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AN EXAMINATION OF RELATIONAL GOVERNANCE STRATEGY
IN MANUFACTURER-FOREIGN DISTRIBUTOR RELATIONSHIPS

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ANTHONY STERLING ROATH

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**AN EXAMINATION OF RELATIONAL GOVERNANCE STRATEGY IN
MANUFACTURER-FOREIGN DISTRIBUTOR RELATIONSHIPS**

By

Anthony Sterling Roath

A DISSERTATION

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ABSTRACT

AN EXAMINATION OF RELATIONAL GOVERNANCE STRATEGY IN MANUFACTURER-FOREIGN DISTRIBUTOR RELATIONSHIPS

By

Anthony Sterling Roath

This study addresses a gap in the international distribution channel literature by examining the relational governance issues between the domestic manufacturer and his foreign distributor. Relational governance strategy refers to the activities the manufacturer employs to manage the relationship with an independent partner. The dissertation posits that the manufacturer, who is involved extensively in international distribution activity, emphasizes different dimensions of relational governance. These dimensions represent relational governance "tools" which the manufacturer employs to help influence his ability to performance in the foreign market.

The thesis recognizes that optimal tradeoffs between economic and behavior factors are integral to contractual relationships. Consequently, the study first investigates and conceptualizes the formal structure (legal dimension) and the relational interrelatedness (behavioral dimension) components of relational governance strategy. Second, the framework establishes an empirical basis from which to examine the manufacturer's emphasis on different aspects of the relational governance strategy dimensions. This framework helps to determine how the dimensions influence separately, or in combination, the manufacturer's ability to enhance performance outcomes. The findings indicate that the use of the different dimensions of the relational governance strategy results in different performance consequences in the international

environment. In general, the greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the potential to achieve high performance.

The conclusions from this research offer important insights into the management of offshore relationships between autonomous partners. It also helps to extend research efforts in relational governance strategy by defining and examining relational governance strategy as a concept, which contributes to the competitive advantage of a firm.

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Dedication

Este esfuerzo es para mi alma—juntos, lo realizaremos.

TABLE OF CONTENTS

LIST OF TABLES	x
LIST OF FIGURES	xi
CHAPTER 1 INTRODUCTION	1
1.1 Introduction	1
1.2 Research Problem	5
1.3 Research Objectives	6
1.4 Relational Governance Strategy	10
1.5 Scope of the Dissertation	14
1.6 Research Background	15
1.7 Expected Research Contribution	17
1.7.1 Theoretical	17
1.7.2 Managerial	18
1.8 Methodology Approach	20
1.9 Summary	22
CHAPTER 2 REVIEW OF THE LITERATURE	23
2.1 Introduction	23
2.2 Agency Theory vs. Transaction Cost Economics	24
2.2.1 TCE's Shortcomings	26
2.3 Agency Theory Overview	28
2.4 Shortcomings of Agency Theory	35
2.5 Summary of Agency Theory Contribution	37
2.5.1 Application to International Marketing	40
2.6 The Contract	42
2.7 Relational Contracting	44
2.8 Relational Governance Strategy	49
2.8.1 Relationship Building Strategy	52
2.9 Contractual Dimensions	55
2.9.1 Legal Dimensions	56
2.9.2 Behavioral Dimensions	63
2.10 Conclusion	69

CHAPTER 3	CONCEPTUAL DEVELOPMENT	72
3.1	Introduction	72
3.2	Relational Governance Strategy Framework	75
3.2.1	Relational Governance Strategy	75
3.2.2	Contractual Dimensions (Legal and Behavioral)	77
3.3	Hypotheses Development	80
3.3.1	Proposition 1 –Relational Governance Strategy's Influence on Strategic and Economic Performance	80
3.3.2	Proposition 2 – Strategic Performance to Economic Performance	89
3.3.3	Proposition 3 – Relational Governance Strategy to Economic Performance	91
CHAPTER 4	RESEARCH METHODOLOGY	99
4.1	Introduction	99
4.2	Data Collection	99
4.3	Questionnaire	101
4.4	Sampling Frame	103
4.5	Construct Measures	104
4.5.1	Relational Governance Strategy	104
4.5.2	Strategic Performance	107
4.5.3	Economic Performance	109
4.5.4	Context	110
4.6	Data Analysis	112
CHAPTER 5	ANALYSIS AND FINDINGS	114
5.1	Introduction	114
5.2	Response Rate and NonResponse Bias	115
5.3	Sample Characteristics	117
5.4	Measurement Models	121
5.4.1	CFA for Legal Dimension (Formal Relationship Structure)	123
5.4.1.1	Second-Order CFA	125
5.4.2	CFA for Behavioral Dimension (Relationship Interaction)	127
5.4.2.1	Second-Order CFA	131
5.4.3	CFA for Performance	134
5.5	Hypotheses Testing	138
5.5.1	Interaction of Legal and Behavioral Dimension	142

CHAPTER 6 CONCLUSIONS, DISCUSSION AND IMPLICATIONS OF RELATIONAL GOVERNANCE STRATEGY	154
6.1 Introduction	154
6.1.1 Overall Model Significance	154
6.1.2 Hypotheses Significance	157
6.2 Theoretical and Managerial Implications	162
6.3 Limitations	165
6.4 Research Directions	166
 APPENDIX	 170
Case Interviews	171
 LIST OF REFERENCES	 187

LIST OF TABLES

Table	Page
3.1 Interaction Between Legal and Behavioral Dimensions	96
3.2 Hypotheses Summary	98
5.2.1 Mail Survey Outcome	116
5.2.2 Nonresponse Bias – Early vs. Late	117
5.3.1 Respondent Characteristics	119
5.3.2 Sample Characteristics	120
5.4.1 Goodness-of-Fit Indices for First-Order Legal Dimension CFA	123
5.4.2 Measurement Reliability for First-Order Constructs of the Legal Dimension	124
5.4.3 Goodness-of-Fit Indices for Second-Order Legal Dimension CFA	126
5.4.4 Goodness-of-Fit Indices for First-Order Behavioral Dimension CFA	128
5.4.5 Measurement Reliability for Behavioral Dimension	129
5.4.6 Goodness-of-Fit Indices for Second-Order Behavioral Dimension CFA	132
5.4.7 Goodness-of-Fit Indices for Performance CFA	134
5.4.8 Measurement Reliability for Performance	136
5.4.9 Construct Correlations (Legal and Behavioral Dimension 1st Order Factors)	137
5.5.1 Construct Correlations (Legal and Behavioral Dimension 2 nd Order Factors)	139
5.5.2 Regression Results – Relational Governance Strategy on Performance	140
5.6.1 Comparisons Between Legal and Behavioral Dimensions	145
5.6.2 Comparisons Within Group Means (Legal Dimension)	146

5.6.3	Comparisons Within Group Means (Behavioral Dimension)	146
5.6.4	MANOVA Results of Relational Governance Strategy on Performance	147
5.6.5	Interaction of Legal and Behavioral Dimensions	148
5.6.6	Summary of Hypotheses Results	153

LIST OF FIGURES

Figure	Page
1.4 Basic Model	13
3.1 Proposed Model of Relational Governance Strategy	74
3.2 Hypothesized Relationships	97
5.4.1 First and Second-Order Factor Results for Legal Dimension	130
5.4.2 First and Second-Order Factor Results for Behavioral Dimension	133
5.6.1 Interaction Plots for Performance Objectives on Legal and Behavioral Dimensions	152

1.1 INTRODUCTION

Researchers examining international issues have reflected on the significance of cross-border relationships as one of the fascinating aspects of multinational firms' participation in the global economy (Anderson and Coughlan 1987, Thorelli 1986, Cavusgil and Sharma 1993, Dyer and Singh 1998). The *Financial Times* (July 14, 2000) recently reported that the intensive growth of interorganizational relationships has become an increasingly important issue to firms who strive to ensure they develop capabilities that increase their potential for success. Ohmae's (1989) observations about multinational organization's attention to their relationships captures the essence of global economic competition: "globalization mandates alliances, makes them absolutely essential to strategy" (p. 143). Similarly, Drucker (1995) suggests that business changes are most evident in the growth of relationships as they become based more upon partnership, rather than ownership. Hence, a research direction that holds promising insights into the efficiency and performance of the multinational corporation is the investigation of manufacturer-foreign distributor relationships. The growing awareness of the impact organization structural changes and corporate behavior patterns have on capabilities and performance has motivated managers to review their interorganizational relationships (*Financial Times* 2000). While doing so, management has placed more emphasis on the development of the scope and scale of their cross-border configurations as well as their maintenance.

Although there is a lag between operations and academic study, academe has reacted to these organizational changes. This is evident by a corresponding increase in the types and quality of research on interfirm relationships in the international literature

(Aulakh and Kotabe 1993, Heide 1994, Ring 1996). Weitz and Jap (1995) argued that the focus of practitioners and academics in channel relationship management has shifted from governing corporate channel structures through the use of power and dependence toward understanding and managing relationships between independent firms by employing relational governance mechanisms. Although Weitz and Jap's study is based on a domestic setting, their study has important implications for interorganizational issues in international settings. For instance, Smith et al. (1995) proposed that interfirm collaborations would become an important avenue for firms to pursue as they seek competitive advantages. Other authors have raised the idea that the manner in which a firm maintains its relationship could itself be a competitive strategy (Narus and Anderson 1986) and a competitive capability (Johnston and Lawrence 1988).

Still, others have called for more theoretical work on the dynamism associated with firms' reactions to environmental forces (Bartlett and Ghoshal 1991, Buckley and Casson 1998). Certainly, dynamic forces are a natural part of international relationships. In this context, dynamism can be understood to reflect the complexity inherent to firms' decisions regarding their strategic and operational handling of relationships. This prompts the notion that a firm's reactions are manifestations of management decision-making, which invokes intriguing questions about the management of cross-border relationships. For example, the inability to manage the dynamism resulting from the pressures of globalization drivers (e.g., various national policies, cultures and evolving technology) has led to the demise of many interorganizational partnerships (Rosson and Ford 1982). Sherman (1992) reports that one third of alliances are outright failures citing one example of a study by Harrigan (1988) that claims seventy percent of alliances in the

United States fell short of partners' expectations. These findings suggest that partnerships are fragile entities. If a relationship is a difficult enterprise to manage effectively, how does a company supervise its cross-border relationship in order to optimize the benefits gained from the arrangement?

Further, the international marketing literature has investigated multinational companies' drive behind seeking interfirm relationships and generally considers corporations' motivations to be based upon their desires to develop competitive tangible and intangible capabilities (Anderson and Gatignon 1986, Amit and Schoemaker 1993, Bello and Gilliland 1997). Tangible capabilities include definable processes such as production, R&D, finance, marketing and distribution. Intangible capabilities, which include constructive learning, cross-functional integration/coordination, and entrepreneurship, are desirable elements that can be created and nurtured as social behavior dynamics existing between partners. Indeed, attaining these capabilities, or firm competencies, has been identified as a core managerial concern (*Financial Times* 2000). In their study of CEOs from North American, European and Asian multinational companies, Conn and Yip (1997) report that developing and managing *interorganizational* skills were more of a priority than *intraorganizational* capabilities such as low-cost production. Typical of the comments they received from CEOs of multinational corporations about what they consider to be competitive capabilities is the following, "We have three interlinked capabilities: negotiating, developing contracts, and building relationships" (Conn and Yip 1997, p. 26).

One important insight that can be reached from these observations is that interorganizational structures are conduits for developing valuable assets that add to

competitive capabilities. Consequently, development and utilization of these capabilities require that interorganizational structures be managed actively. This underscores a multinational's *efficiency* approach to international economic participation, suggesting that international research literature should be extended from a market failure approach that investigates cross-border relationship formation to a theoretical framework that examines the *management* of the relationship. The idea of managing a relationship in order to develop competitive capabilities shifts attention to the basic structure upon which the relationship is built and managed—the contractual agreement.

A contractual relationship between the exporting manufacturer and his foreign distributor offers the manufacturer many advantages in terms of strategic and operational flexibility. For example, when confronted with rapidly changing global economic conditions, value-added activities can be coordinated between the parties via the contract to help increase economies of scale and scope, to improve operational efficiency (Lusch and Brown 1996, Bello and Gilliland 1997), to reduce exposure to environmental risks (Stern and El-Ansary 1982, Bello and Williamson 1985), and to increase the organization's alignment with its environment (Kogut 1986, Ghoshal 1986, Ghoshal and Nohria 1993). If the global economy dictates that the multinational company must manage effectively its cross-border relationships in order to enhance value-added activities, the fundamental research problem becomes:

How can a manufacturer manage the relationship with his foreign distributor in order to influence performance?

The research question underlies the starting point and the basic assumption upon which this dissertation is based. That is, the dynamic nature of cross-border relationships

can be investigated within a framework that encapsulates managerial decision-making process tools that are designed to enhance performance in the global economic environment.

