

# Dynamic Development of Competitive Hybrid Governance Structure in Supply Chain: A Longitudinal Qualitative Data Analysis

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## INTRODUCTION

The purpose of this paper is to explore how firms dynamically develop competitive hybrid governance structures in their supply chain network across borders. The hybrid form of governance structures in the supply chain has received some research attention in recent years (Dyer, 1996a, 1996b, 1997; Dyer & Sigh, 1998; Takeishi, 2001, 2002; Kotabe, et al., 2003). The findings in studies of the Japanese automobile industry suggest that a firm's critical resource may span across firm boundaries and may be embedded in interfirm routines and processes. Although the previous literature focused largely on exploring a mechanism on the extent to which firms choose hybrid forms as a governance structure over a market or hierarchical mode, little is known about how a principal firm can develop and maintain a competitive hybrid form of supply chain network that contributes to its sustainable competitive advantage from scratch. However, as previous studies have been conducted mostly at the firm or industry level (and mostly with one-shot questionnaire survey data collected from the Japanese automobile industry), we do not have much in-depth understanding of the dynamic outsourcing strategies

employed by new, growing Japanese companies, i.e., how to develop and control a tight supply chain with high quality and high profitability without resorting to hierarchical governance by owning their suppliers from scratch. Therefore, our study adopted a qualitative longitudinal case study method, as the issue is an emerging phenomenon and such an approach excels in detailed historical contextual analysis. We focus on the successful history of Uniqlo, a Japanese apparel firm with its supply chain network without any ownership control.

This study makes two contributions to the literature on supply chain management. First, by combining different perspectives on the mechanism of hybrid governance formations, a theoretical framework will be developed. Second, it explores critical activities that a small start-up firm needs to engage in to develop and maintain highly competitive hybrid forms over time. Finally, we propose testable propositions for dynamic developments of hybrid governance structure in supply chain networks.

## WHAT IS THE HYBRID FORM OF GOVERNANCE STRUCTURES

The term governance can be defined as a “mode of organizing transactions” (Heide, 1994; Williamson, 1985). In general, a mode of transactions has been known as an issue of “make or buy” decisions in the context of vertical transaction or sourcing strategies. For the principal firm, by increasing its amount of outsourcing, it is assumed to be easier to respond to a rapidly changing environment in the global economy because of its lower fixed-asset position providing operational flexibility. Flexibility suggests that firms can better respond to changes and accommodate their partners as the need arises. Firms must prepare to negotiate and renegotiate adjustments as unforeseen events develop (Heide, 1994). Hybrid or interfirm governance is the intermediate mode of transactions somewhere between the market and a hierarchy. It can

be defined as a bilateral relationship in which the parties jointly develop policies directed toward the achievement of certain goals (Heide, 1994; Usui, 2005). Because the hybrid form can be developed either in an open-ended relationship or in a fixed relationship, it may enjoy relatively higher degrees of flexibility of transactions than a hierarchical mode and also achieve relatively lower transaction costs compared with employing market governance (Williamson, 1985).

In addition, from the strategic viewpoint, a hybrid form may have another advantage. Dyer & Singh (1998) suggested that a hybrid governance or a relational view of a pair or network of firms can be the source of sustained competitive advantage because interfirm assets accumulated with long-term joint investments from both parties can be inimitable and rare in the market. For example, in the Japanese automobile industry, the long-term intimate relations between assemblers and parts suppliers have helped strengthen the competence of both parties (Dryer, 1996a, 1997; Kotabe, et al., 2003; Takeishi, 2001).

In this study, we define competitive hybrid governance as a strategic interfirm relationship in vertical transactions that the principal firm develops by forming and managing a network of supply chains with worldwide operations that achieve higher flexibility in transactions with relational competence. A large investment in fixed assets (i.e., manufacturing facilities) has turned out to be a major financial burden in a rapidly changing environment. In the era of turbulent global competition, it may be important for a principal firm to maintain a certain level of flexibility in its supply chain network. However, by pursuing a high level of flexibility in supply chain operations, a principal firm may lose its competence in the quality of manufacturing and other capabilities in upstream activities. Without internalizing manufacturing capabilities, a principal firm can choose to form

renewable transaction relationships with specific partners and make relationship-specific investments to possess manufacturing capabilities jointly with its partners. A hybrid form may be more efficient in achieving the dual goals of pursuing higher operational flexibility and internalized manufacturing competence in its supply chain network.

