

Governance mechanisms in inter-organizational relationships: domestic vs. international relationships

Governance mechanisms have been identified as a key element of business relationships. However little is known about possible differences between their use in domestic vs. international business relationships. In an empirical study the authors compare the use of five governance mechanisms (contracts, value-creating norms, value-claiming norms, specific investments and trust) and their impact on business customers' satisfaction and commitment in relationships between German suppliers and sellers vs. relationships between German customers and foreign sellers.

Keywords: contracts, value-creating norms, value-claiming norms, specific investments, trust, satisfaction, commitment, governance mechanisms

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In order to reduce the risk of opportunism in inter-organizational business relationships, governance mechanisms need to be implemented. Typical governance mechanisms used in business-to-business relationships are formal written contracts, relational norms, specific investments, pledges etc. The design of the governance structure for a given exchange relationship represents a strategic decision which both parties in the dyad need to work on jointly. The extant literature on the management on industrial buyer-supplier relationships comprises a series of contributions which enable us to draw a fairly clear picture of the individual governance mechanisms, their relative importance for the performance of a relationship, and the conditions under which certain governance mechanisms should be used. Most of the empirical studies in this context have been conducted in national settings, particularly in the US and Europe. Research on governance mechanisms in international business relationships is rare. This paper aims at a better understanding of governance issues in international business relationships. Our aim is to analyse whether the governance structures used in such relationships and the performance impacts of specific governance designs are identical in domestic and in international relationships or whether specificities exist.

The governance of buyer-supplier relationships

Governance mechanisms are safeguards that firms put in place to govern inter-firm exchange, minimize exposure to opportunism, protect transaction cost investment and promote the continuance of relationships (Jap & Ganesan, 2000). Several studies have provided empirical evidence that the type of governance mechanisms implemented in a specific relationship has a significant impact on key outcome variables, such as satisfaction, commitment, or profitability. In this research, explicit contracts, specific investment, social norms and trust will be discussed as mechanisms that either inhibit opportunistic behavior or induce long term orientation within a given relationship.

Contracts are often considered to represent the fundamental structural dimension in relationships (Ness & Haugland, 2005), and they are widely used as regulators in business exchanges. The contract-based approach emphasizes the use of formalized, legally-binding agreements to govern the inter-firm partnership (Lee & Cavusgil, 2006). Relational contracts are based upon the assumption that formal contracts are incomplete by definition. As Macneil (1980) argues, in relational exchange a person cannot anticipate all contingencies and design complete contracts. The relational contracting perspective supports these incomplete contracts as it replaces discreteness by relational norms (Hagedoorn & Hesen, 2007). These norms or tacit assumptions allow the exchange parties to develop a long-term orientation and can be divided into norms which control value-creating behaviours and norms controlling value-claiming behaviours (Kaufmann 1987, Ivens 2006). It is also important to note that it does not mean that relational exchanges imply merely normative contracts (norms) are governing exchanges (Lusch & Brown, 1996). Indeed, some scholars find that formal contract and relational governance function as complements (Poppo & Zenger, 2002). Transaction-specific investments or “idiosyncratic investments” are such investments that are highly specialized to the given exchange context and not easily (or impossible) to re-deploy. In other words, they

would have little value in other relationships. The actor concerned would suffer loss of substantial value if the relationship was terminated. By making the specific investments in a relationship, the party creates an incentive to maintain the relationship (Anderson & Weitz, 1992). If the other party also invests specific assets in the exchange we observe “reciprocal investment” or “mutual investment”. Such investment can convert a competitive relationship into a cooperative relationship (Anderson & Weitz, 1992). Trust is defined by Moorman, Zaltman & Deshpande (1992) as “a willingness to rely on an exchange partner in whom one has confidence” (p.315). They argue that trust should be interpreted in two dimensions: a belief or an expectation about an exchange partner or as a behavioral intention. These two dimensions are supposed to be present for trust to exist, otherwise, trust is limited (Moorman, Deshpande & Zaltman, 1993). Trust is also defined as the perceived credibility and benevolence of a target of trust (Ganesan, 1994; Doney & Cannon, 1997). This reflects two distinct components: credibility, which is based on the extent of one party’s expectancy on the partners, and benevolence, which focus on the motives and intentions of the exchange partner. Both of these definitions have an insight into the importance of confidence. The literature suggests that confidence on the side of the trusting party results from the firm belief that the trustworthy party is reliable and has high integrity (Morgan & Hunt, 1994).

