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Suppressing partner opportunism in emerging markets: Contextualizing institutional forces in supply chain management

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ABSTRACT

Drawing on the literature of supply chain opportunism and institutional theory, this study examines the confluence of institutional and efficiency views to assess how institutional forces restrain the impact of exchange hazards (i.e., transaction-specific assets and performance ambiguity) on supply chain opportunism. We predict that legal enforceability and *guanxi* importance mitigate supply chain opportunism, but their interaction does not necessarily help to curb opportunism. In addition, we propose that legal enforceability and *guanxi* importance have differential moderating effects on the relationships between exchange hazards and opportunism. The empirical analyses of a dyadic buyer-supplier dataset in China confirm the predicted direct and interactive effects of the institutional forces. In addition, the positive impact of transaction-specific assets on opportunism is attenuated by legal enforceability but not by *guanxi* importance, whereas the effect of performance ambiguity decreases due to *guanxi* importance but not legal enforceability.

1. Introduction

Opportunism is a central issue in supply chain management, especially in emerging markets, in which more research is needed to understand how firms manage and control opportunism (Zhou, Su, Yeung, & Viswanathan, 2016). The supply chain management literature has examined the antecedents (Handley & Benton, 2012; Morgan, Kaleka, & Gooner, 2007), performance consequences (Morgan et al., 2007), and governance mechanisms to curtail opportunism (Cao & Lumineau, 2015; Wang, Zhang, Wang, & Sheng, 2016). Because institutions regulate transaction rules and coordinate exchange behaviors (Cao & Lumineau, 2015; North, 2005; Peng, 2003; Zhou et al., 2016), accounting for institutions is critical when examining how to curtail partner opportunism in emerging markets. However, most prior studies of supply chain management, while recognizing the importance of institutions, have not explicitly examined their roles, leading to Zhou et al.'s (2016) call for more research to contextualize institutional factors within model development.

Using efficiency-based perspectives, such as transaction cost economics (TCE), prior studies have identified various mechanisms that constrain opportunism in supply chains (Liu, Luo, & Liu, 2009; Lumineau & Henderson, 2012). Because supply chain relationships are embedded in the larger social context, firms must establish social fitness and maintain institutional legitimacy (Rogers, Purdy, Safayeni, & Duimering, 2007); i.e., firm behavior should be "desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). Opportunistic behaviors represent responses to alluring short-term efficiency considerations in conditions of bounded rationality (Rogers et al., 2007; Williamson, 1985), but organizational survival depends on the firm's alignment with institutional environments through legitimating processes (DiMaggio & Powell, 1983; Scott, 1995). Additionally, the transaction costs associated with economic exchanges and sociopolitical activities reflect institutional impacts, especially in emerging economies in which market-supporting institutions tend to be unstable and underdeveloped (North, 2005; Wang, Zhang, et al., 2016). Therefore, it is warranted to examine how institutional environments shape supply chain opportunism in emerging markets (Zhou et al., 2016).

Moreover, although opportunistic behaviors can occur in any circumstances, defining their origins is necessary because their origins determine the potential constraints on opportunistic behaviors (Williamson, 1985), and supply chain governance misalignment can lead to inferior performance (Gray & Handley, 2015). The sources underlying vulnerability to opportunistic behaviors vary across exchange

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hazards (Williamson, 1985), and different institutional forces have distinct enforcement mechanisms (North, 1990). Therefore, it is important to understand the interplay between institutional forces and exchange hazards in suppressing opportunism. However, the paucity of institutional research in the supply chain management literature has left unclear how legitimacy-based institutional compliance interacts with efficiency-based exchange factors (Bai, Sheng, & Li, 2016; Rogers et al., 2007; Yang, Su, & Fam, 2012).

We build on the literature on supply chain opportunism and institutional theory to model the confluence of exchange hazards and institutional forces and their effects on partner opportunism in buyer-supplier exchanges in China. We consider two focal exchange hazards: transaction-specific assets (TSAs) and performance ambiguity (Williamson, 1985). Whereas TSAs create safeguarding issues and increase the level of tolerance for opportunism, performance ambiguity incurs measuring and monitoring costs and "increases the difficulty of detecting opportunism" (Wathne & Heide, 2000, p. 43). In addition, we examine the effects of formal and informal institutional forces, manifested as legal enforceability and *guanxi* importance, respectively. We suggest that supply chain opportunism is attenuated by legal enforceability and *guanxi* importance, whereas these two institutional factors function as substitutes in curbing opportunism. In addition, the positive association between TSAs and a recipient's opportunism is attenuated by legal enforceability but not by *guanxi* importance, whereas the positive relationship between performance ambiguity and opportunism is diminished by *guanxi* importance but not by legal enforceability.

China serves as a suitable context for our research because it has heterogeneous institutional environments across sub-national regions due to uneven economic development and institutional transition (Cai, Jun, & Yang, 2010; Dong, Ju, & Fang, 2016; Sheng, Zhou, & Li, 2011). Although China has a centralized legal system, local government officials and courts differ in their interpretations and implementation of laws and regulations set by the higher hierarchical body, leading to varying levels of legal enforcement (Cai et al., 2010; Shou, Zheng, & Zhu, 2016). In reality, developed countries demonstrate regional variations in the quality of their legal systems as well. For example, the legal system in Italy demonstrates significant heterogeneity across its 20 regions (Lanzolla & Frankort, 2016).