*Theoretical basis: Transaction Cost Analysis and Resource-Based Perspectives on Interfirm Relationships*

The previous discussion on the issue in the selection of governance structures in firm boundaries has two different perspectives that explain the emergence of hybrid forms, transaction cost analysis (TCA) and the resource-based view of the firm (RBV). TCA explains that two opposed transaction structures occur either in the market or within a hierarchy (within a vertically integrated organization) and sees that a firm may select hybrid forms as a structure somewhere between the market and a hierarchy. TCA researchers operate on the assumption of selecting governance structures to minimize the cost of transactions and avoid opportunistic behaviors by partners (Williamson, 1985, 1991). TCA predicts that if a firm employs market governance, it takes advantage of opportunities to deal with new contractors who may have innovative technologies, while the transaction cost, including the searching for partners and information-seeking costs, monitoring costs, and costs of enforcing contractual performance will be relatively higher. This discrete exchange relationship provides the firm the flexibility to pursue transactions with various different partners concurrently and/or over time for a given activity (Joshi & Stump, 1999; Williamson, 1985). In contrast, hierarchical governance attempts to internalize all transactions within the firm or the group of firms. While a vertically integrated firm minimizes transaction costs arising from its partners' opportunistic behavior, it faces inflexibility in exchange

relationships that may lead to manufacturing cost inefficiency (Williamson, 1985).

Although the original TCA argument assumes that choice of governance structures is either markets or hierarchies and nothing in-between, Williamson (1991) stressed that certain types of transactions require a hybrid governance structure that is characterized as having repeatable transactions with specific partners who have idiosyncratic assets. TCA is then extended to include the repeated transaction relationships and this extension requires the development of an intermediate structure for interfirm boundaries (Dyer, 1996a, 1996b; Imai, et al., 1982). When firms choose to form intermediate structures with their partners, they tend to have a certain level of asset specificity in the relationship. The modified TCA perspective considers that high asset specificity may lead to opportunistic behavior by partners, and firms risk bearing much higher transaction costs due to their efforts to minimize the level of such opportunistic behavior. It views specialized investments as putting firms at greater risk of a “hold-up” or “lock-in” in its transactions. TCA argument suggests that the principal firm would need to have a mechanism to avoid or lower the opportunistic behavior of partners. Securing cooperation from partners is a necessary condition in developing and maintaining competitive hybrid governance in the principal firm’s supply chain network (Dyer, 1997).

While TCA perspective focuses on the negative aspects of asset specificity by the formation of hybrid governance, RBV focuses on how firms can enhance and sustain their competitive advantage through creating and acquiring their resources and capabilities within the interfirm relationship (Barney, 1999; Johnston & Lawrence, 1988). The RBV assumes that the interfirm relationship emerges when a firm recognizes the effectiveness of creating and accumulating resources

with partners rather than within its own organization. Some empirical studies support the view that these co-specializations increase the productivity of resource owners (Dyer & Singh, 1998).

Unlike the TCA, the RBV views relationship-specific investments made jointly with partners as one of the factors in improved performance. These investments are made for the relationship-specific assets (RSAs) that are only functionally effective within a specific relationship with particular partners. The findings in studies of the Japanese automobile industry suggest that a firm's critical resource may span across firm boundaries and may be embedded in interfirm routines and processes (Dyer 1996a, 1996b, 1997, Dyer & Singh, 1998). Dyer's study (1996a, 1996b) summarizes that the competitive advantage of Japanese automobile industry is linked to the proposition that resource owners increase their productivity through relationship-specific investments. In addition, researchers specializing in the automobile industry suggest that co-specialization within the interfirm relationship between supplier and manufacturer allows for product differentiation and may improve quality by increasing the product integrity or fit (Clark & Fujimoto, 1997; Takeishi, 2001, 2002; Kotabe, et al., 2003).

The RBV suggests that interfirm competitive advantage can be created through joint idiosyncratic contributions and complementary resource endowments by the specific partners (Dyer & Singh, 1998; Lambe et al., 2002). Since idiosyncratic resources are unique to the interfirm relationship and are constantly evolving, they help interfirm relationships maintain their durability and inimitability of resource advantage (Lambe et al., 2002: 144).

Combining these arguments on the theoretical conditions of how RSAs convert into the firm's critical resources, RSAs are defined as

those that 1) are created in its long-term transactions with specific partners through joint investments made by both parties, 2) are functionally effective only within the specific relationship with partners (idiosyncratic contributions), and 3) must be complementary to the resources of the specific partners (Usui, 2005).

We can conclude that the major strengths of selecting hybrid forms, instead of a market or hierarchical structure, are maintaining an appropriate level of flexibility in their fixed assets and possibilities of developing RSAs with partners for sustainable competitive advantage. The shift from a traditional market and hierarchical structure in vertical transactions for selecting hybrid forms is based on interfirm learning through cooperation. However, when the principal firm chooses a hybrid form without ownership-based control, the major issue the firm may face would be the weakness of control over joint asset accumulations and soliciting suppliers' cooperative behavior. The above discussion highlights the questions about how a principal firm can solicit cooperation from its suppliers and at the same time develop integrative valuable resources (i.e., RSAs) from both parties to achieve even higher value on the market without ownership-based control of suppliers. A hybrid form needs to have non-ownership-based forms of control mechanisms to accomplish organizational objectives in interfirm partnerships.

