

How to deal with damaged supply chain relationships - the victim's perspective

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Abstract

When a supply chain partner misperforms, to what extent is the supply chain relationship hurt? Despite important advances in research on supply chain relationships little attention has been aimed at exploring how firms should deal with misperforming supply chain partners. Whenever engaging in relationships with other firms there is always the risk that the other firm fails to perform as expected, and all over the world there are firms that daily experience the damage created by such misperformance. Recognizing the need for a theoretical framework suitable for enhancing our understanding of such damage and its implications for supply chain management is the point of departure in this paper. Dependence theory is developed in order to provide a conceptualization of damage created by misperformance in interorganisational relationships.

I outline a theoretical framework that explains to what extent misperformance causes damage in supply chain relationships. Such framework has the potential to guide firms in their efforts to deal with misperformance in their supply chain relationships. There are three key implications that follow from applying this framework. First, "damage" is defined as the product of misperformance and the victim's dependence on the misperformer, and "damage" is hence perceived to be contingent on the dependence context of the victim. I introduce the idea that a given level of misperformance and its actual impact on the victim is contextual and allows us to incorporate the victim's original goals for the relationship into the assessment of the effect of misperformance on the supply chain partner. Second, damage (and misperformance) need not result only from actual under performance but also due to changes in the victim's goals themselves, rendering the output/outcome generated by its supply chain partners as not satisfactory. Finally, the victim's reaction to misperformance is not based on the actual damage caused by the misperformance, but on an assessment of the relational damage created. Relational damage occurs when the victim perceives the misperformer to misbehave (defect, break relational norms or provide too little effort) or to be incompetent.

Keywords: Misperformance, damage, dependence, interorganisational relationships.

Introduction

Whenever one actor in a supply chain relationship (SCR) fails to perform as expected, the relationship suffers and actors must choose appropriate actions. For example, relationships can be terminated because of a single failure in delivery (Ford 1984; Ring and Van de Ven 1994), the inability of a partner to meet a firm's expectations with respect to price or quality (Ring and Van de Ven 1994), or poor role performance (Ping and Dwyer 1988; 1992).

On the other hand, there is some evidence that misperforming partners are not penalized in terms of e.g. relationship termination. For example, under certain conditions, a retailer will not terminate (or penalize in other ways) the relationship with a manufacturer because of late deliveries (Joshi and Stump 1996), and Stewart (1998) finds that consumers choose to exit relationships because of quality decline etc. only under certain conditions. Kaufmann and Stern (1988) suggest that strong relational norms obstruct dramatic reactions in responses to the damage caused by poor performing partners. Effectively, considering other responses to misperformance than relationship termination, Ping (1993) in his study of hardware dealers and their primary suppliers, inspired by Hirschman (1970), considers five different ways to deal with misperformance: exit, voice, loyalty, opportunism and neglect.

In an interorganisational theoretical perspective, opportunism (Williamson, 1985) represents a problem in supply chain relationships when the partners have invested in the relationship and there have not been implemented appropriate safeguards (assuming bounded rationality, and non-trivial levels of uncertainty). Other types of misperformance that are focused in an intraorganisational perspective but that might also apply in interorganisational settings, might include: not working hard enough, not being conscientious about the work, deliberately restricting output, undertaking sabotage, etc. (Ackroyd and Thompson 1999). If there is misperformance despite the misperformer's sincere efforts to do his best, misperformance is the result of incompetence. Finally, other forms of misperformance, like unethical behaviour and socially irresponsible investment behaviour, including reliance on children workers or using animals for testing out new cosmetic products will probably gain more attention from practitioners and researchers in the years to come. In summary, then, the notion of misperformance encompasses deviations in effort or in terms of unwanted effort, and as deviations in performance.

One important determinant of how misperformance is dealt with, is the damage it causes to the relationship. While it seems obvious to suggest that damage co-varies with misperformance (e.g. the greater the violations of expectations, the greater damage, and the higher the probability that the relationship is terminated), it is also so that the same misperformance causes different levels of damage to different relationships (or even to the same relationship at different points in time) (Ping and Dwyer 1992; Halinen, Salmia and Havila 1999). This means that there is no straightforward relationship between misperformance and the amount of damage it causes in relationships.

In this paper I outline a theoretical framework that explains to what extent misperformance causes damage in supply chain relationships. Such framework has the potential to guide firms in their efforts to deal with misperformance in their supply chain relationships. There are three key implications that follow from applying this framework. First, "Damage" is defined as the product of misperformance and the victim's dependence on the misperformer, and "damage" is hence perceived to be contingent on the dependence context of the victim. I introduce the notion that a given level of misperformance and its actual impact on the victim is contextual and allows us to incorporate the victim's original goals for the relationship into the assessment of the effect of misperformance on the supply chain partner. Second, damage (and misperformance) need not result only from actual under performance but also due to changes in the victim's goals themselves, rendering the output/outcome generated by its supply chain partners as not satisfactory. Finally, the victim's reaction to misperformance is not based on the actual damage caused by the misperformance, but on an assessment of the relational damage created. Relational damage occurs when the victim perceives the misperformer to misbehave (defect, break relational norms or provide too little effort) or to be incompetent. Relational damage means that a firm's perceived certainty about satisfactory partner cooperation is reduced (Das and Bing-Sheng Teng 1998).

