

## **Governance dynamics in a multi-stakeholder network: The case of Nespresso AAA Sustainable Quality Program**

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# **Governance dynamics in a multi-stakeholder network: The case of Nespresso AAA Sustainable Quality Program**

## **Summary**

The study reports on an empirical investigation of the dynamics of governance in the inter-organizational relationship of a sustainable sourcing initiative. We propose a framework integrating earlier contributions from Ring and Van de Ven (1994), Doz (1996) and Ariño and de la Torre (1998) and use it to analyze the creation and evolution over five years of a cross-sector relationship involving a leading coffee roaster, its suppliers, governmental and non-governmental organizations and farmers. The study suggests that in a context of high uncertainty and program experimentation, relational norms based on organizational and interpersonal trust from pre-existing relationships can provide a higher level of flexibility and openness to experimentation and a process of formalization can be introduced later in the relationship as a way to clarify roles, activities and governance mechanisms and allow expansion of the program to incorporate new activities and new players.

## 1. Abstract

This study reports on an empirical investigation of the dynamics of governance in the inter-organizational relationship of a sustainable sourcing initiative. Based on earlier contributions by Ring and Van de Ven (1994), Doz (1996) and Ariño and de la Torre (1998) we propose a framework to study the changes in formal and informal governance mechanisms at different stages of a relationship. A cross-sector relationship involving a leading coffee roaster, its suppliers, governmental and non-governmental organizations (NGOs) and farmers is analyzed. Relationship documentation was reviewed and over 50 interviews were conducted among current and past representatives of all the organizations concerned to trace the evolution of governance mechanisms. In contrast with previous literature, we find that, in a context marked by high uncertainty and need to experiment, governance mechanisms relied initially on informal mechanisms. As the program expanded in scale, complexity and number and type of actors, formal governance mechanisms were increasingly introduced. Relational quality and processes were critical elements in the early phase. As the relationship expanded in complexity, they continued being relevant, building and reinforcing trust and confidence in the relationship. We conclude by proposing that in a context of high uncertainty and initial experimentation, relational norms based on organizational and inter-personal trust from pre-existing relationships can provide a higher level of flexibility and openness to experimentation, and that processes that build or reinforce relationship quality are critical both during the experimentation phase and the formalization and expansion phase.

## 2. Introduction

There has been growing interest in literature on the creation and operation of inter-organizational relationships (IORs), which are relationships that encompass “relatively enduring transactions, flows, and linkages that occur among or between an organization and one or more organizations in its environment” (Oliver 1990). Collaborating with other organizations have been presented as a way to reduce transaction costs (ex. Cavinato 1992, Williamson 1975, Williamson 1979), to access resources (Das, Teng 2000, Pfeffer, Salancik 1978, ex. Barney 1991) or to increase market power (Porter 1985, Porter 1998, Doz, Hamel 1998). However, collaborating with other organizations has been found to be a difficult undertaking, with partners facing difficulties in areas such as problem definition, fragility, lack of staff support (Waddock 1988), trust building (Huxham, Vangen 2005), or conflict management (Gray 1996). As expressed by Huxham and Vangen:

“...seeking collaborative advantage is a seriously resource-consuming activity so is only to be considered when the stakes are really worth pursuing. Our message to practitioners and policy makers alike is *don't do it unless you have to*”(Huxham, Vangen 2005).

Academic interest in IORs has resulted in a vast body of literature on the subject, with hundreds of articles in the main management economic and sociology journals (Barringer, Harrison 2000). This literature, however, has been largely focused on a static view of the relationship, investigating how relationships are formed, the appropriate mix of governance mechanisms adopted and the effect of governance mechanisms on performance (Barringer, Harrison 2000).

Numerous calls from academics have been made to study the dynamic aspects of collaboration (Gulati 1995, Parkhe, Wasserman & Ralston 2006, Doz 1996, Reuer, Arino 2002, Salk 2005, Parkhe 1993), arguing that “managing the relationship over time is usually more important than crafting the initial formal design” (Doz, Hamel 1998) and that “firms make governance decisions in alliances not only at the formation stage but after they have been set up” (Reuer, Arino 2002).

This paper responds to this call, analyzing a relationship from a dynamic perspective. It studies a multi-stakeholder program in the coffee sector that was developed in conditions of high initial environmental and relationship uncertainty. It addresses the key question of what mixture of governance mechanisms were utilized, how and why they evolved and what were the mediating variables involved.

In the next section we summarize the existing literature on dynamics of collaboration and governance. In Section 4, we propose a model of IOR evolution that integrates the concepts developed in the previous section. Section 5 describes the methodology and research design and provides a background on the research setting. Section 6 analyzes the key findings of the research, with Section 7 presenting four resulting hypotheses. Finally, Section 8 presents our conclusions and suggestions for further research.

### **3. Literature overview**

#### **3.1. The study of IOR dynamics**

Though comparatively few academics have focused on the dynamic and process aspects of collaboration, the field has benefited from important contributions over the past 20 years. Van de Ven and Poole (1995) review theories of change from different disciplines and classify them in four models ranging from linear and irreversible organic growth (life cycle) to purposeful cooperation (teleology). Among these, life cycle has been the most used in management literature to explain evolution of relationships (e.g. (Dwyer, Schurr & Oh 1987, Ellram 1991, Ellram, Edis 1996, Spekman, Kamauff & Myhr 1998). It does, however, suffer from being mostly a linear perspective and, as Reuer and Ariño point out, an important contribution of the work of Ring and Van de Ven and Doz has been the evolution from this linear perspective to an iterative one (Reuer, Arino 2002).

Ring and Van de Ven (1994) observe that an alliance evolves through iterative processes of negotiations, commitments and executions, each of which is assessed by the organizations in terms of efficiency and equity. Doz’s model (1996) identifies learning on environment, tasks, process, skills and goals as a mediating variable between the initial conditions and the outcomes of alliances, while initial conditions may themselves also influence these learning processes.

More recently, other important variables in the study of IORs have been proposed such as establishing procedural solutions for conflict resolution as part of the initial conditions (Arino, de la Torre 1998) and the way trust, control and learning co-evolve in joint ventures (Inkpen, Currall 2004).

#### **3.2. Governance mechanisms**

Relationships between organizations can be governed by a wide range of mechanisms that support and sustain cooperation (Grandori, Soda 1995). Formal interfaces encompass the

control and reporting mechanisms through which firms structure their interaction, command structures and authority systems, incentive systems, standard operating procedures, documented dispute resolution procedures and agreed upon non-market pricing systems (Dekker 2004, Gulati, Singh 1998). Beyond the formal mechanisms, the term governance has also been used to identify coordination mechanisms characterized by informal social systems rather than by bureaucratic structures (Jones, Hesterly & Borgatti 1997, Powell 1990) essentially based on mechanisms inducing self-regulation (Ouchi 1979 cited by Heide and John, 1992). These include norms (Dwyer, Oh 1988, MacNeil 1981, Heide, John 1992), conventions or standards (Ponte, Gibbon 2005), pledges (Anderson, Weitz 1992) and informal cultures and social bonds among managers (Spekman, Kamauff & Myhr 1998, Wilson 1995). Some authors have suggested that social control based on personal relationships can be more effective than economic control (Larson 1992).

