Performance-enhancing Effect of Eased Negotiations through Relational Governance

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ABSTRACT

The aim of this study is to examine the impact of transaction cost variables (environmental uncertainty and negotiation costs) and prior cooperation as a proxy for inter-organizational trust on relationship performance. This study proposes that relational governance (through prior cooperation) provides negotiation efficiency which in turn enhances relationship performance by improving the access to information and promoting situational flexibility in harmony of mutual interests and hence facilitating sequential coordinated adaptations. In this connection, prior cooperation is considered as a moderator in the relationship between negotiation costs and performance. The empirical results of this study confirm the moderating role of relational governance in improving performance. To the best of our knowledge, this study provides the first empirical evidence for the performance-enhancing effect of eased negotiations through relational governance. Therefore, we believe that this study that offers an understanding of performance enhancement based on efficiencies gained from eased negotiations contributes to the literature.

Keywords: relationship performance, negotiation costs, prior cooperation, environmental uncertainty.

1. Introduction

The extent of drafting a contract in sufficient detail is an important strategic choice that affects the performance of inter-organizational relationships (Lui, Wong and Liu, 2009; Wuyts and Geyskens, 2005; Zaheer, McEvily and Perrone, 1998). Contract design decisions are influenced by the trade-off between the ex-ante costs of crafting more complete contracts and the ex-post costs of adjusting contracts in accordance with changing circumstances (Crocker and Reynolds, 1993; Mooi and Ghosh, 2010). On the one hand a more complete contract that specifies the conditions of transactions in coverage of planning for unanticipated contingencies during negotiations reduces the risk of opportunism and facilitates subsequent adaptation (Luo, 2002, 2005; Poppo and Zenger 2002). On the other hand the ability of exchange partners to completely specify all potential contingencies in a contract is limited by ex-ante costs of contracting (Crocker and Reynolds, 1993; Saussier, 2000; Zaheer et al., 1998). Due to the high costs of drafting, negotiating and safeguarding an agreement (Williamson, 1996) increasing the level of contractual incompleteness gives rise to the ex-post inefficient renegotiation that decreases the performance of the relationships (Crocker and
Reynolds, 1993; Zaheer et al., 1998). However the governance of inter-organizational relationships involves more than contractual governance (Dyer and Singh, 1998; Granovetter, 1985; Poppo and Zenger, 2002).

Prior research (i.e., Dyer and Chu, 2003; Heide and John, 1990; Lui et al., 2009; Luo, 2002; Lursch and Brown, 1996; McEvily, Perrone and Zaheer, 2003; Noordewier, John and Nevin, 1990; Poppo and Zenger, 2002; Zaheer et al., 1998) has observed that relational governance encourages cooperative behaviour between the exchange parties by facilitating coordinated actions in planning and executing inter-firm activities and hence leads to better relationship performance. Among those recognized for performance-enhancing effect of relational governance, the work of Zaheer et al. (1998) has made a distinctive contribution to the literature by investigating the trust-performance link mediated by negotiation costs. Their results strongly support the thesis that relational governance (i.e., inter-organizational trust) influences negotiation processes and performance. Subsequently, the findings of Dyer and Chu (2003) provide further support for the hypothesis that relational governance facilitates negotiations and results in improved performance. Although the results in both studies strongly support the direct impacts of relational governance on negotiation costs and performance, there is still no empirical evidence confirming the basis of performance enhancement based on efficiencies gained from eased negotiations. Accordingly, our aim here is to fill this gap in the literature by examining the moderating effect of relational governance on the transaction cost-performance relationship.

This study considers that performance losses are outcomes of high governance costs (Gulati and Nickerson, 2008; Williamson, 1985, 1991; Zaheer et al., 1998). Under environmental uncertainty, exchange parties need to adapt to changing conditions when protecting themselves against opportunism risk arising from unpredictability of future behaviour (Artz and Brush, 2000; Gulati, Lawrence and Puranam, 2005; Puranam and Vanneste, 2009; Williamson, 1991). According to the transaction cost theory, contracts as formal governance mechanisms have an information processing and adaptation function beyond their role in reducing incentive conflict under foreseeable circumstances. However designing a contract with sufficient coverage of contingency planning is costly and risky way of managing inter-organizational relationships (Saussier, 2000; Artz and Brush, 2000; Anderson and Dekker, 2005). When the parties have conflicting expectations on the future requirements of the trade, it is difficult to negotiate mutually acceptable responses to environmental changes (Crocker and Reynolds, 1993). In this case, more flexible contracts are desirable because they provide exchange parties with the possibility of making adjustments at
low cost (Fehr, Hart and Zehnder, 2009). On the other side, increasing relational risk with fewer formal safeguards will likely to discourage cooperative orientation in mutually adjusting future actions (Young, Sapienza and Baumer, 2003).

