

# The Formation and Evolution of Inter-firm Governance in China's Emerging Automobile Groups

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## ABSTRACT

This paper presents a pioneering study of the governance of inter-firm relationship within the emerging Chinese automobile groups. Our intensive case analysis of Tianjin Automotive Group (TAG) shows the inter-firm relationship in TAG before the late 1990s was characterized by top-down hierarchical administration and over time there was a movement of TAG's strategy from hierarchy to hybrid for governing its supplier relationships. We demonstrate that the extant theories are conceptually complementary in explaining the evolving nature of TAG's inter-firm relationship, with macro-level governance perspective explaining the causes and micro-level governance perspective capturing the effects of TAG's changing governance modes.

Keyword: automobile industry, China, hierarchy, hybrid, inter-firm governance

## **1. Introduction**

Despite the rapid growth of the automobile industry in China, little is known about the governance structure of the emerging Chinese automobile groups especially the governance of inter-firm relationship within these groups. In addition, it is unclear how the current theories which were built heavily on the comparative studies of Western and Japanese automobile groups can help us understand the inter-firm governance of the new players in the world's automobile industry. Answering the increasing call for more context-specific theory-based research (as opposed to theory-driven context-free research) to make international business and management research more relevant to the wider community (White, 2002; Tsui, 2004; Peng, 2005; Meyer, 2006, 2007), we chose the classical single case study method to contextualize the general knowledge of the existing theoretical perspectives in the new setting of the automobile groups in China. We ask a basic research question: how the emerging Chinese automakers manage the buyer-supplier relationship within the group?

Through an intensive case study of one of China's major automobile groups, Tianjin Automotive Group (TAG), we identify three major factors that shaped the governance of inter-firm relationship, including institutional arrangements between the Chinese state and the TAG, the market conditions in the automobile industry, and learning from joint ventures with Toyota Group. The case study shows a movement of TAG's strategy from hierarchy to hybrid for governing its supplier relationships. We demonstrate that the three existing theoretical perspectives are conceptually complementary in explaining the evolving nature of inter-firm governance in TAG. While macro-level governance perspective (and to the less extent learning perspective) offers an explanation for the

causes of the evolving inter-firm governance in TAG, micro-level governance perspective captures the effects. The paper provides managerially relevant insights into the evolving nature of inter-firm governance in the rapidly developing Chinese automobile industry.

The rest of the paper is organized as follows. Section 2 reviews existing theoretical perspectives on inter-firm governance in automobile industry. Section 3 describes the case study method. Section 4 reports findings from a detailed case study of Tianjin Automobile Group (TAG), with a comparison to the practices typically adopted by Japanese auto groups. Section 5 discusses three inter-related factors that shaped the changing structure of inter-firm governance within the TAG and establishes the causes and the effects of such changes and their theoretical explanations. Section 6 concludes by drawing broader theoretical and empirical implications.

## **2. Literature Review**

The extant literature on inter-firm governance in the world's automobile industry draws upon three theoretical perspectives: micro-level governance perspective, macro-level governance perspective and learning perspective.

The micro-level perspective follows Williamson-type transaction costs-comparative contracting approach (Williamson, 1975, 1979) to classify inter-firm governance into the hierarchical, relational and market-based arm's length modes according to the nature of transactions between assemblers and suppliers. This approach has been used to compare the buyer-supplier relationships in Japan with that in the US (McMillan, 1990; Helper, 1990; Helper & Sako, 1995) and the UK (Thoburn & Takashima, 1992; Sako, 1992),

where the buyer-supplier relationships in the US and the UK are often characterized as recurrent but market-based, and the relationship between assemblers and suppliers in the Japanese automobile groups is described as relational or obligational (Helper, 1990; Sako, 1992; Dyer, 1996a). But this body of literature remains descriptive and fail to explain why international differences exist for governing basically similar types of transactions in automobile industry. The explanation of such a contrast often lies in the broader discussion on the differences between these countries' macro-level institutions (both formal and informal) rather than transactions themselves.

Built upon both economic branch (North, 1990, 1991) and sociology branch (DiMaggio & Powell, 1991; Scott, 2001) of institutional theory, the macro-level governance perspective highlights a country's macro-level institutions in shaping the formation and evolution of the inter-firm relationships in automobile groups and argues that international differences in the transactional modes are attributed to different institutional settings in respective countries (Hemmert, 1999). For example, the US corporate governance institutions and the US business culture induce the US automakers to adopt an arm's-length approach toward managing their supplier relationships – the weak bank-firm ties, the reliance on capital markets for finance that push the US firms to pursue short-term profitability, and the low incidence of cross-shareholding, all contributed to the arm's-length approach toward managing inter-firm relationships. By contrast, the strong bank-firm ties and the lower reliance on capital markets for finance, plus the high incidence of cross-shareholding allow Japanese automakers to develop a long-term, stable relationship with their affiliated suppliers based on reciprocity and trust (Gerlach, 1992). In addition, the relationships between group-affiliated companies in