1.2 RESEARCH PROBLEM

One of the research avenues that examines the complex issues integral to relationship interaction is relational governance. Arguably, the foundation of relational governance is the contracting basis of relational exchange (Macneil 1980, Nevin 1995). Macneil views the contract as reflecting "the relations among parties to the process of projecting exchange into the future (Macneil 1980, pg. 4). However, previous studies have not examined how the manufacturer actually emphasizes different aspects of the contract to achieve strategic goals. Investigation of this particular aspect of relational contracting especially has been absent in an international setting.

Although industry and academe acknowledge that the contract's purpose is to set forth a definite structure that parties to the contract should follow in case of unforeseen circumstances (Williamson 1985), the parties ultimately have to rely upon more than the formal structure of the contract. The significance of this can be exaggerated in an international setting. Previous research also has examined the role of the contract in relationships yet, results conflict regarding how the contract contributes to performance between domestic partners in a domestic environment (Lusch and Brown 1996) and how performance is manifested by cross-border partners in an international environment (Bello and Gilliland 1997). Thus, if the literature on interorganizational relationships is to advance, it must capture and examine the differences between relationship management that may reflect differences among various environments.

Much of the international marketing literature on inter-firm cooperation focuses on alliance formation issues and in identifying variables that enhance the relational aspects of specific relationships, it has yet to address effectively the notion of relational governance as a set of inter-related activities that are managed through a contractual structure in order to achieve strategic performance objectives. Essentially, implementation or active management remains a neglected area in the relational governance area of international marketing. Indeed, Buckley (1988, 1990) argues that one of the major problems of international theory is the lack of integrating dynamic factors, which may originate in managerial decision-making, into the theory of the multinational firm. Fortunately, some of the recent research directions have worked towards integrating pro-active management into the core theories of international literature (Aulakh and Kotabe 1995, Buckley and Casson 1998).

1.3 RESEARCH OBJECTIVES

The international marketing literature has identified the following main issues. One, interfirm relationships has mainly dealt with the choice of governance structures or the design issues associated with governance structures that correspond to a desired cost (a focus of the transaction cost economics literature). Recently, the TCE literature stream has concentrated on extending its structural design issues to incorporate relational elements that complement governance structures (e.g., trust and commitment, culture, behavioral attributes). The combination of relational factors, as part of governance structures, is then examined for affects on performance (Zaheer and Venkatraman 1995). Understandably, the emphasis has been upon the attributes and boundaries of the

relationship with the relationship as the unit of analysis. Less attention has been devoted to the processes that keep the partnership viable (Rindfleisch and Heide 1997).

Two, the international channel literature has studied relational governance but has yet to define relational governance in the context of a viable strategy that is grounded in interorganizational structures. Neither has the literature defined relational governance that outlines its scope as a management structure. With the increased significance of interfirm collaboration, this concept needs to be defined.

Three, to date, studies that have examined the nature of relational governance have not addressed thoroughly its actual role as the basis of an exporting manufacturer's strategic asset. Although relational governance is recognized as a series of managerial governance mechanisms--a vehicle to control the behaviors of the parties (Dwyer, Schurr, and Oh 1987, Morgan and Hunt 1994, Ganesan 1994, Gundlach, Achrol, and Mentzer 1995, Lusch and Brown 1996, Bello and Gilliland 1997), researchers have not investigated the concept beyond this role. For example, studies have investigated relational governance as it reflects the parties' dependence structure (Anderson and Weitz 1989), power differences (Kumar, Scheer, and Steenkamp 1995), and uncertainties about the environment surrounding the relationship (Etgar and Valency 1983). Yet, in the global economy, foreign distributors arguably have more autonomy and hold more resources that can be attractive to exporters desiring to increase their market. Consequently, governance issues must take a more bilateral form in order to better ensure the partners' survival and success. This prospect raises the question of relational governance as a strategy that can be developed as a company's competitive competency. Accordingly, relational governance may have different dimensions or variables that the

manufacturer can highlight and emphasize to obtain or maintain high effectiveness in the foreign market.

Because these dimensions have not been captured fully in previous literature, the dissertation focuses on this aspect: the manufacturer's utilization of relational governance's structural and behavioral attributes which are formulated as a strategy to increase competitive capability.

The previous discussion illustrates some of the gaps in the international marketing literature. Generally:

- 1) the lack of a robust conceptualization of relational governance as a strategy that incorporates the complexities of the manufacturer's attempts to enhance strategic capability,
- 2) the investigation of how the manufacturer manages relational governance strategy in order to maximize performance; and
- 3) agency theory's application to the concept of relational governance strategy and empirical testing of its dimensions in the context of international marketing channels.

To extend Lusch and Brown's (1996) and Bello and Gilliland's (1997) work and resolve some of the conflicting results, this study suggests investigating the contractual structure as a relational governance strategy that the exporting manufacturer employs in order to enhance attributes of performance (Çavuşgil and Zou 1994).

One approach to the investigation of this phenomenon is to frame the problem in agency theory because agency theory incorporates formal and informal dimensions to explain relationship management from a contractual basis. Within this context, the dissertation focuses on extending the research on the contract's role in international

relationships by concentrating on the following research objectives to support the fundamental research question:

- 1) develop the underlying contractual dimensions of the relational governance (as strategy) concept;
- 2) develop and model a conceptual framework to apply relational governance strategy, which also incorporates organizational and strategic factors;
- 3) extend the development of the relational contract literature by modeling the outcomes of the relationship's utilization of relational governance strategy; and
- 4) extend the generalizability of the international channel literature by applying the concepts, constructs and data frame to the international environment context.

To address these objectives, a conceptual framework is developed that employs the agency theory literature while integrating some elements of the transaction cost economics, and strategic management theories. This conceptual model is illustrated in Figure 1.4.

Consequently, the dissertation attempts to fill the theoretical gaps associated with the treatment of the contract as a static governance mechanism by developing and extending the conceptual development of *relational governance* as a relational strategy governance mechanism. Relational governance integrates the dimensions that highlight the contract as a strategic and operational tool, a tool that facilitates the manufacturer's goal of building an efficient and operationally effective relationship structure. In order to meet these objectives, the dissertation assumes that the contract is the core component upon which to create a strategic asset. This overarching proposition considers the issues regarding the interaction between the manufacturer and distributor and the interaction's affect on overall performance.

1.4 RELATIONAL GOVERNANCE STRATEGY

Relational governance is the conceptualization of an organization's active and on-going intent to manage a relational process by employing a combination of formal and informal governance mechanisms (Dwyer, Schurr, and Oh 1987, Morgan and Hunt 1994, Gundlach, Achrol, and Mentzer 1995). Zaheer and Venkatraman (1995) investigate aspects of relational governance using the transaction cost perspective. They argue that the concept of relational governance suggests, "interfirm exchange which includes significant relationship-specific assets." Further, "relational governance is embodied in both the structure and the process of an interorganizational relationship..." (Zaheer and Venkatraman, p. 374).

Management activities result from management's conscious decision to supervise the relationship as a means to achieve desired ends. The focus on managing activities underscores the idea that managers make decisions to achieve organizational goals, which is the definition of strategy. Specifically, strategy is "a specific pattern of decisions and actions that managers take to achieve an organization's goals" (Hill and Jones, p. 3, 1998). From these conceptual studies and definitions, the dissertation explores relational governance as a strategy the manufacturer implements to achieve desired goals. Subsequently, relational governance strategy is defined in this dissertation as *a firm's active management of the relationship with his foreign distributor that utilizes contractual and behavioral mechanisms to positively affect performance.*

The study adopts Zaheer and Venkatraman's (1995) proposition that these governance mechanisms are outlined in a formal structure and/or enforced in the partners' social interaction. But in their study, they regard relational governance as a vertical

exchange relationship. This dissertation departs from this approach to consider relational governance as a strategy of interorganizational management between autonomous partners.

Thus, this study employs relational governance (as strategy) to represent the manner by which the manufacturer purposely structures the relationship with an independent foreign distributor. The structure is designed in order to manage the interaction so as to ensure that the exporting manufacturer has the capability to obtain strategic and economic performance. Relational governance strategy also is envisioned as a concept that embodies different approaches or dimensions that a firm can use in its relationship management. These approaches are grouped under two different categories: *legal dimension* and *behavioral dimension*.

The *legal dimension* is the extent to which the manufacturer-distributor relationship is governed by formal versus informal guidelines (Dwyer, Schurr and Oh 1987, Lusch and Brown 1996). The *behavioral dimension* represents how the manufacturer manages interfirm interactions in order to develop self-enforcing safeguards (Heide and John 1992, Barton and Weitz 1992). These two basic dimensions capture the relationship's formal guidelines and the self-governing aspects of the contract that could lead to competitive capabilities and competence (Macneil 1980, Williamson 1988, Heide 1994).

The legal and behavioral dimensions do not represent polar ends of a spectrum in contrast to previous studies of relational governance (Dwyer, Schurr, and Oh 1987, Morgan and Hunt 1994, Gundlach, Achrol, and Mentzer 1995). Although the dimensions are related, this study considers them to be separate dimensions of an active strategic

management process. Thus, a company that follows a strong legal orientation does not automatically have weak behavioral process integration and vice versa. For example, the pharmaceutical, telecommunications, and electronics industries may follow a strong legal orientation in order to protect intellectual property rights given the nature of a foreign host's political environment. At the same time, the behavioral dimension (e.g., collaborative information) may not be emphasized due to the company's focus on asset protection. Other combinations of legal and behavioral contractual dimensions are likely candidates of relational governance strategy. Industrial machinery, electronic equipment, and heavy machinery industries may opt for greater use of behavioral dimensions because of their perceived need to develop long-term relations with companies in the host market.

Essentially, the basis of the relational contract as a strategic approach relies upon the premise that the manufacturer endeavors to incorporate the foreign distributor's resources, capabilities, and competencies into his strategic process. In this sense, legal and behavioral dimensions are considered to be unique dimensions that can be separated or employed in combination. Thus, the relational governance strategy concept is a combination of structure and process, which helps to contribute to a more complete description of the complexity and dynamics of the relationship.

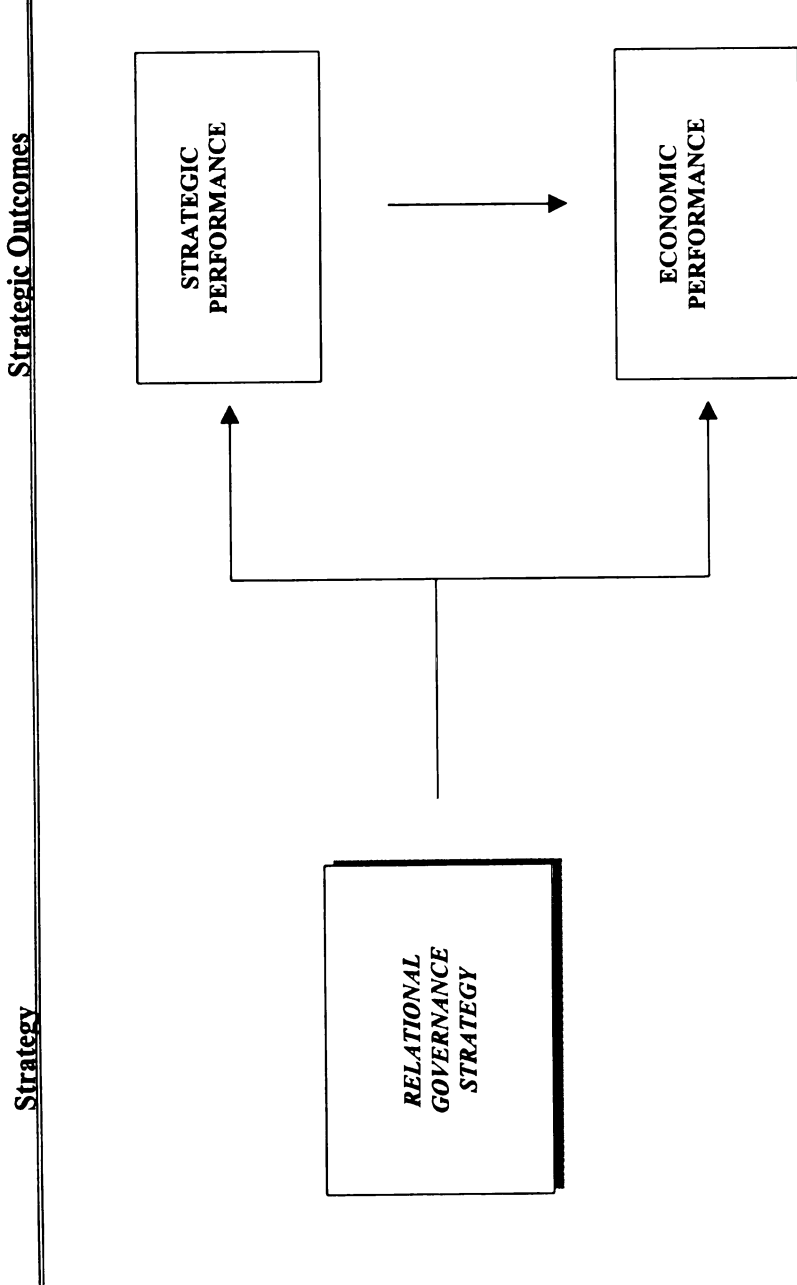


FIGURE 1.4 BASIC MODEL

1.5 SCOPE OF THE DISSERTATION

Lusch and Brown (1996) and Bello and Gilliland (1997) applied elements of Macneil's relational contracting to their investigation of the manufacturer-distributor relationship. Both studies explored the relationship's attributes and its influence on economic performance. Lusch and Brown (1996) examined the relationship in a *domestic* context using primarily the transaction cost economics (TCE) framework. They outlined the attributes that contribute to economic performance and found that the relationship's *behavioral* attributes enhance performance. On the other hand, Bello and Gilliland (1997) studied the manufacturer-distributor relationship in an *international* context using TCE as a basic groundwork to support their theoretical logic. They also examined the attributes of the relationship that contribute to economic performance, but in contrast to Lusch and Brown, found that the *formal* attributes of the contractual relationship enhance economic performance. The conflict in their studies points to some implications that could be investigated using a different contextual forum. Namely that these studies are great illustrations of the literature's focus on defining the attributes of relational governance. Moreover, studies have not extended to defining relational governance as strategy or relational governance's influence on the ability to attain performance.

