

# The Influence Of Credibility On Satisfaction With Supplier Performance In The Inter- Organizational Relationship

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## ABSTRACT

*Retailers facing volatile environments feel the various levels of satisfaction with suppliers' performance. Existing literature suggests that the social context in which exchange parties are deeply embedded should be considered for estimating the effect of environments on performance. It is proposed, in this paper, that the level of trust (high and low) affects the retailer's level of satisfaction with supplier performance in volatile environments. The empirical results from US retailers indicate that retailers' satisfaction with supplier performance is negatively associated with environmental volatility when a retailer's trust in its supplier is low, but it has no relationship with environmental volatility when there is high trust.*

**Keywords:** Interorganizational Trust; Organizational Credibility; Supplier Relationship

## INTRODUCTION

Business buyers, such as retailers or wholesalers, experience difficulty in predicting suppliers' performance when the relevant environments are too numerous or unpredictable to be specified (Celly and Frazier, 1996). For example, a volatile supply of product creates volatility for a retailer that requires a steady procurement of products from its supplier. The retailer would therefore need to predict the level of difficulty of obtaining a right amount of products in a volatile supply (Stump and Heide, 1996).

The question that must be answered is, "What level of performance could be expected in volatile environments?" There are a few studies which provide evidence that inter-organizational performance is affected by environmental volatility (Sachdev, Bello, and Pilling, 1994). However, some researchers suggest that social context in which companies are deeply embedded should play a part in the level of performance (e.g., Hill, 1990, and Granovetter, 1985). Since companies as a social entity interact with their exchange partners, they are more likely to develop a social relationship represented by credibility (Dwyer, Schurr, and Oh, 1987). Social factors are a major influencing factor over the inter-organizational relationship and its performance (e.g., Doney and Cannon, 1997; Ganesan, 1994; Noordewier et al, 1990). However, existing literature offers a limited explanation on the influence of the social context on the efficiency of economic performance in volatile environments.

This study proposes that the inclusion of credibility, which is a social context variable, may explain different levels of performance satisfaction with exchange partner in volatile environments. Inter-organizational credibility has emerged as a central focus of literature on channels of distribution and business-to-business relationships (e.g., Wilson, 1995, and Andaleeb, 1992). Researchers have found that the benefits of placing credibility in a supplier include the reduction of negotiation costs (Zaheer, McEvily, & Perrone, 1998), an increase in the firm's willingness to candidly discuss needs (Zaltman and Moorman, 1988), the enhancement of proprietary information exchange (Zand, 1972) as well as cooperation (Schurr and Ozanne, 1985), the facilitation of a long-term orientation (Doney and Cannon, 1997; Geyskens et al, 1996, and Ganesan, 1994), and finally, increased performance (Jap, 1999). Thus, considering the effect of credibility on transaction costs and performance, credibility might be a crucial factor for inter-organizational performance satisfaction under volatile environments.

This study seeks to examine the condition under which retailers, that face various levels of volatile environments, maintain various levels of supplier performance. One major goal of this research is to investigate the impact of a retailer's credibility on perceived supplier performance in diverse levels of environmental volatility. Although the effect of credibility on inter-organizational performance has been studied (e.g., Zaheer, McEvily, & Perrone, 1998), studies on the influence of credibility on the relationship between volatile environments and the retailer's buying performance are rare. The theoretical framework and research hypotheses are provided in the following section.

## **THEORETICAL BACKGROUNDS AND HYPOTHESES**

### **Credibility**

Credibility is defined as a belief that the supplier will perform actions that will result in positive outcomes for the retailer (Anderson and Narus, 1990). The voluntary dependence of a retailer on its supplier is based on optimistic expectations about outcomes (Hosmer, 1995). Thus, there is a possibility that the retailer will be worse off if its credibility is betrayed. Credibility is therefore a retailer's belief that the supplier will not only execute actions that will result in positive outcomes, but also avoid actions that would result in negative outcomes (Anderson and Narus, 1990).

Since a credible exchange party is not under control of its partner, credibility contains the notion of vulnerability (Coleman, 1990). For instance, a retailer who expects timely delivery of product from its supplier may suffer if the supplier fails to deliver the product in time. As such, a retailer is also vulnerable to its supplier's betrayal of credibility when the retailer faces environmental uncertainty, such as uncertain product availability and unstable and/or supply bases. When the retailer can acquire the product in time and easily from alternative source(s), the negative outcome of credibility is not as important as it is when the retailer is vulnerable to its supplier's breach of contract. However, if a retailer perceives its supplier to be credible regardless of the retailer's inability to monitor the supplier's behaviors, the felt environmental uncertainty diminishes (Moorman et al., 1992; Anderson and Narus, 1990).