Japanese automobile industry are often historically embedded and socially complex (Gerlach, 1997). For a long period of time, these informal but institutionalized relationships between assemblers and suppliers have served as an effective substitute for both hierarchical and arm's-length organization for buyer-supplier interface in Japan (Dore, 1987; Ahmadjian & Lincoln, 2001). Thus, the formal and informal institutions in Japan collectively shaped the legally independent, yet organizationally closely affiliated, nature of inter-firm governance in the post-war Japanese auto industry. Interestingly, therefore, the extant literature often relies on the macro-level institutional theory of industrial organization to explain the micro-level differences in inter-firm relationships across different countries' automobile groups (Hemmert, 1999).

Finally, some studies offer a learning perspective to explain the changes in the inter-firm governance modes in the West (Oliver & Wilkinson, 1988; Dyer, 1996b) and in Japan (Ahmadjian & Lincoln, 2001). Although the macro-level governance perspective explains the cause of the differences in governance structures between Japanese and Western automakers, it appears unable to provide insights into the temporary changes in such governance features within one country. For example, recent studies show that the changes in the Japanese institutional environment did not lead to significant changes in the *Keiretsu*-type of inter-firm system (McGuire & Dow, 2003). Instead, a learning perspective was used to explain a movement toward establishing Japanese-style long-term purchasing arrangements in the US (Dyer, 1996b) and in the UK (Oliver & Wilkinson, 1988). Similarly, Ahmadjian and Lincoln (2001) showed the learning perspective is better suited than both governance perspectives to account for the recent

shift from hybrid governance modes toward the extremes of market-based contracting and top-down hierarchical administration in Japanese automakers such as Toyota.

In the remainder of the paper, we provide a detailed case study to examine the relative power of the existing theories in explaining the inter-firm relationship in China's emerging automobile industry.

### **3. Research Design**

To deliver the paper's promise to contextualize the general knowledge of the existing theories in a new empirical setting and advance managerially relevant insights, we adopt the classic single case study aiming to 'maximize' the richness of the context (Meyer, 2006). Like any qualitative research, the case method is subject to the critiques on their reliability/replicability and external validity. But these stringent criteria of nomothetical social science can be only met when researchers find an invariant law and the possibility of establishing invariant laws for social phenomena is questionable (Numagami, 1998). As Giddens (1984) pointed out, relationships between researchers and data in social studies are essentially different from those in natural sciences. While natural scientists interpret data that are not pre-interpreted by natural things, social scientists interpret data that are pre-interpreted by social agents. Thus, hard statistics are not inherently better than qualitative data in helping us understand social phenomenon. By contrast, rich qualitative descriptions through a single case study do a greater job than statistical demonstrations of ideas and claims in uncovering underlying dynamics of the phenomenon (Van Maanen, 1979).

The in-depth study of a single case also serves our purpose of gaining managerially relevant insights better than alternative qualitative methods such as multiple cases study (Eisenhardt, 1989) or comparative case study approach (Yin, 1989). Resembling the logic of large-sample quantitative methods, the multiple or comparative case study approach takes a more objective and positive theory building stance (Eisenhardt & Graebner, 2007) and focuses on the constructs development at the expense of the context – because the more case contexts the researcher investigates the less contextual insight he or she can communicate (Dyer & Wilkins, 1991). Such a method inevitably deviates from the classic case study and misses the context.

The purpose of a single case study is not to build new theory; instead, it emphasizes the social construction of reality and focuses on revealing how extant theory operates in particular examples (Gephart, 2004). The goals are to provide a rich description of the phenomenon, to describe the context in which events occur, and to gain theoretical insights into the deeper social dynamics (Light, 1979). For classical single case research, the truth always lies in the context and the perspective. Therefore, rather than searching for an invariant law through larger sample quantitative or multiple cases study, we return to the classics to allow the reflective dialogue among practitioners and researchers, which should be the focus of management studies (Tsoukas, 1989) and which will improve the relevance of our research by generating insight practitioners find useful for understanding their own organizations and situations (Vermeulen, 2007).

The case study was conducted through 67 onsite interviews with executives, managers, engineers and administrators etc. (see Appendix for the complete list of interviewees) in Tianjin Automobile Group (TAG) and its affiliated companies from different hierarchical

levels and functional areas over the period of 1996 and 2004. Documents provided by both TAG's Group Corporation (the group's holding company) and Toyota headquarters (Toyota was TAG's JV partner for many years) were also consulted to gauge the differences in the two automobile groups' engagement with their suppliers.