International scholars have employed TCE as a theoretical underpinning of cross-border relationship management (Zaheer and Venkatraman 1995). Unfortunately, TCE cannot determine how managerial decisions ultimately affect performance (Rindfleisch and Heide 1997, Peng 1998). Its attempt to incorporate some behavioral variables to explain managerial decisions fall short due, in part, to bounded rationality. This point is

understood well. Doz and Prahalad (1991, p. 148) acknowledge "transaction cost economics, by its assumptions...prohibits itself from addressing managerial issues."

Some of the limitations of TCE motivate an alternative approach. Agency theory is appropriate as a theoretical base in this context because agency theory is not concerned with the origin of attitudinal differences between partners or the impact of control mechanisms on the partners to a relationship. This is the domain of TCE. Instead, agency theory deals with the behavioral consequences associated with partner interaction.

1.6 RESEARCH BACKGROUND

Agency theory addresses how two parties attempt to maximize their welfare through a contractual arrangement. Because agency theory views the firm as a nexus of contracts (Jensen and Meckling 1976), the implication is that one party does not necessarily own nor control the actions of the other (Alchian and Demsetz 1972, Eisenhardt 1989). This situation lends itself well to situations of separation of ownership and control; similar to those found in manufacturer-foreign-based distributor partnerships. However, agency theory rarely has been applied to the international channel literature and subsequently has been underutilized in empirical studies of international contractual relationships. To illustrate, Lusch and Brown (1996) recently focused on the nature and consequences of the contract between domestic partners using transaction cost economics (TCE). Yet, the scope of their research limited an explanation of how relational factors, under the influence of an international context affect the management of the contract using TCE. Agency theory could have been a good possibility to use in this study.

Bello and Gilliland (1997) examined the contract between manufacturing exporters and their foreign partners. They explored the impact of bilateral and unilateral controls on foreign market performance from the exporter's perspective but did not investigate the control and cooperative process tradeoffs that are critical to the continuing maintenance of the contractual arrangement. Moreover, their study did not emphasize cultural differences, which ultimately may affect the manufacturer's choice of governance mechanisms.¹ Again, agency theory's propositions regarding managerial decision-making under different risk scenarios could apply to their study.

Succinctly, the studies that have investigated the management of cross-border relationships have an *ex-post* perspective in that they address manager's decisions regarding which variation of interorganizational structure is appropriate in order to correspond with a *perceived* outcome. These studies consistently treat the decision-making structure as passive management and therefore static. In order to address manager decision-making that influences *desired* outcomes, Zaheer and Venkatraman (1995) developed a model of relational governance as a specific form of interorganizational strategy using TCE as a basis from which to develop the governance strategy. They concluded that structure and process dimensions are related as different forms of governance in their model, which supports Celly and Frazier's (1996) recognition that process and structure are unique dimensions of relational governance. Moreover, they call for developing these dimensions, while investigating the performance implications of alternative governance mechanisms (Zaheer and Venkatraman 1995).

¹ For instance, United States managers are considered to have short-term orientations (Hofstede 1994, Trompenaars 1998), to which preliminary case studies have given merit (See Appendix A).

1.7 EXPECTED RESEARCH CONTRIBUTION

1.7.1 Theoretical

Prior studies have examined the manufacturer-foreign distributor relationship using a transaction cost economics approach (TCE). These studies generally explored the issues of governance mechanisms (Robicheaux and Coleman 1994, Bello and Lohtia 1995, Zaheer and Venkatraman 1995, Lusch and Brown 1996), the capabilities needed to achieve performance outcomes (Rosson and Ford 1982) and the relational dimensions of the contractual structure (Lusch and Brown 1996, Celly and Frazier 1996, Bello and Gilliland 1997). In addition, many of these same scholars have recognized that examination of the relationship needs to incorporate behavioral aspects such as trust and commitment. The common theme underlying these studies is the notion that relationships have explicit and normative elements. However, while showing that contracts have explicit and normative elements (Heide and John 1992, Dwyer, Schurr and Oh 1987); these studies have not examined how the manufacturer manages the contract to obtain these performance outcomes. In other words, the literature has not investigated whether strategic performance outcomes result from managing the relationship and whether or not these strategic performance outcomes ultimately influence performance. Yet, rigorous empirical testing of the dynamics associated with these variables in a cross-border partnership is lacking. This indicates that there is a need for research in the area of relationship management. Indeed, Management Science Institute (MSI) has identified the topic as a research priority (www.msi.org, 2000).

This dissertation intends to address these limitations by examining relational governance strategy as a management tool. To add to previous studies, this study

examines agency theory in an international setting to posit that the manufacturer manages or balances legal and behavioral dimensions of the relational structure so as to increase the manufacturer's capability to control factors that lead to strategic capability and high performance. The dissertation incorporates economic and sociological perspectives to position the management of relational governance as an important strategic component. This approach answers Macneil's (1980) and others' (Heide 1994, Bello and Gilliland 1997) assertions that economic explanations of exchange may not completely consider the influence of social components. Further, combining the economic and behavioral perspectives would explain more of the variance of interorganizational exchange in the relational governance process. Further, this dissertation places relational governance strategy in the international context, which has been a rare study objective in the international literature.

1.7.2 Managerial

Due to the complexity and ambiguity surrounding strategic and operational decision-making, managers must make decisions that are consistent with their experience bases. Therefore, the experiences of managers and their perceptions of the environment are key to shaping the organizational structures that support their strategies. For example, TRW has tried to push export responsibility to their Tier I and II suppliers, due in part, to the lack of international experience among the managers of their own company. Instead, many unforeseen problems have surfaced because the suppliers to TRW also lack the technical and managerial international experience that is needed to do the job well. Due to their suppliers' shortcomings, TRW has had to reevaluate their

strategic plans to place more emphasis on developing stronger and interactive contractual relationships with their foreign distributors instead of relying upon their suppliers to manage the intricacies of the relationship.

This dissertation is timely in that periodicals and trade journals regularly report on cooperative international alliances and ventures as firms move in and out of foreign markets (e.g., *Financial Times*, September 14, 2000). One of the main themes common to these articles is the idea that companies seek alliances as a way to take advantage of benefits that accrue from cooperative relationships. Yet, multinational industry also acknowledges the potential drawbacks: "The current Western business fads for win-win negotiating, profit partnerships...and sundry other expressions of the cooperative approach may appear to be a trifle foolhardy" (Ramsay 1990).

This points to the importance of effective relationship management. It is imperative that the principal understand the tradeoffs associated with agency costs in the relationship. For example, as the partners in the relationship evolve and become much more adept at working with each other, the distributor's opportunities for opportunistic behavior may increase. This is because the parties may become more familiar with each other and have greater access to each other's information that they may not receive from market sources. In addition, the parties may have developed specialized assets that are unique to their relationship and therefore become much more exploitable. Even long-term relationships are subject to agent opportunistic behavior. While controlling for opportunistic behavior, the manufacturer may reduce the distributor's incentive for higher performance and cause the distributor to seek alternative choices (e.g., other

manufacturers). Recognizing and controlling for these situations calls for the manufacturer to manage actively.

1.8 METHODOLOGY APPROACH

A framework is conceptualized with the dimensions of relational governance strategy by analyzing contracts and interviewing international lawyers managers that work directly with export operations. The interviews helped to verify common constructs from the literature's theoretical base (MacNeil 1980, Eisenhardt 1989, Celly and Frazier 1996, Bello and Gilliland 1997) as well as to introduce analogous relationships that could be examined. The legal and behavioral dimensions of the contract have been highlighted through interviews with international contract lawyers and managers that work with foreign distributors. In addition, sample contracts have been analyzed for their content. Summaries of these case studies are included in the Appendix. The interviews, in combination with a review of the relevant literature, provide the basis and support for the contract's dimensions that lead to the framework developed in Chapter 3.

The unit of analysis is the relationship, considered to be based upon the contractual arrangement between the U.S. manufacturer and an independent foreign distributor. The key informant is the export manager or an individual from the manufacturing company who is directly involved with the strategic and tactical operations of the relationship. This is an important requirement since the manager must be familiar with overall corporate activities as well as the operations between the company and its foreign distributor. The sampling frame is from a cross section of industries in order to have a greater potential for relational governance strategy variations

(e.g., heavy equipment and machinery, appliances, medical equipment, electronic industry). These industries most likely have developed contractual arrangements with independent foreign distributors as one of many strategic alternatives to foreign market entry and growth.

Existing scales identified through the literature review are modified to suit the research purpose and particular study context. These modified scales are supplemented with interviews from managers and lawyers involved in export operations. The development of the multi-item measure scales for the various constructs was based on Churchill's (1979) suggested procedure. All measurement items ranged from one to seven (Strongly Disagree to Strongly Agree).

The study's constructs are tested for convergent and discriminant validity using confirmatory factor analysis (Fornell and Larcker 1981, Anderson and Gerbing 1988). The measure reliabilities are evaluated by Cronbach's alpha coefficient. Hypotheses testing are accomplished through MANOVA and structural equation modeling (SEM). MANOVA is used to test the mean differences between groups in order to find evidence of different effects of the governance on performance. SEM is an applicable method for this study since it provides testing of interdependencies and interrelationships among constructs as well as an examination of the relationship management's antecedent effects on the dependent variables. In addition, SEM is useful for examining direct and indirect effects concerning the constructs representing relationship management and their influences on strategic outcomes and performance.

1.9 SUMMARY

The first part of the chapter provided the research problem, research objectives and a brief background. The remainder of the chapter addressed the notion of relational governance as a strategic process. One section outlines the expected managerial and theoretical contributions this study can provide to relational governance strategy in the international channel setting. Finally, the chapter introduces the methodological basis for addressing the research problem and objectives. To remain consistent with agency theory terminology, the manufacturer is alternatively referred to as the principal and the foreign-based distributor is the agent. This occurs throughout the dissertation.

REVIEW OF THE LITERATURE

2.1 INTRODUCTION

This chapter analyzes the international marketing channel literature as a basic foundation from which to develop a conceptual model of manufacturer-foreign distributor relationships. The dissertation proposes that the manufacturer manages the relationship through a relational governance strategy by stressing different legal and behavioral dimensions associated with the relationship's contractual agreement. The legal dimensions outline the formal structure of the relationship while the behavioral dimensions reflect self-governing mechanisms. The basic argument presented is that the management process envelops relational governance, which essentially is a strategy the manufacturer employs to influence strategic and economic performance.

Agency theory is an appropriate theoretical basis for the model due to its potential for compatibility on the economic and sociological perspectives of the relationship, yet some elements of the transaction cost economics and strategic management literature streams are integrated in order to address the research objectives. A review of the theoretical approaches (namely TCE's treatment of relational governance), and the agency theory literature is presented. Company examples from interviews are included in order to illustrate some of the motivation behind the application of agency theory's propositions to the dissertation study. This is followed by a literature summary of the contract and the conceptual model's key constructs. The objectives of this chapter are 1) to position the dissertation in the stream of international marketing channel literature, 2) to provide the basis for the dissertation's conceptualization of relational governance strategy, and 3) to identify the areas that would benefit from a greater understanding of

relational governance strategy. Transaction cost economics is highlighted because the theory has been examined extensively as a basis for relational governance and it provides an important foundation for the choice of governance mechanisms to managerial decision-making.

2.2 AGENCY THEORY VS. TRANSACTION COST ECONOMICS

Transaction cost economics (TCE) and agency theory have fundamental differences that lead to their unique approaches to the examination of the firm. Yet, there are many similarities between the two theories to warrant an overview of their approaches. TCE investigates the interaction of the firm with its environment from an economic organizational approach. This approach emphasizes the firms' desire for economic efficiency. For example, TCE explains channel structure development as a function that protects transaction-specific assets from opportunistic behavior. Firms will either internalize the transaction exchange or increase hierarchical control over the other party in the relationship.

