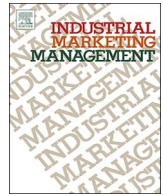




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Explicit and normative contracting in collaborations of varying magnitudes: Differing perspectives of component suppliers and original equipment manufacturers

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ABSTRACT

Industrial component suppliers and original equipment manufacturers utilize explicit and normative contracting to facilitate effective collaboration so as to garner joint profits. However, although collaborations vary in magnitude, research have yet to examine how these governance mechanisms may vary across collaborations of differing magnitudes, especially when considering the effects given differences in the longevity of firms' relationships. The results of a two study, empirical analysis employing structural equation modeling indicates that (1) component suppliers and original equipment manufacturers regard explicit and normative contracting as full and distinctive mediators of the relationship between collaborative magnitude and joint profits, and (2) that the longevity of the relationship between the firms moderates the effects of collaborative magnitude on explicit and normative contracting. Furthermore, between-group analyses indicate that component suppliers and original equipment manufacturers regard the effects of collaborative magnitude on explicit and normative contracting differently, and their perceptions of the effects of each contracting form on joint profits also differs.

Industrial channels consist of component suppliers (CSs) that collaborate to varying degrees with original equipment manufacturers (OEMs) to produce products that are integrated into OEM products that the OEM then markets to industrial customers. For example, Rockwell International, the CS, and Cisco Systems, the OEM, collaborate to produce heavy-duty wireless routers for the “internet of things.” Alternatively, Intel, the CS, and General Electric, the OEM, collaborate to develop “industrial predictivity technologies” for industries such as aviation, oil & gas, and power generation. While these collaborations may appear similar, they can vary greatly in relation to the collaboration's requirement for a breadth of commitments, complementary actions, management time and resources, and specific investments (termed *collaborative magnitude*). Variations in collaboration magnitude create differences in a party's exposure to exploitation (with collaborations of greater magnitude creating greater exposure to the firms than collaborations of lesser magnitude). Given the variations in collaboration magnitude, CSs and OEMs are challenged to vary their use of two prominent governance mechanisms to safeguard investments while facilitating joint profits: explicit contracting (*i.e.*, the precision of the collaboration's formal contract in articulating the expectations of each

party's role, responsibilities, performance, and handling of unexpected events and failure to perform) and normative contracting (*i.e.*, the level of mutual understanding between firms as to each party's role, responsibilities, performance, and handling of unexpected events and failure to perform). Unfortunately, researchers have yet to address this issue. Further complicating the nature of CS-OEM governance is the history of collaboration between firms (*i.e.*, the shadow of the past), as this may also influence the effectiveness of explicit and normative governance mechanisms differently, necessitating that firms incorporate the influence of the longevity (*i.e.*, the number of years where the subject firm has been a supplier or customer) when working to understand the effective implementation of explicit and normative contracting.

Although the importance of interfirm marketing collaborations has stimulated significant research (e.g., Anderson & Jap, 2005; Dahlquist & Griffith, 2014; Duffy, 2008; Ghosh & John, 1999; Heide, 1994; Homburg, Wilczek, & Hahn, 2014; Jap, 1999; Luzzini, Amann, Caniato, Essig, & Ronchi, 2015; Sun & Lee, 2013; Whipple, Lynch, & Nyaga, 2010), building most often from transaction cost economics (TCE) or its extensions (e.g., Anderson & Jap, 2005;

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Ghosh & John, 1999; Heide & John, 1992), these works, do not account for variations in collaboration magnitude nor its effect on governance mechanisms. Specifically, the extant literature (e.g., Dean, Griffith, & Calantone, 2016; Ghosh & John, 1999; Heide, 1994; Heide & John, 1988; Jap, 1999), treats collaborations' magnitudes as *invariant* or *uniform*, neglecting magnitude variance. Similarly, although a great deal of interfirm research has been engaged regarding contracting, only recently have researchers focused efforts to understand how explicit and normative contracts act in a complementary fashion (e.g., Cao & Lumineau, 2015; Dean et al., 2016; Lusch & Brown, 1996; Poppo & Zenger, 2002; Seshadri & Mishra, 2004). These limitations inhibit our understanding of an array of interfirm collaborations and how variances in collaborations are effectively governed for the enhancement of joint profits and constrain the utility of the extant research in aiding managerial decision-making. This study works to overcome these limitations, contributing to the literature in three ways.

First, the work introduces the *collaborative magnitude* construct, and empirically investigates its effects on explicit and normative contracting. The introduction of the collaborative magnitude construct advances the interfirm collaboration literature (e.g., Duffy, 2008; Ghosh & John, 1999; Heide, 1994; Heide & John, 1988; Jap, 1999; Spekman & Carraway, 2006; Whipple et al., 2010), providing a parsimonious means of assessing and distinguishing collaborations by their relative breadth of commitments, complementary actions, and specific investments. The construct also possesses managerial relevance as it can serve as a mechanism for practitioners (e.g., OEMs and component suppliers) to more succinctly and consistently characterize current and potential collaborations. Firms engage in collaborations with an anticipation of achieving strategic and/or profit objectives and therefore assess the investments and potential returns of alternative collaborative opportunities. The collaborative magnitude construct serves as an effective and informative means of differentiating collaborations and allows for more informed decision making. Further, we build on previous works investigating the influence of relational longevity (e.g., Dwyer, Schurr, & Oh, 1987; Hoppner & Griffith, 2011; Zheng, Roehrich, & Lewis, 2008), specifically we analyze its influence on the effects of collaborative magnitude on explicit and normative contracting. This approach enhances academics' and practitioners' abilities to understand how collaborations differ from each other, and how these differences can influence their participants' perceptions of governance mechanisms.

