The impact of formal control and guanxi on task conflict in outsourcing relationships in China

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ABSTRACT
The purpose of this study is to explore how manufacturing firms manage task conflict with their outsourcing suppliers in the context of China. Using survey data collected from manufacturing firms operating in China, we found that when implementing R&D and manufacturing outsourcing, both formal control and Chinese guanxi are useful governance mechanisms for suppressing outsourcing task conflict. We also observe that Chinese guanxi moderates the impact of formal control on task conflict, especially when implementing R&D outsourcing. By investigating the roles of formal control and Chinese guanxi in outsourcing practices in China, this study contributes to a better understanding of how to manage task conflict effectively.

1. Introduction
Manufacturing companies have increasingly recognized the potential to enhance their operational efficiency and innovation capability by mobilizing the knowledge and expertise of external organizations (Bengtsson, Von Haartman, & Dabhilkar, 2009). Moreover, in the increasingly networked economy, outsourcing has emerged as an important strategic tool for obtaining competitive advantage (Gottfredson, Puryear, & Phillips, 2005; Han & Bae, 2014; Kang, Wu, Hong, Park, & Park, 2014). When multinational manufacturers make decisions on outsourcing locations they primarily consider factors such as cost arbitrage, availability of skills and manpower, infrastructure and country risk (Graf & Mudambi, 2005; Linda Boardman, Paul, Amy, & Arthur, 2008; Pawar & Rogers, 2013). China scores very high on these criteria and subsequently has become one of the most attractive outsourcing destinations in the global economy (Wu, Wu, & Zhou, 2012). Outsourcing in China provides manufacturing companies various potential benefits, such as cost reduction, innovation capability enhancement, freedom to focus on core competencies and operational flexibility (Kang, Wu, Hong, & Park, 2012a). However, these benefits are not guaranteed, as outsourcing in China also has various risk factors that threaten the success of the outsourcing relationship. Among these risk factors, outsourcing has the potential to lead to conflicts related to the transactions between the outsourcer firm and its suppliers (Lawler, Ford, & Blegen, 1988). Without proper handling of outsourcing conflict, especially in the highly relationship-oriented Chinese business culture, an outsourcer firm’s long-term orientation toward its suppliers might decrease, resulting in relational inefficiency, high transaction costs and disappointing performance (Lee & Dawes, 2005b).

However, despite the recognized importance of conflict management in the inter-organizational collaboration literature, few studies, if any, have explored outsourcing conflict management. In particular, it is still unclear how outsourcing firms avoid or mitigate outsourcing task conflicts with their suppliers. With the growing importance of China sourcing and China’s relationship-oriented cultural characteristics, China is an appropriate and important context in which to investigate conflict management within outsourcing relationships. Thus, to address the research gap, this study investigates how manufacturing companies operating in China manage outsourcing task conflicts with their suppliers. More specifically, this study considers two specific types of governance mechanisms for managing outsourcing task conflict management: formal control and Chinese guanxi. From the governance perspective, both formal contracts and informal relational mechanisms are vital to reduce partners’ opportunistic behavior and promote continuity of inter-organizational exchanges (Poppo & Zenger, 2002). Thus, it is reasonable to suggest that both formal control and Chinese guanxi...
may be useful governance mechanisms that have an important impact
on the effectiveness of outsourcing task conflict management in the
unique context of China. This paper also attempts to test how Chinese
guanxi and formal control function as complements in managing
outsourcing task conflict. In addition, recognizing that different types
of outsourcing require different governance mechanisms for effective
outsourcing practices (Kang et al., 2012a), we test our model by using
two sub-samples, one representing R&D outsourcing and the other
representing manufacturing outsourcing.

2. Theoretical background and hypothesis development

2.1. Formal control

Formal control mechanisms include formalized roles, job descrip-
tions, clear goals and procedures in written format, through which
firms can influence their partners to behave according to their specific
requirements and thus achieve organizational goals (Das & Teng,
2001; Kirsch, Sambamurthy, Ko, & Purvis, 2002). Control studies high-
light that formal control mechanisms are useful measures to mitigate
uncertainties and partner’s opportunistic behaviors, because they pro-
vide clear task and goal specifications and thus help reduce problems
that could be caused by divergent views of tasks or goals (Das & Teng,
2001; Li, Xie, Teo, & Peng, 2010). If outsourcer firms fail to establish
formal control mechanisms with their suppliers, they might be exposed to
numerous outsourcing risk factors, such as the opportunistic behavior
by the supplier, loss of core competence, increased dependence on sup-
pliers, increased transaction costs, unnecessary conflicts and undesir-
able outsourcing performance (Kotabe, Mol, & Murray, 2008; Tibor,
Oya Icmeli, & Walter, 2006). Outsourcing by nature entrusts tasks to ex-
ternal suppliers through contracts, and thus it is very important to clear-
ly specify the requirements in order to reduce outsourcing risks and
increase outsourcing benefits.

