



Vaasan yliopisto
UNIVERSITY OF VAASA

Niklas Sorvali

**Managing buyer-supplier relationships to reduce
the ex-post transaction costs and foster supplier
component innovation**

School of Marketing and communication
Bachelor thesis
International Business

Vaasa 2025

UNIVERSITY OF VAASA**School of Marketing and communication**

Author:	Niklas Sorvali		
Title of the thesis:	Managing buyer-supplier relationships to reduce the ex-post transaction costs and foster supplier component innovation:		
Degree:	Bachelor of science in economics and business administration		
Discipline:	International business		
Supervisor:	Tahir Ali		
Year:	2025	Pages:	39

ABSTRACT:

International business scholars acknowledge the significance of reducing ex-post transaction costs and enhancing supplier's component innovation in buyer-supplier relationships. However, there is very limited understanding of mechanisms manufacturing buyers employ to reduce ex-post transaction costs and foster supplier component innovation. Therefore, the purpose of this thesis is to explore the mechanisms manufacturing buyers use to reduce the reduce ex-post transaction costs and foster supplier component innovation.

The conceptual model of this thesis is developed by reviewing the prior key literature on buyer-supplier relationships, importance of managing ex-post transaction costs and supplier's component innovation, and mechanisms reducing ex-post transaction costs and fostering supplier's component innovation. The findings suggest that economic mechanisms of contract completeness and performance-based incentives reduce both ex-post transaction costs and supplier's component innovation. However, economic mechanism of symmetric dependence, and sociological mechanisms of trust, communication, relationship duration, and future orientation not only reduce ex-post transaction costs, but also enhance supplier's component innovation.

Furthermore, the findings indicate that economic and sociological mechanisms function as complementary in reducing ex-post transaction costs and fostering supplier component innovation. These findings have important implications for efficiently managing buyer-supplier relationships.

Kansainvälisen liiketoiminnan tutkimuksessa on tunnistettu ex-post-transaktiokustannusten vähentämisen ja toimittajien komponentti-innovaatioiden edistämisen merkitys ostaja-toimittaja-suhteissa. Kuitenkin ymmärrys siitä, millaisia mekanismeja valmistavat ostajat käyttävät näiden tavoitteiden saavuttamiseksi, on edelleen rajoitettua. Tämän tutkielman tavoitteena on tutkia niitä mekanismeja, joita valmistavat ostajat hyödyntävät vähentäessään ex-post-transaktiokustannuksia ja edistäessään toimittajien komponentti-innovaatioita.

Tutkielman konseptuaalinen malli on luotu tarkastelemalla aikaisempia tutkimuksia ostaja-toimittaja-suhteista, ex-post-transaktiokustannusten hallinnan merkityksestä sekä toimittajien komponentti-innovaatioista. Tulokset osoittavat, että taloudelliset mekanismit, kuten sopimusten kattavuus ja suoritusperusteiset kannustimet, vähentävät ex-post-transaktiokustannuksia, mutta samalla ne saattavat rajoittaa toimittajien innovaatiota. Toisaalta taloudellinen symmetrinen riippuvuus ja sosiologiset mekanismit, kuten luottamus,

viestintä, pitkäaikaiset suhteet ja tulevaisuuden suuntautuneisuus, eivät ainoastaan vähennä transaktiokustannuksia, vaan myös edistävät toimittajien komponentti-innovaatiota.

Tutkimus tuo esiin, että taloudelliset ja sosiologiset mekanismit toimivat täydentävinä toisiinsa nähden, ja yhdessä ne voivat tehokkaasti vähentää ex-post-transaktiokustannuksia sekä edistää innovaatiota toimittajapuolella. Nämä tulokset tarjoavat arvokkaita näkökulmia ostaja-toimittaja-suhteiden tehokkaaseen hallintaan.

Contents

1	Introduction	6
1.1	Background of the study	6
1.2	Research question and objectives of the study	7
1.3	Delimitations of the study	8
1.4	Definition of key terms	9
1.5	Previous studies	10
1.6	Structure of the thesis	15
2	Literature review	17
2.1	Buyer-supplier relationship	17
2.1.1	Conceptualization of buyer-supplier relationship	17
2.1.2	Characteristics of buyer-supplier relationship	19
2.2	Ex-post transaction costs and supplier component innovation in buyer-supplier relationships	21
2.2.1	Conceptualization and importance of managing ex-post transaction costs in buyer-supplier relationships	21
2.2.2	Conceptualization and importance of managing supplier component innovation in buyer-supplier relationships	22
2.3	Mechanisms for reducing the ex-post transaction costs and fostering supplier component innovation in buyer-supplier relationships	24
2.3.1	Economic (i.e. hard/transactional) governance mechanisms	25
2.3.2	Sociological/soft/social governance mechanisms	28
2.3.3	Balancing Social and Economic Mechanisms	31
2.4	Conclusions of the study	32
2.4.1	Summary of the findings	32
2.4.2	Managerial implications	35
2.4.3	Future research suggestions	35
	References	37

Figure 1 Structure of thesis. 16

Table 1 : Previous studies 11

1 Introduction

1.1 Background of the study

In a global and highly competitive business environment, managing relationships with suppliers has become one of the most important functions of the buying companies. When buying companies try to build solid relationships with their suppliers, they can often cut costs and work together on new ideas, and that may lead to better products and services (Cannon & Homburg, 2001, p. 30; Liu et al., 2009, p. 295). When supply chains become even more complicated, it's very important for firms to manage supplier connections with a long-term strategic mindset to stay ahead of the competition.

This study looks at the manufacturing sector, where companies often have problems with these two questions: managing costs that come after deals are made and encouraging suppliers to come with better component ideas in the future. These are called ex-post transaction costs which show up after contracts are signed and may include things like keeping track of agreements, fixing problems, or even changing the contract if needed (Buvik & Andersen, 2002, p. 4). If these costs aren't kept under control, they can cut the profits and even hurt the company's ability to stay competitive on the market. While, when suppliers bring in new or even improved components, that's called supplier component innovation, it can help manufacturers improve product quality, make new ideas and innovation, and make products that are best on the market (Sumo et al., 2016).

Previous studies suggest that good management of buyer-supplier relationships very often comes to using both economic and social methods. On the economic side, mechanisms like contracts and money-based incentives help to control costs and keep risks minimum. On the social side, mechanisms like trust, open talk and long-term commitment between firms can make working together easier and be good for new ideas (Dyer & Chu, 1997, pp. 3-4; Liu et al., 2009, p. 297). Still, even though this topic has been well studied, we don't yet know clearly how manufacturing firms actually use these

mechanisms to reduce the ex-post transaction costs that come after contracts are signed and try to push suppliers to innovate new ideas. This study tries to look into that by finding what kind of mechanisms manufacturers really use to handle both at the same time – means reduce ex-post transaction costs and foster supplier's component innovation.

1.2 Research question and objectives of the study

Previous discussion steers the course of present study. The primary research question guiding this study is:

Which mechanisms do manufacturing buyers employ to reduce ex-post transaction costs and foster supplier component innovation in buyer-supplier relationships?