To their credit, TCE scholars gradually have advanced the theory to investigate some of the relational elements that agency theory typically addresses (Eisenhardt 1989, Hill 1990, Bergen, Dutta and Walker 1992, Lusch and Brown 1996). This shift in perspective has generated research into the behavioral components of the channel structure, which is highlighted by Stern and Reve's (1980) article integrating the economic and behavioral perspectives into a political economy framework. This framework has introduced interesting and insightful avenues for broadening channel theory. For example, Heide and John (1992) combine the economics of TCE with

Macneil's (1980) behavioral aspects of relational contracting to show that the behavioral norms of relationships help firms to reduce the costs of hierarchical structures and transaction costs associated with opportunistic behavior.

Agency theory also explores the interaction of the firm with its internal environment by combining economic elements with social factors to describe intrafirm interactions. Essentially, TCE and agency theories have closely related conceptual approaches. Their commonality lies in the behavioral assumptions of how firms interact with their environments and to each other under bounded rationality and opportunism. Both theories assume that the parties involved in a relationship are motivated by economic self-interest and will engage in opportunistic behavior. For example, Anderson and Oliver (1987) compare and combine propositions from agency theory and TCE to gain insights about the appropriate conditions for the use of alternative compensation systems to control a sales force. Both theories examine efficiency aspects that deal with how firms organize and monitor relationships. Recently, Bello and Lohtia (1995) used TCE to investigate manufacturers' motivations to use foreign distributors or agents in their export channel network. Transaction cost economics deals with asset specificity as a decision motivator (an antecedent variable), whereas agency theory's antecedent variable is rooted in the risk preferences that motivate the decisions of the principal and agent (Bergen, Dutta, and Walker 1992). Overall, the transaction cost perspective argues that the transaction costs of exchange are the most significant form of governance control motivation (Zaheer and Venkatraman 1995).

2.2.1 TCE's Shortcomings

TCE has some shortcomings that limit a more robust examination of the contractual relationship phenomenon. While TCE focuses on the organizational boundaries and governance structures that result from a firm's management of its transaction costs, agency theory focuses on the contract that is established between the parties, regardless of organizational boundaries (Eisenhardt 1989). According to Wilson and Moller (1995), TCE does not explain the firm's capability to carry out transactions or employ governance mechanisms. This may be one of the reasons why TCE does not address the independence between parties to a transaction. Neither does the theory address organizations that repeat transactions (Ring and Van de Ven 1992). The concepts of trust and commitment are therefore neglected (Granovetter 1985).

Transaction cost economics only examines ex-post governance systems as optimal contract structures that minimize transaction costs, TCE's dependent variable. Since the purpose for the governance structures is to monitor and evaluate, TCE does not go beyond a static environment in which these governance decisions have been made. In other words, the transaction cost options are already established, it is only incumbent upon the manager to choose a governance mechanism that will lead to the established transaction cost outcome. The theory does not address the manipulation of the governance mechanism itself to influence an outcome. Subsequently, TCE's basic focus is to explain how an organization develops boundaries through governance and control, rather than how organizations manage relationships with autonomous partners. Hence, the theory cannot determine directly how managers' decisions actually impact performance. Indeed, Doz and Prahalad (1991) have recognized that TCE cannot address

managerial issues. They state “transaction cost economics, by its very assumptions...prohibits itself from addressing managerial issues” (p. 148).

However, a great limitation of TCE as an economic-based theory is its emphasis on developing organizational and governance structures in order to reduce costs. In contrast to the domain of TCE as an economic cost explanation theory, organizations are adopting approaches that emphasize the value that interorganizational relationships can provide. In other words, organizations are intensifying their focus toward an anticipated value gain from their relationships rather than anticipated losses.

Reiterating earlier assertions, within the context of this study, agency theory views the firm as a series of agreements. Thereby, the theory concentrates on the connections that form the contractual agreements among the different parties. This suggests that the examination of the manufacturer-foreign distributor relationship structure goes beyond TCE’s static study of efficient governance mechanisms to place more emphasis on the relatively more dynamic view that agency theory offers.

In sum, although the TCE approach has been used extensively, it is a market model approach. TCE theorists explain that managerial decisions are based upon manager's perceptions of market failures, therefore, managers look at how best to organize the structure under a “make vs. buy” scenario. Eventually, their decisions concerning transaction cost minimization may lead to a hierarchical development of the firm. Yet, cross-border alliances and partnerships that are not hierarchical organizations are forming with increasing frequency. This practical realization suggests that TCE may not be sufficient to explain multinational firms' activities in the current global economy.

Indeed, more applicable is to study the phenomena of relationship building as an active and manageable process rather than a static investigation of management decisions.

This dissertation follows some of the basis of earlier arguments (e.g., Ring and Van de Ven 1992, Kogut and Zander 1993), which claim that multinational firms seek efficiency by transforming interorganizational processes, knowledge, and know-how into valuable assets and strategic capabilities across their value chains. To investigate the interaction of multinational companies and the management of the manufacturer-distributor relationship, in particular, calls for incorporating the relational aspects of agency theory and relevant governance structure issues of TCE while shifting the fundamental unit of analysis to the contract. Agency theory's concentration on the contractual agreement between two organizations implies independent organizational decision-making and thus a greater reliance on the development of relationships to minimize the risk inherent to agreements between autonomous partners.

2.3 AGENCY THEORY OVERVIEW

The origin of agency theory is rooted in a problem posed by Berle and Means (1932) concerning how a company manages internal functions (from Williamson 1988, p. 568). Their observations and study of company operations led to their assertion that ownership and control of a large corporation were separated, which they believed could possibly lead to problems associated with companies' efficient management of their operations. One situation that could arise from these arrangements is that those who own the company may have different agendas than those who run or control the company's operations. Although the examination of corporate separation of ownership and control seemed to be a promising approach to study the firm, it was not until Alchian and

Demsetz (1972) and Jensen and Meckling (1979) considered this aspect of organization dynamics that agency theory developed further. Consequently, these academics generally are acknowledged as the scholars who originally examined the separation of ownership and control. They are credited with eliciting the development of agency theory and its applications to contractual issues.

Agency theory evolved during the 1960s and 1970s from a major branch of organizational economics. It has generally been examined as an explanatory alternative to the transaction cost economics theory (TCE), which itself is based in organizational economics. Complimentary to TCE, agency theory focuses on the contract that is established between the parties, regardless of organizational boundaries (Eisenhardt 1989). Agency theory looks at the *ex-ante* incentive-alignment of the contract and regards the individual agent, who is the recipient of contractual dimensions, as the unit of analysis (Williamson 1988). Both theories have organization economic roots, but there is a fundamental difference in focus that outlines the delineation between the theories. Transaction cost emphasizes economics as a basis behind decisions involving transactions, whereas agency theory uses its economic base to draw attention to the behavioral aspects that motivate and drive the transaction. Agency theory views the firm as a series of agreements and thereby incorporates the connections that form the agreements, or contracts, among the different parties.

In short, agency theory represents the principal's perspective to address the problems that arise when 1) the goals of the party (principal and agent) conflict, 2) the principal has difficulty in identifying what the agent is doing, and 3) the agent and principal have different attitudes toward risk (Eisenhardt 1989, Bergen, Dutta and Walker

1992). Essentially, the agent may not completely share the principal's goals and may be motivated to take advantage of a situational opportunity because the principal cannot monitor the agent or the agent's actions completely. This inherent conflict is the main thrust of agency theory.

There are two streams of agency theory, the positivist and the principal-agent. Both streams recognize the contract between the principal and agent as the unit of analysis. However, the streams differ somewhat in their dependent variables and mathematical rigor. The positivist stream focuses mainly on identifying the most efficient governance structure that limits the agent's opportunism. Therefore, it concentrates on the factors behind the inherent principal-agent goal conflicts. Eisenhardt (1989) describes two theoretical propositions that illustrate and highlight the basic premise behind the positivist stream. The positivist stream argues that 1) outcome-based contracts are more effective in lessening agent opportunism and 2) effective use of information systems help to restrict agent opportunism.

The other stream of agency theory is the principal-agent, which is the more abstract and mathematically rigorous of the two. In comparison to the positivist stream, the principal-agent stream is more general and has a broader focus in its examinations of theoretical implications. The principal-agent theorists explore ways to determine the optimal contract between the principal and agent while assuming that goal conflict between the two is always present. In addition, the principal-agent stream assumes that the agent is more risk averse than the principal is averse to risk. In summary, the positivist theory examines the different contract types that principals may use to control agent opportunism, while the principal-agent stream analyzes under which contextual

factors (e.g., uncertainty, risk aversion and information asymmetry) the contracts are optimal. The positivist stream does not tie itself to clean economic assumptions and mathematical constraints. Instead, it allows for the possibility of “unclean” managerial behaviors. The principal-agent stream is concerned with optimizing the utility of both the principal and agent’s decisions, yet adheres to strict economic mathematics that ground the theory. In spite of these distinctions, Eisenhardt (1989) emphasizes that the important point about these streams is that they are complementary since both examine manager’s decisions regarding an optimal contract structure. The limitation of the principal agent approach is that it is static. Accordingly, this dissertation follows the positivist stream as it examines the different elements of the contract that affect strategic performance by taking into account the principal's management of the relationship.

Agency theory has few, but important, assumptions that guide its approach to the investigation of the firm’s contractual issues. It assumes that the contracting parties are risk neutral, that they are guided by bounded rationality (defined as behavior that is intended to be rational but cannot due to limited access to information), and that the parties are prone to opportunism. These assumptions are the basis for determining the problems associated with the costs that are always part of the relationship. Three general problems represent the costs resulting from exchange relationships. These costs are recognized as *agency costs* and are borne by the principal (Jensen and Meckling 1976, Eisenhardt 1985, 1989, Fama 1980).

Agency costs are composed of monitoring costs (expended by the principal to monitor the agent’s actions), bonding costs (which the agent incurs to show good faith in honoring the principal’s interests) and residual loss (Jensen and Meckling 1976). The

residual loss is the loss in value from the divergence between the principal and agent's goals and the effect of the divergence on the relationship's outcomes. From the viewpoint of the principal, residual loss is the loss due to lack of relationship efficiency. To minimize these three cost components of the relationship is one of the primary goals of the principal in relationship management.

If the principal and agent are assumed to maximize their individual utility, then the agent will not always act in the best interests of the principal (Jensen and Meckling 1976). Hence, the two primary issues that agency theory addresses is how the principal can reduce agency costs by: 1) establishing a structure that helps monitor the agent's actions so that the principal may align any differences and 2) motivating the agent to work in the principal's best interests. If the manufacturer could manage these approaches by structuring an effective relationship structure and providing incentives that support the working efficiency of the structure it would minimize the agent's potential for opportunistic behavior. Thus, effective management could lead to a more efficient working structure and contribute to enhancing performance.

As implied in Chapter 1, the principal's desire to reduce the agency costs inherent to the relationship is rooted in two basic concepts: 1) the principal can structure and manage the contractual arrangement to transfer risk to the agent and 2) the principal may rely upon a perceived power and dependence advantage to threaten or coerce the agent into adhering to the principal's goals (Sharma 1997, Peng 1998). Contract structuring is designed to address the bonding and monitoring components of agency costs, while relationship management helps to decrease the residual agency costs associated with the inefficiencies of less than optimal relationship management. This is arguably the most

difficult and most crucial component of agency cost (Peng 1998). Regardless, active relationship management encompasses both concepts.

Handling the first approach requires the principal to establish an information system in order to reveal the agent's behavior, assess his skill-levels and determine his ability to fulfill contractual obligations. This option allows the principal to more easily monitor the agent and transfer the risks to the agent if the relationship is managed effectively. The second option, coercion in the context of manufacturer-distributor relationships, is usually accomplished in three basic forms. The manufacturer holds a veiled threat to 1) discontinue the contract with the current distributor and select a new one; 2) discontinue the contract and perform the export operation directly; and 3) discontinue the contract and discontinue export (Karunaratna and Johnson 1997, Peng 1998).

One unique contribution of agency theory is its investigation of information as a strategic asset and its dynamics to the relationship in terms of risk and outcome uncertainty (Fama 1980). Agency theory literature has identified two aspects of the agency problem associated with information asymmetry. These attributes contribute to the principal's agency costs (Alchian and Demsetz 1972, Jensen and Meckling 1976, Eisenhardt 1989). The two factors are the direct result of each partners' propensity to act in their self-interest and refer to the initial principal-agent goal conflict as well as to the principal's problem with accurately monitoring the agent once the contract is established. The first aspect is *adverse selection*. Adverse selection describes the agent's potential for misrepresentation at the time of contract negotiation. For instance, in an attempt to

secure the business of the principal, the agent may claim certain skills and abilities that the principal would not be able to verify (Sharma 1997).

