

Does Trust Still Matter in Business Relationships Based on Online Reverse Auctions?

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Abstract: The Internet-driven electronic marketplace has been presented as a mean of enhancing collaboration between buyers and suppliers while generating significant advantages for both parties. Nevertheless, the introduction of online reverse auctions (ORA) in the negotiation process has been perceived as a resource that decreases inter-organizational trust, limiting the possibilities of collaboration.

Online reverse auctions enable buyers to achieve tremendous financial savings through a considerable decrease in suppliers' margins and profits. Consequently, online reverse auctions are blamed for destroying buyer-supplier trust and creating distrust among suppliers toward buyers. Indeed, there is a widespread perception among suppliers that online reverse auctions are unfair since they only take buyers' interests into consideration, increasing the suppliers' suspicion of buyer opportunism. Suppliers feel that online reverse auctions tend to undermine relationships, and they feel exploited by the process, consequently reducing their level of trust in buyers.

This paper focuses on the outcomes of ORA use in the business relationships of one major French retailer and its industrial suppliers. Based on a case study built upon 70 semi-directive interviews, we propose an analysis of the impact of ORA use in business relationships. We show that it is not the technology of ORA itself which is responsible for trust deterioration but the way it is used. Our results suggest three factors that would allow inter-firm trust to be maintained when using ORA: the management of ORA, the integration of qualitative criteria and the eradication of abuses related to ORA use.

Key words: trust/distrust, online reverse auctions, opportunism, specific investment, power.

Introduction

“Another area that deserves attention is the relationship between buyer-seller trust and the use of reverse auctions” [SC03, p.488]

Advances in information technologies have led to major changes in the buyer/supplier relationship [EA01]. Organizations profit from the integration of IT¹ in their processes for improved collaboration with their exchange partners, especially their suppliers [Ka03]. This confirms Muller et al.’s forecast (2003) of a logic change in buyer/seller relationships with the consistent integration of IT in the relational processes and in the negotiation process. Electronic market places have thus been put forward as an opportunity to enhance buyer/seller collaboration [Ka03]. However, the specific application of online reverse auctions (ORA) has also been blamed as a cause of deteriorating trust in buyer/supplier relationships ([Em05], [Ja03], [SC03]). In ‘reverse auction’ it is not the buyers who bid in an ascendant way but rather the suppliers who bid in a descending manner. The ‘winner’ is the supplier who offers the lowest bidding price. There is a widespread perception among suppliers, however, that online reverse auctions are unfair as they only take the buyer’s interests into consideration, [ES02] increasing the suppliers’ suspicions of buyer opportunism [Ja03].

In effect, suppliers believe that online reverse auctions tend to undermine relationships, and they feel exploited by the process which reduces their level of trust in buyers [Ja03]. These perceptions were reinforced when online reverse auctions became associated with unethical behavior such as allowing non qualified suppliers to bid, and forcing suppliers to honor unreasonably low prices [SC03].

Several researchers have noted that, to date, research has not sufficiently examined the changes in the buyer/seller relationship when it is influenced by ORA. In particular, the impact on trust – a key element in inter-organizational collaboration [Sy98] – has not been studied in enough depth ([SC03], [Ja03]). The aim of this article is to develop a better understanding of the impact of the introduction of ORA on buyer-supplier relationships and, more specifically, on trust.

The article is based on an in-depth case study about the effects induced by the use of ORA between a major player in the French retail industry and its suppliers. Data was collected through a series of 70 in-depth interviews with key actors from the buyers’ and supplier’s side.

¹ IT : Information Technology

We posit that the technology of ORA in itself does not cause trust deterioration. It is rather the emergence of opportunistic behaviors amplified by a rumor effect that can lead to a threshold that creates distrust in business relationships. We focus on how the issue of distrust can affect potential supplier's behavior in an online reverse auction environment in terms of idiosyncratic investments and opportunism. Three factors emerge as facilitators in maintaining inter-organizational trust: ORA management, the integration of qualitative criteria in a supplier's initial selection and the development of ethical behavior in the online environment.

1 – From Trust to Distrust

In inter-firm exchanges, trust is regarded as a fundamental element in successful relationships [MH94], the “bonding strength which characterizes the majority of productive buyer/supplier relationships” [HMS89], the “heart of industrial relations” [MR04] and the “lubricant of social relationships” [Ar74]. Indeed, the literature has traditionally been interested in trust as a mechanism able to reduce costs - in particular transaction costs ([BH94], [Sy98]) - and risk [RV92], at the same time improving value creation [Ro98]. Trust is apprehended as complex and multidimensional ([BJ91], [Sa92]), which explains the plurality of its definitions in the literature [BP98].

