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Performance feedback and supplier selection: A perspective from the behavioral theory of the firm

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ABSTRACT

Drawing upon the behavioral theory of the firm, this study explores the behavioral antecedent of buying firms' decisions in supplier selection through relational referrals, beyond the predominant argument from relational network theory. Centering on the risk and uncertainty of searching for new suppliers, this study attempts to integrate the behavioral theory and relational network theory in explaining buying firms' supplier selection. Data from 112 Chinese manufacturing firms were used to test the hypotheses. The results suggest that performance feedback triggers buying firms' decision on the extent of reliance on relational referrals to select suppliers. Outperforming firms are more likely to use relational network to select suppliers while underperforming firms are less likely to use. This relationship will be strengthened when the intensity of market competition and specific investment in buyer-supplier relationship are high.

1. Introduction

Selecting appropriate suppliers and integrating them into the whole supply chain are of great importance for buying firms to gain competitive advantages (Choi & Hartley, 1996). Since searching for new suppliers is risky and uncertain when the capability and reliability of new suppliers are unknown to the buyer (Baum, Rowley, Shipilov, & Chuang, 2005), buying firms rely heavily on partners' partner or relational referrals for approaching new potential suppliers (Li, Eden, Hitt, & Ireland, 2008; Li & Rowley, 2002). Based on the relational network theory in business-to-business (B2B) relationship marketing literature, the explanation on the role that relational referrals play in supplier selection predominantly lies on the basis of comparing the costs and benefits of using relational referrals by suggesting both the bright and dark sides of existing relational network of the buying firm (Fang, Chang, & Peng, 2011; Johnsen & Lacoste, 2016; Mitręga & Zolkiewski, 2012; Villena, Revilla, & Choi, 2011).

The central premise of relational network logic is that it implicitly assumes that decision makers of buying firms are rational and capable of understanding the pros and cons of the relational network that the buying firms possess or will develop. With rational evaluations, the task of the buying firms is to choose the appropriate searching strategy that maximizes their benefits. Therefore, this camp of studies focuses extensively on the contingent value of relational referrals for supplier selection within their relational network (Meuleman, Lockett, Manigart, & Wright, 2010; Palmatier, 2008; Wuyts & Geyskens, 2005). However, this logic can shed little light on supplier selection when the rational assumption is relaxed. Managers may still stick to relational referrals for supplier selection even though they know well the weaknesses of the current relational network (Baum et al., 2005; Rogan & Sorenson, 2014). The antecedents that trigger buying firms' decision makers to stay with or deviate from the relational referrals for searching new suppliers are not well understood. And this question is also relevant for the debate between structural versus social cohesion views in social capital theory in supplier selection where the former believes social capital is created through establishing new ties with new suppliers (Burt, 2000; Kogut, 1988; Powell, Koput, & Smith-Doerr, 1996), while the latter emphasizes the cohesion of the network by involving in trusted suppliers through relational referrals (Chung, Singh, & Lee, 2000; Coleman, 1988; Gulati, 1995; Podolny, 1994).

To address this gap, this study takes the perspective from the behavioral theory of the firm, and assumes that buying firms are bounded rational and make decisions according to their past experiences (Cyert & March, 1963; Gavetti, Greve, Levinthal, & Ocasio, 2012; Levitt & March, 1988; March, 1994). We argue that performance feedback relative to the buyer's aspiration level will signal decision makers whether there are organizational failures that need to be fixed and trigger search for new solutions, thus will affect buying firm's risk preference and searching behavior (Audia & Greve, 2006; Greve, 1998, 2003). Negative performance feedback will push decision makers confronting problems and trigger risk-taking search for new suppliers without referring to existing relational referrals, while positive performance feedback will

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undermine decision makers' incentives to change and strengthen their inertia of relying on relational referrals for supplier selection. In addition, the triggering effect may depend on risk tolerance of the buying firm that may be affected by market competition and past specific investment in buyer-supplier relationship.

This study is positioned in B2B relationship marketing and tries to contribute by providing new insights in the behavioral antecedent of supplier selection beyond the predominant insights from relational network theory. Centering on the risk in searching for new suppliers, we try to integrate the behavioral theory of the firm and relational network theory, and attempt to reveal the triggering effect of past performance feedback on buyer's inclination of using relational referrals to search new suppliers.

The study is organized as follows. First, we review the literature and develop research hypotheses. Second, we present the research methodology and test the hypotheses using a combined dataset of both first-hand survey and archive dataset from China. Finally, we discuss the major contributions and limitations of the study and make suggestions for future research.

