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Formal control and social control in domestic and international buyer–supplier relationships

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ABSTRACT

Focusing on long-term buyer–supplier relationships, this article addresses two questions: (1) What are the antecedents that lead to the adoption of formal control, social control, or both? (2) What is the nature of the relationship between formal control and social control - are they substitutes or complements? We develop a model to investigate the impact of the length of cooperation and institutionalization on the use of control mechanisms. Further, we argue that in China, formal control and social control may be substitutes in domestic buyer–supplier relationships, but they may be complements in international relationships. Survey data collected nationwide with executives in 380 domestic and 200 international buyer–supplier relationships in China are used to test our hypotheses.

1. Introduction

As trade barriers have been reduced and IT and logistics technologies have improved, buyer–supplier relationships increasingly involve not only domestic partners but also international partners (Joshi, 2009; Kaufmann and Carter, 2006). Many firms in developed countries establish buyer–supplier relationships with firms from emerging economies such as China. According to the U.S. Department of Commerce (2007), U.S. automakers imported $ 8.5 billion worth of Chinese automotive parts in 2007, making China the fourth largest source of auto parts after Mexico, Canada, and Japan. How to effectively manage domestic and international buyer–supplier relationships thus represents a major challenge for many firms.

Control mechanisms in interfirm cooperation – structural arrangements deployed to regulate partners' behavior – greatly influence the success of buyer–supplier relationships (Fryxell et al., 2002). Choosing effective control mechanisms is a must when managing these interorganizational relationships (Jap and Ganesan, 2000). There are two broad categories of control mechanisms: (1) formal control (which primarily relies on contracts) and (2) social control (which primarily relies on informal means) (Dyer and Singh, 1998; Uzzi, 1997). The existing literature has focused on two crucial questions: (1) What are the antecedents that lead to the adoption of formal control, social control, or both in domestic and international buyer–supplier relationships? (2) What is the nature of the relationship between formal control and social control in explaining cooperation performance - are they substitutes or complements?

Addressing the first question, the existing literature has generally adopted transaction cost economics (TCE) as its underlying paradigm (Williamson, 1985; Wuyts and Geyskens, 2005). This is mainly because TCE focuses on the make-or-buy decision, which is crucial in buyer–supplier relationships (Williamson, 2008). Researchers in this stream assume that minimizing transaction costs is the fundamental driver for firms to adopt various control mechanisms in interfirm exchanges (Poppo and Zenger, 2002). Thus, several transaction cost factors have been identified as antecedents of control mechanisms, including asset specificity, environmental uncertainty, and behavioral uncertainty (Beckman et al., 2004; Ghosh and George, 2005; Poppo and Zenger, 2002; Reuer and Ariño, 2007; Rindfleisch and Heide, 1997).

Despite the significant insights generated by TCE-based research, findings have been inconsistent. For example, Joshi and Campbell (2003) and Poppo and Zenger (2002) report contrasting findings on the relationship between environment dynamism and social control. These inconsistent findings lead

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Madhok (2002) and White and Lui (2005) to suggest that TCE may be relatively narrow to adequately account for how firms choose formal or social control in interfirm relationships. According to Zhou et al. (2003), three logics underlie the behaviors of firms in economic exchanges: (1) transactions costs, (2) social relations, and (3) institutional constraints. Thus, in addition to TCE, social network theory and institutional view may also provide helpful insights on the adoption of control mechanisms in interfirm exchanges (Lin et al., 2009).

Empirically, most existing research has focused on firms in developed economies. As our research horizon now increasingly expands to Asian countries such as China, India, and Korea (Jiang et al., 2007; Zhao et al., 2007), it is unclear whether the same sets of antecedents apply to control mechanisms in these new settings. In this article, we invoke social network theory and institutional view to develop a model to suggest that in China, (1) the length of time that two firms have been involved in a buyer–supplier relationship – which we refer to as "the length of cooperation" – and (2) institutionalization of interfirm beliefs and values in the cooperative process may significantly shape the use of control mechanisms.