The organizational literature offers two options in defining the constituents of trust, namely predictability of the other's behavior [Ro98] and belief in the other's goodwill [RV92,94], [Ho95]. [Ro98], [SR93] define trust as a psychological state integrating the acceptance of vulnerability based on expectations of positive intentions and behavior from the other party. Ring and Van de Ven (1992, 1994) define trust as the belief in the goodwill of the other and the expectation that the trustor can count on the trustee to respect his or her obligations, to act in a predictable way and to negotiate in an equitable way,² even if the possibility of opportunism exists³.

² For [Wi93], opportunism constitutes a clear behavioral assumption insofar as economic agents who seek their own interests. [Wi73] had already defined opportunism as being “the attempt to carry out individual profits on the basis of lack of frankness or honesty in the transactions. It can take two forms indifferently. The most widespread is the exploitation of asymmetries of information and strategic information disclosure. The second form takes place during the performance and the renewal of the contracts.” [Wi73, p.317].

³ [RV92] explain why the concept of equity has been well developed in the social theory of exchange [BI64]. Equity in a relationship of exchange develops through the following concepts: (1) reciprocity of the exchange, (2) exchange rights of costs and benefits between the utilities involved and (3) reception proportional to the benefit related to the exchange.

Moreover, trust has largely been identified in the theory as a process which emerges and develops gradually through time thanks to the development of positive experiences [RV92], in particular through exchange performance, negotiations and constructive conflict resolution [BOB02]. In parallel, trust has been recognized as something that is easily destroyed [Ba83]. [BA00]⁴ introduced the notion of trust resilience. They suggested that there is a threshold up to which trust would be able to resist possible erosion and that the repetition of opportunist behavior in an inter-organizational context would lead to a rapid fall in trust beyond a certain critical point: "*There is a threshold that, once crossed, leads to a precipitous drop in trust levels*" [BA00, p.14]. In this case, the shift from trust to distrust would correspond to a rupture leading to a relationship of distrust. Lewicki et al., (1998) define distrust as the expectation of assured negative behavior by the other party. Distrust can also be defined as a lack of belief in the other party and the apprehension that the latter is acting in order to harm the interests of the party that creates the trust ([Ba99], [Gr94]).

It is only recently that research has started to analyze the process of inter-organizational trust deterioration ([Ba99], [BOB02]). While Lewicki and Bunker (1996)⁵ began a theoretical examination of the deterioration and rebuilding of trust through time, their work has not been subject to empirical application [BOB02]. [SI93] explains that there are a variety of cognitive mechanisms that lead to the destruction of trust including negative events and the fact that those in breach of trust have a greater impact than positive events. In this regard, Deustch (1958) presents suspicion as being a central element of distrust and describes it as a psychological state where individuals actively maintain several potentially rival hypotheses for the other party's behavior.

The level of trust and distrust is of special concern as far as buyer/supplier relationships are concerned. As [CF06] explain, distrust may result in a significant deterioration in the performance of both buyers and suppliers. In effect, distrust can made supply chain members hesitate to provide information or have no confidence in the information provided by other party. We therefore suggest that it is necessary to look at the nature of the events responsible for the deterioration in trust and the emergence of distrust following the use of ORA. This is a key point in developing a better understanding of the performance of business relationships.

⁴ Cited in [BOB02].

⁵ [LB96] proposed four stages: recognition of the violation of trust, identification of the cause, destroying recognition of the aspect of violation, and the acceptance of responsibility for the violation of trust.

2 – Online Reverse Auctions, Trust and Distrust

ORA are traditional bids in the opposite direction [SH03]. Thus, instead of a supplier offering a product for sale to the highest-bidding buyer, the buyer offers a contract to the lowest-bidding supplier. ORA may thus be seen as a stage in a reconstructed relational process and not an end in itself. The buyer begins the process by requesting a traditional quote from a wider number of suppliers⁶ but only selected suppliers will be invited to ORA. The buyer then gives a virtual appointment⁷ to the selected suppliers at a precise date and time. The process starts with the fixing of a starting price⁸ [Em00]. From this moment, the suppliers start to propose decreasing prices, aware that the bidding time restarts with each new quote from a supplier, until a price has been reached that the suppliers consider to be optimal and beyond which no supplier will make a new bid ([Ja02,03], [SC03]).

ORA were initially presented as a way to enhance buyer's sourcing performance, and to decrease administrative management costs and the costs of supply chain management [SC03]. The spirit of ORA's technology stipulates that suppliers have to be qualified, trustworthy, and able to honor the market. For this, buyers require samples to prove product eligibility and conformity with schedules of conditions.

ORA became increasingly popular with industrial companies because it guaranteed more attractive prices, a less cumbersome negotiation process and optimization of the buyer's productivity ([DN05], [Em00, 05]).