Relational governance mechanisms reduce the perception of opportunistic hazards during the adaptation period when increasing flexibility to respond to changing circumstances (Anderson and Weitz, 1989; Guati and Nickerson, 2008; Jones, Hesterly and Borgatti, 1997; Paulin and Ferguson, 2010, Puranam and Vanneste, 2009; Ring and Van de Ven, 1992). Under the principle of flexibility in a harmony with mutual interests parties are confident that future actions will be adjusted fairly as contingencies change (Dyer and Chu, 2003; Uzzi, 1997; Zhou, Poppo and Yang, 2008). Therefore coordinated responses to environmental changes can be achieved not by referring to costly and inflexible formal safeguarding mechanisms, but by processes of mutual adjustment (Dyer and Singh, 1998; Faems, Janssens, Madhok and Van Looy, 2008, Goo, Kishore, Rao and Nam, 2009; Larson, 1992). Consequently, relational governance results in better performance by providing governance-cost reduction benefits when enhancing the adaptive capacity of governance (Gulati and Nickerson, 2008).

The results of this study obtained from the hotels in the Turkish tourism industry are compatible with this argument. The findings show that increasing costs of negotiating a contract under environmental uncertainty leads to lower levels of relationship performance due to the inefficiencies in mutually adapting to changing environmental situations. Based on the assumption that relational governance improves the performance of inter-organizational relationships by promoting cooperative orientation in adjusting future actions when decreasing the costs of negotiating a contract, the research findings provide support for the performance-enhancing effect of eased negotiations through relational governance. In conclusion, this study contributes to the inter-organizational governance literature by showing that the negotiation efficiency of relational governance relieves the tension between the costs of contracting derived from the two competing requirements (control and adaptation) of governance in uncertain business environments and hence leads to better performance.

2. Hypotheses development

2.1. Transaction cost theory

*Environmental uncertainty and relationship performance:* Under bounded rationality (Cyert and March, 1963; Simon, 1957) environmental uncertainty causes adaptation problems (Gulati et al., 2005; Rindfleish, 1997; Paulin and Ferguson, 2010). According to bounded
rationality as a main behavioural assumption in transaction cost theory (Williamson, 1985), rationality of decision makers is limited by their cognitive constraints on information processing and communication capabilities. In this case, they are not able to accurately predict changes and to plan all feasible actions to be taken in the future despite their best effort to deal with the complexity and unpredictability of environmental circumstances (Aldrich, 1979; Cannon, Archrol and Gundlach, 2000; Leiblein, 2003).

When prices serve as an insufficient statistics to induce market changes, environmental uncertainty requires a more complex form of adaptation that allows coordinated responses by realigning incentives and responsibilities as circumstances change (Williamson, 1991). This cooperative form of adaptation restores inter-organizational efficiency by promoting information exchange and integration of the information into decision-making processes and hence enabling the realignment of actions in a coordinated manner. Governance mechanisms provide exchange parties with access to coordinating capabilities to cooperatively adapt to changing environmental situations when decreasing the relational risks (Lee and Cavusgil, 2006; Poppo and Zenger, 2002). Therefore exchange parties can manage capacity flexibly through recurrent adaptations and mutual adjustments on operations under the circumstances of frequent and simultaneous changes in demand and supply. For example, suppliers (i.e., hotels) would better control their capacity and increase asset utilization if they have access to their customer’s (i.e., tour operators) production plans (/sales forecasts) (Clemons, Reddi and Row, 1993). Without the use of effective mechanisms in managing exchange relationships uncertainty increases residual risks arising from misalignment of incentives and responsibilities as circumstances change (Mellewigt, Decker, and Eckhard, 2012) and hence leads to negative performance effects (Lee and Cavusgil, 2006; Poppo and Zenger, 2002; Heide, 1994; Noordewier et al., 1990).

H1: Environmental uncertainty negatively affects relationship performance.