The interview protocol includes open-ended questions in three areas: (1) main practices TAG used to manage its buyer-supplier relationship, and the reasons for the adoption of such practices, (2) main changes in these practices since the establishment of the group in 1996 to the merger of TAG into First Automotive Works (FAW) in 2002, and the reasons for the changes, and (3) main differences between TAG's practices and those typically adopted in Japan (especially in Toyota Group). The recordings and transcripts were analyzed using the open-coding techniques (Jones, 1985; Coffey and Atkinson, 1996), which resulted in the emergence of four mutually exclusive categories of data on TAG's supply management practices, including contracting, payment settlement, pricing and intra-group dealing. To state anything practically meaningful about 'Chinese' inter-firm governance, we compared TAG's methods of parts supply management in these four areas with well-established knowledge of how they are practiced in Japan (particularly Toyota).

#### **4. The Case Study**

A good case study should not only report important facts to advance managerially-relevant knowledge (Hambrick, 2007) but also should be a good storytelling with theoretical import (Dyer & Wilkins, 1991). The documentation of the case story should be intertwined with the theory to demonstrate the connection between empirical evidence

and theory (Eisenhardt & Graebner, 2007). This section reports and interprets our case study through the theoretical perspectives reviewed above.

Tianjin Automotive Group (TAG) was formally established in 1996 but its history can be traced back to Tianjin Automobile Industry Company (TAIC) established by Tianjin municipal government in 1956. In 2002, TAG was merged into China’s largest automobile group First Automotive Works (FAW) after a government-initiated industry restructuring. Our observation of the formation and evolution of TAG’s inter-firm relationship started with 1996 when TAG was formally established and ended with 2002 when TAG was merged with FAW, but as elaborated later in the discussion section, the pre-1996 history matters in explaining the evolving nature of TAG’s governance structure. Table 1 provides a brief history of TAG and its predecessors.

Table 1. A brief history of Tianjin Automotive Group (TAG) and its predecessors.

Year	Event
1956	Tianjin Automotive Industry Company (TAIC) was established in the city of Tianjin
1964	TAIC commenced complete car production; during 1960s-1970s in the city of Tianjin there were other finished car manufacturers and parts suppliers, belonging to different administrative bodies
1982	In an administrative-driven merger, TAIC “absorbed” other car manufacturers and parts factories in Tianjin; Parallel with this developments, in 1982 under the central government’s policy to establish “seven consolidated business groups” in automobile industry, TAIC, together with Beijing Automobile and Beijing Second, became an affiliated company of the Jing-Jin-Ji Automobile Consolidated Company
1985	The “seven business groups” policy failed due to local government resistance, and the Jing-Jin-Ji Automobile Consolidated Company was broken up. TAIC was again under the administrative oversight of Tianjin municipal government
1986	TAIC commenced the production of small car model <i>Xiali</i> , which was for a long period of time ranked second by sales in the small car sector.
1995	The lower body (suppliers) of TAIC started JVs with Toyota for parts production

1996	TAIC was granted “independence” from the Tianjin municipal government and renamed the “Tianjin Automotive Industry (Group) Corporation” – Tianjin Automotive Group (TAG) as a shorthand
2000	Tianjin Toyota Motor Company (TTMC) was established for finished car manufacturing
2002	TAG was merged into First Auto Work (FAW) Group Corporation after another industry restructuring. After the merger, however, the TAG still held independent corporate rights and continued to conduct its business as it was accustomed to

#### **4.1 The Formation: 1996-1999**

An intensive analysis of the four major aspects of inter-firm relationships in contracting, payment settlement, pricing and intra-group dealing revealed that unlike the automobile groups in Japan the inter-firm relationship in the TAG was governed by hierarchical coordination at the formation stage.

In Toyota, the contracting practice that rules parts-related business incorporates a “basic contract” and “monthly schedules.” The basic contract sets out general obligations that must be followed by both parties and is normally reviewed every year. The monthly schedules are individual contracts that determine the variety, design and delivery dates for the parts which are traded (Asanuma, 1989). This kind of contracting is peculiar to continuous purchasing/supplying relationships with the “monthly schedule” acting as a built-in mechanism to allow for adjustment in unforeseen circumstances and leave less room for dispute on each purchasing transaction (Smitka, 1991). This contracting practice between auto assemblers and suppliers is consistent with the broad relational contracting approach described in the literature about the Japanese inter-firm system (Williamson, 1985).

In TAG there was no equivalent form to the “basic contract” of Toyota. The amount, cost and design of parts were generally confirmed in an individual contract made on a yearly basis and conducted on a one-to-one basis between the General Corporation (GC) or *Zong Gong-si* and each parts subsidiary. The yearly contract resembles European and American practices (Cusumano & Takeishi, 1991; Helper, 1991; Sako, 1992), where the general rule is to have a contract in which all matters pertinent to the business – such as amount, cost and design – are confirmed in a written document. But there was notable difference between the Chinese practice and the Western arm’s-length approach. In the west, these contract terms were determined through negotiation and bargaining by both parties. But in TAG, the contract terms were determined by GC in “consultation” with subsidiaries and implemented through hierarchical procedure as if they were “production plans” rather than contracts. Though GC was created as a holding company, in reality it operated as the *de facto* headquarters. Put simply, the truly inter-firm contracting was absent because there was a lack of recognition of both assembling and parts subsidiaries as independent companies.

