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Governing buyer–supplier relationships through transactional and relational mechanisms: Evidence from China

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ABSTRACT

Building on economic and social exchange theories, this study investigates the different roles transactional and relational mechanisms have in hindering opportunism and improving relationship performance in an emerging economy. Our study applied to manufacturer–distributor dyads in China and used matched survey data (225 paired sample firms) to test our hypotheses. Our hierarchical multivariate regression and semipartial correlation analyses suggest that transactional mechanisms are more effective in restraining opportunism while relational mechanisms are more powerful in improving relationship performance. This performance is improved more significantly when both contracts and relational norms are used jointly than when used separately. Likewise, opportunism is curbed more effectively when both contracts and trust are used jointly than when used individually.

1. Introduction

Restraining opportunism and improving relationship performance are central to any repeated economic exchange, such as alliances or partnerships. Opportunism is defined by Williamson as self-interest seeking with guile (1985). It is commonly held that governing interorganizational exchanges entails both transactional and relational mechanisms (Heide, 1994; Jap and Anderson, 2003; Poppo and Zenger, 2002). Transactional mechanisms are those that govern interparty exchanges, avoiding uncertainties through legal stipulations and economic incentive systems. Conversely, relational mechanisms emphasize inherent and moral control, governing exchanges through consistent goals and cooperative atmospheres. Previous research has documented that transactional and relational mechanisms are both important in mitigating opportunism and improving relationship performance for participating organizations (Barclay and Brock, 1997; Dahlstrom and Nygaard, 1999; Cannon et al., 2000; Cavusgil et al., 2004; Heide and John, 1992; Jap and Ganesan, 2000; Lusch and Brown, 1996; Poppo and Zenger, 2002; Wuyts and Geyskens, 2005). However, the relative effectiveness of transactional and relational mechanisms in curtailing opportunism and enhancing relationship performance has yet to be addressed. Empirical comparison within a unified analysis of the two effects side by side will help us understand the relative contribution of varying mechanisms to the governing of buyer–supplier relationships.

Research on interfirm exchange governance argues that participating firms should employ multiple mechanisms for governing interorganizational relationships. However, scholars have opposing views on whether transactional and relational mechanisms act as complementary (Poppo and Zenger, 2002) or substitutive forces (Wuyts and Geyskens, 2005). An interesting question is whether the joint use of transactional and relational mechanisms is altogether more effective in curbing opportunism and fostering relationship performance than individual use. If

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the joint effect is confirmed, it follows that there will be some additional or synergetic effect of using relational and transactional mechanisms together.

This study intends to address the questions above. Since the governance effectiveness of transactional and relational mechanisms is not context-free (Jap and Anderson, 2003), we investigate these questions in a specific context—namely, manufacturer–distributor channel partnerships in China, a leading emerging market and a primary producer of consumer products for the world. Most previous studies have investigated only the single party perception and assume that this perception is mutually shared across the relationship, but some recent studies caution that this may not be the case for all relationships (Kim, 2000; Sollner, 1999; Zaheer and Zaheer, 2006). To fill this void, we conducted a survey of 225 paired manufacturers (suppliers) and distributors (buyers) in China's household appliance industry to verify our premise and test our hypotheses. Our analysis generally supports our arguments that (1) transactional mechanisms are relatively more effective in curtailing opportunism while relational mechanisms are more effective in enhancing relationship performance and (2) there is a significant and positive joint effect on restraining opportunism and nourishing cooperation when transactional and relational mechanisms are employed together.