Negotiation costs and relationship performance: A more complete contract design provides an adjustable framework that facilitates adaptive responses to the changes by specifying each party’s actions during evolving stages of circumstances when defining remedies for conflict resolution and hence reduces the potential for ex post inefficiencies (Williamson, 1991; Luo, 2005). However, its benefits gradually reduce with the increasing costs of drafting a more complete contract under environmental uncertainty (Saussier, 2000). These costs primarily include the difficulties of identifying feasible contingencies and
negotiating mutually acceptable responses (Crocker and Reynolds, 1993). When economizing on transaction costs of conducting exchange is the central premise of improving organizational efficiency that leads to superior performance (Williamson, 1985, 1991), it depends on the parties’ willingness to save the economic costs of contracting by balancing the trade-off between ex ante cost of crafting more complete contracts and ex post inefficiencies associated with less detailed agreements (Zaheer et al., 1998; Crocker and Reynolds, 1993; Mayer and Bercovitz, 2008). Accordingly, the performance of an exchange relationship is negatively influenced by the waste of resources in negotiation process of contracting (Zaheer et al., 1998).

Excessive concentration on negotiating how to distribute realized costs and benefits in each contingency to design a more complete contract restrains exchange parties from establishing a collaborative relationship that allows them to achieve mutually beneficial outcomes in a situation of high uncertainty (Zaheer et al., 1998). It means that the performance of inter-organizational relationships is likely to be lower under environmental uncertainty and information asymmetry when costly efforts of crafting more detailed contracts to control exchange hazards cause inflexibilities in mutually adapting to changing environmental situations (Heide and John, 1990; Dyer, 1996; Nooteboom et al., 1997). This is compatible with the argument that exchange parties are willing to be more flexible, which in turn implies a demand for less safeguards due to the difficulty and costs of crafting more complete contracts under high environmental uncertainty (Balakrishnan and Wernerfelt, 1986; Klein, 1989; Teece, 1992; Saussier, 2000; Anderson and Dekker, 2005; Argyres and Mayer, 2007). High flexibility facilitates sequential coordinated adaptations (Heide and John, 1992; Noordewier et al., 1997; Wathne and Heide, 2004) that enables the parties to fill the planning gaps in the agreements as contingencies arise (Kaufmann and Stern, 1988; Macneil, 1980; Wathne and Heide, 2004). Despite its adaptive advantages, however, high flexibility may increase the relational risk under fewer formal safeguards (Young et al., 2003). In this case, the efficiency and performance of a relationship will reduce by increasing costs of negotiating an acceptable contract whereas opportunism risk continues to exist during the adaptation period.

$H_2$: Negotiation costs negatively affect relationship performance.
2.2. Relational governance view

*Prior cooperation and performance:* Contrary to the above-mentioned effect of contractual governance based on cost-benefit calculus, relational governance has a linear and constant effect in improving performance (Parkhe, 1993; Gulati, 1995; Luo, 2002). This study considers prior cooperation as the determinant of relational governance that captures the history of collaboration between the exchange partners (Gulati, 1995; Poppo and Zenger, 2002; Reuer and Ariño, 2007). Positive experiences from the history of transactions with the same partner enable exchange partners to build a trust-based relational capital (Kale, Singh and Perlmutter, 2000; Lui et al., 2009). Building a strong relational capital creates a climate of openness that facilitates information exchange between the partners when reducing the risk of opportunistic behavior hindering to learning and promoting reciprocity through mutually cooperative behavior (Doz, 1996; Kale et al., 2000; Luo, 2002; Lui et al., 2009). Thus exchange partners can share the external risks arising from uncertainty with a fairly payoff distribution (Ouchi, 1980; Parkhe, 1993; Luo, 2002; Dyer and Chu, 2003) and achieve mutually favorable outcomes from such a cooperative behavior in managing transaction instability when they take complementary coordinated actions (Katz and Kahn, 1978; Anderson and Narus, 1990; Lui et al., 2009). Accordingly, previous empirical work (e.g., Zaheer et al., 1998; Poppo and Zenger, 2002; Lee and Cavusgil, 2006; Lui et al., 2009) has showed that relational governance improves the performance of inter-organizational relationships.


