The Conditions under which a Supply Chain Relationship might create Economic Value

Honors Undergraduate Thesis

Presented in Partial Fulfillment of the Requirements for the Degree Bachelors of Science in Business Administration in the Undergraduate School of The Ohio State University

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The Ohio State University

2014

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Abstract

A more collaborative approach to supplier relationships has generally been thought to lead to opportunities for value creation as opposed to simply cost reductions. However, a vast majority of empirical studies which look to study this are conducted on a static basis which only permits an analysis of the general conditions under which some firms outperform others. Studies of this nature cannot capture the dynamic relational components inherent within knowledge intensive supply chains. As a result, these studies do not take place at the proper level to systematically study individual managers’ perceptions of potential value creation. Because of this, these studies cannot explain the enactment of a value creating, path dependent, creation entrepreneurial opportunity which could lead to a sustained competitive advantage. In my thesis, I attempt to address this research gap by providing theoretical evidence that when dialogical communication takes place between firms, the conditions are created which might lead to the formation of a creation entrepreneurial opportunity. In doing so, I show how learning might take place across firm boundaries which makes a contribution to extant work on the theory of firm boundaries by explicating the potential for a value producing external governance structure.
Acknowledgments

I would like to thank my advisor Tom Goldsby for all of his dialogical communication and wise professory advice, Roy Lewicki for reviewing an earlier version of this paper, and Matt Schwieterman for introducing me to the right people.
Vita

May 2014 .......................................................BSBA Logistics Management, The Ohio State University

Fields of Study

Major Field: Marketing & Logistics
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Introduction

“The Westerner and the Japanese man mean something different when they talk of “making a decision”. In the West, all the emphasis is on the answer to the question. Indeed, our books on decision making try to develop systematic approaches to giving an answer, To the Japanese, however, the important element in decision making is defining the question. The important and crucial steps are to decide whether there is a need for a decision and what the decision is about. And it is in that step that the Japanese aim at attaining consensus. Indeed, it is this step that, to the Japanese, is the essence of decision. The answer to the question (what the West considers the decision) follows from its definition. During the process that precedes the decision, no mention is made of what the answer might be… Thus the whole process is focused on finding out what the decision is really about, not what the decision should be” (Drucker 1974 p. 466-467).

In order to advance the logistics and supply chain management disciplines (Fawcett et al. 2011), scholars must find ways to address the fundamental questions central to competitive strategy (Fawcett & Waller 2011). One such question is: Why do companies exist? Zenger et al. (2012) frame this as the cognitive decisions of the entrepreneur/manager as attempting to identify a complementary bundle of assets, resources, and activities and governing this bundle through ownership and accessing the rest through market mechanisms. It is the use of market mechanisms which defines the
firm boundaries. Another question is: What leads to differential organizational performance? Barney (1991) frames this as firm resources which are valuable, rare, inimitable, and non-substitutable. Dyer & Singh (1998) frame this as dyad specific characteristics which increase the potential for relational rents.

Since the publication of Zenger et al. (2012), the theory of firm boundaries was primarily associated with transaction costs economics (Williamson 1985). This is largely associated with its long history of empirical success (Shelanski & Klein 1995, Geyskens et al. 2006). However empirical research on Japanese inter-organizational relationships does not align well with transaction cost logics (Dyer 1996). And TCE does not account for governance associated with interpretive uncertainty (Weber & Mayer 2014). Recent advances in the theory of firm boundaries, creation entrepreneurial opportunities, and the co-creation of value in business-to-business relationships provides the theoretical support necessary for a synthesis which might more clearly articulate the theoretical role of supply chain in the academic field of strategy and provide a stronger conceptual base with which to study transactions that do not neatly coincide with the market or hierarchies paradigm. In my thesis, I hope to make the first steps towards describing what that might look like.

**Literature Review**

Zenger et al. (2011) argue that a complete theory of firm boundaries must account for the cognitive decision of an entrepreneur/manager in assembling a value-creating
bundle of assets, activities, or resources. The boundary is defined as the distinction between the bundle which is “owned” and those which are accessed through market mechanisms. The manager must also make a decision in regards to how to access those resources via market mechanisms. When making the decision to access a resource through market mechanisms, managers must simultaneously address the questions associated with value creation while reducing the risk of opportunistic hold-up. TCE focuses on aligning contracts with transactions based on asset specificity to reduce the risk of opportunistic behavior. Less attention has been paid to developing a theory at the strategy level, which systematically captures the value creation associated with inter-organizational transactions. The most recent attempt to capture this construct comes from an inter-organizational conceptualization of competitive advantage (Dyer & Singh 1998), which is classified as a dynamic capability (Helfat et al. 2007). Firms that are skilled in managing these inter-organizational alliances are thought to have an alliance capability (Kale et al. 2002) and know how to learn to create value (Anand & Khanna 2000).

