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Transaction cost, strategic positioning, and institutional determinants of relationship governance in international business-to-business relationships

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Abstract

This paper examines transaction cost, strategic and societal influences on the organization and management of cross-border relationships. A firm's product differentiation strategy and the export market's ethnocentricity are identified as possible antecedents to relation-specific investments whereas the export market's regulative institutional environment is identified as a possible antecedent to relationship governance. The hypotheses are empirically tested on a sample of 160 international business-to-business relationships. The results show that the suggested antecedents impact the level of specific investments in the relationships and how the relationships are governed. The results also show that specific investments play an important mediating role between, on the one side, strategic and societal influences, and on the other side, the extent to which the relationship is governed by formal contracting.

Key words: Cross-border relationships, marketing strategy, institutional theory

INTRODUCTION

A common approach to the study of governance of international business-to-business (B2B) relationships is to conceive governance as a mix of formal contracting and relational norms, and the literature has accumulated a considerable body of knowledge about the conditions under which either or both of these forms of governance are deployed. Despite extensive research efforts in this area, researchers have barely paid attention to the influences of institutional pressure (Grewal and Dharwadkar 2002) and product strategy (Ghosh and John 1999) on relationship governance. This article will address this void by studying such influences empirically.

Transaction cost economics (e.g., Williamson 1985) is a widely used theoretical perspective for studying relationship governance. The core idea is that when the actors to a relationship undertake relation-specific investments termed as asset specificity, they need to safeguard these investments against potential opportunistic behavior. Formal contracting is according to the theory the primary mechanism to safeguard these investments. The theory suggests that as asset specificity increases, the actors are in need of implementing more extensive formal contracting to secure the investments. Furthermore, empirical studies have also found that relational norms or trust-based governance can be used to safeguard such investments (e.g., Rindfleisch and Heide 1997). The level of asset specificity is thus considered to be one of the main antecedents influencing relationship governance. We will have this model as our starting point, and complement the model by adding possible influences of product strategy and institutional pressure on both asset specificity and relationship governance.

First, the effects of product strategy will be studied by applying the strategic positioning perspective. In particular, we will capitalize on Day and Klein's (1987) assertion

that the level of asset specificity reflects strategic choices made by the actors, and examine whether a differentiation strategy results in higher levels of investments on either side of the relationship. Any direct effect of product strategy on relationship governance will also be explored. Second, we will apply an institutional perspective in a relationship context. Grewal and Dharwadkar (2002) introduced an institutional perspective to the study of marketing channels. To our knowledge, their conceptual work has not been followed by empirical studies. However, there have been attempts to combine TCE with institutional theory when trying to predict firms' foreign entry mode choices (Brouthers 2002; Yiu and Makino 2002; Delios and Beamish 1999; Davis et al. 2000; Brouthers and Brouthers 2000). In particular, Yiu and Makino (2002) concluded in a study on the choice between joint venture and wholly owned subsidiary that both "*institutional factors and transaction-cost factors [...] are important determinants for foreign entry-mode choice*" (Yiu and Makino 2002: 680). Building on Grewal and Dharwadkar (2002) and the aforementioned works, this study will investigate empirically the influences of such forces. In particular, we focus on the influences of the host country's institutional environment on asset specificity and relationship governance.

Studies of international business-to-business relationships have traditionally placed strong emphasis on economic, cultural and managerial issues. Perspectives that focus on societal influences have rarely been applied resulting in little emphasis on the role of legitimacy in institutional environments (Grewal and Dharwadkar 2002). This study contributes to the international business literature by incorporating the role of the institutional environments in conjunction with economic and managerial issues reflected in asset specificity and product strategy. This enables us to investigate the management of international business relationships both in terms of efficiency and legitimacy. The study thus responds to the requests for a better understanding of the role of institutions in forming and

maintaining cross-border relationships. We develop a conceptual model extending the core transaction cost model with product strategy and institutional environment. The hypotheses are tested on data from a sample of 160 exporters and their relationships to importers in different countries.

THEORY AND HYPOTHESES

We will in this section discuss factors that may impact the governance of international business-to-business relationships, and various types of relationship governance are identified. Transaction cost economics (TCE) is our point of departure. TCE is a widely used perspective for studying how inter-firm relationships are governed, and the theory argues that the principal governance problem is to safeguard specific investments against potential opportunism by implementing non-market governance labeled as formal contracting or administrative controls (Williamson, 1985). The core argument is that the costs of organizing transactions differ depending on transactional attributes. These attributes are specific investments labeled as asset specificity, uncertainty, and frequency of the transaction (Williamson, 1985). Although all three dimensions are expected to influence relationship governance, asset specificity is the most important one: *"Asset specificity is both the most important dimension for describing transactions and the most neglected attribute in prior studies of organization"* (Williamson, 1981, p. 555). As the level of specific investments in a relationship increases, the need for formal contracting will also increase. This proposed link between specific investments and formal contracting will be our starting point for developing a conceptual model for studying governance of international relationships. The core TCE argument will be extended by first expanding relationship governance to include cooperative norms in addition to formal contracting. Second, we will discuss how strategic positioning

may impact both specific investments and relationship governance, and third, we will address any impact of institutions on specific investments and governance.

Relationship governance

While TCE focuses on how market incentives are supplanted by formal contracting and administrative controls as means to safeguard specific investments (Williamson, 1991), many researchers claim that we cannot understand relationship governance only in terms of market incentives versus administrative controls (cf., Bradach and Eccles, 1989; Powell 1990). A key property of all relationships is the reliance on norms and shared values resulting in relational governance (e.g. Macneil, 1980; Dwyer, Schurr, and Oh, 1987; Poppo and Zenger, 2002). Basically, we have two different approaches to relationship governance. First, in line with transaction cost economics, relationship governance can be described in terms of administrative controls, here termed as *formal contracting*. Alternatively, we can describe relationship governance in terms of relational or trust-based mechanisms, here termed as *cooperative norms*.