The second feature under investigation is the payment settlement practice. Unlike in Japan, the settlement of TAG’s parts payment did not correspond to each purchasing transaction in parts. Instead, income from finished car sales was collected and distributed by TAG Sales Company (which was treated as a sales department) to the group’s affiliated companies. Revenue from finished car sales at directly-managed stores and at dealerships was first sent to the Sales Company. Payments to each company were determined at a payment distribution meeting held between the Sales Company’s accounting center and companies at the core level of TAG. Payments were made first to

these core companies according to the costs of sold parts and then distributed by these core companies to subordinate suppliers to cover their parts and components costs.

Although monthly settlement was also a feature commonly observed in Japan, but in China payment did not necessarily correspond to the quantity of parts supplied. In TAG, a lag between business results and the estimation of demand or the production plan often produced an increase of stocks of finished cars. If the costs of finished cars were not recovered, payment was not made for parts costs. The arrangement resulted in the so-called “triangle debts” which expanded upstream as a chain reaction. This was a serious issue, as suppliers’ dependence on group sales was extremely high in China. The reason that the settlement of TAG’s parts payment did not correspond to each purchasing transaction in parts was because the group’s affiliated supplier companies were not treated as independent profit centres. The supplier companies were instead treated as internal departments or factories (like they were before 1996 when TAG was formally established) to bear the costs for the whole group. Any inter-firm purchasing/supplying exchanges were still considered “business within the group.”

In Japan, where suppliers were also often encouraged to share the costs with the assemblers, the assemblers cannot impose the cost-reduction through hierarchical means. Car makers can only use a combination of market incentives and other relational mechanisms such as supplier associations to work with suppliers to reduce costs through continuous innovation of parts and components production and pass the savings on to the assemblers (Dore, 1987; Nishiguchi, 1994). The arrangement provides a win-win situation both for assemblers and parts suppliers, an example of what relational contracting means in Japan. In the case of TAG, such features of relational contracting

were completely absent prior to 1999, and the payment settlement practice reflected the administrative nature of relationship between GC (the *de facto* headquarters of TAG) and its subsidiaries despite their nominal independent legal status.

Thirdly, the GC held the right to set the parts prices, although suppliers could negotiate for price changes at the end of every year. Sometimes the demand for price cuts by GC during these negotiations was so aggressive that they completely siphon off the fruits of any improved efficiencies by suppliers. In some cases, the prices set for the parts were lower than the production costs. This kind of price-setting practice would not be possible if the supplier companies were treated as independent firms. As a result, negotiations on parts costs with some suppliers could extend for prolonged periods during which time parts had been supplied in the absence of fixed prices.

In Japan, renewal negotiations on parts unit prices are usually held every six months. The reduction in the purchase price for parts is less than any reduction in suppliers' production costs gained from rationalization conducted by suppliers. This method encourages suppliers to invest in rationalization. If the price cut for purchasing is too large, suppliers will not have the capacity to invest in further rationalization. Inversely, if it is too small, they will have less incentive to invest in rationalization. Again, on pricing, we found TAG's inter-firm relationship was hierarchical, in contrast to the quasi-market, quasi-hierarchy feature of the Japanese practice.

Finally, in TAG each affiliated company dealt almost 100 percent within the group. This exclusiveness was partly due to the fact that most suppliers in TAG were spin-offs from its predecessor TAIC's branch factories and partly attributed to Tianjin Municipal Government policies known as "The priority of dealing within the group" (*xian nei, hou*

*wai*) and “The priority of dealing within the city” (*xian benshi, hou waibu*). Although TAG was granted “independence” from local government since 1996, in reality its GC and core-affiliated companies maintained extensive organisational and personal ties with Tianjin municipal government and were heavily influenced by the local government’s policies.

While intra-group business dealings were once a core feature of the Japanese system, the exclusiveness of such dealings has weakened dramatically as the competition for buyers significantly intensified since the 1980s. Within automobile industry, for example, the buyer-supplier relationship has shifted from more of a quasi-hierarchy system to more of a quasi-market based (Sako, 2004). In the Toyota Group, as early as the mid-1980s, more than one third of its group-affiliated companies had already reduced their reliance on delivery within the group to less than 70 percent.