A former vice president in charge of Brunswick Industrial Corporation's export operations provides a good illustration of a way to help mitigate adverse selection. Brunswick developed an international exporting strategy that was based upon sequential market entry through independent foreign distributors. Due to the fact that Brunswick possessed limited resources and experience in international operations, they would require that each bidding distributor develop a three- to five-year business plan. They did so in order to augment their assessment of the distributor's business experience and ability to perform in the market.

“We wanted to find out what the distributor had to offer and whether or not the distributor was capable, financially and operationally, to support our strategy.” (Graham 1999)

The other aspect, *moral hazard*, occurs due to the agent's propensity to reduce his effort, or shirk because the agent recognizes that the principal may not be able to monitor the agent's performance. Basically, the agent may have special skills and/or contacts in the foreign market that he utilizes to fulfill his job as the principal's agent, yet the principal may not be in a position to fully appreciate the agent's skills and therefore could not assess the agent's contribution to performance. In both the adverse selection and moral hazard cases, the agent's claims cannot be verified without access to inside information before or after the agreement has been signed (Eisenhardt 1989).

Instead of threats, the principal may offer any number of initiatives to motivate the agent to work harder and to orient his goals toward those of the principal. Geographic or product exclusivity and taking title to the goods are two common practices

that increase the agent's residual profits, thereby leading to stronger incentives to develop markets on behalf of the principal.

2.4 SHORTCOMINGS OF AGENCY THEORY

Agency theory's origin in economics is a source of conceptual strength as well as a cause of some of its limitations. As Hirsch, Michaels, and Friedman (1987) argue, economic theories have the advantage of carefully constructed assumptions. In addition, they incorporate variables and concepts that have been given relatively little attention in other behavioral sciences, such as the notions of risk preferences, the behavioral consequences of risk sharing, and information asymmetries, all of which are found in agency theory.

On the other side, however, Hirsch and his colleagues argue that economics is dominated by a single paradigm, price theory, and a single view of human nature, self-interest. This narrowness of focus aids the internal consistency of economic theories and its tendency to follow mathematical constraints and assumptions to explain managers' decisions. But it also limits the theory's usefulness for understanding many marketing phenomena, phenomena that are often affected by a variety of human motives and the complexity of contingency variables.

Donaldson (1995) argues that responses to reduce self-interest (opportunistic behavior) are not limited to economic motives. Rather, employees respond to a variety of ways that are not economic. Because agency theory concentrates on the optimum contractual agreement between two parties, the theoretical focus can tend to be narrow as the complexity of behavioral variables makes it difficult to analyze phenomena involving

interorganizational relationships. Consequently, “pure” applications of the theory in marketing have had to center on only the simplest cases or to assume away many of the variables that complicate the decisions faced by marketing managers. Yet, human motives and interactions cannot be ignored in contractual agreements. Thus, it is not surprising that many potential extensions and new applications of agency theory in marketing call for examinations of more complex situations and the incorporation of a broader range of behavioral variables that reflect the sociological aspects of the relationship surrounding the contract (Hirsch, Michaels and Friedman 1987, Eisenhardt 1989, Bergen, Dutta and Walker 1992, Rey and Salanie 1996).

Another shortcoming that has been raised about past agency theory applications is the lack of sufficient rigorous testing of its propositions (Bergen, Dutta and Walker 1992, Lassar and Kerr 1996). Although evidence of more empirical testing is encouraging, it has not been sufficient to resolve questions about the theory's external validity or the generalizability of its propositions. Also, some results must be viewed with caution because of problems in the operationalization and measurement of key constructs. Those problems are exacerbated in some studies because they examine agency propositions at inappropriate levels, testing motivation and incentive concepts that are designed for individual-level models with corporate- or industry-level variables. Unfortunately, agency theory's transition as a form to investigate larger organizations introduces a complexity that is difficult to resolve cleanly.

Other shortcomings related to agency theory's empirical issues include measurements such as an agent's performance. Unfortunately, it is difficult for a principal to directly measure agent performance. One major obstacle of performance

measurement is that if the parties that work together cannot or do not have the ability to monitor each other's activity at any given moment, then an objective outside observer cannot accurately do so. As Rey and Salanie (1996) note, "Moral hazard models a measure of performance that is observed by both parties. Unfortunately, it is generally very difficult for the econometrician to observe performance." Finally, if private information could actually be observable and reduced to understandable and measurable variables, the information would no longer be private; there would be no need to develop monitoring structures, no need to ensure commitment through bonding and no lack of ability to determine performance. In short, with full access to information, there would be no agency conflict.

2.5 SUMMARY OF AGENCY THEORY CONTRIBUTION

Despite these shortcomings, agency theory has a distinctive value in explaining the relationship between the manufacturer and foreign distributor (principal-agent). Consequently, the theory can help predict the consequences of incompatible goals and differences in risk attitudes. In the context of this dissertation, autonomous organizations develop a contract. The principal's aim is to effectively co-align the goals of both partners to reduce the conflicts that inherently arise from differing goals and to minimize any potential for opportunistic behavior. Successful contractual agreements are able to accomplish these objectives (Eisenhardt 1989). Yet, what is intriguing about contractual agreements in the context of cross-border relationships is that the contract, as defined by agency theory, includes the expectation that the principal (manufacturer) does not necessarily have to induce the agent, through potentially destructive coercion, to act in

the principal's interests. The principal recognizes that the agent has goals that may not always co-align with those of the principal. Recognizing this, the principal must work with the agent, as this is the best way for the manufacturer to minimize the agent's potential for opportunistic behavior.²

The partners must be able to develop synergy among a set of mutually compatible goals and create an incentive system that incorporates more than economic objectives in order to increase the efficiency and effectiveness of their relationship (Jensen and Meckling 1976). Agency theory addresses the incentive alignment structure of the relationship, recognizes the behavioral elements that are inherent to any relationship, and allows extending the testing of these elements to an international context. As outlined in the section comparing TCE to agency theory, agency theory's use in describing the manufacturer-foreign distributor setting considers the contractual structure that maximizes the efficiency of individual transactions by balancing different mechanisms such as asset specificity and bounded rationality (Williamson 1979).

In a competitive global environment, the partners in an international relationship may be in a relationship where assets cannot be transferred readily. Under these circumstances, the transaction costs of switching to other partners may be too high: "the level of specialized assets required to support the exchange, and the frequency of exchange are identified as the principal factors that make market-mediated exchange inefficient" (John and Weitz 1988, p. 121-2). However, scholars also recognize that the manufacturer increasingly confronts autonomous and independent distributors, which reduces the opportunity for manufacturers to resolve high market-driven transaction costs

² Agency theory predicts that the two parties will not have compatible goals due to their propensity to be maximize their utility; a reflection of organizational economy (Karunaratna 1997).

through internalization—a governance monitoring mechanism. Therefore, the manufacturer must be able to find and create an efficient and effective relationship structure to minimize costs associated with opportunism while increasing the value-added benefits a relationship can provide. While the exporting manufacturer may be motivated to forward integrate, the transaction costs may not justify the future benefits that could be gained from the risks. Under these conditions, the manufacturer may opt to continue the relationship with an independent distributor as a more viable option that captures the benefits of relational outcomes while reducing *agency* costs associated with the risks. This moves the dissertation study into the domain of agency theory.

2.5.1 Application to International Marketing

Within marketing, agency theory has been used to examine sales force management issues, channel coordination, promotion, market signaling decisions (Bergen, Dutta and Walker 1992) and agency compensation decisions (Ellis and Johnson 1993). One of the more dominating research applications of agency theory, especially within the principal-agent model, is the cost associated with the inherent conflict between shareholders and the managers who represent them. The underlying research question that guides agency theory research is generally, “How well is the agent motivated to maximize the principal’s interest and value considerations?”

However, agency theory's basic appeal to relationship management supports its extension to international marketing issues. Consequently, agency theory is increasingly generating its involvement as a theoretical base to apply across a wide range of areas in international marketing (Aulakh and Kotabe 1995). The areas that have been

investigated from an agency theory perspective include licensing agreements (Horstmann and Markusen 1987), foreign direct investment (e.g., subsidiaries; Senbet and Taylor 1986) and international strategic alliances (Dwyer 1994). Most of the issues investigated have been applied toward examining incentive structures to protect the principal's interests. Underlying these investigations has been researchers' interest in the bonding and monitoring components of agency costs (the incentive costs). Very little theoretical and empirical work has been done on the residual component of agency costs; the costs associated with relationship management. The scant research that has been accomplished in this area primarily addresses the issues and attributes that define and outline the relationship structure. For example, Bello and Gilliland (1997) and Roath (2000) investigate interorganization process and flexibility structures and their effects on performance in a manufacturer/foreign agent context. This follows earlier work that explores the nature of cross-border relationships (Bello and Lohtia 1995) and the attributes that characterize the relationship structure.

As alluded to earlier, a review of the international marketing channel literature suggests that scholars applying agency theory to international marketing have not yet captured the subtleties and dynamics of the manufacturer-foreign distributor relationship. Dynamics are introduced from managers' reactions to their environment. These reactions constitute the behavioral factors of the relationship and arguably should be considered as influential elements that help to frame the contract's structure. Indeed, some studies emphasize the need to examine behavioral factors as components of a definitive structure that organizes the behavior of cross-border partners. Because some of the outcomes predicted by agency theory for minimizing opportunistic behavior are dependent upon the

behaviors of the partners (Gencturk and Aulakh 1995, Bello and Lohtia 1995, Stump and Heide 1996), investigating the international relationship from this perspective may reveal more about the “efficiency” and “optimality” of the contractual structure (Gencturk and Aulakh 1995).

Bonoma (1976) challenged agency theory’s premise that human behavior is opportunistic and only motivated to satisfy self-interest. Bergen, Dutta, and Walker (1992) argue that some applications of agency theory have ignored positive human behavior characteristics and that scholars could make a contribution by incorporating the factors influencing behavioral responses. What these scholars are implying in their analysis of the agency literature is that research should move beyond defining the attribution characteristics of a relationship and toward an assessment of the relationship’s dynamics, which is introduced through managerial decision-making (Buckley and Casson 1998). Furthermore, the fact that managers make decisions regarding how to manage their particular governance mechanism implies that cost-reduction and value creation are considerations within their “choice sets.” This type of investigative attention has been applied sparingly to the international context. One attempt to heed this academic call is to explore the dimensions of the contract, which include behavioral elements that underscore a relationship’s dynamics. These dimensions will be explored further in Chapter 3.

The following two sections introduce the contract as a basic foundation upon which the relationship is built and developed.

2.6 THE CONTRACT

Transaction exchanges between partners are governed by contracts, which are instruments designed to facilitate exchange while preventing opportunism. The contract ensures that parties are able to maximize their investment at minimum cost. The contract provides a structure to the relationship's exchanges that, ideally, suppresses opportunism, increases cooperative behavior, and increases the potential for learning (Cheung 1983, Hackett 1993).

Coase (1937) stressed the importance of transactions as factors behind a firm's decision to produce or buy from the market. He argued that the reduction of transaction costs relative to the costs of market exchange were necessary conditions for the emergence of the firm. He believed that operational logic, which emphasized low costs, would dictate a transaction cost approach to economic organization. Macneil (1978), who wrote later under more global economic conditions, developed a theory of contracts in which he conceptualized a three tiered typology. He called the first tier the 'classical contract' and described it as: "sharp in by clear agreement; sharp out by clear performance" (Macneil 1978). This level reflects an agreement or transaction based upon purely economic terms; one party has what the other wants. However, Macneil observed that this discrete transaction type did not fit the contract processes that commonly emerged under the conditions of uncertainty that defined the emerging global economy at that time. Therefore, Macneil developed a second tier called the "neo-classical" contract in order to recognize the idea that increasing transaction costs, environmental complexity and 'bounded rationality' demanded some flexibility in contracting because not all contract elements could be complete. The fact that parties cannot possibly have access to

or interpret all contingencies forces an incomplete contract. The neo-classical tier includes some of the human factor variables inherent to the reaction of decision-makers to environmental certainty. This neo-classical contract was said to work as long as there was confidence in the partners' ability to resolve any disputes.

With further conceptualization, Macneil (1978) believed that his 'neo-classical' explanation of contract law was displaced by a third tier he called 'relational contracting.' He reasoned that this level would define the richness and complexity of the contract as a mini society that functions under societal norms, which are centered on the exchange and its immediate process (Macneil 1978). These adaptations to the original contract law go beyond formal contract legalities because the relationship elements that bind the strict wording of the contract would not be reflected in a contractual agreement. Thus, the contract has become defined in a much broader scope. In a sense, a purely formal contract, which has strict and explicit language, could be absent or have little status since there would be greater reliance on the spirit of the contract (the relationship building factors) rather than the letter of the contract. According to Macneil, the classical and neo-classical contractual forms concentrate on the contract as the reference point while relational contracting's reference point is the entire relation between the parties as it develops over time (Macneil 1978).

