

Print ISSN: 1738-3110 / Online ISSN 2093-7717  
<http://dx.doi.org/10.15722/jds.12.12.201412.19>

# The Effects of TSI(Transaction Specific Investment) on Dependence, Trust, Commitment and Re-Contract Intention\*

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Received: November 14, 2014. Revised: December 09, 2014. Accepted: December 15, 2014.

## Abstract

**Purpose** - This paper aims to test the effects of Korean food service franchisors' and franchisees' TSI (Transaction Specific Investment) on dependence and trust toward the franchisor and re-contract intention. The study examines the effects of both franchisors' and franchisees' TSI on dependence and trust, as compared with Ganesan (1994).

**Research design, data, and methodology** - Data were collected from 495 Korean food service franchisees and analyzed with structural equation modeling using path analysis through SPSS 18.0 and AMOS 18.0.

**Results** - 1) The franchisor's TSI has positive effects on the franchisee's dependence and trust toward the franchisor. 2) The franchisee's TSI has a positive effect on the franchisee's dependence toward the franchisor. 3) The franchisee's dependence and trust have positive effects on commitment. 4) The franchisee's dependence, trust, and commitment have a positive effect on re-contract intention.

**Conclusions** - The franchisor's and franchisee's TSI affect the franchisee's dependence and trust toward the franchisor. The franchisee's dependence and trust influence commitment and re-contract intention. This has managerial implications for franchisors striving to raise franchisees' re-contract intention.

**Keywords:** Dependence, Trust, TSI, Re-Contract Intention, Franchise.

**JEL Classifications:** L66, L89, M31.

## 1. Introduction

In 1979, 35years ago Lotteria who is well-known Korean fast food franchisor started it's business. In statistics of 2013 Korea Fair Trade Commissions, there are 2,976 franchisor and 190,730 franchisees. Korean food service franchise is accounted for 70.3% of the total numbers. For Korean food service franchise, centralization and overcrowding is very serious condition. It inhibits the balanced development of whole franchise industry.

According to Korean Franchise Association(2012), industry culminated in sales of 94 trillion Korean won(about US\$770 billions reaching 8.8% of GDP).

According to Korea Fair Trade Commissions(2013), the numbers of franchisor is expanding from 1,505 in 2009 to 2,973 in 2013 and the franchisees was increased from 132,443 in 2009 to 190,730 in 2013. Expected future growth potential is greater but for sustaining growth for Korean franchise industry, centralization tendency for food industry needs to be reduced and encourage other types of franchise to grow evenly.

<Table 1> Numbers for Korean franchise industry

Category	Numbers( %)
Food	2,809 (70.3%)
Retail	601 (20.2%)
Service	283 (9.5%)
Total	2,973( 100%)

Keeping existing customers than acquiring new customers is more profitable(Eyuboglu and Buja, 2007) and maintenance of relationships through retaining of existing customers is more important than acquiring of new customers(Rosenberg and Czepiel, 1984).

Goodman(1980) explained re-contract intention as willness of closing or retaining the relationship in the future considering past results of relationship. In the context of long term relationship, many other previous studies had emphasized the importance of keeping existing relationship than acquiring new relationship.

\* This paper proposed at 2014 East Asia International conference, and faithfully reflected the views of two panelists and three anonymous reviewers then modified and supplemented.

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Most of Korean food service franchisor are seems to consider acquiring new relationship like opening new store for new comers more important than retaining existing relationship, because that Korean franchisees tend to take not paying royalty as granted and as a result, franchisor prefer to acquire new relationship than try to keep existing relationship.

This study is to find preceding factors influencing re-contract intention of franchisee as perspective of franchisee giving franchisor managerial implications for antecedents of leading to re-contract.

In addition, this study is to verify the effect of franchisor and franchisee's TSI(Transaction Specific Investment) as antecedents of dependence and trust, the effect of the dependence and trust as antecedents of commitment and a commitment as antecedents of re-contract intention by hypothesis verifying the effects of re-contract intention of the previous Ganesan(1994) and Bendapudi and Berry(1997)'s study of depend and trust in the context of Korean franchise industry.

TSI has been studied as important antecedent of relationship reinforcement because many scholars found TSI have influenced dependence and trust and it leads to commitment. So to study effects of TSI can bring many implications to franchisors for the relationship management strategy with franchisees.