In this paper, supply chain relationships are sometimes referred to as relationships, and the parties are referred to as (supply chain) partners. I present the arguments and examples in a dyadic perspective not only because such a dyadic perspective is popular in research on SCRs (e.g. Ghosh and John

(1999), Dyer and Singh (1998)), but also for the sake of argument - this simplification renders more salient the key ideas.

First, I review the literature and find that there has been little theorizing effort - misperformance (including organizational misbehaviour) is by and large a neglected topic. There are some interesting insights, however, and these are used as a foundation for the theoretical framework, presented next. The proposed theory conceptualizes misperformance in terms of the magnitude of its consequences (damage), at a general level, in addition to its consequences for the relationship (relational damage). Misperformance is related to the misperformer's decision to engage in trust building efforts (reparation efforts), and the victim's reaction to the relational damage, cf. Figure 1. It is essentially a unilateral model, like models dealing with relationship termination (e.g. Ping and Dwyer, 1992), because relationship termination is usually unilaterally initiated (cf. Baxter (1983) observing romantic relationships). Implications and suggestions for further research are discussed.

Literature review

Supply chain Relationships

Governance of SCRs is a field of research that has attracted considerable attention from academics in the last 15 - 20 years. It is certainly recognized that organizations need a tool for dealing with crisis, undesired situations or damage in SCRs, but misperformance has not been given priority on the research agenda (Heide, 1994).

Recently, a promising initiative for misperformance research was initiated in a specific branch of interorganizational studies tradition - the European Industrial, Marketing and Purchasing Group (IMP) (see e.g. Halinen, Salmi, and Havila, 1999). Schurr (2004), in his review of the IMP literature, concludes that it is widely agreed that interaction episodes generate different relationship states (or cause change in relationship states). However, there is no agreement about the nature of interaction episodes, and hence no well-founded paradigm, nor well-founded terminology that explains how episodes foster trust, create conflict or spark commitment. Schurr (2004) suggests that some interaction episodes are more important than others, and proposes that there are three classes: generative, degenerative and neutral interaction episodes.

While it is useful to know which critical interaction episodes cause important changes in SCRs, it is important to remember that the environment is an equally important generator of change (Halinen et al., 1999). This means that what is classified as a critical interaction episode in one SCR is not necessarily classified as such in another. Furthermore, the evaluation of criticality is time-dependent. What would be judged as critical at one point in time will not necessarily be so at another point in time. For example, an extremely low level of customer service will normally be treated as a critical, degenerative interaction episode, leading to relationship termination. More generally, and that is a central concept in service management theory, service failures are critical episodes that lead buyers to switch to other service providers (Singh, 1990). Naturally, it is not always so. If the customer has no alternative supplier or does not mind the low level of customer service, he may not even consider terminating the relationship – he has little choice but to continue with the same partner. More generally, Ping and Dwyer (1992) claim that firms are in relationships because they want to, or because they have to. Accordingly, it seems wise not to search for absolute definitions of which interaction episodes belong in each category, since their degree of criticality will depend on other factors as well.

Another interesting insight from the IMP branch of interorganisational studies, is that reparation efforts by the misperformer are naturally conceived as trust building efforts, and misperformance is expected to cause misperformers to undertake reparation efforts. In other words, damage (caused by misperformance) leads to increased levels of effort devoted to trust building when reputation is damaged. This relationship is originally proposed by Schurr and Ozanne (1985), who found reputation effects in a bargaining experiment – a low level of trust damaged relational prospects for hard bargainers (see also Morgan and Hunt, 1994). In SCRs trust is important and leads to increased levels of confidence about satisfactory partner cooperation according to Das and Bing-Sheng Teng (1998). They define the concept “confidence in partner cooperation” as: “.. a firm's perceived certainty

about satisfactory partner cooperation" (1998: 492). In the following, relational damage is defined as the negative difference in confidence in partner cooperation that is caused by misperformance.

Organizational Theory

Organizational theory is, and should be, one important source of inspiration for new advances in research on SCR, because the governance insights in intraorganisational settings have been the subject of scientific attention for far longer than interorganisational settings, and because the subject matter is essentially the same – the only difference being that the span of governance embraces (parts of) two or more organizations rather than a single one. The research centre "Global Supply Chain Forum" (see e.g. Lambert, 2004), was established based on this recognition in 1992, in order to stimulate research into one type of IOR – supply chains. As the reviews by Ackroyd and Thompson (1999) and Vardi and Weitz (2004) show, organizational and psychological theory also largely assume that behaviour is conforming and dutiful, and have emphasized the study of desirable behaviours, even if practitioners have long claimed they need more realistic theories. Hence, there is little to build on in our efforts to establish a theory of misperformance management. Ackroyd and Thompson (1999) show how deviant or antisocial behaviour has been neglected in the organizational literature, except for being barely touched upon under headings such as resistance, management of change and the like. Vardi and Weitz (2004) make a similar point, mentioning exceptions like management ethics and industrial relations, and suggest a number of antecedents to unethical behaviours. The same ideas have also given birth to a recent book (including a collection of cases) on the same topic, "Managing Organizational Deviance", edited by Kidwell and Martin, that aims to help academics and practitioners to understand how deviant behaviour can be managed (see Kidwell and Martin, 2005).