2.7 RELATIONAL CONTRACTING

Macneil (1980) distinguishes between discrete and relational exchange, which has been reviewed and revised for the marketing literature by Dwyer, Schurr, and Oh (1987). Briefly, the summarization of the two types of exchanges is as follows:

Discrete exchanges are characterized by very limited communications and narrow content. The identity of parties to a transaction must be ignored or relations creep in (Dwyer, Schurr and Oh 1987, pg. 12 from *Lusch and Brown 1996*).

Relational exchange is a series of transactions that have a history and an anticipated future. The basis for future collaboration may be supported by mutual assumptions of the relationship (e.g., mutual trust and planning). The participants in the relational exchange can be expected to derive complex, personal, and noneconomic satisfaction through their engagement in social exchange. Because duties and performance are relatively complex and occur over an extended time period, the parties may direct much effort toward carefully defining and measuring the items of exchange (Dwyer, Schurr and Oh 1987, pg. 12 from *Lusch and Brown 1996*).

Scholars have widely accepted that discrete and relational exchange transactions do not represent opposite ends, but rather are part of a continuum of exchanges from discrete to relational features (Anderson and Narus 1991, Dwyer, Schurr and Oh 1987, Heide and John 1992). Essentially, the contractual structure can influence the degree of discreteness or explicitness of the exchange of the exchanges, which Macneil (1980) terms *presentation*. *Presentation* is a concept that is used to denote the extent to which the parties to a contract attempt to compensate for all possible future contingencies through the contract's structure. Contracts can also vary in terms of their normative structure. Normative contracts are those that exhibit mutual understanding between the parties as to how they would react to certain contingencies or changes in their environment. They represent "a social consensus and reinforcement of specific behaviors

and exchange patterns” (Rousseau 1995, pg. 51) and are characterized by socially embedded relationships (Granovetter 1985).

Gundlach and Murphy’s (1993) perspective of relationships is consistent with Macneil’s (1980) argument that an individual or organization in relational exchanges cannot anticipate all contingencies in order to plan appropriately. In their view, the contract serves as a tool that includes many tacit assumptions such as trust to compensate for not being able to predict future events. Gundlach and Murphy (1993) suggested that predominantly legal and formal agreements characterize the transactional exchange end of the spectrum more than the relational end of the spectrum, which they term *ethical principles*.

However, Lusch and Brown (1996) point out that it is important to clarify that explicit and normative contracts are not the same constructs in spite of their relation. For example, a discrete exchange does not necessarily mean that an explicit contract is in place. Neither does a normative contract imply a relational exchange; essentially, a discrete exchange can occur in a normative contract. Indeed, Celly and Frazier (1996) and Bello and Gilliland (1997) found in their empirical studies of international channel management that economic (legal) and behavior-based governance mechanisms are strongly correlated and hinted that each of the mechanisms may play different roles in the relationship. For example, Lusch and Brown found that the manufacturer's emphasis on the relational or behavioral aspects of the relationship led to enhanced performance.

Interestingly, Bello and Gilliland (1997) applied the notion of discrete and behavior-based governance to international relationships. Their empirical result indicated that discrete or legalistic forms of governance contributed to high performance. The

scholars' conclusion contrasts Lusch and Brown's finding that behavior-based control influenced performance. The implication behind these results is that governance is based on different forms of governance; that discrete (legal) and behavior-based controls are separate dimensions that influence the relationship differently, and that these dimensions may be contingent upon the environment. Essentially, this points to the notion that examination of relationships can be extended to focus on the contract and its role as a tool in the maintenance of relationships. Even the Uniform Commercial Code (UCC) recognizes the role of tacit assumptions and its association with the normative elements in the contractual structure.³

A company's intrinsic inability to capture all that a particular environment has to offer leads to intriguing alternatives. In order to understand the environment better, the corporation must rely upon other companies for information and must therefore cooperate. For example, the concept of global strategy implementation among multinational corporations has led to interests in developing cooperative alliances as a competitive strategy alternative (Ghoshal 1986, Harrigan 1988). The implication underlying the nature of a cooperative contractual relationship, as a strategic choice, is that the manufacturer's recognition that some ways to achieve competitive success require a greater emphasis on cooperation. Cooperation between partners helps to promote relational ties that complement economic transactions (Macneil 1980, Williamson 1988) and develop competitive capabilities. In other words, the firm must develop relationship-

³ The UCC identifies three terms that are commonly used in contractual language: *course of dealing* (a sequence of previous conduct between the parties to a particular transaction...to be regarded as establishing a common basis of understanding for interpreting expressions and other conduct); *usage of trade* (any practice or method of dealing with the other party having such regularity of observance in place, vocation or trade...); and *course of performance* (where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other). Thus, any course of performance accepted or acquiesced...shall be relevant to determine the meaning of the agreement (White and Summers 1972).

building factors that emphasize mutual commitment, shared trust, and understanding of the other party's cultural characteristics.

Ghoshal (1987) asserts that a multinational company must be able to achieve efficiencies in its operations, manage risks associated with interorganizational activities and develop internal learning abilities to increase his innovation and ability to adapt to changing conditions. Further, Harrigan (1988) emphasizes that managers must embrace learning in order to use cooperative strategies advantageously to generate their skill base as well as take advantage of strategies to create and deliver value to their customers. Consequently, the manufacturer must be able to manage the relationship actively to cultivate and realize the competitive capabilities that increase positive performance outcomes. When confronted with rapidly changing global economic conditions, activities can be coordinated between the parties via the contract to help increase economies of scale and scope, to improve operational efficiency, and to reduce exposure to environmental risks (Stern and El-Ansary 1982, Bello and Williamson 1985, Kogut 1986, Ghoshal 1986). Thus, a contractual relationship between the exporting manufacturer and his foreign distributor offers the manufacturer many advantages in terms of strategic and operational flexibility.

Nevin (1995) provides a very good description and summary of Macneil's (1980) insights into contractual exchange relationships. As Nevin explains, Macneil's approach to the contract is from a behavioral perspective, which encompasses the "societal relations of custom, status, habit, hierarchical structures, and even past exchange relationships...(Nevin 1995, pg. 329). " Because all contracts are affected by normative behavior, there exist elements of the exchange that cannot be anticipated and described

concretely in a well-defined document—unforeseen circumstances will affect the relationship's exchange. Subsequently, the formality issues of the contract become a way to structure the relationship, whereas the normative behavior guides and supplements the exchange relationship.

The preceding discussion underscores the importance of relational versus discrete transactions. Transactions between the contracting parties rely on a sequence of previous conduct to help determine the meaning and spirit of the contract. In other words, the course of dealing, usage of trade, and course of performance as tacit assumptions can be used to fill gaps that the explicit contract fails to address. Even international law recognizes that norms or tacit assumptions develop and help guide the relationship the longer the two parties are together as “good faith and fair dealing are two important principles that apply to all participants, regardless of nationality, political ideology, or economic goals. The principles can be used as guides for those resolving international contract disputes (DiMatteo 1997).” Therefore, this dissertation follows the logic that the interaction between partners is actually governed along two distinct, yet related dimensions (Zaheer and Venkatraman 1995, Lusch and Brown 1996, Bello and Gilliland 1997).

2.8 RELATIONAL GOVERNANCE STRATEGY⁴

The preceding section provided a good background into the formation and direction of relationships involving structural and behavioral dimensions. Much of the literature now recognizes these dimensions as a firm's relational governance or

⁴ Buckley “[c]ross-fertilization rather than merger seems the most fruitful way to proceed” (p. 47)

governance control mechanisms (Zaheer and Venkatraman 1995). This section continues with the literature's expansion and development of the relational governance concept, while providing arguments to solidify the relational governance concept as a strategy in order to extend its use for examining relationship management.

The control mechanisms used to govern relationships generally are built upon recurrent transactions that have different classifications. Ouchi (1979) proposed control mechanisms to be markets, hierarchies and relational controls (manifested as clans). Heide (1994) examined market controls and reduced them into unilateral and bilateral control mechanisms that are coordinated through monitoring and enforcement. In this way, Heide considered governance across organizational structures to be much more than control because the governance mechanisms could be based on how the relationship is established and managed through mutually evolved behavioral characteristics. Essentially, transactional exchanges can develop into relational exchanges that are based upon different unilateral and bilateral governance mechanisms including markets, hierarchy, trust, commitment, legalities, social norms and reputation. These mechanisms are the building blocks that are key to complex exchanges in channels of distribution (Nevin 1995).

In the context of the export channel, unilateral control is a manufacturer-initiated directive aimed at influencing foreign distributors to perform marketing actions (Jaworski 1988, Sachdev, Bello and Pilling 1994). This orientation has evolved from the literature, which originally treated the concept of control in an intrafirm context (this references earlier literature review of agency theory and the separation of ownership and control). However, later studies of this separation of ownership and control have applied the

concept to an *interfirm* context in which the manufacturer and foreign distributor are autonomous firms. This suggests that the manufacturer's use of unilateral controls is oriented towards *influencing* rather than dictating distributor behavior (Celly and Frazier 1996).

The practice of control has different forms. Scholars have taken the notion of control mechanisms, expanded them and applied them to interorganizational structures. Recent literature has identified two types of control mechanisms that are used to influence agent behavior: *process or behavior* control and *output* control. Process control is the control that the principal uses to manipulate how the agent achieves the desirable performance goals. Process control concentrates on the operations aspects that help to produce desirable outcomes. This control is illustrated by efforts such as promotional practices, training and daily marketing activities. Process or behavior-based controls address the entire process of selling and marketing activities that the manufacturer believes contribute to higher performance. Therefore, instead of concentrating on the end result, the manufacturer (principal) will focus on the process by instituting mechanisms that are designed to influence the distributor (Gencturk and Aulakh 1995, Cadogan, Diamantopoulos and de Mortanges 1999).

In contrast, output control refers to the principal's efforts to influence the actual performance goals. Principals who use outcome control are characterized by their use of monitoring mechanisms, which focus on ensuring performance-based measures such as agent's sales volumes, customer satisfaction ratings, market penetration and other performance-based measures (Ouchi 1979, Bello and Gilliland 1997). For example, Brunswick installed an annual renewal clause (performance expectation clause) into their

contract. If the distributor did not meet these performance standards, Brunswick retained the option of continuing or terminating the partnership. In order to avoid substandard performance or some type of misinterpretation (probably due to lack of international experience), Brunswick included language outlining specific performance goals. In addition, there were usually stiff penalties included in the contract (e.g., if the distributor was caught with product from a competitor, Brunswick had the option of terminating the contract).

Outcome-based control assumes that the agent understands best how to determine the direction and level of effort to achieve the goals. Under this control, the principal transfers risk to the agent by setting the performance standards to which the agent meets. However, the principal remains in a position to monitor the performance of the agent. The advantage to this control arrangement is that the agent has maximum autonomy and an incentive to meet high performance standards since the agent will receive the extra rents (Cadogan, Diamantopoulos and de Mortanges 1999). On the other hand, under the right circumstances, the distributor (agent) has the opportunity to take advantage of the situation and to exhibit opportunistic behavior.

2.8.1 Relationship Building Strategy

Researchers interested in the broad topic of marketing channels began to adopt a behavioral orientation in the late 1960s (Brown, Lusch and Koenig 1984). Since that time a significant stream of research has reviewed behavioral relationships involving power, dependence, conflict and relational norms. Mohr and Nevin (1990) conceptualize channel structure as the degree to which firms resemble either end of the extremes in discrete/relational exchange continuum. Discrete transacting norms include an emphasis

on individual goals, formal communications, and minimal investment in a relationship. On the other hand, win-win negotiation philosophies, informal communication, and high levels of mutual goal setting and planning characterize relational norms (Dwyer, Shurr and Oh 1987). Moreover, the interorganizational structure is established through norms of behavior that both parties understand are necessary for exchanges (Boyle and Dwyer 1995).

Different elements posited to form the relationship structure have been measured in several empirical studies (Robicheaux and Coleman 1994). The studies have gradually evolved from a bureaucratic orientation to include more of a relational tone. Mohr and Nevin (1990) built upon Macneil's (1980) neo-classical approach of contractual exchanges to add norms of behavior that are inherent to parties participating in exchange whether the exchanges are discrete or ongoing. They refer to norms as organizational norms, which are expectations of behavior that are partially shared by a group of decision-makers (Heide and John 1992, Heide 1994). Predictably, norms have been studied in many branches of social science and more recently been applied to marketing.

Although organizational norms have been studied in various branches of channels literature, the general concept has essentially maintained a consistent approach and meaning across literature streams (Heide and John 1992, Heide 1994). In terms of marketing, scholars have operationalized norms as flexibility, solidarity and mutuality (Gundlach, Achrol and Mentzer 1995; Boyle, Dwyer, Robicheaux and Simpson 1992); information exchange, flexibility, and solidarity (Heide and John 1992); formalization, centralization, control and participation (John 1984; Dwyer and Welsh 1985, Dwyer,

Schurr, and Oh 1987); and harmonization of conflict and role integrity (Noordewier, John and Nevin 1990).