*The moderating role of prior cooperation:* The performance of an exchange relationship is influenced by the negotiation costs of contracting under environmental uncertainty (Zaheer et al., 1998; Dyer and Chu, 2003). According to Williamson (1985, 1991) economizing on transaction costs improves organizational efficiency and hence leads to superior performance. It depends on the adoption of effective governance mechanisms that provide efficient use of resources and facilitate adaptive coordination. Trust as a relational governance mechanism increases coordinating capabilities of the exchange partners in adapting to changing environmental conditions by improving the access to information and promoting situational flexibility when its sanctions (i.e., loss of reputation that damages future business opportunities) exceed the potential benefits of opportunistic behaviour (Macaulay, 1963; Axelrod, 1984; Granovetter, 1985; Uzzi, 1997).
Prior cooperation can be viewed as an operational proxy for inter-organizational trust (Zucker, 1986; Gulati, 1995; Currall and Inkpen, 2003). When inter-organizational trust is incrementally built in cooperation stages, it alters the incentive structure in such a way that the exchange partners believe in fair division of payoffs (Parkhe, 1993; Dyer and Chu, 2003). This confidence emerged from past experience allows them to be more flexible in adjusting to changing environmental situations (Gulati, 1995; Uzzi, 1997; Dyer, 1997; Madhok, 1995; Sako and Helper, 1998; Dyer and Chu, 2003) when decreasing the relational risk due to the expectation for the future relationship (Granovetter, 1985; Raub and Weesie, 1990; Batenburg, Raub and Snijders, 2003).

In addition, the amount of time and effort spent by exchange partners to reach an acceptable contract can be reduced by increasing confidential information sharing. For example, a tour operator with a trustworthy reputation in exchange relationships will be more willing to share demand forecasts with the hoteliers. In this case, they can fill the planning gaps in the agreements as contingencies arise (Kaufmann and Stern, 1988; Macneil, 1980; Wathne and Heide, 2004) when hoteliers have greater confidence that the information provided by the tour operator is not misrepresented to obtain early booking discounts or special offers for last minute bookings and beneficial behavior is reciprocated in order to jointly gain greater rents from cooperative adaptation. This effect increases with the development of specialized skills and inter-organizational routines as the partners sustain their relationship over time (Gulati, 1995; Dyer and Singh, 1998; Reuer, Zollo and Singh; 2002; Luo, 2002; Kotabe, 2003; Zollo, Reuer and Ariño, 2007; Lui et al., 2009). Such skills and routines facilitate the continuous exchange of information by fostering efficient communication and hence increase the ability of the partners to anticipate market changes and respond to unforeseen circumstances (Uzzi, 1996, 1997; Kotabe et. al, 2003; McEvily et al., 2003; Zhou et al., 2008). Thereby prior cooperation also enables the exchange partners to overcome the adaptive limits of contracts in the presence of both change and conflict (Poppo and Zenger, 2002; Goo et al., 2009). In conclusion, prior cooperation shifts the negative effect of negotiation costs on performance by providing such a situational flexibility to respond to changing market conditions that improves cooperative adaptation when decreasing the waste of resources during negotiations (Luo, 2002; Poppo and Zenger, 2002; Dyer and Chu, 2003). Hence we derive the hypothesis that relational governance leads to better performance by providing negotiation efficiency consistent with the arguments of prior research (Zaheer et al., 1998; Dyer and Chu, 2003).
H₄a: The negative effect of environmental uncertainty on performance is weakened as prior cooperation increases.

H₄b: The negative effect of negotiation costs on performance is weakened as prior cooperation increases.

3. Research methodology

3.1. Data collection and sample

The empirical data of this study were collected through a questionnaire-based survey from the 4 and 5-star hotels operating in Antalya/Turkey. To determine the number of hotels in the population, the authors utilized the statistics of the Republic of Turkey Ministry of Culture and Tourism (http://www.antalyakulturturizm.gov.tr/ana-sayfa/15346820101209.html, accessed in November 2010). According to the statistics, 402 of the total 468 tourism investment and establishment licenses are 4 & 5-star hotels operating in Antalya. Sample size was found about 270 hotels at the 95% confidence level. Sample was drawn through a simple random sampling procedure and then questionnaire was sent out electronically to the general managers/sales managers of the total 270 hotels in the sample after having informed the participants by telephone. The number of valid questionnaires was 139, which represents an effective response rate of 51.2%. The data were analyzed with SPSS package program (version 18) and the hypotheses were tested by applying linear regression analyses.