## 2. Literature Review

### 2.1. TSI(Transaction Specific Investment)

Transaction specific investments is the investment to be suitable only for exchange relationships with certain partner during the contracted relationship period. It is specialized assets or unique assets that can not be easily relocated with the other partners, and when relocating, assets' worth would be nearly disappearing.

It includes all inputs like intangible time, effort, mutual relationships with education, training, etc. For example, franchisee pays for investment like POS terminals, a specially designed computer program supplied by the franchisor, franchisor's logo imprint or packaging, furniture, tableware, and the interior such as the unique design applied.

That is to be invested for a unique franchise business as contractual relationship including all tangible and intangible investments.

If the transaction specific investment burden investor over the transition to another relationship, the more difficult to transit the more have tendency to rely on the existing relationship(Heide and John,1988). One party adopts the strategies that sustain high dependency relationship with the other party by transaction-specific investments(Anderson and Narus,1990). Transaction specific investments as an important factor unique to determine the relationship, is asset investments in a particular transaction, and tends to act to stabilize the relationship between the companies, because it provides an economic incentive to make a specific relationship persists. and are investments in durable assets that

are highly specialized to the exchange relationship and not easily re-deployable and have little salvage value in other relationships(Williamson, 1981).

It can create exchange difficulties for the investing party(Heide & John 1988). Ganesan(1994) distinguished transaction specific investment as transaction specific investment by retailer and transaction specific investment by vendor. Ganesan described that the extent of dependence is a function of the magnitude of the specific assets. It means a retailer who has invested in specific assets has created barriers to exit from such a relationship. These relationships result in the retailer's inability to replace the vendor easily. Thus, retailer's TSI increase the dependence of the retailer on the vendor but decrease the perception of the vendor's dependence on the retailer. In contrast, a retailer's perception of vendor's TSI is likely to decrease the retailer's dependence on the vendor but increase the perception of the vendor's dependence on the retailer.

### 2.2. Dependence, trust, commitment and re-contract intention

Commitment is enhanced due to the increase of dependency. Commitment levels as a result of an increase in the dependence is a kind of psychological attachment, such as a long-term orientation(Van Lange, Rusbult & Langston, 1998). One party is more dependent on the other party the higher the degree of dependent levels of one party(Gundlach and Cadotte,1994).

Trust is the willingness to rely on an exchange partner in whom one has confidence(Moorman et al.,1992). In Relationship marketing, to build long term relationships, trust play a key mediating variable. Trust is main determinant for commitment and the higher the level of trust, the higher the level of commitment. Commitment is an important element in the relationship marketing with trust. One kind of the reason for the parties to commit and concentrate on a particular exchange relationship is because they believe that it is important to try as much as possible to maintain an ongoing relationship with the other party(Morgan & Hunt 1994).

Individuals are motivated to maintain relationships either because they genuinely want to or because they believe they have no other option. The former is referred to as dedication-based relationship maintenance and the latter as constraint-based relationship maintenance(Stanley and Markman,1992). Bendapudi and Berry(1997) explained this kind of maintenance based on the desire to continue the relationship (dedication-based relationship maintenance) or on the dependency in the relationship(constraint-based relationship maintenance). Recognizing the incompleteness of such an approach, scholars such as Ganesan (1994) suggest that both the desire for relationship to continue as well as constraints that keep it intact must be considered for understanding relationships.

Trust plays a key role in the persistence of relationship (Doney and Cannon 1997; Ganesan 1994) and the perceived trust of franchisee affects positively the intention to stay in the franchise system(Chiou & Droge, 2006).

The deeper the dependence the less the intention to cease

the relationship. The higher the degree of dependence means that much of the benefits of the current relationship is greater, also means that the current relationship is important.

If dependence is lower then the degree of intent to terminate, the relationship will be increased relatively in the same circumstance. That is, dependence is negatively related to termination of contract. For this reason, the higher the degree of dependence, intention to terminate the relationship will decrease(Oh & Kang, 2009). Considering above studies, following hypotheses are posited:

Hypothesis 1 : The franchisor's TSI(Transaction Specific Investment) will be positively related to dependence of franchisee forward franchisor.

Hypothesis 2 : The franchisor's TSI(Transaction Specific Investment) will be positively related to trust of franchisee forward franchisor.