Formal contracting. Formal contracting refers to the use of authority, rules and procedures for controlling activities. Even though such mechanisms are primarily associated with authority or fiat within organizations, they can also be used to govern various inter-firm relationships. According to Stinchcombe (1985), such governance between independent actors can take the form of giving one party the right to: (1) set the agenda, (2) control and motivate, (3) develop rules and procedures, (4) specify conflict-solving procedures, and (5) decide on reasonable costs when market prices do not exist. Formal contracting will in this study describe the extent to which the relation is regulated by rules, procedures and fixed policies.

Cooperative norms. Cooperative norms refer to norms of obligation and cooperation as coordinating devices (Macneil, 1980; Bradach and Eccles, 1989). Under such governance, actors are expected to follow certain patterns of behavior (Rousseau 1995) represented by a set of shared norms and values (Dwyer *et al.*, 1987). Such codes of conduct develop between the exchange partners through socialization processes, and they serve the role of regulating and controlling behavior to the benefit of both parties. The bilateral nature of the norms facilitates cooperation and restrains individual firms from pursuing their own goals out of concern for the wellbeing of the dyad. Cooperative norms identify the extent to which the parties work closely together and have a desire to continue to develop the business relationship (Anderson and Narus 1990). We follow Cannon and Perrault (1999) and assume cooperative norms to cut across relational norms such as solidarity, flexibility, information exchange, and relational continuity.

Specific investments and relationship governance

A central concern in TCE is the extent to which resources are deployed to facilitate a particular transaction. If a transacting party tailors its investments to fit the idiosyncratic requirements of a particular counterpart, cost savings and/or value creation are likely to accrue. The downside is the specificity of these investments to the specific transaction, which places the actor in a lock-in situation; the partner may act opportunistically and exploit these investments in order to appropriate a larger share of the 'cake' (Jap 2001), and thereby incur economic losses on part of the investor. This threat induces the investor to safeguard its investments by adopting contracts where rules, fixed policies, and standard operating procedures related to the particular transaction are specified. Hence, we advance the following hypothesis:

Hypothesis 1: Relationship-specific investments will have a positive effect on formal contracting.

Strategic positioning, specific investments and relationship governance

Teece (1984) and Day and Klein (1987) have pointed out the conceptual complementarity between the industrial organization paradigm and TCE and recommended researchers to combine the two perspectives in empirical research. Ghosh and John (1999) and Nickerson and colleagues (Nickerson 1997; Silverman *et al.* 1997; Nickerson 2000) have later unpacked and clarified the underlying conceptual intricacies and provided guidance in regards to how we can make a conceptual model empirically testable.

These contributions explained how relation-specific investments could be endogenized by assuming that each position leads to a different level of investment. This point deserves clarification. Consider a supplier that is selling high quality products to an important customer. This seller has decided to support these transactions by some specific investments. The effects of these investments can be categorized in terms of (i) a reduction in the marginal cost of the product, and (ii) an enhancement of the appeal of the product further down the value chain. The sum of the effects of these investments is the increase in joint value for the exchange parties (Ghosh and John 1999). Alternatively, the firm will not invest in the relationship if the investment costs exceed the joint value increase. Which level of investment will be chosen? Following the Coase theorem, the firm will implement the mix of activities, i.e., choose the level of specific investments that maximizes joint value. Not doing so means inefficiency, because opportunities to realize value are not pursued. In essence, this is the 'strategizing calculus' of Nickerson's (2000) framework.

Alternatively, one may consider the scenario from the counterpart's perspective; the buyer is purchasing high quality products from an important supplier. The buyer has made some specific investments directed towards the supplier in order to reduce the cost of the

product and enhance its appeal. The sum of the effects of these investments is the increase in joint value for the exchange parties. The Coase theorem maintains that the buyer will choose the level of specific investments which maximizes joint value in order to maximize efficiency and pursue value creation. This is the strategizing calculus from the perspective of the buyer.

The effect of product differentiation on relation-specific investments. A differentiation strategy refers to developing a unique image for a firm's products, so that the value of this product is perceived to be higher compared to the offerings of the competitors (Myers and Harvey 2001). Hence, such a strategy is accompanied by a need to justify the higher prices of assumedly higher-value products. We argue that by investing in the exchange relationship interface from either or both sides, such justification can be partially brought about.

From the perspective of the supplier, one rationale of making such investments is to support and enhance crucial product attributes, so that the perceived value of the product throughout the value chain increases (Ghosh and John 1999). In turn, this may secure that one *"convey to the customer an image of quality and prestige that is congruent with overall product strategy"* (Lassar and Kerr 1996: 619). Second, successful implementation of a product differentiation strategy requires a 'well-orchestrated' marketing strategy and value chain (Myers and Harvey 2001). Supplier-specific investments may enable dealing more efficiently with the customer, such as being more able to support just-in-time initiatives and improve on delivery schedules. Hence, such investments support coordination across inter-firm boundaries, so that coherent behavior from production to consumption (Haugland *et al.* 2002) can be facilitated and more easily be brought about. Third, the deployment of specific investments may be taken as a signal of commitment by competitors, thus deterring their entrance to this particular product segment. The investments then serve to protect the supplier's position in the customer market.

Taking the perspective of the buyer, these arguments can be mirrored. First, in order to make the best use of the product's features, the customer is likely to find it necessary to support the transaction by making some investments. Second, such investments may result in better coordination with the supplier. And third, such relation-specific investments may also convince the supplier about the customer's intentions to further continue the relationship, and functions to protect the buyer's position in the supplier market. For example, this makes it more difficult for other buyers to appropriate some of the supplier's limited capacity to deliver.