To address this question, the study is guided by three sub-objectives:

(1) To investigate the conceptualization and characteristics of buyer-supplier relationships.

The aim here is to get good understanding of buyer-supplier relationships by going through what they are on theoretical level. What they are in practice, and what the key factors are. This part uses ideas from many theories, like relational view and transactional cost economics, to show what really matters in these relationships and what affects them the most (Cannon & Homburg, 2001; Charterina et al., 2016).

(2) To enhance understanding of the conceptualization and significance of managing ex-post transaction costs and supplier-driven component innovation within buyer-supplier relationships.

This objective looks at what ex-post transaction costs and supplier component innovation actually mean, why they matter so much to manufacturing firms. It also explains why it's very important to manage ex-post transaction costs and supplier's

component innovation strategically for short- and long-term performance (Buvik & Andersen, 2002; Sumo et al., 2016; Mitrega et al., 2017, p. 579).

(3) To explore the specific economic (transactional) and social (relational) governance mechanisms that manufacturing buyers use to manage ex-post transaction costs and foster supplier's component innovation.

This part looks the both types of governance mechanisms: economic ones like contract and performance-based rewards, and relational ones like trust, sharing knowledge and solving problems together with partner firm. The idea is to understand how these mechanisms work individually and jointly when companies deal with managing ex-post transaction costs and supplier's component innovation.

By going through these goals, this study gives a full picture of how manufacturing companies manage their supplier relationships in a way that keeps costs down but still supports new innovation and ideas. This can be useful both in theory and in practice level.

1.3 Delimitations of the study

The main delimitations of study are discussed below:

1. This study only focuses on buyer-supplier relationships between manufacturing firms, specially exploring the mechanisms used to manage ex-post transaction costs and foster supplier-driven component innovation. Relationships on service and retail sectors are not discussed, as they may involve different methods and dynamics.
2. This research is limited to ex-post transaction costs which means that pre contractual and other types of transactions costs are not discussed. In terms of innovation, the focus is mainly in restricted only to component level innovation, excluding bigger forms such as process, organizational, or marketing innovation.

3. The study focuses only to economic (transactional) and relational (social) governance mechanism, while leaving out other theoretical views.
4. Geographically study doesn't have a single target region. The used literature is mostly international.
5. The research is only based on secondary sources and academic writing, so empirical data was not collected to this thesis.

1.4 Definition of key terms

Key terms used in this thesis are defined below:

Buyer-supplier relationship means an ongoing connection between a company and another company that supplies to it, where both sides depend on each other, work together, and aim for shared goals to improve performance (Cannon & Homburg, 2001).

Ex-post transaction costs are the kind of costs that came up after a contract is signed. These include things like keeping track of the deal, making changes to contract (if needed), solving disagreements, and making sure that both sides follow the rules (Buvik & Andersen, 2002).

Supplier component innovation happens when a supplier comes up with new or better parts, which helps the buyer improve their own products and stay more competitive (Sumo et al., 2016).

Economic governance mechanisms mean using formal tools, like detailed contracts, performance targets and financial rewards to manage relationships between buyers and suppliers and to keep risk under control during partnerships (Liu et al., 2009).

Relational governance mechanisms are more like informal ways of managing relationships. They are based on trust, open communication, long term commitment

and shared values, all of which helps both firms to work better together and understand each other (Dyer & Chu, 1997; Liu et al., 2009).

1.5 Previous studies

Research on buyer-supplier relationships has looked into topics like cost control, ways of managing the relationships and how these things can affect innovation. Cannon & Homburg (2001) studied how these relationships influence the costs of the buying company. They pointed out that good relationship management can hugely improve both profits and how well the company runs overall. At the same time Buvik & Andersen (2002) showed how important vertical coordination can be for lowering the extra costs that may come after the contracts are made, especially in international business relationships, where cross-border deals bring more complexity and added expense costs. That is because different nationalities act differently in terms of business practices.

When it comes to governance methods Liu et al. (2009) argued that there needs to be a balance between both economic and relational methods to get better results from suppliers. Their research showed that trust and commitment, key parts of relational governance, work well with formal economic tools. Together they reduce selfish behavior and make cooperation more likely to work.

Innovation coming from suppliers has also been a major topic in earlier research. Sumo et al. (2016) looked into how companies can use performance-based contracts to support both small improvements and bigger, even more radical innovations from their suppliers. Their results show that the way relationships are managed can have direct impact on how suppliers behave and how much they can actually innovate. In a similar way Mitrega et al. (2017) pointed out that having strong networking skills is highly important for supplier innovation. They showed that how companies build and adjust their supplier relationships to help new products get developed.

Even though earlier research has offered a lot of useful ideas, we still don't fully understand how manufacturing companies actually use both economic and relational governance at the same time, especially when trying to deal with ex-post transaction costs and support innovation from their suppliers. This study tries to fill that gap by looking how these two governance approaches work together in real life manufacturing settings.

Below is a comprehensive table 1 detailing the principal findings of the research referred to, further breaking down the various dimensions of buyer-supplier relations and the drivers of cost control and supplier innovation.

Table 1 : Previous studies

Author(s) / Year	Focus of the Study	Theoretical Roots	Methodology	Findings of the Study
Agndal, H. & Nilsson, U. (2007)	Complexity of applying Activity-Based Costing (ABC) to indirect purchasing costs in long-term buyer-supplier relationships	Interaction model	Case study approach, Swedish automotive industry	Challenges in allocating costs for Supplier Relationship Management (SRM) in long-term relationships.
Buvik & Andersen (2002)	Impact of asset specificity and vertical coordination on ex post transaction costs in domestic and international relationships	Transaction Cost Analysis (TCA)	Quantitative survey, 177 Norwegian firms	Vertical coordination reduces ex-post transaction costs, especially in international relationships with high asset specificity.
Cannon & Homburg (2001)	Supplier behaviors and management impact on customer costs	Cost management, relational exchange, TQM, TCE	Survey data, 500 US and German buying organizations	Frequent communication, flexibility, and supplier proximity lower costs and

Author(s) / Year	Focus of the Study	Theoretical Roots	Methodology	Findings of the Study
	and future purchase intent			increase future purchases from suppliers.
Charterina, Basterretxea & Landeta (2016)	Impact of specialized resources, idiosyncratic investments, and knowledge sharing on innovation in the machine-tool industry	Embeddedness theory, relational view	Quantitative survey, 202 European machine-tool firms	Knowledge sharing enhances product innovation performance, while idiosyncratic investments and complementary resources have indirect effects.
Fehr & Rocha (2018)	Role of open-book accounting (OBA) and trust in buyer-supplier relationship satisfaction in the Brazilian automotive sector	Transaction Cost Economics (TCE), Relationship Marketing Theory	Qualitative case study, Brazilian automaker and suppliers	Open-book accounting (OBA) is often imposed by buyers, with mixed effects on supplier satisfaction; trust and cooperation are not always prerequisites for effective OBA. satisfaction positively or negatively
Dyer & Chu (1997)	Relationship between supplier trust and transaction costs, information sharing, and relation-specific investments	Transaction Cost Economics (TCE)	Survey data, 453 supplier-automaker relationships in the U.S., Japan, and Korea	Supplier trust in the buyer lowers transaction costs and enhances information sharing.
Joshi (2025)	Manufacturer incentives and collaboration's impact on fostering	Social exchange theory	Survey data, 188 supplier-manufacturer dyads in Canada	Incentives and collaboration positively impact supplier innovation, with