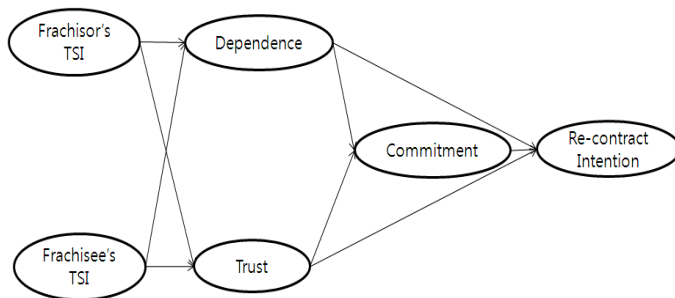
Hypothesis 3 : The franchisee's TSI(Transaction Specific Investment) will be positively related to dependence of franchisee forward franchisor.

Hypothesis 4 : The franchisee's TSI(Transaction Specific Investment) will be positively related to trust of franchisee forward franchisor.

Hypothesis 5 : Dependence will be positively related to commitment.

Hypothesis 6 : Trust will be positively related to commitment.

Hypothesis 7 : Dependence, Trust and Commitment will be positively related to re-contract intention.



<Figure 1> Proposed Model of TSI on Dependence, Trust, Commitment and Re-Contract Intention

### 3. Research Methodology

#### 3.1. Data

Data were collected by questionnaires distributed to food service franchisees who belong to registered franchise headquarters in Seoul / Gyeonggi Province who are owners or managers and surveyed 500 people and 495 units were used for the analysis. Surveyed franchisees were limited to the owner or

manager, the reason is that many employees are not able to answer exactly about overall relationship with the franchise headquarters. The survey carried out in advance through education, and students familiar with the content and purpose of the survey visited the individual franchisee for ten days from Oct.04 to Oct. 13, 2011.

#### 3.2. Measurement

7 points Likert-type multi-scale measures was used in this study, with a 7 point scale of "totally agree" whereas one point represent for "I do not agree at all". After examining the feasibility of questionnaire based on previous studies by professors and industry experts, the revised questionnaire reviewed and confirmed by graduate students, distribution, franchise industry professionals and professors, and then survey was conducted.

The franchisor's TSI(transaction specific investment) was measured by three items using Ganesan(1994)'s methods which were modified for the fitness of Korean food service franchise industry.

The franchisee's TSI(transaction specific investment) was measured by three items using Sheng Brown and Nicholson(2006)'s methods which were modified for the fitness of Korean food service franchise industry.

The dependence was measured by four items using Ganesan(1994)'s methods which were modified for the fitness of Korean food service franchise industry.

The trust was measured by five items using Doney and Cannon(1997)'s methods which were modified for the fitness of Korean food service franchise industry.

The commitment was measured by seven items using Morgan and Hunt(1994)'s methods which were modified for the fitness of Korean food service franchise industry.

The re-contract intention was measured by three items using Lewis & Lambert(1991)'s methods which were modified for the fitness of Korean food service franchise industry.

### 4. Data Analysis and Results

#### 4.1. Properties of sample

Table 2 reports the properties of samples. For gender, male takes 49.3% and female takes 50.7%. For position, 59% is owners, employee(representative) takes 12.7% and manager takes 15.4%. For business statue, coffee and ice cream takes 28.9%, ethnic food takes 18%, noodle takes 9.1%,Korean banquet takes 8.7% and chicken takes 5.1%.

&lt;Table 2&gt; Properties of sample(N=495)