While they provide the buyer with a number of advantages, at times they appear to damage inter-organizational trust ([Em01, 05]). ORA use is perceived as a brake to trust [Ja00] especially in relation to prior successful experience with the supplier [SC02]. Indeed, ORA are perceived as impersonal and dehumanizing, excluding valuable account relationships and emotional aspects [Ja03]. This could explain why Howard et al., (2006)⁹ present the erosion of the suppliers' trust as a serious barrier to the adoption of ORA. They can lead to an imbalance in the power/dependence couple which increases the perception of risk and consequently leads to trust degradation [Sy98].

⁶ Hosting ORA in a virtual electronic market place enables the buyer to widen their supplier base network

⁷ The virtual Rendezvous takes place within an electronic marketplace. [KS00] "electronic hubs are third-party Internet based intermediaries that focus on specific industry verticals or specific business processes, host electronic marketplaces, and enable any-to-any transactions among businesses".

⁸ The most interesting price from the point of view of the buyer (the lowest price suggested by the suppliers at the time of the pre-selection stage).

⁹ [HVP06] studied 4 e-market places in the car industry: Ford/Covisint; Volvo/eVEREST; Bosch/Supply One and Hella/Covisint.

Jap (2003) suggests that ORA harm the climate of inter-organizational trust. She also considers that recourse to ORA motivates suppliers to carry out investments that are idiosyncratic to the relationship as defined by Williamson (1975). She advances that suppliers perceive ORA as an indicator of the buyer's awareness about recent technological developments able to bring common benefits and hence increase the supplier's willingness to make dedicated investments. This analysis is not shared by [SC02, 03], however, who find that suppliers will be less inclined to carry out such specific investments since they have no guarantee of the buyer's commitment to continuity.

Moreover, Smeltzer and Carr (2003) underline three principal risks related to the use of ORA: a) the fact that price becomes the only decision criterion, b) the genesis of distrust with regard to the distorted bidding¹⁰ and the loss of trust in the buyers and c) the suppliers' suspicion with regard to the buyers' use of ORA as an additional form of pressure to obtain more concessions [SC02, 03].

Beyond the idea of power, suppliers accuse buyers of being opportunistic and only considering their own interests to the detriment of those of the suppliers. Indeed, the latter cannot support a continuous and aggressive reduction in prices in the long term and they are convinced that the reduction in their profits is transformed into an increase in buyers' profits ([Em00, 05], [ES01], [Ja03], [SHW03]). Thus suppliers feel that their relationship with buyers is reduced to the single criterion of price, which makes harder the anticipation of buyer's commitment [SC02, 03]. Finally, trust deterioration risks to lead buyer/seller relationship to a pure transactional perspective in which, because of a deteriorated communication due to the supplier's feeling of injustice [DN05], specific investments are used by suppliers to rebalance the power game in an opportunistic perspective or suppliers might demand more explicit contractual assurances or contingency agreements to safeguard their returns [Ja03].

3 – Advantages of Online Reverse Auctions

Despite the possible negative effect of ORA on trust, the emerging literature on the subject shows that some advantages are perceived by both buyers and suppliers.

¹⁰ [SC03] explain that suppliers may be concerned that the buying customer already has a favorite supplier and that the granting of the market has already been negotiated.

From the buying side, ORA clearly allow economic savings [Ja03] and were presented as a mechanism that reveals market prices [SH03]. In effect, relying on trust implies an exposure to a risk of supplier's opportunism [SH96]. Indeed, a trusted supplier may propose increasing prices which reflect market and thus profit in a non ethical manner of a lack of control in a trusting relationships [Co99]. Hence, once the market price has been revealed by ORA [SH03], buyers would be able to choose effectively between a trusting and collaborative relationship or a transactional relationship based on market prices¹¹. That is to say if the ORA have not destructed the pre-existing trust.

In addition, ORA were presented as reducing transaction costs [Wi75] for both the buyer and the supplier. The negotiation process is highly optimized, and both deadlines and administrative costs are reduced ([DN05], [Em00], [SC03]).

From the supplying side, ORA were presented as a guarantee to improve transparency between buyers and suppliers [MM87], in particular in the granting of markets through inviting and selecting only reliable suppliers to the final stage of ORA [Em05]

Smeltzer and Carr (2002) also point out that ORA allow suppliers to improve their production planning. [Em00], in fact, advances that ORA improve the discipline of the whole supply process by providing worldwide sourcing horizons. In addition, suppliers have more opportunities to penetrate new markets, generating significant growth perspectives through all the buying organizations that choose the ORA system ([SC02, 03], [Em00]) even if certain suppliers sacrifice their margins to penetrate these markets [SC02]. ORA also enable suppliers to benchmark themselves empirically with their global competitors and thus to check their competitive capacity and the viability of their resources ([Em00], [SH03]). ORA can thus provide an opportunity for suppliers to call themselves into question as they are confronted with the realities of their particular market.

In conclusion of our literature review, we want to underline the ambiguity of ORA regarding both their impact on the relationship and their economic outcome. This led Jap (2003) and Emiliani (2005) to call for more in-depth research on ORA. It is through a deeper analysis of the impact of ORA on the supplier/buyer relationship and especially on trust that we want to contribute to filling this gap.