Author(s) / Year	Focus of the Study	Theoretical Roots	Methodology	Findings of the Study
	supplier component innovation			economic rewards enhancing the effect for economically stronger suppliers.
Lee et al. (2018)	How manufacturers' long-term orientation towards suppliers affects outsourcing performance in China	Outsourcing relationship management, TCA	Survey data, 244 manufacturing companies in China	Long-term orientation positively influences supplier development and outsourcing performance.
Liu et al. (2009)	Roles of transactional and relational mechanisms in improving relationship performance	Transaction cost economics (TCA), Social exchange theory	Survey data, 225 paired manufacturer-supplier relationships in China	Transactional mechanisms curb opportunism, while relational mechanisms improve relationship performance, with combined mechanisms most effective.
Lou et al. (2022)	Impact of supplier selection and control mechanisms on innovation	Interorganizational control systems	Fuzzy-set qualitative comparative analysis (fsQCA), 203 firms in China	Transactional mechanisms curb opportunism, while relational mechanisms improve relationship performance, with combined mechanisms most effective.
Mitrega et al. (2017)	Networking Capability (NC) and its impact on product	Resource-based view (RBV), Relational view	Survey data, 156 Iranian automotive parts firms	Networking capability positively influences

Author(s) / Year	Focus of the Study	Theoretical Roots	Methodology	Findings of the Study
	innovation and firm performance	(RV), Dynamic capabilities (DC)		product innovation and firm performance.
Patrucco et al. (2022)	Triadic supplier relationships in collaborative innovation projects	Relational view (RV)	Qualitative multiple case study, ten innovation projects	Triadic supplier relationships affect project performance, with governance structures impacting cost, time, and quality.
Shahzad et al. (2018)	Impact of economic and sociological governance methods on post-agreement transaction costs	Transaction cost economics (TCE), Social exchange theory (SET)	Survey data, 170 Finnish SMEs	Sociological governance (trust and communication) complements economic governance (contract completeness, symmetric dependence) to reduce transaction costs and improve relationship commitment.
Sumo et al. (2016)	Performance-based contracts and their effect on supplier innovation	Transaction cost economics (TCE), Agency theory (AT)	Survey data, 106 inter-organizational relationships in the Dutch maintenance industry	Term specificity in contracts has an inverse U-shape effect on incremental innovation, and pay-for-performance boosts radical innovation.
Bag (2018)	Impact of organizational culture and supplier management	Dynamic capability view (DCV), Resource-based view (RBV)	Survey data, 75 South African manufacturing firms	Organizational culture influences supplier relationship management, and

Author(s) / Year	Focus of the Study	Theoretical Roots	Methodology	Findings of the Study
	on sustainable innovation in South African networks			supplier performance impacts sustainable innovation.

1.6 Structure of the thesis

This thesis is divided to into two main chapters, as shown in figure 1 below. Chapter 1 serves as an introduction and includes the background of the study, the research question and objectives, limitations of the study, definition of the key terms, a summary of previous research, and an overview of the thesis structure.

Chapter 2 gives a literature review that begins with a look at buyer-supplier relationships, what they are and why they matter so much. It continues by explaining ex-post transaction costs and supplier component innovation, explaining their meaning and why they are so important to manage well. The chapter also discusses economic and relational governance mechanisms that manufacturing firms use to handle these costs and encourage innovation from suppliers.

The thesis ends with a summary of the main findings from the literature and presents ideas for the future research. A full list of references is included at the end.

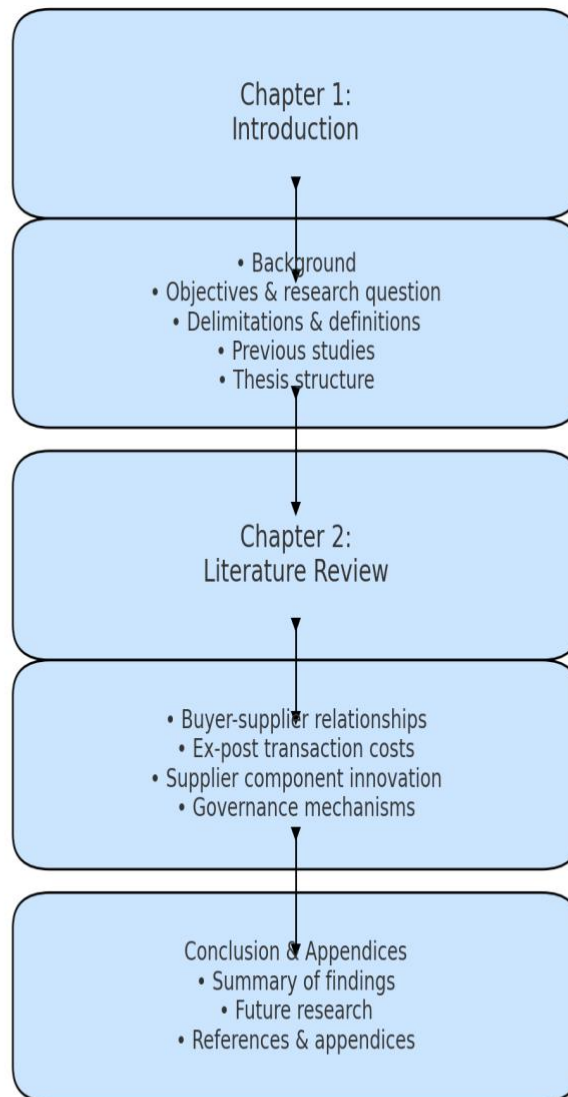


Figure 1. Structure of thesis.

2 Literature review

2.1 Buyer-supplier relationship

2.1.1 Conceptualization of buyer-supplier relationship

The conceptualization of buyer-supplier relationships has changed hugely over the past decade. They were once seen more like short-term and price-focused, they are now viewed more as long-term, strategic partnerships that help firms build and maintain a competitive edge over others (Cannon & Homburg, 2001).

This kind of relationships are often pretty complex, and they usually are based on shared goals, mutual interests, and just working together over the long time. For manufacturing companies, handling them well really matters. That doesn't mean just for everyday performance, but also for staying innovative (Cannon & Homburg, 2001; Liu et al., 2009).

From a theoretical view, buyer-supplier relationships can be divided in two parts: economic and relational. The economic view is based on transaction cost economics and agency theory, and it focuses more on using formal contracts, clear performance goals, and incentives to reduce risks and control costs (Liu et al., 2009). Having detailed agreements and measurable results makes things more predictable and helps avoid problems. Still, some researchers argue that relying too much on strict contracts can make relationships less flexible and hurt long-term cooperation (Charterina et al., 2016).

