

THE IMPACT OF CULTURE ON THE RELATIONSHIP BETWEEN GOVERNANCE AND OPPORTUNISM IN OUTSOURCING RELATIONSHIPS

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To address concerns of opportunism, outsourcing firms are encouraged to deploy contractual and relational governance. The individual and collective effects of these mechanisms have been previously examined but not in specific contexts. This study examines the effects of contractual and relational governance on provider opportunism, incorporating the moderating influence of a “shift parameter”—national culture. Our results reveal that contractual governance is more effective in individualistic and low uncertainty avoidance cultures. Relational governance is more effective in collectivist and high uncertainty avoidance societies. The individualism–collectivism dimension also moderates the joint effect of these mechanisms. While the mechanisms are generally complementary in mitigating opportunism, a singular focus on either contractual or relational can be just as effective under situations of high individualism and collectivism, respectively. Copyright © 2014 John Wiley & Sons, Ltd.

INTRODUCTION

The goal of our research is to understand *how* culture impacts the relationship between governance mechanisms and opportunism in outsourcing relationships. The outsourcing of noncore business processes has been acknowledged as potentially offering substantive organizational benefits. As such, outsourcing of business processes and services continues to grow as a prevalent business model (e.g., KPMG, 2012; NASSCOM, 2009). Notwithstanding the popularity of outsourcing, there are salient risks associated with outsourcing including the prospect that the outsourcing service provider may act in a deceitful, self-serving (i.e., opportunistic) manner to the detriment of the customer. Indeed, opportunism is one of the key behavioral assumptions

of transaction cost theory (TCT) and is heralded as a central consideration in outsourcing decisions (Ghoshal and Moran, 1996; Williamson, 1979). However, Provan and Skinner (1989) suggest that of the conditions of TCT that impact transaction costs, opportunism is the least understood. While a significant literature on outsourcing exists, research examining the unique challenges of outsourcing across national boundaries is surprisingly sparse. A persistent challenge in managing international relationships is understanding the implications of culture (Couto *et al.*, 2006). Considering that a substantial portion of outsourced relationships span country boundaries, it is somewhat surprising that more research has not investigated the impact of culture. Our study departs from others in that we investigate a context under which domestic firms outsource to a wide variety of countries that inherently possess variance in culture. This is theoretically and practically interesting because it provides broader insights about the role that culture plays in transactions, which can be applied to other phenomena.

Keywords: outsourcing; opportunism; contractual governance; relational governance; culture

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To address concerns of opportunism, outsourcing organizations need to decide the extent to which governance (or control) mechanisms will be deployed (Jap and Ganesan, 2000). The appropriate alignment of governance structures with the characteristics of an exchange is a crucial consideration in the establishment and management of interfirm relationships (Dyer and Singh, 1998). Two general modes of interorganizational governance mechanisms recognized in the literature are formal mechanisms (i.e., principally formal contracts) (Jayaraman, Narayanan, and Luo, 2013; Kalnins and Mayer, 2004; Kirsch *et al.*, 2002; Lafontaine and Shaw, 1999; Masten and Crocker, 1985; Poppo and Zenger, 2002) and informal mechanisms (i.e., social or relational) (Bradach and Eccles, 1989; Jayaraman *et al.*, 2013; Kirsch *et al.*, 2002; Macneil, 1985; Poppo and Zenger, 2002; Ring and Van De Ven, 1994). Agency theory and TCT emphasize the prominent role of formal contracts as incentive alignment mechanisms aimed at controlling the behavior of an exchange partner (Eisenhardt, 1989; Williamson, 1979). The relational view of interorganizational competitive advantage highlights committed and cooperative relationships (informal mechanism) as prominent governance mechanisms (Dyer and Singh, 1998). Contractual governance involves the extent to which formal incentives/disincentives (typically financial) are used clearly to specify and control service activities between a buyer (i.e., customer firm) and supplier (i.e., service provider). Implicit within our conceptualization is that with contractual governance, the service provider has some variable portion of its revenue or compensation explicitly tied to performance against contractually specified outcomes. Relational governance, on the other hand, assesses the extent to which a business relationship involves commitment and cooperation from both parties, and performance targets that are less clearly specified. Both mechanisms are consistently argued to be effective at bringing the service provider's behaviors into better alignment with the interests of the customer, and improving the performance of interorganizational relationships (Goo *et al.*, 2009; Kirsch *et al.*, 2002; Poppo and Zenger, 2002). However, the literature is not conclusive on whether contractual and relational governance are substitutes (i.e., contractual can take the place of relational governance and vice versa) or complements (one adds to the effectiveness of the other) in their effect on opportunism (Lumineau and Malhotra,

2011; Rigdon, 2009). In light of the mixed results and arguments put forth, the relationship between contractual and relational governance is increasingly thought to be context-specific (Li *et al.*, 2010; Lumineau and Henderson, 2012; Zhou and Poppo, 2010). In fact, some have asserted that extant research findings in purely domestic contexts (i.e., U.S.-based) may not hold in certain international environments with the complicating influence of culture being specifically cited (Ellram, Tate, and Billington, 2008; Li *et al.*, 2010; Poppo and Zenger, 2002; Zhou, Poppo, and Yang, 2008).

Our study is most closely related to the literature that *concurrently* evaluates the influence of contractual and relational mechanisms (e.g., Jayaraman *et al.*, 2013; Li *et al.*, 2010; Liu, Luo, and Liu, 2009; Poppo and Zenger, 2002; Wuyts and Geyskens, 2005). Simultaneous consideration of both contractual and relational governance enables a cleaner view of the incremental effect of each governance mechanism while controlling for the effect of the other. For example, Liu *et al.* (2009) argue that transactional (contractual) mechanisms are more effective than relational in deterring opportunism, however, culture is not considered in their study. Similarly, Jap and Anderson (2003) consider how opportunism moderates the relationship between safeguards and exchange performance, but national culture is not within the scope of their study. Lumineau and Henderson (2012) consider *how* and *when* these governance mechanisms are effective in mitigating conflict in buyer–supplier relationships, but again, the role of culture is absent. Of the prior contributions that do concurrently examine the effectiveness of contractual and relational mechanisms, the one most similar to ours is Liu *et al.* (2009). They utilize dyadic data to evaluate the impact of contractual and relational mechanisms on opportunism in manufacturer–distributor relationships. The key distinction between our study and the contribution of Liu *et al.* (2009) is that we directly evaluate the moderating influence of culture whereas Liu *et al.* (2009) do not explicitly consider any location-related moderators.

Williamson (1991) provides the lens through which we examine our phenomenon of interest. He acknowledges the interactive role of governance and institutional environments, arguing that changes in the institutional environment constitute “shift parameters” that alter the relative effectiveness of governance mechanisms. In short, Williamson (1991) states that the institutional

environment is made up of a “locus of parameters” (e.g., political, social, legal, reputational, etc.) and changes in this set of parameters can change (shift) relative governance costs at the exchange relationship level (we discuss this in greater detail during our theoretical development below). With few exceptions (Oxley, 1999), empirical research examining the role of shift parameters vis-à-vis their impact on governing interfirm exchanges is lacking. A likely reason for the sparse use of shift parameters is that they evaluate the impact of changes or differences in the institutional environment, and thus requires “heterogeneity in institutional environments” (i.e., culture in the present study) (Oxley, 1999: 284). For this reason, a multicountry study such as ours is both empirically and theoretically important to achieving the necessary cultural heterogeneity. Those studies that do exist tend to focus on the impact of formal institutions (e.g., legal and regulatory) on governance (Li *et al.*, 2010; Zhou and Poppo, 2010) rather than the role of informal institutions such as culture. While some authors have drawn connections between national institutions and organizational decision making and structure (Crossland and Hambrick, 2011; Oxley, 1999; Siegel, Licht, and Schwartz, 2011), the interactions between national culture, contractual governance, and relational governance has not been investigated in a multicountry study, despite the multiple calls for research (Poppo and Zenger, 2002; Wuyts and Geyskens, 2005).

In accordance with these observations, the current study was undertaken to examine the role that two distinct aspects of culture (i.e., individualism–collectivism and uncertainty avoidance) play in moderating the relationship between contractual and relational governance and their effect on opportunism in outsourcing relationships. In testing this set of relationships, we aim not only to illuminate the moderating influence of culture on each governance mechanism individually, but also to use national culture as a means of contributing to the reconciliation of the aforementioned divergent perspectives in the literature regarding the relationship between contractual and relational governance (Liu *et al.*, 2009; Lumineau and Henderson, 2012; Zhou and Xu, 2012). Our objectives require that we draw from a sample that incorporates multiple cultural distinctions found in international contexts. We use dyadic data (i.e., from both customer and service provider organizations) collected on 102 outsourcing relationships to test these relationships.

In our sample, all customer firms are based in the U.S., whereas service providers had operations in 41 different countries. This research setting allows for findings with greater external validity than previously offered in the literature.