#### **4.2 The Evolution: Since 2000**

The top-down hierarchical structure of TAG caused some problems during the formation stage, including the above-mentioned triangle debts within the group’s supply chain. In theory, TAG planned its “production according to market-trend forecasts”, which were made jointly by the sales company and its dealers. They made a yearly estimate based on the previous year’s sales records for each dealer and the macro-projections for the following year. GC’s production planning section then made a yearly production plan based on the yearly demand estimate. However, two unstable factors persisted. First, the information supplied by dealers tended to be inaccurate. Sales figures tended to be inflated because most of the dealers were not exclusive, and often involved

in the sale of both *Xiali* and its competing model *Santana* (made by Shanghai Volkswagen). Second, the production plan was often amended by “administrative guidance” from the Tianjin Municipal Government. As a result, the production plan was often ill-informed by inaccurate market intelligence and led to an excess stock of finished cars. The excess stock led directly to a lack of cash flow in the sales company, which in turn resulted in an increase in triangle debts among suppliers (due to the payment settlement practice described above). The inefficiency produced accumulated debts along the supply chain throughout the whole group.

This problem was not serious up until 1999 because TAG’s main model, the *Xiali*, enjoyed robust sales. But, from 1999 to 2000 events unfolded dramatically. The *Xiali* suffered a notable slump in sales. In the latter half of 1999, *Xiali*’s monthly sales ranking dropped to third in the small car sector, and its market share fell at an increasing rate. The sales slump made the latent weaknesses in the supply chain apparent. Sales information showing the true state of the market was not appropriately fed back to the production plan. The slump in the sales of *Xiali*, which normally accounted for two thirds of TAG’s sales volume, contributed directly to a management crisis, forcing the company to improve its efficiency. TAG did not possess the technology to develop a new product to replace *Xiali*, so GC made a desperate decision to increase its collaboration with Toyota in 2000. The company started a top-down systematic overhaul, studying Toyota’s methods to improve TAG’s supply payment management. It should be noted that joint ventures between the two groups began in the latter half of 1995, even before TAG was formally established. But the collaboration remained among group-affiliated parts and components suppliers at the lower levels of both groups. TAG did not seek to learn Japanese practices in

managing supplier relationship systematically through these early joint ventures because TAG's main model *Xiali* had been enjoying a comfortable market position.

The systematic diffusion of Japanese-style supply chain management only started with the establishment of a joint venture Tianjin Toyota Motor Company (TTMC) in 2000 in finished car production for China market. The establishment of TTMC meant the creation of another core firm in the TAG, parallel to GC, which led to significant changes in the governance of TAG's inter-firm relationships. Although TTMC was a 50:50 joint venture, Toyota Group seized the initiative in the management of TTMC and the car models produced were sold under Toyota brand names. With regard to the sales channels for TTMC, Toyota first selected 100 candidate shops that met Toyota's standards for sales dealers with Chinese executives selecting dealers from this pool. The standard adopted here matched Toyota's global practice, and sales customs peculiar to China were abolished. As for suppliers, many companies affiliated with Toyota stepped forward. As a result, TAG has taken on a double-head structure, encompassing the Chinese "Tianjin Auto Group" with GC as its core firm, and the "Tianjin Toyota Group", with Tianjin Toyota as its core firm. Both groups share suppliers of Japanese descent. The Japanese style inter-firm system advanced dramatically within TAG as Tianjin Toyota was empowered to administratively coordinate market research, estimation and supply of parts, and production and sales across the production chain.

A number of important changes in the governance of TAG's inter-firm relationship resulted from the systematic introduction of Japanese-style purchasing practices. First, price negotiation between GC and suppliers became more often, held in every 6 months rather than once a year, in response to quick changes in the market conditions. Second,

the suppliers enjoyed a fair say in the negotiation of the price for the parts. Third, the group set up a new subsidiary sales company, the Tianjin *Xiali* Sales Co. Ltd., which was responsible for selling *Xiali* and preparing the ground for an exclusive dealers' network. In 2000, between 80 and 100 exclusive dealer shops were set up under the direct control of the new sales company. These shops engaged in sales, parts supply and after-sales service. Thus, the sales company had more direct control over the market information gathering. Fourth, supplier dealing outside the group was liberalized and their exclusive reliance on sales within the group was generally lessening. This trend was first triggered by *Xiali*'s sales slump in 1999, but it was widely expected that the trend would continue as long as the market remains competitive as the TAG management started to realize that it would be unrealistic to expect suppliers to be able to survive on business generated within the group.

These changes (e.g. the price negotiation practice, the reduction of intra-group sales and the increase in sales to non-group affiliated firms) signals that the relationship between TAG and its affiliated companies were gradually transformed into truly inter-firm relationship between legally independent firms, with lower level suppliers being treated as independent companies first and group members second. A quasi-market governance structure consisting of a core firm and quasi-independent associated companies took the shape and replaced the old hierarchical governance structure for member companies.