Description		Number	(%)	Description		Number	(%)
Gender	Male	244	49.3	Contract Period	Under one year	32	6.5
	Female	251	50.7		Under Two year	54	10.9
Age	Under 30	133	26.9		Under Three year	118	23.8
	30 - 39	149	30.1		Under Four year	34	6.9
	40 - 49	149	30.1		No answer	257	51.9
	Over 50	48	9.7		Transaction period	Under one year	118
	No answer	16	3.2	Under Two year		91	18.4
Education	Under High school	120	24.2	Under Three year		128	25.9
	College	186	37.6	Under Four year		32	6.5
	University	157	31.7	No answer	126	25.5	
	Over Graduate school	32	6.5	Store size	Under 66 sq. meters	173	34.9
Position	Owner	152	30.7		Under 132 sq. meters	79	16.0
	Owner(Representative)	140	28.3		Under 165 sq. meters	27	5.5
	Employee(Representative)	63	12.7		Over 165 sq. meters	10	2.0
	Manager	76	15.4		Under 66 sq. meters	79	16.0
	No answer	64	12.9		No answer	127	25.7
Monthly Revenue	Under 10 Million Won	141	28.5	Numbers of employee	Under 2	78	15.8
	11- 20Million Won	92	18.6		3 ~ 5	156	31.5
	21 - 30Million Won	66	13.3		6 ~ 10	97	19.6
	31 - 40Million Won	26	5.3		11 ~ 20	27	5.5
	41 - 50Million Won	49	9.9		21 ~ 30	15	3.0
	51 - 60Million Won	12	2.4		Over 30	12	2.4
	61 - 70Million Won	14	2.8		No answer	110	22.2
	71 - 80Million Won	15	3.0		Business statue	Korean banquet	43
	Over 80Million Won	35	7.1	Korean(Meat)		11	2.2
	No answer	45	9.1	Pub(Liquer)		4	0.8
Initial Investment	Under 50Million Won	125	25.3	Noodles		45	9.1
	51~100Million Won	48	9.7	Sea Foods		6	1.2
	101~300Million Won	104	21	Ethenic		89	18.0
	301~500Million Won	30	6.1	Bakery		43	8.7
	501~1Billion Won	18	3.6	Coffee, Ice cream		143	28.9
	Over 1Billion Won	12	2.4	Chicken		25	5.1
	No answer	158	31.9	others		45	9.1
				No answer	41	8.3	

### 4.2. Reliability Test and Correlations

Six variables' Cronbach  $\alpha$  indicated as .899 and Table 3 provides Pearson correlations among the institutional variables. All variables are positively correlated.

<Table 3> Mean, Standard deviation and Correlations of variables

Variables	1	2	3	4	5	6
Franchisor's TSI	1					
Franchisee's TSI	.661**	1				
Dependence	.517**	.493**	.1			
Trust	.791**	.466**	.488**	1		
Commitment	.683**	.490**	.609**	.823**	1	
Re-Contract Intention	.550**	.418**	.554**	.708**	.779**	1
Mean	4.39	4.32	4.75	4.83	4.89	4.82
Standard deviation	1.30	1.08	1.00	1.29	1.19	1.35

Note: \*\* P<0.01, \* P<0.05, \*\* indicates that the correlation coefficient is significantly different from zero at the 1% and 5% level, respectively(two-tailed).

### 4.3. Confirmative Factor Analysis

A confirmatory factor analysis was conducted in order to verify the convergent validity and discriminant validity for each study unit(Anderson & Gerbing, 1992). For the measures have already proven the validity of each study unit, confirmatory factor analysis is more appropriate than exploratory factor analysis(Bhattacharjee, 2000).

Confirmatory factor analysis was conducted for this paper. The measurement model that included latent constructs was assessed with the fit indexes using Amos 18.0.

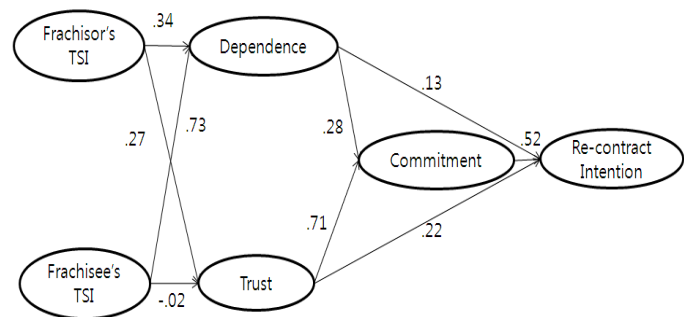
Table 4 provides the results of Confirmative Factor Analysis, 25 items used for confirmative factor analysis showed goodness of fit indices as  $\chi^2= 1733.864(df=260, p\text{-value}=0.000)$ ,  $GFI=.791$ ,  $CFI=.887$ ,  $RMR=.111$ ,  $RMSEA=.107$ . All statistics support the overall measurement quality given a large sample and the number of indicators(Anderson & Gerbing, 1992). Seven items were excluded for lower factor loading(one item for franchisor's TSI, two items for franchisee's TSI and four items for Dependence). For convergent validity, table 4 indicates that all items' standard factor loading has minimum 0.578 and shows  $C.R.>1.965$  and  $p<.05$ , have convergent validity as significantly loaded on their corresponding factors(Smith & Barclay, 1997).

The standardized estimates were used to calculate the AVE(Average Variance Extracted) and CCR(Composite Construct Reliability). Results indicate CCR as 0.72~0.93 and AVE as 0.47~0.66 and established guidelines recommend an AVE of >.5 and  $CCR>.7$ (Fornell & Lacker, 1981). Results met up with these

guidelines with somewhat lower AVE estimates(AVE .469 for franchisee's TSI).

