

The dark side of formal and informal governance

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Abstract

The literature on governance has promoted formal and informal governance as two mechanisms to mitigate hazards in business relationships. Based on transaction cost theory and social exchange theory, formal governance (e.g. contracts) and informal governance (e.g. trust and social norms) can reduce risk and uncertainty in business-to-business relationships. However, the two mechanisms may lead to disadvantages, such as costliness, inflexibility, and misplaced or blind trust. Our study extends this research stream by claiming both bright and dark sides of formal and informal governance. The moderating effect of informal governance on how information sharing affects total relationship value should follow an inverted U shape, while formal governance should simply decrease this effect. In contrast, while informal governance should strengthen the negative effect of information sharing misalignment on total relationship value, the moderating effect of formal governance on this relationship should follow an inverted U shape.

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