The management of international buyer-supplier relationships

Summarizing the research on international relationships in the 1980s, Douglas and Craig (1992, p297) state: “While the management of buyer-seller relationships has become an increasingly important issue (...), the complexity of buyer-seller relationships in an international context has been sadly neglected”. This is astounding, given that empirical studies reveal important effects of the international setting on relationships. For example, they show that, as compared to domestic relationships, in an international context: (a) the frequency and intensity of contacts between buyers and suppliers are lower (Johanson & Wootz, 1986; Håkanson, 1986; Hallén, 1986), (b) the social distance between the parties to a relationship is higher (Johanson & Hallén, 1989), (c) the willingness for adaptation and investments into the relationship is lower (Cunningham, 1986; Valla, 1986; Hallén, Johanson, Seyed-Mohamed, 1987), and (d) the average duration of buyer-seller relationships is lower (Spencer, Wilkinson & Young, 1996).

More recently, authors have conducted more focused studies. For example, Friman, et al. (2002) did a research based on the commitment-trust theory in the service sector. They suggest the entrepreneurs are open-minded for cultural differences and develop strong interpersonal relationships in international trade in order to reduce uncertainty. Spencer et al. (1996) find similar results in industrial supplier-customer relations.

Research on the governance of international buyer-supplier relationships

At the intersection of the two fields of research (relationship governance and international relationship management) described above, only few studies have been published. Bello and Gilliland (1997) find that certain nonmarket forms of governance – output control and flexibility – enhance the performance of international distributor relationships. Homburg et al. (2002) analyze customer satisfaction in buyer-supplier relationships across national boundaries for manufacturing firms. They observe that perceived quality and flexibility are

important antecedents of satisfaction, and more importantly, perceived quality and perceived information sharing would have low levels in transnational relationships compared to domestic ones. Zhang, Cavusgil and Roath (2003) find evidence that supports trust and relational norms create relationship specific adaptations in the export market. Finally, Andersen and Buvik (2001) find that environmental uncertainty is stronger related to inter-firm co-ordination in international buyer-seller relationships compared to domestic ones.

Summarizing, we observe that while there are substantial bodies of research on, on the one hand, governance mechanisms and, on the other hand, international buyer-supplier relationships as isolated topics, scholars have attributed little attention to the design and the effects of governance structures in international buyer-supplier relationships. With this paper, we intend to contribute to closing this gap.

Design of the empirical study

The study is based on a written survey among managers involved in professional purchasing processes. In order to control for environmental influences it was conducted in a business-to-business setting. Two supplier industries were selected. The packaging industry represents a classical industrial goods market whereas the market research sector was chosen as an industrial service market. In both industries, long-term relationships play an important role.

Questionnaires were distributed to purchasing managers for packaging goods on the leading international trade show. Potential participants were identified at the entrance, asked to complete the questionnaire at their office and to return it within four weeks. On the market research side questionnaires were sent out to those members of a leading national market research association who are concerned with the purchasing process of market information. Participants were asked to select one important supply relationship and to answer all questions referring to this one supplier. Selection criteria were relationship duration (at least two years) and the supplier's economic importance to the customer company. The response rate for the packaging sample was 28.5 %. In the market research sample it amounts to 31.9%. Empirical results are based on a total of 297 questionnaires. These questionnaires are completely filled-in. An analysis of potential non-response effects (Armstrong and Overton 1977, comparison of early vs. late responses) revealed no significant differences concerning the core constructs. In all cases, the respondents had been concerned with the relationship for at least two years, so that we assume that they are knowledgeable. The responding customer companies cover all three major industry sectors (industry, retail and services). The sample consists of SMEs as well as large companies. The size structure of the supplier companies is closely correlated to the relative importance of these types of companies in their markets. Hence, sample representativity appears to be established.