#### *The Non-ownership-based Control Mechanism: The Concept of Power and Trust*

A solution to maintain higher control of its suppliers by a principal firm without ownership would be to find the sources of power the principal firm can utilize and build trust in the relationship with partner firms. The concept of power in buyer-and-seller relationships in the context of the marketing channel was examined extensively in the

1970s to 80s (Hunt & Nevin, 1974; Lusch, 1976). Gaski (1984), who elaborated on the concept of power, defines it as the ability to cause someone to do something he or she would not have done otherwise. The marketing channel literature suggests that the power and the sources of power may provoke increased conflict in the dyad. There are two types of sources of power: coercive and non-coercive. Coercive power is based on legitimate and punishment rights over others. Non-coercive power is characterized as rewards or assistance (providing expertise to others) While the coercive sources of power tend to increase conflict and reduce the satisfaction of partner firms, non-coercive sources of power would do the opposite. For instance, the expectation of economic reward or greater total volume of exchanges promised by the principal firm would serve as a source of control in its supply chain network (Dyer, 1997).

To seek cooperative behavior or trust relationship with partners without ownership-based control, a principal firm may provide some special knowledge and expertise as its source of power to help its partners with their own competence development and continuous growth (Gaski, 1984, 1986; Gaski & Nevin, 1985). Such an action could further increase the liking and respect received from those suppliers (Gaski, 1986). Sending experts from a principal firm to partners would be critical in gaining referent power and helping develop partners' technical competence as well (Fraizer, 1983; Fraizer & Summers, 1986). Referent power is the source of power based on the identification of the principal firm with suppliers where identification means a feeling of oneness or a desire for such an identity (Hunt & Nevin, 1974: 187). Suppliers without advanced skills could improve their manufacturing capabilities through learning opportunities provided by a principal firm and those improved suppliers' competences would contribute to forming



better overall RSAs of both parties. Having shared goals and a joint learning or improvement process on manufacturing capabilities provided by the principal firm, suppliers tend to form a feeling of oneness with their principal firm. The non-coercive power, such as economic rewards or providing some special skills to suppliers, would reduce conflict and gain satisfaction for those partners even more when the sources are actively exercised. A principal firm can have power without using it (Fraizer, 1983), but the reward should be granted continuously and perceptibly to make sure that the partners' cooperative behavior would stay positive toward the principal firm.

Trust is an indispensable ingredient in effective business relationships that may lead to cooperative behavior from the partners. Defined as a confidence in the other party that entails, among various aspects, a willingness to be vulnerable toward others despite an uncertainty regarding their motives, intentions, and prospective actions (Dyer & Chu, 2000; Mayer, et al., 1995), trust in business relationships has been shown to promote greater cooperation and richer information exchange, thus increasing the effectiveness of organizational activities such as resource acquisition and value creation (Aulakh, et al., 1996; De Wever, et al., 2005; Dyer & Chu, 2000). As we discussed above, both exercised economic and referent power provided by the principle firm will contribute to maintaining stronger trust relationships with partner suppliers.

Based upon the literature review above, we realized that collecting longitudinal data on interfirm relationships in supply chain networks would help better understand the dynamic development process of a competitive hybrid governance structure, its power-generating driving forces, and its performance implications. We choose Uniqlo, a Japanese apparel giant as a sample to explore this issue. Uniqlo is perceived as

one of the best quality apparel producers with the lowest market prices in the world. Our focus is on how a small firm such as Uniqlo in the early 1990s has developed its competitive hybrid governance structure with its primary suppliers in China over time to achieve both high quality and low production cost. Based on our literature review and guidelines proposed by Eisenhardt (1989) and Eisenhardt & Graebner (2007) for building theories from case studies, we developed a theoretical framework on the principal firm's conduct and performance outcomes (see Figure 1). Data collected from our case study and fieldwork will provide justifications for developing our research propositions in the later section.