For discriminant validity also examined using Fornell and Lacker(1981)'s criteria, it validated in three ways. First, it validated by latent variable's AVE is exceeding  $\varnothing^2$ . According to Fornell and Lacker(1981), the evidence of discriminant validity exists when the proportion of variance extracted in each construct exceeds the square of the  $\varnothing$  coefficients representing its correlation with other factors. The highest correlations is between commitment and re-contract intention(.779), commitment shows AVE as .639 and re-contract intention as .620 and those AVE are exceeding  $\varnothing^2$ (.606), which indicates adequate discriminant validity. Second, using correlations and standard error(using the highest correlations commitment and re-contract intention(.779) with the standard error commitment and re-contract intention(.097), if  $[\varnothing \pm 2 * S.E.]$  does not include 1, i.e. the confidence interval around the correlation between any two latent constructs does not include 1, it indicates adequate discriminant validity(Smith & Barclay, 1997). Value as .585~.973 does not include 1.0, so it indicates adequate discriminant validity. Third, discriminant validity was examined by comparing difference between standard non-constraint(free) model and constraint model. Covariance between commitment and re-contract intention(.779) was fixed(to a value of 1) and compared chi-square difference between two models. Non-constraint model has 1733.864( $\chi^2$ , df 260) and constraint model has 1740.572( $\chi^2$ , df 261). If difference of chi-square exceed 3.84, it indicates significant discriminant validity(Klein et al. 1990). The difference between two models show 6.708 and it has discriminant validity.

In summary, the measurement model testing supported the hypothesized multi-dimensional model and confirmed that they are distinct constructs.



$\chi^2= 34.105(df=5, p\text{-value}=0.000, GFI=.977, CFI=.985, RMR=.057, RMSEA=.109$   
 \*  $p<.05$ , \*\*  $P<.01$

<Figure 2> Structure Equation Model Results

<Table 4> Results of Confirmative Factor Analysis

Variable	unstandardized	standardized	S.E.	C.R.	P	AVE	CCR
Franchisor TSI						0.592	0.812
Franchisor1	1.000	.929			***		
Franchisor2	.987	.918	.029	33.959	***		
Franchisor3	.929	.750	.042	21.864	***		
Franchisee TSI						0.469	0.719
Franchisee1	1.000	.888			***		
Franchisee2	.996	.876	.045	22.332	***		
Franchisee3	.637	.578	.047	13.527	***		
Dependence						0.523	0.811
Dependence1	1.000	.621			***		
Dependence2	1.296	.736	.096	13.447	***		
Dependence3	1.704	.887	.112	15.219	***		
Dependence4	1.741	.890	.114	15.236	***		
Trust						0.660	0.907
Trust1	1.000	.871			***		
Trust2	1.069	.909	.036	29.651	***		
Trust3	1.003	.886	.036	28.054	***		
Trust4	1.060	.890	.037	28.322	***		
Trust5	1.091	.898	.038	28.825	***		
Commitment						0.639	0.925
Commitment1	1.000	.836			***		
Commitment2	1.048	.879	.041	25.597	***		
Commitment3	1.015	.846	.042	23.969	***		
Commitment4	1.079	.844	.045	23.882	***		
Commitment5	1.088	.857	.044	24.488	***		
Commitment6	1.150	.906	.043	27.004	***		
Commitment7	1.124	.923	.040	27.968	***		
Re-Contract Intention						0.620	0.830
Re-Contract Intention1	1.000	.912			***		
Re-Contract Intention2	.948	.830	.037	25.827	***		
Re-Contract Intention3	.946	.903	.031	30.891	***		

$\chi^2= 1733.864(df=260, p\text{-value}=0.000)$ ,  $GFI=.791$ ,  $CFI=.887$ ,  $RMR=.111$ ,  $RMSEA=.107$

AVE: Average Variance Extracted

CCR: Composite Construct Reliability

\*\*\*  $p<.001$

#### 4.4. Structural Equation Model Results

After the validation of the measurement model, tested hypothesized relationships between the constructs. Structural equation model was performed using Amos 18.0. Indexes [ $\chi^2=34.105(df=5, p\text{-value}=0.000, GFI=.977, CFI=.985, RMR=.057, RMSEA=.109)$ ] showed that the model adequately fit the data, thus allow interpretation of the results.