One important topic addressed in governance literature has been the appropriate mix of governance mechanisms under specific conditions. The topic, however, has been strongly influenced by Transaction Cost Economics (TCE) theory in which governance is seen from a structural perspective and decisions on governance mechanisms take place at the beginning of the relationship and are driven by conditions of uncertainty, asset specificity and interaction frequency (Wilding, Humphries 2006, Williamson 1979, Williamson 1985). Contracts and transaction specific investments are set up as a protection against opportunistic behavior (Anderson, Weitz 1992, Bradach, Eccles 1989). Complementing the TCE view, authors have identified other factors influencing the choice of governance mechanisms such as alliance experience (Gulati 1995), embedded social structures (Granovetter 1985), power-dependence roles (Pfeffer, Salancik 1978) and perceived opportunity for value creation (Zajac, Olsen 1993). The study of governance in relationships has been thus influenced by TCE and has also been far mostly static in nature, focused on governance decisions mostly at the formation stage.

It has frequently been observed that organizations actually make governance decisions not only at the formation stage but also after the relationship has been established (Das, Teng 2002, Arino, de la Torre 1998, Reuer, Arino 2002, Reuer, Zollo & Singh 2002). The dynamic view of IOR addresses this topic, covering four important aspects: 1) how is the initial mix of governance mechanisms defined; 2) how do these mechanisms evolve over time; 3) how the balance between formal and informal mechanisms evolves; and 4) what are the mediating variables influencing changes in governance mechanisms.

On the first topic, Ring and Van de Ven (1994), in their iterative view of relationships, propose that supplemental agreements can be established to deal with misunderstandings or conflicts, whilst informal, psychological contracts are more prevalent as partners become more committed. Doz (1996) finds that initial conditions and learning influence the partners willingness to make irreversible commitments and improve jointly on initial conditions. Ariño and de la Torre (1998) integrate the two views and conclude that partners' assessments of equity and efficiency, based on their interactions and on external shocks, result in renegotiation of the contract or in unilateral behavior. Reuer and Ariño (2002), in an empirical study of contractual negotiations in equity and non-equity relationships, contend that firms tend to renegotiate contracts based upon misalignment between the governance structure and the attributes of the transaction and the contracting environment.

As for the second topic, the balance between formal and informal mechanisms, a relatively generalized view is that relationships can move in a 'virtuous cycle', where over time positive trust among actors increases, and relationships tend to depend proportionately more on informal mechanisms relative to formal ones. Heide and John (1992), for example, argue that in the early stages of a buyer-seller relationship norms may not be fully established and buyers

rely on contractual protections. As the relationship develops, “supporting norms may evolve and eventually enable a buyer to establish control” (Heide, John 1992p. 42). Inkpen and Currall (2004) also argue that “learning about the joint venture partner increases the likelihood that partner firms will reduce their emphasis on formal joint venture controls” (2004p. 593).

As for the third important topic – identification of possible mediating variables influencing the sense-making and renegotiation that occur in IORs – most authors identify trust in the partner’s intentions (e.g. Inkpen, Currall 2004, Zajac, Olsen 1993), relationship quality<sup>1</sup> (Arino, de la Torre 1998) and joint vs. differential learning (Doz 1996, Ring, Van de Ven, Andrew H. 1994, Inkpen, Currall 2004, ex. Kumar, Nti 1998) as mediating variables impacting the need or desire to re-negotiate conditions in an IOR.

Ariño and de la Torre (1998) identify external changes as impacting partners’ re-evaluation of the alliance, though on a later paper Reuer and Ariño (Reuer, Arino 2002) do not find empirical evidence of this impacting joint venture contractual changes. Beyond uncertainty in the partners’ intentions and capabilities, captured in trust, Ring and Van de Ven (1994) Ariño and de la Torre (1998) and Inkpen and Currall (2004) also allude to the uncertainty on the state of nature and the clarity of objectives as influencing governance decisions over time.

Table 1 summarizes selected authors’ approach to factors impacting the evolution of governance mechanisms and the forms that these mechanisms take over time.

**Table 1: Selected authors’ approach to factors impacting the evolution in governance mechanism**

Authors	Initial conditions and governance mechanisms	Evolution of conditions and impact on governance mechanisms
Ariño and de la Torre (1998)	<p>Initial expectations of efficiency and equity</p> <p>Initial relational quality (based on previous personal bonds and institutional reputation)</p> <p>Uncertainty on partners, state of nature and venture</p> <p>Administrative procedures</p> <p>Task definition</p> <p>Decision rules on functional areas</p>	<p>Changes that impact evaluation on equity and efficiency and uncertainty:</p> <ul style="list-style-type: none"> <li>• Execution of commitments</li> <li>• Learning</li> <li>• Conflict resolution</li> <li>• External changes</li> <li>• Relationship quality</li> <li>• Learning-action-reaction loops</li> </ul> <p>Conditions can be adjusted to restore efficiency and/or equity but also there may be unilateral reactions or the dissolution of the relationship if balance cannot be restored.</p>
Doz (1996)	<p>Initial conditions determine whether and how learning takes place between partners:</p> <ul style="list-style-type: none"> <li>• Task definition</li> <li>• Partners’ routines</li> <li>• Interface structure</li> <li>• Expectations of performance, behavior and motives</li> </ul>	<p>Learning about environment, tasks, processes, skills and goals allows re-evaluation of efficiency, equity and adaptability leading to revised conditions</p> <p>Successful alliances engage in iterative and interactive learning cycles over time, with greater trust, adaptive flexibility and commitment.</p> <p>Failure may occur if initial conditions block or delay learning or do not foster joint learning</p>

<sup>1</sup> Relationship quality refers to the measure of strength of a relationship. We use here Arino and de la Torre’s (1998) interpretation of the concept encompassing an initial state of trust and confidence, the firm’s cumulative experiences during the execution and external events that can affect reputation or credibility of partners.