¹¹ Smart and Harrison (2003) advance that thanks to ORA, buyers benefit from an interorganizational flexibility which enables them to develop a "portfolio" approach where they can choose between collaborative or transactional relationships.

4 – Research Methodology

The domination of positivist thought in managerial issues relating to information technology has not prevented a growing interest in qualitative research [Wa95]. Kaplan and Maxwell (1994) consider that data quantification is likely to damage the comprehension of phenomenon from the point of view of the participants and its institutional and social context. Benbasat et al., (1987) put forward three reasons to justify the use of case studies. Firstly, case studies provide an analysis of inter-organizational information systems in their natural state, and also a basis for the generation of theory founded on practice. They also offer better comprehension of the nature of processes by answering ‘how’ questions [Yi03]. Lastly, they are very useful when there are few research studies¹² on the subject and when the study relates to real events¹³. The exploratory case study approach is particularly necessary in new emergent situations [Yi03].

We used this approach because it fits in with our research objectives. Moreover, the inductive approach allowed us to acquire and incorporate in-depth information and revealed unexpected clues that helped us develop a theoretical contribution ([Ei89], [Pe90])

The present research is therefore based on a qualitative, in-depth, contextually rich case study involving a major French retailer. We would like to add that this study was made possible thanks to a scientific research project agreement with this major French retailer. Its management volunteered for the research to develop their understanding and interpretation of the human effects that advanced technologies like ORA can bring to business relationships with their supplier base.

¹² Confirmed by emergent literature like [Em05]; [Ja02, 03]; [SH03]; [SC02, 03].

¹³ ORA are the subject of a topical wide-ranging and theoretical debate (preceding note), practical (major purchase economies, recent merger (November 2005) of the two principal electronic market places in the worldwide retail industry (World Wide Retail Exchange and GNX), giving rise to the new and exclusive e-market place for the retail industry AGENTRICS (AGENT for Retail Information and Collaborative Solutions: <http://www.agentrics.com>), involvement of the major actors in the global retail industry (Carrefour, Sears, Auchan, Sainsbury's, Pinault Printemps Redoute etc.) and legal (interest of the French and European legislator in the mechanism of ORA in particular given the recent reconsideration of ORA's use within the framework of the circular of December 8, 2005 relating to business relationships in favor of small and medium-sized enterprises and aimed at raising moral business standards (Dutheil law)).

Our case study was based on 70 semi-directive interviews conducted with three major profiles, comprising our key interlocutors. Firstly, we made 19 interviews with profiles involved in the definition of the technology. This involved for instance: the Manager of Business to Business Technological Applications, a Sales Manager Responsible for Business to Business Applications, an Information Systems Director, an ORA coordinator, an Electronic Market Place General Manager¹⁴, an Electronic Market Place Member Engagement Advisor for French Corporate Customers¹⁵ etc. Secondly, we wanted to verify the extent to which the assumptions and hopes of the first profiles were similar to the concrete empirical results provided by the second and the third profile, in other words, respectively buyers and industrial suppliers. We conducted 21 interviews with buyers and 30 interviews with suppliers¹⁶. The interviews lasted from 1 hour to 2 hours and 15 minutes.

For the reasons stated above we designed three types of interview guides¹⁷ adapted to the three profiles concerned in order to improve our understanding of the extent and diversity of reflections triggered by ORA in the heterogeneous community of stakeholders [We90].

All the interviews with key informants about the use of ORA were recorded and then fully transcribed in verbatim. We then tried to establish connections between the different theoretical concepts developed during our literature review.

We carried out a qualitative and thematic analysis of the interview contents based on our codes analysis. Data was originally coded to categorize coherence between sets of themes [MH94]. This method consists of analyzing the data and locating the existence and frequency of the topics identified in the literature. We focused on identifying topics through verbatim matching. These topics were analyzed in relation to our research questions based on an iterative process respecting Miles and Huberman's (1994) recommendations. The qualitative analysis was conducted using N-vivo software. In addition to the interviews, we conducted two non-participant observations of two online reverse auctions in the retailer's headquarters.

¹⁴ WolrdWideRetailExchange General Manager (WWRE was the former e-market place leader for the retail industry before its merger with GNX in November 2005)

¹⁵ With regard to the retailer since Agentrics has become the exclusive electronic market place for the worldwide retail industry.

¹⁶ We should note that the suppliers involved in our study offer products under the brand of the retailer concerned in both the food sector and the non food sector. The suppliers questioned have used the system at least once.

¹⁷ Attaining theoretical saturation enabled us to decide on the relevance of the interviewing guide with regard to our research topic and the profiles interviewed (buyers, suppliers, e-market place manager, ORA coordinator etc.).