All relevant governance constructs were operationalized based upon measurement instruments documented in the extant literature. Scales which had initially been developed for alternative research settings (e.g. channel relationships) needed to be reformulated to fit the two industries selected for this study. Nationality of business partners refers to the number of supplier employees which are not German. This information was measured as a percentage number. International business relationships refers to those cases in the sample whose suppliers are partly foreign, majoritarily foreign, and completely foreign companies.

Headquarters of supplier represents the location of headquarter of the supplier company. In our sample, headquarters are located in Germany (200), Switzerland (3), the United States (40), France (23), the United Kingdom (19), and other countries (11), thus on total 296 cases. For this question of the study, only supply companies located in Germany were regarded as domestic partners. Finally, two dimensions of relationship quality, satisfaction and commitment, were operationalized and included in the study. Again, scales were taken from the extant business marketing literature.

In order to test the questionnaires usability, in a pre-test phase all scales were intensively discussed and where necessary modified in interviews with buyers as well as sellers from both supplier industries. This process led to the final questionnaire which was pre-tested again with a different set of buyers and sellers from both industries. Scale reliability was tested in two steps. First, coefficient alpha was calculated. All scales fulfil the generally accepted criterion of $\alpha > 0.7$. In addition, each construct was assessed using confirmatory factor analysis. The results (factor reliability, average variance extracted, t-values) equally meet the criteria formulated in the literature.

Results of the empirical study

In a first step, in order to verify the impact of supplier internationality on the level of usage of governance mechanisms, independent-sample t tests were conducted. These analyses were done for two constellations: in the first case, we distinguished between domestic and international relationships based on the nationality of a supplier's employees (table 1), in the second case we distinguished between national and international relationships based upon the location of the supplier's headquarters (table 2). The result of the first five t-tests between the sub-samples show that significant differences exist concerning the level of trust (at 95% confidence level), for value creating norms (at 99% confidence level) and for value claiming norms (at 99% confidence level) for domestic vs. international relations. The second five t-tests confirm trust and value-creating norms as those variables where significant differences exist. In addition, significant differences are found for the three other variables.

Table 1

Differences between the means for the two sub-groups across five governance mechanism (on the nationality factor)

Governance mechanism	Mean relationships)	(domestic Mean relationships	(international Sign.
Specific investments	3.278	3.292	0.934
Trust	4.886	4.489	0.001**
Formal contracting	3.759	3.722	0.850
Value creating norms	4.688	4.215	0.000**
Value claiming norms	4.783	5.133	0.008**

**Significant at $p < 0.01$

Table 2

Differences between the means for the two sub-groups across five governance mechanism (on the headquarter factor)

Governance mechanism	Mean (domestic relationships)	Mean (international relationships)	Sign.
Specific investments	3.517	2.797	0.000**
Trust	4.922	4.387	0.000**
Formal contracting	3.628	3.977	0.085*
Value creating norms	4.745	4.047	0.000**
Value claiming norms	5.083	4.854	0.094*

**Significant at $p < 0.01$

*Significant at $p < 0.1$

We also examine how the internationality of supplier impact on the relationship quality perceived by the customer. Through t-test analysis this report tests whether observed mean of relationship quality (customer satisfaction and customer commitment) in domestic and international relations are statistically significant. The findings reveal that there exist structural differences between domestic and international relationships regarding customer satisfaction and customer commitment. In general, both customer satisfaction and customer commitment were somewhat lower in international business relationships than in domestic ones. Table 3 describes the differences between the means for the domestic relationships vs. international relationship of relationship quality.