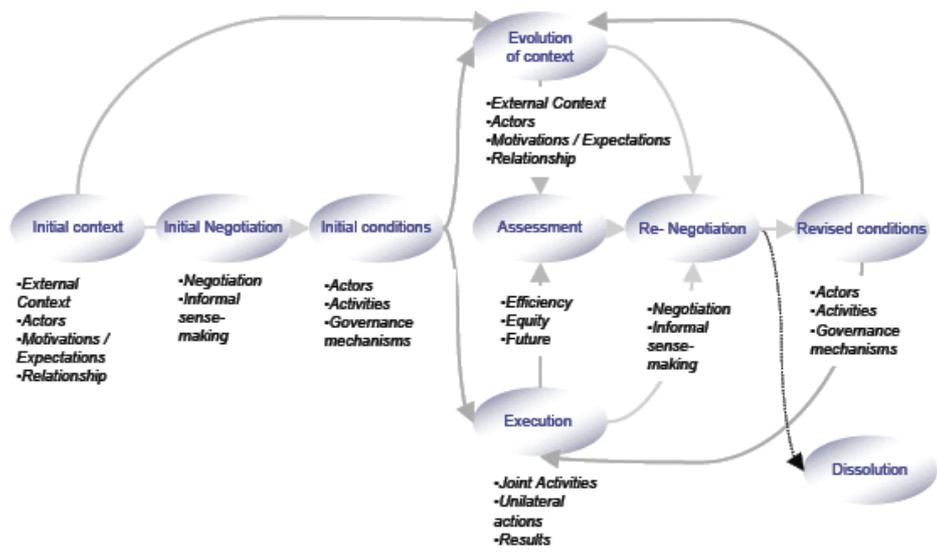
<b>Authors</b>	<b>Initial conditions and governance mechanisms</b>	<b>Evolution of conditions and impact on governance mechanisms</b>
Heide and John (1992)	Safeguarding against opportunistic behavior and investment of specific assets  Governance mechanisms include contracts and Transaction Specific Investments	Increased presence of supportive norms provides confidence  Norms may eventually enable a buyer to establish control independent of contracts
Inkpen and Currall (2004)	Expectations on trustworthiness of partner (competence and benevolence) influence decision on control mechanisms  Clarity of collaborative objectives and performance guidelines foster initial development of trust  Social controls play a larger role when initial trust is high  Extensive initial use of formal control can slow down development of trust, while formal controls that create structure assurance will foster development of trust	Trust, control and learning (partner and venture) co-evolve in the relationship  Social control complements formal control as trust and learning about partner and venture increases  Imbalanced learning leading to shift in bargaining power can lead to increased formal controls
Ring and Van de Ven (1994)	Expectations about motivations, investments  Uncertainty on future states of nature and behavior of partners  Bargaining process includes process of sense making  Governance through formal legal contracts and informal psychological contracts	Execution of commitments through role interactions and personal interactions  Continuous sense-making and formal bargaining  Supplemental agreements are established to deal with misunderstandings, conflicts and changing expectations  High commitment relationships increasingly governed by informal, psychological contracts

#### **4. Integrative model of IOR evolution and governance dynamics**

In an effort to integrate existing models, Figure 1 presents an evolutionary model of IORs and the evolution of context, activities and the accompanying governance mechanisms.

Initial context conditions, both external and actor-related conditions, influence the initial negotiation phase and this negotiation in turn leads to a first set of initial conditions that specify the actors involved, the activities or tasks to be performed and the governance mechanisms to regulate the relationship. Evolution in the external and internal context, as well as the outcomes of execution of activities and unilateral actions, lead to re-assessment of the current status of the relationship and expectations on its future evolution. This in turn leads to a new phase of re-negotiation and either continuation, revision or dissolution of the relationship.

**Figure 1: A Model of IOR evolution**



Also based on existing literature, we identify the setting of initial governance mechanisms and the evolution of these mechanisms at three levels: actor (motivations, trust on other actors, expectations of efficiency and equity, expectations on future context, unilateral actions), relationship (equity, efficiency, joint expectations of future of relationship, relationship quality, activities and processes) and context (embedded relationships, external context conditions and evolution).

## 5. Methodology

### 5.1. Case Study

The need to increase research on the evolution of relationships has been extensively argued for (Doz 1996, ex. Parkhe 1993, de Rond, Bouchikhi 2004). So has the need for in-depth longitudinal studies that explore subjective meaning systems and social processes, “requiring interview and observation over time in a relatively small number of cases (or a single case)” (Salk 2005).

For this research, a detailed Case Study methodology was selected to “help *explain* causal links in real-life interventions that are too complex for the survey or experimental strategies” (Yin 1994).

The research analyzed the creation and evolution of Nespresso’s AAA Sustainable Quality Program, a multi-stakeholder relationship that was initiated by Nespresso, the specialty coffee division of Nestlé, and that involved a network of actors including suppliers, farmers, non-governmental organizations and multilateral development agencies.

The case was selected based on three considerations: 1) As the program was started about five years before the analysis was conducted, it provided enough opportunities to review evolution

in conditions and governance conditions while at the same time affording the possibility to identify and interview relevant participants and offering an increased probability that records were kept and memory of key events was fresh enough; 2) as sustainable sourcing initiatives in the coffee sector are a relatively recent phenomena, there was no prescribed or standard process to organize the network and therefore it provided an opportunity to observe creation and evolution patterns under conditions of context and process uncertainty; 3) access to key decision makers in all intervening organizations was facilitated, thus allowing interviewing all relevant stakeholders, from farmers at location, to partners, to Nespresso’s past and present executives.

## 5.2. Research Setting

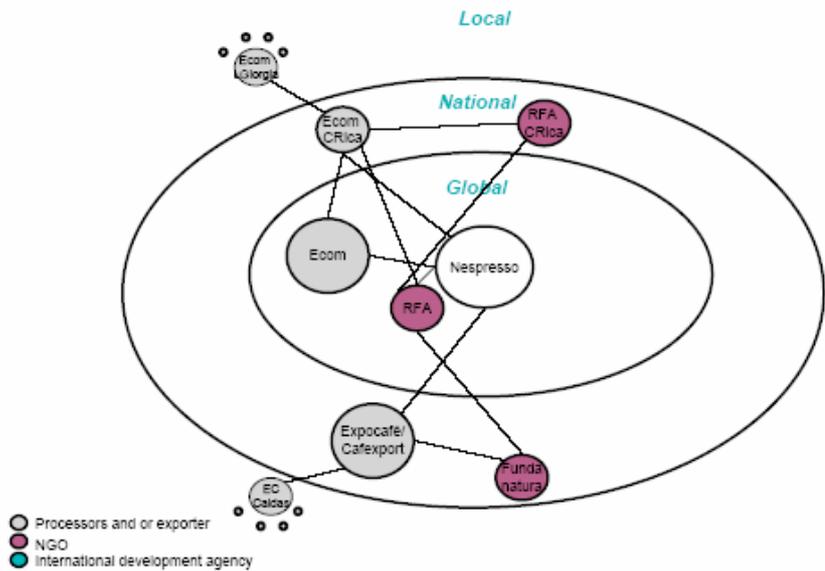
Nespresso’s products are positioned on the high-end of the coffee market, with a patented coffee-capsule technology, associated machinery and coffee capsules. The Nespresso AAA Sustainable Quality™ Program was launched in 2003 as part of an effort to secure highest quality coffee while promoting environmental, social and economic sustainability along the entire value chain, from the farmer to the consumer(Nestlé Nespresso 2008).

Initiated by Nespresso collaborating with two suppliers, Ecom and Expocafé, and a biodiversity conservation NGO, Rainforest Alliance; the program initially operated in two countries. Over time the program has evolved and by the end of 2007 it involved a complex network involving six suppliers, other NGOs and the International Finance Corporation, the private sector arm of the World Bank. It was operating in nine local clusters of activity in five countries, involving approximately 14,000 farmers. Table 2 presents the organizations that were involved in the Nespresso AAA Program while Figure 2 a, b and c illustrate the inter-organizational relationships established over time at the central, national and local level.