We examined each text through a comprehensive line by line exploration in order to become highly familiar with each profile's way of interpreting events [Ei89]. According to Yin (2003), a case study analysis entails examining, classifying and selecting or recombining facts. Lastly, and in order to argue our case, we present the passages which we consider to be most representative of the specific answers of the heterogeneous inter-organizational community.

5 – Results

In order to present our results, we will categorize them as follows: disadvantages associated with ORA use, ORA advantages for both buyers and suppliers and the key success factors in ORA use.

5.1 Negative effects of ORA

5.1.1 Decline in trust and genesis of distrust

Our results show that ORA use can cause serious disadvantages for both parties. First of all, the simple use of ORA can lead the suppliers to call into question the point of making an effort to build trusting relationships (*Supplier: "ORA represent a system stripped of humanity and interpersonal contacts, they don't take into account either the qualitative aspect of the relationship or of the existing trust for which I invested so much in the past... buyers have short memories.. their only objective is to reduce prices and thus our margins"*).

Secondly, the non-appropriate management of ORA pushes the suppliers to call into question their existing trust in their buyers (*Supplier: "there is a problem with regard to trust and the auctions, as I know full well that among the suppliers invited, there are at least half that the buyer will not work with ... because they are not worthy of trust and the main reason for their presence is to act as a hare and to this extent ORA are pernicious and completely distorted"*).

Besides, the systematic use of ORA confirms the distrust felt by suppliers (*Supplier: "we can imagine that ORA could lead to distrust especially if they are conducted systematically"*). We should add to the preceding quote that the actual drifts related to ORA use by certain French or European retailers confirm the suppliers' suspicions with regard to ORA and increase their distrust of buyers (*Supplier: "there are many rumors floating around, like the existence of phantom suppliers in ORA to urge qualified suppliers to reduce their prices, buyers who take part in ORA, unreliable suppliers who take part in the bidding etc..."*).

Supplier: “even if we believe that this retailer behaves in an ethical manner during auctions, the other retailers don’t have the same rigorous practices in handling ORA, and non-ethical practices result in a lot of suspicion and rumor about the whole community of retailers”).

Lastly, even if the use of ORA is not likely to degrade the relationship to the level of distrust, it risks leading to a shift in the relationship from relational trust to transactional trust (*Supplier: “when I have the business and if I know that it is necessary to build trust, I will make a lot of effort, and I will invest in the relationship because I know that I have to gain my buyer’s loyalty...however if I know that at the end of the year, the same market will be granted through ORA I won’t make any effort...I will deliver as planned but not more and I would do exactly what is in the contract and no more. There will be no commercial gesture because I know that at the end of the year the sanction of the e-auction will decide”).*

5.1.2 ORA and buyers’ opportunism

The practice of ORA supposes that the suppliers selected are reliable, qualified and trustworthy and that the lowest price will be retained. Nevertheless, certain ORA generate the suspicion of suppliers with regard to buyers’ opportunism as they fear that buyers create a biased market with unreliable suppliers who force reliable suppliers to lower their prices artificially. Suppliers have made these allegations because they see such surprising and sometimes unbelievable offers during the auction that they can hardly believe that the suppliers who are bidding share the same productivity, raw materials, wage constraints etc. Consequently, the suppliers accuse the buyers of opportunism since they do not appear to respect the rules laid down for ORA and they use this type of behavior to deviate the market from its reality just to obtain the lowest price without bothering about the suppliers’ constraints and other specific contexts (*Supplier: “sometimes you find quotes which are lower than the price of the raw materials before processing, and it’s certainly enough to raise questions and to wonder if the buyer really invited reliable people as was announced or whether they are distorting market reality since these suppliers are not reliable, are unlikely to provide the expected performance and do not represent market reality... by behaving in this way, buyers confirm the fact that they are looking essentially to their own interests and at the same time are neglecting our interests.”)*

5.1.3 ORA and specific investments

The specific investment of suppliers was widely identified in the business to business literature as one of the main advantages of trusting relationships. It is logical that in situations of distrust, the willingness of suppliers to engage in specific investment for buyers using ORA will be lower. The perception of buyers' opportunism following the use of ORA – especially when they are frequently repeated in a short space of time – has been identified as a curb for suppliers in making idiosyncratic investment for the buyers (Supplier: *"ORA are perceived as a form of Russian roulette... suppliers will be less inclined to invest in the relationship... I refuse to let the buyer profit from my research and development effort, I will not be proactive nor develop a forceful sales argument and this is regrettable for both the buyer and the future of the product."*)

5.1.4 ORA and power

Our results show that ORA are perceived by suppliers as an opportunity that buyers take advantage of to exert their power in an unjust way, harming inter-organizational relationships according to Sydow (1998) (Supplier: *"ORA are a kind of manifestation of the buyers' power and there is only one winner... we feel that we are being somewhat abused"* – Supplier : *"with ORA, buyers ask you to choose your death: either you win the ORA with no or reduced margins, or you don't take part in the bidding process and you lose your market, yet at the same time you still have wages to pay and machines to run"*).

