Journal of Business Research 67 (2014) 2123–2131

Contents lists available at ScienceDirect

Journal of Business Research

Interaction effects of formal and social controls on business-to-business performance☆

Jin Hwa Rhee [a,1], Jae Wook Kim [b], Jong-Ho Lee [b,*]

[a] Korea Small Business Institute, 189 Sungam-Ro, Mapo-Gu, Seoul, 121-904 South Korea
[b] Korea University Business School, 145 Anam-Ro, Seongbuk-Gu, Seoul 136-701 South Korea

ARTICLE INFO

Article history:
Received 1 March 2014
Received in revised form 1 April 2014
Accepted 30 April 2014
Available online 15 May 2014

Keywords:
B2B relationship
Formal control
Social control
Environmental dynamism
Prior ties
Buyer lock-in

ABSTRACT

Marketing and Strategy studies have treated relational governance as a critical factor of business-to-business (B2B) performance. Extant studies offer contrasting views on whether formal or social control is a better control mechanism, with little known about their interaction effect. In this study, the authors aim to investigate the interaction effect of these two control mechanisms by dividing a B2B contract (formal control) into two provisions (transactional and relational) and to examine the specific interaction effect of social control on each provision. The authors also seek to investigate the moderating effects of environmental dynamism, prior ties, and buyer lock-in. The measure of B2B performance reflects relational quality and financial outcome. The results show significantly different interactions between each provision of the contract and social control depending on the level of environmental dynamism and buyer lock-in, and suggest that the environmental condition of the transactions is reflective of managers' optimal control mechanisms.

1. Introduction

Relational governance is crucial because it influences a firm's exchange relationship performance (Dyer & Singh, 1998; Moon & Tikoo, 2013). Liker and Choi (2004) emphasize that in today's global business environment, corporate competitiveness heavily depends on the firms' ability to manage their buyer–seller relationships effectively. Many scholars have studied the effects and problems of different types of governance mechanisms (Dyer & Singh, 1998; Ghoshal & Moran, 1996; Gulati, 1995; Li, Xie, Teo, & Peng, 2010; Luo, 2002; Poppo & Zenger, 2002; Wuyts & Geyskens, 2005). Extant research has identified two general categories of business-to-business (B2B) governance or control mechanisms: formal control based on Transaction Cost Analysis (TCA) and social control based on Social Exchange Theory (SET) (Dyer & Singh, 1998; Fryxell, Dooley, & Vryza, 2002; Uzzi, 1997). According to TCA, corporations need more specific and explicit contracts, that is, written legal agreements between two or more parties, to prevent opportunistic behavior (Williamson, 1985). Some studies also investigate weaknesses of formal control, which cannot reflect the historical characteristics of the ongoing relationship (Granovetter, 1985; Zajac & Olsen, 1993) and the dilemma of efficiency, which involves high transaction cost for making and performing a concrete contract. In contrast, SET asserts that social control encourages desirable behaviors leading to joint problem solving and participatory decision making through information exchange and the fulfillment of promises if firms develop strong trust between them (Fryxell et al., 2002; Luo, 2002). However, Jeffries and Reed (2000) criticize that the effect of social control has excessively positive assumption.

Based on these studies about the effect of each control method, there are some attempts to examine the integrated effects of the two controls. However, previous studies provide contrasting results: substitutes vs. complements. The substitutes' perspective posits that corporations should employ only one control method (Dyer & Singh, 1998; Ghoshal & Moran, 1996; Gulati, 1995; Li et al., 2010; Wuyts & Geyskens, 2005). In contrast, the complements' perspective asserts that firms should utilize both mechanisms together (Luo, 2002; Poppo & Zenger, 2002). Both perspectives do not show a clear answer for these mixed results, and the complements' perspective gradually is being emphasized more in recent studies than the substitutes' perspective that dominated earlier studies.

In this paper, the authors suggest three reasons for the conflicting viewpoints. First, previous B2B marketing and strategy studies have focused on SET and RM based on relational contract theory (RCT) (Macaulay, 1963; Macneil, 1978, 1980). Most of the substitutes' perspective studies conclude that social control is a more beneficial method after firms develop a sufficiently close relationship (Dyer & Singh, 1998; Ghoshal & Moran, 1996; Gulati, 1995; Li et al., 2010; Wuyts & Geyskens, 2005), which leads to reduced costs. Moreover, while most of these studies have considered social control as a complicated and multi-dimensional mechanism (Li et al., 2010; Luo, 2002; Poppo & Zenger, 2002), they have represented formal control only with a contract length

☆ This paper is supported by Korea University Business School research fund.
* Corresponding author. Tel.: +82 2 3290 2821; fax: +82 2 3290 1307.
E-mail addresses: jhrhee@kosbi.re.kr (J.H. Rhee), jaewook@korea.ac.kr (J.W. Kim), jongholee@korea.ac.kr (J.-H. Lee).
[1] Tel.: +82 2 707 9888; fax: +82 2 707 9895.

http://dx.doi.org/10.1016/j.jbusres.2014.04.021
0148-2963/

(Poppo & Zenger, 2002) or completeness of underlying dimensions that could change according to the test sample (Li et al., 2010; Luo, 2002; Wuyts & Geyskens, 2005). These inconsistent measurements show that the lack of understanding about B2B contracts may be an important reason for the contrasting view. Second, previous studies have not considered the moderating effects of various business conditions. Only Li et al. (2010) shows that the interaction effects of control methods are different between international and domestic transactions. Third, B2B studies have used a variety of performance measurements. Their results may vary depending on the performance variable.