2. Theory and hypotheses

2.1. Theoretical background

Governance is essential to the stability of buyer–supplier relationships (Benton and Maloni, 2005; Carr and Pearson, 1999). In such relationships, governance involves actions or mechanisms by which both parties behave, leading to the fulfillment of joint objectives. There are always some elements of private incentive in such exchanges, resulting in the need for control (Gaski, 1986; Heide, 1994; Jap and Anderson, 2003; Provan and Skinner, 1989). Buyers and suppliers are often uncertain whether their expectations will be fulfilled and whether the other party will act cooperatively when bargaining pressures rise. Goal differences, ambiguous contracts, opportunistic behaviors, differences in operational routines, and unexpected market changes are portrayed as endogenous factors driving conflict and as underlying reasons that give rise to governance in buyer–supplier partnerships (Birnberg, 1998; Jap and Ganesan, 2000; Mohr and Spekman, 1994). Governance is pivotal to the relationship development between supply chain members.

In buyer–supplier dyads, as in other types of inter-organizational exchanges, governance is realized through both transactional and relational mechanisms (Aulakh et al., 1996; Brown et al., 1995; Heide and John, 1992; Jap and Ganesan, 2000). Transactional mechanisms are manifested in jointly stipulated contractual clauses (contract hereafter) and bilateral transaction-specific investments (TS investment hereafter) (Brown et al., 2000; Heide and John, 1992; Gundlach et al., 1995; Williamson, 1985). According to transaction cost economics, transactional mechanisms are derived from economic rationality and emphasize governing relationships through monitoring and incentive-based structures. A well-specified contract is viewed as the major instrument that protects specific investments from opportunistic behavior (Williamson, 1985). It stipulates the rights and obligations of both parties through formal rules, terms and procedures. It also explicitly states how various future situations will be handled (i.e., product responsibility, trading procedure, penalties for noncompliance, etc.). Williamson (1999, p. 1090) suggests that "credible contracting is very much an exercise in farsighted contracting, whereby the parties look ahead, recognize hazards, and devise hazard mitigating responses—thereby to realize mutual gain." Although contracts cannot completely suppress opportunism, buyers and suppliers may mitigate ex post opportunism and investment distortions by using more complete agreements (Heide, 1994; Lusch and Brown, 1996; Wathne and Heide, 2000).

Meanwhile, transaction-specific investment is an important incentive tool used in monitoring relationships (Wathne and Heide, 2000). Bilateral TS investments will lose considerable value if the focal relationship of both parties ends prematurely (Lohtia et al., 1994). It is very difficult for parties to redeploy TS investments in a particular buyer–supplier relationship elsewhere, thus inhibiting the parties' opportunistic behavior in the current transaction. Such investments may be tangible (e.g., a manufacturing facility, a specific tool or machine) or intangible (e.g., tacit knowledge, a specific technology or capability) (Jap and Anderson, 2003). It guides buyer–supplier exchanges and reduces uncertainty or conflict by providing relationship-bound economic incentives to continue vertical partnerships (Kotabe et al., 2003; Mudambi and Helper, 1998). TS investments discourage an individual party's private incentive seeking. Moreover, it makes one party's behavior more observable to the other, promoting accountability. Contracts and TS investments are supplementary because contracts specify important conditions and measures of governance that are not covered in TS investments while TS investments furnish extra economic incentives for ongoing relationships, something that contracts cannot deliver. Luo (2002) demonstrates that contracts and TS investments are particularly complementary in emerging markets where structural ordering through transaction-specific incentives compensates the relatively weaker contractual governance.

According to social exchange theory, relational mechanisms focus on the roles of social interactions and socially embedded relationships in economic activities (Granovetter, 1985). Relational mechanisms have been recently recognized as useful instruments to control opportunism and nourish cooperation in buyer–supplier channels (Gundlach et al., 1995; Heide and John, 1992; Kim, 2000). In long-term buyer–supplier dyads, TS investments are gradually embedded in social relations. Social exchange theorists suggest that individual opportunistic desire is curbed by the prospect of ostracism by the partner when relational mechanisms support courtesy between them (Levinthal and Fichman, 1988). Relational mechanisms govern buyer–supplier exchanges because the embeddedness of social connections generates standards of expected behavior that obviate the need for, and are superior to,