5.1.5 Emerging outcomes

While the drawbacks of ORA that we cited above were identified in earlier works (for instance, [Ja01, 03], [SC02,03]), we identified several significant risks concerning buyer/supplier relationships.

Initially, we noted that the systematic use of ORA is likely to generate suppliers' opportunism in the shape of a reduction in product quality. In effect, unable to support the fall in their margins on an ongoing basis, suppliers might not respect the entire schedule of conditions and even of providing non-valid information during the Internet bidding (Supplier: *"for the buyer, the risk is that ORA use in the long term will be reflected in a reduction in the quality of the products since suppliers cannot continually support a fall in their margin"*).

There is also a risk that suppliers may try to divert the system of ORA and proceed to preliminary agreements to give a minimal quotation or to artificially inflate prices in one market to reflect the loss of margin suffered in other markets (*Supplier: "you know, in the long term all the suppliers know each other since we are all in the same market and are likely to get together as a preliminary to the market attribution*). Lastly, the suppliers are likely to simply refuse to take part in the ORA since they don't see any interest for their business (*Supplier : here our management was clear: we will reduce our participation in ORA because we consider that it is a risky system which only takes buyers' interests into account*").

5.2 Positive outcomes of ORA

Our results show that after all, ORA encapsulate several positive outcomes for both parties [DN05].

5.2.1 New market penetration

While suppliers perceive ORA as a threat, they recognize that it can enhance their expectations for faster market penetration more than the classical system. Traditionally, in fact, the buyers' commitment toward suppliers needs time to develop. When talking about their past relationships with suppliers, almost all the buyers agreed that they needed time and satisfaction to trust suppliers and then to develop their commitment. This meant that becoming a new supplier was not very easy especially when the retailer had no previous experience of the challenger. With ORA, suppliers feel that they don't need to wait so long before being able to compete with existing suppliers, developing opportunities at the same time to gain new markets without past relational experience (*Supplier: "ORA were an advantage for us at the beginning because we were able to penetrate new markets rapidly and because the margins were still reasonable...in the past we needed time to develop quality relationships and then to gain new markets."* *General Manager of Business to Business Relationships: "during a recent meeting, one supplier said that reverse auctions were an advantage for him as he was able to penetrate new markets and so have more production volume."*)

5.2.2 ORA and Transparency

By the same token, our results prove that the revelation of market prices is possible thanks to ORA transparency, and this allows suppliers to benchmark themselves empirically in relation to their competitors. Some buyers argue that one of the risks of trust is that suppliers may think that they are married to their buyers, and so no longer make any additional effort to enhance their competitiveness or to improve their research and development strategy. Instead, they continue to deliver the same product and even to increase prices. ORA have meant that suppliers can discover crucial information about market trends by knowing the effective market price. Suppliers confirm that such transparency allows them to examine their real competitive advantage within their own market. The ideal outcome is that suppliers who lose out in ORA draw the necessary lessons to improve their strategy and/or their production infrastructure or design (Supplier: *“the advantage is that suppliers can use the information revealed by reverse auctions to check their competitiveness because ORA enables us to compare between the different prices on the spot, so even suppliers who lose an ORA will be aware of the distance that separates them from the competition and may enhance their business since suppliers will be keen to improve and in a forthcoming ORA will be able to lower their prices because finally what motivates suppliers is the idea of becoming a benchmark.”*)

5.2.3 ORA and Transaction Costs

ORA result in a reduction in transaction costs through the considerable time saved on the negotiation process. In face-to-face negotiations, buyers deal independently with each supplier individually, and may even need to renegotiate with them later on. With ORA, the final negotiations take much less time than traditional face-to-face negotiations since suppliers are grouped at a precise point in time in an online environment with no geographical or material boundaries. Suppliers worldwide can submit prices into the system. In addition, all the suppliers can see the price variations immediately and react quickly at the same time. Evidently, this gain in transaction costs supposes that all things being equal, suppliers are selected in a rigorous manner and that they fulfill all the requirements of a qualified supplier (Buyer: *“in general, the reverse auction means a considerable saving in terms of time as it avoids the need for a number of return trips that might have been made with suppliers in traditional face-to-face negotiations or talks...in one and a half hours the negotiation is finished ...suppliers no longer have to come to our headquarters”* – Supplier : *“The only advantage of ORA is saving in terms of time”*).

5.3 Online Reverse Auctions Key Success Factors

5.3.1 Qualitative Criteria

Our results show that the integration of ‘non quantitative criteria’ in the reverse auction bidding process, which have been widely identified as trust antecedents - like satisfaction, idiosyncratic investments etc –, would enable the distrust and the dehumanizing perception of the business relationship by suppliers to be reversed (Supplier: “*qualitative criteria integration which reflects the satisfaction and trust that a supplier has invested in them would make the system fairer and more balanced... I think that this would encourage suppliers to be more committed and enable them to develop dedicated investment.*”)

5.3.2 ORA Management

We suggest that ORA management – upstream, during, and downstream – can contribute to lessening the suppliers’ distrust. The following three levels of accompaniment help mitigate the impersonal aspect of ORA perceived by the suppliers.