## **5. Discussion**

The case study demonstrates that in TAG, the inter-firm system has shifted from hierarchy-based administrative control prior to the late-1990s to a quasi-hierarchy, quasi-market type of governance entering 2000. The changing nature of TAG's inter-firm governance structure is best understood through a combination of three inter-related factors: institutional arrangements between the Chinese state and TAG, the market conditions in the automobile industry, and the role of learning from Toyota. In particular, the specific institutional settings in China serve as the most critical explanatory variable for TAG's response to market conditions and its decision to learn from joint venture partner Toyota.

TAG was formally established in 1996, but its governance structure took shape under the old planned-economy system and the group inherited its initial inter-firm relationship from its immediate past practices. Therefore, the starting line of the inter-firm governance features that we are discussing here is not so clear-cut – they did not really start in 1996, but basically adopted the same practices employed by TAIC before 1996. The formation of large auto groups in China such as TAG was part of the government's broad agenda to reform property rights in large inefficient state-owned enterprises (SOEs).

The evolution of the inter-firm governance in TAG also reflects the changing institutional arrangement between the Chinese state and automobile groups. Before the 1988 Law on SOEs, the nature of the relationship between TAG and its controlling body as well as the relationship among different units (e.g. assembling factories, parts and components factories) within TAG were purely administrative. Indeed, TAG and affiliated companies were themselves administrative bodies (known as work units) under the old planned economy system. After the introduction of the SOE Law, state enterprises

such as TAIC were in theory separated from the state and became independent legal entities. But in reality, with the state as the sole or majority owner, these enterprises only acquired quasi-independent legal status with the fulfillment of state production quotas remaining as their main responsibilities. In the case of TAIC, the Tianjin municipal government was the nominal owner representing “the whole people,” but it still exercised significant influence or indirect control over the production and sales of the company. Managers had to content with the pervasive influence of local government on their business activities (Boisot & Meyer, 2008). When TAG was formed in 1996 to replace TAIC, the embedded hierarchy-administrative ties made it difficult to transform the relationship among group members to a truly inter-firm relationship between legally independent firms.

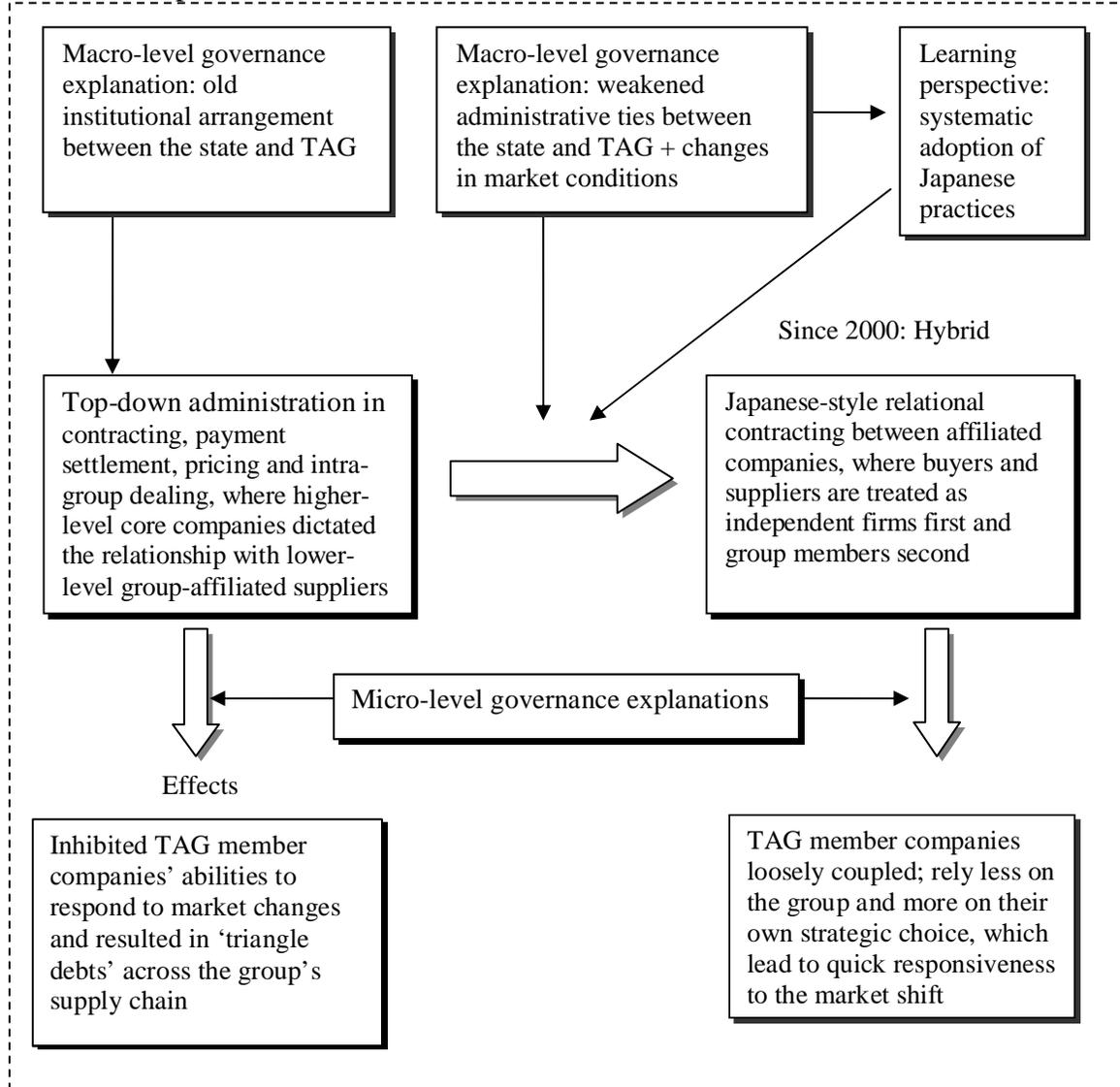
With the deepening SOE reform in the late 1990s, the relationship between the state and TAG as well as between TAG’s member companies was increasingly governed by ownership and less by administrative control, which weakened the administrative ties between TAG and the government bodies as well as the administrative ties between group member companies. The weakened administrative ties also meant weakened institutional support in areas such as financing. Coupled with the slump in the sales of its main model *Xiali* in 1999, the group was desperate to change in order to survive in the increasingly competitive passenger car market. Thus, the increasing institutional distance between the state and TAG and changes in market conditions induced the group’s organizational changes towards managing its supplier relationship.