The potential for response bias was examined by comparing early versus late responses. The test of multivariate analysis of variance (MANOVA) shows no significant differences for the measures between early and late respondents (Wilk’s Lambda = 0.919, F = 1.437, df = 8, p = 0.181). The comparison provides evidence regarding the external validity of the study and generalizability of the findings. In addition, the possibility of common method variance was examined. To test this, Harman’s single factor test (Harman, 1967) where all variables are hypothesized to load on a single factor was performed using exploratory factor analytic approach (Podsakoff, MacKenzie, Lee and Podsakoff, 2003; Podsakoff and Organ, 1986). The results of the unrotated factor solution of the 16-items reveal that the first factor does not account for the majority of the variance and there is no general factor.
3.2. Measurement

To test the hypotheses concerning the factors that effect relationship performance, the authors include the variables of environmental uncertainty and negotiation costs as independent variables in the multivariate regression model. In addition, to examine the potential shifting effect of relational governance on the relationship between negotiation costs and performance, prior cooperation as a moderator was integrated into the model. Reliability analysis was performed to assess the internal consistency of measures of the constructs. Cronbach’s alpha values of all constructs exceed the recommended threshold level of 0.70 (Hair, Anderson, Tatham and Black, 1998). Table 1 reports descriptive statistics and Pearson correlation coefficients for the independent variables. The results show that none of the correlation coefficients is large enough (> .80) to cause concern about severe multicollinearity (Hair et al. 1998).

Relational performance: Relationship performance is measured with three items consistent with the study of Boyle and Dwyer (1995). The items reflect the extent to which inter-organizational exchange activities are efficient; (1) There is an efficient working relationship between our hotel and this tour operator, (2) coordination is easily accomplished with this tour operator, (3) overall, our hotel and this tour operator perform well together in carrying out our respective tasks. These three indicators were measured on a 7-point Likert scale ranging from strongly disagree to strongly agree. (Cronbach’s alpha = 0.93).

Environmental uncertainty: Environmental uncertainty refers to the unpredictability of the environment (Carson, Madhok and Wu, 2006; John and Weitz, 1988). The inability to predict relevant conditions for each type of environment (Porter, 1980) was measured with eight items; (1) general tourism demand, (2) hotel occupancy rate, (3) competitive conditions in the tourism market, (4) demands, tastes and preferences of tourists, (5) activities of tour operators, (6) market activities of competitors, (7) government regulations and policies, (8) entrance of new competitors into the market. The respondents were asked to rate on a 7-point rating scale to evaluate how predictable each of the items has been during the past 3 years (Cronbach’s alpha= 0.89).

Negotiation costs: Following the studies of Artz and Brush (2000), Dyer and Chu (2003) and Mesquita and Brush (2008) this study considers negotiation costs as the amount of
time the hotel spends preparing for and actually negotiating allotment contracts. The construct was measured with five items to capture the extent to which negotiating of the contract terms (i.e., prices, payments, prepayments, reduction and promotions, allotments and release periods) is difficult and time-consuming. These indicators were assessed on a 7-point Likert scale. (Cronbach’s alpha= 0.78).

Prior cooperation: Prior cooperation was measured as the number of years since the beginning of the relationship between hotel and tour operator. The values of observations for this variable were grouped into the five categories varying from <3 years to >15 years.

Control variables: The variables labeled as hotel class and origin of tour operator, which might influence the performance of relationship between hotels and tour operators, were incorporated in the model. In order to include the categorical variable of tour operator’s origin in multiple regression prediction model dummy coding was used. Three dummy variables (i.e., origin_German, origin_Russian, origin_UK) were created for four categories of the predictor variable of origin of tour operator. Each case was coded as 1 and all other cases coded as 0 whereas the reference category (Baltic-origin) is always coded as 0. In addition, the variable of hotel class was included as dummy variable which equals 1 if the hotel is a five-star hotel and 0 if it is a four-star hotel.

3.3 Validation of measures

In this study, exploratory factor analysis with varimax rotation was conducted to check the validity of the constructs (Table 2). The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is 0.73 and the Bartlett test of sphericity is highly significant (Bartlett's Test: 1485.448; p = 0.00), indicating that the data are suitable for factor analysis. The exploratory factor analysis yielded a three-factor solution accounting for 65 percent of the cumulative variance. According to the Kaiser rule (Kaiser, 1960) the factors were retained with eigenvalues greater than 1. Factor loadings of the 16 items are above 0.50 (Hair et al., 1998), ranging from 0.63 to 0.96. The findings provide evidence for sufficient internal consistency with construct validity of the measurement scales.
4. Results

