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The use of asset specific investments to increase customer dependence: A study of OEM suppliers

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A R T I C L E I N F O

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A B S T R A C T

Making asset specific investments without sufficient economic safeguards is usually seen as a poor managerial practice according to transaction cost economics. However, in practice, many suppliers still invest in asset specificity to satisfy their major customers' requirements, who do not make sufficient investment commitments. The objective of this study is to explore how suppliers that make asset-specific investments maintain long-term relationships with their customers and even make their customers reliant on them. Empirical analysis of data from a sample of Taiwanese original equipment manufacturer (OEM) suppliers shows a significant positive indirect effect of asset specificity on the dependence of customers on suppliers, mediated through joint learning capacity. In addition, a positive link between a proactive market orientation and the degree of customer dependence on the supplier was found. This investigation finds evidence that joint learning capacity and proactive market orientation play critical roles in linking asset specificity to customer dependence.

1. Introduction

The presence of sellers and buyers and the relationships between the two are essential to marketing (Monga, Chen, Tsiros, & Srivastava, 2012). However, managing these relationships can be a challenge for many suppliers (Nyaga, Lynch, Marshall, & Ambrose, 2013). Given the different goals, resources, knowledge and expectations of the partner firms, each party competes for a competitive advantage, and this leads to a power asymmetry (Cowan, Paswan, & Van Steenburg, 2015). Specifically, one party in a buyer-seller relationship often has more power than the other, which means relative power endowments are highly important to the relationship (Christos & Ivaylo, 2011).

According to market power theory, a firm's behaviors are driven by power differentials (Shervani, Frazier, & Challagalla, 2007). The more powerful party is tempted to use coercive power (e.g. financial penalties, withholding support) and non-coercive power (expert, reference, legitimate, reward) to gain a greater share of the relationship's benefits (Cowan et al., 2015; French & Raven, 1959). The weaker party usually has few alternative options, and thus it is forced into more asset-specific investments, putting the weaker party in a hostage position (Kim & Choi, 2015). For example, original equipment manufacturer (OEM) suppliers are often forced to invest in asset specificity to their customers because of the lack of alternative channels and strong brand recognition of their buyers (Jean, Sinkovics, & Cavusgil, 2010). Typically, OEM networks include a few main customers with many peer suppliers that compete aggressively against each other to serve those same customers (Cheng, 2010). The structure of the relationship between the OEM supplier and its customer is often characterized by an asymmetric bargaining power (Jean et al., 2010). Therefore, OEMs tend to use their relatively strong bargaining power to ask OEM suppliers to dedicate significant asset-specific investments (Kang, Mahoney, & Tan, 2009). OEM suppliers may accept such unreasonable requests to satisfy their powerful customers' expectations, as long as they also benefit (Cowan et al., 2015).

Asset specificity refers to tangible and intangible investments that exchange parties use to build transactional relationships. Once made, asset specificity create substantial switching costs when the transaction relationship fail to develop (Wu, Chen, & Chen, 2015). Making asset-specific investments without sufficient economic safeguards is seen as a source of dependence (Tjemkes & Furrer, 2010). According to transaction cost economics, these investments are a sign of poor managerial practice (Williamson, 1996). In other words, a firm that makes asset-specific investments increases its dependence on its transactional partner. Dependence indicates the extent to which one party's outcomes rely on the behavior of the other (Molm, 1994), and it also determines the degree of influence on the partner in the buyer-seller relationship (Lusch & Brown, 1996). A dependent party is unlikely to switch even if there are plenty of alternative partners available (Yeniyurt,

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Henke, & Yalcinkaya, 2014).

Although asset-specific investments bring the risk of dependence, many suppliers still invest in asset specificity for their major customers without receiving sufficient commitments in return (Jean et al., 2010). For example, Japanese automobile suppliers make greater asset-specific investments and develop more unique components for their customers (Hwang, 2006). In the USA and Europe, several smaller computer software companies do enter relationships with larger customers and tolerate the requests of asset-specific investments (Pérez & Cambra-Fierro, 2015). Previous research has found that suppliers are willing to commit to asset-specific investments, which refers to the supplier's informal, non-contractual commitments, when they are confident that they can realize benefits from them (Yeniyurt et al., 2014). Kang et al. (2009) also proposed that a supplier's asset-specific investments can yield additional knowledge and capability development benefits. For instance, managers of a supplier in a weak bargaining position might accept an unreasonable request because they have determined that the deal may generate positive economic spillovers via learning and capability development that can be deployed in future transactions with the same or other exchange partners. The premise of this viewpoint is that the supplier has an opportunity to develop multiple transactions, not just a single transaction with a particular customer. Therefore, a supplier's decision to make asset-specific investments can be rational when the transaction is examined more comprehensively (Trigeorgis, 1996).

However, a supplier making asset-specific investments for a particular customer does not mean the relationship will definitely be stable. A supplier that has made substantial asset-specific investments is more dependent on the buyer because the value of the investments will be greatly reduced if the relationship with the focal buyer is terminated (Williamson, 1991). Because the benefits provided by a dependent supplier are only slightly greater than or equal to the benefits provided by other suppliers, buyers have very little incentive to build a long-term relationship with the dependent supplier (Ganesan, 1994).