The inherently "negative" focus on voluntary misbehaviour, committed by choice (intentionality is a necessary condition for saying that there is misbehaviour (O'Leary-Kelly, Duffy and Griffin, 2000)), is certainly narrow, covering only a part of the broader concept of misperformance. Ackroyd and Thompson (1999) define three types of organizational misbehaviour: effort limitation, appropriation of time, and appropriation of product. Misbehaviour is treated as one type of misperformance in this paper. Such misbehaviour is conceived as being the result of the motivation and disposition of individuals, and, at the same time, hierarchical governance processes related to identification of misbehaviour, monitoring, categorization, labelling of activities etc. (Ackroyd and Thompson, 1999: 75). A fundamental assumption is that how employees choose to behave is affected by the organization of work, and Vardi and Weitz (2004) find support for the hypothesis that two aspects of organizational climate, the reward and support climate respectively, affect misbehaviour.

Insert Figure 1 about here

Theoretical framework

In this section I first rely on dependence theory to establish a conceptualization of misperformance and a conceptualisation of the damage it causes in SCRs. Next, the notion of relational damage is explored. Finally, I develop a set of researchable propositions.

Misperformance and Damage in SCRs in a Dependence Perspective

Dependence is one of the most (if not *the* most) widely used concepts in SCR research, and it is conceived in a variety of ways. As such, our knowledge about dependence in SCRs is not easily summarized because the different approaches are not comparable (Hammervoll, 2005). Hammervoll tries to remedy this by suggesting a unifying dependence framework. Drawing mainly on Emerson (1962) and Pfeffer and Salancik (1978), he asserts that a dependence situation is defined by an actor A having a goal (α) that another actor B mediates by performing some action (β). The extent to which there is dependence is determined by three other variables, namely: 1) actor A's motivational investment (X) in the goal, 2) actor A's costs of switching to another relationship (switching costs) (Y), and 3) the number of alternative partners available to actor A (Z). Emerson (1962) asserts that

dependence is (positively) proportional to the values of X, while inversely proportional to the values of Z. Hammervoll's (2005) review reveals that studies of dependence are comparable only to a very slight extent, because they have examined: 1) different goals (α) and /or actions (β), or 2) because they have studied X, Y or Z without any reference to a specific α or β .

This conceptualization of dependence allows a fruitful conceptualisation of the damage concept because misperformance can be directly related to the key-variable "actor B-action" (β) and many factors identified as important in prior research in various fields coincide with the X, Y and Z variables. Assuming that damage is correlated with a) the deviance in β and b) the dependence of the victim on the misperformer, damage is expressed as the product of these two. This assumption is derived from the recognition that if there is no dependence between firms, then misperformance will not affect the other party at all, and at the other extreme, if dependence is high, damage is potentially high. In other words, being dependent on another firm implies vulnerability because your partner can let you down, and the more dependent, the more it hurts when your partner misperforms. Accordingly, the damage is higher as the victim is more dependent on the misperformer, and the greater the misperformance ($\Delta\beta$), and vice versa. Damage is hence descriptive of the negative effects created by misperformance, from the victim's point of view.

Misperformance means the difference between what was expected, and what was really performed in relative terms ($\Delta\beta$). In other words, misperformance is conceived as the degree to which there is an unsought negative deviance in one actor's (the misperformer's) performance, as viewed by the other party. For example, failures in delivery (Ford (1984); Ring and Van de Ven (1994)), inability of a partner to meet a firm's expectations with respect to price or quality (Ring and Van de Ven, 1994), or poor role performance (Ping and Dwyer (1988); (1992)) are known to cause damage to SCRs.

The other variables; α X, Y and Z, covers key variables identified in previous research especially on switching behaviour and relationship termination. In their study of agency-client relationships, Doyle, Corstjens and Mitchell (1980) identify changes in the client and agency's marketing policies as one factor with major impact in the switching decision. Change in policy means that both goals (α) and motivational investments (X) in goals are altered. Rodin (1982), in a different discipline, makes a similar point with regard to personal relationships – intimate relationships tend to dissolve when the criteria satisfied by the relationship decline in importance. In other words, a change in the value of X, affects the relationship.

Switching costs (Y) partly determine the amount of damage created by misperformance. The higher the value of Y, the more a firm is inflexible because it is costly to replace the partner. Stewart (1998) reviews the literature on customer exit process and concludes that exit barriers (switching costs) is one of three key exit issues (in addition to quality decline ($\Delta\beta$) and the availability of alternatives (Z)).

The availability of alternative partners (Z) has also been identified as an important determinant of relationship dissolution in a case study of a relationship in the banking industry (Perrien, Paradis and Banting, 1995), and in IORs in general (Ping and Dyer, 1992). This finding is also emphasised in research on personal relationships, where it is conceived as partner substitutability (Rodin, 1982).

In sum the proposed conceptualisation of damage incorporates key variables that according to previous research on SCRs are important in order to fully understand the notions of misperformance, damage and its consequences.