Since 2000, systematic learning from Toyota altered the way intra-group transactions were governed. The changes in payment settlement method and the price-negotiation

practice, the reduction of intra-group sales and the increase in sales to non-group affiliated firms all showed a shift from top-down administrative control toward market-based governance for inter-firm relationship, resembling closer to the quasi-market feature of inter-firm governance commonly observed in Japanese auto groups. But on the other hand, the initial institutional arrangement created a powerful path dependence effect that allowed GC to continue to determine most of the contract terms for parts supply. As a result, the inter-firm relationship within TAG retained quasi-hierarchy characteristic distinctive from Japanese practices.

The above discussion helps us to establish clearly the theoretical explanations of the causes and the effects of the TAG's changing governance structure for its buyer-supplier relationship. Specifically, we identify institutional arrangement between the state and TAG and its changes as the causes of the adoption of different governance modes over time within TAG. The changing macro-level institutional environment also explains TAG's initial delay as well as the eventual learning of the Japanese practices in managing buyer-supplier interface. The existing theoretical perspectives, taken in concert, offer the full explanation of the observed phenomena, with macro-level governance perspective explaining the causes and micro-level governance approach capturing the effects of TAG's evolving governance structures. The learning perspective provides partial explanation of the changes since 2000 but the learning phenomenon itself was a consequence of the combined effect of the institutional change and the market shift since the late 1990s. Figure 1 below summarizes exactly which factors cause the relevant others and how the different theoretical perspectives help us understand the causes and the effects.

Figure 1. The causes and the effects of TAG's inter-firm governance structure and their theoretical explanations



## 6. Conclusion

Compared to the established knowledge on inter-firm governance in Western and Japanese automobile industry, little is known about the structure of inter-firm relationship in the emerging Chinese automobile groups. This paper provides a pioneering case study of Tianjin Automobile Group (TAG) detailing the operation of four major practices in managing buyer-supplier relationship within the group and explores how the dynamics of

institutional change impact on the way TAG organize these practices. We found that the inter-firm governance in TAG before 1999 was characterized by top-down hierarchical administration due to the heavy influence of the old institutional arrangement between the state and TAG. Over time, especially entering 2000, the weakened institutional ties between the state and TAG forced the group to be more responsive to market changes and to systematically learn Japanese-style supplier management from Toyota Group. As a result, inter-firm relationships within the group shifted from hierarchy to hybrid governance.

The three extant theoretical perspectives are conceptually complementary in providing relevant empirical insights to our case but the macro-level governance perspective is more fundamental than alternative theories in explaining the evolving nature of the inter-firm governance in TAG – it was mainly China’s changing macro institutional environment that shaped TAG’s evolving strategy towards organizing the buyer-supplier relationships with group-affiliated companies.

By combining existing theoretical perspectives with a deep knowledge of the Chinese context, we provide a rich description and explanation of the formation and evolution of the inter-firm governance in one of the major automobile groups in China. Our context-specific theory-based research design enabled us to help practitioners to look deep into the nature of the inter-firm relationship inside the company and offers a rare and true comprehension of the inner-running of the emerging Chinese automobile groups and the underlying institutional environment that shaped their governance structures.

