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## Internet-Based Market Places and Buyer-Seller Relationships: Governance Implications

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### Abstract

The recent emergence of internet-based electronic market places is changing the structure of traditional marketing channels in a fundamental way. Collaboration may increase because of lower transaction costs related with increased information availability. At the same time these same factors, through the effect they have on mutual dependency and uncertainty in the buyer-seller dyad, are considered to be key drivers of a shift towards a market-type of governance of buyer-seller relationships. Understanding the impact Internet based electronic marketplaces have on buyer-seller relationships is of crucial importance for the success of such market places as well as for buyers and sellers to fully exploit the benefits. In the present paper a theoretical framework is presented to investigate the main effects of internet based marketplaces on the governance of buyer-seller relationships.

**Keywords:** exchanges, inter-firm relationships, dependency, governance structure

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## 1 Introduction

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“ The marketing channel is an inter-firm system whose members, by an exchange of outputs and negotiated roles, are involved in the process of making a product available for consumption ” (Dwyer and Oh 1988). Producers and distributors depend on each other’s outputs, such as information, (physical) products, financial support, marketing and logistics activities. Channel participants therefore are involved in managing relations with complex interchange patterns of outputs of different nature. Some of the factors that further complicate the management of these interchange relationships are to be found in unbalances in power, unbalances in the amounts invested in the relationship, environmental and behavioural uncertainty, different degrees of operational integration.

In the last decade much research and practice has shown (Ganesan 1994, Jap 2001) that building long-term relationships between suppliers and manufacturers, or distributors, can be a key success factor for firms to achieve efficiencies and create competitive advantage.

‘ long term close relationship structures and the ongoing management of them impacts key outcomes such as satisfaction performance commitment and overall relationship functioning. All of these are relevant to the long- term viability of supply chain relationships.’(Jap 2001).

Developing long term relationships with a restricted number of suppliers or buyers based on trust and mutual commitment is necessary because of the consistent transaction specific investments to be made e.g. in inter-organizational information systems, or necessary to set up and maintain contracts with a large number of suppliers, or clients.

With the advent of electronic markets, and in particular of industry-specific internet-based market places, or industry web-based networks (hereafter IBMP) these costs are deemed to be much lower (Bailey and Bakos 1997). The promise these new intermediaries make to their customers is increased collaboration made possible through the availability of -non relationship specific- facilitating software (or license availability), increased information access to alternative exchanges and markets as well as a range of other functionalities to support buyer-seller collaboration<sup>3</sup>.

In this paper we analyze how the governance of existing collaborative dyadic industrial buyer-seller relationships are affected by the introduction of IBMP’s.

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<sup>3</sup> See [www.elemica.com](http://www.elemica.com), or [www.covisint.com](http://www.covisint.com) for an example.

## 2 The Emergence of Internet-Based Electronic Market Places, and their consequences for buyer-supplier relationships

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The main IBMP's are industry specific (vertical) IBMP's, where manufacturing and finished goods which are of strategic importance for the buying company can be exchanged, and where transactions occur on a frequent basis. The functionalities IBMP's offer, range from transaction based kind of procurement activities (e.g. auctions and reversed auctions) to relational exchange collaboration support like the implementation of information exchange systems to gain logistic advantages, collaborate in product development and introduction, category management and other supply chain activities. Support involves not just exchange of messages, but activities which can be automatically generated through the IBMP, like logistic capacity optimization.

Although the exchange is usually set up by third parties, in many cases the IBMP is sponsored by a base of suppliers and or retailers, this being a key factor for generating business through the marketplace. Nevertheless despite considerable investments being made and the promises of efficiencies to be gained and of support being offered to collaborative integration, IBMP's are so far not big generators of liquidity (Wise and Morrison 2001). More in general with IBMP we thus refer to web-based networks which offer matching, aggregation and supply chain support activities to one specific industry.

The number of IBMP's has been developing exponentially since their appearance about 1997. A major, and one of the first IBMP's is Covisint . This IBMP has been set up to joint forces of car manufacturers in the procurement of automotive parts. It is now claiming to offer solutions that range from auctions to supply chain integration, procurement and product innovation ([www.covisint.com](http://www.covisint.com)). Other examples of major IBMP's are Elemica, in the chemical industry, or Transora and Retailexchange in the consumer packaged goods industry, Fashionworld in the fashion industry and e-steel in the metal industry.