The results of the study are modestly supportive of a *complementary* relationship between contractual and relational governance as they relate to deterring opportunism. The results related to the moderating impact of culture suggest that the effectiveness of both contractual and relational governance mechanisms in mitigating opportunistic behavior is context-specific. Specifically, contractual governance is more effective at mitigating service provider opportunism in more individualistic and low uncertainty avoidance cultures. Conversely, relational governance is more effective in collectivist and high uncertainty avoidance cultures. These findings suggest that the effectiveness of these governance mechanisms is more context-specific than previously thought. Furthermore, culture appears to be one variable (of potentially many) that might explain the inconsistent findings related to the complementary/substitutive role that the two governance mechanisms play in their impact on opportunism. These findings make an important contribution to the nascent empirical literature on the management of international outsourcing as well as to the literature investigating the independent and joint effects of contractual and relational governance on interfirm opportunism. Finally, our work provides further nuance to the voluminous transaction cost literature in that it lends empirical support to the notion of shift parameters in interfirm, multicultural relationships.

THEORETICAL DEVELOPMENT

Opportunism and governance

Opportunism is defined as “self-interest seeking with guile” (Williamson, 1975: 9), with the term “guile” referring to “lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse” (Williamson, 1975: 47). Transaction cost theorists argue that exchanges characterized by a high risk of opportunism require more pronounced expenditures on mechanisms aimed at controlling the behavior of the other party; in our case, the outsourcing service provider. In this study, opportunism is

reflected as a higher order construct comprised of shirking and poaching; two germane forms of opportunism in outsourcing relationships (Aron, Clemons, and Reddi, 2005; Wathne and Heide, 2000). Shirking is the extent to which the provider deliberately underperforms or withholds resources when the customer is unable to detect the action (Handley and Benton, 2012) and is related to the moral hazard concern in agency theory (Eisenhardt, 1989). Poaching, also referred to as diffusion risk (Walker, 1988), represents the degree to which the provider is inclined to utilize information obtained through the relationship for its own unauthorized benefit (Handley and Benton, 2012).

Proponents of TCT argue that contracts are “the primary alternative to vertical integration as a solution to the general problem of opportunistic behavior,” (Klein, Crawford, and Alchian, 1978: 302). Properly designed contractual incentives reduce goal misalignment and thus mitigate the risk of self-interest seeking behavior. Accordingly, it is suggested that outsourcing contracts incorporate penalty and reward clauses explicitly tied to performance against service level objectives (Eastwood, 2006; Landis, Mishra, and Porrello, 2005; Robinson *et al.*, 2008). In keeping with these perspectives, the construct of contractual governance here represents the degree to which the service provider’s near-term compensation and longer-term business opportunities are impacted by their performance against contractual service level agreements. These contractual mechanisms should, *ceteris paribus*, reduce the risk of service provider opportunism. This relationship has been extensively supported in prior research—particularly in the economics field (Kalnins and Mayer, 2004; Lafontaine and Shaw, 1999; Masten and Crocker, 1985), but also in strategic management (Barthélemy and Quélin, 2006; Dyer and Singh, 1998; Lumineau and Malhotra, 2011) and operations management (Li *et al.*, 2010)—therefore, we do not hypothesize a specific link but instead assume provider opportunism to be negatively related to contractual governance.

Unlike TCT’s emphasis on formal control, the relational view of interorganizational competitive advantage (Dyer and Singh, 1998) centers on informal mechanisms to achieve control. This perspective asserts that relationships characterized by cooperative practices such as open communication, extensive information sharing, and joint problem resolution result in shared norms and mutual commitment (Bradach and Eccles, 1989; Li *et al.*,

2010; Poppo and Zenger, 2002; Uzzi, 1997). In such an environment, actions are governed by a desire for solidarity (Dyer and Singh, 1998; Heide and John, 1992; Liu *et al.*, 2009; Ring and Van de Ven, 1992) and goal alignment is driven by informal social pressures to behave in accordance with the shared value system. The negative association between committed and cooperative relationships and the level of interfirm opportunism is also widely recognized in the extant literature (e.g., Gulati, 1995; Liu *et al.*, 2009); therefore we do not formally present an associated hypothesis. Rather, our intent is to build upon these established relationships between governance and opportunism and highlight the important role that culture plays as a moderator. However, we first consider the expected complementary role that contractual and relational governance play in influencing opportunism.

The manner by which contractual and relational governance interact with one another continues to be subject to significant debate (e.g., Lumineau and Malhotra, 2011; Rigdon, 2009). Some argue that more extensive use of either contractual or relational governance reduces the need for the other (Dyer and Singh, 1998; Gulati, 1995; Macaulay, 1963). That is, they are substitutes. Many suggest that committed and cooperative partnerships with shared norms and values reduce the risk of opportunism in ways that are more flexible and cost effective than can be achieved through formal contracts (Dyer and Singh, 1998; Gulati, 1995; Uzzi, 1997). Thus, as the relationship becomes more embedded, the need for costly formal control subsides (Ring and Van De Ven, 1994). Studies in the economics literature argue that coupling economic incentives to performance outcomes undermines the intrinsic motivation to cooperate (Kessler and Leider, 2012) and signals a weakening relationship leading to a reduction in cooperative exchange behaviors (Rigdon, 2009). Despite these arguments for contractual and relational governance having a substitutive relationship, others posit the opposite. Due to bounded rationality, the development of a fully specified contract is often not possible or practical (Klein *et al.*, 1978; Williamson, 1979). This incompleteness necessarily results in a residual opportunism risk that can be further addressed through informal, relational means (Li *et al.*, 2010). Further, adaptations to the formal agreement are often necessary through the course of the relationship. In exchanges with greater relational governance, contractual modifications can be

achieved more effectively due to the cooperative and committed orientation that exists (Goo *et al.*, 2009; Poppo and Zenger, 2002). Finally, contractual agreements can improve clarity about the roles, responsibilities, and performance expectations of each party. This clarity reduces uncertainty while enhancing coordination and commitment (Jap and Ganesan, 2000). Thus, interfirm relationships governed *jointly* by economic and social incentive mechanisms should result in a lower risk of opportunism than relationships governed by only one, suggesting that they serve as complements. While we acknowledge that some studies have argued and found support for contractual and relational governance being substitutes (Dyer and Singh, 1998; Gulati, 1995; Macaulay, 1963; Malhotra and Murnighan, 2002), the majority of recent empirical evidence suggests the relationship is complementary (Goo *et al.*, 2009; Jayaraman *et al.*, 2013; Liu *et al.*, 2009; Poppo and Zenger, 2002). We proceed from the premise that they will be complementary and focus our attention on the moderating role of national culture.

National culture as a shift parameter

There is some debate as to the impact of national culture on management practices. The convergence view holds that as countries become more integrated into the global economy, their work practices and organizational cultures become more similar (Naor, Linderman, and Schroeder, 2010; Shenkar and Ronen, 1987). On the contrary, the divergence view suggests that due to deep-rooted differences in norms and value systems, organizations in different countries will adopt different practices and form heterogeneous organizational cultures (Ralston *et al.*, 1997). The influence of national culture has been studied with regard to a wide array of managerial issues including some related to the current study. For instance, prior research on interorganizational management has examined the impact of culture on the buyer's long-term orientation toward supplier relationships (Cannon *et al.*, 2010), the personal attachment of boundary spanning personnel (Luo, 2001), international negotiation schema (Brett and Okumura, 1998), joint-venture dissolutions (Park and Ungson, 1997), financial contracts between lenders and borrowers (Giannetti and Yafeh, 2011), and the propensity to enter international marketing alliances (Yeniurt *et al.*, 2009).

Following the divergence perspective and the Williamson (1991) shift parameter framework, the overriding thesis adopted here is that the culture (in provider countries) impacts the degree to which contractual and relational governance are effective at mitigating opportunism. Our intent is to examine how governance decisions (contractual and relational) interact with the cultural environment to affect opportunistic behavior. The theoretical framing of our model, as well as our intended empirical analysis, implicitly assumes that governance misalignments (i.e., mistakes) do occur, and that these misalignments have important performance implications, with regard to opportunism. Such a framing begs the question of "why governance mistakes are made." Alternatively, "why would either party agree to a governance framework that does not sufficiently protect its interests?" Extant research provides several explanations (Argyres and Bigelow, 2007; Nickerson and Silverman, 2003; Sampson, 2004). One such explanation is that firms perceive the hazards in their contracting environment with some degree of error (Masten, 1993; Sampson, 2004). Additionally, due to anchoring and insufficient adjustment biases, some firms may erroneously perceive contractual and/or relational governance to be similarly effective across cultural contexts, when in fact they are likely to be different (Bowman, 1963; Tversky and Kahneman, 1974). In short, we argue that outsourcing across national boundaries represents a complex contracting environment subject to governance mistakes. These mistakes place some firms in the unfortunate situation of operating under a governance framework that is ineffective in mitigating opportunistic behavior. Thus, while we have no reason to expect that either party will systematically and knowingly agree to an egregiously one-sided relationship, there is a possibility they will agree to a governance system that is misaligned with their cultural norms to some extent. While it is difficult to perfectly disentangle governance decisions from their impact, the focus in this study is not specifically how or why the firms arrived at the agreed upon-governance system, but rather, once in place, how effective it is at deterring provider opportunism.