On the other hand, the relational perspective sees buyer-supplier relationships more as social than financial in nature. Things like trust, shared understanding, commitment, and good communication are important things for making the relationships work well (Dyer & Chu, 1997). When firms focus on strong relational governance, it usually supports more flexibility, openness, solving problems together and that makes cooperation last longer. This also means there's less need for everyday monitoring or formal control. Even though formal governance tools like vertical coordination are still important for

managing costs, companies often need more flexible setups to deal with uncertainty in these kinds of relationships. Buvik & Andersen (2002) pointed out that more vertical coordination can help reduce costs that come up after the deal is made, especially when firms invest in very specific assets. In this kind of cases flexible governance can make big difference.

Understanding the buyer-supplier relationships, so what really deepens it? One good idea is embeddedness. That is where structure and relationships mix together. Charterina et al. (2016) talked about how ties can be both formal like contracts or more personal, like trust between people. And both kinds seem to matter when the goal is innovation or working in together well. With strong embeddedness firms usually get better at sharing knowledge and collaboration. But that depends of the industry how it works, in some sectors formal rules carry more weight (Sumo et al., 2016).

Then Patrucco et al. (2022) who looked through what happens when more than two parties are involved, for example triadic relationships in the supply chain when there are three companies involved. They found that managing these complex setups well means using more advanced relational skills to handle the connections and keep things stable. So again, its quite clear that just having contracts or just believing on trust alone is not enough. You need a bit of both to make it on long-term or there will be more ex-post transactions costs. These relationships will become even harder if many different nationalities are mixed in terms of company's home country.

Managing buyer-supplier relationships in this kind of complex relationship well usually means that firms must find the right balance between these two sides, the more transactional stuff like contracts and the more relational side like trust and communication. When both are used together in a smart way, it can lead to stronger relationships with fewer costs and better teamwork between firms (Dyer & Chu, 1997; Liu et al., 2009).

So, in short, thinking about buyer-supplier relationships means you have to look at both the economic side, like contracts and structures, and the more social one, which includes trust and collaboration, so if you concentrate only on one you will probably have problems at some point. That mix helps make sense of why these relationships aren't simple, and why they're key when a company wants to stay sharp, keep coming up with new things, and just generally run better.

2.1.2 Characteristics of buyer-supplier relationship

Buyer-supplier relationships usually build on a things like trust, clear communication, mutual dependency, investing in the relationship and having shared goals (Cannon & Homburg, 2001). When these things are taken together, they will shape how strong or effective the relationship can be, and what kind of strategic value it could offer. Economic tools like contracts and bonuses gives often the relationship structure, but the more human side, like trust plays a bigger role in keeping things working on long-term and keeping extra costs low (Liu, et al., 2009).

Trust stands out as one of the most important factors in buyer-supplier relationships. Dyer & Chu (1997) point out that when trust is high, there's less need to constantly monitor everything all the time. This also helps with things like open knowledge sharing and solving problems together which also makes the relationship more tense. Even though formal tools like vertical coordination could help control costs, companies still often need flexibility to deal with the ups and downs of these relationships. Buvik & Andersen (2002) argue that more vertical coordination can help reduce the extra costs that show up after the deals are made, especially when the company has made very specific investments. That's why it's often better to have a setup that balances control with flexibility when things get uncertain or hard.

Good communication matters hugely in buyer-supplier relationships, especially when its open, clear and happens on time, and not too late when you are already late. When communication works well, it's easier to solve problems together, avoid unnecessary

conflicts and share important knowledge, these are things that all are positive for partnership (Liu et al., 2009). But if communication is unclear or lacking, it often leads to misunderstandings, mixed expectations and even situations where one side takes advantage of the other (Charterina et al., 2016).

Mutual dependence means that where both sides rely on each other, and that also plays a big part in making buyer-supplier relationships stronger. When both firms invest time, resources, or both of them into the relationship, they usually work better and act more fairly (Charterina et al., 2016). Still, if one party depends too much on the other, it can become risk for that company. For example, it might weaken their ability to negotiate or make them more exposed if something goes wrong in the supply chain (Sumo et al., 2016).

Embeddedness in this context means that there's both structure and relationships tied together, things like contracts and formal rules on one side, and trust and personal connections on the other. It's very important part of how buyer-supplier relationships work. When this kind of connection is strong, it might help to build mutual commitment, make collaboration around innovation easier and allow resources and know-how to move between the two firms more smoothly, all which can boost innovation and make companies more competitive (Charterina et al., 2016).

These embedded ties make it easier for companies to share things like knowledge, tools, or capabilities, which really matters for long-term success in partnerships which is more important in the long run than short term profits. But how much of this "embeddedness" is needed depends on the company and the field. Some firms do better with flexible, adaptable partnerships instead of strict and formal structures (Patrucco et al., 2022). In same time Sumo et al. (2016) argues that how well these relationships work comes often down to the industry. When in some fields stricter rules and formal systems are needed, but in other things might work better with more flexibility and informal teamwork.

To sum up, things like trust, clear communication, mutual dependence and mix of formal and personal ties all play a big role in making these relationships successful. Together they help firms lower costs, come up with new ideas and just work more effectively and better. What matters almost most is what kind of mix of this methods firms should use and how well it will fit in their industry and situation.

2.2 Ex-post transaction costs and supplier component innovation in buyer-supplier relationships

2.2.1 Conceptualization and importance of managing ex-post transaction costs in buyer-supplier relationships

Ex-post transaction costs are the kind of costs that come up after a deal has already been made between buyer and a supplier. These could include things like checking whether both sides stick to what was agreed, enforce the contract, doing changes to some parts or settling disputes if there are problems (Buvik & Andersen, 2002). Even though contracts are made to set clear rules, unexpected situations often happen, and when they do, costs usually rise.

Keeping these costs under control is important for keeping operations smooth and making the buyer-supplier relationship last longer. Cannon & Homburg (2001) point out that using both formal rules and personal trust together helps to lower these kinds of costs and also makes the relationship stronger. But if a company only uses strict contracts that can backfire because too much monitoring or overly tight terms can make things rigid and hurt the cooperation (Dyer & Chu, 1997). So instead, mixing formal contracts with more human elements like trust and open conversation usually leads to better results and less need for everyday rule enforcement and that will lead to better result.

Trust really helps bring down the extra cost that can show up after a contract is signed. When buyers and suppliers build strong, trust-based relationships, there is usually less need for everyday checking or enforcing what is in the contract, so both sides tend to

act more fairly (Dyer & Chu, 1997). Trust also can make it easier to solve problems when and if they show up, there's less fighting or need to rewrite agreements. And when the relationship is rock-solid both sides are more open to share info and adjusting things when needed, which also makes contract management a lot easier (Liu et al., 2009).