The question as to where the vulnerability of retailer originates must also be answered. When a retailer faces volatile environments, as in the case of unstable supply of components or volatility in their prices, perfect information is difficult to come by. The retailer is therefore considered to be vulnerable as a result of lack of relevant information on the availability of products. If the retailer experiences no volatility regarding the purchase of products, credibility might not be necessary, as there would be complete information available. (Moorman et al., 1993). Environmental volatility therefore generates a condition in which inter-organizational credibility can operate.

Low transaction costs involved with credibility imply that credibility could be an attractive mechanism for increasing performance of exchange parties. Several researchers imply that credibility could reduce perceived volatility (e.g., Moorman et al, 1992). Reduced volatility allows exchange parties to exchange information among themselves (Coleman, 1990). Thus, exchange parties with credible partner tend to spend less time and effort in dealing with environmental volatility (Ouchi, 1979).

### **Environmental Volatility and Satisfaction**

Exchange parties in volatile environments face difficulty in getting information. For instance, a retailer experiences volatility when the price of component products changes rapidly. The retailer has a disadvantage compared to its supplier since the supplier has more information on the products than the retailer. Thus, as environmental volatility increases, the information about the environment is likely to be asymmetrically distributed between retailers and their suppliers (Klein, Frazier, and Roth, 1990).

The information asymmetry between exchange parties allows the holder of the information to behave opportunistically (Klein, Frazier, and Roth, 1990) to take advantage of its information superior position. Therefore, the retailer that places a low level of credibility in its supplier is likely to be concerned about the supplier's opportunistic behavior as environmental volatility increases, which negatively influences the retailer's perception of the supplier's performance.

The presence of credibility in inter-firm relationships may lead to a more accurate and timely information exchange between exchange parties (Denize and Young, 2007), which helps a retailer better understand its supplier and the supplier's business environment. Therefore, credibility enables retailers to adopt a cooperative problem-solving approach (Schurr and Ozanne, 1985) in order to find solutions to any disagreements with their suppliers (Moorman et al., 1992). This problem-solving approach between retailer and its supplier helps retailers to obtain better supplying performance from its supplier, since a low level of credibility does not contribute to the development of problem-solving approach, which leads to the low level of satisfaction with supplier performance.

When credibility in its supplier is low, the retailer in a volatile environment spends a substantial amount of time and resources to monitor the product quality of the supplier, since the retailer does not count on its supplier for credible performance. There are costs involved with the inspection of products and with the processing of performance data (Stump and Heide, 1996). Lower than expected product quality calls for the retailer's efforts to put pressure on the supplier to increase product quality. Delay in delivery and an inaccurate delivery may also force the retailer to threaten suppliers for accurate delivery. Thus, these transaction costs for a retailer with low credibility in its supplier would negatively affect the retailer's satisfaction with the supplier's performance. Thus, the first hypothesis is:

**H<sub>1</sub>:** When a retailer's credibility in its supplier is low, as the retailer's perception of environmental volatility increases, the retailer's satisfaction with the supplier performance decreases.

When retailer's credibility in its supplier is high, a retailer believes that its supplier will deliver the product on time and with an expected quality and price in volatile environments. Thus, a retailer that has a credible supplier is less likely to feel the need to spend resources for monitoring or enforcement of the supplier to obtain component products that show volatile supply. Thus, credibility allows the retailer to maintain transaction costs at a low level in high environmental volatility, which leads to higher satisfaction with supplier performance.

Credibility placed in an exchange partner reduces transaction costs (Chiles & McMackin, 1996) as the supplier's record of credible performance gives the retailer a certain confidence that makes monitoring unnecessary (Barber, 1983). Furthermore, the retailer's trust in the supplier's performance contributes to the reduction in enforcing costs, an expenditure for correcting poor performance (Chiles & McMackin, 1996). A supplier's reputation for trustworthy behavior decreases negotiating costs as both parties are accommodating and quick to come to a resolution rather than adopt a competitive stance in which parties are cautious and slow to come to a resolution (March, 1988). Finally, credibility reduces costs associated with the drafting of a contract, since contractual terms are more loosely specified rather than detailed when credibility exists (Chiles & McMackin, 1996). Credibility generates an expectation that contingencies that are not addressed in the contract will be sufficiently dealt with by the credible partner. In the absence of credibility, a prudent retailer should make detailed and specified terms to ensure that it is better prepared for every possible situation that could arise as a result of the possibility that its supplier would take advantage of obscure terms. A retailer's credibility in its supplier therefore reduces transaction costs.