IBMP's are said to affect markets and buyer-seller relationships in several ways. Through IBMP's geographical dimensions can change. Markets can become more transparent, costs of specific channel activities can change and the costs of switching between (different type of) channel partners can be affected (Rosson 2000, Sawney and Kaplan 2000).

IBMP's allow buyers and sellers to:

- Have access to up-to-date information about markets
- Have easier access to third parties
- optimise logistic infrastructures thus reduce transportation costs
- Implement inventory management and order fulfilment systems
- Online benchmarking
- Overall reduce transaction costs

In other words it offers a source of information that was previously too costly to achieve and creates opportunities to streamline all kind of post-sales activities because of collaboration support functionalities.

Collaborative efforts between buyers and sellers are of utmost importance to create new business opportunities through for instance joint product development or joint marketing activities and to reduce costs involved in everyday exchange activities; in spite of the many potentialities of the internet, we think these new platforms render collaborative relationships more difficult to manage because of the following mechanism:

- ?? Firms do not have to have proprietary software
- ?? Have easier access to information on alternative exchange possibilities
- ?? Have easier access to industry/market information and increase time to market

### ***1) No Proprietary software: lower asset specific investments***

Many business processes internal and external to the firm, are being carried out through IT systems like ERP (Enterprise resource planning) or EDI (Electronic Data Exchange) and the like. Now firms have invested a lot in the implementation of such systems; having to buy and use such systems requires a great deal of time and money. In particular for inter-firm relationships this presents a crucial issue also for the governance of buyer seller relationships because these investments constitute relationship specific investments, i.e. investments which are not redeployable outside that particular relationship (Williamson 1979)

The issue of asset specificity plays a crucial role in the shaping of inter-firm relationships both in the marketing channels literature and in the information systems literature. Reasons for this is mainly that given the variety of such interfirm systems when two firms decide to communicate through one specific system, their processes must be encoded to communicate with that particular system and this means that communicating electronically with clients or supplier having different systems becomes difficult. Relationship specific assets are considered to be an antecedent of long-term orientation (Ganesan 1994), or commitment and Trust between organisations (Morgan and Hunt 1994).

Through the internet firms have access to web-based software through which it is possible to communicate with other firms without having to adapt internal processes to different communication standards (note: XML are open standards to translate encoding) and invest in these particular system (Hagel III and Brown 2001), and as a consequence in that particular buyer-seller relationship. On the one hand this permits to reduce costs and streamline more easily and faster inter-firm exchange processes. On the other hand the fact that firms are less prone to show long-term commitment to the relationship acts as a limitation; when 'lock -in' effects are created by relationship-specific investments, firms are expecting to pursue the relationship because these investments constitute a safeguard for opportunistic behaviour (Williamson 1997). Firms will be less willing to exchange

relevant, strategic data to support joint activities aimed at creating value through new business opportunities.

*2) Increased access to alternative exchange possibilities: reduced mutual dependency*

In the 'off-line' world (Actually the world without the internet), looking for alternative business partners requires having a network of contacts, going to fairs, search costs are an important deterrent from switching business partner. In the online world (where companies have access to the World Wide Web) search costs are deemed to be considerably lower. Through internet based electronic market places a company can not only have access to catalogues of companies which meet the exact specifications needed, world-wide, they can also make use of functionalities such as web-based auctions, and reversed auctions to bundle orders and gain negotiating power. This kind of transactional functionalities have a fundamental impact on inter-firm collaboration (Jap 200). IT is like a fair being open 24 hours a day, without having to move from the office.

In the marketing channels literature, the concepts of the comparison (of the relationships with one specific business partner) with alternatives and the availability of alternative resources are crucial determinants of the satisfaction with one business partner (Thibaut and Kelley 1959, Anderson and Narus 1990) satisfaction being an important indicator of the willingness of firms to pursue the relationship (Gladstein 1984).

Through the Internet firms will feel to be less mutually dependent, because of increased alternatives for exchange; this can be a deterrent from exchanging relevant information to engage in joint actions to collaborate in product development or other marketing activities.

*3) Increased information availability and uncertainty about the environment and the business partner*

Through the internet a load of extra information is disposable about industry news, product characteristics, markets, suppliers and clients. As a result of increased quantity of information (because of technology i.e. internet), a greater level of complexity is faced by who has to make decisions based on such information (Palme 1984, Shulze and Vandenbosch 1998).

Uncertainty and complexity can be either related to Human behaviour or unpredictable events. They are both the outcome of an unequal *distribution* of information between the actors involved in the transaction (Cordella 2001). Unpredictability of technological change and future events is higher, and more information about market circumstances and alternative exchanges increases uncertainty about the behaviour of the channel partner. More information means also and more information to coordinate and thus more co-ordination costs, which firms must be willing to embark on.

