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# Governance mechanisms in domestic and international buyer–supplier relationships: An empirical study

Michael Burkert [a,*], Björn Sven Ivens [b,1], Jialu Shan [c,2]

[a] Faculty of Business & Economics, University of Lausanne, Internef 506, Campus Dorigny, CH-1015 Lausanne
[b] Faculty of Social Sciences, Economics & Management, Chair of Marketing, Otto-Friedrich-University Bamberg, Feldkirchenstrasse 21, D-96052 Bamberg
[c] Faculty of Business & Economics, University of Lausanne, Internef 531, Campus Dorigny, CH-1015 Lausanne

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ABSTRACT

Governance mechanisms are a key element of business relationships. However, little is known about the possible differences between their uses in domestic versus international business relationships. Drawing on empirical data, we investigate three issues. First, we compare the use of five governance mechanisms (contracts, value-creating norms, value-claiming norms, specific investments, and trust) in purely domestic relationships as opposed to relationships with an international component. We also investigate whether customer satisfaction and commitment differ in these two settings. Second, we extend the model of Palmatier, Dant, and Grewal (2007) by adding two distinct types of governance norms—value-claiming norms and value-creating norms—and analyze the interrelationship between the five governance mechanisms as well as their impacts on business customer satisfaction and commitment. Finally, we analyze the moderating role of internationality on relationships between governance mechanisms and customer commitment. Data from a survey of 296 companies support most of the hypothesized relationships.



## 1. Introduction

In exchanges with international business partners in industrial markets, firms increasingly encounter specific challenges. Even in domestic markets, firms may face international issues, such as those related to their foreign business partners' corporate cultures or employees of foreign origin. Purely domestic relationships and relationships with an international component are both part of a company's relationship portfolio. Relationships can be described in various ways, for example, in terms of the actors, activities, and resources involved in the exchange (Håkansson & Snehota, 1995). One characterization, the interaction model (Håkansson, 1982), emphasizes that any relationship is embedded in an atmosphere, that it depends on environmental factors, and that the activities of the actors are mutually interdependent. Because mutual interdependence is a source of risk, economic actors must safeguard their interests against opportunistic behavior (Wathne & Heide, 2000). To this end, they put governance mechanisms in place.

Governance mechanisms are safeguards that firms use to control inter-firm exchange, minimize exposure to opportunism (Wathne & Heide, 2000), protect transaction cost investment, and promote the continuance of relationships (Jap & Ganesan, 2000). Among the governance mechanisms typically used in business-to-business relationships are formal written contracts, relational norms, specific investments, and pledges (Cannon, Achrol, & Gundlach, 2000; Heide & John, 1992; Heide, Wathne, & Rokkan, 2007; Jap & Ganesan, 2000; Macaulay, 1963; Macneil, 1980; Williamson, 1975). The design of the governance structure for a given exchange relationship represents a strategic decision that requires both parties to work together to reach their ultimate goals. The extant literature on the management of industrial buyer–supplier relationships comprises a series of contributions providing a clear picture of the individual governance mechanisms, their relative importance for the performance of a relationship, and the conditions under which certain governance mechanisms should be used (Bello & Gilliland, 1997; Ferguson, Paulin, & Bergeron, 2005; Gassenheimer, Calantone, & Scully, 1995; Kaufmann & Dant, 1992; Lusch & Brown, 1996; Palmatier, Dant, & Grewal, 2007; Palmatier, Dant, Grewal, & Evans, 2006).

Research provides evidence that relationships involving partners from different countries are generally complex and subject to high levels of uncertainty. Consequently, implementing relationship management becomes more challenging (Homburg, Krohmer, Cannon, & Kiedaisch, 2002), and crafting an appropriate governance structure is even more important than it is in a purely domestic setting. Thus far, however, most empirical studies have analyzed domestic business relationships, chiefly in the US and Europe. Research on governance mechanisms in international business relationships is sparse.

* Corresponding author. Tel.: +41 21 692 3363; fax: +41 21 692 3305.
*E-mail addresses:* Michael.Burkert@unil.ch (M. Burkert), Bjoern.Ivens@uni-bamberg.de (B.S. Ivens), Jialu.Shan.2@unil.ch (J. Shan).
[1] Tel.: +49 951 863 2566; fax: +49 951 863 5566.
[2] Tel.: +41 21 692 3665; fax: +41 21 692 3305.

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This paper aims to provide a better understanding of governance issues in business relationships with an international component. More precisely, this study makes three contributions:

(1) We analyze whether the use of governance mechanisms and relationship outcomes (customer satisfaction and customer commitment) differ in relationships with an international component compared with domestic relationships.
(2) We retest the relationships between governance mechanisms and relationship outcomes currently developed in the literature (Palmatier et al., 2007) in an international context. We propose a model that accounts for the interrelationships between governance mechanisms (formal contract, value-claiming norms, value-creating norms, relationship-specific investments, and trust) and customer commitment and satisfaction as relationship outcomes.
(3) We examine the moderating role of internationality on the relationships between governance mechanisms and customer commitment.

Our analyses reveal significant differences in the use of governance mechanisms between purely domestic relationships and relationships with an international component. We also find support for the model based on Palmatier et al.'s (2007) work. Finally, we observe a moderating effect of internationality, in particular, on the relationships between both formal contracts and commitment and trust and commitment.