Overall, it is argued that specific investments on both sides are likely to occur as a result of a supplier pursuing a product differentiation strategy. In turn, such specificities result in higher levels of formal contracting. It is asserted that differentiated products do not represent an incentive in itself for the parties to undertake the costly activity of writing more detailed contracts, because they do not represent exchange hazards on their own. In other words, buyer-specific and supplier-specific investments are likely to represent the generative mechanisms through which the supplier's product differentiation strategy influences the degree of formal contracting. Hence, the following hypotheses are proposed:

Hypothesis 2: Product differentiation will positively affect relationship-specific investments.

Hypothesis 3: Relationship-specific investments function as intermediating variable between product differentiation and formal contracting.

The effect of product differentiation on cooperative norms. Anderson and Coughlan (1987) and Lilien (1979) argue that pursuing a differentiation strategy requires extensive knowledge about customer needs and preferences. This knowledge also needs to be continually updated in markets that change rapidly (Haugland *et al.* 2002). Hence, a

differentiation strategy intensifies the need for information about local market idiosyncrasies. Such "sticky" (von Hippel 1994) information must be acquired through ties characterized by close interaction and coordination. Day and Klein (1987) concurred with this, emphasizing that closer vertical relations may be a means for capturing better intelligence about market and technology, which in turn are crucial factors in the staying ahead of the competitive race. We believe such closer vertical relations to be closely related to an exchange climate where strong mutually accepted codes of conduct have been built over time.

Strong ties are traditionally associated with the exchange of high-quality information and tacit knowledge. Uzzi's (1996) study in the New York apparel industry demonstrated that strong ties (e.g., Granovetter 1973) provide rich exchanges of customized information, enabling firms to exchange fine-grained knowledge. Similarly, Larson (1992) and Helper (1990) reported that "thick information" on issues such as strategy and production know-how must be transferred through embedded ties. For this purpose, market structures are not effective or available (Meldrum 1995), because the tacit know-how involved is difficult to transfer without personal contact involving teaching, demonstration, and participation (Polanyi 1962). In general, tacit or sticky knowledge is more readily transferred between firms between which the boundaries are blurred (Hägg and Johanson 1983).

Hypothesis 4: Product differentiation will positively affect cooperative norms.

Institutions, specific investments and relationship governance

Institutional theory emphasizes the emergence of organizational practices and structures. In the pursuit of legitimacy, institutional pressures have influences on the adoption of governance structures (Dimaggio and Powell 1983). There are many forces of different nature that give rise to isomorphic pressures. Scott (1995) conceptualized these into three

distinct groups; regulative forces include laws and rules; normative forces include values, cultures, and norms; and cognitive forces refer to taken-for-granted cognitive structures. Institutionalization refers to the processes by which these forces are formed and give rise to institutional pressures that influence (inter)-organizational structures and processes.

Research on the ex ante choice of foreign entry mode emphasizes that the institutional perspective is valuable due to the focus on, for example, legal restrictions regarding foreign ownership (Brouthers 2002), hazards that can accompany transactions due to weaknesses in institutional environment (Delios and Beamish 1999), and sanctions following behavior that do not accommodate local norms and values (Yiu and Makino 2002). Further, these institutional forces are believed to influence the foreign entry mode choice. From the perspective of institutional theory, the central premise guiding this choice is the pursuit of legitimacy.

Grewal and Dharwadkar (2002) brought institutional theory into the marketing channels domain. Capitalizing on Grewal and Dharwadkar (2002) as well as the aforementioned empirical studies, this study examines the influence of the export market's regulative and normative forces on governance mechanisms and relation-specific investments in cross-border relationships. Following institutional theory, we posit that firms choose governance mechanisms and the level of specific investments that are in accordance with regulative and normative pressures.

The effect of normative institutions on relation-specific investments. The normative domain of institutional theory starts from the premise that organizations are embedded in their institutional contexts of societal norms and expectations that define socially acceptable behavior. The shared understandings and meanings define the "logic of appropriateness" (March 1981); that is, what is expected of organizations. They need to embrace the

institutionalized norms of the local market to be accepted as legitimate entities (Davis *et al.* 2000). The basis of compliance comes from social obligations; not accommodating these obligations may result in both societal and professional sanctions (Selznick 1984). Hence, when operating in foreign markets, it is important for the exporter to gain an understanding for and embrace local norms and values. The international business literature is full of examples where “things have gone wrong” due to cross-cultural misunderstandings. In this respect, it is extensively documented that it is important to conform to the local social expectations in order to gain legitimacy (see Deresky 2000 for an overview).

However, even if foreign firms accommodate and conform to such normative expectations, they face additional problems in culturally ethnocentric environments. In such institutional contexts, they also have to overcome normative impediments from the local people. Hence, it is hard for foreign firms to be perceived as socially acceptable. For example, locals may simply prefer locally produced goods whenever they are available in order to protect the local industry. Furthermore, possible prejudices (such as stereotypes) against foreigners may make the locals consider a foreign firm to be inferior to local firms. The foreign firm may also face problems if they want to access institutional constituents and economic resources in such environments.

This study asserts that the export market’s ethnocentricity will influence the level of relation-specific investments. The likely effect on investments made on each side of the relationship will be considered in the following. Taking the perspective of the supplier (foreign firm), a natural response to the obstacles of operating in an ethnocentric environment is to limit the exposure in the market. If the exporter is treated as an inferior alternative relative to local firms, the likely increase in value coming from specific investments is curbed. Hence, it is harder to justify the risks of committing potentially valuable, but vulnerable, investments to a relationship with a customer that is operating in an ethnocentric market. The

potential value increase is also likely to be inferior relative to the potential value increase following investments in markets not characterized by such impediments. Hence, such investments could be channeled towards customers operating in markets that welcome foreign companies. Accordingly, the level of supplier-specific investments will be lower towards customers operating in ethnocentric markets.