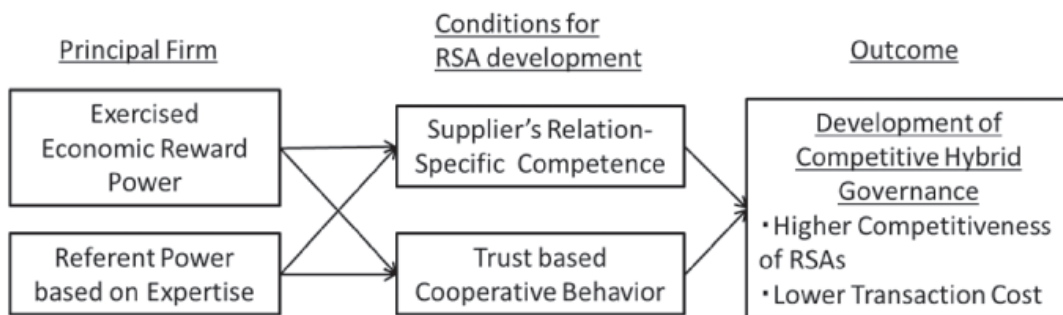


Figure 1. Theoretical Framework

## METHODS

### *Method and Sample Selection*

In order to examine how a principal firm develops and maintains its competitive hybrid governance structures with primary suppliers over time, we conducted an in-depth and longitudinal case study owing to the complex, evolving, and entwined phenomena involved (Eisenhardt, 1989; Eisenhardt & Graebner, 2007). We choose the longitudinal content analysis of news articles, internal documents, books, other published reports, and personal interviews with the company and industry as primary data.

Because our research question cannot be captured with one-time spot questionnaire survey, a historical content analysis is conducted. For our study, the unit of analysis is the long-term dynamic relationships between the focused principal firm and its primary suppliers.

In this paper, we examine the history of Uniqlo's (the store brand name operated by Fast Retailing Co. Ltd. based in Japan, henceforth FR) supply chain network development in China as a sample, and how it has selected its partners and developed the relationships with them to build a strong relational competitive advantage over time. There are two main reasons why we chose Uniqlo for our case study. First, Uniqlo is known as one of the most successful apparel firms in the world in the last two decades, so that there is a significant amount of secondary data available over time. Uniqlo started their business as a small family-owned apparel store in a rural area in Japan. Uniqlo's success started when its first store opened in Hiroshima, Japan in 1984. As of August 2013, its annual sales reached almost ¥934 billion (approx. US\$9.7 billion), of which ¥683 billion (approx. US\$7.0 billion) is for the domestic market (a total of 853 stores), and ¥251 billion (approx. US\$2.7 billion) from its overseas markets (a total of 446 stores). In 2011, according to the company's website, FR was listed as the 4th-largest apparel firm in the world in terms of sales volume.

Second, Uniqlo's business model and operation are classified as SPA (Specialty Store Retailer of Private Label Apparel) because it sells all in-house designed items at its own stores. SPA originally meant that its activities are fully integrated from product design, manufacturing through sales, including material procurement, product design, production, distribution, inventory management, and final sales. Despite this definition, Uniqlo is known for not owning manufacturing facilities in-house. Although all items it sells in its own stores are designed in house, all production activities are outsourced, mainly to

independent Chinese suppliers. Uniqlo seems to enjoy higher flexibility without fixed assets tied up in production facilities and achieve to high quality and low cost production simultaneously. The high performance of Uniqlo's business model is interesting in and of itself and is therefore worthy of a serious investigation to explore our research questions.

### *Data Collection*

We used several data sources in our study. Our secondary data consist of articles relating to Uniqlo's supply chain development. Initially, we obtained 2,425 articles from 12 magazines and newspapers from the Nikkei, Nikkei BP, Asahi, Yomiuri, and Mainichi News databases with the keywords containing "Uniqlo, China, and production or manufacturing". All collected articles were published during the period from January 1, 1990 to November 16, 2012. Once we read through all articles, we chose 327 more relevant articles from the original 2,425 articles. We also utilized the company's annual reports from 2006 to 2011 published on its corporate website and six books written about Uniqlo's business success and problems published in Japan. Additionally, we obtained primary data from interviews with two senior managers of Japanese apparel firms that are considered Uniqlo's competitors and one manager who has been involved in business transactions with one of Uniqlo's main suppliers in China (with a total of three interviews that lasted two to three hours each). Unfortunately, we could not collect interview data from Uniqlo's officials because it is against the company's corporate policy.

The next section summarizes the significant amount of data we obtained from our primary and secondary data sources. We used both primary and secondary data to ensure the consistency of our analysis.

## DATA ANALYSIS AND RESEARCH PROPOSITIONS

Our theoretical framework suggests that a competitive hybrid governance structure should be developed and maintained through building RSAs between a principal firm and its primary suppliers. The competitive RSAs should be achieved through suppliers' cooperative behavior (opposed to opportunistic behavior) and supplier-possessed competence in the principal firm—supplier relationships. Our literature review and longitudinal content analysis provide the background for the development of research propositions. We propose that both exercised economic reward and referent power based on expertise possessed by the principal firm provide a positive impact on supplier's competence development and lead to cooperative behavior by partner suppliers. When the supplier's competence and cooperative behavior is higher, the competitive hybrid governance structures in the supply chain network should be formed in appropriate ways and in a sustained, effective manner, thereby minimizing transaction costs and building competitive RSAs in the principal firm-supplier relationships. The question that should be asked here is how a small firm such as Uniqlo in the 1980s and early 1990s could have developed these powers over time. Our longitudinal content analysis is expected to provide the critical answer to this important question.