Misperformance can be operationalized in different ways. One advantage of my approach is that it: 1) does not rule out particular interpretations of the nature of misperformance, and 2) does not impose restrictions on the measurement level. With regard to 1), I limit myself to accept that there are various ways in which firms can misperform. With regard to 2), consider for example what happens when a supplier only manages to deliver only 90% of an order. Certainly, this could create different amounts of damage at two different times in the same SCR. The second time, there might for example be negative consequences for the buyer's customers, which might not be the case the first time. This corresponds to what Halinen et al. (1999) refer to as confined and connected change respectively. The approach suggested here allows for including such consequences in the calculation of misperformance ($\Delta\beta$). One advantage that derives from relying on the notion of misperformance advocated above is that the assessment of its magnitude could be based on different aspects of

performance or units of analysis (e.g. firms, dyads or networks). The obvious weakness from a measurement and operational point of view, is that $\Delta\beta$ cannot be easily assessed.

Re-expressing Hammervoll's (2005) ideas, an actor's dependence on another with regard to one specific goal can be expressed as a (positive) function of X and Y, and a (negative) function of Z, as in equation (1), and the damage caused by another actor's misperformance can be expressed as in equation (4), the damage equation.

$$\text{DEPENDENCE}_{(\alpha)} = f(X, Y, Z) \quad \text{Dependence Equation(1)}$$

The subscript (α) identifies the actor's goal, and the right hand side of the Dependence Equation represents the amount to which the actor is dependent on another party for achieving this goal. This conceptualization depicts how actors depend on other actors with regard to *one specific goal*. In SCRs there are likely to be many goals held by each actor, and many writers advocate the idea that, overall, dependence often is, and for sake of the effective relationship outcomes should be, symmetrical (Anderson and Weitz, 1992; Gundlach, Achrol and Mentzer, 1995). Other writers, like Söllner (1999), do not find that asymmetrical dependence has negative effects on relationship performance. As already noted, the conceptualization of dependence is problematic, and has been inconsistently dealt with in research. This also holds for the conceptualizations of symmetrical or asymmetrical dependence.

In SCRs there are a multitude of such Dependence Equations – one for each goal that are mediated by partners. This is illustrated in (3). For the sake of simplicity, it is assumed that there are only two partners and that actor A has three different goals that actor B mediates, while actor B only has two (mediated by actor A).

$$\begin{aligned} \text{DEPENDENCE}_{(A-B)} &= \text{Actor A's dependence on actor B} + \text{Actor B's dependence on actor A} \\ &= (\text{DEPENDENCE}_{\alpha_{A1}} + \text{DEPENDENCE}_{\alpha_{A2}} + \text{DEPENDENCE}_{\alpha_{A3}}) \\ &\quad + \\ &\quad (\text{DEPENDENCE}_{\alpha_{B1}} + \text{DEPENDENCE}_{\alpha_{B2}}) \quad (2) \\ &= f(X_{A1}, Y_{A1}, Z_{A1}) + f(X_{A2}, Y_{A2}, Z_{A2}) + f(X_{A3}, Y_{A3}, Z_{A3}) \\ &\quad + \\ &\quad f(X_{B1}, Y_{B1}, Z_{B1}) + f(X_{B2}, Y_{B2}, Z_{B2}) \end{aligned}$$

In general terms, dependence in a given IOR can be calculated as in (3)¹:

$$\text{DEPENDENCE}_{(A-B)} = \sum_{i=1}^{i=n} f(X_{Ai}, Y_{Ai}, Z_{Ai}) + \sum_{j=1}^{j=m} f(X_{Bj}, Y_{Bj}, Z_{Bj}) \quad (3)$$

For example, in a supply chain an actor A has to dispose of her products, which means she has a goal (selling) and depends on B, a buyer, who mediates this goal by buying. The buyer must procure inputs, which means that he has the goal of buying, and depends on Actor A, the seller, to reach this goal. If these are the only goals in the relationship that are mediated by partner actions, two Dependence Equations suffice for illustrating the dependence at play.

Another more complex example is when an exporter of farmed salmon relies on a customer, a smokery, in joint research efforts in order to improve his products, in addition to disposing of his output. Also, the exporter benefits from his contact with this partner in terms of collecting information in order to learn about the activities of his competitors in this market. Accordingly, the exporter has three goals mediated by the customer. The customer has two: one related to procuring inputs, and one related to research efforts in order to improve the quality of his products. Specifically, the smokery is interested in increasing the share of fillets that do not crack during the smoking process, because cracked fillets sell at a lower price than uncracked fillets. In this case, five Dependence Equations are needed to fully describe the dependence at play in this SCR.

An actor who decides to switch to another partner for achieving a goal may terminate the relationship with the current partner or terminate only the activities related to this goal. For example, an exporter of farmed salmon carries out joint research with a smokery (a customer that buys salmon and then smokes it), for example by jointly researching how different breeding methods affect the final smoked product. The exporter can decide to terminate such cooperation, but continue to sell fish to the customer, if he considers that the smokery has lower expertise in research projects than expected. Stated differently, the smokery's performance is below the exporter's expectations, and the relationship is damaged. This means that the exporter terminates one part of the relationship (in which there is misperformance).

In some cases, such as in the example mentioned above, terminating some aspect of the cooperation is feasible. In other situations only the entire relationship can be terminated, not only a part of it. As a consequence, an actor's Ys and Zs will be identical for different goals in the same SCR, as long as the switching costs and the number of alternative partners do not vary across these goals. On the other hand, if it is possible to terminate only one part of a relationship, the actor's Y and Z values could vary across different goals.