Taking the perspective of the buyer (local firm), we should also expect lower investments. The importer is embedded in an institutional context that is generally hostile-minded towards foreigners. If the local firm shall be accepted as a legitimate entity in this institutional field, it needs to embrace similarly-minded behavior. Hence, it is most logically appropriate for the importer to reduce its commitment towards foreign firms. This allows the following hypotheses:

Hypothesis 5: Market ethnocentricity will negatively affect relationship-specific investments

Hypothesis 6: Relationship-specific investments function as an intermediating variable between export market ethnocentricity and formal contracting.

The effect of regulative institutions on relationship governance. The regulative domain of institutional theory starts from the premise that organizations are embedded in their political environments. This domain includes laws and rules that constitute the grounds of organizational action (North 1990; Scott and Meyer 1994; Williamson 1975, 1991). According to the institutional perspective, firms face pressures to adopt governance mechanisms and structures that are within the subset of socio-politically legitimated designs (Roberts and Greenwood 1997).

In regards to foreign entry mode, it is rather obvious that the foreign firm is facing several important obstacles, such as for example, legal restrictions on foreign ownership of

domestic enterprises (e.g., Delios and Beamish 1999) and varying risk of a future undermining of property rights (e.g., Meyer 2001). Such considerations are crucial due to the nature of the research questions. For example, researchers have studied the choice between joint venture (JV) versus wholly owned subsidiary (WOS) (Yiu and Makino 2002), acquisition versus greenfield start-up (Brouthers and Brouthers 2000), or the degree of ownership in foreign countries (Delios and Beamish 1999). In brief, these studies complemented TCE with institutional theory in order to investigate if the institutional structures do have any impact on the foreign entry mode chosen.

Empirical research within marketing channels has rarely considered the societal influences on the governance of marketing channels (Grewal and Dharwadkar 2002). Rules, regulations, and orders from the export market's regulative institutions enforce constraints on channel structures and force the channel members to adapt their exchange arrangement to comply with the requirements of the society. The impingement of constraints restrains the room within which the parties can maneuver to pursue economic efficiency on the part of the dyad. Such restrictions are likely to impact both the extent to which the relationship is governed by formal contracting as well as the extent to which cooperative norms are developed in the relationship.

In regards to formal contracting, official regulations constrain the extent to which the relationship can be pragmatically governed by explicit and predefined rules and procedures. Instead, the parties may find it more pragmatic to leave certain elements of the contract out in order to avoid that regulative constituents perceive certain aspects of their business to be socially illicit. For example, exporters that have experienced certain contractual arrangements to be beneficial in other export markets may find that regulatory aspects of this importer's environment make the same contractual arrangements impossible. As it is costly to work out a new detailed contract, the contract is left more open than it would otherwise have been.

In regards to cooperative norms, Grewal and Dharwadkar (2002) placed particular emphasis on the symmetry of the imposition pressures and ensuing concerns for pragmatic legitimacy from the regulative environment. For a given channel dyad, "*imposition pressures are symmetric when both firms of the focal channel dyad face the same imposition pressures (e.g., both channel members face the same restrictions or sanctions). In contrast, asymmetries in pragmatic legitimacy concerns develop when imposition pressures are greater for one channel member than for the other*" (p. 26). In the context of exporter-importer relationships, the exporter sometimes faces a restrictive export market institutional environment that restrains its abilities to operate efficiently in the market. For example, it may need to comply with a number of local regulations applying specifically to foreign firms. This brings pragmatic legitimacy concerns to the forefront on the part of the exporter. The importer, on the other hand, often does not face the same imposition pressures. This asymmetry of imposition pressures may hinder the development of shared expectations and common understandings in the dyad. In turn, this lack of bilateral convergence of what constitutes fundamentally meaningful behavior thwarts the development of strong cooperative norms; the positive interactive cycle whereby positive behavior is reciprocated by similarly-minded behavior by the counterpart is disrupted as the parties do not share a common understanding of the environment. The fact that there is considerable distance between cross-border trading partners magnifies this issue. The following hypothesis is proposed:

Hypothesis 7: Export market state influences will negatively affect formal contracting and cooperative norms.

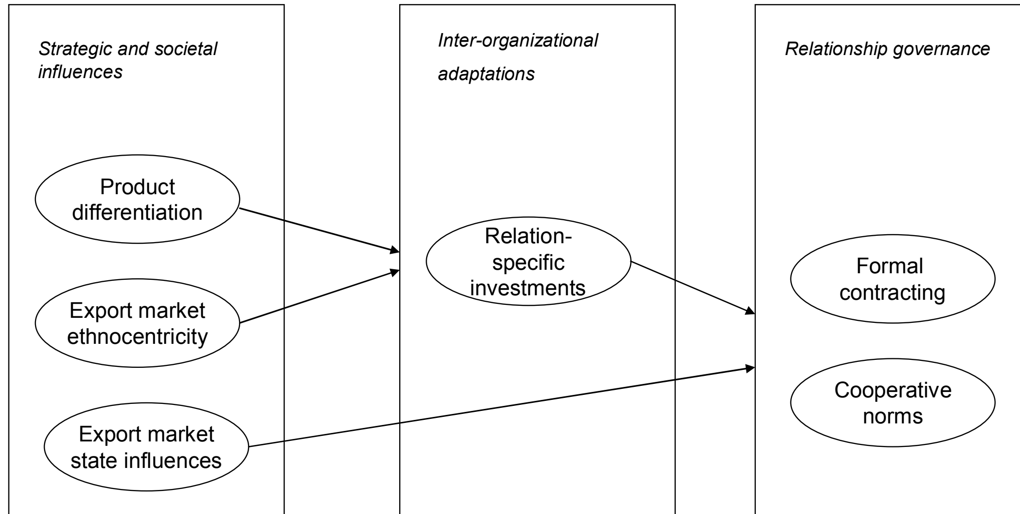

Figure 1: Conceptual model

RESEARCH METHOD

Context, sampling and data collection

The industries of Norwegian fish exporters, and Norwegian, Swedish, and Finnish wood products exporters were chosen as the empirical context. The unit of analysis is the relationship between the exporters and one of their most important international customers. We used different Internet databases in order to assess relevant companies within these industries and the name of an appropriate key informant within each company. The marketing manager or managing director of each company was contacted, as this person was assumed to best meet the criteria of a key informant. Most of the sampled companies were small and medium-sized, and they did not have a manger whose task and responsibility were the

management of relationships to foreign customers. Rather, the managing director or a general marketing manager was the most appropriate key informant.

