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Abstract

When a buyer firm and a supplier firm plan to transact, what factors drive their choice of mechanism to govern the relationship? Focusing on contract-governed versus joint venture–governed relationships, the authors present a theoretical framework that specifies the conditions that make one or the other form of relationship structure more appropriate. This study was designed to address potential limitations regarding measurement, financial consequences, and context in the extant literature. The authors employ measures derived from Standard & Poor's Compustat financial database and an overall measure of firm reputation to examine empirically differences in firm characteristics across the two types of relationships. To examine the financial consequences of relationship structure, the authors use event-study techniques that tie stock price reactions to the governance mechanism choice. The results suggest that buyers and suppliers are more likely to form a joint venture (versus simple contract) when (1) the supplier's degree of asset specificity is high, (2) monitoring the supplier's behavior is difficult, and (3) the supplier has a poorer reputation. The authors find that vertical joint ventures (between buyers and suppliers) are economically similar to contracts, to the extent that abnormal wealth gains go solely to the supplier firms. Horizontal joint ventures (partners are at the same level of the value chain), however, provide bilateral, synergistic wealth gains. The results suggest that buyers and suppliers can use joint ventures to reduce certain governance problems rather than to gain synergies.

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