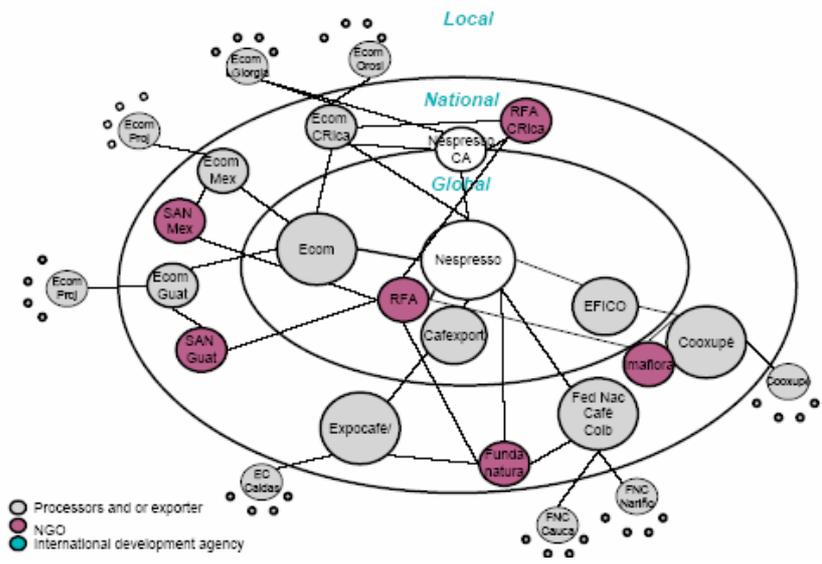
**Table 2: Organizations involved in the AAA Program 2003-2007**

Organization	Type of organization
Nespresso	Buyer – Special coffee roaster
ECOM	Supplier – Coffee Trader
Expocafé	Supplier – Coffee Trader
SKN-Neumann – EDE Consulting	Supplier – Coffee Trader
Volcafé	Supplier – Coffee Trader
National Coffee Federation of Colombia	Supplier – Coffee Trader and Organization
Extensionists	Agronomists, local support organizations
Cooperatives	Farmer Cooperatives
Rainforest Alliance and Sustainable Agriculture Network (SAN)	NGO – Social and environmental
Technoserve	NGO – Technical assistance
International Finance Corporation	Multilateral organization
Individual farmers	Coffee Farmer
Goodbrand & Company	Corporate Social Responsibility Consulting firm

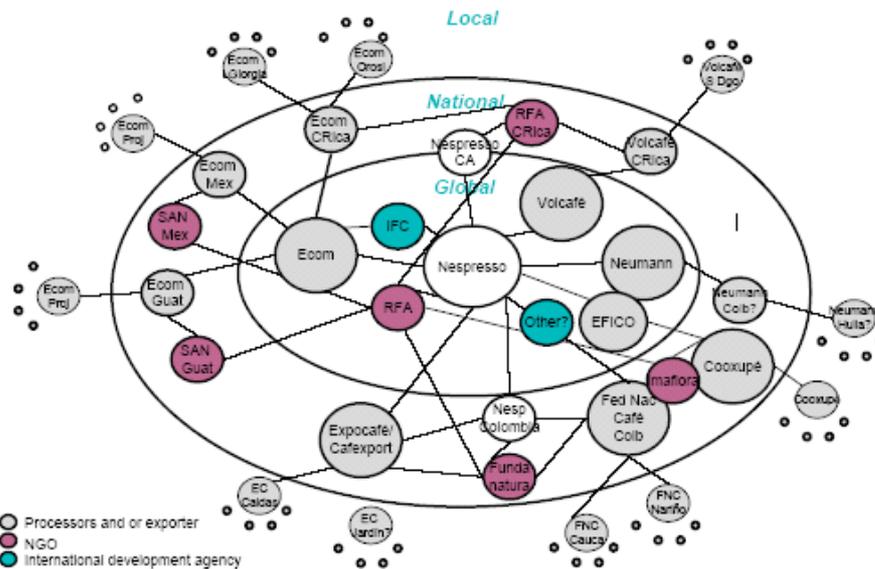
**Figure 2a: Nespresso AAA Program – Inter-organizational relationships 2003**



**Figure 2b: Nespresso AAA Program Relationships 2005**



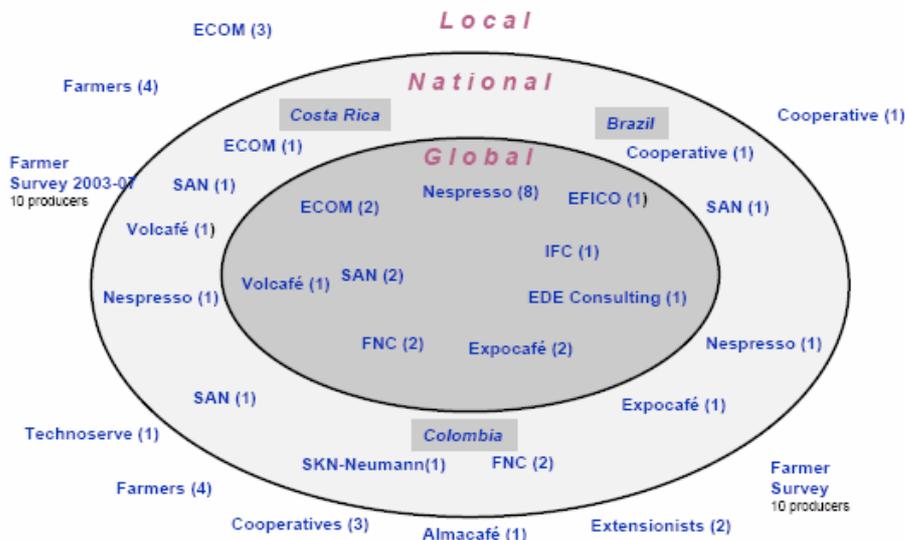
**Figure 2c: Nespresso AAA Program Relationships - End of 2007**



**5.3. Data Collection and Analysis**

Data was collected in field studies through both semi-structured interviews and through access to archived documents. Interviews lasting about 60 minutes were conducted with 50 people representing the different organizations involved in the relationship. The majority of these interviews were face-to-face meetings, with seven being done via phone. Some informants were interviewed more than once and the interviews were conducted between June and September 2007. Figure 3 shows the organizations interviewed.

**Figure 3: Interviews conducted at local, national and central level (Total = 50)**



All interviews were recorded and later transcribed and several interviewees were re-interviewed to clarify specific points or to comment on early drafts of this paper.

Archival information included presentations exchanged between the initial organizations in preparation for the launch of the program, the initial Memoranda of Understanding between parties, subsequent negotiation documents between Nespresso and the NGO and with its suppliers, management presentations, publications, websites as well as press releases during the period. Reviewed documentation also included the 50 page document produced as output of the first stakeholder meeting in 2005 and participants' presentations to the second stakeholder forum held in 2007.