We identified about 700 business units through these Internet databases. This number was reduced to 390 business units by excluding firms that did not want to participate in a survey, firms that had ceased to operate, firms that did not export on a regular basis or only exported a minor share of their total sales, and firms that did not have administrative personnel responsible for exporting. Structured questionnaires were mailed to the 390 business units, and 160 usable questionnaires were returned. This gives a response rate of 41%. The key informants were asked to choose one of their largest customers, in one of their most important international markets for one of their major export products. All questions should be answered in relation to this particular customer. By using this procedure, we received data about B2B relationships involving marketing of specific products in specific markets.

Measures

All variables were measured by multi-item scales relying closely on scales used in previous empirical studies. In the development of the scales, we followed the recommendations of Churchill (1979) and Anderson and Gerbing (1988). On the basis of theory, operational definitions, and operationalizations in previous empirical studies, construct item pools were created. From this pool, items that obviously did not fit the chosen context were eliminated. Then, the remaining items were subjected to a number of peer review iterations by using academic experts with knowledge of the field as well as four industry experts. During this process, ambiguous questions and inappropriate vocabulary were corrected, and irrelevant items were eliminated. Further, the questionnaire was pre-checked

through in-depth interviews with three export sales managers in different companies. These interviews did not reveal any further need for correction or deletion.

Formal contracting refers to the extent to which the inter-organizational relation is regulated by rules, procedures, and fixed policies. The chosen items were primarily based on the studies by Lusch and Brown (1996), Heide (2003), Cannon *et al.* (2000), and Dahlstrom *et al.* (1996). *Cooperative norms* refer to the extent to which the actors work together and have a desire to continue and further develop the relationship. Following Cannon and Perrault (1999), the construct represents relational norms such as solidarity, flexibility, information exchange, and relational continuity. Items regarded to represent an important element in a cooperative norms scale were extracted from each of the individual norm scales earlier developed by Heide and John (1992) and Heide and Miner (1992). *Relation-specific investments* describe the investments in physical equipment, procedures, and human capital made by the supplier or the buyer dedicated to the relationship. We used one scale to measure supplier-specific investments and one scale to measure buyer-specific investments. The two scales focus on the same issues on each side of the relationship, and the chosen items were primarily based on items developed by Heide and John (1990) and Anderson (1985). *Product differentiation* refers to the extent to which the product was differentiated compared to the products offered by competitors. The three chosen items were based on Aulakh and Kotabe (1997), Aulakh *et al.* (2000), and Myers and Harvey (2001). *Export market state influences* refer to the extent to which local regulative forces influence foreign firms' activities in a host country. We relied upon Yiu and Makino's (2002) seven-item scale, and adapted this scale to our setting and eliminated irrelevant items resulting in a three-item scale. *Export market ethnocentricity* refers to normative institutional forces in a host country. The two-item scale used by Yiu and Makino (2002) were replicated. The two items represent unequal treatment (the extent to which foreigners are treated unequally compared to native citizens) and cultural

confinement (the extent to which national culture is closed towards foreign cultures). Table 1 displays the wording and source of each scale.

Table 1: Wording and source of items

Construct	Items	Empirical studies using items
Formal contracting	There is a written agreement that specifies the tasks and responsibilities of each party.	Lusch and Brown (1996); Cannon et al. (2000); Dahlstrom et al. (1996).
	How to handle the day-to-day management of the relationship is expressed in a written agreement.	Jap and Ganesan (2000); Lusch and Brown (1996); Cannon et al. (2000); Dwyer and Oh (1987, 1988).
	There are rules and procedures for most issues in this relationship.	Lusch and Brown (1996); Heide and Weiss (1995); Heide (2003); Dahlstrom et al. (1996).
	It is important for us to behave formally accurate as according to the agreement.	Gilliland and Manning (2002); Provan and Skinner (1989); Dahlstrom et al. (1996)
Cooperative norms	The parties are committed to improvements that may benefit the relationship as a whole and not only the individual parties.	Heide and John (1992); Lusch and Brown (1996);
	Flexibility in response to requests for changes is a characteristic of this relationship.	Jap and Ganesan (2000); Bello et al. (2003).
	In this relationship, it is expected that any information that might help the other party will be provided to them.	Heide and John (1992); Lusch and Brown (1996); Jap and Ganesan (2000); Bello et al. (2003).
	We assume that renewal of agreements with this supplier will generally occur.	Heide and Miner (1992)
Supplier-specific investments	In order to deliver to this customer it has been necessary to make special investments or adaptations in equipment.	Heide and John (1990); Jap and Ganesan (2000); Stump and Heide (1996); Heide (2003).
	It has been necessary to give employees who are working with this customer special training	Anderson (1985); Anderson and Weitz (1992); Stump and Heide (1996); Rokkan et al. (2003).
	In order to deliver to this customer we have made specific investments or adaptations in our distribution systems.	Buvik and John (2000); Heide and John (1990); Stump and Heide (1996); Rokkan et al. (2003).
Buyer-specific investments	This customer has made significant investments in equipment dedicated to the relationship with us.	Heide and John (1990); Jap and Ganesan (2000); Stump and Heide (1996)
	This customer has given special training to employees that work towards our firm	Anderson (1985); Anderson and Weitz (1992); Heide and John (1990); Jap and Ganesan (2000)
	This customer has made adaptations in their distribution systems towards our firm	Heide and John (1990); Jap and Ganesan (2000); Stump and Heide (1996)
Product differ-entiation	In order to deliver to this customer it has been necessary to make special investments or adaptations in equipment.	Haugland et al. (2002); Myers and Harvey (2001); Aulakh et al. (2000); Aulakh and Kotabe (1997).
	It has been necessary to give employees who are working with this customer special training	Myers and Harvey (2001); Aulakh and Kotabe (1997); Aulakh et al. (2000).
	In order to deliver to this customer we have made specific investments or adaptations in our distribution systems.	Myers and Harvey (2001)
Export market state influences	Official bureaucracy makes it more difficult to export to this country	Yiu and Makino (2002)
	National protectionism makes it more difficult for us to export to this country	Yiu and Makino (2002)
	Governmental interference make it more difficult for us to export to this country	Yiu and Makino (2002)
Export market ethno-centricity	Foreigners are often treated differently than local citizens in this market	Yiu and Makino (2002)
	In this market the national culture is closed towards other cultures	Yiu and Makino (2002)