Because of the increased alternative exchange possibilities, and mainly because of the increased market and industry information, of e.g. price levels, firms could be more afraid of their partner to behave in an opportunistic fashion.

In the marketing literature (in particular in the Transaction Costs economics approach) specific assets, uncertainty and dependency are key variables for understanding the governance of inter-firm relationships. To understand how the internet affects and changes the way inter-firm relationships are shaped we must first define what we intend by governance; after we will present a general research model and explain the hypothesized relationships.

### 3 Conceptual framework

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In the academic literature, research on buyer-seller relationships - has mainly been addressed from two perspectives: economic and socio-psychological. In this study we will combine the two perspectives. In the economic approach, transaction costs theory has been extensively used to explain the existence of different inter-firm organizational forms (see Reindfleisch and Heide 1994 for an overview). From a sociological perspective insights from social exchange theory have been applied to understand why and how parties engage in exchange relationships (mainly deriving from the work of Thibaut and Kelley 1957 or Blau 1964, Emerson 1962), and the impact of power sources and exercise on the compliance of channel partners (Hunt and Nevin 1974, Gasky 1984).

Transaction costs theory has also been a basic tenant of much Information Systems literature (a.o. Malone et Al, Sakar et al. 1997, Benjamin and Wigand 1997).

In this stream of research electronic integration between firms is seen as a form of governance (Malone Yates and Benjamin 1987); mainly efficiency based arguments are used to explain the adoption of inter-organizational systems (IOS) like Electronic Data Interchange systems (Zaheer and Venkatraman 1994, Bakos 1991, 1993) and in this respect IBMP's offer tremendous opportunities for a radical reshaping of distribution and marketing channels (Christiaanse and Kumar 2000).

In the following a conceptual model will be presented to analyze the effect of a change in dependency structures and uncertainty on the governance structure of collaborative agreements and ultimately on the willingness of firms to further engage in such kind of collaborative agreements.

#### Governance structure

Governance structures (a.o. Heide 1994, Robicheaux and Coleman 1994, Williamson 1979) describe the way buyers and sellers define and shape collaborative agreements and therefore forms the core variable of our study. Governance has been defined as : "The institutional framework within which the integrity of transactions is decided." ( Williamson 1979) That is the ex ante as well as ongoing shaping and management of inter-firm relationships (a.o. Anderson and Jap 2001, Heide 1994, Wathne and Heide 2000). In a collaborative relationship, or *working partnership*, the way risks and benefits are shared and operational as well as decision making processes are structured should have a major impact on the assessment by the parties involved over the relationship and on their willingness

to pursue the relationship on a mutual basis (Anderson & Narus 1990). When looking at collaborative agreements between firms, we interpret governance in terms of: which resources are shared, and how is the decision making process organized. Elaborating from a framework outlined in Robicheaux and Coleman 1994, we distinguish between levels of process integration and relational integration.

*Process integration* defines the extent to which the various stages in the business process are integrated and information on current processes is being exchanged (Noordwier, John and Nevin 1990, Robicheaux and Coleman 1994). Information exchange to achieve process integration is mainly addressed to reducing costs of trade, i.e. costs related with day-to-day exchange of goods, information and money.

*Relational integration* is related to the allocation and co-ordination of marketing channel functions; the choice of specialized relational governance structures is aimed at reducing transaction costs which arise due to the need to safeguard specific assets in conditions of uncertainty i.e. to reduce ex-post bargaining costs (Artz and Brush 2000). Parties can decide to allocate decision responsibilities in a hierarchical or a more clan-like way (Ouchi 1980). When relational integration is low, decision making processes rest at one side of the dyad, when it come to a specific issue; it reflects a governance form where e.g. withdrawal of information is a preminent form of opportunism. On the other hand, when relational integration is high both sides of the dyad are willing to exchange relevant information, and share responsibilities in a trustful fashion and on a mutual basis.

Drawing from the work of Reve an Stern 1986, Dwyer and Oh 1987, 88, Ouchi 1980, among others, this form of integration is measured by the levels of:

- ?? participation, i.e. the degree of input in decision processes,
- ?? decentralization, i.e. to which extent decisional power is lying at the one or other channel partner,
- ?? formalization, i.e. the extent to which norms are formulated explicitly,
- ?? shared paradigm, or to which extent firm goals are shared

Firms having low levels of process integration are less likely to pose emphasis on relational integration; if operational processes are not shared firms will have little to discuss. On the other hand when operational integration is high, the structure of decision making processes can vary considerably and the degree of relational integration will have greater impact on the outcomes of the relationship.