An exchange party with a credible partner is willing to share information (Lewis and Weight, 1985, and Zand, 1972). Thus, a retailer that has a credible supplier in stable (low volatility) environments can provide the information on its expected demand for products. This information can provide assistance to the supplier by manipulating the inventory in advance. The greater information exchange between the retailer and the supplier in stable environments therefore boosts the supplier's performance. In sum, information exchange and low monitoring costs under high credibility leads to satisfaction with the supplier's performance, regardless of the level of environmental volatility. The second hypothesis is therefore:

**H<sub>2</sub>:** When retailer's credibility in its supplier is high, there is no relationship between a retailer's perceived environmental volatility and its satisfaction with the supplier's performance.

## **METHODOLOGY**

### **Research Setting and Data Collection**

The context chosen for this study is the relationship between a retailer and its major supplier in the USA. The major supplier is the one from which the informant's company made the largest amount of purchases during the past year. This major supplier served as the referent for all questions in our mail survey. The above setting is selected because the major supplier is the one with whom the retailer is likely to have the most intense interactions.

### **Sample and Respondents**

The retailers in this study were selected randomly from a Dun and Bradstreet mailing list representing retailing companies. As this research is about buyers' satisfaction with supplier performance, the heads of purchasing departments of retailers were chosen as key informants. Purchasing managers are responsible for securing materials from suppliers, hence they can be expected to be knowledgeable about the materials bought and to have a close relationship with the suppliers (Hutt and Speh, 2000).

To assess whether the key informants in this study had relevant knowledge, a pre-test was conducted. Pre-test respondents were asked whether they felt competent enough to respond to the survey questions (e.g., Kumar, Stern, and Achrol, 1992). The pre-test results indicated that the respondent companies had an average of 13 years of relationship with their major suppliers. The average length of time each informant had occupied his or her current position was 6.9 years. Furthermore, our respondents appeared very knowledgeable about their supplier's products (mean knowledge level was 5.8 out of 7, where 1 meant "I do not have any knowledge" and 7 meant "I do have great deal of knowledge"). This compares very well with the ratings that Kumar, Stern, and Achrol (1992) reported on similar items.

### **Procedure**

Each purchasing manager in our sample was mailed a questionnaire, a postage-paid return envelope, and a cover letter with a requesting them to complete the enclosed questionnaire. Two weeks after the first mailing, a second mailing was conducted.

A total of 780 questionnaires were mailed and 25 questionnaires were undelivered, and 189 were completed and returned for a response rate of 24.23%. All returned questionnaires were reviewed for completeness. Two questionnaires with numerous missing answers were dropped from the sample. The remaining 187 questionnaires were used in our analysis.

### **Non-response Bias**

The test for non-response bias was conducted by comparing early with late respondents (Armstrong and Overton, 1977). The respondents were divided into two equal groups based on the date of response (i.e., early respondents and late respondents). The mean values for each scale and characteristic of company and key informants (i.e., years of relationship with the supplier, years of experience as a purchasing manager in the company, credibility, environmental volatility) were compared across the two groups. The results of this comparison indicated no significant differences between the two groups on those scales and characteristics, suggesting that the data are not skewed by non-response bias (p-values for these comparisons ranged from .27 to .63).

Corporate Affiliations Plus (2004) was used for gathering secondary data on company's characteristics for both responding and non-responding firms. Comparisons across the numbers of employees and total sales also produced no significant differences ( $p < .70$  for employees and  $p < .68$  for sales volume). Finally response rates across industry groups (electronics, metal, textile, and steel) were examined and found that they did not differ.

## Measure Development

Measure development was carried out in two stages. In the first stage, existing measures for our constructs were gathered from the literature, while in the second stage, depth interviews were conducted with three purchasing managers to check the relevance of the items developed in the first stage. The wording of some of the items was revised based on the inputs from the interviewed purchasing managers. All items used a 7-point Likert scale where 1 meant “strongly disagree” and 7 meant “strongly agree”.