Measurement model

Confirmatory factor analysis in LISREL 8.54 was conducted to test model-to-data fit. The constructs were allowed to freely correlate, so that the measurement model was subjected to the strongest test (Jöreskog 1993). The fit indexes indicated an acceptable fit to the data. Due to the relatively small sample size, we did not rely on the goodness-of-fit (GFI) index. Instead, we relied on the comparative fit index (CFI), the incremental fit index (IFI), and root mean square error of approximation (RMSEA). These indexes report all acceptable fit of the model to the data (CFI=0.91, IFI=0.91, RMSEA=0.081) (Browne and Cudeck 1992; Hu and Bentler 1995).

Composite reliability (CR) for construct η was calculated by the formula $CR_\eta = (\Sigma\lambda y_i)^2 / [(\Sigma\lambda y_i)^2 + (\Sigma\varepsilon_i)]$, where λy_i is the standardized loading for scale item y_i, and ε_i is the measurement error for scale item y_i. Average variance extracted (AVE) was calculated by the following formula $V_\eta = \Sigma\lambda y_i^2 / (\Sigma\lambda y_i^2 + \Sigma\varepsilon_i)$. Further, we examined the parameter estimates and their associated t-values (Anderson and Gerbing 1988). Table 2 shows all factor loadings to be significant, acceptable scale reliabilities and generally satisfactory AVEs. The cooperative norms scale has somewhat low AVE. The CR is however acceptable for this scale, which is not surprising as AVE is a more conservative measure than CR (Fornell and Larcker 1981). We calculated a 95% confidence interval around the correlation estimate for the latent constructs (Table 3). No intervals included unity, thus indicating discriminant validity (Anderson and Gerbing 1988). Also, following Fornell and Larcker's (1981) test for discriminant validity, we checked that the shared variance between all possible pairs of constructs was calculated, and it was verified that none of the squared correlations were higher than the AVE for each construct (Table 2).

Table 2: Confirmatory factor analysis of constructs

Construct	Indicator	Loading	*t* value	CR_M	AVE	Highest shared variance
Formal contracting	FC1	0.84	12.64	0.88	65%	0.50
	FC2	0.87	13.27			
	FC3	0.79	11.55			
	FC4	0.73	10.30			
Cooperative norms	CN1	0.70	8.82	0.63	41%	0.23
	CN2	0.49	5.84			
	CN3	0.63	7.72			
	CN4	0.72	9.14			
Supplier-specific investments	SSINV1	0.81	12.10	0.89	73%	0.50
	SSINV2	0.84	12.78			
	SSINV3	0.91	14.33			
Buyer-specific investments	BSINV1	0.69	9.14	0.78	54%	0.45
	BSINV2	0.84	11.78			
	BSINV3	0.67	8.91			
Product differentiation	PDIFF1	0.84	11.89	0.81	59%	0.38
	PDIFF2	0.83	11.65			
	PDIFF3	0.61	7.90			
Export market state influences	SINFL1	0.92	14.96	0.95	85%	0.46
	SINFL2	0.92	15.03			
	SINFL3	0.93	15.48			
Export market ethnocentricity	ETHNO1	0.57	6.76	0.71	55%	0.46
	ETHNO2	0.83	9.16			

Model diagnostics: $\chi^2_{(188)} = 395.80$, RMSEA=0.81; CFI=0.91; IFI=0.91

Table 3: Correlation among constructs

	1.	2.	3.	4.	5.	6.	7.
1. FC	-----						
2. CN	0.44[a]	1.00					
	(0.08)[b]						
3. SSINV	0.71	0.37	1.00				
	(0.05)	(0.09)					
4. BSINV	0.46	0.16	0.66	1.00			
	(0.08)	(0.10)	(0.06)				
5. PDIFF	0.50	0.48	0.62	0.47	1.00		
	(0.07)	(0.08)	(0.06)	(0.08)			
6. SINFL	-0.19	-0.41	0.04	0.37	-0.06	1.00	
	(0.08)	(0.08)	(0.09)	(0.08)	(0.09)		
7. ETHNO	-0.11	-0.23	-0.02	0.35	-0.04	0.68	-----
	(0.11)	(0.10)	(0.10)	(0.10)	(0.10)	(0.07)	