### *How to Develop Economic Reward Power and Referent Power Based on Expertise*

Fast Retailing Co Ltd. was founded in 1984 in Yamaguchi prefecture in Japan by Tadashi Yanai, the current CEO of the company, who is well known for starting up Japan's No.1 casual clothing store 'Uniqlo'. In the beginning, because Uniqlo originally started as an independent apparel retail store, it procured almost all items from textile manufacturers and sold them in its own stores. It gradually began to

design its own products and to manufacture at independent manufacturing firms in China (we call them as suppliers in this paper) for differentiation purposes. During the late 1980s and early 1990s, Uniqlo asked some Japanese general trading firms, such as Marubeni, Mitsubishi Shoji, and Sojitsu, to find appropriate Chinese suppliers and to control manufacturing operations as intermediaries. Because Uniqlo needed to learn how to procure apparel products from China at a relatively low cost, its first order was placed at an intermediary to avoid transaction costs which might have arisen from direct transactions with unknown suppliers. Mr. Yanai recollected that their first order to a Chinese supplier was for about 1500 pieces—it was such a small order that the supplier refused to deal with Uniqlo. As most of the leading suppliers in China were already supplying to major Western apparel companies, it was initially extremely difficult for Uniqlo to deal with them on equal terms. In 1994, in its tenth year in business, Uniqlo's sales reached ¥40 billion (approx. US\$470 million) and it had 118 stores located throughout the western part of Japan, while in the same year the American casual clothing retailer Gap already had annual sales of US\$ 3.7 billion with 1260 stores. Uniqlo was still a much smaller client for suppliers in China (Li, 2009:143). At this point, Uniqlo, with trading companies as intermediaries, had transactions with over 100 suppliers in China.

In 1994, Uniqlo launched two major long-term strategic initiatives: accelerating the opening of new stores and developing direct transactions with Chinese suppliers by reducing assistance from Japanese trading companies. By expanding its outlets in the eastern region of Japan, the company decided to open at least 50 stores every year and this initial expansion plan was achieved in the following ten years (with 655 stores by 2004). To supply high quality and low cost

items to the growing number of stores, supply chain reforms by increasing the volume of direct transactions with Chinese suppliers became a strategic imperative for Uniqlo. In 1998, the firm established two production management offices, one in Shanghai, the other in Shenzhen and attempted to select only 40 primary partners out of 120 suppliers to develop more intimate relationships with a smaller number of partners. Uniqlo realized that it was necessary to place a large amount of orders with these selected suppliers to receive favorable terms from them. Yoshihiro Kunii, chief operating officer of the production division, officially announced that at this time the company ordered some tens of thousands to hundreds of thousands of pieces of one product item from one supplier to gain its cooperation because Uniqlo was a still smaller-sized client than Western apparel firms, such as Gap and H&M. By 2012, the average order size per item per factory had reached 8.75 million pieces with a sales volume in billions of yen on an annual basis (Tsukiizumi, 2012: 81-82). To make even larger-scale orders for every item, Uniqlo has tried to minimize the number of variations for each item sold at its stores. According to Mr. Kunii, although the number of items increased from 200 in the late 1990s to 400 in 2012, it was about 10 to 30% compared with the number of items usually carried by its competitors such as Gap and H&M.

In June 1998, Uniqlo installed an advanced information system in its supply chain network, which connected factories, stores and the head office online to achieve even more efficient inventory control and accurate production planning. In addition, the company started sending technical engineers from Japan to its suppliers' manufacturing sites every week to help improve their operational capabilities. From 1998 to 2000, Uniqlo's sales more than doubled, exceeding ¥220 billion (approx. US\$2.7 billion). When the sales volume doubled and the number of

suppliers was reduced by about 70% from 120 to 40, the total transaction volume for each supplier increased dramatically during this period. Exercising this economic reward power on hand, Uniqlo had been able to maintain strong relationships with its selected suppliers over time. By the year 2000, those 40 selected suppliers had developed and improved their manufacturing capabilities by utilizing technical assistance from Uniqlo. They had made a series of relation-specific investments to develop manufacturing lines that were jointly designed to be functionally effective only with Uniqlo. One executive from Uniqlo's competitor mentioned in our interview that some of those suppliers discarded weaving machines that they had installed, and replaced almost all of them with machines to meet Uniqlo's specific requirements. Now some of those primary suppliers are able to respond to flexible manufacturing operations that required carrying semi-finished goods for postponing final production based on demand changes.