When there is misperformance in an SCR, the damage in absolute terms is assessed as the product of $\Delta\beta$ and some function (g), for example Actor A's goal number 1:

$$\text{DAMAGE } (\alpha_{A1}) = \Delta\beta \times g (X_{A1}, Y_{A1}, Z_{A1}) \quad \text{Damage Equation} \quad (4)$$

g is a positive function of X, Y and Z: The higher Actor A's motivational investment, switching costs and the fewer alternative exchange partners that are available, the more damage is created by the misperformance. This argument may create the impression that only failure to perform as expected (misperformance) creates damage. Of course, this is not the entire truth. There are several ways in which there can be damage without changes in the misperformer's performance even if there was no damage previously. First, actors can adopt new goals. This could (see equations 2 and 3) alter all calculations of dependence and damage. Hence, partner performance in a specific domain that previously was judged appropriate (or at least not considered as a problem) may now be judged as misperformance. Likewise, for the X, Y and Z variables, any changes could influence dependence and damage considerations in the SCR. So, in addition to inappropriate performance on behalf of the misperformer, misperformance can be caused by the victim when he adopts new goals or when he increases his motivational investment in existing goals, or by changes in the network (the number of the misperformer's competitors can change, or the costs of switching can change, altering the victim's alternatives).

Proposition 1

In a supply chain relationship the damage caused by misperformance is a positive function of the misperformer's misperformance ($\Delta\beta$), the victim's motivational investment in the concerned goal (X) and the victim's switching costs (Y), but a negative function of the victim's number of alternative supply chain partners (Z).

Relational damage

The victim interprets the causes of misperformance before he decides how to deal with it. Is the misperformer to blame, is it caused by issues outside the misperformer's control, or is it a result of inappropriate governance- or incentive mechanisms? If the misperformer is to blame (in the eyes of the victim), there is relational damage provided that the victim's expectations about the partner's cooperative behaviour in the future is negatively affected (Das and Bing-Sheng Teng, 1998). In agency theory, this is the hidden action problem and in transaction cost theory, it corresponds to opportunism (Williamson, 1975).

The victim's problem is that it is not always easily established if the misperformer's misperformance is intentionally produced (misbehaviour) or not. Intentionality is a necessary qualifier for concluding that there is misbehaviour. Relational damage occurs as the misperformer is conceived to be likely to misbehave again (break relational norms, provide unsatisfactory levels of effort or act opportunistically), or because he is, contrary to what the victim expected, incompetent for the tasks in

question. Then, while damage is assessed according to the victim's goals and how the misperformance affects the achievement of these goals, relational damage is not. Relational damage means that the victim's certainty that its SCR partner will cooperate (rather than act opportunistically) in the future is reduced.

Bouty (2000) studies personal relationships between R&D scientists that belong to different organisations. She finds that the deeper the mutual acquaintance and trust, the more repeated the violations of expectation necessary to cause the deterioration of a relationship, because of cognitive inertia. Misperformance in close relationships where the partners deeply trust each other (in the sense that they will not harm the other party) will be interpreted as "unintended incidents", or "exceptional incidents", and partners are given the benefit of the doubt whenever they could have been suspected to not collaborating. Such relationships, in an interorganisational setting, would correspond to what Ping and Dwyer (1992) refer to as being in the "positive phase". This is the expected stage of a committed relationship. If the firm is satisfied overall, episodic misperformance are not apt to jeopardize strong relational norms (Kaufmann and Stern, 1988). Indeed, any relationship involving humans in an uncertain and dynamic environment are bound to experience some slippage. Ping and Dwyer (1992) present different stages interorganisational relationships go through, in a stepwise process, including dissolution.

Even in relationships that just have been established, there is some evidence that partners are given the benefit of the doubt – Fichman and Levinthal (1991) label this the "honeymoon effect", which means the initial suspension of the threat of relationship termination in IORs.

Extending the argument above (cf. proposition 2a), misbehaviour (or incompetence) in less important dependence equations is expected to create less relational damage than misbehaviour in more important ones, in SCRs with more than one dependence Equation.

Misperformance caused by issues perceived (by the victim) to be outside the misperformer's control, like when there are changes in α or X, does not result in relational damage. Such changes are the result of an internal process within the victim's organisation, but can be produced as a result of pressure from external stakeholders. For example, the victim can forget to inform the misperformer, or informs the misperformer insufficiently, about important changes in requirements etc. Pressure from external forces might render hitherto more or less accepted (or neglected) practises like reliance on children workers etc. unsatisfactory, which means that there is misperformance despite the fact that the supply chain partner only pursues his activities like he always did. In such situations there might be no relational damage than the damage, despite the fact that there is damage.

Also when there is misperformance that the victim perceives to be explained by inappropriate governance- or incentive mechanisms, there is no relational damage. Such misperformance occurs for example when a manufacturer would like his suppliers to undertake specific investments or to quickly adapt to sudden changes in the business environment if the relationship is governance by an incentive mechanism that does not promote such behaviour (Ghosh and John, 1998).

In sum, little damage can cause important relational damage if the victim perceives the misperformer to intentionally misbehave. On the other hand, even devastating damage does not cause relational damage if the victim does not perceive the misperformer to misbehave.