Table 3

Differences between the means for the domestic and international relationships of relationship quality (customer satisfaction and customer commitment)

Relationship Quality	Mean (domestic relationships)	Mean (international relationships)	Sign.
Nationality			
Customer satisfaction	5.000	2.797	0.004**
Customer commitment	4.640	4.387	0.000**
Headquarter			
Customer satisfaction	5.041	4.587	0.000**
Customer commitment	4.527	3.683	0.000**

**Significant at $p < 0.01$

In a second step, in order to test the way how governance mechanism are related to relationship quality, and how it varies between “national relationships” and “international relationships”, multiple linear regression analyses were conducted. The predictors were the five governance mechanisms: specific investments, formal contracting, trust (customer in supplier) and two types of norms (value claiming norms and value creating norms). The basic models were as follows:

$$Satisfaction = \beta_0 + \beta_1 SpeInv + \beta_2 Trust + \beta_3 Contract + \beta_4 Norms1 + \beta_5 Norms2 + \varepsilon$$

$$Commitment = \beta_0 + \beta_1 SpeInv + \beta_2 Trust + \beta_3 Contract + \beta_4 Norms1 + \beta_5 Norms2 + \varepsilon$$

Where SpeInv is the specific investments made by supplier, Norms1 the value creating norms, Norm 2 the value claiming norms, ε the disturbance term, β_0 the intercept, $\beta_1 - \beta_5$ are the regression coefficients. Tests were conducted for national relationships and international relationships both for the employee nationality variable and the headquarter location variable for the two dependent variables. Thus, a total of eight regression models was tested.

The results of the multiple regressions indicate the regression equations were significant. Tables 4 and Table 5 present the estimated coefficients and t values of the eight models. For example, in model 1, the linear combination of customer satisfaction was significantly related to the five governance mechanisms, $F(5, 185) = 57.071$, $p < 0.01$. The sample multiple correlations of Model 1 and Model2 were 0.779 and 0.784, respectively, indicating that approximately 61% of the variance of the satisfaction in the sample can be accounted for by the liner combination of governance measures. In both regression models, three of the five governance mechanisms have a significant impact ($p < 0.01$) on customer satisfaction: trust, value creating norms and value claiming norms. This indicates no difference for domestic and international relationships regarding the impact of governance usage on customer satisfaction. The relationship between the three governance variables and customer satisfaction is significant and positive.

In terms of the consequences of customer commitment, both regression equations of Model 3 and Model 4 are significant ($F(5, 185) = 41.550$, $p < 0.01$; $F(5, 100) = 11.694$, $p < 0.01$).

However, the significance of different predictors varies by the type of business relationship (domestic vs. international). The effect of trust ($t = 4.827$, $p < 0.01$) and value creating on customer commitment is significant and positive ($t = 6.685$, $p < 0.1$) in domestic relationships. In international relationships, both value creating norms ($t = 4.977$, $p < 0.01$) and value claiming norms ($t = 2.095$, $p < 0.05$) have significant effects on customer commitment. On the factor of headquarter, trust ($t = 4.515$, $p < 0.01$) and two terms of norms ($t = 5.345$, $p < 0.01$ and $t = 2.789$, $p < 0.1$, respectively) have significant and positive effect on the customer commitment for domestic relations. However, value claiming norms and trust did not significantly related to the customer commitment in international relationships. In addition to the effect of value creating norms on customer commitment, formal contracting is also positively and significantly associated with customer commitment.