All hypothesized relationships except for hypothesis 4(The franchisee's TSI(Transaction Specific Investment) will be positively related to trust of franchisee forward franchisor) were supported showing statistically significant and positive.

#### 5. Discussions and Implications

Regarding TSI and trust, Ganesan(1994) indicated partner's particular investment gave a truthful signal and enhanced trust

against partner and this paper showed the same result that franchisor's TSI is positively related to trust. Regarding TSI and dependence, Ganesan(1994) hypothesized both retailer and vendor's TSI would increase dependence of investors and decrease dependence of partners because that TSI had a properties of switching costs and prevented to change partners as a barriers for investors. The results were partially supported and showed TSI increased all dependence of investors and the counter partners. Ganesan(1994) assumed that it may caused by that vendor's TSI stimulated and improved outcomes of retailer, then this is likely to increase retailer's dependence on vendor. The results of this paper indicate that franchisor and franchisee's TSI are positively related to franchisee's dependence on franchisor. For franchisee, franchisor's TSI is likely to interpreted as a particular kinds of benefits which will be lost when relationship is terminated and it plays a role of exit barrier and as a result, franchisee tends to be dependent on franchisor. For franchisee, franchisee's TSI is likely to interpreted as the biggest investments which is bound by contract and it plays another exit barrier. Because of those two different exit barriers, franchisee is reluctant to cling to the relationship with franchisor.

Re-contract intention is the intention of persisting existing relationship so it can stands for one of signals of willingness for long-term relationship. For a study of long-term relationship, dedication-based relationship maintenance and the constraint-based relationship maintenance has been examined by many scholars like Stanley and Markman(1992) and Bendapudi and Berry(1997). They explained those of maintenance based on the desire to continue the relationship(dedication-based relationship maintenance) or on the dependency in the relationship(constraint-based relationship maintenance). Especially, Bendapudi and Berry(1997) stressed those two construct as positive form and negative form. Positive form is asking if relationship will grow as quality of the relationship. Negative form is asking if relationship will persist as stability of the relationship. The former can be described as active form of structure and the latter can be described as passive form of structure.

Other scholars also studied those construct like attitudinal commitment and continuous commitment. Jones(1995) proposed attitudinal commitment as based on mutual trust and satisfaction and continued commitment as reflection of the necessity based on sustainable relationship because of exit barriers or lack of substitutes which are not easily removed. Jones(1995) explained the former as true long term loyalty and the latter as spurious, false loyalty. Ganesan (1994) suggested that both the desire for relationship to continue as well as constraints that keep it intact must be considered together for understanding of relationships considering the incompleteness of such an approach.

The results of this study show that franchiser and franchisee's TSI are related positively to dependence and franchisor's TSI is related positively to trust. On the other hand, dependence and trust are related positively to commitment and re-contract intention. This results give implications to Korean food service franchisor from the point of view of franchisees. This paper aims to be a strategic reference for franchisor, it can be helpful for setting up tactical level of the marketing plan and the

allocation of resources. Through this study, understanding for franchisee will be helpful for what franchisor have to consider to reinforce relationship and raise dependence, trust and commitment so that it can be leaded to re-contract.

## 6. Conclusions and Research Limitations

In this study, by practical understanding of dependence, trust, commitment and re-contract intention, franchisor can understand more about effects of TSI with franchisee's perspective, and this paper give managerial implications for marketing and resources allocation strategies for franchisor who are eager to pertain and raise long-term relationship with franchisees.

The purpose of this study is to investigate franchisee with the perspective of franchisee for empirical analysis of the theoretical and practical implications, but has some limitations, so I propose some direction for a future research.

Firstly, because the study limited samples to Seoul / Gyeonggi area, so it has limitation for generalization. Therefore, for future studies wider range of samples is recommended in order to increase the reliability of the model.

Secondly, this study only investigated for food service franchise, so studies for retailing and service franchise are recommended.

Thirdly, the variables were derived from the previous literature of the antecedents of dependence and trust, but because there might be additional factors that were not contemplated in this study, additional research is needed on these variables.

Fourthly, this paper studied from the perspective of franchise only, but in order to understand relationship between franchisor and franchisee more precisely, like Ganesan(1994)'s study two-dimensions of both perspectives are likely to be necessary.

Finally, The paper did not take into account the time sequence therefore, to identify how a significant impact to the franchisee is different with time variation, in the future, time sequential study would be an interesting research topic.

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