 1999).

Second, when internal fiat is not available, joint problem solving allows trading partners to work on dispute resolution strategies (Claro et al., 2003). Third, collaborative communication between two parties allows them to access relevant information as in the case of hierarchy (Mohr et al., 1996; Mohr and Nevin, 1990). As such, collaborative communication enables companies to monitor each other's activities, and thus protect their TSIs. In addition, such information exchange is critical to the innovation in the relationship (Handfield and Ragatz, 1999). Although these three elements are by no means exhaustive of all relational activities, they are frequently utilized by researchers either separately or in an integrated manner.

Finally, since quasi-integration occurs between two independent parties, legal contract should play a critical governing role. Often, relational governance mechanisms are not sufficient for resolving all conflicts between two parties. For instance, joint problem solving is a process whereby the buyer and the supplier work together to settle their differences. However, even in a highly cooperative relationship, one should not expect that all disputes can be resolved through such a process. Companies need to turn to legal contracts when negotiation between two parties fails. A legal contract specifies the obligations of trading partners and allows them to turn to a third party to sanction an opportunistic trading partner (Dyer, 1997). Consequently, legal contracts could protect TSI, and provide the means for parties to settle their differences when joint problem solving cannot. In this sense, legal contracts, along with joint problem solving, become the counterparts of fiat in the context of quasi-integration.

Based on the above discussion, we propose that the key governance mechanisms of quasi-integration are: joint planning, joint problem solving, collaborative communication, and legal contract. We then discuss the linkages between interdependence and the four governance mechanisms in the next section.

2.2. The effects of interdependence on governance mechanisms of quasi-integration

RDT has maintained that interdependence introduces uncertainty into a firm's decision making. That is, uncertainty could arise when a