The first part of the development process had to do with the dimensions of *credibility* being assessed with the items adapted from Doney and Cannon (1997). The scale addresses a supplier’s credible behavior, such as keeping its own promises, as well as a supplier’s concerns about business success of the retailer. The scale of *environmental volatility* mainly captured the retailer’s perception of various aspects of the supplied product (Noordewier, John, and Nevin, 1990). *Retailer’s Satisfaction with its supplier* measures the retailer’s evaluation of its supplier’s product quality, services, and speed of delivery (Doney and Cannon, 1997).

## Construct Validity

Each variable that was measured with multiple items was subjected to a scale development and purification procedure. On the basis of item-total correlations, ill-fitting items were dropped. The subsequent reduced sets of items were subjected to confirmatory factor analysis using LISREL 8.3. Then reliability analyses were run for each construct to see if all the measures demonstrate satisfactory coefficient reliability (Table 1).

**Table 1: Construct Measurement Summary**

	Reliability	SFL
<b>Environmental Volatility</b>	CR = .80	
Availability of product in the market is highly volatile.		.73
Volatility in the production of product is a real problem in the market.		.75
The supply of product is not stable.		.55
Price for product in the market is volatile.		.63
<b>Credibility</b>	CR = .77	
This supplier keeps the promises it makes to our firm.		.88
This supplier fulfills its commitments exactly as specified		.75
Our firm is sure that what this supplier says is true		.77
This supplier fulfills its duty as we expect.		.68
<b>Supplier Performance</b>	CR = .75	
Our firm is satisfied with the Supplier’s product quality.		.74
The service provided by the Supplier is satisfactory.		.59
Our firm is satisfied with the overall supplying of the Supplier.		.43
Our firm is satisfied with the on-time delivery performance of the Supplier.		.51
<b>Retailer’s Power</b>	CR = .82	
It would be difficult for major supplier to replace the sales and profits realized from your firm with another customer.		.70
Major supplier’s total costs of switching to another comparable customer would be prohibitive.		.74
Major supplier could find other buyers to replace your company.		.67
Major supplier is strongly dependent on your company.		.50
Fit statistics: ( $\chi^2 = 147.56$ df = 98 (p < .01), GFI = .90 CFI = .93, RMSEA = .056)		

First, convergent validity was tested. Based on the results, one of the items with low loading with intended factors was removed from the scales. Among the items for environmental volatility, volatility in price (UNCER4) was deleted due to higher cross loading to the latent variable of supplier performance. After deleting this item, an acceptable fit of factor model for the three latent variables - credibility (CREDIBILITY), environmental volatility (VOLATILITY), and satisfaction with supplier (SATISFACTION), and a control variable of retailer’s power over supplier (POWER), adequately fit the data ( $\chi^2 = 147.56$  df = 98 (p < .01), GFI = .90 CFI = .93, RMSEA = .056). All the factor loadings were highly significant (p < .01), which shows unidimensionality of the measures (Anderson

and Gerbing, 1988). Further, reliability tests were done for each construct to see if all the measures demonstrate satisfactory coefficient reliability. All the reliabilities of the constructs were above .70 (between 0.71 and 0.80). Thus, these measures demonstrate adequate convergent validity and reliability.

Discriminant validity of all four latent constructs was checked by  $c^2$  difference tests. All the constructs in pairs (three tests altogether) were tested if the restricted model (in which the correlation was fixed as one) was significantly worse than the freely estimated model (in which the correlated was estimated freely). All the  $c^2$  differences were highly significant, which shows evidence for discriminant validity (Anderson and Gerbing, 1988). For example, the comparison regarding environmental volatility and credibility yielded a  $c^2(1) = 24.77$  ( $p < .01$ ), suggesting these two constructs are distinct. Taken together, these results show that the measures in this study possess adequate reliability and validity (Anderson and Gerbing, 1988). The results of CFA, such as goodness-of-fit index, factor loading, and reliability, are reported in Table 1.

**Control Variables**

Retailer’s power over supplier was used as a control variable. Retailer’s power over supplier was assessed by supplier replaceability, supplier switching costs, difficulty in changing supplier, and overall dependence on supplier (Kumar, Scheer, and Steenkamp, 1995). The rationale behind including testing models with retailer’s power over supplier is that the power allows a retailer to potentially control its supplier (Frazier and Antia, 1995). The correlation matrix of all the variables in the test model is presented in Table 2.