Buvik & Andersen (2002) point that in more unpredictable markets, companies are more likely to face problems like opportunism and rising costs. To deal with this, again firms have to use the vertical coordination, which means regular planning together, clear communication and ongoing collaboration can offer extra protection for what is not written in the contract. Especially in industries with fast-changing tech or complex setups, it helps to combine detailed contracts with flexible and trust-based ways of working (Sumo et al., 2016).

In short, managing ex-post transaction costs well requires more than just contracts, it needs trust, flexibility, and the right balance. What works best depends on the industry and the nature of the relationship that firms have.

2.2.2 Conceptualization and importance of managing supplier component innovation in buyer-supplier relationships

Supplier component innovation means that a supplier is able to come up with new or clearly improved components that may help the buyer's products be better and more competitive on the market (Sumo et al., 2016). In today's supply chains, companies trust more on this kind of supplier-driven innovation to keep up with the overall market and competitors. Though managing this is not easy and it takes careful balance between structured rules and more personal, trust-based cooperation.

How the relationship between buyer and supplier is governed plays a big role in how much innovation actually happens. Liu et al. (2009) argue that economic governance tools like written contracts or performance-based bonuses help make the expectations more clearer and keep suppliers accountable. But if the rules are too strict, that can actually backfire if that takes something away from innovation. Suppliers may feel boxed

in and become less motivated to bring new ideas forward Charterina et al. (2016) argued.

In contrast more personal governance tools like trust, long-term commitment, and open communication, surely help to build a kind of environment where suppliers feel safe enough to try new things and take risks in terms of innovation. Dyer & Chu (1997) highlight how trust between firms makes it easier to share knowledge more openly, which in turn leads to more dynamic and better innovation. Charterina et al. (2016) add that strong ties between companies whether formal or personal help ideas and know-how flow more easily, and this makes it possible to create custom solutions that fit perfectly to certain companies. Using both methods gives a solid bottom for better supplier innovation.

Patrucco et al. (2022) mentioned that supplier innovation doesn't happen the same way in every field. It depends a lot on how fast things happen and how complex relationships are. For example, in industries where technology moves quickly and innovation is fast, companies need to stay flexible, yes using clear goals but in the same time staying open-minded to new ideas. And in more specialized sectors, deeper supplier partnerships often work best, especially when both sides put effort into development and long-term investment (Sumo et al., 2016). For example, big mobile phone companies need strong and deep partnerships, but for example some clothing manufacturers that may not be the case.

One of the big challenges in managing supplier innovation is dealing with risks, like highly important knowledge leaking to competitors or the supplier and buyer having different goals in terms of innovation. To handle this, firms need to carefully balance between being open and knowing what are the things that must be protected. So, it is about sharing just enough information to keep the supplier motivated, while still keeping the most important ideas and technologies safe (Liu et al., 2009).

To sum it up, managing supplier innovation takes a combination of formal methods and personal cooperation. Hard mechanisms and bonuses help to set structure and keep things accountable, but same time creativity and the best innovations usually come from trust and long-term relationships. Innovation depends a lot on the industry, when companies get that balance right, they're in a good position to get the most out of supplier-driven innovation and keep their edge in the market.

2.3 Mechanisms for reducing the ex-post transaction costs and fostering supplier component innovation in buyer-supplier relationships

To manage buyer-supplier relationships well, companies need to use mechanisms simultaneously while trying to reduce ex-post transaction costs while at the same time supporting innovation. The tricky part is that these goals don't always go hand in hand. Cost control usually means more rules and strict monitoring, but innovation tends to work better in places where there is room to move, and both parties trust each other. So, to balance these demands, firms have to adopt dual governance methods that uses the economic part and the relational mechanisms (Cannon & Homburg, 2001). As discussed earlier, managing transaction costs typically involves formal controls such as contracts and performance monitoring, complemented by trust-based mechanisms to increase flexibility (Buvik & Andersen, 2002; Liu et al., 2009; Dyer & Chu, 1997).

In contrast, getting innovation from suppliers isn't about setting clear targets, it takes mechanisms that boost development efforts and the right environment. That means there must be room for working more freely. Economic governance tools like incentives, strict innovation agreements, and contracts might help keep suppliers' goals aligned with what the buyer is after (Sumo et al., 2016). However, those alone don't get the job done, relational ties play a critical role in helping to reduce uncertainty and keep conversation going, which is the most important thing for the real innovation to happen (Charterina et al., 2016).

Lee et al. (2018) argues by the hybrid governance methods, which include both economic and relational methods, works especially well when trying to cut costs and support innovation at the same time. With this kind of setup, firms have control over contract enforcement while at the same time creating space where suppliers feel motivated to innovate. Shahzad et al. (2018) points out how digital platforms and data-sharing agreements helps suppliers work more closely with buyers. This reduces information gaps and makes collaboration smoother while improving innovation.

To wrap up, keeping ex-post transaction costs low while the same time supporting innovation from suppliers isn't something that firms can do with just one method. The following section explore the specific economic and relational mechanisms that firms use to make things work.

2.3.1 Economic (i.e. hard/transactional) governance mechanisms

Economic governance means using formal and structured tools to keep buyer-supplier relationships running smoothly. These tools are often aimed at cutting post-contract costs and making sure suppliers stay aligned with the company's goals. Things like well-made contracts, balanced dependency between the two sides, and incentives tied to performance all help make expectations clear, reduce risk, and keep the collaboration on track (Cannon & Homburg, 2001).

Contract Completeness

Contract completeness refers to how thoroughly agreements define roles, responsibilities and potential future scenarios between buyers and suppliers that might happen. Highly detailed contracts help to reduce opportunism by making expectations clear and enforcement processes (Liu et al., 2009). In this way well-structured contracts can reduce ex-post transaction costs and support better coordination between the buyer and supplier.

However, there is also another side. If contracts are too tight, they may limit flexibility and even slow down the innovation, especially in industries that change quickly and partners need to adapt to new things quickly (Charterina et al., 2016). Joshi (2025) mentioned that in innovation-focused supply relationships, well-designed contracts may help the buyers keep the goals and suppliers' efforts aligned. Same time Lou et al. (2022) note that in highly complex or fast-moving industries, the detailed contracts might be burden or slowing factor if they can't keep up with the change, which may come with too strict contracts. It seems that contract completeness is not the ideal method for the innovation.

There are different views, but the dominant perspective in the transaction cost theory is that contract completeness mainly reduces transaction costs because there is not so much uncertainty and they can enforce clarity. Well-structured contracts also support innovation when used with certain level of flexibility. Based on above discussion, following proposition is developed:

Proposition 1: Contract completeness reduces ex-post transaction costs but may limit supplier-driven component innovation.

Symmetric Dependence

Symmetric dependence means that the buyer and supplier equally rely on each other to fulfill their objectives. This scenario creates a more balanced relationship, where neither side has all the power, and that kind of balance often supports long-term cooperation (Dyer & Chu, 1997). If the dependence is not even, the more powerful side might act opportunistically, which can damage their trust and weaken collaboration (Buvik & Andersen, 2002). So fair power balance seems to be building better mutual commitment and keeps the relationship more stable. Same way Shahzad et al. (2018) pointed that when both sides are equally invested, they're more likely to follow rules. So, in big picture symmetric dependence will reduce ex-post transactional costs.

