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Abstract

Relational contracts – informal agreements sustained by the value of future relationships – are integral parts of global production processes. This paper develops a repeated-game model of global sourcing in which final good producers decide whether to engage with their suppliers in relational contracting and whether to integrate a supplier into a firm’s boundaries or deal with the latter at arm’s-length. The model predicts that the relative prevalence of vertical integration increases in the long-term orientation of the headquarters’ and suppliers’ managers. It further hypothesizes that the share of a foreign subsidiary owned by a final good producer increases in the headquarters’ long-term orientation. Combining industry-level data from the U.S. Census Bureau’s Related Party Trade database with measures for long-term orientation from Hofstede et al. (2010) and the World Management Survey, I find empirical evidence supportive of the positive link between the long-term orientation of cooperation parties and the relative prevalence of vertical integration. Using information on managerial composition of firms and ownership stakes from the Bureau van Dijk’s Orbis database, I find that firms led by long-term oriented managers own higher shares of their foreign subsidiaries.

Keywords: Relational contracts, long-term orientation, international make-or-buy decision

JEL-Classification: D02, D23, F14, F23, L14, L22

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