Chapter 42
Investment in Transaction-Specific Assets and Opportunistic Behavior in a Chinese Supply Chain

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ABSTRACT

This chapter addresses the relationship between a supplier and the manufacturers that it serves, from the perspective of transaction cost economics theory (TCE). TCE deals with relationships between organizations, such as customers, manufacturers and suppliers. It states that investment in transaction-specific assets opens the door for opportunistic behavior by an organization's partners. Interpreted from the perspective of a supplier, the supplier's investments in transaction-specific assets, such as dedicated plant and equipment, workforce with transaction-specific skills and the development of transaction-specific relationships, will lead to opportunistic behavior on the part of the manufacturers that they serve, providing an environment where behaviors intentionally designed to take advantage of the supplier will flourish. Because the supplier will not be able to redeploy those investments to a different manufacturer if the relationship is discontinued, manufacturers will be motivated to capitalize on this vulnerability by employing behaviors such as seeking unfair price concessions, sharing proprietary information with competitors or other unethical behaviors. This study advances the application of TCE to the context of supply chain management by breaking investments in transaction-specific assets into investments in transaction-specific tangible assets, such as plant and equipment, and transaction-specific intangible assets, such as relationships and the development of human resources, and examining their impact on opportunistic behavior separately. These relationships are examined using a survey of 230 suppliers in the household appliances industry in China. Hierarchical regression analysis revealed that there was a positive relationship between suppliers' investment in transaction-specific tangible assets and opportunistic behavior by the manufacturers that they serve, but that there was a negative relationship between suppliers' investments in transaction specific intangible assets and opportunistic behavior by their manufacturers. The moderating role of contracts and relational norms was also examined.

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INTRODUCTION

What leads a manufacturer to intentionally engage in behaviors that take advantage of its suppliers? Although there is a substantial body of theoretical and empirical literature related to the benefits of supplier integration, anecdotal examples of manufacturers and suppliers that engage in behavior that is less than supportive of their partners are not unusual. Such behavior, which is known as opportunistic behavior, may include overt behaviors such as lying, cheating and demanding unfair price concessions, as well as more subtle behaviors, such as threatening to withdraw business, establishing the potential for legal action and sharing secrets with competitors.

The existence of opportunistic behavior in a supply chain presents a paradox. On the one hand, as effective supply chain design and management grows in importance in the global economy, the importance of supply chain integration has grown correspondingly (Jap, 1999; Bowersox, Closs & Stank, 1999). There is extensive literature supporting the role that supply chain integration plays in achieving competitive advantage (Bowersox & Morash, 1989; Lee & Billington, 1992; Morris & Calantone, 1991) and enhancing performance (Ahmad & Schroeder, 2001; Frohlich & Westbrook, 2001; Johnson, 1999; Narasimhan & Jayaram, 1998; Stank, Keller & Closs, 2001, Zhao, Nie, Huo, & Yeung, 2006). On the other hand, however, the very steps that a supplier takes to establish supplier integration may set the stage for opportunistic behavior by the manufacturers that it serves. According to transaction cost economics (TCE) theory, investments in transaction-specific assets create a transaction cost imbalance, which will be opportunistically exploited to benefit the partner organization. In a supply chain, this imbalance can be weighted towards either the customer or the supplier. In this chapter, we examine the situation where a supplier has made investments in transaction-specific assets, such as tooling or dedicated human resources, that are specific to a particular manufacturer. TCE predicts that the manufacturer will capitalize on its knowledge that these investments would be difficult to redeploy to a different manufacturer if the relationship were to end, engaging in opportunistic behavior to benefit itself.

Prior research has examined the effectiveness of contracts and relational norms in safeguarding against opportunistic behavior (e.g., Achrol & Gundlach, 1999; Jap & Ganesan, 2000). An effective contract prescribes appropriate behaviors for supply chain partners, as well as routines for the distribution of outcomes. Relationship norms provide a set of mutual expectations and understandings between supply chain partners, built upon a foundation of trust and the encouragement of long term cooperative behavior. Although such mechanisms are expected to moderate the positive relationship between investments in transaction-specific assets and opportunistic behavior, the previous empirical research on this relationship is quite inconsistent. For example, Achrol and Gundlach (1999) found that contracts did not limit the opportunistic behavior resulting from a partner's investments in transaction-specific assets, while relational norms did. However, Jap and Ganesan (2000)'s study showed that neither contracts nor relational norms had any effect. Thus, there is no clear conclusion about the role that contracts and relational norms play in safeguarding against the opportunistic behavior associated with investments in transaction-specific assets.

Part of the reason for the apparently contradictory results is that transaction-specific assets vary in their tangibility. For example, investment in plant, equipment and tooling dedicated to serve a specific customer is visible, and it is relatively easy to evaluate the value of the investment because the assets are physical and tangible in nature. In contrast, investments in time, the development of human resources to help better understand a supply chain partner's needs and customized processes to meet the customer's needs are much more difficult to value and fully account for (Nielson,

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