In keeping with the concept of shift parameters (Oxley, 1999; Williamson, 1991), we posit that cultural norms in the countries where the service providers operate "shift" the effectiveness of governance decisions. Because governance mechanisms operate at the relationship level and culture operates

at a higher level of social analysis (see Williamson, 2000), culture is posited to constrain or enhance the role of contractual and relational governance. While cultural distance between partners has been shown to be an important determinant of the quality of interorganizational relationships, knowledge sharing, and other relational issues (Griffith, Myers, and Harvey, 2006), we focus on the provider's culture rather than the difference between the buyer's and provider's culture. Our theoretical argument is that the culture of the provider firm influences their opportunistic behavior and the effectiveness of mechanisms aimed at altering this behavior. This logic is similar to the theoretical arguments made by Shane (1994) that a foreign country's culture influences American firms' tendency to use licensing agreements rather than direct foreign investment and the Hewett and Bearden (2001) hypothesis that the culture in a foreign country moderates the extent to which managers in that country will cooperate with headquarters in the U.S. Yet, we acknowledge that cross-cultural relationships may respond differently from those that are intracultural, therefore we control for this in our model. We do not use *cultural distance* because it suggests that providers will potentially respond differently depending upon the culture of their customer. This is a different, albeit very interesting, research question but one that is beyond the scope of our study.

Drawing on the commonly invoked framework of core cultural dimensions, based principally on the work of Geert Hofstede (Hofstede, 1980, 1985), we hypothesize that the effectiveness of contractual and relational governance mechanisms is moderated by two dimensions of national culture: individualism–collectivism (IDV) and uncertainty avoidance (UAI). We chose these two dimensions for multiple reasons. First, both IDV and UAI have been found to be more predictive than other cultural dimensions in managerial decision making (Crossland and Hambrick, 2011). Second, although multiple cultural value typologies have been presented, the IDV dimension (or something similar) has appeared in several recognized frameworks and is consistently considered a core dimension distinguishing different cultures (Cannon *et al.*, 2010; Crossland and Hambrick, 2011). The UAI dimension has previously been associated with the design of international control and governance systems (Homburg *et al.*, 2009; Ueno and Sekaran, 1992). We opt here to focus on the theoretically supported relationships regarding IDV and UAI

and leave the other dimensions—which would be more exploratory—for future research.

As shown in Figure 1, extant research suggests a negative relationship between the extent of use of governance mechanisms and provider opportunism (see a). The combined effect of relational and contractual governance is said to further decrease opportunism (see line CG + RG). In Figure 1(b–d), we highlight the role that one dimension of national culture—individualism/collectivism—plays in shifting the effectiveness of governance on opportunism. Although not depicted, the shifting effects associated with uncertainty avoidance would be similar in nature. Consistent with Williamson's (2000) theorizing that higher levels of social analysis (e.g., culture) constrain or enhance lower level governance structures, we argue that a tighter alignment between the characteristics of the governance mechanism and the provider's cultural values will manifest in a more pronounced effect on mitigating provider opportunism, whereas misalignment is expected to detract from the effectiveness.

The impact of individualism–collectivism

The individualism–collectivism dimension reflects how tightly knit the social framework is in a society. In high individualism cultures, there is a preference for a loosely knit social framework in which “individuals are supposed to take care of themselves and their immediate families only” (Hofstede, 1985: 348). In more collectivist cultures, individuals expect “their relatives, clan, or other in-group to look after them” (Hofstede, 1985: 348). Individualism and collectivism represent opposite ends of the same dimension. We argue that contractual governance is more suited to individualistic cultures; therefore increased contractual governance will be more effective at deterring opportunism (see Figure 1b; slope of $CG_I < \text{slope of } CG_C$). The basic intuition underlying our expectation that contractual governance is more effective in individualistic cultures is that members of these societies are more rational, calculative in their decision making, and are therefore more responsive to extrinsic economic incentives (Cannon *et al.*, 2010; Davis, Schoorman, and Donaldson, 1997; Doney, Cannon, and Mullen, 1998). In more individualistic cultures, people and organizations are more receptive to compensation systems that are contingent on their performance (Gelfand *et al.*, 2004; Redding, Norman, and Schlander, 1994), including incentive-based contracts

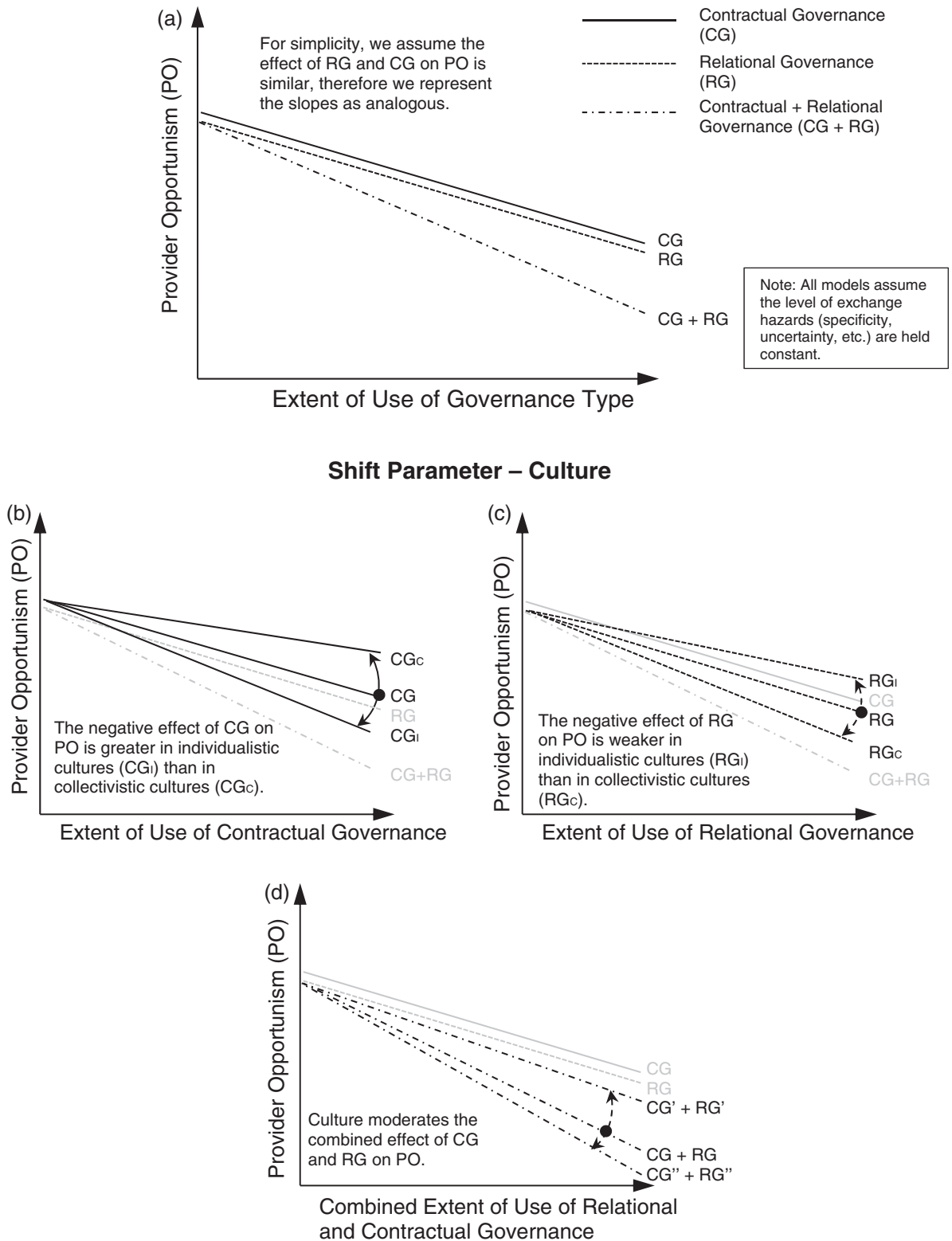


Figure 1. (a–d) National culture (individualism/collectivism) as a shift parameter

with compensation and future opportunities tied to performance against service level agreements. Consistent with this logic, empirical research on CEO compensation has found that CEOs in individualistic cultures have a higher proportion of their total compensation contingent upon performance than do those in more collectivist cultures (Tosi and Greckhamer, 2004). Building on this extant research, we posit that contractual governance, which makes the service provider's financial prospects more contingent upon performance, is more aligned with the cultural norms in individualistic as opposed to collectivist societies. This tighter alignment is expected to result in contractual governance being more effective at deterring opportunism. Therefore we test

Hypothesis 1 (H1): The negative influence of contractual governance on opportunism is stronger in individualistic cultures than it is in collectivist cultures.

It is widely acknowledged that there are asymmetric conceptions of relational quality in business relationships that cross international borders and thus cultures (Zaheer and Zaheer, 2006). Whereas prior research associates individualistic cultures with calculative, rational decision making motivated predominantly by economic concerns, other research observes that members of collectivist societies are more driven by social factors, potentially at the expense of material considerations (Davis *et al.*, 1997; Gelfand *et al.*, 2004). Cannon *et al.* (2010: 508–509) concisely summarize these observations by stating that in collectivist cultures “people are valued over performance criteria” and “business exchange relationships are primarily social rather than instrumental.” Because relational governance is often referred to as social or clan control (Eisenhardt, 1985; Li *et al.*, 2010), we expect service providers in collectivist societies to be more receptive to relational governance mechanisms. As societies become less individualistic, cultural norms emphasize long-term relationships, harmony, and cooperation (Davis *et al.*, 1997; Doney *et al.*, 1998), hallmarks of strong relational governance (Dyer and Singh, 1998). The mismatch between individualistic cultures and relational governance is likely to minimize the effectiveness of this mechanism at attenuating opportunism. That is, we posit relational governance to be more effective in collectivist societies (see Figure 1c; slope of $RG_C < \text{slope of } RG_I$).