#### *Factors influencing the governance structure*

There is a general consensus in Transaction Cost Economics (Reidfleish and Heide 1994, Geyskens, Steenkamp and Kumar 2001) that asset specificity, leading to mutual dependency of the trading partners, the frequency with which transactions take place and uncertainty are the key determinants of the form of governance.



*Dependency: availability of alternative resources and asset specificity*

Consistent with the findings of Frazier, Gill and Kale (1989) and more recently of Geyskens, Steenkamp, Scheer and Kumar (1996), a key dimension of *dependency* is the number of available alternative trading partners to the current one. Another key dimension of dependency consists in specific assets, which are investments not redeployable outside the relationship (Williamson 1979). Asset-specificity leads to dependency when they imply a lack of replaceability of the business partner, as Heide and John define it (1988): "the party with specific assets is potentially dependent on good faith non-opportunistic behaviour by the exchange partner".

In an IBMP business parties use the same open set of communication protocols, software and standardized information communication structure. Therefore with IBMP's the level of transaction specific investments in information technology is considerably lower than with Electronic Data Interchange systems (Christiaanse and Kumar 2000); the investments to be made in an IBMP can be applied in different buyer-seller relationships. Also ex-ante transaction costs relative to e.g. the search for viable third parties like marketing firms, transportation companies or consultancy companies, will be lower because of their availability through the IBMP in this case acting like a facilitating intermediary (Christiaanse, Sinneker and Mossinkoff 2001). These lower transaction specific investments will lower the relationship exit-barriers. It allows companies to switch more easily between available exchange parties.

Several studies have shown that firms perceiving to be less mutually dependent are less likely to engage in co-operative actions (Anderson and Weitz 1989, Robicheaux and El-Ansary 1975, Kumar et al 1995). We expect IBMP's to change this relationship. IBMP's offer exchange parties a standardized integrated platform, that they can use without making significant transaction specific investments, but allowing them to integrate operational processes. Higher levels of relational integration become relevant only when the operational integration is there. Lower levels of dependency however will impact the planning horizon in relationships negatively. Because of lower TSI, thus lower dependency and reduced long-term orientation business parties are less willing to share firm's goals, leave agreements unwritten (Dwyer and Oh1988) and invest time in discussing allocation of shared responsibilities.

*Hypothesis 1a: Participation in IBMP's will reduce the level of dependency between existing exchange parties.*

*Hypothesis 1b: Participation in IBMP's will increase levels of process integration.*

*Hypothesis 1c: Participation in IBMP's will reduce the levels of relational integration in existing working partnerships*

*Uncertainty* is “the difficulty of making accurate predictions about the future” (Achrol and Stern 1988, John and Weitz 1988, Celly and Frazier 1986). Uncertainty relates both to the environment and to the behavior of the exchange partner (Rindfleish and Heide 1997, Heide and John 1990). The first dimension, relates to how difficult it is to predict market conditions; mainly because of increased market and price transparency and diffused difficulty in foreseeing how the emergence of IBMP affects the industry (Forrester research).

The second dimension is related to difficulties in estimating the behavior of the exchange partner, and can thus be defined as relational uncertainty. As Williamson (1985) states it: ‘ Uncertainty of a strategic kind is attributable to opportunism and will be referred to as *behavioral uncertainty*’ Thus relational uncertainty refers to the fact that the behaviour of the business partner is more difficult to assess, and deterrents from opportunism harder to build into the relationship. As IBMP’s increase market transparency, offers alternative distribution opportunities and reduce the levels of mutual dependency, the need for compliance with established agreements will reduce; the introduction of an IBMP will therefore increase the perception of uncertainty for both producer and distributor on both dimensions.

As Pfeffer and Salancik (1978) note, "uncertainty itself is not problematic. Uncertainty is only problematic when it involves an element of critical organizational interdependence". Likewise, in the language of transaction cost theory, "an increase in parametric uncertainty is a matter of little consequence for transactions that are nonspecific" (Williamson 1985).