The remainder of this paper has the following structure. The next section reviews the extant literature on governance mechanisms, international business relationships, and the governance of international business relationships. In Section 3, we derive hypotheses concerning the relationships between governance mechanisms, customer commitment, and customer satisfaction, including the direct and indirect effects as well as the assumed moderator effects of internationality. Section 4 describes the design of our empirical study, and Section 5 details the results of the statistical analysis of 296 inter-firm relationships comprising both purely domestic dyads and cases with an international component.[3] Section 6 concludes by discussing the managerial and theoretical implications, limitations of the study, and suggestions for future research.

## 2. Theoretical background

### 2.1. Governance and governance mechanisms

Researchers describe the economic exchange processes among firms in different ways. As Heide (2003, p. 18) points out, "Much of the recent research on interfirm relationships in marketing has relied on the theoretical notion of governance." Various bodies of literature, such as transaction cost analysis (Williamson, 1985, 1991), legal sociology (Macneil, 1978, 1980), and marketing (Arndt, 1979), classify exchanges based on the governance concept. One extreme, usually referred to as market governance, is often portrayed with such attributes as "complete transferability, primary focus on the substance of exchange, a sharp division of benefits and burdens and price as a regulatory mechanism" (Dwyer, Schurr, & Oh, 1987, p. 12). The other extreme classifies governance mechanisms in terms of organizational or quasi-organizational regulatory mechanisms. Long-term business relationships fall somewhere between the two poles of this continuum. They constitute a type of governance referred to variously as the hybrid form (Buvik, 2002; Gencturk & Aulakh, 2007; Williamson, 1991), domesticated markets[4] (Arndt, 1979, p. 70), relational exchange (Ivens & Blois, 2004; Macneil, 1980), or clans (Ouchi, 1980). From a marketing perspective, Heide (1994) proposes the term "non-market governance."

Heide (1994) insists that any type of governance "includes elements of establishing and structuring exchange as well as aspects of monitoring and enforcement" (p. 72). This study focuses on governance mechanisms in relational exchange types of governance rather than on the more general decision for a specific governance type in an exchange with a given actor. Jap and Ganesan (2000, p. 230) define governance mechanisms as "safeguards that firms put in place to govern interorganizational exchange." Among these safeguards are, for example, "incentive structures, monitoring mechanisms, contractual provisions, reputations, norms, and interpersonal trust" (Jap & Anderson, 2003, p. 1). The paper reported herein examines a specific subset of governance mechanisms that is often discussed in marketing's relational exchange literature. These include formal written contracts (Cannon et al., 2000; Lusch & Brown, 1996; Stinchcombe, 1985), specific investments (De Wulf, Odekerken-Schröder, & Iacobucci, 2001; Gundlach, Achrol, & Mentzer, 1995; Jap & Ganesan, 2000), and relational norms (Andersen, Christensen, & Damgaard, 2009; Dant & Schul, 1992; Heide & John, 1992; Pilling, Crosby, & Jackson, 1994; Tangpong, Hung, & Ro, 2010).

Formal written contracts are legally binding documents in which the parties involved agree on their rights and obligations in the transactions they intend to execute. Contracts and contract law continue "to play a key governance role in almost all exchanges" (Gundlach, 1994, p. 246).

Specific investments comprise all investments one party makes in transactions with a partner that would have limited value outside this focal relationship (Stump & Heide, 1996; Williamson, 1985). Such investments are often made deliberately, for example, by a supplier. From the buyer's perspective, they represent a safeguard against supplier opportunism because if supplier opportunistic behaviors lead to the termination of the relationship, these investments lose their value (Jap & Ganesan, 2000).

Heide and John (1992) refer to relational norms as expectations about behavior that actors in a relationship share, at least partially. Norms control behaviors not through incentives but through moral control and internalization (Joshi & Stump, 1999). They are "not necessarily enforceable" (Kaufmann, 1987, p. 75), but they define both appropriate and deviant behavior. Macneil (1980) describes a set of ten common norms (such as solidarity, flexibility, and reciprocity). In our examination of norms, we draw on a classification of common norms that distinguishes between norms that aid in creating value and norms that govern value-claiming processes (Kaufmann, 1987). Value-creating norms help the parties expand the level of value created by the exchange. Value-claiming norms govern the distribution of that value among the parties. Although this conceptual distinction has been confirmed empirically (Ivens, 2006), it has not been tested in an international context thus far.

Finally, we include trust as an additional variable that we expect to be closely related to our focal governance mechanisms. Instead of controlling a relationship through the time-consuming and costly deployment of specific governance mechanisms, actors can rely on trust (Dwyer et al., 1987; Moorman, Deshpandé, & Zaltman, 1993; Morgan & Hunt, 1994). Trust has been defined as the perceived credibility and benevolence of a target of trust (Doney & Cannon, 1997), and trusting an exchange partner can provide a strong basis for reducing other governance mechanisms. From an economic point of

[3] We use independent *t*-tests and structural equation modeling in Mplus 4.0 to test our hypotheses.

[4] In a comment on Arndt's (1979) article, Stidsen (1979) points to the work of Commons (1934), who had already discussed forms of exchange, which he referred to as rationing transactions. Goodman (1979) mentions the work of Alderson (1965) and Commons (1934): "The idea of continuity in relationships … is clearly evident from Commons, Alderson, and nearly all the work in organizational buying."