Proposition 2

- a. The more severe misbehaviour, or incompetence, the more relational damage.**
- b. The less important the affected Dependence Equation, the less relational damage results from misbehaviour or incompetence.**
- c. Relational damage is not affected by the amount of damage caused by misperformance.**

In any case, both actors need to evaluate how misperformance affects the victim. The misperformer relies on this assessment for deciding whether to repair the damage or not, and the victim relies on his assessment for deciding his reaction (and to accept or not accept the misperformer's reparation efforts). It is mandatory that the victim in his evaluation distinguishes between damage and relational damage.

Relational damage management: the victim's reaction

Previous research has investigated the direct relationship between misperformance and the victim's reaction, like exit (Ring and Van de Ven (1994), Ping and Dwyer (1988), Ping (1993)). The model advocated here assumes that the effect of misperformance on victim's reaction is mediated by the damage (including relational damage) it creates. In fact Ping (1993) finds that investment and switching costs are indirectly associated with victim's reaction (exit), while relationship satisfaction was found to be directly associated. Since relationship satisfaction means that there is no (or at least only moderate) relational damage, Ping's findings support the idea advocated here that the consequences of misperformance depend on the victim's assessment of the incident(s). Exit is by some writers considered to be the last resort when relationships do not work as they are supposed to (Stewart, 1998), and represents the most researched victim option. The alternatives – voice, loyalty, opportunism and neglect – have not benefitted from much theorizing efforts when it comes to responding to misperformance.

One interorganizational theory that deals with misperformance is the transaction cost approach (TCA) (Williamson, 1975, 1985), which has recently been presented as governance value analysis (GVA) (Ghosh and John, 1999). This theory deals with misbehaviour and governance in terms of an incentive system (Heide, 1994). In ongoing IORs, Heide in fact identifies six different governance dimensions – role specification, planning, adjustments, monitoring, and enforcement in addition to the incentive system – but, among these, the incentive system stands out as a highly relevant management area.

According to GVA, different governance forms rely on different logics in order to ensure that exchange partners perform according to expectations (Ghosh and John, 1998). There are three alternatives: under market governance, the threat that one party will terminate the relationship serves to discipline the other party, and motivates him to perform as expected. Under relational governance, relationship preservation disciplines and motivates partners to perform according to expectations; while under hierarchical governance, reward schemes are relied upon to ensure that performance is according to "plan". Accordingly, the victim will under different governance regimes to varying degrees be more inclined to terminate the relationship, to allow the misperformer to repair damage, or to implement administrative arrangements for coping with misperformance.

Following GVA reasoning, allowing misperformers to repair efforts are indicative of relational governance - the relationship has a value in itself, and it is valuable for the partners that it continues (MacNeil, 1980; Macauley, 1963), and relationship termination is less likely the more reliance there is on relational governance.

Hierarchical governance is recognized as being of a distrusting nature, and under such a regime trust is low because authority, rather than implicit social norms, operates to control behaviour, and both market and hierarchical governance imply low reliance on trust in relationships (Ring and Van de Ven, 1992; Williamson, 1985).

Proposition 3

- a. The more relational damage, the stronger the probability that the victim terminates the relationship.**
- b. The more reliance on market governance, the higher is the probability that the victim terminates the relationship when there is relational damage.**
- c. The more reliance on relational governance, the lower the probability that the victim terminates the relationship when there is relational damage.**

Relationship termination is more likely when the victim's motivational investment is high, and it is easy (and cheap) to replace the misperformer. When all the other goals of the victim are considered, termination is less likely as motivational investments in these goals are higher, and it is difficult (and costly) to replace the partner. It is assumed here that the Y- and Z-variables can take on different values for different goals in the same IOR, in accordance with Hammervoll (2005). For example, if a customer firm enhances both a supplier's goal of achieving sales and of developing new products, it may be that the customer firm is more easily replaced for the purpose of disposing of output (sales) than replaced by a new partner in product development.

Relational damage management: the misperformer's reparation efforts

The misperformer will under different governance regimes to varying degrees be inclined to repair damage. The misperformer will only undertake reparation efforts as long as s/he desires to continue the relationship. In general, this appears to be a fair assumption in IORs, cf. Håkansson and Snehota (1995), who finds that companies do tend to engage in long term relationships with other firms. Whenever the misperformance creates little relational damage, the misperformer is not expected to undertake particular reparation efforts, but the more relational damage, the more reparation efforts are necessary for the misperformer to undertake. If the victim perceives the misperformer as misbehaving (or being incompetent), even small deviations in performance may require huge reparation efforts.

When there is market governance the decision whether to repair damage or not will be based on assessments of the consequences of repairing versus not repairing. The more there is reliance on market governance, the less likely it is that some partner will undertake reparation efforts. The underlying argument is that under market governance, dependence between partners is low and one partner will not increase her dependence by making dedicated investments because then he will be more exposed to opportunistic behaviour from the other party (Williamson, 1985).