From 2000 to 2001, Uniqlo's sales almost doubled again, reaching ¥400 billion (approx. US\$5 billion) with 433 stores. To meet with this rapid expansion, by the year 2001, Uniqlo had selected another 20 suppliers as new partners in China; the total number of partner suppliers reached 65 firms with 80 factory locations. For providing even more effective technical support to those suppliers, Uniqlo newly organized a professional engineering team, called *Takumi*, in April, 2000. According to the company's annual report in 2011, *Takumi* Team, made up of veteran personnel trained and seasoned in Japan's textile industry, played a central role in providing technical support to partner factories. These *Takumi* professionals have a diverse range of backgrounds and skills, with each playing a major role in supporting Uniqlo's product quality. Most *Takumi* professionals are retired veterans who were re-hired by Uniqlo with performance-based salary.



*Takumi* professionals have acquired their own expertise, with over 30 years' experience, such as in cutting, sewing, dyeing, and operation management. One industry official pointed out that Uniqlo's *Takumi* professionals visit their suppliers two or three times a week to provide on-site technical support. On the other hand, technical support staff from Western apparel firms, such as Gap, Nike, and H&M, usually visit sites only once a month, and in some cases just once or twice a year. In the case of Gap, although the company sends over 200 staffmembers to its suppliers' factories in over 40 countries, they are only quality inspectors (Li, 2009: 140) and are not assigned to help develop suppliers' capability.

*Takumi's* support includes both manufacturing-skill improvements and operation management development. The manufacturing skills that *Takumi* needed to teach Chinese workers involve tacit knowledge in nature, so that frequent visiting and joint problem solving are necessary in order to transfer all skills to local workers effectively. For example, in the dyeing process for materials, it was very difficult to keep the exact same color by using different cauldrons, because the temperature and humidity of each site affect the color of finished products in a major way. Therefore, by learning from *Takumi's* tacit knowledge of dyeing, which was complex and uncodifiable, those suppliers have improved their skills in achieving the same finished colors that satisfy Uniqlo's quality standards (Matsushita, 2010: 130).

In operation management development, *Takumi* also helps to reform the whole production process from procurement of raw materials (e.g., original yarn) to final inspections. To achieve total production performance, achieving higher quality, lower cost, and quick responses simultaneously, while pursuing the highest degree of fitness of each process within the total production process is necessary, but the

improvement of each process alone does not offer a critical solution. *Takumi* team has made continual efforts to reform each production process and achieve total fitness of the production system as a whole to achieve just-in-time operations and quick response to orders (Kawashima, 2008: 86-88).

In the fiscal year 2000, Uniqlo produced a total of 300 million pieces with 200 product items (with the average production lot per item being 1.5 million pieces) and 90% of those produced items were manufactured in China. With *Takumi*'s support, those suppliers have improved their operational capabilities continuously to build their own business scale and resource base faster.

In 2002, sales failed to increase as much as the company had expected. In fact, its annual sales volume remained at the same level as in the previous year; therefore, the company decided to reduce the number of partner suppliers from 65 to 40. Because Uniqlo did not have ownership-based control over suppliers, this temporary reform was relatively easier to execute in a short period of time. Uniqlo required 40 remaining partner suppliers to achieve even more flexible manufacturing capabilities to respond to turbulent demand changes by achieving even higher quality and lower cost operations. *Takumi* professionals increased to over 40 members by 2012, who visited as many factory sites as possible to improve their partners' manufacturing capabilities. The company also renewed its supply chain information system to be able to manage all operational stages from material procurement to sales data at stores more efficiently and more accurately. The major challenge for apparel retailers and manufacturers in recent years has been how to respond accurately to turbulent demand changes. Usually the lead time for apparel products is relatively long because there are many manufacturing stages or

processes from material procurement to final inspection. Although most firms must rely largely on their demand forecast to plan for an appropriate amount of production and meet with unexpected demand changes that always happen in the market, Uniqlo has developed a flexible supply chain network that is able to postpone some manufacturing stage until more accurate demand and actual sales data have been collected from its own stores. The development of just-in-time operations at Uniqlo is largely attributed to revamping its total supply chain information system.

As a result, by the mid-2000s the manufacturing capabilities, including cutting, sewing, dyeing, and inspection, of Chinese partner suppliers had improved dramatically. Uniqlo has been supporting those partner suppliers' dynamic growth by offering a large amount of orders and technical assistance and has succeeded in strengthening relationships with them in China. These excellent suppliers consider Uniqlo their primary customer to cooperate with for the long haul. According to Uniqlo's dynamic supply chain network development, we expect that the more economic power the principal firm exercises that rewards partners through providing larger amounts of orders, the more cooperative those partners will become in their behavior toward the principal firm. At an earlier stage in the 1990s, Uniqlo did not have enough economic power to exercise this economic power compared to Western competitors. It is important to note that Uniqlo has gradually increased the scale of orders to each partner by minimizing both the number of suppliers and the number of items sold at its stores. When the suppliers respond to Uniqlo's orders and requirements appropriately, the reward they gain is the promise of greater volume in the next order from Uniqlo.

