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Social ties and firm performance: The mediating effect of adaptive capability and supplier opportunism☆

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ABSTRACT

This study integrates dynamic capabilities and relational governance theories to examine how business ties and political ties affect firm performance. The findings from a survey of 187 Chinese distributors of construction and decoration materials indicate that increased firm adaptive capability and reduced opportunism mediate the contribution of both ties to firm performance. In addition, legal enforceability and demand uncertainty determine the relative prominence of the two process intermediaries in joint consideration with the type of social ties (i.e., business ties and political ties). Specifically, political ties foster firm performance mainly by constraining supplier opportunism when legal enforceability is weak, whereas adaptive capability has a stronger mediating effect in the link between business ties and firm performance when demand uncertainty is high.

1. Introduction

Social ties, as pertaining to a firm's informal social connections with business players (i.e., business ties) and government officials (i.e., political ties), are receiving considerable attention in the marketing and management literature (e.g., Li, Poppo, & Zhou, 2008; Li, Zhou, & Shao, 2009; Luo, Huang, & Wang, 2011; Sheng, Zhou, & Li, 2011; Xin & Pearce, 1996). Both business ties and political ties have positive effects on firm performance in the dynamic environment of an emerging economy (Luo et al., 2011; Peng & Luo, 2000; Sheng et al., 2011). Previous studies have investigated the mediators that link social ties and firm performance from the perspectives of dynamic capabilities and relational governance theories. Dynamic capabilities theory holds that social ties help build firms' adaptive capabilities, which in turn enables firms to achieve sustainable competitive advantage and superior performance (Gu, Hung, & Tse, 2008; Lu, Zhou, Bruton, & Li, 2010). On the other hand, according to relational governance theory, social ties deter partner opportunism and consequently enhance firm performance (Sheng et al., 2011; Wang, Li, Ross & Craighead, 2013).

Combining the ideas from both theories is important so that firms can consider both value creation and transaction costs that combine to shape firm performance (Mclvor, 2009; Vivek, Richey, & Dalela, 2009). Moreover, existing empirical studies have not discerned the relative mediating effects of or identified the boundary conditions for each mediator (adaptive capability vs. opportunism reduction) in terms of their functional links between social ties and firm performance. Therefore, how social ties affect firm performance has remained uncharted.

To address this research gap, this study integrates dynamic capabilities and relational governance perspectives on the functional mechanism of social ties and scrutinizes environmental factors that define the boundary conditions under which each functional mechanism works. Given the differential roles of business ties and political ties (Sheng et al., 2011), this study also examines the way each affects firm performance. The expectation is that business ties and political ties alike foster firm performance by means of heightened adaptive capability and reduced opportunism. Moreover, given that legal institutions and market dynamism will influence the roles of social ties (Sheng et al., 2011), this research considers the specific conditions under which different mediators are more or less relevant. Specifically, political ties positively affect firm performance, primarily by suppressing supplier opportunism when legal enforceability is weak, whereas business ties enhance firm performance, mostly by improving adaptive capability when demand uncertainty is high.

This study uses primary data from 187 distributors in China to test the conceptual model (see Fig. 1), and the results provide strong

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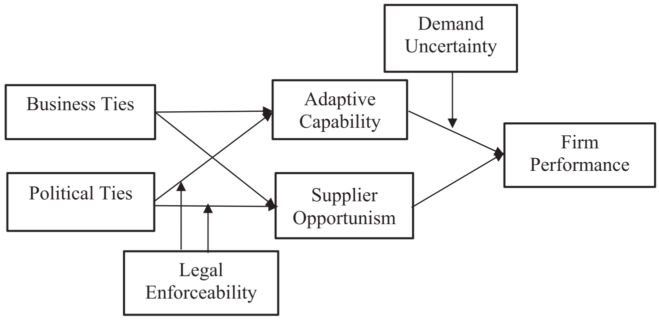

Fig. 1. Conceptual model.

support for the hypotheses. Consequently, this article contributes to the literature on social ties by simultaneously considering the crucial roles of adaptive capability and supplier opportunism that transform business ties and political ties into firm performance through their relative mediation under different conditions.

2. Conceptual framework

Social ties encompass business ties and political ties with their distinct relationships and roles (Sheng et al., 2011; Wu, 2011). *Business ties* refer to a firm's informal social connections with business players including suppliers, customers, and other business intermediaries (Peng & Luo, 2000). *Political ties* are a firm's informal social connections with government officials at various levels and regulatory organizations such as tax bureaus and commercial administration bureaus (Peng & Luo, 2000; Sheng et al., 2011).