Alvarez & Barney (2014) describe creation opportunities as those that are enacted (Weick 1979) by an entrepreneur with customers, suppliers, and other stakeholders within a given context (Alvarez et al. 2013). The knowledge created within this opportunity must enable routines and innovative social behavior between those forming the opportunity and those adopting the opportunity (Edmondson et al. 2000, Crossan et al. 1999). Through the institutionalization of the routines enacted by the realization of the opportunity, firms have the ability to construct markets (Santos & Eisenhardt 2009, Khaire 2014).
Lambert & Enz (2012) provide a case study describing the role of cross-functional involvement in a business to business relationship between a large restaurant chain and its distributor. This relationship is framed within a service dominant logic (Vargo & Lusch 2004). The last sentence of the article is, “In this research, it was shown that financial gains can be achieved when B2B relationships are structured to facilitate communication across functions and firms” (p. 1606). The theoretical model of communication used to inform this study was the communicative practice of reciprocal value propositions (Ballantyne & Varey 2011). These authors propose that a communication as process instead of a communication as transfer model leads to the development of relationship specific history (Varey 1996, Ballanytne 2004). Kodish & Pettigrew (2008) also critique the communication as transfer model implied within most relationship marketing theory. Ballantyne & Varey (2006) frame dialogical interaction within a service-dominant logic, critique four of its foundational premises, and describe how companies use this interaction mode as a way to learn together.

Methodology

The impetus of this research was the disconnect that I noted between the assumptions made of the economic actors whose behavior is modeled by scholars in the fields of strategy and supply chain management. This difference in assumption, I believe, is the primary factor that leads supply chain scholars to encourage partnerships while strategy scholars probably would not. The strategy field, based in transaction cost
economics, famously makes the assumption of “self-interest seeking with guile”.

Although I am unaware of any explicit literature streams in the supply chain field which address this concern, the two seminal contributions in this field (Cooper et al. 1997, Lambert et al. 1998) emphasize the importance of information flow in order to facilitate coordination. At the strategy level, TCE would discourage this because the flow of information increases vulnerability and therefore the risk of opportunism. But yet supply chain as an academic field of study is growing and so is the increased emphasis on relationships in industry. So there must be something that TCE is missing. I think the answer lies somewhere in its assumption of “self-interest seeking guile”. Although I do not explicitly address trust in a social psychological sense in this research, I do frame the co-creation of value in business to business relationships as an example of a creation entrepreneurial opportunity. The mutual perception of a beneficial economic relationship is likely to lead to the positive expectations of future behavior, or trust.

I draw from three literature streams in conducting this research: the theory of firm boundaries, the entrepreneurial theory of creation opportunities, and the co-creation of value in business-to-business relationships. In order to show how supply chain relationships create economic value, it must first be framed into the theory of entrepreneurship because opportunities create the potential for the realization of economic value. In order to enact a creation opportunity, the parties must learn together, which is facilitated through the existence of social capital and dialogical interaction. So I frame two longitudinal supply chain studies within an organizational level learning framework consistent with a creation theory of entrepreneurial opportunities. Since TCE
is the primary approach to studying inter-organizational relationships at the strategy level, the theory of the firm has not yet been able to account for external governance structures which create value. Under TCE logic, contracts, or external governance structures, are written only to reduce the risk associated with opportunistic hold-up or appropriation. But as conceptualized here, under conditions of social capital and dialogical communication, external governance structures can produce value too.

Lambert & Enz (2012) and Henke et al. (2009) are the only two studies I could find which longitudinal data in order to capture the dynamic aspects of social behavior within a supply chain relationship. Lambert & Enz (2012) conduct a case study while Henke et al. (2009) conduct a correlational analysis. The dynamic behavior captured in these studies permit the application of a multi-level theoretical framework which explains how individual learning can lead to the institutionalization of innovative (or more valuable) behavior. Crossan et al. (1999) develop an organizational learning framework consisting of four processes; intuinging, interpreting, integrating, and institutionalizing; to describe how an organization renews itself and how its routines account for new learning. Lambert & Enz (2012) conceptualize value co-creation as a three phase cycle, the first of which entails the joint crafting of value propositions (Ballantyne et al. 2011) which are deemed attractive to both parties (Gronroos 2011). This would probably correlate with the integrate section of the organizational learning model, Crossan et al. (1999) write, “Through dialogue the group can evolve new and deeper shared understandings” (p. 529). Storbacka & Nenonen (2011) describe how actors might actively alter market configurations within a service-dominant logic. This would probably correspond with the
institutionalize section of learning (Crossan et al. 1999). Henke et al. (2009) found that automakers who were able to interface characteristics with their suppliers received higher price concessions than those that simply demanded one. In order to interface characteristics, the automaker must first form a shared understanding in order to develop knowledge in practice (Brown & Duguid 2001). This would probably correspond with the integrating section of organizational learning.