The data was analyzed using data reduction techniques to identify emerging themes and concepts, guided by the main research question: how and why did governance mechanisms evolve in the multi-stakeholder network?

Interview transcripts and documents were reviewed using the classification criteria and identifying relevant references to context factors, actors (organizations and people), negotiation, conditions (activities and governance mechanisms), unilateral actions and other events considered important by interviewees. The software tool Nvivo (QSR International Pty Ltd 2006) was used to analyze all transcripts and documents. These were all uploaded and then codified using the free and tree node functionality provided by the software. The attributes and relationship functions were also utilized to record the different types of relationships that existed between organizations and between individuals.

Data was also classified according to the topic(s) and along a timeline spanning from 2002 to 2007. A blank timeline filled in by 2-3 representatives from each organization with what each considered a "key event in the relationship" was also used as a reference to what interviewees considered the significant moments and phases in the creation and evolution of the relationship. A chronological matrix was developed to integrate the data from the different sources by the year in which it happened. A narrative of the main context conditions and evolution of conditions was synthesized (presented in Section 6.1) and an integration of the data in relation to the model over time was performed (presented in Section 6.2).

As a way to test the findings and correct any mistakes in the data, several interviewees were re-interviewed. One of the authors also participated in the second stakeholder forum, in October 2007, where 34 of the 50 interviewees were present. Initial findings from this research were presented in this opportunity and feedback was solicited.

## **6. Preliminary Findings**

The Nespresso program began in 2002-03 in an initial context of pressure from external factors, readiness among the key actors and uncertainty on the scope of the program and conditions. Over the following four years, the program expanded dramatically to incorporate new actors and new geographies. Section 6.1 provides a narrative description of the evolution of the relationship while Section 6.2 analyzes patterns identified in this evolution.

## **6.1. Narrative description**

### *6.1.1. Initial context - Years 2002-03*

Coffee prices fell to an all time low in the second half of 2001 (International Coffee Organization 2007). The crisis hit especially hard coffee producers, many of them subsistence farmers. Activist organizations such as Oxfam and Equal Exchange organized at the time campaigns to sensitize consumers and the media on the precarious conditions of coffee growers and to question the sourcing practices of some of the large coffee roasters (Argenti 2004, Oxfam America 2002).

At the same time, while demand for coffee was slowing, consumer appetite for high quality coffees was on the rise and Nespresso's coffee capsules enjoyed great success, pushing company to grow at rates of over 30% per year. This growth, and competition with other specialty coffee roasters, highlighted the need to secure long-term supply of high quality raw materials.

Conversations between Nespresso's green coffee manager, the quality manager, the technical director and Nestlé experts led to a first discussion on how to incorporate sustainability and quality concerns into the supply chain. These conversations continued over 2002, but it was when Nespresso's CEO became engaged that the concept initially took hold. As stated by one of the original project promoters: "Once the CEO got engaged, he provided a vision for this project and then the project took off internally".

An initial dialog started with experts on the topic and with Nespresso's coffee suppliers. Among these, Ecom, a leading coffee trader and longtime supplier, expressed interest in co-developing a customized approach to fit Nespresso's needs. At the time, Ecom had started an analysis of sustainability conditions in Costa Rica and two senior company leaders were particularly open to these new initiatives. Executives at Ecom, had, over time, developed strong relationships with the Nespresso's green coffee team, facilitating initial discussions. An additional supplier, Expocafé, had recently started selling green coffee to Nespresso and was interested in differentiating Expocafé's positioning by participating in a sustainable sourcing program. Though Expocafé was a new supplier to Nespresso, its European representative, the green coffee manager and the quality manager knew each other from a previous professional experience.

At the same time, Rainforest Alliance had decided to work "with" corporations instead of "against" them in the belief that this would be a more effective approach to promoting change. After a successful experience with the Chiquita Corporation in the banana industry, Rainforest Alliance targeted coffee. During 2002, its leaders visited all major coffee roasters to invite them to work together and to promote their own certification program. Nespresso showed interest in initiating conversations, but this dialogue was tentative based on lack of prior relationships. An external consultant, previous colleague and confidant of the CEO, played an important role in setting up and building a dialogue with Rainforest Alliance, establishing communications lines and an initial level of trust.

Between May and October 2003, internal talks, conversations with Nestlé, with suppliers, and with Rainforest Alliance resulted in the decision to develop a customized program, integrating Rainforest Alliance conservation practices and Nespresso's quality considerations, with input from the involved suppliers.

### *6.1.2. Program launch and initial activities*

The program was publicly launched at an important industry event, Sintercafe, in Costa Rica in 2003 as a program “designed to promote production and supply of sustainable, highest quality coffee” (Nestlé Nespresso 2008).

By that time, a memorandum of understanding (MOU) had been signed between Nespresso, Rainforest Alliance and the first two suppliers. The MOU signed with Rainforest Alliance covered 11 areas of activity to be developed, including training sessions, development of a farm assessment tool, and establishing a traceability system. The agreement with Ecom and Expocafé, on the other hand, was less specific, with a commitment to cooperate on information of origin, assessment of farms and participation of the suppliers in the pilot project (Nestlé Nespresso 2003, Nestlé Nespresso, Rainforest Alliance 2003).

During 2004, initial activities of the program were carried out by Ecom Costa Rica, and by Expocafé Colombia. At this time, there was considerable experimentation on supply regions. Besides the development of a first assessment tool (later called TASQ) coordinated by Rainforest Alliance, specific projects with suppliers were initiated, including such as a reforestation program in Costa Rica, funding for processing equipment in Colombia and sponsoring school facilities in Mexico.

Objectives were difficult to quantify at this stage and resources were not specifically assigned for the project by participating organizations. Statements such as “we didn’t know what it would take... maybe that was better” by a supplier, or “we didn’t have a specific budget for this, we just took it from our regular budget” by Nespresso, meant that investments were generally small and fragmented.

During this time the program involved few organizations and communication between the main actors was intense and frequent, with numerous conference calls and continuous e-mail exchanges. There were also frequent face-to-face interaction between Nespresso and the other organizations as well as between the local Rainforest Alliance organization and the local supplier’s offices.

Overall, this first period was characterized by high degree of experimenting and learning, supported by previous personal bonds and institutional relationships. The conditions and governance mechanisms allowed for significant flexibility in crafting the program over time. But this flexibility required intense and frequent communication among authors and resulted in certain inconsistencies in the program activities, as well as some frustration among certain actors.

### *6.1.3. Program formalization*

The original players were generally very satisfied with the program and the relationships among the different actors. Nespresso continued growth at over 30% per year, its premiums, and a combination of quality and sustainability influenced the criteria for assessing farms supported a good relationship among the actors.

But there was also a feeling the program should evolve from a series of independent projects to a more consistent overall program. Rainforest Alliance was also interested in increasing cooperation by further integrating its own certification process with the Nespresso AAA program

In 2005, a new Head of Green Coffee at Nespresso was named. In retrospect, many viewed this as a turning point in the evolution of the program. As expressed by an exporter: “This thing was growing and growing, and it started to need some discipline. He was the person to do it”.