On the other side, symmetric dependence may also support supplier-driven innovation. When neither side dominates, suppliers are more likely to feel that their ideas matter and that innovation efforts will be fairly recognized or rewarded. This can increase both sides motivation to develop and share new solutions. Based on above discussion, following proposition is developed:

Proposition 2: Symmetric dependence reduces ex-post transaction costs and can enhance supplier-driven component innovation by encouraging trust and shared commitment.

Performance-Based Incentives

Performance-based incentives, such as financial bonuses, milestone payments or penalties for underperformance, are common tools for aligning suppliers' actions with what buyer wants (Sumo et al., 2016). These economic mechanisms are made to motivate suppliers to fulfill their obligations and in some cases to innovative, and by that rewarding those who go over basic compliance (Liu et al., 2009).

Bag (2018) argues that these incentives can push suppliers to introduce more sustainable and innovative products, especially when innovation is tied to rewards. Same time Patrucco et al. (2022) warn that if firms use too heavy economic incentives, it may lead to short-term thinking rather than long-term work. This could be problem in industries where innovation depends more on relational methods.

A case study by Fehr & Rocha (2018) backs this up. They studied Alfa a large car manufacturer and found that while strict incentive-based contracts improved short term results, they also discouraged smaller suppliers from contributing new ideas. These rigid agreements gave suppliers little flexibility, especially those with less power on negotiating. So, in big picture big companies with more power were able to get better deals and that supported longer-term collaboration. Based on above discussion, following proposition is developed:

Proposition 3: Performance-based incentives reduce ex-post transaction costs but may hinder supplier-driven component innovation when applied too tight, especially on one-sided contract structures.

2.3.2 Sociological/soft/social governance mechanisms

Sociological governance mechanisms focus on the relational sides of buyer supplier relationships. They are made to build trust open communication and long-term business relationships. Unlike economic governance methods which uses more strict contracts and incentives, these social mechanisms aim to use voluntary cooperation and shared goals (Dyer & Chu, 1997). They are considered especially useful for reducing opportunistic behavior and strengthening supplier commitment, which can support innovation in collaborative behavior in both ways Charterina et al. (2016) note.

Trust

Trust refers to the willingness of a partner firm to accept vulnerability towards another firm based on positive expectations regarding the counterpart's reliability, fairness, and goodwill (Ali & Larimo, 2016).

Trust plays a big role in buyer-supplier relationships because it reduces the need for strict monitoring and contract enforcement, and that lowers the burden and overall transaction costs (Dyer & Chu, 1997). When firms trust one another, they are more likely to communicate openly and solve problems together and not escalating them. This helps create smoother coordination and a more agile response to unexpected changes in the market (Liu et al., 2009). That will reduce ex-post transactional costs because both sides can be more flexible when trust is good.

Over just cost savings, trust also builds confidence between firms. Suppliers who feel trusted are more willing to share ideas, commit resources, and take innovation-related risks without bigger fear. Charterina et al. (2016) point out that trust embedded with

supplier networks increase the likelihood of long-term collaboration and joint development projects, which are important for component innovation. Based on above discussion, following proposition is developed:

Proposition 4: Trust reduces ex-post transaction costs and enhances supplier-driven component innovation.

Communication

Effective communication when it's clear, transparent and continuous have huge role in maintaining successful buyer-supplier relationships (Liu, Luo & Liu, 2009). Open communication reduces misunderstandings and helps to resolve issues quicker. That lowers ex-post transactional costs by minimizing the need for remaking the contracts or formal enforcement (Dyer & Chu, 1997).

On other side good communication routines, like feedback loops or regular meetings also support supplier-driven innovation. By aligning expectations and enabling smoother exchange of knowledge helps suppliers to contribute new ideas with greater confidence. Patrucco et al. (2022) also argues that in complex supply networks involving multiple parties' clear communication is even more important to keep all parties aligned.

While communication is one of the key parts, company's still have to use formal methods because companies can't usually only trust to words. Based on above discussion, following proposition is developed:

Proposition 5: Structured and transparent communication reduces ex-post transaction cost and enhances supplier-driven component innovation through better coordination and smooth knowledge sharing.

Relationship Duration

The duration of buyer-supplier relationship has huge affects how well the two parties work together. Long-term relationships reduce the need for constant renegotiation, changes to contract or solving problems, all of which lower the ex-post transaction costs (Dyer & Chu, 1997). Over time firms build mutual understanding and develop smoother routines, making coordination more efficient and less costly (Liu, Luo & Liu, 2009). Longer relationships also create an environment where trust can grow and giving knowledge to other firms becomes natural. This allows suppliers to feel more secured to try new things and put more time in new product development. Long-term relationships lead to new innovation, because they often provide an ongoing and deep nature for joint development efforts and customized solutions (Mitrega et al., 2017).

That being said, a long relationship can also backfire if it leads to supplier complacency or dependency. (Charterina et al., 2016) argued that over time buyer's power in negotiations may erode. Based on dominant view of relationship duration, following proposition is developed:

Proposition 6: Long-term buyer-supplier relationships reduce ex-post transaction costs and enhance supplier-driven component innovation.

Future Orientation (Length of Future Relationship)

Future orientation means that both parties expect that the relationship will last into the future. This long-term look encourages investments in joint projects, sharing information and making relationship better (Lee et al., 2018; Patrucco et al., 2022). So, when both sides see the partnership as ongoing, the trust grows and suppliers are more likely to align their own innovation with the buyer's long-term goals.

Sumo et al. (2016) argues that this mindset also helps to reduce ex-post transaction costs. With future on the mind both parties want to have relationships without bigger problems and that will reduce ex-post transactional costs.

On the other hand, Bag (2018) argues that in volatile industries, uncertainty about relationship length often lead to weaker cooperation and higher enforcement costs.

Future orientation also helps supplier-driven component innovation, because when suppliers believe the relationship will last, they are more willing to put effort into new ideas and component improvements. They feel more secure to invest time and resources into things that might not pay off right away but could benefit both sides later. To counter this multi-year contracts or shared relational norms support stability. Based on above discussion, following proposition is developed:

Proposition 7: Future orientation reduces ex-post transaction costs and enhances supplier-driven component innovation by fostering trust and long-term commitment.

2.3.3 Balancing Social and Economic Mechanisms

Social governance methods build trust, flexibility, and collaboration. Though they can't be used alone because they will lack enforceability. On other side economic governance mechanisms offer the formal part but may lack innovation part. To manage supplier relationships closely, firms must balance these two sides to reduce ex-post transactional costs and support innovation at the same time (Dyer & Chu, 1997; Liu et al.,2009). This hybrid governance approach gives the best from both sides.

