

# Safeguarding investments and creation of transaction value in asymmetric international subcontracting relationships: The role of relationship learning and relational capital

Kuo-Hsiung Chang<sup>\*</sup>, Donald F. Gotcher<sup>\*</sup>

*Department of International Business, Tunghai University, P.O. Box 953, Taichung 407, Taiwan, ROC*

## Abstract

This study examines how suppliers who do not have bargaining power to protect relationship-specific investments (RSIs) can use safeguarding mechanisms to create transaction value in the context of asymmetric international subcontracting partnerships. From a supplier perspective, two different types of bilateral safeguarding mechanisms, relationship learning and relational capital, play discrete roles in the process of creating transaction value. Drawing on a resource-based view (RBV) of the firm, this study proposes that RSIs (a firm's resources), can enhance relationship learning (capabilities), which in turn, facilitates dyadic capability enhancing (joint competitive advantage). In addition, from a social capital perspective, relational capital facilitates relationship learning and strengthens the positive relationship between RSIs and relationship learning. Relationship learning plays the key role, and acts as the catalyst in transforming RSIs and relational capital into dyadic capability enhancing. The hypotheses are tested using data from a survey of 118 Taiwanese supplier–international buyer relationships in information technology industries. The study finds that relationship learning mediates the relationship between RSIs and dyadic capability enhancing, and that relational capital moderates the relationship between RSIs and relationship learning.

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## 1. Introduction

International outsourcing has been identified as a strategic means for U.S. and European-based firms to select world-class suppliers and effectively minimize costs (Kaufman, Wood, & Theyel, 2000; Mol, Pauwels, Matthyssens, & Quintens, 2004). In international buyer–supplier relationships, mature U.S. and European-based OEMs (original equipment manufacturers) compete in global markets. They have outsourced non-core competence activities to foreign suppliers located

in Pacific Rim countries, including Taiwan, India, Korea, and Hong Kong (Celly, Spekman, & Kamauff, 1999). International subcontracting relationships are often characterized by considerable power asymmetries. Powerful buyers (OEMs) possessing strong brand names, having powerful access to markets, and manifesting high bargaining power, often require weaker suppliers to make significant relationship-specific investments (RSIs) to improve coordination between the organizations and to enhance buyer presence at the manufacturing end. For example, typically HP and Dell require Taiwan's contract manufacturers (e.g. Quanta, Compal, or Wistron) to invest in unique facilities, information technology software and hardware, and electronic data exchange systems. RSIs in transaction cost economics (TCE) have been defined as “those assets having little or no

<sup>\*</sup> Corresponding authors. Tel.: +886 4 23590239; fax: +886 4 23592898.

E-mail addresses: [kuo1@thu.edu.tw](mailto:kuo1@thu.edu.tw) (K.-H. Chang), [dongotcher@yahoo.com](mailto:dongotcher@yahoo.com) (D.F. Gotcher).

value outside the focal exchange relationship” (Brown, Chekitan, & Lee, 2000: 53; Williamson, 1985). When making RSIs, weak suppliers are concerned OEMs will terminate their relationships, resulting in irrevocable losses.

According to a traditional approach, the supplier had better seek ways to efficiently protect these RSIs through the use of safeguarding mechanisms (Dyer, 1997; Jap & Ganesan, 2000; Subramani & Vernkatraman, 2003). However, this prior literature on safeguarding mechanisms is incomplete in several respects.

First, international subcontracting relationships are often characterized by considerable power asymmetries. Therefore, it is difficult for a weak supplier to limit a powerful buyer’s opportunistic behaviors by unilateral governance tools such as vertical integration or persuasion of buyers in making investments in idiosyncratic assets (Subramani & Vernkatraman, 2003).

Second, although TCE has emphasized RSIs as a source of *transaction cost* (Williamson, 1985), resource-based view (RBV) literature has emphasized RSIs as a source of competitive advantage (Dyer, 1997; Dyer & Singh, 1998). Some researchers have argued that RSIs have a very positive effect that can contribute substantially to organizational *transaction value* (Adler & Kwon, 2002; Dyer, 1997; Zajac & Olsen, 1993). Little attention however has been paid to how RSIs do this through the use of safeguarding mechanisms (Dyer, 1997; Zajac & Olsen, 1993). Our aim, consequently, is to examine this area using an RBV approach.

Third, prior literature on international outsourcing has been mostly focused on the behavior of U.S. and European-based buyers. The behavior of suppliers in Pacific Rim countries has been largely ignored.

Therefore, this study was designed to fill these gaps in the literature. First, we seek to address asymmetrical supplier–buyer dyads outside of a unilateral governance scenario. According to Williamson (1985) and Heide (1994), bilateral governances are expected to be appropriate safeguarding mechanisms to handle substantial transaction cost and dependence. Expanding on this use of safeguarding mechanisms, we focus on the concept from an RBV perspective. We believe relationship learning and relational capital are two bilateral safeguarding mechanisms that can contribute to transaction value, and are considered separate from market-based and unilateral governance safeguarding mechanisms. Relationship learning is an inter-organizational learning phenomenon. It is a joint activity between a supplier and buyer (Selnes & Sallis, 2003). A second mechanism, relational capital, includes the level

of trust and the degree of close interactions between buyers and suppliers (Kale, Singh, & Perlmutter, 2000). The supplier’s efforts to build these stronger social and structural bonding behaviors with its buyer are a reflection of the supplier’s desire to reduce its dependence in response to the opportunism created by RSIs (Heide & John, 1988).

Second, how do RSIs create transaction value through these appropriate safeguarding mechanisms (relationship learning and relational capital)? We argue that relationship learning and relational capital play discrete roles in the process of creating transaction value. According to an RBV of the firm (Barney, 1991), firm resources lead to capabilities, and capabilities influence firm performance (Barney, 1991; Wernerfelt, 1984). Drawing on this RBV, we propose that RSIs (firm resources) can enhance relationship learning (capabilities), which in turn, facilitates dyadic capability enhancing (joint competitive advantage) in international subcontracting relationships (Dyer & Singh, 1998). Relationship learning delivers better transaction benefits to buyers in the context of a particular relationship than in alternative contexts. It plays a mediating role between RSIs and transaction value creation. In addition, relational capital, manifesting itself as trust, friendship, and interaction between both parties (Kale et al., 2000), reduces transaction cost, encourages partners to make RSIs, and facilitates information transfer (Dyer & Singh, 1998; Tsai & Ghoshal, 1998). Consequently, relational capital plays a moderating role between RSIs and relationship learning, also resulting in a strengthening of the relationship between RSIs and relationship learning. We argue that adoption of bilateral safeguarding mechanisms allows a powerful buyer and a weak supplier jointly to create dyadic capabilities in asymmetric international subcontracting relationships (Joshi & Stump, 1999).

Finally, the purpose of this study was to enhance our understanding of how the RSIs create transaction value (dyadic capability enhancing) through appropriate safeguarding mechanisms in asymmetric Taiwanese supplier–international buyer relationships in information technology industries.

## 2. Theory and hypotheses

Dyer and Singh (1998) extended the RBV to explain how competitive advantage is achieved in an inter-organizational setting. According to Dyer and Singh (1998), resources can span an organization’s boundaries and be embedded within inter-organizational collaborative processes. To create competitive advantage,

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