Therefore, the purpose of this study is to investigate the interaction effect of the two control mechanisms by considering these three issues. We organize the paper as follows: First, we explain how to understand B2B contract and describe performance variables. Second, we introduce the research model and build hypotheses by considering the moderating effects of various business conditions (three-way interaction), such as environmental dynamism, prior ties, and buyer lock-in. Third, we analyze a research model using a sample of Korean B2B exchange data and validate hypotheses. Finally, we discuss the study's results, contributions, and limitations (Fig. 1).

2. Conceptual framework and hypotheses

2.1. Relational contract theory: the contractual provisions

RCT provides the rationale for dividing the contract into its dimensional components and examining the effect of each. RCT suggests that each transaction lies on a spectrum ranging from discrete through to relational (Macneil, 1978), and depending on the point that the B2B relationship fits within this spectrum, the contract's contents and composition will differ. According to Heide (1994), who reviews relationship management in the marketing channel literature, the resource dependence view, and in RCT and TCA, he explains a governance mechanism with six different component dimensions (role specification, planning, adjustment process, monitoring system, incentive system, and explicit enforcement) based on its utilization. He also explains the characteristics of each dimension (terms in law). Among them, the relationship created between firms can distinguish the form of governance from others. Although the planning and adjustment processes are not imperative to a market transaction, they can be very useful for a nonmarket transaction to differentiate them from the other four contract dimensions. In the B2B contract, we can utilize these dimensions and criteria if the transaction of firms is important and sizable. Therefore, this research assumes that a contract incorporates six dimensions (terms) and that these dimensions are classified as two provisions (transactional and relational).

2.2. B2B performance: relationship quality and financial outcome

Extant B2B governance studies use two performance measurements: applied financial performance (e.g., ROI, ROA, and cost efficiency; Luo, 2002; Uzzi, 1997) and relational performance (e.g., trust, commitment, conflict, satisfaction, and opportunism; Carson, Madhok, & Wu, 2006; Li et al., 2010; Poppo & Zenger, 1998). Some researchers use financial performance as an objective measure, whereas others argue that relational performance (e.g., satisfaction) can predict the future better (Gladstein, 1984; Poppo & Zenger, 2002). To identify the variations of interaction effects across dependent variables, this study uses both relational quality and financial outcome.

2.3. Interaction effect of control mechanisms: complements vs. substitutes perspectives

The interaction effect of control mechanism has appeared differently in the complements and substitutes perspectives. Concerned with the substitutes' perspective, Gulati (1995) argues that if the trust between firms reaches a certain standard to be used as a social control, the use of both control methods is inefficient. Dyer and Singh (1998) insist that one control method could obviate the need of the other, because a self-enforcing safeguard achieves better performance than a third-party (court) safeguard for the firm. On the contrary, concerned with the complement perspective, Luo (2002) and Poppo and Zenger (2002) suggest that a detailed contract provides guidelines for better cooperation and that trust proves its advantage if unexpected disturbance occurs in the contract details.

Both perspectives have strong underlying logics; therefore, neither is dominant when considering the general transaction between firms. Underlying the key motivation of this study, we suggest thus the following hypotheses.

H1. *The interaction between transactional provision and social control is not significant on (a) relationship quality and (b) financial outcome.*

H2. *The interaction between relational provision and social control is not significant on (a) relationship quality and (b) financial outcome.*

2.4. Moderating effect of environmental dynamism on the interaction of control types and firm performance

Environmental dynamism represents a frequent change or shift in the business environment (Achrol & Stern, 1988). According to the TCA, these fluctuating circumstances compel business partners to solve ex-post problems frequently; therefore, firms in dynamic environments need control methods. In particular, under high environmental dynamism,

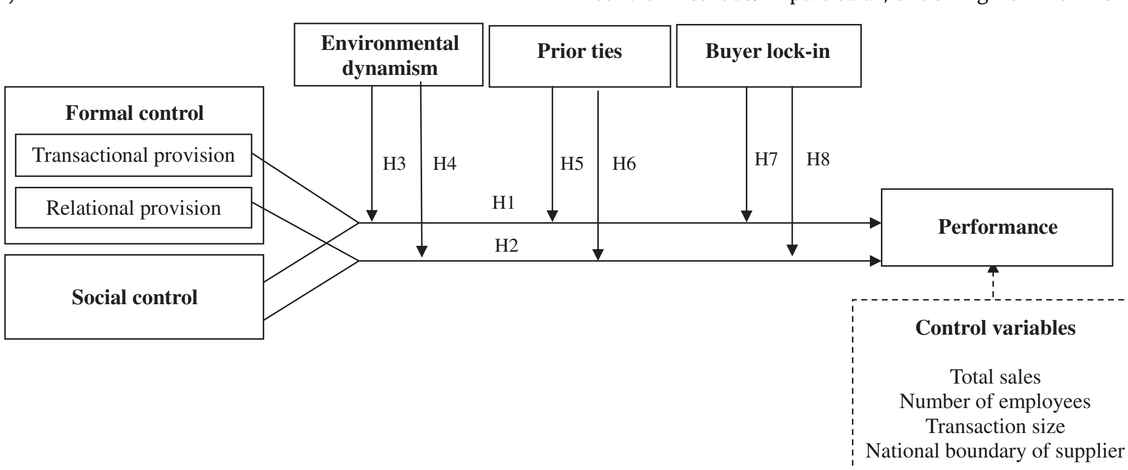

Fig. 1. Research model.