Second, the work empirically investigates the indirect effects of collaboration magnitude on the collaboration's joint profits (*i.e.*, the potential or actual profits resulting from the collaboration, generated by the firms); wherein explicit and normative contracting act as separate but co-existing mediators. This approach not only incorporates explicit and normative contracting as coexisting but separate mechanisms in the same model, thereby advancing this stream of inquiry (e.g., Cao & Lumineau, 2015; Dean et al., 2016; Lusch & Brown, 1996; Poppo & Zenger, 2002; Roehrich & Lewis, 2014), it also captures the participants' perceptions of the effects of collaborative magnitude on “precision” versus “mutual understanding,” and subsequent effects on collaboration performance. By contrasting precision and mutual understanding in the same collaboration, we illuminate the importance of these unique mechanisms, advancing the study of governance mechanisms. Mooi and Ghosh (2010) determined that increasing contract specificity increases *ex ante* costs and lowers *ex post* costs (*i.e.*, transaction problems). This finding and others (e.g., Dean et al., 2016; Lusch & Brown, 1996; Poppo & Zenger, 2002; Roehrich & Lewis, 2014) illuminates the practical decision facing managers, *i.e.*, what type of governance mechanisms are relevant and call for investment in advance, and what others should be developed over time?

Third, the investigation enhances our understanding of differences in the perspectives of industrial CSs and industrial OEMs. Extending the literature demonstrating variations in the perspectives of buyers and suppliers (e.g., Anderson & Narus, 1990; Bello & Zhu, 2006; Nyaga,

Whipple, & Lynch, 2010; Spekman & Carraway, 2006), this work compares collaboration and governance through the perspectives of two important roles in industrial supply chains. As such, this work advances our understanding of how perspectives pertaining to the effectiveness of collaboration and the employment of governance mechanisms are influenced by a firm's positioning in the buyer/seller dyad. In addition, it provides managerial guidance to component suppliers and OEMs considering collaborations. For example, a CS that anticipates a collaborative OEM partner's concern for explicit contract utilization can more effectively negotiate the contract's contents, and at the same time seek ways to enhance normative contracting initiatives. Thus, this work presents new insights into the governance perspectives of the industrial OEM and component supplier.

1. Theoretical development

While there are rich research streams in a variety of important collaborative initiatives such as strategic channel development (e.g., Heide, 1994), industrial joint ventures (e.g., Deitz, Tokman, Richey, & Morgan, 2010), and public-private partnerships (e.g., Roehrich, Lewis, & George, 2014; Zheng et al., 2008), our focus is on collaborative relationships between industrial OEMs and their suppliers due to their unique qualities and abundance in supply chains. Collaborative relationships and the associated governance mechanisms between OEMs and CSs have been examined in a variety of contexts and across a number of activities; e.g., collaborative cost reduction initiatives (Cannon & Homburg, 2001), forces influencing the institutional designs that safeguard exchanges between international OEMs and CSs (Bello & Zhu, 2006), the effects of environmental dynamism (Joshi & Campbell, 2003), the influence of strategic fit between suppliers and OEMs (Ghosh & John, 2005), the use of branded component contracts by OEMs (Ghosh & John, 2009), and the responses of OEMs to CSs' investments in brand equity (Dahlquist & Griffith, 2014). These works, and others, illustrate that the CS-OEM relationship is a complex economic structure comprised of varying levels and types of both resource commitments and governance mechanisms. Further, these works argue that the performance of a collaboration is a function of the effective use of governance mechanisms to both facilitate success and safeguard the parties' interests. As mentioned, extant works tend to treat collaborations' magnitudes as *invariant* or *uniform*, neglecting magnitude variance and thus only partially characterizing or capturing the possible effects of multi-dimensional differences; while collaborations may appear similar, they can vary greatly in relation to the collaboration's requirement for a breadth of commitments, complementary actions, management time and resources, and specific investments. For example works often focus on one or two collaborative dimensions such as idiosyncratic investments and coordination efforts (e.g., Jap, 1999), but do not consider other dimensions such as the breadth of financial and managerial commitments called for by the collaboration. In practice, we argue that managers consider a broad range of collaborative dimensions in their assessment of the potential for profitable or strategic returns, and pursue those that maximize their investments (Williamson, 1991). As such we offer the collaborative magnitude construct as an effective and efficient means of characterizing collaborations.

Extant work in typologies of industrial buyer-seller relationships (BSRs) (e.g., Cannon & Perreault, 1999; Duffy, 2008; Vesalainen & Kohtamäki, 2015; Whipple et al., 2010), denote that BSRs are distinguishable by the discreet factors that include economic, transactional, and relational dimensions. Duffy (2008) provides a theoretical framework of buyer-supplier relationships wherein the *structure of economy*, *structure of polity*, *relationship climate*, and *relationship performance* prove useful in differentiating between levels of coordination and partnership on a continuum between market transactions and vertical integration. Vesalainen and Kohtamäki (2015) use three dimensions, *economic*, *structural*, and *social*, to differentiate relationships,

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