Repair (and also termination) decisions can affect the performance of partners in other relationships (network). In order to motivate effectively by use of market governance, other organizations must believe that the victim is willing to use it, whenever performance doesn't meet expectations. Hence, failing to "punish" misperformers can be interpreted as a sign of weakness, and the more reliance on market governance, the more likely it is that misperformance leads to relationship termination. In Axelrod's (1984) terms, if one party is perceived as not cooperating, a popular strategy is to not cooperate as well (the "tit-for-tat" strategy). To the extent that this strategy is used in relationships, an important issue is the victim's perception of the partner's misperformance, because his interpretation of the other party's cooperative orientation is fundamental to his decision on how to react. Still, obviously the misperformer's reparation efforts may influence the victim's assessment of the situation.

Following GVA reasoning, reparation efforts are indicative of relational governance - the relationship has a value in itself, and it is valuable for the partners that it continues (MacNeil, 1980; Macauley, 1963). The parties are motivated to do their best to perform according to the expectations of their partners (Håkansson and Snehota, 1995). Hence, when there is misperformance the misperformer repairs the damage undertaking efforts that re-establish his reputation, cf. Schurr and Ozanne (1985).

Ignoring that misperformers invest in trust building efforts with the objective of achieving relational governance instead of hierarchical at a later point in time (what Halinen et al. (1999) describe as confined change), misperformance is not expected to cause reparation efforts under hierarchical governance. In other words, when hierarchical governance prevails, misperformers do not rebuild trust. Conversely, misperformance under hierarchical governance increases the possibility that the relationship will be terminated.

Proposition 4

- a. The misperformer will engage in reparation efforts the more he has misbehaved, or revealed incompetence.**
- b. The more there is reliance on market or hierarchical governance, the less reparation efforts.**
- c. The more there is reliance on relational governance, the larger reparation efforts.**

Implications and further research

Apparently there is a variety of possibilities for undertaking research that will add to our present body of knowledge. In this section I discuss implications and further research possibilities. I start by looking into dependence theory, then misperformance, damage and relational damage are treated.

Dependence Theory

The functional relationships between dependence variables have yet to be estimated. Emerson (1962) posited that an actor's dependence is proportional to his motivational investment, and that his dependence is inversely proportional to the availability of alternative exchange partners, but there have been no efforts to investigate these relationships in detail. The functions (**f** and **g**) in the Dependence and Damage equations need to be determined, i.e. we need to establish how X, Y and Z variables affect dependence and damage. Furthermore, is **g** different from **f**, and are **f** and **g** universal functions that apply to a wide range of different IORs? The proposed conceptualization of damage may encourage researchers to estimate such relationships, and such efforts are certainly valuable, and most welcome, to dependence research as well.

Furthermore, the inter-relationships between dependence (and hence damage) variables need to be clarified. Are X, Y and Z independent variables, or are they, in a given context, related in some way? For example, is it possible that switching costs are positively correlated with motivational investment?

On the basis of the discussion in this paper, one important conceptual issue related to the notion of dependence that deserves further attention, emerges: Emerson (1962) treats dependence and power as opposite poles on a power-dependence continuum. This means that when an actor becomes more dependent on another, he reduces his power. This "zero-sum game" conception has been contested by several authors, who argue that, in some cooperative relationships, where both parties are highly dependent on each other, dependence is a source of mutual power that allows the parties to achieve value creation or symbioses (Borys and Jemison, 1989; Frazier, 1999; Håkansson and Snehota, 1995; Pfeffer and Salancik, 1978). Empirically, several studies have focused on such dependence situations (e.g. Bello and Gilliland, 1997; Heckman, 1999; Johnsen and Ford, 2000). The conceptualization proposed in this paper remedies this shortcoming, since it allows one organization to be more or less dependent on another, regardless of how dependent the other organization is on the first. Accordingly, one actor can increase its dependence on another, without reducing its power. Hence, the proposed framework renders obvious one serious weakness of Emerson's (1962) dependence framework, namely that the dependence-power continuum relates to one single goal (one single Dependence equation), and not the entire relationship, which may contain several Dependence equations.

The proposed framework also allows a distinction between relationships with little dependence and relationships with much dependence. Dependence research currently focuses on which party depends on which, and to what degree. Is it now time for investigating in more detail why the parties depend on each other, and the interplay between different Dependence equations? One possible avenue is to investigate "thin" and "thick" relationships. In fact, empirical and conceptual work in sociology point to the fact that close and enduring relationships are in some cases characterized by exchange of information and other transactions that are difficult to carry out in markets, in addition to commercial transactions (Gadde and Håkansson, 1993; Håkansson and Snehota, 1995; Larson, 1992; Uzzi, 1997), and social exchanges for social legitimacy purposes (Pfeffer and Salancik, 1978), and that economic transactions are embedded in social relationships (Granovetter, 1985).

Misperformance, damage and relational damage

Misperformance is conceived as failure to meet partner expectations, for example with regard to delivery time, or delivery precision, or with regard to other aspects of customer service in buyer-seller relationships. Damage is conceived as this gap between performed versus expected performance, weighted by the importance of the goal in question (determined by X-, Y- and Z-variables).

As pointed out with regard to dependence, the functional relationships need to be further explored. While it is obvious that X belongs in the damage equation (misperformance with regard to a more important goal creates more damage than misperformance with regard to a less important goal), and can be said to have a direct effect on damage, it is not perfectly clear what role Y and Z play.

An important area for further research includes the identification of different types and causes of misperformance, including the victim's and the misperformer's perceptions of such causes.

