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How Buyer-Seller Relationship Quality Influences Adaptation and Innovation by Foreign MNCs' Subsidiaries

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ABSTRACT

Based on embeddedness theory and transaction cost theory, this study explores the influences of innovation and adaptation, which benefit from relationship quality between the subsidiaries of foreign MNC and their local suppliers, on the corporate performance of foreign subsidiaries. In order to examine the hypothetic relationships, 104 subsidiaries of foreign MNCs operating in Taiwan were surveyed. The results indicate that the relationship quality, including social capital, information exchange, and frequency of contact, have positive impacts on innovation and adaptation. Additionally, innovation and adaptation function as the mediating mechanism delivering the beneficial influences of relationship quality to the foreign subsidiary's performance. These results imply that the foreign subsidiaries not only devote their resources to innovation for their own interest, but also adjust themselves and invest in the relationships with local suppliers.

1. Introduction

The relationship between buyer and supplier received increasing awareness and attentions from academicians and practitioners (Björkman & Kock, 1995; Cannon & Perreault, 1999; Fynes & Voss, 2002). This importance of business relationship lies in its functions of exchanging knowledge and resources, and developing further activities (Harris & Wheeler, 2005). Managers and researchers deem this relationship as the greatest resource for developing sustainable competitive advantage for both buyers and sellers (Claycomb & Frankwick, 2010). While buyers can reduce transaction costs associated with multiple service ordering, sellers can develop loyalty from their customers whose loyalty is challenged by competing brands (Palmer & Bejou, 1994). It is particularly important that buyers have close relationships with their suppliers to stay ahead of competition (Parsons, 2002). For example, the leading edge of Toyota in the automotive industry and the survival of Chrysler are achieved by investing in the establishment of a network of supplier partnerships (Ploetner & Ehret, 2006).

Accordingly, the establishment, development, and maintenance of relationships between buyer and seller are crucial to achieving success (Morgan & Hunt, 1994). Within the business-relationship research stream, the term "relationship quality" is used to describe business relationships (Ulaga & Eggert, 2006). Relationship quality, deemed as a critical aspect in maintaining and evaluating business relationship (Nguyen & Nguyen, 2010), represents an overall assessment of the nature of business relationship (Skarmeas & Robson, 2008; Woo & Ennew, 2004). If the relationship is characterized by high relationship quality, it is recognized as a stable and healthy one (Lai, Bao, & Li, 2008). In terms of the elements of business relationship quality, some studies stated that the social capital (Björkman & Kock, 1995; Harris & Wheeler, 2005), information exchange (Björkman & Kock, 1995; Cannon & Perreault, 1999), and frequency of contact (Cannon & Perreault, 1999; Harris & Wheeler, 2005; Holm & Eriksson, 2000) were critical antecedents to form linkages and would influence the development of the focal relationship.

Two significant theories particularly underline the beneficial consequences of relationship quality as to buyer-seller relationship. Building on embeddedness theory, Uzzi and Gillespie (2002) found that the one actor could gain the competencies and resources through embedded relationship with another actor, and use these resources to enhance transactions with a third actor. Based on Uzzi and Gillespie (2002), buyers can operate better in the market by means of the business relationship quality which they develop with their sellers, in that the relationship can be regarded as a conduit through which information benefits or resources flow (Borgatti & Foster, 2003; Uzzi & Gillespie, 2002). Thus, the buyer-seller relationship with good quality aids innovation (Harris & Wheeler, 2005) due to information benefits (Lewis, 2003). In practice, the embedded and close interactions

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between buyer and seller lead to innovations of better quality (Athaide & Klink, 2009).

Many benefits accruing to buyer and seller encourage their willingness to maintain the long-term relationship (Holm & Eriksson, 2000). This process can also be viewed as the so-called adaptation, which occurs when suppliers adapt to the need of specific important customers and customers adapt to the capabilities of specific suppliers (Hallén, Johanson, & Nazeem, 1991). Buyers incline to invest in the relationship with specific supplier in that their switches to new alternates will cause higher transaction cost (Mudambi & Mudambi, 1995). Accordingly, transaction cost theory's notion of asset specificity, which refers to investments that are idiosyncratic to a focal relationship, is related closely to the concept of adaptations (Athaide & Klink, 2009; Cannon & Perreault, 1999). Adaptation processes include relationship-specific investments in areas such as technology, logistics, administration, financing, and knowledge (Claycomb & Frankwick, 2010). Buyers decide to continue investing in a relationship due to favorable evaluation of relationship performance (Palmer & Bejou, 1994). Once the relationship is terminated, the values from the relationship are lost (Ploetner & Ehret, 2006). Thus, transaction cost theory can explain why the business relationship quality is a driver of adaptation.

The embeddedness theory is consistent with the transaction cost theory in some respects. The former focuses on the benefits stemming from embedded ties, whereas the latter regards these benefits as the driver of exchange behavior (Borgatti & Foster, 2003). The embeddedness theory contends that the arm's-length relationship is characterized by opportunistic actions (Uzzi & Gillespie, 2002), with which adaptation cannot be realized (Williamson, 1991). Additionally, the information and resources exchanged in the arm's-length relationship are in the form of general assets and publicly accessible (Uzzi & Gillespie, 2002), which are nothing to enhancement of innovation.