Hypothesis 2 (H2): The negative influence of relational governance on opportunism is weaker in individualistic cultures than it is in collectivist cultures.

The impact of uncertainty avoidance

Uncertainty avoidance represents the extent to which a society feels “uncomfortable with uncertainty and ambiguity” and a preference for “beliefs promising certainty” (Hofstede, 1985: 347–348). Prior research has characterized members of high uncertainty avoidance cultures as being risk averse (Luque and Javidan, 2004). Established theory recognizes that incentive or outcome-based contracts shift risk to the agent (i.e., the service provider in our context) (Beatty and Zajac, 1994; Eisenhardt, 1989). Therefore, contracts that shift risk to the service provider are misaligned with the norms in high uncertainty avoidance (i.e., risk averse) cultures. Consequently, we would *not* expect individuals or organizations in high uncertainty avoidance cultures to respond favorably to contractual arrangements that place their compensation at risk. Although in different contexts, prior empirical work has supported these theoretical arguments by demonstrating a negative association between high uncertainty avoidance cultures and the use of incentive or performance-based compensation mechanisms (Brown Johnson and Droege, 2004; Tosi and Greckhamer, 2004). Our conceptualization of contractual governance centers on the extent to which the service provider's compensation and future commercial opportunities are tied to performance against service level objectives. Thus, while some contract forms may be argued to serve as uncertainty reducing mechanisms through the clarification of roles and responsibilities, the contingent nature of the contractual provisions we examine introduces financial uncertainty and ambiguity that members of high uncertainty avoidance societies seek to avoid. Again, this misalignment of cultural norms with governance is proposed to moderate negatively the effectiveness of contractual governance in discouraging opportunistic behavior. While we did not graphically depict the UAI shift parameters, we expect them to function similarly to the relationships represented in Figure 1(b–d).

Hypothesis 3 (H3): The negative influence of contractual governance on opportunism is

weaker in high uncertainty avoidance cultures than it is in low uncertainty avoidance cultures.

We know from prior literature that uncertainty avoidance is essentially a proxy for the extent of unpredictability and risk a firm is willing to undertake (Crossland and Hambrick, 2007). One strategic action that can serve as a source of unpredictability and ambiguity is discontinuing an existing interfirm relationship. Given that members of high uncertainty avoidance cultures seek to avoid risk, it is expected that they would be reticent to move in and out of business relationships. Indeed, existing research observes that people and organizations in low uncertainty avoidance cultures sever existing relationships and enter new relationships more freely (Doney *et al.*, 1998; Kale and Barnes, 1992). Alternatively, high uncertainty avoidance societies favor permanence and stability in relationships and nurture bonds for longer-term benefits (Luque and Javidan, 2004). Interorganizational relationships characterized by high levels of relational governance also favor a long-term, partnership orientation where the parties are committed to the relationship (Cannon *et al.*, 2010; Dyer and Singh, 1998; Jap and Ganesan, 2000). Thus, relational governance is well aligned with the norms in high uncertainty avoidance cultures. Due to this strong alignment, it is expected that relational governance will be more effective at controlling provider behavior in high uncertainty avoidance cultures. Therefore, it is posited

Hypothesis 4 (H4): The negative influence of relational governance on opportunism is stronger in high uncertainty avoidance cultures than it is in low uncertainty avoidance cultures.

Governance, culture and opportunism

Earlier we highlighted the debate in the literature related to the joint effect of contractual and relational governance on opportunism. We also argued that culture moderates the unique effect of each of these governance mechanisms on opportunism. Since we do not hypothesize main effects for contractual and relational governance and instead focus on their complementary effect on opportunism, we feel it is critical to examine the moderating effect of culture on the two governance mechanisms *jointly* as well. As we expect culture to influence the extent

to which both contractual and relational governance are effective deterrents of opportunism, we would also anticipate that culture will impact how the two mechanisms interact with one another in their effect on opportunism. From a pragmatic perspective, providing theoretical support for complex three-way interactions is challenging. Some authors have chosen to simply posit a significant effect without committing to directionality (Halford *et al.*, 2005) and acknowledge that the important insights come when graphing the interactions and post-hoc analyses (Angst and Agarwal, 2009; Dawson and Richter, 2006). Ultimately this is somewhat exploratory, but it can provide guidance for future theoretical contributions. Thus, we simply hypothesize that both IDV and UAI will significantly moderate the two-way interaction between contractual and relational governance in its effect on opportunism (see Figure 1d) and in a post-hoc analysis we will discuss specific aspects of the findings. Therefore, we hypothesize:

Hypothesis 5 (H5): The individualism–collectivism cultural dimension moderates the relationship between contractual governance and relational governance in their complementary effect on opportunism.

Hypothesis 6 (H6): The uncertainty avoidance cultural dimension moderates the relationship between contractual governance and relational governance in their complementary effect on opportunism.

A complete representation of our conceptual model is shown in Figure 2 below.

METHODOLOGY

Data collection, sample, and measurement

The target population for this study was large U.S.-based firms engaged in domestic and/or international outsourcing of business processes. Service provider operations could be located in the U.S., in an international location, or both. Engaging organizations meeting these criteria began by compiling a listing of contacts obtained through multiple online databases. This search was restricted to only those firms found in the Russell 3000 Index as of October 2009. Key contacts were identified by reviewing job titles and, where available, job descriptions.

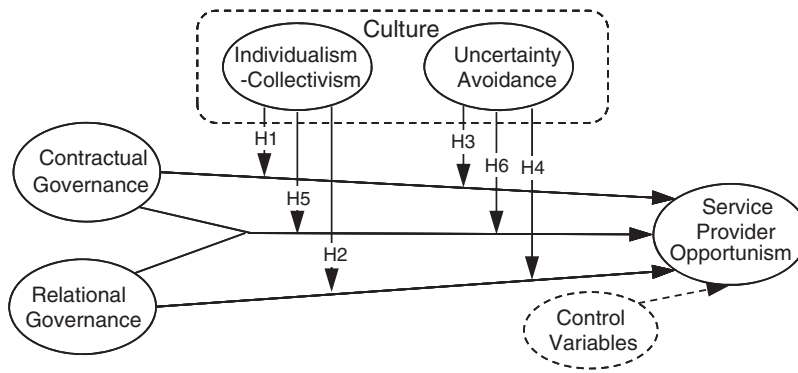


Figure 2. Conceptual model

Contact information was obtained for members of management at 2,356 companies. Each of these organizations was provided with an overview of the research project detailing what would be expected of them. Interested firms were asked to provide the research team with the contact information for *all* outsourcing relationships within a functional area. Following this procedure, an initial agreement to participate was obtained from 78 organizations (i.e., customers). Telephone or email communications were established with 176 other firms in an effort to determine their reason for not participating. These correspondences did not reflect an observable bias, with the majority citing company policy against sharing sensitive information (i.e., names of their service providers) or a personal lack of sufficient knowledge with the firm’s outsourcing initiatives.

Web-based surveys were distributed to the 78 customer firms who agreed to participate along with their identified service providers. As requested, some customer firms provided contact information for multiple service providers to reflect all of their outsourcing relationships within a particular functional area. As our analysis is dyadic in nature, we only included in the final sample relationships for which we obtained a completed survey from both the customer and service provider organization. Completed surveys representing 134 outsourcing relationships were submitted from the customer firms, while service provider surveys were submitted for only 105 of the relationships. After accounting for the nonresponse from either the service provider (mostly) or customer firm representative (a few instances) at the relationship level, both customer and service provider responses (i.e., matched dyads) were received for 102 relationships. While modest, the rate of response and sample size is

an anticipated by-product of the rigorous research design (i.e., requesting the inclusion of all relationships within a functional area and requiring matching responses from service providers). Traditional assessments of nonresponse bias were conducted by comparing early versus late respondents (Armstrong and Overton, 1977). Moreover, a χ^2 test was used to compare respondents to all firms in the Russell 3000 Index in terms of industrial sector representation. These assessments did not offer reason for a significant concern of a response bias; although we acknowledge that we cannot fully rule out this potential. The majority of the customer firms in our sample came from four sectors (Consumer Discretionary, 22%; Technology, 22%; Producer Durables, 17%; and Health Care, 15%) and most of the outsourced activity broke down into two functional areas (Logistics/Supply Chain, 49% and Information Technology, 31%). For more details, see online Appendix S1, Tables S1 and S2.

In the sections below, the measurement basis for each variable is described. The final items used in the multiitem constructs are presented in the online Appendix S1. All single-item constructs are sufficiently described within the text. Except for the buyer-switching difficulty, previously in-house, and provider expert constructs, all items are measured from the provider’s survey.