The Konsum case Patrucco et al. (2022) demonstrates this well. Komsum had multiple suppliers, one was for technology design and other was for product development. Although this doesn't straight demonstrate governance methods, it shows that strict contracts were mixed with active coordination and that led to faster development,

lower costs, and better outcomes. This example is for the idea that firms must adapt their governance approaches to fit the specific challenges of each supplier.

So, the balanced approach which combines both of the methods is crucial for the relationship. Cannon & Homburg (2001) found that while contractual structures reduce risks and give control, they can also limit the innovation. And in contrast the relational governance methods support deeper cooperation but may be insufficient if used alone because there might be opportunistic behavior (Sumo et al., 2016).

Proposition 8: Sociological governance mechanisms and economic governance methods function as complementary tools in reducing ex-post transaction costs and same time fostering supplier-driven component innovation.

2.4 Conclusions of the study

2.4.1 Summary of the findings

This study looked into how manufacturing companies try to keep down the extra costs that pop up after the contracts are signed – i.e. ex-post transaction costs, while at the same time try to boost innovation from suppliers. To answer the research question, an extensive literature review is done and interesting findings are drawn.

When it comes to reducing post-contract costs, economic mechanisms like contract completeness (Liu et al., 2009), symmetric dependence (Buvik & Andersen, 2002), and performance-based rewards (Sumo et al., 2016) are key methods. Clear agreements help to set expectations and cut down misunderstandings or opportunism, which all lead to ex-post transaction costs (Liu et al., 2009). But if you get too strict on those (except symmetric dependence) they will backfire. That can make collaboration too hard or leave less room for innovation and change (Charterina et al., 2016; Lou et al., 2022). Further, relational governance mechanisms of trust, communication, long partnerships, and shared future were also found to be almost equally important in lowering ex-post

costs because they made relationships more stable (Dyer & Chu, 1997; Liu et al., 2009; Patrucco et al., 2022).

However, when it comes to encouraging innovation from suppliers, this study shows that the most effective mechanisms were the relational ones (i.e. trust, communication, long-term relationship, and future orientation) along with the economic mechanism of symmetric dependence (Dyer & Chu, 1997; Liu et al., 2009; Charterina et al., 2016; Patrucco et al., 2022; Buvik & Andersen, 2002). Trust creates space for open idea exchange (Dyer & Chu, 1997). Long-term relationships give suppliers the feeling that they should invest (Charterina et al., 2016). And good communication creates a safer environment where suppliers feel that they can take more risks (Liu et al., 2009). Still, when companies rely only on these mechanisms, they will probably go off track, and that's where hybrid governance comes in (Sumo et al., 2016).

The most effective turned out to be mix of economic and sociological methods. That kind of hybrid governance helps companies to manage costs and reduce risks, while same time leaving enough flexibility for suppliers to innovate and have space for making new and better components naturally during the partnership. Findings of this study are summarized in below figure 1.

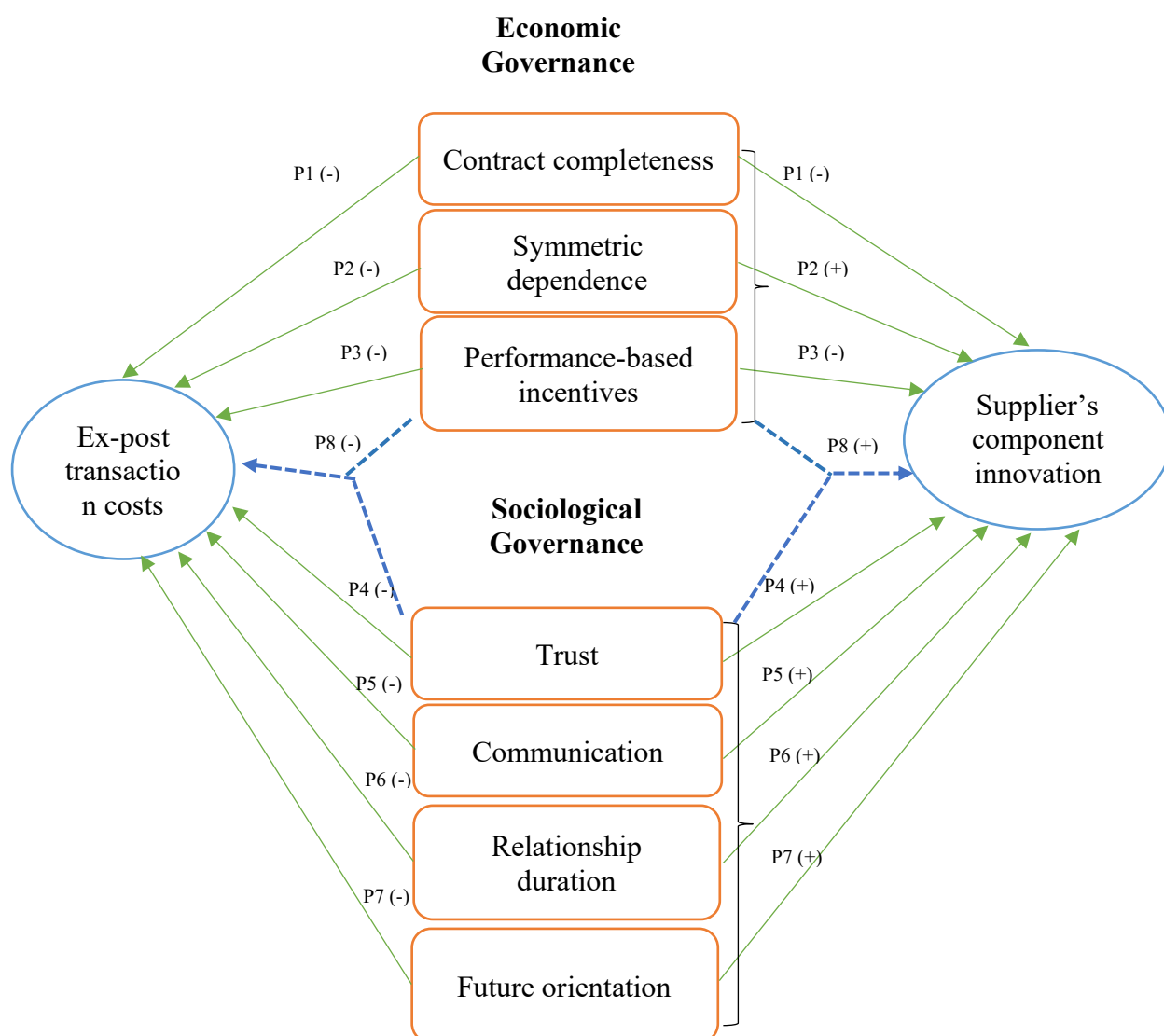


Figure 1. Conceptual model of the study

Research Limitations

Like any study, this also has its limits. The power of different methods can depend a lot on the type of industry. In tightly regulated field contract might carry more weight, while in fast changing industries relational methods might be more important. You can't use same methods on pencil factory and mobile phone manufacturing. This study is based only on existing literature. So, to really test the ideas we would need more real cases, surveys or actual company data. Though that is quite hard to get.