In circumstances of lower dependency, uncertainty will not influence levels of process and relational integration. If however exchange partners do depend on each other and there is uncertainty, they will strive for higher levels of integration because transaction costs necessary to safeguard from opportunism will be higher; they strive towards ‘relational exchange’ (Dwyer and Oh 1988). Results in Jap 2000 indicate that environmental uncertainty motivates suppliers to form collaborative exchanges with buyers, and motivates the dyad to create binding, relationship specific investments. Nevertheless since the change for opportunistic behaviour is greater in a collaborative relationship firms will be less likely to show trust and commitment to the relationship, and these sociological factors facilitate co-ordination efforts between firms while complementarities in the firm’s capabilities are a powerful incentive for joint collaboration and investments.

We expect the participation in an IBMP to increase uncertainty and to reduce dependency, to thus provoke a shift towards more market-like forms of governance (Malone, Yates and Benjamin 1987). It will induce a move towards a more ‘market like’ form of governance with lower levels of relational integration. Increased environmental uncertainty will withhold firms from attempting to establish long-term engagements; they want to retain the flexibility that may be necessary to turn to business partners with more appropriate marketing or technological capabilities (Malone, Yates and Benjamin

1987, Achrol, Reve and Stern 1983). Levels of process integration will still be high *ceteris paribus* because of higher standardisation and lower need for joint decision making.

*Hypothesis 2a: Participation IBMP's will increase the level of environmental and relational Uncertainty for firms involved in a collaborative relationship*

*Hypothesis 2b: Increased levels of uncertainty and the reduced level of dependency will have a negative effect on the levels of relational integration*

*Hypothesis 2c: Increased levels of uncertainty and reduced level of dependency will not influence any changes in the level of process integration.*

### Channel outcomes

In the marketing channels literature satisfaction is considered as a crucial outcome of marketing channel relationships (Frazier 1983a, Gaski and Nevin 1985, Anderson and Narus 1984, 1990, Geyskens Steenkamp and Kumar 1999). Firms being satisfied with the relationship are more willing to pursue the relationship and further engage in collaborative actions (e.g. Anderson and Narus 1990). Following the definition given by Anderson and Narus (1984) two aspects are evident: satisfaction is an affective state, and it results from the appraisal of all aspects of a firm's working relationship with another firm. Economic as well as non economic psychological aspects are considered by firms when deciding whether the relationship with another firm is being and will be satisfactory. Economic satisfaction is defined as a channel member's evaluation of the economic rewards that flow from the relationship with its partner, whereas non-economic satisfaction refers to the channel member's evaluation of the personal dealings with its exchange partner (Geyskens 1998). The firm's goal is in first instance economic in nature. When channel members are socially more satisfied with the relationship (non-economic satisfaction) they will be less likely to engage in search for alternative relationships (Dwyer, Schur and Oh 1987, Geyskens 1998).

Ring & Van de Ven (1994) claim that the way in which agents negotiate, execute and modify terms of an inter organizational relationship strongly influence the degree to which parties judge it to be equitable i.e. satisfying in a non-economic sense. Geyskens Steenkamp and Kumar (1999) found that higher levels of centralisation of decision making and higher levels of formalisation are associated with lower levels of non-economic satisfaction.

Therefore we separate for the effects of the governance structure on economic and non-economic satisfaction.

*Hypothesis 3a: Lower levels of relational integration have a negative effect*

*on non-economic satisfaction.*

Efficiency improvements will probably take place independently of the levels of uncertainty, dependency and decision making integration. They purely relate to the application of the basic functionalities of the IBMP's.

*Hypothesis 3b: Higher levels of process integration will have a positive effect on economic satisfaction*

We believe that through IBMP's uncertainty will increase and dependency will decrease because of higher information availability and increased alternative resources. Therefore firms are operating under more pressure. It is known that firms feeling under pressure have a lower degree of satisfaction than ones that are not (Gaski and Nevin 1985). Therefore it is hypothesized:

*Hypothesis 4: the level of non-economic satisfaction will be lower for firms participating in an IBMP*

#### Covariates

One important reason for firms not adopting new technologies is the legacy of extant investments previously made into EDI systems. Firms not big enough to make such considerable investments in the past are on the other hand more advantaged by the opportunities offered by the Internet since they are now able to implement systems just sharing the license with other IBMP's users, and not actually having to implement the software on its own systems.

Also there could be a substantial difference between firms which have a long relational history or which have just started investing in the collaborative relationship. Therefore we correct the model for the length of the relationship.