2. Literature review

2.1. Relational referrals for supplier selection

Relational referrals for supplier selection refer to the approach of searching new suppliers through referrals from relational partners (Xie, Peng, & Zhao, 2013). Previous research highlights the benefits of selecting new suppliers based on relational referrals. First, relational referrals help reduce information asymmetry. Because of close relationship and trust with existing partners that are established through repeated interactions, buying firms are more likely to access to the information about the capability and reliability of potential suppliers by the introduction of trusted partners (Doney & Cannon, 1997; Gulati & Gargiulo, 1999). The similarities between a trusted partner and the partner's partner ease the problem of asymmetric information and increase buying firms' preference transitivity along the relational ties (Li et al., 2008). Second, relational referrals help create a binding norm through the common third party referral who introduce the new supplier. Endorsements and referrals from common partners can reduce opportunistic behaviors because of the reputational effect (Burt & Knez, 1995). Violating shared norms at the expense of trading party's benefit will be punished by spreading the negative reputation among the community (Coleman, 1988). Such social cohesion reduces the possibility of holding up the buying firm by the referred new suppliers (Reagans & McEvily, 2003). As social cohesion view of social capital theory suggests, because of the trust and trustworthy relationship between members, relying on relational referrals for supplier selection is less risky and uncertain for the buying firm, and can further provide the focal buyer with strong binding norm and collective resources for future development (Coleman, 1988; Gulati, 1995; Podolny, 1994).

However, some other studies caution that relying on relational referrals for selecting new suppliers can be harmful (Fang et al., 2011; Mitręga & Zolkiewski, 2012; Noordhoff, Kyriakopoulos, Moorman, Pauwels, & Dellaert, 2011; Poppo, Zhou, & Zenger, 2008). By suggesting the dark side of relational network, recent studies argue that relational referrals may not function effectively in helping buyers to select the right suppliers. First, relational network not only binds, but also blinds parties (Poppo et al., 2008). Embedded relationships may suffer from constrained information search (Uzzi, 1997), ignorance of necessary restructuring and fatigued interest (Anderson & Jap, 2005). Such inertia of embedded relationships results in ineffective commitment of the buyer to a dysfunctional network and limits the efforts of searching for new solutions (Rogan & Sorenson, 2014). Second, relational network may also incur worse negotiation position for the buyer due to the embedded tie with a powerful supplier (Mitręga & Zolkiewski, 2012). Wathne and Heide (2000) indicate that such worsening negotiation position is indicative of passive opportunism that is apparent in many relationships. Such passive opportunism may bring unqualified suppliers into the network (Rogan & Sorenson, 2014). Hence structure view of social capital theory indicates that the social capital should be generated by establishing new ties with unfamiliar partners, instead of relational partners, to create structure holes, thus the focal firm can leverage resources between members to enjoy information and control the advantages (Burt, 2000; Kogut, 1988; Powell et al., 1996).

Therefore, whether a buying firm will select new suppliers by relational referrals depends on the contingent value of the relational referrals that the buyer may derive from its relational network (Meuleman et al., 2010; Wathne, Biong, & Heide, 2001; Xie et al., 2013). Meuleman et al. (2010) find that the role of relational referrals playing in partner selection will depend on the risk of agency problems between partner firms. Relational referrals will be important in partner selection when the agency problems with potential candidates are severe, or the knowledge complementarity between members is high, but will be less important when the potential partner has a good reputation in its community. Xie et al. (2013) suggest that a buyer will be more likely to take relationship-based strategy for supplier selection when demand and institutional uncertainty are high, but will be less likely to adopt relationship-based strategy when technology uncertainty and competition intensity are high.

A key implicit assumption for the above arguments of supplier selection based on the contingent value of relational network is that the buying firm is rational, and can choose alternative strategies according to the rational evaluation on its relational network. Information about different selecting strategies which is the basis for rational evaluation can automatically flow into the buying firm, so that managers of the buying firm can follow the rule of comparison to make decisions. However, recent findings suggest that (1) information about different supplier selection strategies may not be available for buying firms' decision makers (Anderson & Jap, 2005); (2) buying firms may not stick to the rational comparison between the contingent values of their relational network (Rogan & Sorenson, 2014). These findings suggest that the rational assumption may not be satisfied and the logic of relational network theory may not fully explain the strategic choice of supplier selection.

2.2. The behavioral theory of the firm

Relaxing the rational assumption may give us more hints on the supplier selection of a buying firm. Two major theories, Transaction Cost Economics (TCE) and the behavioral theory of the firm, sharing the common bounded rationality assumption, may contribute to the explanation (Greve, 2003; Heide, 1994; Poppo & Zenger, 2002; Williamson, 1985). But three reasons make that the TCE is not appropriate in our context to explain the relational referrals for supplier selection. First, the priority of TCE logic is to economize costs, in particular transaction costs (Williamson, 1991). Though transaction cost is one of the major concerns in supplier selection, buying firm may still undertake open market search when the potential transaction costs are high (Yang, Su, & Fam, 2012). Enlarging benefits may dominate economizing transaction costs in the buyer's decision of supplier selection (Ghoshal & Moran, 1996). Second, though TCE assumes bounded rationality, it focuses more on external contingencies which may affect transaction costs. It can hardly explain the buying firm's internal decision-making process. Third, the unit of analysis of TCE is more appropriate at contract level while the supplier selection decision is at firm level. On the other hand, the behavioral theory of the firm (Cyert & March, 1963) that tries to unravel organizational decision process with more realistic assumptions different from traditional rational-agent models (Gavetti et al., 2012), may give us more insights.

Three central postulates constitute the basic cognitive foundation of the behavioral theory of the firm. First, organizations make decisions with the principle of satisfaction instead of maximization. Subjective

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