Although suppliers hope to gain from the spillover effects of their investments, long-standing cooperation between the two sides is not inevitable. Knowledge sharing and absorptive learning between the partners depend on the accessibility of the knowledge assets and characteristics of the partners' relationship (Srivastava & Gnyawali, 2011). However, organizational knowledge is usually tacit, sticky, and embedded in organizational routines; thus, it is difficult to learn (Ho & Ganesan, 2013). In addition, a supplier's learning behaviors may cause leakage of the buyer's knowledge (Jiang, Bao, Xie, & Gao, 2016), which in turn decreases the buyer's intent to continue cooperating with the supplier. Furthermore, potential economic value gained from spillover effects might be not realized if the buyer takes actions to prevent this from happening (Arrunada & Vazquez, 2006). In other words, commitments made by a supplier may not be sufficient to build a long-term relationship with the customer. This indicates that after making considerable asset-specific investments, suppliers should deliberate how to turn the tables so that they are not stuck in a passive position. If not, the suppliers would only continue to benefit their powerful customers, while trying to survive another year and playing the same games in this kind of exploitative relationship (Cox, Lonsdale, Watson, & Qiao, 2003). The suppliers need to either invest in development of resources and capacities, and somehow reduce competition between the transactional parties, or become indispensable in some other way (Cowan et al., 2015). Cuevas, Julkunen, and Gabrielsson (2015) also proposed that the suppliers could increase social encounters and experiences in the formal relationships, and this may help the suppliers develop social capital that would facilitate reconciling opposed interests in the asymmetric relationships. However, the extant literature has not fully explored this issue with quantitative research yet.

The main purpose of the current study is to address the gaps in the literature by examining how suppliers that make asset-specific investments can maintain long-term relationships with their customers, and even make their customers reliant on them. Since the buyer's dependence on the supplier is a source of power for the supplier (Caniëls & Gelderman, 2007), this means the degree of power asymmetry could be mitigated. Although this scenario is not uncommon in practice, it is still a new area that can be explored further. For example, Foxconn focuses on satisfying specific requests by Apple, and invests in substantial asset specificity to maintain the relationship between the two. However, the *Fox-Apple* partnership goes well beyond a traditional transactional relationship, as it involves intensive and extensive collaboration (Xing, 2015). To investigate this topic, we focus on two different supplier capacities: The first, *joint learning capacity*, refers to the extent that the supplier engages in cooperative and synergistic learning to develop relationship-specific knowledge, routines, rules, and processes that benefit both transaction parties (Fang & Zou, 2010). The second, *proactive market orientation*, refers to the extent that the supplier is proactive in understanding and satisfying the customer's latent needs as part of the value creation and relational processes (Flint, Woodruff, & Gardial, 2002; Tuli, Kohli, & Bharadwaj, 2007). We hypothesize and test the mediating roles of these two capacities on asset specificity and customer dependence on the supplier using a sample of Taiwanese OEM suppliers that supply powerful customers.

This contributes to the literature by linking asset specificity to customer dependence through these two capacities, which explore how a supplier is not always subject to powerful customers' demands, even if the supplier has made asset-specific investments. As Williamson (1999) mentioned, there is room for refinement of transaction cost theory to capture differential firm-level capabilities and learning in explaining the variance of governance choice (Kang et al., 2009).

The remainder of this study is organized as follows. In the next section, the conceptual framework and research hypotheses are proposed. This is followed by descriptions of the methodology, measurements, and data analysis of the study. Finally, we conclude the article with a discussion of the results and its managerial implications.

2. Theoretical development and hypotheses

2.1. Asset specificity and joint learning capacity

Asset specificity has emerged as a core concept in transaction cost theory, and it has been used in research on the boundary choices of organizations (Geyskens, Steenkamp, & Kumar, 2006). Williamson (1975) pointed out that the critical factors that influence transaction costs, which determine a firm's governance structure choice, are asset specificity and opportunistic behavior. In buyer-seller relationships with high asset-specificity, vertical integration is a preferred governance structure because the associated higher transaction costs safeguard against costly opportunistic behaviors. Therefore, transaction cost theory contends that asset-specific investments should only be made when there are expectations of substantial cost savings or other benefits (De Vita, Tekaya, & Wang, 2011).

Because asset-specific investments are tailored to a particular customer or value chain partner, they cannot easily be redeployed to alternative value-generating uses. These investments are also less valuable for suppliers outside of the focal relationship (Lohtia, Brooks, & Krapfel, 1994; Williamson, 1991). Heide (1994) indicated that investments of physical or human capital that are dedicated to a particular partner entail considerable switching costs. A supplier may be locked-in with a particular customer due to its asset-specific investments. From the suppliers' viewpoint, lock-in is risky because it increases the supplier's vulnerability to customer opportunism (Williamson, 1985). Asset-specific investments increase a supplier's reliance on the transactional partner, and therefore lead to a subordinate and exploitable bargaining position (Kang et al., 2009). Liu, Liu, and Li (2014) postulated that specific investments induce two different forms of opportunism by the partner. One is opportunistic