Results

Nahapiet & Ghoshal (1998) argue that, “organizations as institutional settings are conducive to the development of high levels of social capital relative to markets” (p. 256-257). And that it is these factors which constitute the “significant body of work that indicates organizations have some particular capabilities for creating and sharing knowledge, giving them their distinctive advantage over other institutional arrangements, such as markets” (p. 259). This article creates a binary distinction where the only possible options are markets, with “low” social capital, and hierarchies, with “high” social capital. Although this is a fruitful distinction, there still ought to be some sort of intermediate case whereby although there are two different firms, the social relations between are not classified as an arm’s length transaction. The relationships described in Lambert & Enz (2012) and Henke et al. (2009) would fall under this category.

Nahapiet & Ghoshal (1998) position their article by describing two mechanisms—the combination and exchange of information, which are moderated by
levels of social capital, and lead to the creation of intellectual capital. These mechanisms can be further broken down into their analytical components by framing them as dialogical interaction. Dialogical interaction is the process by which tacit knowledge re-articulates itself and becomes explicit. It is a crucial factor which can lead to organizational learning. Nonaka (1994) writes, “The dominant mode of knowledge conversion here is externalization. Theories of organizational learning have not given much attention to this process. Tacit "field-specific" perspectives are converted into explicit concepts that can be shared beyond the boundary of the team. Dialogue directly facilitates this process by activating externalization at individual levels” (p. 25). In a later review, Nonaka & von Krogh (2009) write, “Through knowledge conversion (e.g., externalization and combination), practitioners may discover new ways of defining problems and searching for solutions (Nonaka & Konno 1998; Leonard & Sensiper 1998)” (p. 645). Spender (1996) offers a similar epistemology within an organizational context yet incorporates the socially constructed subjective interpretations implied within firm boundaries. Khun (2013) describes knowing in practice within organizational communication studies.

The findings of Nahapiet & Ghoshal (1998) can be reframed from the combination and exchange of knowledge leading to intellectual capital into knowledge created dialogically (Tsoukas 2009). Where the findings would be repositioned by claiming that organizations hold advantages over markets due to the ease at which dialogical interaction can take place. But there is nothing keeping dialogical interaction
from taking place between firms, as I demonstrated in the methodology section. It just may happen to a lesser degree than within a single firm.

**Contribution**

Argyres & Zenger (2012), and colleagues (Argyres et al. 2012, Zenger et al. 2011) develop a rich and insightful synthesis of the organizational economics and capabilities literature consistent with an integrative approach to the value production choices inherent within asset bundling and governance decisions made by an entrepreneur/manager associated with the theory of firm boundaries. They clearly assume the role of economists and do not attempt to integrate any sort of unified sociological perspective associated with the theory of firm boundaries. In fact they “think that the joint efforts of both more sociological and economic reasoning can help provide us with a more holistic picture of markets” (Zenger et al. 2011 p. 104). Along those lines, these scholars suggest that future research might consider governance choices, learning and its effect on capability formation (Argyres & Zenger 2012) as well as the capability of governance (Argyres et al. 2012). My research was positioned consistent with neo-institutional theory (Scott 2013) and the institutional logics perspective (Thornton et al. 2012). It is based on well received theory on the organizational benefits of social capital (Nahapiet & Ghoshal 1998) and well received and immediately managerial relevant work on supply chains (Lambert 2014). I provide theoretical evidence that when market governance structures are structured to facilitate dialogical communication, the
conditions are created which might enact a creation entrepreneurial opportunity and result in economic wealth. As a result, supply chain scholars might offer an insightful approach to addressing the capabilities and structures associated with the formation of value in external governance decisions (Hitt 2011). Pitelis & Teece (2009) incorporate entrepreneurial attempts to create value into their conceptualization of the theory of the firm.

Kraaijenbrink et al. (2010) provide a review of the critiques of resource based theory. One of the future directions they suggest is to demarcate and define resources. Near the end of this section they write, “If we are to understand the complementarity and substitutability of resources in a firm, we need to consider the organization level as well. Some attempts at this have been made in the knowledge-based literature, and Spender and Grant’s work may deserve further attention. Spender’s (1994, 1996, 2005) distinction between individual and social knowledge points to crucial differences between individual and organizational resources. Grant (1996a, 1996b) provides the rudiments of a resource-based theory based largely on these differences” (p. 363). My research, although positioned relative to inter-firm relationships, articulates the importance of dialogical communication (Tsoukas 2009). And viewing the firm as a distributed knowledge system (Tsoukas 1996) whose ability to prosper in dynamically competitive environments is dependent on its ability to integrate knowledge (Grant 1996a), might make progress towards addressing this critique.