Opportunism

Service provider *opportunism* is reflected by two first-order constructs representing salient forms of opportunism noted in the outsourcing literature: shirking and poaching. The scales used to represent these two constructs were newly developed for this research project. While other measures of opportunism exist, our objective was to assess these

two specific forms of opportunism highlighted in the extant literature (Aron *et al.*, 2005; Jap and Anderson, 2003; Wathne and Heide, 2000). To our knowledge, no prior scales specifically measure shirking and poaching. The items were developed and refined through a multiround q-sorting exercise involving academic peers and experienced sourcing professionals (c.f. Menor and Roth, 2007). The sorting exercise included shirking and poaching among a battery of seven multiitem constructs. By the final round, each item was correctly matched with its intended construct at an acceptable rate. The psychometric results surpassed thresholds prescribed in the literature (overall placement rate > 90%, mean proportion of substantive validity = 0.90, and mean coefficient of substantive validity = 0.81).

Governance mechanisms

The four-item scale used to represent *contractual governance* (CG) was developed for this study. The scale was not included in the q-sorting exercise. Rather, it resulted from discussions with one of the sourcing experts who served as a “sorter” in the exercise. As previously explained, our CG construct specifically represents the extent to which the service provider’s compensation and business opportunities are tied to their performance against contractual service level agreements (SLAs). To our knowledge, previously validated measures of interfirm contracting do not specifically assess these contractual contingencies as conceptually specified herein. We sought to word the items in a vernacular familiar to the respondents. As such, the CG items all relate to the SLAs that exist within the contract between the two organizations. SLAs are frequently noted as key elements in outsourcing contracts (Eastwood, 2006; Landis *et al.*, 2005; Robinson *et al.*, 2008).

Relational governance (RG) represents the reliance upon committed and cooperative relations to govern the commercial exchange. Relational governance or similar constructs have been operationalized in a multitude of ways in the literature. Drawing on multiple previously validated scales, we utilize a composite of four items to reflect RG (Benton and Maloni, 2005; Cannon and Perreault, 1999).

National culture

The culture scores are with respect to the location of the service provider’s operations. Each culture

measure— *individualism–collectivism* (IDV) and *uncertainty avoidance* (UAI)—is based on Hofstede’s cultural dimension scores (Hofstede, 1980). Scores were obtained from <http://www.geerthofstede.nl> in December 2011. While alternative cultural typologies exist in the literature, Hofstede’s dimensions and scores are widely utilized (Sousa and Bradley, 2008; Yenyurt *et al.*, 2009). As highlighted previously (Crossland and Hambrick, 2011), using the Hofstede measures allows for more direct comparison with other contributions in this literature. To determine the values for IDV and UAI for each outsourcing relationship, the questionnaire presented the respondent with a listing of countries (along with space to type in countries) and asked him/her to indicate all countries where the provider had operations servicing the focal relationship. This information was combined with the culture scores for each country to arrive at an average relationship score for IDV and UAI.

Exchange hazards and other contextual control variables

Transaction cost theory posits that interorganizational difficulties depend upon three characteristics: asset specificity, uncertainty, and frequency (Williamson, 1979). In this study, the focus is on recurring relationships and thus frequency is not a distinguishing factor. Measures of asset specificity and uncertainty, the most commonly assessed exchange hazards in empirical studies of TCT (David and Han, 2004), are included. It is important to control for these hazards in contractual relations as they have been linked to dependency, vulnerability, and ultimately the risk of opportunistic behavior (Wathne and Heide, 2000). Human or physical assets that are specialized to a certain relationship may be difficult to redeploy or have limited value outside of the relationship (Holmström and Roberts, 1998). Their presence creates a lock-in situation, leaving the owner vulnerable to opportunistic action by their exchange partner. To reflect these exchange conditions, this study includes measures from both the buyer (i.e., *switching difficulty—SD*) and provider perspectives (i.e., *provider specificity—PS*). The buyer’s lock-in vulnerability is captured by a single-item measure of switching difficulty to provide a broader, and perhaps more practical, assessment of exchange hazards from their perspective. A two-item measure of the extent to which the provider has made

investments in human and physical resources, which are unique to this relationship, is used to assess the provider's lock-in vulnerability. Importantly, switching difficulty and relationship-specific investments are also noted as key determinants of interfirm dependency and relative bargaining power (Buchanan, 1992; Heide and John, 1988). The inclusion of both buyer and provider perspectives capitalizes on the dyadic nature of our data, and is a strength of the analysis. Uncertainty represents the rate and predictability with which the exchange environment is changing. Environmental uncertainty exacerbates the difficulty in developing fully specified and complete contracts (Crocker and Reynolds, 1993; Klein *et al.*, 1978; Williamson, 1979). This contractual incompleteness also leaves organizations vulnerable to opportunistic behavior (Crocker and Reynolds, 1993). *Technological uncertainty (TU)* is the most commonly used measure of uncertainty (David and Han, 2004). Our multiitem measure of TU is adapted from a previously validated scale (Dröge, Claycomb, and Germain, 2003). As explicated in the Analysis section below, these exchange hazard variables are used as predictors for the use of the governance mechanisms as well as for provider opportunism.

Eleven additional contextual variables are included to control for their potential influence on the use of the governance mechanisms, the risk of opportunism, or both. Three dummy variables are included to reflect the functional type of outsourcing activity—*IT outsourcing (IT)*, *logistics outsourcing (LOG)*, and *finance/accounting outsourcing (FA)*—and *Other Business Processes* was used as the baseline. Next, data obtained from Yahoo! Finance (<http://finance.yahoo.com/>) was used to determine customer *firm size (FS)* in terms of annual revenue. *Longevity of relationship (LR)*, measured in years, represents how long the provider has been rendering these services to the customer. Three variables serve as instruments in our first-stage analysis (discussed in detail below). First, *contract size (CS)* represents the annual value of the outsourcing contract (1 = <\$1 million; 2 = \$1.0–\$24.9 million; 3 = \$25.0–\$49.9 million; 4 = \$50.0–\$99.9 million; 5 = >\$100.0 million). Second, a dummy variable is included to represent whether or not the outsourced activity was previously performed in house (*PI*). Third, a three-item scale is included to reflect the extent to which the buying firm considers the provider an expert (*PE*). The measurement for *PE* is based on a previously validated scale (Benton and

Maloni, 2005). *Contract enforcement (CE)* captures the strength of the legal institutions in each service provider country and is based on the enforcing contracts ranking in the World Bank's *Doing Business* database (<http://doingbusiness.org/>). Finally, we include two variables that capture additional aspects of the relationship between the buyer and provider. The first, called *Cross-cultural Relationship (CR)*, is a dummy variable coded 1 if the buyer and provider are located in different countries; 0 otherwise. Inclusion of this variable allows us to isolate the potential influence due to the relationship being cross-cultural as opposed to intracultural in nature. The second, *Buyer Subsidiary (BS)*, reflects the average duration, in years, that the customer firm has had subsidiaries in the countries where the service provider operates in support of their relationship (0 = no subsidiary exists; 10 = 10 or more years). This serves as an indicator of the buyers' experience with the different cultures, which could impact the use and effectiveness of different governance mechanisms. As each customer firm is a public company, the locations of their subsidiaries were obtained from their 10-K filings.

Measurement model evaluation

Confirmatory factor analysis (CFA) using LISREL 8.8 was performed on all multiitem scales measured from the provider survey: shirking, poaching, contractual governance, relational governance, provider specificity, and technological uncertainty. The sole multiitem scale measured from the buyer's survey (i.e., provider expert) was not included in this provider CFA. Analysis of this construct independently demonstrated strong validity and reliability. The provider CFA exhibited sufficient overall model fit (RMSEA = 0.077; $\chi^2/df = 1.59$; CFI = 0.90; IFI = 0.90; RMR = 0.079). Strong convergent validity is supported by all items loading significantly on their intended construct (all loadings > 0.45 with *p*-values < 0.001). The average variance extracted (AVE) for each construct exceeds the square of its largest interfactor correlation; demonstrating significant discriminant validity. The Cronbach's α and composite reliabilities of all constructs ranged from 0.63 to 0.87. These figures are within the routinely accepted range for scales with adequate reliability. Modeling opportunism as a meta-construct reflecting shirking and poaching was empirically validated by the

Table 1. Item descriptive statistics

Constructs & items	Mean	Std. dev.	Constructs & items	Mean	Std. dev.
Longevity of relationship (years)	6.53	3.71	Buyer subsidiary ^a	7.50	3.30
Technological uncertainty ($\alpha = 0.65$)			Opportunism		
TU1	3.70	1.32	Shirking ($\alpha = 0.82$)		
TU2	2.77	1.18	SH1	1.43	0.68
TU3	2.79	1.33	SH2	1.40	0.85
Switching difficulty	4.71	1.35	SH3	1.51	0.89
Provider specificity ($\alpha = 0.63$)			SH4	1.50	0.73
PS1	5.98	1.05	Poaching ($\alpha = 0.85$)		
PS2	4.88	1.76	PO1	1.29	0.75
Contractual governance ($\alpha = 0.82$)			PO2	1.26	0.72
CG1	5.82	1.43	PO3	1.43	0.92
CG2	4.76	1.80	Provider expert ($\alpha = 0.86$)		
CG3	5.32	1.64	PE1	5.77	0.94
CG4	5.59	1.39	PE2	5.74	0.90
Relational governance ($\alpha = 0.81$)			PE3	5.59	0.94
RG1	6.35	1.13			
RG2	6.21	0.99			
RG3	6.37	0.86			
RG4	5.41	1.31			
Individualism	71.63	22.19			
Uncertainty avoidance	48.09	9.62			

^a If provider operation is in same country as the customer headquarters (i.e., the U.S.), this was coded at the maximum scale value (10 or more years).

strong second-order factor loadings ($p < 0.001$) and the Marsh and Hocevar target coefficient (T) equaling 0.994 (Marsh and Hocevar, 1985). Table 1 provides the descriptive statistics for all items (except those detailed in Appendix S1, Table S1) and the Cronbach's α for each multiitem scale.