Two perspectives that have explained the path of social ties in contributing to firm performance have claimed distinct mediators. According to the dynamic capabilities theory, a firm's dynamic capabilities are the source of sustained competitive advantage (Teece & Pisano, 1994; Teece, Pisano, & Shuen, 1997). As a key component of dynamic capabilities (Zhou & Li, 2010), adaptive capability functions to link social ties and firm performance. For example, Gu et al. (2008) suggest that a firm's guanxi network strengthens its responsive capability, which in turn increases its brand market performance. Lu et al. (2010) find that adaptive capability is a critical intermediary variable linking social ties and international performance among entrepreneurial firms in emerging markets. On the other hand, social ties as an informal governance reduce transaction costs by deterring partner opportunism (Sheng et al., 2011; Wang, Li, Ross and Craighead, 2013). Scholars have provided insights on how social ties work to improve performance from the perspective of transaction cost economics (TCE; e.g., Yang, Ho, & Chang, 2012). However, although the existing literature has treated dynamic capabilities and relational governance perspectives as independent, a growing body of literature has argued that both perspectives are complementary (Mclvor, 2009; Vivek et al., 2009). The relational governance perspective, advanced by TCE (Vivek et al., 2009), highlights governance strategies, whereas the dynamic capabilities perspective focuses primarily on value creation (Mclvor, 2009), both of which pertain to firm performance. This study combines both perspectives to give an integrated perspective on how business ties and political ties cultivate firm performance via adaptive capability and reduced supplier opportunism.

2.1. The mediating effects of adaptive capability and supplier opportunism

Adaptive capability pertains to a firm's flexibility in adapting to market changes and specifically reflects the firm's ability to align internal resources with external demand (Wang & Ahmed, 2007; Zhou & Li, 2010). It establishes a core competitive advantage for a firm in the volatile environments that characterize transitional economies, such as the Chinese economy (Gu et al., 2008; Zhou & Li, 2010). Specifically, emerging markets are fraught with industry-wide reforms, structural uncertainty, and unreliable market information (Gu et al., 2008; Luo, 2007). In such environments, a firm must be able to adjust to and coordinate in turbulent markets when pursuing firm growth and superior market performance (Gu et al., 2008; Luo et al., 2011).

Business ties help build a firm's adaptive capability in the following two ways. First, business ties provide firms with access to relevant and reliable market information in a timely manner (Sheng et al., 2011). Such timely and fine-grained information is important because it informs a firm of changing customer preferences and updated technology and thus attenuates the risks induced by market unpredictability. Second, close ties with firm partners induce cooperative norms and behaviors in the form of joint problem solving and better alignment among individual firms. Accordingly, firms embedded in tight business circles could request network members to make real-time changes in response to significant market changes (Uzzi, 1997). For example, it is possible for distributors with strong business ties to adjust the supply plan with their suppliers and collaborators to meet unexpected demands from customers. In short, business ties could help a firm better understand the demands of customers and respond swiftly to market changes, thereby promoting firm performance.

Hypothesis 1a. Business ties have a positive impact on firm performance by improving firms' adaptive capability.

Similarly, political ties enhance a firm's adaptive capability in two ways. First, political ties could reduce policy uncertainty by allowing firms to better understand government regulations, emerging policies, and aggregate industrial information collected by government agencies (Hillman & Hitt, 1999; Sheng et al., 2011). Firms with such information will have more confidence in marketing products required by the government or accepted by customers (Sheng et al., 2011; Wu, 2011). Second, firms tend to encounter fund shortages in emerging markets such as China, where there is a lack of efficient financing networks (Lu et al., 2010; Wu, 2011). Political ties enable firms to access land, subsidies, tax rebates, and bank loans (Faccio, Masulis, & McConnell, 2006; Sheng et al., 2011). The valuable regulatory resources accrued through political ties could financially support a firm's reactions to changes in customer demands. The preceding arguments suggest that by intensively networking with political authorities, firms are likely to develop adaptive capabilities that lead to enhanced firm performance (Gu et al., 2008; Lu et al., 2010; Zhou & Li, 2010).

Hypothesis 1b. Political ties have a positive impact on firm performance by improving firm's adaptive capability.

Opportunism is a major concern for firms operating in emerging markets lacking market-support institutions (Gu et al., 2008; Luo, 2007). It may exist in many forms, "including lying, cheating and calculative efforts to maximize individual returns" (Williamson, 1975, p. 9). A considerable body of research has documented that opportunism exerts a negative impact on organizational performance by increasing transaction costs and impairing commitment, trust, and interfirm cooperation (Crosno & Dahlstrom, 2008; Wang & Yang, 2013; Wathne & Heide, 2000).

Business ties function to effectively deter opportunism by providing market information and generating trust. First, close social interactions and communications with network members promote the timely transfer of relevant and fine-grained market and focal supplier information (Dyer & Singh, 1998; Sheng et al., 2011). Such information may ease the difficulties in evaluating the performance of the supplier in question and lower inter-firm information asymmetry. Second, close and ongoing interactions with focal suppliers cultivate interfirm trust and relational norms, which constrain opportunistic behaviors (Sheng et al.,

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