[a] inter-construct correlation; [b] standard error

RESULTS

LISREL 8.54 was used to test the structural model. Table 4 provides the results of this analysis. In regards to model diagnostics, the model reached $\chi^2_{(197)}$= 428.34, RMSEA=0.86, CFI= 0.90, IFI= 0.90, NNFI= 0.89. Hence, the diagnostics differ from those achieved in the confirmatory factor analysis. To check whether the difference was significant, we conducted a χ^2 difference test of the (theoretical) structural model [$\chi^2_{(197)}$= 428.34] and the construct

measurement model [$\chi^2_{(188)}$= 395.80]. The χ^2 difference is 32.54 at *df*=9, which is statistically significant (the corresponding value is 16.92). This means that there is at least one additional path in the structural model which is statistically significant. The modification indices in LISREL indicated that there is a significant structural path from buyer-specific investments to supplier-specific investments. This path was opened for, and the LISREL model was rerun. The modified structural model reached $\chi^2_{(196)}$= 401.54, RMSEA= 0.81, CFI= 0.91, IFI= 0.91, NNFI= 0.90, and the additional path buyer-specific investments – supplier-specific investments was significant (β_{34}= 0.59, *t*= 4.77). This suggests that specific investments in the relationship by one part demonstrate commitment which promotes a reciprocal action by the supplier to further strengthen the basis for cooperation. To check for any additional structural paths, we conducted a χ^2 difference test between the (modified) structural model [$\chi^2_{(196)}$= 401.54] and the construct measurement model [$\chi^2_{(188)}$= 395.80]. The χ^2 difference shows 5.74 at *df*= 8, which is not statistically significant (the corresponding value is 15.51). Hence, according to Anderson and Gerbing (1988), the modified model can be accepted.

The analysis shows that all direct effects except one are supported. Supplier-specific investments is strongly associated with the level of formal contracting (β_{13}= 0.61, t= 5.39), whereas the effect of buyer-specific investments on formal contracting is not significant, albeit in the expected direction (β_{14}= 0.16, t= 1.37). This provides partial support for hypothesis one. The second hypothesis receives strong support; product differentiation is strongly associated with both supplier-specific investments (γ_{31}= 0.35, t= 3.68) and buyer-specific investments (γ_{41}= 0.50, t= 5.12), suggesting that investments in the interface between the exchange partners are crucial to realize the potential value of differentiated products. The support of hypothesis four (γ_{21}= 0.48, t= 4.89) indicates that closer bonds between the exchange partners is an important element in the implementation of a differentiation strategy. Export market ethnocentricity is negatively associated with the level of supplier-specific

investments (γ_{32}= -0.23, t= -2.45), and positively related to the level of buyer-specific investments (γ_{42}= 0.43, t= 4.47). This provides partial support to the fifth hypothesis. To our surprise, perceived export market ethnocentricity in the export market environment seems to have a strong positive effect on the degree to which the local buyer makes relationship-specific investments. Finally, export market state influences is negatively associated with both the level of formal contracting (γ_{13}= -0.26, t= -3.52), as well as with the level of cooperative norms (γ_{23}= -0.39, t= -4.27), providing solid support to hypothesis seven. It should also be noted that the percentage explained variance of the dependent variables range favorably compared to similar studies in distribution channel contexts.

Table 4: Testing the direct effects structural model

Structural linkages in the model	Hypo thesis	Sign	Para-meter	Theoretical model	
				Estimate	*t* value
Supplier-specific investments – formal contracts	H1	+	β_{13}	0.61	5.39***
Buyer-specific investments – formal contracts	H1	+	β_{14}	0.16	1.37
Buyer-spec investments – supplier-spec investments			β_{34}	0.59	4.77***
Product differentiation – supplier-specific investments	H2	+	γ_{31}	0.35	3.68***
Product differentiation – buyer-specific investments	H2	+	γ_{41}	0.50	5.12***
Product differentiation – cooperative norms	H4	+	γ_{21}	0.48	4.89***
Export market ethnocentricity – supplier-spec investments	H5	-	γ_{32}	-0.23	-2.45**
Export market ethnocentricity – buyer-spec investments	H5	-	γ_{42}	0.43	4.47***
Export market state influences – formal contracts	H7	-	γ_{13}	-0.26	-3.52***
Export market state influences – cooperative norms	H7	-	γ_{23}	-0.39	-4.27***

Significance levels: t>1.96: p<0.05*; t>2.33: p<0.01**; t>3.10: p<0.001***

	Sq. multiple correlation for structural equation	Sq. multiple correlation for reduced form
Formal contracts	0.57	0.27
Cooperative norms	0.39	0.39
Supplier asset specificity	0.61	0.41
Buyer asset specificity	0.42	0.42

Goodness-of-fit indices: χ^2=401.54 (df=196); RMSEA= 0.081; CFI=0.91; IFI=0.91; NNFI=0.90

Testing perfect mediation

In regards to the mediating roles of supplier- and buyer-specific investments, we first compared the chi-square statistics of the (modified) structural model to that of the measurement model. As the reported difference in the chi-squares is not significant, there are no additional statistically significant paths in the structural model.

To double-check this conclusion we estimated two alternative models where we sequentially freed the path from product differentiation and export market ethnocentricity to formal contracting. The additional structural path resulted in the loss of one degree of freedom. Accordingly, if there was a significant difference in the chi-square of any of these two new structural models compared to the chi-square of the original structural model (at $\Delta df = 1$), this would mean that the effect of the independent variables are not perfectly mediated by relationship-specific investments (Anderson and Gerbing 1988; Patterson *et al.* 1997). The largest chi-square difference observed was $\Delta\chi^2 = 0.16$ which, at one degree of freedom, is not significant (the corresponding value is 3.84). Hence, perfect mediation holds. This means that relationship-specific investments transmit the effects of export market ethnocentricity and product differentiation to formal contracting. This provides support to hypotheses three and six.