The hypotheses were tested by applying multiple regression analysis. Each set of variables were included in the model block by block for testing the exploratory power of treatments. Model 1 only consists of control variables (origin of tour operator and hotel class). The transaction cost variables (environmental uncertainty and negotiation costs) were included in Model 2 to test hypotheses $H_1$ and $H_2$. Then the relational variable of prior cooperation was added as a moderator variable in Model 3 that tests hypothesis $H_3$. Following the entrance of the first-order terms, the interaction terms (environmental uncertainty*prior ties, negotiation costs*prior ties) were included into the model in a stepwise fashion and thereby the moderating effects of prior cooperation were examined in the final model (Model 4b). Before creating the interaction terms, the scores of the main effects were mean centered to avoid potential problem of multicollinearity. The results from analyzing variance inflation factors show that the largest variance inflation factor as an indicator of probable multicollinearity is 3.42, well below the 10.0 cutoff (Neter, Wasserman and Kutner, 1985). This finding indicates that there is no serious multicollinearity problem for this study. By including the interaction effects in the model the explanatory power of the dependent variable increased to 0.444 (see the changes in adjusted $R^2$). This indicates that the model explains 44% of the variance. The results of hierarchical moderated regression analysis are summarized in Table 3.

| INSERT TABLE 3 ABOUT HERE |

According to the final regression model, the findings indicate that the relationships between hotels and German/UK originated leading tour operators of incoming tourism market in Antalya result in lower performance compared to the reference category of Baltic-origin tour operators. This effect depends on the asymmetrical distribution of power due to the differences in size, switching costs and dependence among partners. The results are compatible with Nyaga, Lynch, Marshall and Ambrose (2013) who argue that the negative influence of power asymmetry on adaptive and collaborative behavior leads to decreased performance. Although hotels also operate with Russian originated tour operators in a high power distance, a negative but statistically insignificant relationship was found between this subcategory and performance. In addition, the results show that the relationship performance
of five-star hotels is higher than four-star hotels due to a more equitable distribution of bargaining power.

Hypothesis 1, predicting a negative relationship between relationship performance and environmental uncertainty is strongly supported ($\beta = -0.184; p<0.01$). Prior research has (i.e., Balakrishnan and Wenerfelt; 1986; Heide and John; 1990; Poppo and Zenger, 2002; Walker and Weber, 1984; Zaheer et al., 1998) extensively focused on the effects of environmental uncertainty on governance structures and processes. Unlikely, this study considers the direct effect of environmental uncertainty on performance and thus provides evidence for the assumption that adaptation problems arising from unpredictability of environment creates performance losses. On the other hand, the results indicate that the relationship between negotiation costs and performance is negative and significant, in support of H2 ($\beta = -0.309; p<0.01$). This finding provides further support for the idea (e.g. Zaheer et al., 1998) that exchange performance decreases at higher levels of negotiation costs. Consistent with H3 prior cooperation as information sharing and coordination mechanism has a positive and significant effect on performance ($\beta = +0.309; p<0.05$). Regarding H4b, the results show that prior cooperation as a proxy for trust significantly moderates the effect of negotiation costs on relationship performance by improving negotiation efficiency ($\beta = +0.172; p<0.05$). However, the results do not provide sufficient support for the moderator role of prior cooperation on the relationship between environmental uncertainty and performance (H4a). Overall, the empirical results provide support for the performance enhancing effect of eased negotiations through relational governance.

4. Conclusion

This study examines the impact of transaction cost variables and prior cooperation as a proxy for inter-organizational trust on relationship performance. Our empirical results from the Turkish tourism industry provide support for the performance-enhancing effect of eased negotiations through relational governance. Firstly, consistent with the transaction cost prediction, the data indicate that environmental uncertainty negatively affects relationship performance as environmental uncertainty leads to inefficiencies in realigning of actions in a coordinated manner without using effective governance mechanisms. Secondly, the findings of this study show that negotiation costs have a critical impact in improving performance. When the costs of contracting decrease, exchange partners can make mutual adjustments on operations during the adaptation period at low cost and hence concentrate on establishing a collaborative relationship to reach mutually beneficial outcomes rather than negotiating the
distribution of realized costs and benefits in each contingency. This result provides further support for the work of Zaheer et al. (2008), who found that performance losses arise from high costs of negotiating a contract.