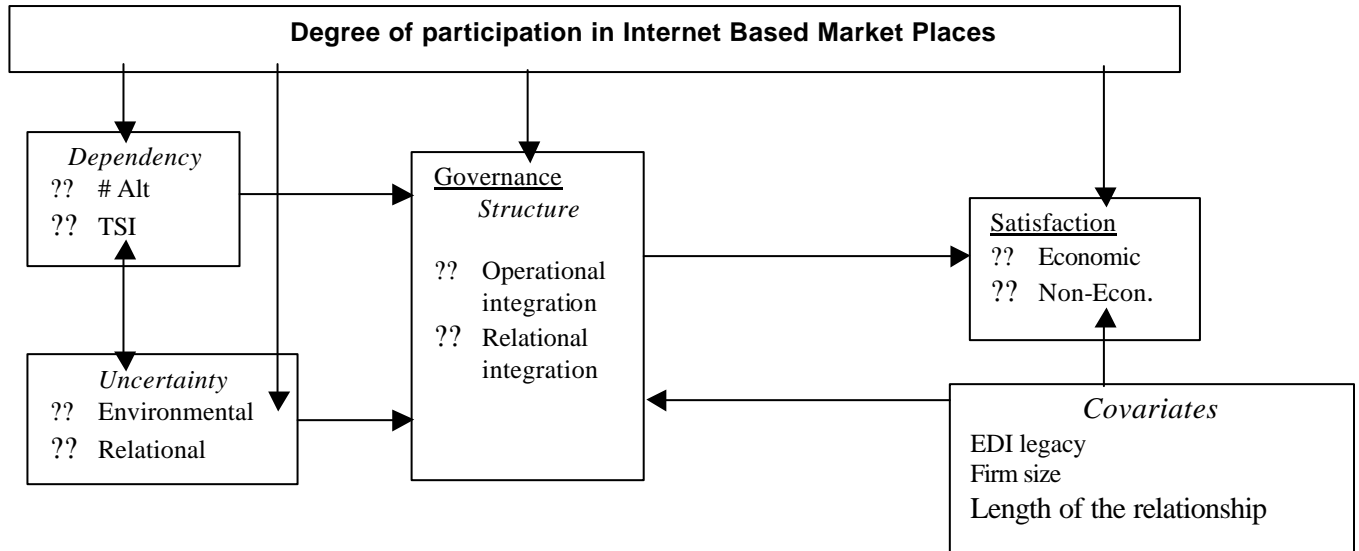
We have so far not mentioned transaction frequency. Following TCA specific assets make sense to invest in when the degree of utilization of these assets is high, and the benefits are too; in such case efficiency will be higher when transaction frequency is high. Empirical research does generally not find strong evidence for frequency being a determinant of governance forms. In this paper we consider that transaction frequency in collaborative agreements is high.

For these reasons we correct the model by adding the following covariates:

Firms size, EDI legacy, relationship length.

In figure 1 the variables and the relations in our model are portrayed.

Figure 1. Conceptual Model



$$GS+SAT=f(DEP+UNC+DEP \times UNC)+(FS+EDILEG+RL)$$

#### 4 Methodology

The model will be operationalized and tested in two industries, the food and the chemical industry. First of all we will conduct an industry analysis. The demand and supply side of these industries will be characterized and the position of the IBMP in the industry will be measured. In depth interviews with key informants of buying and selling companies and IBMP facilitators in the two industries will be held. Aim of this phase is to gain more insight in the dependency and uncertainty in the industry, the current and expected role of IBMP's, the expected benefits of IBMP's and the manager's concerns with IBMP's. Further we will further operationalize and test the constructs.

Secondly, a survey will be held in both industries to test the hypotheses. If possible the questionnaire will be spread before and after the adoption of the IBMP or a specific functionality of the IBMP by buying and selling partners. This quasi-experimental design allows us to measure the impact of changes in the IBMP on uncertainty, dependency, integration and channel outcomes.

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# Internet-Based Market Places and buyer-seller relationships: Governance Implications

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**Abstract:** The recent emergence of internet-based electronic market places is changing the structure of traditional marketing channels in a fundamental way. Collaboration may increase because of lower transaction costs related with increased information availability. At the same time these same factors, through the effect they have on mutual dependency and uncertainty in the buyer-seller dyad, are considered to be key drivers of a shift towards a market-type of governance of buyer-seller relationships. Understanding the impact Internet based electronic marketplaces have on buyer-seller relationships is of crucial importance for the success of such market places as well as for buyers and sellers to fully exploit the benefits. In the present paper a theoretical framework is presented to investigate the main effects of internet based marketplaces on the governance of buyer-seller relationships.

**Keywords:** Exchanges, inter-firm relationships, dependency, governance structure

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