The victim's and the misperformer's perceptions, framing and interpretation of misperformance should be further explored, drawing on insights from organizational psychology and framing, perception and attribution theory. There have been few attempts to apply such insights to SCR settings, but inspiration

can be found in consulting studies from other settings: for example, Manzoni (2002) discusses how e.g. framing helps managers to deliver negative feedback to subordinates without damaging the relationship; Conger (1998) discusses how e.g. framing helps team members to persuade other team-members; and Garder and Avolio (1998) show how framing can be used in promoting leadership. Furthermore, Radley's (1996) study of illness behaviour describes how individuals sustain health beliefs and make their illness situation sensible and bearable. There is certainly room for creative studies on SCRs, targeting questions like: How to communicate misperformance (from the misperformer's and/or the victim's point of view) in order not to create unnecessary obstacles for future cooperation? Are there firms that are badly treated by their partners, or "ill" on other grounds, and how and why do they cope with it? Is it so that when the victim does not blame the misperformer for any misperformance, due to his interpretation of the incident, for some reason, then the risk of relationship termination is low?

The temporal and additive aspects of damage have not been focused on in this paper. For example, misperformance can at one moment have bearings on reparation or termination decisions at a later stage, if there is a second (or third etc.) misperformance replication etc. The additive consequences of repeated misperformance stand out as one avenue for further research. Does misperformance accumulate, and what are the consequences? What are the consequences of recurrent small damage? How do organizations respond to misperformance? When are they likely to readjust their expectations, so that recurrent misperformance is no longer considered as such?

Only negative (critical) incidents have been focused here, but the framework can be applied to positive incidents as well, in order to capture to what extent partners contribute to the creation of new business and enrich the relationship in other ways. For example, insights from intraorganisational theory (see e.g. Gardner and Avolio, 1998) could be explored in IOR settings. Such efforts would probably benefit from recognizing that partners can create more dependence (add more Dependence Equations to an IOR) (Håkansson and Snehota, 1995), which leads to increased demand for both partners' services. In such a "positive" application of the framework, researchers would direct their attention to different variables, such as, in particular, motivation. One possibility is to consider intraorganisational insights into how hard employees work – effort intensity - with the objective of increasing our understanding of what motivates suppliers, buyers and other partners to put more effort into cooperative activities.

Supply chain management

Closely related to the interpretation of misperformance is, of course, the choice of reaction. On the other hand, the misperformer can also ignore, forget or repair, but, perhaps more interestingly, he can hide it, excuse it or blame it on somebody else. Further research should explore this further in SCR settings.

There is an apparent need to operationalize supply chain management, recognizing that different governance forms occur in different governance dimensions (Heide, 1994). For example, there are several relational norms that can operate in ongoing relationships. As far as incentive systems are concerned, the corresponding relational norm is probably the solidarity norm: the relationship has a value in itself, and it is valuable for the partners that it continues (MacNeil, 1980). Whenever the solidarity norms operate in a relationship, the members are motivated to do their best to perform according to the expectations of their partners, and there is, presumably, less need for incentive systems based on market- or hierarchical governance. Furthermore, one obvious line of inquiry is to apply a broader perspective and to investigate other dimensions, like planning, monitoring, conflict resolution, role specification and monitoring, in addition to incentive systems (Heide, 1994). Implementation of appropriate monitoring, for example, can suffice in situations where the relationship has been damaged. One possible research proposition is: When there is relational damage caused by misbehaviour, there is a positive association between the reliance on hierarchical governance and the implementation of administrative control mechanisms, verification efforts etc. in an attempt to reduce the risk for such damage in the future (Williamson, 1985). Another possibility is to examine whether an ethical climate enhances ethical rather than unethical behaviour (as proposed by Victor and Cullen (1988) for intraorganizational relationships).

There are also other interesting insights generated in *intraorganizational* settings that can be explored in interorganizational relationships. For example, Ackroyd and Thompson (1999) suggest that trust building efforts can affect e.g. hierarchical governance, in that one party, when considered as

trustworthy, can benefit from operating in a high trust controlled autonomy regime (at the expense of the alternative - a direct control regime). An important property of hierarchical (*intraorganizational*) control mechanisms is that they produce an amplification of misbehaviour (Ackroyd and Thompson, 1999) - increased attention causes innovative behaviour, and employees adopt new ways of misbehaving (Leatherwood and Spector, 1991). On the other hand, low control may lead to a low degree of misbehaviour, but may also signal organizational weakness and, accordingly, signal an opportunity to misbehave (Verdi and Weitz, 2004). This might also be valid for SCRs. One possible research proposition is: Hierarchical governance in terms of control mechanisms amplifies misbehaviour in SCRs.

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Footnote

1

i: is the number of Actor A goals mediated by Actor B

j: is the number of Actor B goals mediated by Actor A.

α : Goal α_{Ai} = Actor A's goal number 1)

X: Motivational investment in a specific goal. X_{A3} = Actor A's motivational investment in her goal number 3.

Y: Switching costs. Y_{B1} = Actor B's costs of switching to another partner for reaching Actor B goal number 1.

Z: Number of alternative partners. Z_{B2} = Actor B's number of alternative partners for reaching her goal number 2.

FIGURE 1
Model