The levels and influences of relationship quality may depend on the nature of the organizations involved and the nature of the situation (Parsons, 2002). In order to empirically examine the important role of relationship quality as to buyer-seller relationship, this study confines the research scope to the international context. Specifically, this study concentrates on the buyer-seller relationships between foreign subsidiaries (buyer) and local suppliers (seller) and investigates the roles of relationship qualities on buyers' successes. The conditions of multinational companies (MNCs) can particularly underline the importance of buyer-seller relationship. When operating in foreign markets, MNCs will face different conditions from those in home country. Eriksson and Chetty (2003) argued that learning about unfamiliar markets occurred through collaboration with other firms who have this knowledge. Since foreign subsidiaries are not familiar with the local environment so well, they can learn about the local context by means of collaboration with other local firms. In addition, Pagano (2009) argued that MNCs' unit performance was influenced by the behavior of suppliers. Lewis (2003) consented that frequent contacts with suppliers would constitute strategic resources. Accordingly, the relationship between foreign subsidiaries and local suppliers may be critical to successes of the former.

In sum, this study focuses on the business relationships between foreign subsidiary (buyer) of MNC and its local suppliers (seller). The objective of this study is to explore the essential role played by relationship quality in the business relationship between foreign subsidiary and its local suppliers. Specifically, this study attempts to examine influences of elements of relationship quality on foreign subsidiary's innovation and adaptation, and thus its performance. Based on the embeddedness theory and transaction cost theory, this study proposes that the business relationship quality, composed of social capital, information exchange, and frequency of contact, will have positive impacts on foreign subsidiaries' innovation, adaptation, and corporate performance. Besides, the mediated roles of innovation and adaptation between relationship quality and corporate performance of buyer are taken into consideration. Nevertheless, culture has a strong influence on how relationship quality is evaluated and perceived in business market (De Búrca, Fynes, & Roche, 2004). Therefore, it is difficult to develop a generalized model across the world to evaluate the impacts of relationship quality on innovation, adaptation, and performance. In order to eliminate the cultural effect, this study confines the research scope to foreign subsidiaries in Taiwan. Business relationships are particularly important as conducting business in Asia counties, especially in Chinese market (Kwon, 2010). This study can provide unique and deeper insights on this specific context.

These focuses of this study attempt to link the literature gap to make some contributions. First, understanding of the foreign subsidiary's relationship quality with local suppliers can highlight the importance of business relationship in the context of MNC and offer some ways to enhance business relationship. This issue in relation to business relationship for MNC is seldom investigated by previous studies except for Anderson and Forsgren (2000) and de L. Veludo, Macbeth, and Purchase (2004). Accordingly, the role of relationship quality is vague in the context of MNC. Second, although some researchers focused on the business relationship quality in the international market (e.g., exporter and foreign importer), their emphases placed on seller's perspective (e.g., Chang, 2005; Nguyen & Nguyen, 2010; Ural, 2009). Specifically, these researchers argued that a seller should create relationship quality in the buyer-seller relationship. Nevertheless, the theory of supply chain management and network approach indicate that the buyer should attend to its relationship with supplier (Ghauri, Tarnovskaya, & Elg, 2008; de L. Veludo et al., 2004). Accordingly, this study discusses the role of relationship quality from buyer's perspective. Third, the findings of this study can provide several implications for theories of supply chain management and MNC management. Our arguments add an important nuance to the acclaimed benefits of relationship quality for MNC foreign subsidiary and to approaches to managing business relationship.

2. Hypothesis Development

2.1. The Influences of Relationship Quality on Innovation

Foreign subsidiary's innovation is important for MNC in that it creates knowledge outflow (Mu, Gnyawali, & Hatfield, 2007). Innovation refers to the extent to which subsidiaries internally generate, develop, and implement an idea, practice, product, process, or administrative systems, perceived to be new by the relevant unit of adoption (Bhoovaraghavan, Vasudevan, & Chandran, 1996; Bowen, Rostami, & Steel, 2010; Damanpour, 1991; Mu et al., 2007). Mu et al. (2007) suggested that foreign subsidiary's embeddedness in local business relationship could enhance its innovation. Accordingly, this study proposes that elements of relationship quality, involving social capital, information exchange, and frequency of contact, are beneficial to foreign subsidiaries' innovation due to the information benefits resulting from embedded buyer-seller tie. Social capital is defined as the advantages obtained through accessing resources rooted in the inter-firm networks (Batt, 2008). Burt's (1997) structure hole theory argued that the broker spanning the structure hole, which represented the disconnected relation in the social structure, could acquire profound information advantages and thus social capital. In terms of the context of MNC, there is a structural hole existing between the MNC's home country and Taiwan markets. Specifically, Taiwan firms have developed unique practices in relation to international business though they typically follow western practices (Tu, 2010). If the foreign subsidiary is able to develop an embedded relationship with the local supplier, it will play a role of broker spanning the structural hole.