It also contributes to suppliers' competence generation because they

have more opportunities to learn and improve manufacturing skills and total operation efficiency jointly by responding to continuous orders in large quantities from the principal firm. One manager of a trading company who is in charge of transactions between Uniqlo and one of its major partner suppliers pointed out that being a Uniqlo partner provides Chinese suppliers with a high reputation in the industry. Those recognized suppliers can easily find and start transactions with new clients from advanced nations as well as at home because the clients will accept those suppliers as one of the best skilled factories in China without any doubts.

The continuously exercised and promised economic reward and referent power based on expertise provided by the principal firm also help build trust based on cooperative behavior in the relationship between the principal firm and its suppliers. Trust can emerge either from an affective experience with the partner (affect-based trust) or from confidence in the other party's competence and reliability (cognition-based trust) (Chua, et al., 2009; Jiang, et al., 2011). While affect-based trust in the relationship between the two parties may be built when the psychological and social processes associated with intra-cultural or social group attraction enhance the individuals' propensity to establish affective bonds with others, cognitive-based trust is founded on the predictability of the other party's behavior, dependability, and competence (Chua et al., 2011). A perception of high competence in an overseas business partner will reduce anxiety and uncertainty in transactions with partners, promoting collaboration (Chua, et al., 2011; Tschannen-Moran & Hoy, 2000). In the case of Uniqlo's supply chain network developments, Uniqlo has continued to provide large volumes of transaction when its partners effectively respond to Uniqlo's requirements. Suppliers have understood well that the increase in the

volume of transactions from the principal firm has contributed significantly to their own business growth over time.

In addition, we expect that the more specialized skills and know-how the principal firm provides to the partners, the more cooperative its partners will become in their behavior, thus developing their competence in a more efficient way and also gaining cognition-based trust in the relationship with the principal firm. The principal firm and its partners have come to share the same goal and jointly cooperate to achieve that goal. In the case of Uniqlo, in the beginning the firm did not have special production skills inhouse to help to improve suppliers' competence because Uniqlo had originally started its business with apparel-store operations, not as a manufacturer itself. It is important to note that Uniqlo decided to acquire those special skills over time from outside of the company by hiring retired veterans as *Takumi* professionals to maintain referent power on hand. Based on the above arguments, we suggest the following propositions (see Figure 2):

**Proposition 1:** The more exercised economic reward power the principal firm maintains, the higher the suppliers' a) competence development and b) trust-based cooperative behavior in the relationship with the principal firm will be.

**Proposition 2:** The more exercised referent power based on expertise the principal firm maintains, the higher the suppliers' a) competence development and b) trust-based cooperative behavior in the relationship with the principal firm will be.

**Proposition 3:** The more partner concentration there is in the principal firm's transactions, the greater is the exercised economic reward power that the principal firm will develop.

**Proposition 4:** The more partner concentration there is in the principal firm's transaction, the more exercised referent power based

on expertise the principal firm can maintain.

**Proposition 5:** The more a small-sized principal firm acquires production technologies and skills from outside, the more exercised referent power based on expertise the principal firm can maintain.

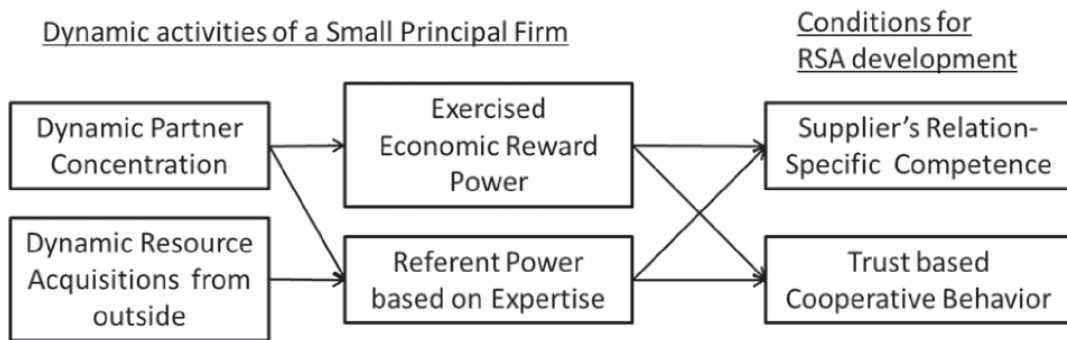


Figure 2. Dynamic Development Model for Hybrid Governance Structure in Supply Chain

