Role of Trust in Governance of Inter Firm Dyads: The Case of Indian Software Offshore Development Centers

Abstract

As output (product market) and input (factor market) conditions for firms become more complex, it gets difficult and in most cases nonviable for them to exist as integrated, extended enterprises. This leads to a higher degree of specialization, which means that firms may no longer find it sustainable to capture the whole value chain. Thus, in order to deliver value firms have to rely on their relationships with other firms. These relationships are costly to maintain but are essential for a typical extended enterprise to be successful. This research draws upon the aforementioned postulates and attempts to address related issues.

Once the salience of inter firm relationships is established, it is proposed to delve into problems related to structures of inter firm relationships and choice of governance mechanisms for same. A typical transaction cost economics (TCE) view is espoused with its traditional assumptions but unlike the bulk of traditional TCE literature, the presence of a strong sociological context is not ignored or overlooked. Present research engages itself with the role of trust in the governance of inter-firm dyadic (one to one) relationships. Objectives of this research is twofold: one, to improve upon the understanding of the way Trust intervenes in an economic model of exchange relationship and two, to describe the association between degree of Trust and strength of ties between partners in the context of software offshore development centers (SODCs) managed by Indian firms.

The thesis posits the complementary relationship between trust and contracts as the basis of inter firm relationships in the context of recent surge in offshore model of engagement for Indian software services firms. Trust is modeled as a moderating variable impacting relation specific assets and uncertainty. It is also hypothesized that "higher Trust is associated with stronger ties". Strength of ties entails, among other things, opportunities to participate in critical processes and products in the client's organization. An instrument to measure the involved constructs has been adopted from literature and has been developed after subjecting it to a pretest.

Data is collected through structured questionnaire and analyzed using structural equation modeling technique. In total, there are six relationships explored in the present study, namely

1. Trust moderating the effect of uncertainty on cost of coordination
2. Trust moderating the effect of asset specificity on cost of coordination, and
3. Trust positively impacting strength of ties.
4. Relation specific assets directly and positively impacting cost of coordination.
5. Uncertainty directly and positively impacting cost of coordination
6. Cost of coordination related negatively with strength of ties

Data support the hypotheses related to 4 and 6 of these hypotheses. The direct impact of asset specificity on cost of coordination is not established to the desired significance level. The same is explained with the notion of fungible skill assets developed by the software services firms. Also, cost of coordination is not related to tie strength which means that trust is functional because it impacts strength of ties directly rather than through mitigation of transaction related costs.