Firstly, ensuring upstream management consists of the buyer conducting all the necessary audits, controls, and analyses in order to guarantee the supplier’s competency, trustworthiness and ability to bid in ORA. In addition, it is up to the buyer to calculate the total cost of ownership¹⁸ in advance and thus to estimate the feasibility of switching supplier (Supplier: “*I think the upstream work is essential, in other words, everything that could be considered ORA’s upstream work, all the upstream philosophy, all the upstream audits, all the upstream qualitative analyses, all the upstream discussions, this is where the key lies in my opinion... evaluating the total cost of ownership. If I were a buyer, I would make it my responsibility; I mean that I would be permanently monitoring what is happening*”).

¹⁸ Total Cost of Ownership: are expressed in terms of the potential expected losses from the termination of a given business relationships [MH94].

Secondly, the presence – even distantly by phone – of ORA’s coordinator enables the company to keep in touch with suppliers in order to compensate for the lack of human contact and, in addition, to reassure suppliers in case of technical difficulties. In fact, technical problems that occur during such stressful moments for suppliers can lead to nervousness, anxiety and even distrust when not accompanied by human communication and explanations concerning the consecutive issues. Following our two non-participant observations, we noted that during interruptions in bidding, the ORA coordinator called the suppliers immediately to explain that there was a small technical hitch in the electronic marketplace, and that the problem would be resolved rapidly. The coordinator explained that this is done to reassure bidders during such stressful moments (*ORA coordinator: “during the Internet bidding, I’m reachable by telephone if suppliers have any questions... we try to compensate for the absence of human relations during ORA by personally helping them through the process during the preparation, and of course the buyer must continue to maintain the relationship with the suppliers after the ORA has ended*).

Lastly, it seems that the buyers’ work should continue after the bidding has taken place. Buyers recognize that they have to call the suppliers who took part in the auction in order to consider their new situation. For the winner or winners, buyers will have to consider the implications of the new deal and the conditions surrounding it. For the suppliers who lost in the bidding, the buyer should consider a future auction and/or contact in order to present new horizons that could be seen as reducing – even a little – the supplier’s deception for not winning the bidding process (*Buyer: “the bidding is not the end; I take time afterwards to consider the new situation with the suppliers involved”*).

5.3.3 Development of Ethical ORA Practices

Even if our specific retailer was recognized by the majority of suppliers interviewed as being honest and following strict ethical rules in the management of ORA, it would appear that ORA has suffered from abusive behavior conducted during recent auctions by other retailers or buyers such as inviting unreliable or non-qualified suppliers, not giving the market to the auction winner, organizing fictitious ORA in order to discover the market trends, etc. These non ethical practices explain to a large degree the reasons why suppliers distrust ORA. It would therefore seem logical that avoiding them would be one way to overcome distrust. In this regard, suppliers agree that they need the institutional actors to get involved – namely the government and legislators – in order to restore trust by drawing up rigorous and strict rules to govern ORA management. The recent ‘Dutheil Law’ drawn up by the French government at the end of 2005 was designed to ensure ethical business practice, to settle ethical issues in business relationships and to draw up a series of sanctions in case ORA management was misused. Suppliers feel that it should not just be the French government who acts but the whole European community (*ORA coordinator: “we chose to develop very strict ethical rules because we believe that we could not trust the suppliers if we were not honest with them, and so we refused to allow phantom suppliers to join ORA, we refused to give fictitious prices and we refused to put suppliers with different products in competition with one another”*). *Supplier: “the doubling of deadlines for notifying suppliers that the buyers are changing their supplier, thanks to the recent ‘Dutheil Law’, seems to me to be a good thing. I don’t know if it’s sufficient but it’s a good start. I think that the French legislator and even the European legislators must impose rules to avoid non-ethical ORA behavior like that of which I was victim in England where I was told that I was the winner but at the same time I did not get the market because of the total cost of ownership that would occur if the changeover from the existing supplier took place. I think that Brussels should intervene in this direction.”*)

6 – Discussion

Our data tend to show that the use of ORA does not necessarily lead to the destruction of trust. Under specific conditions and provided that the success factors we identified are respected, trust can be maintained and the positive outcome of ORA can prevail on the negative ones in a long term perspective.