Guanxi refers to the informal, personal relationships that managers use to coordinate business activities throughout China (Cai et al., 2010; Child, Chung, & Davies, 2003). We consider the role of *guanxi importance*, which is defined as the extent to which *guanxi* is critical in business operations and determines firm performance and survival in the business environment (Cai et al., 2010; Child et al., 2003; Wang, Li, & Chang, 2016). *Guanxi* importance reflects the macro-environment in which firms operate; it is conceptually different from *guanxi* itself, which is a firm's micro-level governance mode. Whereas the use of *guanxi* networks is pervasive in China in general, the level of *guanxi* importance still demonstrates salient regional divergence due to historical traditions and cultural variations (Wang, Li, & Chang, 2016). Additionally, China has experienced substantially uneven regional economic development since the 1980s, causing regional differences in social values, including the importance of *guanxi* networks (Cai et al., 2010).

Our study makes several important contributions to the supply chain management literature. First, we extend previous efficiency-based perspectives on opportunism by adopting an institutional view and examining how institutional forces directly influence supply chain partner opportunism. Institutions are the primary determinants of the size and structure of transaction costs; accordingly, our study complements the efficiency-based TCE perspective with a legitimacy-based institutional view (Bai et al., 2016; Cai et al., 2010; Dong et al., 2016; Wang, Zhang, et al., 2016). Second, we examine the differential roles of institutional forces in suppressing opportunism due to different exchange hazards, enriching our understanding of the most effective alignments between institutional factors and sources of vulnerability (Gray & Handley, 2015; Handley & Benton, 2012). Third, our study extends the prior supply chain literature to emerging markets, responding to the recent call for explicit modeling of institutional factors in supply chain management (Zhou et al., 2016).

2. Theory and hypothesis

2.1. The TCE view of opportunism in supply chains

Opportunism is defined as "self-interest seeking with guile," including behaviors such as cheating, shirking, and agreement breaching (Williamson, 1985, p. 47). Supply chain partners often have different and incompatible goals, which render opportunistic behaviors unavoidable (Bai et al., 2016; Liu et al., 2009; Wang, Zhang, et al., 2016). Opportunism can be manifested as violations of an explicit contract or of informal agreements (Wathne & Heide, 2000). The former is referred as "blatant" opportunism and is often managed through explicit contracts or monitoring, whereas the latter is "lawful" opportunism and is often managed by relational norms (Wathne & Heide, 2000). Although considerable resources are deployed to manage and control opportunism, firms can also choose to tolerate a nonzero level of opportunism if the cost to eliminate opportunism is too high (Dutta, Bergen, & John, 1994; Wathne & Heide, 2000).

According to TCE, opportunism is induced by exchange hazards, such as TSAs, environment uncertainty, and performance ambiguity (Gray & Handley, 2015; Handley & Benton, 2012; Morgan et al., 2007). *Transaction-specific assets* have little or no value outside the exchange relationship or cannot be redeployed if the relationship ends (Williamson, 1985). They create a lock-in for the investor because the recipient can unfairly and opportunistically expropriate or exploit their value (Cao & Lumineau, 2015; Gray & Handley, 2015; Handley & Benton, 2012). *Performance ambiguity* occurs if it is difficult for an exchange partner to monitor or measure the performance of the other party (Williamson, 1985). Because tasks in supply chains often require that partners share responsibilities or work jointly, it is difficult to unequivocally assign responsibilities between the partners or to measure one party's unique contributions. As a result, one party can shirk its responsibility at the expense of the other party (Gray & Handley, 2015). When output quality is difficult to assess, supply chain partners cannot detect or punish misconduct in a timely manner (Poppo & Zenger, 2002). Performance ambiguity thus provides incentives for supply chain partners to engage in opportunistic behaviors (Gray & Handley, 2015; Williamson, 1985).

Both TSAs and performance ambiguity can engender opportunism, albeit through distinct mechanisms. When performance ambiguity exists, a supply chain member lacks the ability to test its partners' quality performance and monitor their behaviors, weakening the ability to reward the partners' good performance or sanction their opportunistic behaviors (Gray & Handley, 2015). In contrast, TSAs create a lock-in situation in which the investor must tolerate the recipient's opportunistic behaviors because it cannot terminate the relationship without incurring economic losses (Handley & Benton, 2012; Wathne & Heide, 2000). The investor's vulnerability is high, even if the investor knows exactly how the other party is behaving.

Prior studies in supply chain management have examined the association between TSAs and opportunism closely, and most of them have found a positive relationship (Handley & Benton, 2012), although a few have suggested that TSAs can decrease partner opportunism (Liu et al., 2009). More recent efforts have sought to identify the contingency conditions of this effect. For example, Wang, Li, Ross, and Craighead (2013) showed that social interactions reduce the positive impact of TSAs on partner opportunism. Liu et al. (2009) found that the interaction between relational norms and TSAs reduces opportunism. Although the impact of performance ambiguity (behavioral uncertainty) on supply chain member opportunism appears evident, empirical evidence has been relatively scarce. Niesten and Jolink (2012)