## DISCUSSION, IMPLICATIONS AND LIMITATIONS

Our study, by using a longitudinal contextual data analysis on Uniqlo, one of the world's most successful apparel companies from Japan in the last twenty years, aims to reveal the mechanism of how a small-sized firm develops hybrid governance forms in its supply chain networks without ownership control from scratch. Uniqlo has developed its upstream supply chain network with non-ownership controls and has still achieved high quality production with low cost operations and a quick response to market. As we discussed earlier in this paper, a competitive hybrid governance form may achieve higher flexibility such that the company can respond efficiently and effectively to turbulent demand changes. Our literature review suggests that to develop and continuously improve its production capabilities on interfirm settings, the principal firm needs to maintain its suppliers' cooperative behavior, help those suppliers' competence developments, and pursue building

trust in the relationships. By combining our literature review and longitudinal case data, we proposed a theoretical framework and research propositions. There are two factors the principal firm can employ to lead to more appropriate conditions for RSAs developments with partners without ownership control: exercised economic reward power and referent power based on expertise. Both economic and referent power is categorized as rewards. Non-coercive power, including such rewards, is better for avoiding conflicts and generating satisfaction with partners. Receiving such rewards continuously and perceptibly the partners' attitude toward the principal firm would stay positive and cooperative. The data from Uniqlo's supply chain development support this view. Uniqlo has gradually increased its volume of transactions with specific partners and provided technical support to help partners' competence-building and their long-term growth. We call it dynamic partner concentration. With a guaranteed large amount of orders and technical support on hand, Uniqlo could develop and maintain competitive RSAs (i.e., interfirm production capabilities) and trust in relationships with its partners. This approach to supply chain network development we found may be different from that used by those major apparel firms from Western nations. In the case of H&M, the company has transactions with more than 10 times as large a number of suppliers in many different parts of the world as Uniqlo, with 70 partners mainly in China. According to the H&M website, H&M does not own any factories; instead, clothes and other products are commissioned from around 700 independent suppliers, primarily in Asia and Europe.

Our research reveals theoretical implications for the active growth of hybrid governance structures. In other words, we explore views of dynamic capabilities to examine the accumulation process of RSAs in

the supply chain network as a whole. Previous literature on RBV and studies of the Japanese automobile industry have largely focused on examining the relationship between the degree of existing RSAs as the competence and performance of the firm (Dyer, 1996a, 1996b, 1997). The unit of analysis was existing relational transactions between manufacturers and suppliers, with ownership control in most cases (e.g., Takeishi, 2001). Nevertheless, our study focuses on how the principal firm can dynamically build up its supply chain network with hybrid governance forms from scratch. Our data point out sources of power that the principal firm should possess and grow over time. Uniqlo, which began as a small apparel retailer in Japan, came to understand the importance of maintaining economic power and referent power that it did not have inhouse in the early phase of its growth. Therefore, the company decided to reduce the number of partner suppliers and items it sold to be able to provide much larger orders to each supplier (e.g. dynamic partner concentration) so as to gain economic reward power and also it formed *Takumi* team by hiring retired professionals from outside of the company (e.g. dynamic resource acquisitions) as referent power to provide technical support for helping its suppliers' own competence growth. To build up a supply chain network with hybrid governance structures without ownership control, our study suggests that the principal firm should possess and renew its resource basis, dynamically by both, reconfiguring its own organizational capabilities and procuring new resources from outside the staff (e.g. *Takumi* professionals). We may expand on our discussion by examining the dynamic capabilities of the firm (Helfat, 2007; Teece, et. al, 2001) to explain how the principal firm obtains and build its bundle of resource basis over time to develop competitive hybrid governance forms in the supply chain network.



Our research also bears a major limitation that will be a focus of future research. Because we examined the relationships with winning suppliers, not those losing suppliers, for a principal firm, we could not confirm that TCA prediction fails to explain the dynamic hybrid supply chain development with non-ownership control. The modified TCA we have discussed earlier in this paper suggests that in interfirm transactions high asset specificity increases transaction costs because of the opportunistic behavior of partners (Williamson, 1985; Dyer, 1997). TCA views specialized investments as putting firms at greater risk for a “hold-up” or “lock-in” in its transactions. However, our study highlights the mechanism by which to avoid or lower the opportunistic behavior of partners and build trust in the relationship with winning partners only. With exercised economic reward power and referent power on hand, the principal firm may keep up better conditions for RSAs development and lower the risk of opportunistic behavior of winning partners, yet we did not focus on opportunistic behaviors of those losing partners. When the winning partners predict an uncertain future in the transactional relationship with the principal firm by finding out what happened to those losing partners, those winning partners may carry out opportunistic behavior against the principal firm. Dynamic partner concentration may have a negative impact on trust-based cooperative behavior of the winning suppliers. Future research needs to explore the mechanism to minimize the entire transaction cost in the on-going supply chain management as a whole.

Overall, because we chose in-depth analysis applied to a single case study, it is necessary to continue this line of research with multiple case observations and a questionnaire survey with a much larger sample.

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