Firstly, we should note that the majority of suppliers perceive the mechanism of ORA as a threat to inter-firm trust, confirming at the same time the results of the emergent literature about ORA [[Em01, 05], [Ja03], [SH03]]. This situation is explained by the fact that the suppliers no longer expect positive behavior from the buyers as suggested by Rousseau et al., (1998) and Sitkin and Roth (1993). Ring and Van de Ven's definition of trust is in turn called into question since the suppliers no longer expect equitable negotiations. In effect, certain buyers behave in an opportunistic manner since when they do not comply with the rules of the internet bidding consisting notably in selecting only reliable suppliers. There seem to be some cases where the pessimistic prognostic of by Smeltzer and Carr (2000, 2003) is confirmed. This is the path towards distrust where the suppliers fear that buyers behave so as to harm their interest by selecting unreliable suppliers who would oblige the reliable suppliers to lower their prices and in consequence their margins. This is coherent with Baba (1999) and Grovier '(1994) description of distrust.

Still, this general result is to be analyzed and nuanced. We detected that it is the systematization of ORA use in a specific relationship that is likely to be understood by suppliers as an opportunistic behavior. The existence of threshold of trust [BA00] is thus confirmed. This threshold corresponds to the repetition and systematization of ORA. They could thus be best used with moderation, up to a level where suppliers feel that the relation is still worth investments on the long-run. When applied blindly and exclusively, ORA eliminate the conditions of reciprocity announced by the social exchange theory [Bl64] and necessary to safeguard trust. In such case, the long run economic impact of ORA for buyers is not as obvious as the short-term one. The systematic use of ORA discourages suppliers from carrying out specific investments. This confirms the vision of [SC02, 03] but disconfirms the results of Jap [03] according to whom suppliers will be motivated to develop their idiosyncratic investments with ORA use. Yet, our result seems to be logic since suppliers evolve in a climate of suspicion where several rival assumptions as for the continuity of the relation coexist [De58]. This non will is accentuated by the perception of a coercive power exerted by the buyer within the meaning of [Ga84].

Further than, our study revealed additional risks related to the distrust caused by ORA. We found that, in turn, suppliers were likely to react in an opportunistic way by cheating on the validity of the elements transmitted in their answer to buyer's schedule of conditions. In addition, ORA use risks to induce anti-competitive behaviors through initial agreements between suppliers and even to concretize the risk announced by [Ho06] namely the refusal to continue to participate to ORA.

However, the use of ORA is not devoid of advantages. In addition to the obvious advantage of considerable savings realized by the buyers ([Em05]; [SC03]), both parties agreed that there are advantages obtained in terms of reduction in transaction costs as defined by Williamson [75] ([DN05], [SC03]), of new market penetration [Em00], and of the possibility to the suppliers to call into question their industrial processes [SH03].

Our study shows that the trust maintaining and the use of ORA would be compatible under certain conditions. Initially, taking into account the qualitative criteria in terms of successful experience [BH94] and of total cost of ownership [MH94] would make the ORA system less depersonalized and would, by taking into account the specific investments carried out by the suppliers in the past, encourage such investments in the future. After that, the accompaniment of the bidding suppliers by the retailer upstream, during and downstream of the ORA would make it possible not to break communication, a factor found to be essential for trust building [MH94]. Lastly, raising the moral standard surrounding ORA would be a benefit at the interorganizational community as a whole. The legislator has a key role to play in this evolution but it is also in the interests of buyers to avoid ORA drifts in order to safeguard interorganizational trust and its positive economic outcome. The proposal for a universal ethical code for ORA use as suggested by Jap [03] and Emiliani [05] seems well to be adapted to our context.

7 – Conclusion

Our research examined the motivations and the risks related to trust deterioration in buyer/seller relationship following the ORA's use. We highlighted tracks for safeguarding the trust capital. Our results show that it is not the technology of ORA *per se* which is responsible for trust degradation. Instead, the deterioration of trust is associated with factors surrounding the technology: ORA's systematization, the invitation of the unreliable suppliers and the rumors surrounding ORA drifts.

We then recorded that such situation of interorganizational distrust is harmful for the both parties implied in the exchange. Thus, in addition to margins' reduction, buyers in their turn are likely to undergo the suppliers' opportunism through harmful behaviors like anti-competitive agreements, invalid informations and even the categorical refusal to take part to the bidding process.

Nevertheless, we also noted that ORA are not deprived of advantages for suppliers. Hence, new markets penetration, large-scale orders resulting in economies of scale and the possibility to benchmark their industrial efficiency were identified as being the principal advantages perceived by suppliers and confirmed by buyers.

We estimate that ORA practice and the safeguard of interorganizational trust is not an illusion. We defend the idea that the integration of qualitative criteria, proper upstream management, during and downstream ORA and the raising the moral standard of ORA practice would constitute solutions for the problem of trust deterioration.

However, our research obviously presents the limits of an inductive case study: our results are specific to the retail industry context and also to a single organization. Further research should include other contexts and industries but also longitudinal designs allowing for an analysis of the situation before and after the introduction of ORA. This will help to refine the success factors presented in the research.

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