2.4.2 Managerial implications

For managers this study offers very practical lessons. For example, take a manufacturing firm needs a new more energy-efficient engine part from its supplier. If the company then uses only strict contract with performance targets, the supplier might just do the bare minimum and nothing more. But then if there is also long-term relationship chance and open communication the supplier might feel more comfortable and suggest more creative ideas. Another view, if buyer has all the power in the relationship, the supplier might become cautious or passive by avoiding the failure or punishment.

In fast changing tech industries, a detailed contract written might be outdated in six months. So instead of constantly renegotiating, its smarter to build trust-based routines that allow flexibility more for supplier. That way it's more likely to get new solutions even when conditions shift. So, in short, managers should avoid on relying only on rigid control systems. Instead, managers of buying companies should combine sociological and economic mechanisms to reduce transaction costs and at the same time to foster supplier's component innovation.

2.4.3 Future research suggestions

Although current study shows how economic and relational methods work together to minimize costs and boost supplier's innovation, there is still much room for new research. **First**, it would be valuable to research how industry affects directly to use of governance mechanisms. For example, pharmaceutical or electronics where market needs to evolve more quickly. There more benefit may come from flexible governance methods. **Second**, future research should collect empirical data to test the developed model. **Third**, digitization and new technologies offer a different angle to this. Tools like AI, blockchain and data-sharing platforms may make changes how firms transfer knowledge. Exploring this could reveal how technology enhances or even replaces traditional governance methods. **Lastly**, governance should also be looked from sustainability view. As companies stake more on ethical sourcing and environmental

responsibility. It's worth studying how governance mechanisms support these values on long-time relationships. By looking on these areas, future research can help building governance methods that are efficient and innovative and can adapt to bigger demands of modern supply chains.

Use of AI: To enhance the clarity of written expression, Grammarly AI was used to support sentence structure refinement and appropriate word choice, without altering the substance of the content.

References

- Ali, T., & Larimo, J. (2016). Managing opportunism in international joint ventures: The role of structural and social mechanisms. *Scandinavian Journal of Management*, 32(2), 86–96. Available from <https://www.sciencedirect.com/science/article/pii/S0956522116000154>
- Agndal, H. & Nilsson, U. (2007). Activity-based costing: Effects of long-term buyer-supplier relationships. *Qualitative Research in Accounting & Management*, 4(2), 222–245. Available from Emerald Insight. Retrieved 15 February 2025 from <https://doi.org/10.1108/11766090710826655>
- Bag, S. (2018). Supplier Management and Sustainable Innovation in Supply Networks: An Empirical Study. *Global Business Review*, 19(3S), 176S–195S. Available from Sage Journals. Retrieved 15 February 2025 from <https://doi.org/10.1177/0972150918760051>
- Buvik, A. & Andersen, O. (2002). The impact of vertical coordination on ex post transaction costs in domestic and international buyer–seller relationships. *Journal of International Marketing*, 10(1), 1–26. Available from Sage Journals. Retrieved 15 February 2025 from <https://doi.org/10.1509/jimk.10.1.1.19526>
- Cannon, J. P. & Homburg, C. (2001). Buyer–supplier relationships and customer firm costs. *Journal of Marketing*, 65(1), 29–43. Available from Sage Journals. Retrieved 15 February 2025 from <https://doi.org/10.1509/jmkg.65.1.29.18136>
- Charterina, J., Basterretxea, I. & Landeta, J. (2016). Types of embedded ties in buyer-supplier relationships and their combined effects on innovation performance. *Journal of Business & Industrial Marketing*, 31(2), 152-163. Available from Emerald Insight. Retrieved 15 February 2025 from <https://doi.org/10.1108/JBIM-04-2014-0071>

- Dyer, J. & Chu, W. (1997). The Economic Value of Trust in Supplier-Buyer Relationships. *MIT Sloan Management Review*. Available from MIT DSpace. Retrieved 15 February 2025 from <https://dspace.mit.edu/handle/1721.1/1439>
- Fehr, L. C. F. A., & Rocha, W. (2018). Open-book accounting and trust: influence on buyer–supplier relationship satisfaction. *RAUSP Management Journal*, 53(4), 597-621. Available from SciELO. Retrieved 15 February 2025 from <https://doi.org/10.1108/RAUSP-06-2018-0034>
- Joshi, A. W. (2025). How and when incentives and collaboration are effective in fostering supplier component innovation: Insights from social exchange theory. *Journal of Business Research*, 189, 115131. Available from ScienceDirect. Retrieved 15 February 2025 from <https://doi.org/10.1016/j.jbusres.2024.115131>
- Lee, G., Shin, G.-c., Hwang, D. W., Kuper, P., & Kang, M. (2018). How manufacturers' long-term orientation toward suppliers influences outsourcing performance. *Industrial Marketing Management*, 74, 288–297. Available from ScienceDirect. Retrieved 15 February 2025 from <https://doi.org/10.1016/j.indmarman.2018.07.003>
- Liu, Y., Luo, Y. & Liu, T. (2009). Governing buyer–supplier relationships through transactional and relational mechanisms: Evidence from China. *Journal of Operations Management*, 27(4), 294–309. Available from ScienceDirect. Retrieved 15 February 2025 from <https://doi.org/10.1016/j.jom.2008.09.004>
- Lou, Z., Ye, A., Mao, J. & Zhang, C. (2022). Supplier selection, control mechanisms, and firm innovation: Configuration analysis based on fsQCA. *Journal of Business Research*, 139, 81–89. Available from ScienceDirect. Retrieved 15 February 2025 from <https://doi.org/10.1016/j.jbusres.2021.09.045>
- Mitrega, M., Forkmann, S., Zaefarian, G. & Henneberg, S. C. (2017). Networking capability in supplier relationships and its impact on product innovation and

firm performance. *White Rose Research Online*. Available from White Rose Research. Retrieved 15 February 2025 from <https://doi.org/10.1108/IJOPM-11-2014-0517>

Patrucco, A., Harland, C. M., Frattini, F & Luzzini, D. (2022). Managing triadic supplier relationships in collaborative innovation projects: A relational view perspective. *Supply Chain Management: An International Journal*, 27, 108-127. Available from Emerald Insight. Retrieved 15 February 2025 from <https://doi.org/10.1108/SCM-05-2021-0220>

Shahzada, K., Ali, T., Takala, J., Helo, P. & Zaefarian, G. (2018). The varying roles of governance mechanisms on ex-post transaction costs and relationship commitment in buyer-supplier relationships. *Industrial Marketing Management*, 71, 135–146. Available from ScienceDirect. Retrieved 15 February 2025 from <https://doi.org/10.1016/j.indmarman.2017.12.012>

Sumo, R., van der Valk, W., van Weele, A. & Bode, C. (2016). Fostering incremental and radical innovation through performance-based contracting in buyer-supplier relationships. *International Journal of Operations & Production Management*, 36(11), 1482-1503. Available from Emerald Insight. Retrieved 15 February 2025 from <https://doi.org/10.1108/IJOPM-05-2015-0305>