The program went through a period of “formalization”, in a large part driven by the new Nespresso’s head of green coffee. Four major elements were included in this effort: 1) defining the process through which a supply cluster is initiated and managed; 2) refining the farmer’s quality assessment tool, including a self-assessment tool used directly by farmers; and 3) establishing key performance indicators (KPIs) to measure cluster progress, 4) establishing formal contracts with partners including agreements on program objectives and quality requirements.

The TASQ tool was also refined, adapting it to local differences and establishing a self-assessment tool to aid farmers evaluate areas requiring improvements. Rainforest Alliance was in charge of this process, and a Terms of Agreement was signed in 2005 with specific responsibilities of each organization. It also set established a verification process of farms carried out by Rainforest Alliance, and agreed to study the costs and benefits of a certification or a hybrid certification/verification process (Nestlé Nespresso, Rainforest Alliance 2005).

The “TASQ Cycle” was also structured, in the form of a wheel containing seven steps. The introduction of this structure was welcomed by suppliers and by Rainforest Alliance, clarifying steps that, until then, were not very clear. As one trader said: “The definition of the program ‘wheel’ was fundamental. Then we could see at which stage of the program we were, what came next, and who was working on what”.

Administrative support for the program was also reinforced by all organizations. Nespresso hired three managers (two local and one in headquarters) to manage the expanding program. Suppliers also hired or appointed specific persons to administer and execute the program, as did Rainforest Alliance.

Communication became more structured, with objective setting sessions and periodic performance reviews. Structured annual review meetings with suppliers brought a new level of formality to the process. A “Joint Statement of Commitment” five-year plan with RA set out specific KPIs for improvement in performance across clusters and the inclusion of new clusters (Nestlé Nespresso, Rainforest Alliance 2005). A Supplier Shared Commitment document followed later, identifying specific commitments by Nespresso and a set of commitments by the supplier. Beyond specific quality specifications, the KPIs also included factors such as number of farms, agronomists dedicated to the project, workshops organized, number of farms assessed and verified by Rainforest Alliance partners. Product traceability and financial transparency became part of the increased specificity of the program. An annual performance review was established to review progress of the program based on nine qualitative and three quantitative criteria (Nestlé Nespresso 2007).

A final important element in this second phase was that relationship building activities, continued and formalized, with a first “stakeholder forum” organized in Switzerland in 2005 and a second meeting in 2006 in Colombia, involving all field participants (agronomists, local managers, etc.). There were also a series of visits during the period by different levels of the organization, and a continuation of informal encounters in different industry events. These relationship-building activities were appreciated by the organizations. As a local representative of a large supplier said: “Nespresso executives came here to visit a local coffee conference, with the attendance of farmers. They explained the program, they interacted with the local people and they organized a tasting of their finished product. That was very powerful. People cannot fall in love with something they don’t see.”

In 2006, the AAA Program represented 30% of the total supply of green coffee for Nespresso. The CEO, believing in the potential of the Program in the future, committed the firm to increase this percentage to 50% by the year 2010. As the company was growing at over 30% per year, this represented a significant stretch in the objectives set out for the program.

#### *6.1.4. Program expansion*

Over 2006-07, the program dramatically expanded in multiple directions. The number of farms in each participating cluster was expanded and new clusters were added. Three new suppliers, National Federation of Colombian Coffee, Volcafé and Neumann, were invited to participate. A second NGO, Technoserve, was engaged to support economic development activities in one cluster. Finally, conversations with the International Finance Corporation were initiated as a way to leverage funds invested in the program.

At the time, sustainable coffee practices were also gaining broader acceptance among suppliers and consumers. Nespresso suppliers, NGOs, and multilateral organization were increasingly involved other coffee industry sustainability efforts (ex. Kraft's RA program, Starbucks CAFÉ Practices program, Utz Kapeh). Although this was a customized program, actors felt more prepared to incorporate such programs in their internal structures, budgets and activities. As one exporter said: "A few years ago we expanded our supply chain with CAFÉ practices certified coffee. In doing so, it helped us define supply chain for other schemes, it was then a smaller step to understand and work on the Utz Kapeh, the Rainforest Certification and now the AAA Nespresso Program". Nespresso suppliers that had not become involved with the program in the beginning, were now keen to participate. In the words of a supplier that joined the program in this phase: "the program was very attractive to our team, especially the people responsible for quality and the farmer support team, everyone was very eager to enter the program and worked very hard on it". Another supplier, new to the relationship expressed: "Our Company has not been considered a leader in sustainability programs in the past, but there has been a change in mentality over the last year or two and now we are playing catch-up. This is an important opportunity for us for the future". Negotiations with these new suppliers were indeed much more structured, with clearer objectives, responsibilities, and clear definition of activities and KPIs.

The program also expanded to include a project with the International Finance Corporation and proposals of cooperation to other multilateral organizations. Two suppliers that had been already working with such organizations co-financing farmer support projects and that facilitated the introduction and initial dialogs. The negotiations however, were quite different from buyer-seller negotiations and even corporate-NGO negotiations. As one supplier experienced in Public Private Partnerships (PPPs) expressed: "we need to be much more coordinated when we approach multi-lateral institutions, their processes and systems are quite different and the projects need to be expressed in their terms, not ours...".

By the end of 2007, the organizations involved remained very positive about the potential of the relationship. Relationships with suppliers had been reinforced and there was a positive working relationship with Rainforest Alliance. There were, however, important questions on the future expansion on the program, the efforts on the upgrading of the farms, and, at some level, the extension of a sustainability focus consideration to the rest of the activities of Nespresso.

The second half of 2007 marked a new important event in Nespresso, with a new CEO taking over the post in August of that year. Since its inception in 2003, the AAA Program had established itself as an innovative initiative and the company now had an opportunity to assess its progress and define, again, its future.

## 6.2. Evolution of variables in the IOR model

This section analyzes the evolution of the relationship using the model developed in Figure 1. Table 2 illustrates the evolution of the variables in terms of initial conditions and two distinct phases of the program. The first phase, marked by experimentation in terms of defining relational opportunities and objectives, relied on informal governance mechanisms and frequent communication. In a second phase, the relationship and the program structure itself expanded in terms of actors and became more formalized and structured, incorporating formal governance and communication mechanisms.