DISCUSSION AND CONCLUSION

This study has examined the effects of transaction costs, strategic positioning, and institutional factors on governance mechanisms in international B2B relationships. Our results show that factors from each of the chosen perspectives are important determinants of relationship governance. While most previous interorganizational studies have primarily investigated the influence of factors that pertains to the exchange relationship, this study

provides evidence that such a narrow focus leaves the conceptual model underspecified. Our empirical results corroborates earlier research in showing that relation-specific investments play an important role, but we have also demonstrated that strategic positioning and institutional factors add explanatory power in explaining the governance of international B2B relationships.

Our findings have important implications regarding how both the strategic positioning and the institutional perspective can add further insight into the field of international business relationships. Concerning the positioning paradigm, two major points have been demonstrated. First, a supplier's positioning strategy is of crucial importance for the degree to which relation-specific investments are made on each side of the relationship. Differentiated products need to be supported with investments in the interfaces between the firms. Such investments can also function as a signal of commitment to the relationship aimed at deterring competitors from entering into this particular market segment. The arguments developed in this respect are broader than the standard TCE model. It should be noted that these considerations are developed from a value maximizing point of view, thus meeting the critiques of TCE's cost-minimizing focus (e.g., Zajac and Olsen 1993).

Second, more differentiated products often involve the exchange of 'sticky' information in order to adapt the products to meet customer preferences. Exchange of 'sticky' information is most aptly acquired through ties characterized by close interaction and coordination. This makes it more important for both parties to nurture the bonds between them and thereby governing the relationship by cooperative norms, so that fine-grained information can be exchanged through personal contact rather than by formal procedures.

In regards to the institutional perspective, a number of points have been demonstrated. The results suggest that the regulative environment has direct effects on relationship governance. First, official rules and regulations (state influences) in the host environment of

the importer are of significant importance for the degree to which formal rules and procedures are specified in the relationship. Such regulations force the actors to adapt their formal contractual arrangement to comply with societal requirements. In turn, this put limits on the extent to which the exchange relationship can be pragmatically governed by explicit and predefined rules and procedures, thus leaving certain contractual elements of the relationship open. Second, such regulations often apply asymmetrically on the exchange parties. The foreign firm often needs to comply with a number of local regulations applying specifically to foreign firms, while the importer does not need to cope with such concerns. Such an asymmetric imposition pressure may result in difficulties in developing shared expectations and common understandings in the dyad. This lack of bilateral convergence of what constitutes fundamentally meaningful behavior thwarts the development of cooperative norms. Hence, the data corroborates with Grewal and Dharwadkar's (2002) proposition that asymmetric regulative influences hinder the development of solidarity in the relationship.

Concerning the influence of the normative environment on the extent to which relation-specific investments are made, the results suggest two major points. First, if the exporter perceives the local market to be ethnocentric, the exporter will hesitate to commit specific investments in the relationship to a customer operating in such a market. Even if the exporter overcome the cultural barrier and embrace local norms and values, the exporter will still face problems in becoming socially accepted. The exporter might therefore believe that it will be disadvantageous in the long-run to invest in this market, and that it is better to route such investments towards markets that are not characterized by such normative impediments. Surprisingly, and opposite of what was expected, an importer that is embedded in a restrictive (ethnocentric) local environment has the choice between terminating the relationship and comply with "the logic of appropriateness" in order to gain social legitimacy or investing in the relationship to realize the potential economic returns. Given the fact that the relationships

studied here have survived at least three years, it is likely that a relationship will not be terminated due to such normative impediments. In turn, facing limited willingness on the part of the supplier to commit specific investments to the relationship, the data indicate that the importer needs to compensate for low levels of investments on the part of the foreign firm and increase its own level of investments in order to realize the value creation potential of the exchange relationship.

Limitations and future research directions

We should also have in mind some of the limitations of the present study. First, due to the theory testing purpose of our study, we have chosen a rather homogenous context (two industries with several similarities). We have in this way limited the number of uncontrollable factors that often create noise in studies covering a wide range of industries, and our measures could be better tailored to the context. However, caution must be shown in interpreting the results especially in trying to generalize the results to other contexts.

Second, in the pursuit of presenting a parsimonious model that took into account elements from a broader set of perspectives, only one construct was chosen to reflect strategic positioning considerations, and only two constructs were chosen to reflect societal influences. These chosen constructs provided significant contribution in explaining both relation-specific investments and relationship governance. Our aim of incorporating fundamentally different perspectives into the same model was thus supported. However, choosing only a limited set of constructs may leave out other important factors. Ideally, several constructs should have represented each of the different concerns, and future studies should try to expand the number of constructs representing strategic positioning and societal influences.

Third, the chosen research design has some obvious limitations. The cross-sectional design disables the studying of the dynamic processes underlying the relationships among the

constructs in the model. Researchers have repeatedly raised awareness of the evolutionary nature of inter-firm relationships. Obviously, the constructs in question are likely to vary with the frequency, type, and history of the exchanges between the parties (Williamson 1975).

Fourth, data was only collected from the exporters, and ideally, data from the importers should also have been obtained. For example, cooperative norms are by nature, a bilateral construct, which should also necessitate an assessment of the importers. Furthermore, it would be interesting to take into account how the importers perceived the regulative and normative nature of the exporters' host environment. We may speculate if a closed normative host environment of the exporter towards foreign cultures would balance the asymmetrical nature of the normative influences in the importer's host environment. Such considerations can only be assessed by dyadic data (Lambe *et al.* 2002).

Finally, further research should also examine how cognitive institutions give rise to cognitive legitimacy concerns resulting in taken-for-granted behavior. This may enable investigating of, for example, how specific contractual arrangements are mimicked by newcomers in a market, especially in situations characterized by a high degree of uncertainty regarding what is the most appropriate channel management behavior.

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