With respect to the second question, some authors argue that formal control and social control mechanisms are substitutes (Dyer and Singh, 1998; Ghoshal and Moran, 1996; Gulati, 1995; Uzzi, 1997). However, others suggest that formal and social control mechanisms are complementary in explaining cooperation performance (Luo, 2002; Mesquita and Brush, 2008; Poppo and Zenger, 2002; Wuyts and Geyskens, 2005). These conflicting views, thus, necessitate further investigation. We posit that the type of cooperation – domestic versus international – would influence this relationship. For example, Poppo and Zenger (2002: 722), who study domestic firms in the United States, speculate that "our notion of complements is not likely to generalize to countries that lack a cultural and legal commitment to the use of formal contracts." However, in China, a country widely believed to be lacking in legal commitment to the use of formal contracts (Peng and Heath, 1996), Luo (2002) reports that some of the Poppo and Zenger (2002) findings on the complementary nature of formal control and social control can also be generalized to a sample of international joint ventures (IJVs). Specifically, Luo (2002) finds that term specificity and contingency adaptability of formal contract between partners interact positively with social control in explaining IJV performance. Extending this line of research, we argue that in China, the relationship between formal control and social control in domestic and international relationships may be different. Specifically, formal control and social control may function as substitutes in domestic relationships, and as complements in international relationships. Following Li et al. (2008), we suggest that the underlying causes of these differences stem from the different traditions and norms governing domestic and international buyer–supplier relationships in China.

Theoretically, this article provides a more nuanced and in-depth understanding of the two questions on the antecedents and nature of control mechanisms. Empirically, we focus on an important form of interfirm cooperation - long-term buyer–supplier relationships (hereafter referred to as "buyer–supplier relationships" for composition simplicity). This article draws on survey data collected from 380 domestic and 200 international buyer–supplier relationships in China. Most existing work has focused either on domestic or international buyer–supplier relationships. Rarely have scholars systematically compared the differences between these two different relationships (Kaufmann and Carter, 2006). This comprehensive sample thus enables us to test hypotheses that formal and social control may be substitutes in domestic buyer–supplier relationships and complements in international relationships.

2. Theoretical foundations and hypotheses

Fig. 1 displays our research framework. It is centered on the notion that effective cooperation depends upon the adoption of appropriate control mechanisms (Dyer and Singh, 1998; Ring and Van de Ven, 1994; Wuyts and Geyskens, 2005). Formal control mechanisms rely primarily (but not exclusively) on explicit contracts. Thus, empirical studies usually focus on the completeness of contracts between partners (Luo, 2002; Poppo and Zenger, 2002; Wuyts and Geyskens, 2005). Formal control mechanisms cultivate cooperation and suppress opportunistic behaviors (Carson et al., 2006), since explicit contracts detail the roles and responsibilities of the partners, determine the deliverable, and specify the adaptive processes necessary to resolve unforeseeable problems (Argyres and Mayer, 2007; Lusch and Brown, 1996). Although formal contracts cannot account for all possible scenarios, the chances for partner firms to act opportunistically may be constrained. Moreover, clauses that specify punishments would discourage short-term opportunism and promote long-term cooperation.

Social control mechanisms in cooperation utilize trust to encourage desirable behavior (Dyer and Singh, 1998). Social control mechanisms usually take the form of joint problem solving, participatory decision making, thorough information exchange, and fulfillment of promises (Fryxell et al., 2002; Luo, 2002). According to Carson et al. (2006) and Uzzi (1997), interfirm trust is a primary foundation for the use of social control. Trust is typically defined as one party's confidence that the other party in the exchange relationship will not exploit its vulnerabilities (Dyer and Chu, 2003; Zaheer et al., 1998). If there is a high level of trust in cooperation, partners would be more likely to use social control

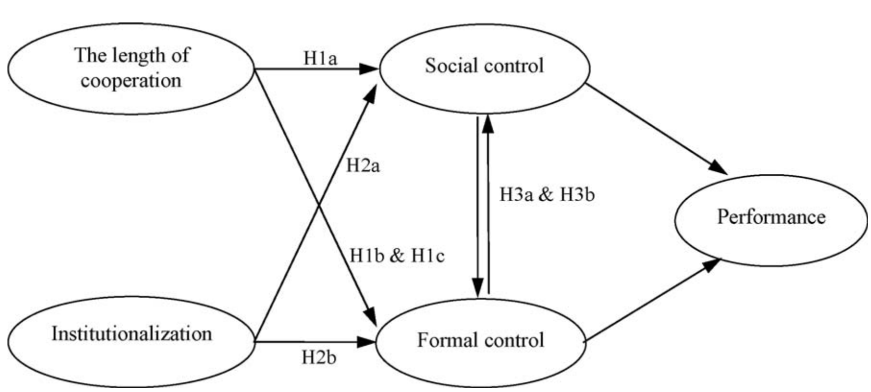

Fig. 1. Our research framework.