**Table 2: Evolution of variables in IOR model**

	2002-03 Initial conditions and Program Creation	2003-05 Phase 1: Experimentation	2005-07 Phase 2: Formalization, Expansion
Context	<ul style="list-style-type: none"> <li>• Coffee crisis</li> <li>• NGO activism</li> <li>• Nespresso's goal to secure long term supply of high quality coffee</li> <li>• Some suppliers developing projects on sustainability</li> <li>• Key actors in several organizations have pre-existing professional relationships</li> <li>• Other players in the industry also start programs</li> <li>• CEO support</li> </ul>	<ul style="list-style-type: none"> <li>• Certification programs expansion in coffee industry</li> <li>• CEO support is strong for the program</li> <li>• Nespresso continues growth of 30-40% year over year</li> </ul>	<ul style="list-style-type: none"> <li>• Industry players interact in a number of different sustainability initiatives</li> <li>• New Head of Green Coffee named in 2005</li> <li>• Nespresso's CEO announces intention of sourcing 50% of its supply of coffee within the AAA Program by 2010</li> </ul>
Negotiation	<ul style="list-style-type: none"> <li>• Informal dialogs</li> <li>• Letter of understanding with Rainforest Alliance</li> <li>• Short contract to document agreement with suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• Frequent, intense dialog among players</li> <li>• Short contract document signed with new suppliers to the program –general terms and conditions</li> </ul>	<ul style="list-style-type: none"> <li>• Objective setting and performance evaluation with suppliers</li> <li>• Establishment of Key Performance Indicators for program and for supplier</li> <li>• Detailed supplier contracts include target setting on quality and on sustainability</li> </ul>
Conditions - Actors and activities	<ul style="list-style-type: none"> <li>• Two suppliers in two regional clusters initiate the program</li> </ul>	<ul style="list-style-type: none"> <li>• Rainforest Alliance involves its local NGO network organizations</li> <li>• Internal initiative handled in small group in HQ with support from CEO</li> <li>• No specific reference in</li> </ul>	<ul style="list-style-type: none"> <li>• By end of 200, six suppliers and nine clusters participate in the program</li> <li>• Activities structured under the "TASQ wheel"</li> <li>• Multilateral technical assistance organizations</li> </ul>

	2002-03 Initial conditions and Program Creation	2003-05 Phase 1: Experimentation	2005-07 Phase 2: Formalization, Expansion
		MOU to projects that will be undertaken as part of the Program	involved <ul style="list-style-type: none"> <li>Nespresso expand number of program managers in headquarters and in origin</li> <li>Visits, informal events and stakeholder meetings organized</li> </ul>
Conditions – Governance mechanisms	<ul style="list-style-type: none"> <li>Pre-existing relationships among organizations and among individuals facilitate dialog</li> </ul>	<ul style="list-style-type: none"> <li>Predominance of informal governance systems</li> <li>Continuous communication between players</li> </ul>	<ul style="list-style-type: none"> <li>Formalization of governance mechanisms, increased use of contracts and written documents</li> <li>Continued informal dialog and informal communication opportunities complement formal mechanisms</li> </ul>
Execution		<ul style="list-style-type: none"> <li>Specific projects in forestation, social programs and farmer infrastructure support</li> </ul>	<ul style="list-style-type: none"> <li>Program structured around Tool for Assessment of Sustainable Quality (TASQ)</li> </ul>
Assessment		<ul style="list-style-type: none"> <li>Actors generally satisfied with development of benefits (Equity) they are receiving from program, seeking more clarity and organization (Efficiency).</li> <li>Nespresso’s growth rate, premium pricing, and reputation for quality is attractive for suppliers</li> </ul>	<ul style="list-style-type: none"> <li>Rainforest Alliance believes there are opportunities for further integration with own certification program</li> <li>Actors satisfied with equity and efficiency conditions but some question “too much” bureaucratization of program</li> <li>Nespresso considers options for consolidation of the program and/or expansion of the program and of sustainability strategy in other areas of the company</li> </ul>

In phase one, the focus of the relationship was on identifying opportunities for collaboration. In this phase, the context was marked by high levels of uncertainty, but supported by pre-existing relationships, Nespresso sought out an opportunity to match its need for superior quality inputs with considerations of sustainability. They specifically sought out potential collaborators with potential mutual interest and where trust was supported either on prior relationships or institutional reputation. At this phase, focused on searching for potential opportunities and experimenting to establish relational benefits, governance mechanisms emphasized informal mechanisms.

In phase two, based on the success in the initial phase, Nespresso formalized its objectives associated with product and process quality and sustainability considerations as it expanded the number of parties involved in the collaborative. This phased focused on expanding and formalizing relations to increase the scale and scope of collaborative activities required by the rapid overall growth of Nespresso’s business. At this stage, Nespresso formalized governance mechanisms, driven by the need to measure specific benefits based on clarity in its objectives, as well as the expanding number of parties involved in the collaborative relationships.

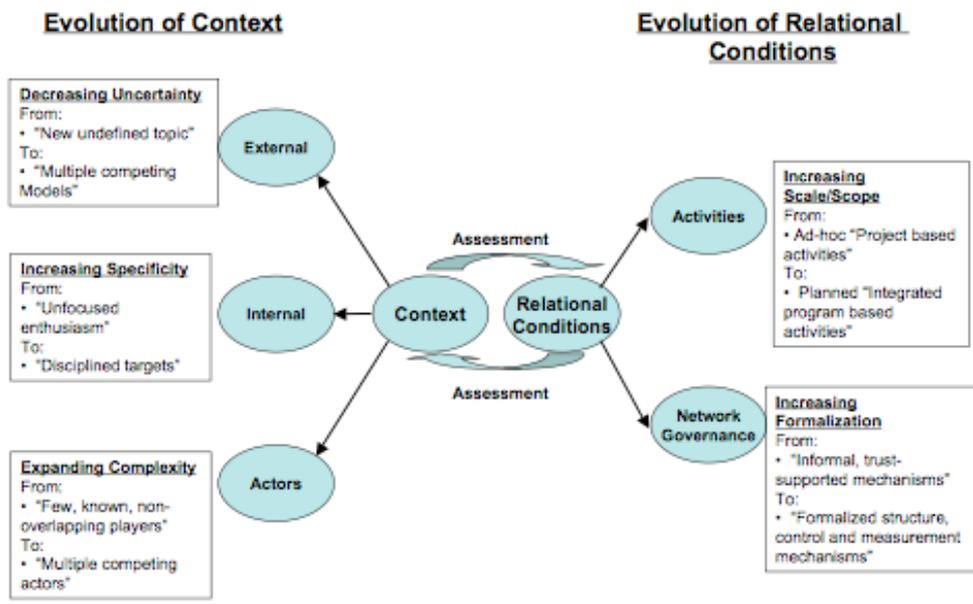
Thus in terms of context, there was an observed evolution in terms of the objectives of the relationship from search and experimentation to growing formalization of objectives by the primary party, Nespresso. In terms of involvement of collaborative parties, there was an evolution from known and trusted partners to an expanding number of parties to enable growing the scale and scope of collaborative activities. In terms of governance mechanisms, the evolution involved moving from informal mechanisms to support initial search and experimentation to expanding formalization to enable expanding the scale, scope, and specificity of the relationships and collaborative activities.