The data for the dependent and independent variables largely come from the same respondents. Hence, there exists a concern for a common methods (CM) bias. The incorporation of secondary data to measure the culture variables helps diminish the CM concern. Moreover, all of our hypothesized effects involve interaction terms. Recent research has demonstrated that interaction effects cannot be due to CM variance (Siemsen, Roth, and Oliveira, 2010). However, one cannot definitively say that a CM bias does not exist. Therefore, we use Harman's one-factor test to assess whether the research method has a large effect on the relationships observed (Podsakoff and Organ, 1986). An exploratory factor analysis with all of the manifest items resulted in the first factor representing a modest 24.6 percent of the total variance. Collectively, these data and model characteristics suggest that the measurement approach is not substantively biasing the observed relationships. While we

recognize that some studies assess opportunism from the other firm's perspective, our measurement of opportunism from the perspective of the opportunistic party (i.e., the service provider in our case) follows prior studies in the interorganizational management literature (Brown, Grzeskowiak, and Dev, 2009; John, 1984; Joshi and Arnold, 1997; Ping, 1993; Provan and Skinner, 1989). One may argue that service providers would be inclined to answer in a socially desirable manner when asked about their firm's tendency to act opportunistically. To address this, respondents were told that the research was voluntary and confidential. Following guidance from consumer behavior literature, the opportunism questions were asked using an indirect questioning technique, which has been shown to significantly mitigate social desirability bias (Fisher, 1993). Finally, we used a statistical procedure (Randall and Fernandes, 1991) to control for the potential that social desirability bias may exist and measured the extent to which respondents felt uneasy answering each of the opportunism questions. A factor reflecting these "desirability" measures (opportunism desirability—OD) is included as a control variable in the analysis.

ECONOMETRIC SPECIFICATION AND ANALYSIS

Our primary research objective is to determine the potential moderating influence of culture on the effect of contractual and relational governance mechanisms on service provider opportunism. Thus, moderated hierarchical regression is an appropriate analytic technique to partition the variance cleanly (Cohen *et al.*, 2003). Our econometric analysis also accounts for the likelihood that the use of contractual mechanisms and the use of relational mechanisms are jointly endogenous decisions. Specifically, the use of contractual (or relational) governance may be influenced by the use of relational (or contractual) governance, the extent of exchange hazards, and other characteristics of the exchange. Contractual and relational governance are also implemented, at least in part, to address opportunism, making them endogenous determinants of our dependent variable. These factors could result in potentially biased estimates from a single-stage analysis. To correct for this likely endogeneity, we follow guidance in the literature and employ a multistage hierarchical regression approach (e.g., Poppo, Zhou, and Zenger, 2008; Slotegraaf, Moorman, and Inman, 2003). In the first stage, each of the two governance mechanisms is regressed on FS, LR, CE, CR, BS, TU, SD, PS and either RG or CG, depending on the dependent variable. In the first-stage model with CG as the dependent variable, contract size (CS) and previously in house (PI) are the instrumental variables. Prior work by Poppo and Zenger (2002) uses an instrument similar to CS (budget) for contractual governance. Other research has demonstrated an association between contract size and the extensiveness of contractual controls (Anderson and Dekker, 2005). Whether the outsourced activity was previously performed in house serves as an indicator of the operational knowledge possessed by the buying firm. Again, extant research has linked such knowledge to more extensive contractual governance (Argyres and Mayer, 2007; Mayer and Salomon, 2006). Using Stata's *estat override* procedure, it was determined that CS and PI do not correlate significantly with the error term in the opportunism equation. For the first-stage model with RG as the dependent variable, provider expert (PE) is the identifying instrumental variable. Prior research suggests that when one party to an exchange perceives the other

to be an expert in their field, it facilitates knowledge and information sharing (Ko, Kirsch, and King, 2005), fosters the alignment of norms and values (Brown, Lusch, and Nicholson, 1995), and is positively associated with committed relationships (Benton and Maloni, 2005). Moreover, our analysis revealed an insignificant correlation between PE and opportunism (-0.10 ; p -value = 0.30). Given the association between the instrumental variables and the governance constructs established in the extant literature, along with their observed insignificant correlation with opportunism, we deem the instruments to be appropriate.

The first-stage regressions allow for the determination of residuals for CG (i.e., CG_r) and RG (i.e., RG_r) that are absent the influence of the other governance mechanism and other characteristics of the exchange. These residuals are used in the second stage. The interaction terms in the second-stage regressions are also calculated using CG_r and RG_r rather than the original governance variables. In addition to the independent variables used in the first-stage models (absent the instrumental variables), the second stage also includes dichotomous control variables indicating the functional type of outsourcing. Separate stage-two regressions are performed for each cultural dimension. The independent variables in the stage-two regression models are sequentially entered in seven blocks to clearly demonstrate how the groups of variables contribute to the explanation of the variance in opportunism. The first block contains the control variables (OD, IT, LOG, FA, FS, LR, CE, CR, and BS) and exchange hazards (TU, SD, and PS). Subsequently, the variables representing the main effect for contractual governance (CG_r), the main effect for relational governance (RG_r), and the interaction of these governance mechanisms (CG_r \times RG_r) are incorporated in the second and third blocks, respectively. The fourth block introduces the individualism construct (along with the associated two-way interactions with the governance mechanisms) to the model containing CG and RG and the fifth block includes the three-way interaction with CG and RG. Similarly, the sixth and seventh blocks include uncertainty avoidance and the three-way interaction. Our data has multiple observations from some customer firms. Using Stata 13.0 we specified the regression models to utilize robust standard errors to account explicitly for the intragroup correlation among the multiple observations from the same customer. Stata's robust clustering procedure

adjusts the standard errors using the Huber-White method known as the “sandwich estimator” of variance. Finally, the largest variance inflation factor (VIF) across all models was 8.1, below the suggested threshold of 10 (Cohen *et al.*, 2003). Thus, excessive multicollinearity is not a concern.

RESULTS

The first-stage results (Table 2) for Model 1a demonstrate that relational governance (0.443; p -value < 0.01) has a significant positive effect on contractual governance. In Model 1b, contractual governance has a significant positive effect on relational governance (0.361; p -value < 0.01). These first-stage results support the argument that contractual and relational governance tend to be *used* in a complementary manner. Further, the results confirm the need to control for the endogenous influence that each governance mechanism has on the other prior to evaluating their association with opportunism. Finally, the three instrumental variables (CS, PI, and PE) are significant predictors of the potentially endogenous governance constructs; validating their strength as instruments.

The full second-stage models—individualism (see Table 3, Models 2d and 2e) and uncertainty avoidance (Models 2f and 2g)—are used to evaluate the research hypotheses. We proceed on the assumption that contractual and relational governance serve as complements in their effect on provider opportunism but conduct a formal test to confirm this criterion (Howell and Dorfman, 1981). In the absence of the interaction term $CG \times RG$, both main effects of CG and RG independently are negative and significant (see Model 2b). The interaction term $CG \times RG$ is not significant in the absence of the culture variables. This is not surprising considering that our theoretical arguments suggest the contextual importance of culture to this relationship. However, when the interactive effect of contractual and relational governance is added to the model that includes the IDV cultural dimension, it too is negative and significant (see Model 2e: -0.230 , $p < 0.05$). These results are clearly not suggestive of a substitutive relationship but do modestly support prior research that identifies contractual and relational governance as complementary in their effect on mitigating opportunism.

The hypotheses related to the moderating influence of individualism–collectivism (H1, H2, and

H5) are assessed by the results of Model 2e. The results demonstrate that the negative effect of contractual governance on opportunism is significant in high individualism cultures ($IDV \times CG_r$: -0.236 ; $p < 0.05$) and less so in more collectivist cultures. Conversely, the interaction between relational governance and individualism ($IDV \times RG_r$) exhibits the opposite effect (0.158; $p < 0.05$). Relational governance has a stronger mitigating effect on opportunism in collectivist cultures. These results support Hypotheses 1 and 2. Model 2e also reflects a moderately significant three-way interaction between IDV and the joint effect of the two governance mechanisms ($IDV \times CG_r \times RG_r$: 0.194; p -value < 0.10), supporting Hypothesis 5.

The hypotheses related to the moderating influence of uncertainty avoidance (H3, H4, and H6) are assessed by the results of Models 2g. We find that contractual governance is less effective in high uncertainty avoidance cultures (0.319; $p < 0.01$). The opposite effect is observed by the interaction of uncertainty avoidance and relational governance (-0.207 ; $p < 0.10$). These results support both Hypotheses 3 and 4. The three-way interaction between UAI and the two governance mechanisms is not statistically significant ($UAI \times CG_r \times RG_r$: -0.060 ; n.s.), thus, the results of Model 2g do not lend support for Hypothesis 6.