Thirdly, our results provide support for the hypothesis that prior cooperation improves the performance of inter-organizational relationships by increasing information sharing that encourages coordinated actions and promoting reciprocity through mutually cooperative behaviour. This result is similar to the findings of prior research (i.e., Dyer and Chu, 2003; Heide and John, 1990; Lui et al., 2009; Luo, 2002; Lursch and Brown, 1996; McEvily et al., 2003; Noordewier et al., 1990; Poppo and Zenger, 2002; Zaheer et al., 1998) that have confirmed the performance-enhancing effect of relational governance by examining the direct link between relational mechanisms and exchange performance. Finally, our results confirm that prior cooperation reduces the negative influence of negotiation costs on relationship performance as circumstances change. Prior cooperation leads to improved performance by decreasing the costs of negotiating a contract and providing such a situational flexibility that foster cooperative adaptation. By testing the moderating role of prior cooperation in the relationship between negotiation costs and performance this study provides support for the governance-cost reducing impact of relational mechanisms in enhancing relationship performance. Although the importance of testing the transaction cost-trust-performance link has been emphasized in the studies of Dyer and Chu (2003) and Zaheer et al. (1998), the results of these studies confirm only the direct effect of relational governance on the relationship between negotiation costs and performance. In particular, the results of this study show that relational governance increases negotiation efficiency and hence performance. To date, we are unaware of any previous study confirming the performance enhancing effect of relational governance through efficiencies gained from eased negotiations. Therefore, we believe that this study contributes to the literature by providing the first empirical evidence on the performance-enhancing effect of eased negotiations through relational governance.

The other important contribution of this study is to examine the interplay among governance costs, prior cooperation as a proxy of trust, and performance in the service industry unlike the other related studies (i.e., Dyer and Chu, 2003; Zaheer et al., 1998). Seasonal fluctuations in the service industry make difficult to design more complete contracts including communication mechanisms and procedures for decision making and conflict resolution dealing with changing demand conditions. By considering these difficulties in reaching an acceptable contract on the distribution of realized costs and benefits in each contingency, we provide support for the governance-cost reducing benefits of relational
governance that lead to improved performance in the context of relationships between hotels and tour operators.

This study also has important managerial implications in the light of the theoretical perspectives mentioned above. First, environmental uncertainty leads to lower performance due to the adaptation pressures. Exchange partners can enhance their performance by cooperatively adapting to the environmental changes. Second, relational governance has a constant effect in improving performance. However, building a strong relational capital may not enough to benefit from improved performance. The benefits of better performance can be augmented by reducing governance costs when developing trust-based relationships facilitates adaptation. Consequently, managers should concentrate on the governance-cost reducing effects of relational governance to utilize from the full benefits of improved performance.
References


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Table 1. Factor analytic evidence for the construct validity of the three-factor subscale scores