However, excessive use of formal control mechanisms could poten-
tially undermine trust and long-term collaboration (Christ, Sedatole,
Tovry, & Thomas, 2008). To address this threat, Kang, Wu, and Park
(2012b) in their case study emphasize that outsourcer firms need to
focus their exercise of formal control on the key processes related
with outsourcing performance (i.e., quality and delivery) in order to ef-
ectively reduce performance risks and relational risks. This is in con-
trast to attempting to exercise broad control over all outsourcing
practices. In this study, we refer to formal control we do not refer
to hierarchical oversight of suppliers in general, but rather refer
to focused formal control applied specifically to the key processes that
ensure clarity in outsourcing goals, such as quality and delivery terms,
or clarify task specifications to avoid suppliers’ self-serving interpreta-
tions or opportunistic behaviors. Different types of outsourcing may re-
quire formal control over different key processes to ensure desired
outsourcing performance. For example, when outsourcing garment
manufacturing, inspection of received raw materials may be a key pro-
cess for ensuring outsourcing quality. In addition, clarifying outsourcing
goals in written format and implementing outsourcing based on de-
tailed task specifications are generally recognized as important formal
control practices in achieving desired outsourcing performance (Chen,
Park, & Newburry, 2009; Das & Teng, 2001). With the high level of un-
certainty in transient economies such as China, such formal control
usage may be essential for reducing conflict with partners and enabling
long-term outsourcing success (Kang et al., 2012a). Therefore, formal
control is incorporated into the research model as an important formal
governance mechanism that is expected to reduce task conflict in
outsourcing relationships.

2.2. Chinese guanxi

Chinese guanxi is a special Chinese-style relational network rooted
in traditional Chinese culture (Park & Luo, 2001), and is regarded as a
source of sustainable competitive advantage for firms that do business
in China (Cheng, Yip, & Yeung, 2012). Chinese guanxi is characterized
by favor exchange and mutual obligation (Chen, Huang, & Sternquist,
2011b). In the literature, Chinese guanxi is defined as “an informal, par-
ticularistic personal connection between two individuals who are
bounded by an implicit psychological contract to follow the social
norm of guanxi such as maintaining a long-term relationship, mutual
commitment, loyalty, and obligation” (Chen & Chen, 2004). One of the
key differences between Chinese guanxi and general relationship man-
gelement is believed to be their guiding principles. According to Wang
(2007), general relationship management is guided by legality and
rules, whereas Chinese guanxi is driven by morality and social norms.

China is known as a relationship-based society. In Chinese culture,
informal personal relationships play critical roles in inter-organizational
transactions, and can directly and indirectly influence the business per-
formance of transacting parties (Xin & Pearce, 1996). Chinese guanxi,
as a unique type of informal personal relationship in traditional Chinese
culture, is believed to have the power to influence social norms as
well as business norms (Wong, 2007; Zhai, Lindorff, & Cooper, 2013).
Chinese people take advantage of guanxi in all aspects of their lives, in-
cluding their political and economic lives. It is a useful source of market
information (Lee & Humphreys, 2007), and has a determinant position
in negotiation processes (Davies, Leung, Luk, & Wong, 1995). An
outsourcer firm operating in China also needs to develop guanxi with
its supplier. Without having a guanxi connection between the outsourcer and the supplier, the two parties are not closely bound by
a relationship of mutual trust and favor exchange, and each party is
free to pursue its own benefit. When a supplier has multiple customers,
it treats each customer differently according to the guanxi it has with
that customer. In times of crisis, the outsourcer firm that has a good
guanxi with the supplier will be treated as a preferred customer (Trent
& Zacharia, 2012). Given the importance of guanxi in business practices in
China (Chen, Ellinger, & Tian, 2011a; Lee & Humphreys, 2007; Su &
James, 2001), its role in buyer-supplier relationships in the China con-
text cannot be neglected. Moreover, the concept of guanxi is associated
with economic and favor exchanges, and also is based on mutual trust
and long-term tendency, and thus a deeper guanxi relationship implicitly
denotes obligation, guarantee, and understanding. (Chen & Chen,
2004).

2.3. Task conflict

Conflict refers to “a process in which one party perceives that its in-
terests are being opposed or negatively affected by another party”
(Wall, 1995). This study focuses on inter-organizational conflict that oc-
curs between buyer and supplier within an outsourcing relationship
(DeChurch & Marks, 2001). More specifically, conflict in this study refers to
task conflict that occurs because of disagreements over how to imple-
ment outsourcing tasks. Such disagreements could be related to differ-
ences in viewpoints, ideas or opinions between an outsourcer firm and
its supplier (Jehn, 1995). In an exchange relationship, conflict is often
inevitable between exchange partners (Gaski, 1984; Lusch, 1976b;
Rosenberg & Stern, 1971), because of the inherent conflict of inter-
est embedded in the very act of exchange (Mallen, 1963). Conflict is
potentially disruptive to efficiency and performance in a channel of dis-
tribution (Lusch, 1976a; Rosenberg & Stern, 1971) and overshadows the
cumulative effects of cooperative channel behaviors (Palmatier, Dant,
Grewal, & Evans, 2006). Without proper management, it can prevent
the buyer and supplier from understanding or adapting each other’s
viewpoints, ideas or opinions, and may result in the buyer or supplier
withdrawing resources from the pursuit of joint business goals, or
restricting or distorting flows of information (Brown, 1983). In the mar-
keting channels and buyer-supplier relationship literature, research
shows that conflict has a negative effect on exchange partner satisfac-
tion and on operating performance (Dwyer, 1980; Frazier, Gill, & Kale,

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