DISCUSSION AND IMPLICATIONS

In alignment with our theorizing, we find that contractual governance is not universal in its ability to mitigate opportunism: the effectiveness of contractual safeguards is highly contingent upon the cultural context of the relationship. These results are pictorially depicted in Figure 3. The desired negative effect of increased contractual governance on opportunism is stronger when the service provider’s operations are located in more individualistic and low uncertainty avoidance cultures. In these societies, the broader social framework is weak, individuals value personal achievement and material reward, and people are more comfortable with ambiguity, uncertainty, and contingent compensation systems (Doney *et al.*, 1998; Redding *et al.*, 1994). The key implication for outsourcing managers is that contractual governance cannot be relied upon to the same extent across all cultural settings. Instead, managers must fully consider the societal norms and value systems in countries where

Table 2. First-stage regression results

Variable	Governance mechanisms			
	Contractual governance (1a)		Relational governance (1b)	
	Coeff	SE	Coeff	SE
Constant	-0.579	0.662	0.589	0.526
Firm size (revenue) (FS)	0.030	0.055	-0.061*	0.034
Longevity of relationship (LR)	-0.001	0.033	-0.031	0.024
Contract enforcement (CE)	-0.001	0.003	0.001	0.002
Cross-cultural relationship (CR)	-0.152	0.356	-0.182	0.277
Buyer subsidiary (BS)	-0.046	0.041	-0.006	0.032
Technological uncertainty (TU)	0.002	0.106	0.122	0.083
Switching difficulty (SD)	0.005	0.066	0.041	0.074
Provider specificity (PS)	-0.036	0.168	0.052	0.131
Contract size (CS)	0.231**	0.105		
Previously in house (PI)	0.398*	0.247		
Provider expert (PE)			0.267***	0.093
Contractual governance (CG)			0.361***	0.129
Relational governance (RG)	0.443***	0.117		
<i>F</i>	2.75		5.16	
Prob > <i>F</i>	0.006		0.000	
<i>R</i> ²	0.254		0.294	

* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Standard errors are calculated using robust clustering on the customer variable.

One-tail t -test used when a directionally specific effect was posited (i.e., instrumental variables and the effects of CG and RG on each other). Two-tail tests used otherwise.

The bold values represent statistically significant values.

their service providers operate. Several examples from our data highlight this intriguing finding. For instance, a large U.S.-based department store sources logistics services from providers in China and Vietnam (low individualism cultures) as well as the U.S. (a high individualism culture). Across these relationships, this firm tends to emphasize contractual governance less than relational governance. Our results suggest that this approach is aligned with the Asian providers, but misaligned with U.S. providers. The opportunism assessments in these relationships reflect this expectation. When service providers are located in more individualistic and low uncertainty avoidance cultures, formal contracts with strong financial incentive mechanisms should hold a prominent position in the overall governance system. Conversely, in collectivist and high uncertainty avoidance cultures, managers need to consider alternatives to contractual governance as the desired effect of reducing opportunism will not be realized, and in fact, opportunism is likely to increase, as reflected in Figure 3. This particular finding complements other recent work identifying institutional contexts in which extensive reliance on contracts may have adverse implications (Zhou and

Xu, 2012). One plausible explanation for this result is that asking service providers in these cultural settings to agree to strong incentive-based contracts is so contrary to their societal norms that it is actually perceived as an injustice that needs to be covertly rectified.

The interactions between relational governance and the two cultural dimensions reveal that the ability of relational governance to mitigate opportunism is strongest in collectivist and high uncertainty avoidance societies. The graphs in Figure 4 suggest that more extensive relational governance is not necessarily counterproductive in individualistic and low uncertainty avoidance cultures, but it is simply ineffective in these contexts. People and organizations in collectivist and high uncertainty avoidance societies respond more favorably to the social and cooperative nature of relational governance, as well as the certainty derived from the focus on solidarity and longer-term commitments under relational governance. Again, the managerial implication is that when the service provider has operations in these societies, the overall governance system should emphasize relational mechanisms such as socialization initiatives, information sharing,

Table 3. Second-stage regression results

Variable	2a		2b		2c		2d		2e		2f		2g	
	Coeff	SE	Coeff	SE	Coeff	SE	Coeff	SE	Coeff	SE	Coeff	SE	Coeff	SE
Constant	-1.116**	0.482	-1.158**	0.498	-1.271**	0.568	-1.399***	0.509	-1.561***	0.547	-0.991	0.634	-0.989	0.641
Opportunism desirability (OD)	-0.120*	0.069	-0.143**	0.067	-0.113	0.080	-0.116	0.075	-0.117	0.075	-0.165*	0.088	-0.163*	0.085
IT outsourcing (IT)	0.271	0.218	0.248	0.205	0.307	0.208	0.452**	0.206	0.442**	0.200	0.215	0.225	0.199	0.237
Logistics outsourcing (LOG)	0.691***	0.243	0.726***	0.245	0.801***	0.254	0.980***	0.236	0.973***	0.228	0.797***	0.264	0.783***	0.260
FA outsourcing (FA)	0.232	0.307	0.227	0.306	0.264	0.308	0.368	0.284	0.396	0.278	0.272	0.322	0.270	0.327
Firm size (revenue) (FS)	0.011	0.059	0.011	0.058	-0.002	0.066	-0.032	0.066	-0.033	0.066	-0.025	0.066	-0.023	0.068
Longevity of relationship (LR)	0.031	0.032	0.030	0.031	0.025	0.027	0.030	0.027	0.031	0.026	0.021	0.026	0.021	0.026
Contract enforcement (CE)	0.000	0.002	0.000	0.002	0.000	0.002	0.001	0.002	0.001	0.002	0.002	0.002	0.002	0.002
Cross-cultural Relationship (CR)	0.137	0.234	0.129	0.237	0.188	0.266	0.265	0.278	0.196	0.324	0.056	0.313	0.046	0.317
Buyer subsidiary (BS)	0.005	0.028	0.006	0.027	0.014	0.026	0.007	0.029	0.016	0.030	0.006	0.033	0.008	0.032
Technological uncertainty (TU)	0.036	0.099	0.034	0.101	0.035	0.111	0.022	0.110	0.016	0.105	0.034	0.111	0.036	0.114
Switching difficulty (SD)	0.084	0.064	0.088	0.065	0.075	0.063	0.063	0.056	0.088	0.065	0.040	0.062	0.040	0.062
Provider specificity (PS)	-0.301*	0.161	-0.304*	0.167	-0.309*	0.170	-0.324**	0.149	-0.313**	0.151	-0.353**	0.172	-0.348**	0.169
Contractual governance (CG_r)			-0.140*	0.089	-0.120*	0.079	-0.036	0.073	-0.026	0.081	-0.097	0.077	-0.093	0.078
Relational governance (RG_r)			-0.190*	0.119	-0.202**	0.109	-0.196***	0.056	-0.163**	0.070	-0.180**	0.089	-0.168**	0.079
CG_r × RG_r					-0.180	0.199	-0.157	0.146	-0.230**	0.118	-0.159	0.156	-0.163	0.150
Individualism (IDV)							0.078	0.131	0.051	0.148				
IDV × CG_r							-0.208*	0.128	-0.236**	0.117				
IDV × RG_r							0.205**	0.096	0.158**	0.085				
IDV × CG_r × RG_r							0.194*		0.106					
Uncertainty avoidance (UAI)														
UAI × CG_r														
UAI × RG_r														
UAI × CG_r × RG_r														
F	1.83	2.24	2.24	4.16	4.16	11.92	23.63	23.63	23.63	9.14	9.14	13.31	13.31	
Prob > F	0.064	0.017	0.017	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	
F (relative to prior)		2.12	2.12	0.82	0.82	6.54	3.39	3.39	3.39	7.32	7.32	0.19	0.19	
Prob > F (relative to prior)		0.129	0.129	0.369	0.369	0.001	0.071	0.071	0.071	0.000	0.000	0.668	0.668	
R ²	0.148	0.175	0.175	0.197	0.197	0.263	0.281	0.281	0.281	0.264	0.264	0.265	0.265	

*p < 0.10; **p < 0.05; ***p < 0.01
 Standard errors are calculated using robust clustering on the customer variable.
 One-tail (/-) test used when a directionally specific effect was posited (i.e., the effects of CG, RG, and all hypothesized effects). Two-tail tests used otherwise.
 CG_r, RG_r, and associated interactions are based on the residuals from the first-stage regressions.
 The bold values represent statistically significant values.