Arguably, the market is being transformed into alternative ways of managing governance issues. Most notable is the apparent emphasis on creating closer buyer-supplier relationships (Dwyer, Schurr and Oh 1987) by developing partnerships and interfirm alliances (Anderson and Narus 1990). As touched upon earlier in the differences between TCE and agency theory, TCE approaches these forms of governance as different hierarchical modes, whereas agency theory regards these governance structures as relational governance alternatives that are manifested through the contract. Heide (1994) posits that three distinct approaches to organizing interfirm relationships exist and argues that nonmarket governance is a heterogeneous phenomenon that can be accomplished in a bilateral and unilateral fashion (Heide 1994, p. 81).

The term governance has been defined broadly as a mode of organizing and monitoring transactions (Williamson 1981). Accordingly, researchers have examined different governance structures that are designed to structure and compliment exchanges in market and hierarchy environments (Williamson 1979, Zaheer and Venkatraman 1995). The market and hierarchy polar forms can be distinguished by the nature of contracts they elicit in organizational exchanges. As suggested by Williamson (1991, p. 271), "each generic form of governance needs to be supported by a different form of contract law."

Recently, Zaheer and Venkatraman (1995) investigated an aspect of relational governance using the transaction cost perspective. They argued that the concept of relational governance suggested, "interfirm exchange which includes significant

relationship-specific assets." Further, "relational governance is embodied in both the structure and the process of an interorganizational relationship..." (Zaheer and Venkatraman 1995, p. 374). Others have described relational governance as a conceptualization of an organization's active and on-going intent to manage activities by employing governance mechanisms (Heide 1994, Gundlach et al., 1995, Lusch and Brown 1996). Hence, the relational governance concept is a combination of structure and process, which more completely describes the complexity and dynamics of the relationship. The choice of the form of governance (the structure and process) is defined broadly as the interorganizational strategy of the firm (Zaheer and Venkatraman 1995).

This thesis adopts Zaheer and Venkatraman's (1995) conceptualization that these governance mechanisms are outlined in a formal structure and/or enforced in the partners' social interaction. But, they refer to relational governance as a vertical exchange relationship. This dissertation departs from this idea to refer to relational governance as an interorganizational strategy between autonomous partners.

2.9 CONTRACTUAL DIMENSIONS

The relational governance strategy notion is envisioned as a conceptualization that embodies two contractual dimensions: *legal dimension* and *behavioral dimension*. The contract's *legal dimension* is the extent to which manufacturer-distributor relationships are governed by formal guidelines (Dwyer, Schurr and Oh 1987, Lusch and Brown 1996) and outlines the basic structure upon which the relationship is built. The contract's *behavioral dimension* is an extension of normative governance as it adds further by addressing how the manufacturer *manages* interfirm interactions through cultivating self-

enforcing safeguards (Heide and John 1992, Barton and Weitz 1992). Hence, these two dimensions capture the relationship's formal guidelines and self-governing aspects of the contractual relationship (Macneil 1980, Williamson 1988, Heide 1994).

The literature on the typology of relationship governance is growing, yet there is less that examines the impact of the structural or behavioral dimensions of relational governance as a strategic management decision that is designed to increase the value of the relationship. For example, Heide notes the lack of literature that “systematically explores nonmarket governance forms and their implications for relationship management (Heide 1994, p. 72).” He argues that the ongoing maintenance of interfirm relationships requires that certain processes be performed through four key aspects. The first is an initial system that assigns decision rights to the parties (e.g., roles and responsibilities). The second aspect is an encompassing one that requires the development of planning, which is a system that addressed future contingencies and partnership rights (Barney and Ouchi 1986). The third aspect is an adjustment mechanism that must be incorporated into the relationship to increase its ability to adapt to changing environmental circumstances (Macneil 1978). The fourth key aspect of relationship maintenance is some form of monitoring system in order to determine the degree to which the contractual obligations and expectations are carried out (Ouchi 1979, Rubin 1990). Essentially, Heide's (1994) aspects represent different contractual dimensions of a relational governance strategy. However, investigating the fundamental strategic question of how firms manage their relationships to affect strategic advantage is one of the areas the literature has yet to address.

2.9.1 Legal Dimensions

Contract Existence

The mere existence of a contract between two parties must be established. Contracts are promises that the law will enforce if these promises made via an agreement are not followed. To be legally binding as a contract a promise must be exchanged for adequate consideration. The fact that a contract exists helps to lay the groundwork for the interorganizational structure. The concept of presentation, outlined earlier in this chapter, indicates a characteristic of the western approach towards interorganizational relationships. That is, contractual relationships are based on the common law structure, which is oriented towards self-protection (Oscar Gonzalez, Braumiller & Rodriguez). In contrast, many cultures, particularly the Asian cultures, create informal contracts that are based upon a “handshake” implying that the particular roles and responsibilities are understood inherently as part of a cultural norm. This type of contracting is similar to the “sensemaking” approach to contracting, which is also referred to as a psychological contract consisting of unwritten and largely nonverbal expectations and assumptions (Ring and Van de Ven 1994). In summary, there are many variations of contracts characterizing a relational structure. Indeed, Palay (1984) proposes that contracts should be thought of in a very broad sense. A contract represents a form of governance as well as a formalized, legally binding agreement.

Contract Language

Neoclassical contracts vary in terms of their explicitness, hardness, concreteness, or their degree to compensate for unforeseen circumstance (Macneil 1980, Dwyer, Schurr and Oh 1987, Lusch and Brown 1996). At one extreme, contracts can be written in very

precise detail whereby future situations are anticipated and incorporated in the contract's terms. A high degree of a contract's legal dimensions is illustrated by considerable internal regulations, policies, and procedural approaches. At the other extreme, these neoclassical contracts can have a relational aspect where mutual understanding exists between parties as to how they will interact and deal with each other (Lusch and Brown 1996, Ring and Van de Ven 1992). This degree of a contract's legal dimensions constitutes the partners' complete mutual willingness to cooperate, share information, and to support flexible adjustment procedures to handle future contingencies. Unlike explicit contracts where all contingencies are formalized a priori and are legalistic in nature, the relational or normative end of the continuum reflects "a social consensus and reinforcement of specific behaviors and exchange patterns" (Rousseau 1995, p. 51) and is characterized by socially embedded relationships (Granovetter 1985).

Brunswick Industrial Corporation's general approach to contracting provides some evidence of the attention some manufacturers pay to the language of the contract. Brunswick followed a consistent pattern of market expansion into markets in which they were unfamiliar. In order to protect their assets and strategic position, Brunswick developed contracts under the idea that all contractual agreements were to be as detailed as possible. Honeywell adopted a similar approach, yet used language that would increase the potential for flexibility within the market. Therefore, their contractual agreements were designed to be specific. The company's basic reason behind contracting was to ensure that,

"it operate as a tool to allow us to as flexible strategically and operationally as possible. Therefore...the common contract between us (Allied Signal-Honeywell) and the independent warehouses is usually written to be vague" (Garcia, Allied Signal-Honeywell).

Performance Measurement Orientation

According to agency theory, the manufacturer can take two generic approaches to the relationship. The manufacturer may shoulder the risks that are involved with working together or pass these risks to the agent (Eisenhardt 1989). The decision to the amount of risk that the manufacturer incurs is manifest through the management's specific approach to attaining performance objectives (Gencturk and Aulakh 1995). For example, the manufacturer may prefer to focus on the performance outcomes of the contract versus focusing on the processes that lead to performance, which reflect an incentive/reward structure. Many of the manufacturers that were interviewed usually tried to establish exclusive contracts, which were based on exclusive territory or product, with their distributors. In general, if the manufacturer were in a relatively dominant position over the distributor, they would enforce these contracts with language stipulating performance goals that the distributor should meet.

For instance, Brunswick stipulated that the distributor carry certain inventory levels as well as maintain specific financial assets,

“We required the distributor to meet mutually agreed upon performance standards, which we reviewed on an annual basis. If they did not meet these standards, we would work with them but also expected them to tell us how they were going to improve the next year. If they did not meet our expectations within that time, then we usually moved on to other distributors that could” (Graham, Brunswick Industrial Inc.)

Likewise, Honeywell set performance standards that the distributor must meet and inventory levels that the distributor must hold. However, performance goals were not necessarily mutually determined, as more often than not Brunswick and Honeywell were accustomed to dictating these levels.

Time Orientation

The manufacturer and foreign distributor need to know each other's short- or long-term relationship orientation in order to establish appropriate interfirm management mechanisms. Understanding how long the other intends to remain in the relationship helps to set marketing tools that correspond to the partners' time horizons (Ganesan 1994). In general, manufacturers and distributors with a short-term orientation are mainly interested in performance outcomes that occur in the current or near term, whereas the partners that have a long-term orientation are concerned with achieving current and future objectives. The difference between short- and long-term orientations can also be determined through the nature of interfirm exchanges (Ganesan 1994, Lusch and Brown 1996). Manufacturers with short-term orientation rely upon the market in order to achieve transaction efficiencies and maximum profit. On the other hand, firms with a long-term orientation tend to rely upon their relational exchanges in order to maximize the profits over the duration of their relationships (Anderson and Narus 1990). These relational exchanges interact and ideally, help to optimize the partners' resource synergies.

Brunswick institutes a very thorough due diligence of prospective foreign distributors. The main reason behind the due diligence efforts is to assess the distributor's capability and potential to obtain resource synergies. In addition, the company analyzes the possibility for establishing a long-term relationship by "determining the ability of the distributor...and its willingness and commitment to agreements with our company" (Graham 1999). Once the company has determined that a relationship is viable, they write long-term oriented language into the contract to "lock

in” the shared resources. This language includes periodic training, performance evaluation, and territory exclusivity.

Likewise, TRW has established several different types of contracts with different distributors in Brazil (e.g., product development, distribution) and have begun to create strategic network ties with the foreign distributors that include TRW’s Tier I and II suppliers. The company’s expressed purpose is to **“create a long-term, fruitful relationship” (Williams 1999).**

When relationships are discrete or short-term oriented, explicit language is placed into the contract to codify the informal understandings and commitments (Ring and Van de Ven 1992, Weitz and Jap 1995). The purpose of this language is to ensure a higher degree of continuity in the relationship and to compensate for circumstances that challenge the relationship’s ability to react together. However, Lusch and Brown (1996) argue that a long-term orientation will contain both specific and ambiguous language since contracts are basically coordinating mechanisms.

Conflict Resolution

The relational contracting literature argues that formal and informal process structures should be relatively balanced if the relationship is to take advantage of the partners’ synergistic resources. For example, excessive legal structuring, agent monitoring, and situations that would question commitment or violate trust issues are conditions that could contribute to destructive conflict and ultimately lead to a failing partnership (Ring and Van de Ven 1992).

Stern and Gorman (1969) posit that conflict within a relationship represents a process of change. Researchers have identified the causes and roots of conflict and conflict resolution as key areas in channel relationships (Stern and Gorman 1969, Rosenbloom and Warshaw 1989). Some of the roots of conflicts include role incongruence, resource scarcities, goal incompatibility, communication difficulties, and disagreements over domain decisions (Stern and Gorman 1969, Ghauri 1992). In cross-national business relationships, some researchers emphasized cultural differences as significant sources of conflict (Johnson, Sakano, and Onzo 1993, Parkhe 1991). The concept of conflict as a process of change is extended in the following idea: when conflict is managed and handled successfully in the relationship it could strengthen interfirm personal relationships and increase trust, communication and satisfaction (Cronin and Morris 1989). This is illustrated below:

“...contractual problems, whether strategic or operational are usually handled through mediation and consultation. Much of the problems that could potentially occur in the partnership are filtered through a careful wording of the contract, which includes the legal jurisdiction. Once the contract is set and agreed upon by both parties, the manufacturer’s primary goal is to manage the relationship through trust and mutual commitment to the relationship’s goals rather than rely upon resolving problems through litigation.” (Stuart Deming, international contract lawyer)

Goal Compatibility

Goal compatibility or goal congruence is an agency theory concept that is control-based. Goal compatibility, within agency theory, can also be seen as a performance measure of the relationship because it implies elements of social bonding and trust that embody the relational behavior dimensions of the contract.

The idea of goal compatibility addresses the fundamental problem that arises between independent parties who may have different requirements and approaches to attain strategic or operational objectives. Problems could arise when one partner's goals override or impede the ability of the other to reach its goals (Brown, Lusch and Smith 1991). If the lack of goal compatibility is not addressed to the satisfaction of both partners, the potential for opportunistic behavior may increase, leading to conflict (Eisenhardt 1989).

Underlying these potential conditions for lack of goal compatibility are cultural factors and different risk preferences (Dwyer 1994). In the international context, these differences can be exacerbated by legal, political and economic differences between the manufacturer and foreign distributor. To manage a channel relationship, the manufacturer would have to curb the agent's tendency to behave opportunistically by monitoring its activities or by employing incentive and support systems (Eisenhardt 1989). Anderson and Weitz (1992) have shown that in a relationship with mutually aligned goals, the partners can develop superior benefits in terms of profitability, performance and relationship satisfaction (Karunaratna and Johnson 1997). Therefore, higher goal compatibility could lead to less opportunistic behavior. Additionally, Wilson (1995) considered goal compatibility to result in better channel coordination, performance and satisfaction in the relationship.