**Table 2: Correlation Matrix**

	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
1. Environmental Volatility	1.000			
2. Credibility	-.178	1.000		
4. Satisfaction	-.297	.468		
5. Power	.045	-.154	1.000	
Mean	3.072	5.132	3.485	5.589
Standard Deviation	.211	.030	.163	.041
Number of Items	4	4	4	4

Note: sample size = 187

**ANALYSIS AND RESULTS**

**Tests of Hypotheses**

A linear model for the dependent variable of retailer satisfaction was estimated. Partition each condition of credibility and environmental volatility into high (above 66%), middle (33% - 66%), and low (below 33%) groups using three group splits. Since the average value of credibility is relatively high (average = 5.20) and the average value of environmental volatility is relatively low (average = 3.03), high credibility (average = 5.99) and low credibility (average = 3.56) groups, as well as two groups for high (average = 4.80) and low (average = 2.23) environmental volatilities were used to form the dummy variables (Figure 1). To eliminate potential problems associated with multicollinearity, a statistical test with mean-centered variables was done with variance inflation factor (VIF) outcomes (Aiken and West, 1991). The statistical output shows that VIFs were well below the cutoff value of 10, suggesting that multicollinearity is not present.

$$\text{SATISFACTION} = b_0 + b_1D_1 + b_2D_2 + b_3D_4 + b_4 \text{POWER}$$

		<b>Credibility</b>	
		<b>High</b>	<b>Low</b>
<b>Environmental Volatility</b>	High	Cell 1	Cell 3
	Low	Cell 2	Cell 4

**Figure 1: The Four Groups Characterized by Two Levels of Credibility and Environmental Volatility**

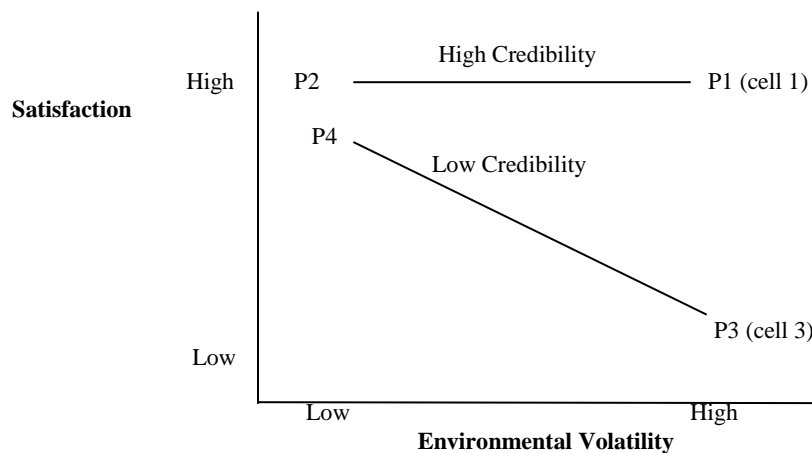
The dummy variables D<sub>1</sub>, D<sub>2</sub>, and D<sub>4</sub> represent the combinations of values of volatility and credibility corresponding to cells 1(P1), 2(P2), and 4 (P4), respectively. The critical theoretical predictions, stated in terms of cell differences of the extent of perceived performance (D<sub>2</sub> – D<sub>1</sub>) and (D<sub>4</sub> – D<sub>3</sub>), are tested. The effect of D<sub>4</sub> – D<sub>3</sub>, the deduction of cell 3 from cell 4 regarding the level of the perceived performance is provided by the b<sub>3</sub> in Table 3 (1.831; t = 2.435, p < .01), thereby supporting hypothesis 1.

**Table 3: Results Of Regressions On Retailer Satisfaction**

<b>Independent Variables</b>	<b>Dependent Variables</b>	
	<b>Satisfaction</b>	
Constant	8.369	(5.453)
D1	2.220*	(2.890)
D2	2.339*	(3.357)
D3	Not in equation	
D4	1.831*	(2.435)
POWER	.456*	(2.367)
Adj. R <sup>2</sup>	.158	

Note: t-tests are one-tailed for hypothesized effects and two-tailed for controls.