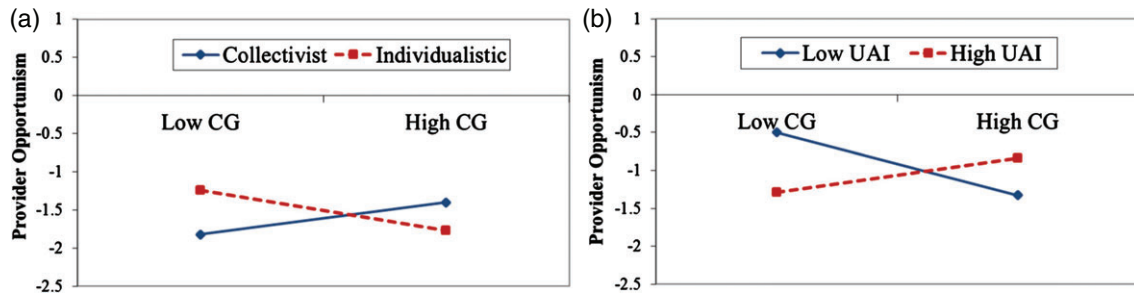


Figure 3. (a,b) Interaction graphs of contractual governance and national culture

cooperative problem solving, and open communication. Doing so should have the most profound impact on reducing opportunism. Alternatively, when service providers operate in individualistic and low uncertainty avoidance cultures, these practices will be only marginally effective at mitigating the threat of opportunism. Outsourcing managers should seek alternative means of addressing these behavioral concerns.

Just as culture moderates the effectiveness of each mechanism individually, it is plausible that culture moderates their joint effectiveness as well (i.e., a three-way interaction). Our results indicate that the interactive effect of the two governance mechanisms is significantly moderated by the individualism–collectivism cultural dimension but not significantly moderated by uncertainty avoidance. To further our understanding of the influence of individualism–collectivism on the joint effect of contractual and relational governance, the three-way interaction is pictorially presented in Figure 5. In this graph, complementarity between contractual and relational governance would be indicated by “High RG, High CG” (line 1), which has lower levels of opportunism than do any of the three other combinations. These results depict an intricate relationship between individualism–collectivism and the effectiveness of these two governance mechanisms. There are a few key takeaways from these findings. First, we generally observe that the combination of contractual and relational governance is an effective strategy; however, it is known that there is a cost to deploying each governance mechanism (Das and Teng, 1998). Therefore, outsourcing firms need to balance the potentially small benefit of using *both* forms of governance against their cost of deployment. In Figure 5, we find that the incremental benefit of using the two governance mechanisms jointly, rather than relying

on a single well-aligned governance approach, may be modest. Bearing in mind the cost, the best strategy for outsourcers may be using a contractual approach with service providers in individualistic cultures and a relational approach with service providers in collectivist cultures even though using both has a more pronounced effect. Next, it appears that contractual governance should not be used as the sole governance mechanism in collectivist cultures. Not only is this approach ineffective, but it seems to be in such contrast to societal norms that service providers perceive it as an injustice they seek to right through more pronounced opportunistic behavior. Thus, firms wishing to employ contractual governance should also incorporate relational mechanisms. Similarly, we do not advise outsourcing firms to rely only on relational governance with service providers in individualistic cultures. Perhaps members of these societies have a greater proclivity toward opportunism (on average), and the trusting nature of high relational governance is dangerous without corresponding economic incentives to control provider behavior. It is important to note, however, that these insights and our interpretations are with regard to the effect of governance on the risk of opportunism. While beyond the scope of this study, we fully recognize that strong relational governance and well-specified contracts may benefit the exchange in other ways such as improved interfirm coordination.

CONCLUSION

Our study makes multiple theoretical contributions to the outsourcing literature. First, the theoretical framing of our model is grounded in Williamson’s (1991) “shift parameter” analysis. The results herein contribute much needed empirical evidence supporting his assertion that the institutional

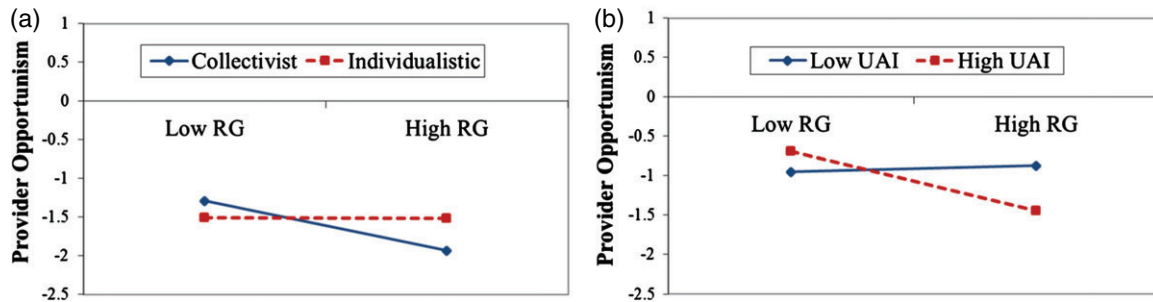


Figure 4. (a,b) Interaction graphs of relational governance and national culture

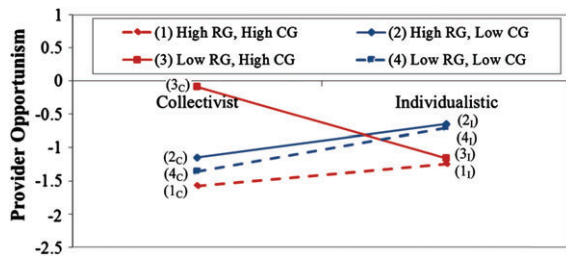


Figure 5. Three-way interaction of CG, RG, and the individualism-collectivism cultural dimension

environment, as it relates to culture, impacts (i.e., shifts) the comparative effectiveness of governance mechanisms. Previously, empirical evidence supporting this framework has been limited (Oxley, 1999). Second, our findings complement prior work on the extent to which governance misalignments matter (Argyres and Bigelow, 2007; Nickerson and Silverman, 2003; Sampson, 2004). We find that firms relying on CG in low IDV or high UAI environments and firms relying on RG in high IDV or low UAI environments, may experience disappointing outcomes in terms of the mitigation of opportunism. Finally, the preponderance of prior studies exploring the individual and joint effects of CG and RG in international outsourcing, do so using a sample of supplier relationships based in a single country such as China (Li *et al.*, 2010; Liu *et al.*, 2009) or India (Jayaraman *et al.*, 2013). These prior contributions offer valuable insights into the effectiveness of governance mechanisms within these specific countries. Yet, their empirical setting lacks sufficient institutional heterogeneity, restricting their ability to speak more broadly about the influence of specific societal factors (e.g., culture). This leads Zhou and Xu (2012: 690) to note that “a multicountry research setting is needed to better assess the effects of alternative governance mechanisms.” Directly to this point, we sought a

context under which domestic firms outsource to a wide variety of countries, which inherently possess a wide array of cultures. This is theoretically and practically interesting because it provides us with broader insight about certain cultural constructs (i.e., IDV and UAI), while also controlling for other germane factors.

There are limitations in our study that present opportunities for additional research on the management of international outsourcing relationships. Also, the nature of our results opens the door for future studies to explore alternative explanations for our findings. First, the cross-sectional nature of our data limits the extent to which assertions of causality can be made. Additionally, although we did not find any evidence of response bias, the validity of our inferences should be judged in light of the modest response rate and sample size. Future research can seek to further validate our findings using larger samples and longitudinal data allowing for stronger claims of causality. The current study reveals the important role that national culture plays in moderating the effectiveness of governance mechanisms, but alternative explanations are worth considering. While we control for several factors, it is also plausible that other national institutions (e.g., strength of contract law, interpretation of laws and the legal environment, regulatory environment, protection of intellectual property, etc.) influence the utility of interfirm management practices. Our model includes the buyer subsidiary variable to control for the buying firm’s prior experience with the provider’s culture; however, such cultural exposure can be gained through previous sourcing activity in these or similar cultures as well. In accordance with TCT, our analysis controls for the effects of technological uncertainty, buyer switching difficulty, provider specificity, and other factors. However, the TCT literature recognizes

additional exchange hazards (e.g., site specificity, temporal specificity) that should be considered in exploring alternative explanations for the intricate relationship between culture, governance, and opportunism. Similarly, while switching difficulty and provider specificity allow us in part to isolate the potential influence of interfirm dependency on opportunism, closely related factors (e.g., supply market dynamics, operational disruption risk, etc.) may also contribute to the relative dependency and vulnerability of both firms. These provide alternative explanations for our findings that could not be ruled out without further research. In the current study, all customer organizations are based in the U.S. Future research could extend this line of inquiry by studying relationships involving non-U.S. customer firms. Our theoretical logic is based on the culture in the provider's country shifting the effectiveness of CG and RG in mitigating opportunism and not the buyer's culture or even cultural differences. Additionally, our model controls for whether the outsourcing relationship is cross-cultural. Thus, we would not anticipate a change in our findings with customer firms in non-U.S. countries. Yet, this is an empirical question worthy of future investigation. We believe it is also important to study opportunistic behavior from the standpoint of the buying firm: we are not familiar with any study that simultaneously accounts for double-sided opportunistic behavior. Finally, the focus herein was on the influence of culture on the ability to control provider behavior. However, another managerial imperative is coordinating with the provider (Dibbern, Winkler, and Heinzl, 2008). Future studies should evaluate the impact of culture on the practices used by customer organizations to coordinate with service providers. We encourage scholars to pursue these and other research questions to continue to advance our understanding of the most appropriate means of managing complex global outsourcing arrangements.

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SUPPORTING INFORMATION

Additional supporting information may be found in the online version of this article:

Appendix S1. Overview of sample and measurement.