<table>
<thead>
<tr>
<th>Factor</th>
<th>F1</th>
<th>F2</th>
<th>F3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>F1. Relationship performance</strong></td>
<td></td>
<td></td>
<td>----------</td>
</tr>
<tr>
<td>PF1. There is an efficient working relationship between our hotel and this tour operator.</td>
<td>0.85</td>
<td></td>
<td></td>
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<tr>
<td>PF2. Coordination is easily accomplished with this tour operator.</td>
<td></td>
<td>0.96</td>
<td></td>
</tr>
<tr>
<td>PF3. Overall, our hotel and this tour operator perform well together in carrying out our respective tasks.</td>
<td></td>
<td></td>
<td>0.96</td>
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<tr>
<td><strong>F2. Environmental uncertainty</strong></td>
<td></td>
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</tr>
<tr>
<td>General tourism demand</td>
<td>0.73</td>
<td></td>
<td></td>
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<tr>
<td>Occupancy rate of your hotel</td>
<td>0.64</td>
<td></td>
<td></td>
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<tr>
<td>Competitive conditions in the tourism market</td>
<td>0.82</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demands, tastes and preferences of tourists</td>
<td>0.68</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Activities of tour operators</td>
<td>0.82</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market activities of competitors</td>
<td>0.86</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government regulations and policies</td>
<td>0.72</td>
<td></td>
<td></td>
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<tr>
<td>Entrance of new competitors into the market</td>
<td>0.82</td>
<td></td>
<td></td>
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<tr>
<td><strong>F3. Negotiation costs</strong></td>
<td></td>
<td></td>
<td>----------</td>
</tr>
<tr>
<td>It is very time consuming and difficult to accomplish negotiations between our firms about price.</td>
<td>0.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It is very time consuming and difficult to accomplish negotiations between our firms about payment terms.</td>
<td></td>
<td>0.72</td>
<td></td>
</tr>
<tr>
<td>It is very time consuming and difficult to accomplish negotiations between our firms about prepayments (i.e., commission, complimentary rooms, kick back and early booking rates).</td>
<td></td>
<td></td>
<td>0.80</td>
</tr>
<tr>
<td>It is very time consuming and difficult to accomplish negotiations between our firms about allotments and release periods.</td>
<td></td>
<td></td>
<td>0.85</td>
</tr>
<tr>
<td>Variables</td>
<td>Mean</td>
<td>S.D.</td>
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<tr>
<td>1. Relationship performance</td>
<td>5.98</td>
<td>1.29</td>
<td>1.000</td>
</tr>
<tr>
<td>2. Environmental uncertainty</td>
<td>2.57</td>
<td>0.96</td>
<td>-0.217*</td>
</tr>
<tr>
<td>3. Negotiation costs</td>
<td>3.22</td>
<td>1.19</td>
<td>-0.264**</td>
</tr>
<tr>
<td>4. Prior cooperation</td>
<td>3.62</td>
<td>1.16</td>
<td>0.159</td>
</tr>
<tr>
<td>5. Origin_German</td>
<td>0.53</td>
<td>0.50</td>
<td>-0.042</td>
</tr>
<tr>
<td>6. Origin_Russian</td>
<td>0.29</td>
<td>0.45</td>
<td>0.007</td>
</tr>
<tr>
<td>7. Origin_UK</td>
<td>0.04</td>
<td>0.19</td>
<td>-0.459**</td>
</tr>
<tr>
<td>8. Hotel class</td>
<td>0.81</td>
<td>0.39</td>
<td>0.194*</td>
</tr>
</tbody>
</table>

*p < 0.05; ** p < 0.01 (two-tailed)
Table 3. Hypotheses testing with hierarchical multivariate regression (N = 139)

<table>
<thead>
<tr>
<th>Control Variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4a</th>
<th>Model 4b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Origin of tour operator</td>
<td></td>
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</tr>
<tr>
<td>German</td>
<td>−0.395**</td>
<td>−0.279**</td>
<td>−0.208*</td>
<td>−0.297**</td>
<td>−0.295**</td>
</tr>
<tr>
<td>Russian</td>
<td>−0.348**</td>
<td>−0.160</td>
<td>−0.021</td>
<td>−0.083</td>
<td>−0.085</td>
</tr>
<tr>
<td>UK</td>
<td>−0.607**</td>
<td>−0.603**</td>
<td>−0.555**</td>
<td>−0.601**</td>
<td>−0.601**</td>
</tr>
<tr>
<td>Hotel class</td>
<td>0.266**</td>
<td>0.169*</td>
<td>0.174*</td>
<td>0.156*</td>
<td>0.154*</td>
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<tr>
<td>Environmental uncertainty</td>
<td>−0.183*</td>
<td>−0.208**</td>
<td>−0.184**</td>
<td>−0.187*</td>
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</tr>
<tr>
<td>Negotiation costs</td>
<td>−0.258**</td>
<td>−0.311**</td>
<td>−0.309**</td>
<td>−0.310**</td>
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<tr>
<td>Prior cooperation</td>
<td>0.194*</td>
<td>0.176*</td>
<td>0.171*</td>
<td></td>
<td></td>
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<tr>
<td>Interactions</td>
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<tr>
<td>Environmental uncertainty*Prior cooperation</td>
<td>−0.014</td>
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<tr>
<td>Negotiation costs*Prior cooperation</td>
<td>0.172*</td>
<td>0.173*</td>
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<tr>
<td>Model F</td>
<td>17.629**</td>
<td>16.502**</td>
<td>15.663**</td>
<td>15.029**</td>
<td>13.263**</td>
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<tr>
<td>( R^2 )</td>
<td>0.345</td>
<td>0.429</td>
<td>0.456</td>
<td>0.480</td>
<td>0.481</td>
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<tr>
<td>Adjusted ( R^2 )</td>
<td>0.325</td>
<td>0.403</td>
<td>0.427</td>
<td>0.449</td>
<td>0.444</td>
</tr>
</tbody>
</table>

* \( p < 0.05 \); ** \( p < 0.01 \)

+Standardized regression coefficients are reported.