Another future direction proposed by Kraaijenbrink et al. (2010) is to incorporate a subjective notion of resource value. They cite Baker & Nelson (2005) and Foss et al.
(2008). My research was positioned to take into account the symbolic aspects of social reality (Ashcraft et al. 2009, Phillips & Oswick 2012) which serves as the socio-historical context in which sensemaking takes place (Weber & Glynn 2006). Baker & Nelson (2005) conceptualizes entrepreneurial bricolage which they define as “making do”, but I think of it as the process by which an entrepreneur constructs a valuable resource by thinking creatively and disregarding the socially conditioned conceptualization of use and finding a new use by combining it with something else. One of the constraints placed on entrepreneurs might be the lack of resources which are conceptualized as valuable. The authors write, “Most importantly, had [the entrepreneur in question] accepted the prevailing definitions of abandoned mines as a “dangerous nuisance” and hydroponic growth media as an “environment for growing plants, not animals,” without taking any action to test the limitations of these definitions, none of the unique services described above would have come to be” (p. 342). Definitions are socially constructed and the institutional logics perspective (Thornton et al. 2012) systematically separates the material from the symbolic to offer the beginnings of a general theory of institutional entrepreneurship (Wright & Zammuto 2013). Foss et al. (2008) work towards synthesizing subjectivism and the entrepreneurship of the resource based view by saying that entrepreneurship is a creative act based on the combination of heterogeneous team mental models (Mohammed et al. 2010). What this theory is lacks is the general societal level combination of symbols which govern sensemaking (Weber & Glynn 2006) and framing (Cornelissen & Werner 2014).
Future Research Directions

This research offers a theoretical explanation that a dialogical form of communication across organizations would tend to have the potential to lead to learning and the creation of entrepreneurial opportunities. In order to do this I had to position such that it was consistent with the inter-subjectivities associated with the symbolic, communicatively constituted or discursive, aspects of society. Inter-organizational relationships have been positioned as communicatively constituted (Korschman et al. 2012) or conceptualized as discursively constructed (Levina & Orlikowski 2009). The symbolic aspects of trust can also serve as the social reality through which trust is formed (Lewis & Wiegart 1985). Kroeger (2012) and Fuglsang & Jagd (2013) provide a more contemporary approach to studying trust as a socially constructed phenomenon.

There can be individual efforts associated with bridging the cognitive differences between actors (Dewulf & Bouwen 2012) or it can take place across organizations (Hardy et al. 1998, Barbara & Purdy 2013). Trust can be seen as a factor that leads to common organization or collective action (McEvily et al. 2003). Knowing in practice can enact collective action (Orlikowski 2002). Commonly held forms of sensemaking makes situations collectively and explicitly comprehended in words which can serve as a springboard for collective action (Weick et al. 2005). The quote that began my research was found in Weick’s (1995) seminal book on sensemaking.
In a recent review on sensemaking, Maitlis & Christianson (2014) write, “these [previously introduced empirical articles] suggest a consistent pattern regarding how sensemaking enables creativity and innovation in organizations. Keys to this link are sensemaking processes that actively engage actors in paradoxes and belief structures generated by disruptive or unanticipated events. Sensemaking creates linkages between elements of these equivocal frameworks which in turn allow the emergence of novel accounts of the organization and ways of doing business that trigger innovation” (p. 93). Sensemaking is grounded in identity, as people make sense of their world based on their socially constructed roles and how they define themselves. A supplier to an automaker can either define themselves as a part of a network identity with the supplier (Dyer & Nobeoka 2000) and sharing common goals despite being separate entities. Or they could see themselves as having completely antagonistic opposite goals and separate entities. Further research could consider the role of a common network identity as a predictor of the form of communication used which would then moderate the existence of trust and the managers actions which lead to this form of communication (Raelin 2013). Tsoukas (2009) writes, “A dialogue is more likely to be productive when the modality of relational engagement is adopted by those involved. In relational engagement, individuals take active responsibility for both the joint tasks in which they are involved and for the relationships they have with others (Anderson & Chen 2002, Cross et al. 2002, Gittell 2003)” (p. 945). Further research might consider the interrelations between communication, intersubjective meaning, identity, sensemaking, and trust within supply chains.
References