Appendix: The list of interviewees

Date interview conducted	Company Name	Interviewee Position
08/27/96 Tue	Shougang Corp. / Liaison & Reception Office	Engineer
08/29/96 Thu	Tianjin Aisan Automobile Parts Co. Ltd.	Director/President Director/VGM/Senior Engineer Director/Manager
08/29/96 Thu	Tianjin Denso Engine Electrical Products Co. Ltd.	Deputy GM
10/14/97 Tue	Tianjin Fengtian Steel Process Co. Ltd.	VP Financial Manager
10/14/97 Tue	Tianjin Toyota Motor Engine Co. Ltd	Trustee/GM
10/15/97 Wed	Tianjin Jinling Steel Co. Ltd.	CEO Sales GM Production Dept. Director
10/15/97 Wed	Tianjin Rihua Steel Products Co. Ltd.	Director VGM VGM
10/15/97 Wed	Tianjin Huazhu Metal Products Co. Ltd.	GM VGM
10/16/97 Thu	Tianjin Mini-Auto Works	Director of Reception Section
10/16/97 Thu	Tianjin Automobile Industrial (Group) Co. Ltd.	Deputy Director
10/17/97 Fri	Tianjin Denso Engine Electrical Products Co. Ltd.	Deputy GM
10/17/97 Fri	Tianjin Aisan Automobile Parts Co. Ltd.	Director/President Director/Manager
10/17/97 Fri	Tianjin Kahou Automobile Decoration Co. Ltd.	Director/VP
10/18/97 Sat	Tianjin Toyoda Gosei Automobile Hose Co.,Ltd.	VP Manager
10/18/97 Sat	Toyota Tsusho Corp./ Tianjin Office	
11/07/00 Tue	Tianjin Aisan Automobile Parts Co. Ltd.	Director/President Director/Manager
11/07/00 Tue	Tianjin Toyota Motor Engine Co.,Ltd	Trustee/GM
11/07/00 Tue	Tianjin Toyota Steel Process Co. Ltd.	VP Financial Manager
11/08/00 Wed	Tianjin Kahou Automobile Decoration Co. Ltd.	Director/VP Director/Manager
11/08/00 Wed	Toyota Motor Technical Center (China) Co. Ltd.	President
11/09/00 Thu	Tianjin Automotive Industrial (Group)	Director, Joint Venture &

	Co. Ltd.	Cooperation Dept.
11/09/00 Thu	Toyota Motor Corp./ Tianjin Office	Chief Representative
11/09/00 Thu	Toyota Tsusho Corp. Toyota Tsushi (Tianjin) Co.,Ltd.	GM
11/10/00 Fri	Tianjin Toyoda Gosei Automobile Hose Co. Ltd.	Prsident/GM
1/10/00 Fri	Tianjin Denso Engine Electrical Products Co. Ltd.	Deputy GM
03/22/04 Mon	Toyota Motor Technical Center (China) Co. Ltd.	Special Consultant VP GM
03/22/04 Mon	Tianjin FAW Toyota Motor Co. Ltd.	Manager, Purchasing Division Assistant GM, General Affairs & Human Resources Division
03/22/04 Mon	Tianjin Denso Air-Conditioner Co. Ltd.	GM VGM VGM
03/23/04 Tue	Tianjin Fujitsu Ten Electronics Co. Ltd.	Administration Director
03/23/04 Tue	Tianjin Tokai Rika Automotive Parts Co. Ltd.	Deputy GM, Project Promotion Dept.
03/23/04 Tue	Aisin Tianjin Body Parts Co. Ltd.	Section Chief Plant Manager Assistant
03/24/04 Wed	Tianjin Toyoda Gosei Co. Ltd.	GM
03/24/04 Wed	Tianjin Denso Engine Electrical Products Co. Ltd.	Deputy GM
03/24/04 Wed	Tianjin Aisin Automobile Parts Co. Ltd.	Manager Manager Manager
03/25/04 Thu	Tianjin Toyota Motor Engine Co. Ltd.	Director, Member of the Board/ President
03/25/04 Thu	Tianjin Kahou Automobile Decoration Co. Ltd.	Director/President Director/Senior Manager Senior Manager No.2 Dept. Senior Manager Management Dept.
03/25/04 Thu	Tianjin Aisan Automobile Parts Co. Ltd. Aisan (Tianjin) Auto Parts Co.,Ltd.	Director/President  Director/President
03/26/04 Fri	Tianjin Fengjin Auto Parts Co. Ltd.	Manager, Administration Dept. Manager, Manufacturing Dept.
03/26/04 Fri	Tianjin Toyota Forging Co. Ltd.	Director/GM
03/26/04 Fri	Tianjin Toyota Steel Process Co. Ltd.	Assistant to President

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