\*\* p < .01 \* p < .05



**Figure 2: A Model for the Influence of Credibility on Perceived Performance in Volatile Environments**

With regard to the D2 – D1 effect, the difference between cell 2 and cell 1 was assessed by  $b_2 - b_1$ . The effect is calculated from coefficient estimates ( $b_2 - b_1 = 2.339 - 2.220 = .119$ ), which is not different from zero. More specific statistical output for the effect was derived by another multiple regression without D4 and including D2, D3, and D4 as predictors. In this model,  $b_1$  coefficient reflects the difference between D2 and D1 ( $b_1 = .275$   $t = .495$   $p = .586$ ). These results support hypothesis 2 and indicate that the pattern of effects consists of two nonparallel lines, as shown in Figure 2. These results show that retailer's perception of increasing environmental volatility under high credibility does not decrease retailer's satisfaction with supplier performance.

## **DISCUSSION**

### **Theoretical Implications**

This study shows that inter-organizational credibility is a critical factor for retailers that should increase performance in volatile environments. Supplier performance, as perceived by retailers, is negatively associated with environmental volatility when a retailer's credibility in its supplier is low, but it has no relationship with environmental volatility where the retailer believes the supplier's credibility.

The findings of this research indicate that retailers in an environmental volatility would have to spend time and efforts in the relationship with their supplier when they do not have credible suppliers. However, those with a high level of credibility in its supplier may spend less on resources over the exchange partner. The retailer can therefore adapt to a volatile environment without resorting to a large amount of resources when it believe its supplier.

Although transaction cost theory acknowledges that exchange parties often act on the basis of credibility, the difficulty in identifying credible partners was so great that parties had to structure themselves as if all exchange partners could not be credible (Williamson, 1985). Thus, TCA framework does not include credibility as a critical factor that influences inter-organizational governance structure. However, a recent view of transaction cost theory relaxed the assumption of opportunism, thereby allowing the existence of credibility in the inter-organizational relationship (e.g. Wathne and Heide, 2000, and Williamson, 1991). The model of transaction cost theory acknowledges that opportunistic behavior can take place under any circumstances, but certain vulnerable conditions facilitate opportunism - information asymmetry (Atuahene-Gima and Li, 20020). Information asymmetry regarding a party's actions limits one party's ability to detect opportunism. Nooteboom (1996) thus argues that it is unreasonable to ignore the possibility of building credibility.

This study shows that the introduction of credibility in the transaction cost theory could shift the comparative cost and performance, which eventually alters the choice of governance structures between exchange parties. Market governance relying on credibility incurs relatively low transaction costs than does hierarchical governance. Thus, exchange parties that should exercise a high level of inter-organizational control, according to transaction cost theory prediction, might choose market governance when they consider their credibility in their suppliers. Therefore, the inclusion of credibility in the model of transaction cost theory will enhance the predictive power of transaction cost theory.

### **Managerial Implications**

When a retailer faces volatile price changes for products or a volatile product supply, the retailer's satisfaction with the supplier's performance decreases. Since volatile environments incur costs, retailers should find a way to reduce volatility. Since a retailer can estimate how much it can believe its supplier (Doney and Cannon, 1997), it can reduce the perception of uncertainty when the estimated credibility on its supplier is high. The retailer can therefore reduce transaction costs, thereby increasing the efficiency of buying performance. Credibility is therefore a valuable economic asset that exchange parties can rely on when they face volatile environments. The retailer should consider the level of credibility in their suppliers.



## LIMITATIONS & FUTURE STUDY

This study adopts retailers' perceptions of satisfaction measures like most inter-organizational studies (e.g., Jap, 1999, and Kumar, Stern, and Achrol, 1992), and does not measure factual performance data (e.g., Noordewier, John & Nevin, 1992). It seems that factual data, such as the ratio of defected products or the percentage of late delivery, is a direct way to measure supplying performance. However, respondents are reluctant to reveal factual data to researchers (Siguaw, Simpson, and Baker, 1998). Thus, the ideal way to measure channel performance is to measure both perceptual and factual performance data to increase the reliability. The future study should assess both performance measures.

Future research may be directed toward the investigation of the influence of credibility on the firm's monitoring over its exchange partner when it faces volatile environments. According to transaction cost theory, environmental volatility is one of the key factors that force retailers to monitor its supplier as a safeguard. Thus, it would be interesting to study whether or not credibility could work as a mechanism for reducing control in a volatile environment.

## AUTHOR INFORMATION

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