Table 4
Regression analysis – Separate analysis of
relationships (on the nationality factor)

Independent Variables	Domestic Coefficients
Constant	0.114
SpeInv	-0.00
Trust	0.29
Contract	-0.00
Norms1	0.50
Norms2	0.13
Model fit	F(5) R^2_{Adj}

**Indicated significant at $p < 0.01$

*Indicated significant at $p < 0.05$

Table 5
Regression analysis – Separate analysis of
relationships (on the headquarter factor)

Norms2 0.136

Model fit F(5, 100)
R² Adj. 0.136

**Indicated significant at p<0.01

*Indicated significant at p<0.05

Discussion

The purpose of this study was to test whether the nationality of suppliers has an impact on the level of governance mechanism and perceived relationship quality, and the relationship between these two variables. The outset for this study was the observation that few empirical studies test governance structures in international buyer-supplier relationships. The only important empirical study analyzing governance structures in international buyer-supplier relationships (Homburg et al. 2002) does not take into account the differentiated perspective on norms. The present research intends to focus on the norms, as well as other governance mechanism in international business relationships.

The first conclusion of the research is that the means for the usage of several control mechanisms are significantly different. More specifically, trust (customer in supplier), value creating norms and value claiming norms would have a relative lower level in international as opposed to domestic relationships in both cases. Only formal contracting has a higher level in international business relationships. One potential reason could be that in the international business settings, the perceived environmental uncertainty (e.g., government policies, legal system etc.) would be higher compared to the domestic ones. A second reason is that the behavioral uncertainty is anticipated to be substantial in international business relationships and low/moderate in domestic dyads because the lack of opportunities for disclosure of information and the options for strategic misrepresentations are likely to be more evident in an international setting (Andersen & Buvik, 2001). Therefore, higher degree of formal contracting may be required as regulations.

Second, the effects of internationality of supplier on the perceived relationship quality were examined. The mean of two items which are assumed as good indicators of relationship quality - customer satisfaction and customer commitment showed statistically significant differences between domestic and international business relationships. Both customer satisfaction and customer commitment have lower levels in international as opposed to domestic relationships. Customer satisfaction has been defined as “a positive affective state resulting from the appraisal of all aspects of a firm’s working relationship with another firm” (Anderson & Narus, 1984, p66) Purchasing companies in international relationships tend to be required to expend higher input and are more likely to have lower expectations such as product quality because of cultural differences, language problems, technological and geographical distance. This result is in line with Homburg et al.’s (2002) findings.

Furthermore, we examined the way how governance mechanisms are related to relationship quality varies between domestic and international relationships through multiple regression analysis. The findings revealed that the use of governance mechanisms in both relationships significantly impacts the relationship quality. Three variables have a significant and positive effect on customer satisfactions: trust, value creating norms and value claiming norms. This result is consistent with the second conclusion given the background that the level of trust, value creating norms and value claiming norms is significantly lower in international relationships. With regarding to the customer commitment, there exists difference between domestic and international relationships. Trust is significantly and positively related to customer commitment in domestic relationships, while formal contracting is a good predictor in international business settings. As previously noted, an international relationship indicates less available knowledge about the actions of the business partners, customer may turn to formal contracting to constrain the partner’s opportunistic behavior; whereas in domestic relationships, customers are willing to contribute to the long-term relationship by “self-enforcing” in an exchange appropriation concerns. Besides, two types of norms are important indicators for customer commitment in both cases. One interesting finding is that among the five governance mechanisms, value creating norms seem to be the best predictor for relationship quality in both types of relationships. This suggests companies should focus more on the value creating items with their business partners.

As in every empirical study, several trade-offs had to be made when designing the survey. We acknowledge the limitations which these trade-offs cause. First, our study only considers two

industries. The generalizability of our results is, hence, limited. Second, we only included customer companies in our sample. The literature on multiple respondents suggests however that supplier and customer views may be diverging. Third, although satisfaction and commitment are key outcome variables in the management of business relationships they do not predict precisely the level of economic profitability in a relationship. Hence, our results are limited to the pre-economic domain. Finally, we focus upon a limited number of governance mechanisms and criteria for defining nationality. Other variables could be used. All of these limitations present avenues for potential future research projects.

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