## **7. Discussion**

We started the research asking the question how and why governance mechanisms evolve in a multi-stakeholder network. The research showed that in complex relationships, the governance mechanisms do evolve over time, but not in line with suggestions of prior research. Whereas literature has suggested that collaborative parties initiate relationships based on high levels of formalization to protect the interests of individual parties in the face of high relational uncertainty, this research found the initial use of informal relationship and governance mechanisms was used to initiate relations with partners as the parties simultaneously sought to identify and specify opportunities for collaborative relationships. Formalization of governance mechanisms was associated with the subsequent need to expand the number of parties involved, to enable measurement of identified specific objectives, and to bring clarity to current and new players involved in the relationship. As collaboration developed from an experimental and project based initiative to being more structured and becoming a more comprehensive program, the governance mechanisms co-evolved with the specificity of objectives and the complexity of parties involved.

These findings are summarized in Figure 4, outlining the evolution of context and relational conditions. Specifically, the context observed can be associated with changes in the external (environmental) and internal (actor-specific) contexts, as well as in the number and type of actors. The context evolved in terms of decreasing uncertainty and associated increasing clarity in terms of the context supporting the relationship. At the same time, there was an increasing complexity in the number and type of actors involved. Associated with this evolution, there were important changes observed in the relational conditions. Specifically, there was an expanding scale and scope of activities observed and supporting this expansion was an increasing formalization of the governance mechanisms associated with the IOR.

**Figure 4: Evolving Context and Relational Conditions**



These findings suggest a number of potential modifications or expansions to existing theory, leading us to present four propositions.

Prior literature has focused on relational uncertainty to protect the interests of collaborative parties. In this regard, individual party interests are protected through formalized governance mechanisms. However, external and internal contextual factors also play an important role in determining the nature and focus of collaborative activities and subsequently of the selection of parties and governance mechanisms. Where there is a high degree of uncertainty associated with not just the management of collaborative relationships but also the opportunities associated with the objectives and scope of the collaboration, resources required and contributions of individual parties, and the benefits of collaboration for individual actors, there is a higher degree of reliance of initial party selection and use of informal governance mechanisms to support initial search and experimentation.

Clarity on these variables has been considered an important factor in determining the initial structure of the network and the success of the relationship (Human, Provan 2000, Kumar, Anderson 2000, Doz, Hamel 1998, ex. Bryson, Crosby & Stone 2006). Transaction Cost Economics theory indicates that detailed contracts and transaction specific investments are mechanisms to safeguard against opportunistic behavior in a new relationship (Anderson, Weitz 1992, Heide, John 1992, Williamson 1979). This was not found to be the case in the initial negotiations of the AAA Program, with relatively vague MOUs being drafted at the time of the program launch.

Small experiments, pilot projects, ad-hoc budgets and the like were used as a means to shape the program in this initial phase and this helped set initial conditions that allowed maximum learning for all parties, in accordance and what Doz (1996) proposes. This flexibility helped

Nespresso and the other actors shape the program incrementally instead of doing so at the outset.

***Proposition 1: Uncertainty in collaborative opportunities and objectives involve an initial search and experimentation process supported by informal and trust enabled governance mechanisms.***

As suggested in IOR literature, previous institutional and personal relationships (between Nespresso and its suppliers and between individual actors) played an important role in the selection of actors (Granovetter 1985, Gulati 1998, Gulati 1999, Gulati, Gargiulo 1999).

The first years of the program relied on a commitment on the general concept and vision on the program from the various organizations and intense, frequent communication among the key actors involved. Norms and trust-based governance were used instead of formal and contractual regulations. These can be effective to provide confidence to a party that relinquishing control will not create a condition of vulnerability and increase confidence (Heide, John 1992), but they are generally viewed as an evolution of the relationship and not as a governance mechanisms with which to initiate a relationship.

Nespresso had an independent on-going buyer-supplier relationship with some of the organizations. Also, key individual players had previous working relationships. These were probably the two main factors that allowed such a loose governance structure to be set up and be successful in the initial phase. The more detailed description of activities is actually found in the initial agreement with Rainforest Alliance, the organization with which Nespresso had no prior relationship.

***Proposition 2: In the context of high initial uncertainty in collaborative objectives, pre-existing relationships support a preliminary reliance on informal governance mechanisms.***

Flexibility, openness and experimentation were built into the initial process. This flexibility, however, also meant that there were few guidelines on how to define and coordinate the program activities and secure the required resources. Intense and frequent communication among the key actors was required to define and coordinate activities. As expressed by one of the managers: “Everybody was talking with everybody and no one seemed to write anything about anything. It was fast and effective, but sometimes we ended up playing broken phone”.

A consolidation and formalization phase allowed for an expansion phase where the program had been codified to a larger extent and could be handled at a larger scale. Contrary to what much of the literature suggest, formalization and supplemental agreements in this case were not actually designed not to deal with misunderstandings and conflicts (Ring, Van de Ven, Andrew H. 1994) or to rebalance the relationship (Arino, de la Torre 1998) but rather as a way to facilitate sense making and deliberate articulation (Viaar, van gen Bosch, Frans A.J. & Volberda 2006, Weick 1995) and to set the basis for the expansion of the program.

***Proposition 3: In the context of collaborative relationships based on high uncertainty in objectives, formalization of governance mechanisms is associated with specificity that promotes clarity, efficiency and that facilitate the expansion of scale of collaborative activities.***

Relationship quality, as proposed by Ariño and de la Torre (1998) was a mediating variable in the relationship. As several relationships pre- dated the program, it could also be said that it was an antecedent and a facilitator to the relationship.

But process decisions that were made in both phases also contributed to fostering relationship quality. Frequent communication at multiple levels, field visits, stakeholder forums and informal gatherings were organized and promoted. These processes were built in the initial

phase of the relationship, but continued over the formalization and expansion phase, contributing to build an increased level of relationship and trust among actors.

**Proposition 4: In an environment of high initial collaborative uncertainty, relational quality is associated both with supporting initial search activities, negotiation and on-going collaboration.**

## **8. Further research directions**

Being a single case study research, obvious caution needs to be applied to generalize any findings. The choice of selecting a successful relationship network clearly affects the research findings. The research would benefit from replicating the model on other networks, both successful and unsuccessful.

Yet we believe that this paper offers an interesting insight into how a multi-stakeholder network is created and how it can evolve over time, how organizations can deal with conditions of uncertainty and how formalization of the relationship can actually occur at a later stage of the partnership.

Beyond replicating the analysis on other successful and failed initiatives, another avenue of research that may further our understanding of the evolution of relationships would involve the study of the network of relationships at the industry level. As it was referred in the paper, there were both previous personal and inter-organizational relationships and there are also co-existing commercial and sustainability networks to which the actors in this relationship participate. Analyzing the impact of these types of relationships would contribute to building a better understanding of the context factors that influence relationships.

A third interesting area to explore has to do with the expansion of networks over time, less explored by the IOR and the social network theory. Changes in the size and diversity of network over time have not been sufficiently addressed thus far. The case of Nespresso comprised different types of players, including multiple public and private institutions and grew to include competitive suppliers. The impact this had on the role and complexity of governance is a further area to be investigated.

As Salk (2005) expressed, research that addresses the evolution of relationships over time has been “often called for but rarely chosen” (Salk 2005). The case of Nespresso AAA Program, highlights the potential benefits of this type of research to develop an understanding of the evolving of complex IOR relations.

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