2.9.2 Behavioral Dimensions

Collaborative Communication

According to agency theory, information asymmetry is one of the key factors that present dilemmas for exchanges. The notion of information asymmetry implies that one

partner in the exchange has greater quantity and/or quality of information. Both partners, of course, have incomplete information and make decisions under conditions of uncertainty. This illustrates the dilemma of agency theory's definition of adverse selection. Since much of the information is determined by the nature of the relationship, the contract provides a guide that managers working with foreign distributors could follow to manage the relationship. This is especially true if managers are not experienced in international operations. Some incentive mechanisms (e.g., exclusive territory, product) allow the principal to cope with ambiguity from the lack of complete information, but they fail to address some of the underlying informational imbalances that cause the initial agency problem. Without mechanisms to reduce informational asymmetry, coping devices lack the power to sustain multiple, long-term exchanges between manufacturers and foreign distributors (Lee and Jang 1998). Therefore, it is incumbent upon the manager to establish mechanisms within the contractual structure to compensate or control for information asymmetry and reduce agency costs.

Information exchange has been defined as "a bilateral expectation that parties will proactively provide information useful to the partner" (Heide and John 1992); "the exchange of atypical information, particularly long-term forecasting, proprietary, and structural planning information" (Noordewier, John and Nevin 1990); and "the nature and timeliness of information shared by exchange partners" (Anderson and Narus 1990).

Interestingly, information exchange is not one of the elements of relationship structure that is explored very much in the international marketing literature. However, within agency theory, information is regarded as a commodity and a key asset of the relationship. Thus, information exchange is included in the relationship structure as a

component of agency theory. In this dissertation it is defined and operationalized using Heide and John's (1992) definition "a bilateral expectation that parties will proactively provide information useful to the partner." This definition is emphasized since it expresses the idea that partners make a deliberate effort to share information for a specified benefit. Therefore, collaborative communication is used to illustrate this process (Nevin 1995).

Relationship Commitment

Research concerning one of many essential factors that maximize productivity in a distributor organization, commitment, has tended to emphasize behavioral aspects of the distributor-manufacturer partnership over marketing based concerns.

Commitment has been described as an essential ingredient of long-term relationships (Gundlach et al., 1995) because it outlines the partners' desire to instill continuity by demonstrating a willingness to invest resources into the relationship. Morgan and Hunt (1994) support this consensus in the marketing channel literature as they define commitment as "an exchange partner believing that an ongoing relationship with another is so important as to warrant maximum efforts at maintaining it..." (p. 23). The point is that the party committed to the relationship will demonstrate his resolve by investing in human and capital resources specific to the relationship to make the collaboration effort successful and competitive. Commitment is a tangible element that reflects the behavioral involvement with the relationship.

Relational Trust

The role of trust within and between organizations is also recognized in recent organizational research, which draws from diverse disciplines such as sociology, psychology, and economics. The different perspectives of trust these disciplines bring have led to various conceptualizations of the trust construct. Nevertheless, Rousseau, Sitkin, Burt, and Camerer (1998) were able to extract common themes among the conceptual definitions to propose an encompassing definition: "Trust is a psychological state comprising the intention to accept vulnerability based on positive expectations of the intentions or behaviors of another" (p. 395).

Empirical research has detected the benefits of trust in many contexts: it reduces conflict (Zaheer, McEvily, and Perrone 1998), improves individual performance (McAllister, 1995), promotes interorganizational cooperation (Ring and Van de Ven 1992), and increases the commitment of foreign subsidiary managers (Kim and Mauborgne 1993). Demirbag and Mirza (2000) also found that inter-partner relations (e.g., trust, cooperation, friendship) play an important role in the existence or non-existence of inter-partner conflicts and therefore influence parent firm perception of joint venture performance.

Trust may develop between individuals (Johnson, George and Swap 1982), between organizations (Gulati 1995), between individuals and social institutions (Barber 1982), between individuals and organizations (Zaheer, McEvily, and Perrone 1998), and as a general characteristic of different societies (Fukuyama 1995). Thus, the appropriate unit of analysis may be any dyadic relationship between individuals, groups of individuals, or organizations. Moreover, Barney and Hansen (1994) argued that

trustworthiness developed between organizations could become a source of competitive advantage since the primary value of the trust concept is its value to social elements. This social value or “social capital” is one of the key ingredients for organizational survival because it helps to produce cooperation with other organizational partners (Nahapiet and Ghoshal 1998).

One of the goals of developing self-governance mechanisms is to enhance trust among partners with the expectation that trust will influence the relational exchange so that both partners benefit from the relationship. Social exchange theory posits that relational exchanges have social and economic dimensions, whereby the partners work to maximize their individual utility (economics) through the social process. Similarly, agency theory proposes that the principal's emphasis on the behavioral aspect of the social, or relational, exchange helps to maximize opportunity while developing trust between the partners, which serves to curb opportunism and promote cooperation (Dyer and Singh 1998).

Relational Cooperation

In a longitudinal study of joint ventures between Swedish multinational enterprises and local Indian companies, Hyder and Ghauri (1993) found that inter-partner conflicts or cooperation might affect the performance of joint ventures.

Cultural Sensitivity

Social scientists have defined national culture as patterns of thinking and feeling that are parts of the fabric of a society's common values (Jusdanis 1995). Culture has also been defined as a concept that represents a system of values and norms. More

broadly, culture consists of a design for living that is shared among a group of people (Hill 1997). Arguably, the values that a group or society possesses constitute their collective outlook or beliefs in how the members of the group should interact. These values become established and evolve into “appropriate” behavioral standards and norms that tend to vary among different groups and societies (Trompenaars 1998).

Researchers have recognized the underlying influence of culture upon the interorganizational relationship. Sandstrom (1994) considers cultural differences to be a combination of different levels: national, industry, organizational, and personal levels. Even though these different levels are complicated to deduce, Sandstrom posits that they exist for the mere fact that exchange does not take place in a neutral setting. For example, *national culture* influences the business ideologies and general approach to business situations that are generated by a nation. *Industry* level is a set of ideas or a set of values and norms associated with the types of activities and interaction within the industry. The *organizational* level is the pattern of norms and values within an organization and finally, the *personal* level is derived as a subset of national culture.

The distance among national cultures introduces significant influences on strategic decisions. The range in culture from one country to another can introduce risk in entry choice (Kogut and Singh 1988), influence decision-making and subsequently impact future performance. For example, cultural distance between international partners contributes significantly to their conflict management, a relationship’s occasional failure (Tung 1984) and managers' decisions (Tse, Lee, Vertinsky and Wehrung 1988). Bangert (1994) suggested that national culture influences each aspect of bilateral negotiations' processes and outcomes.

Further, extensive empirical research has shown that on average the greater the national cultural distance between two countries, the greater the differences regarding their perspectives and approaches to various situations (Hofstede 1980). For example, countries have varying insights and approaches that result from skills developed through innovation, inventiveness, and entrepreneurship. Hofstede (1980) found these factors to vary significantly across countries under his "individualism-collectivism" polarity (McGrath et al. 1992, Shane 1992). Researchers following Hofstede's (1980) example have shown that firms in countries, which are significantly distant along Hofstede's (1980) "uncertainty-avoidance" and "power-distance" national cultural dimensions, indicate specific differences in their decision making practices and in their power and control structures (Hofstede 1980). National cultural distance between countries has also been associated with significant differences in legal systems, incentive routines, administrative practices and working styles (Hofstede 1980, Ouchi 1979, Shane 1992).

In this study, cultural distance is argued to be cultural sensitivity in that cultural distance is manifested through the manufacturer's sensitivity to the factors that define cultural distance. For example, the manufacturer may have different levels of uncertainty associated with their interpretation of the environment (Kogut and Singh 1988). The manufacturer attempts to control and/or to reduce this discomfort by mitigating the perceived level of cultural distance through contract mechanisms. For example, the manufacturer may increase agent monitoring and information sharing by creating a formal contract structure to address these particular issues, encourage the use of learning processes and ensure their use and work towards adaptation of self-enforcing governance safeguards.

This dissertation proposes that the manufacturer's perception of cultural sensitivity is an important factor that determines its view of the contract as one way to manage the relationship. In this sense, cultural sensitivity is an important factor that manifests itself on the organizational level and becomes more tangible at this point.

2.10 CONCLUSION

In this chapter, agency theory is evaluated as the underlying theory that is applied to this dissertation's investigation of the manufacturer-foreign distributor relationship in an international context. Agency theory scholars argue that skillful management of governance mechanisms can lead to a successful relationship.

TCE is reviewed as a complementary theory because this theory also describes elements of the manufacturer-foreign distributor relationship that are associated with contract (relational) efficiency. Yet, the exclusive application of TCE to the study of manufacturer-foreign distributor relationships is not the best choice because the theory is limited. In particular, the theory emphasizes the development of governance structures in order to reduce costs rather than focuses on the value that interorganizational structures can provide. This fundamental difference in philosophy is contrary to some emerging managerial issues which focus on anticipated value gain from cross-border relationships.

The concept of an efficient and effective relational governance strategy can be examined utilizing agency theory with TCE as an augmenting theory. Because agency theory captures some of the human elements of the contractual relationship, this dissertation proposes that some of these elements should be considered as factors in the contractual agreement (e.g., manufacturer experience, cultural distance) and as outcomes of the contract (e.g., satisfaction). Following the review of the theoretical basis and the

literature's review of these areas, the components of the legal and behavioral dimensions were defined and examined in order to provide a basis for the conceptual model.

In summary, the international marketing channel literature initially examined the issues of interorganizational relationships from the economic or structural efficiency perspective while gradually evolving into the investigation of the behavioral aspects of interorganizational efficiency and effectiveness. Hence, the literature has dealt almost extensively with relational governance as a unilateral and bilateral process of managerial decision-making. Specifically, the studies have focused on relational governance as degrees of formality that embodies relationship management. Because of the focus on describing the relationship's attributes, the literature has largely ignored the actual management of the relationship. Consequently, the goal to identify and develop the factors that contribute to relationship performance and the actual impact on performance itself has led to inconclusive findings.

Much of the literature has been descriptive as it has defined and outlined the variables that are present in cross-border relationships and factors that contribute to performance. Consequently, the literature also suggests that theoretical approaches review several different perspectives of organizational structures and interorganizational behavior regarding the nature of the relationship, its managerial orientations and the outcomes of the relationship. But international channel literature has not investigated fully the link of relational governance strategy and performance. As can be inferred, the empirical evidence and findings related to the impact of the relationship on performance is inconclusive.

To overcome these limitations and oversights requires first, examining the underlying contractual dimensions of relational governance strategy. This is necessary in order to establish its use and robustness as a strategic element of the manufacturer-foreign distributor relationship. Second, models developing conceptual frameworks to apply relational governance strategy should incorporate organizational and strategic factors. Chapter 3 follows with the justification for the major components of the model including the proposed construct measurements and the conceptual development.

CONCEPTUAL DEVELOPMENT

3.1 INTRODUCTION

The conceptual model is created and analyzed on a two-part basis. The first part highlights the manufacturer's relational governance strategy, which argues for the existence of different elements of the legal and behavioral dimensions of relational governance strategy. Basically, the first part of the framework reflects the organization's formal and behavioral structure. The second part examines the performance outcomes of the structure and develops the research hypotheses.

The key factors that form the relational governance strategy are *legal dimension* and *behavioral dimension*. The model's other major constructs include two components of performance, *strategic performance* and *economic performance*. The unit of analysis is the manufacturer-distributor relationship, which is taken from the manufacturer's perspective.

The fundamental model proposes that: 1) the manufacturer's emphasis of the contract's legal and behavior dimensions contributes to the manufacturer's strategic performance and 2) strategic performance contributes to the manufacturer's economic performance. Figure 3.1 represents the conceptual relationships among the key constructs.

This dissertation follows the view that an organization's strategy will lead to the type of organization it will develop in order to support its strategic objectives (Chandler 1982). Accordingly, the underlying proposition is that the manufacturer manages the relationship through a relational governance structure by stressing legal and behavioral

dimensions associated with the relationship's contractual agreement. Differing emphasis on the dimensions of relational governance strategy then have various implications on the manufacturer's ability to enhance strategic and economic performance.

Subsequently, the thesis' context studies the manufacturer's (principal's) perspective of export in which the principal is assumed to be the export initiator and in "control" of export operations. Behind this assumption is the notion that the principal's control of the relationship is considered to be unilateral as it reflects the manufacturer-directed initiatives that are oriented to ensure that the distributor perform the marketing actions that support the manufacturer's goals (Sachdev, Bello and Pilling 1994, Bello and Gilliland 1997). However, underlying this premise is the idea that the manufacturer must consider the distributor's position and goals as part of establishing his overall objectives in the host market.

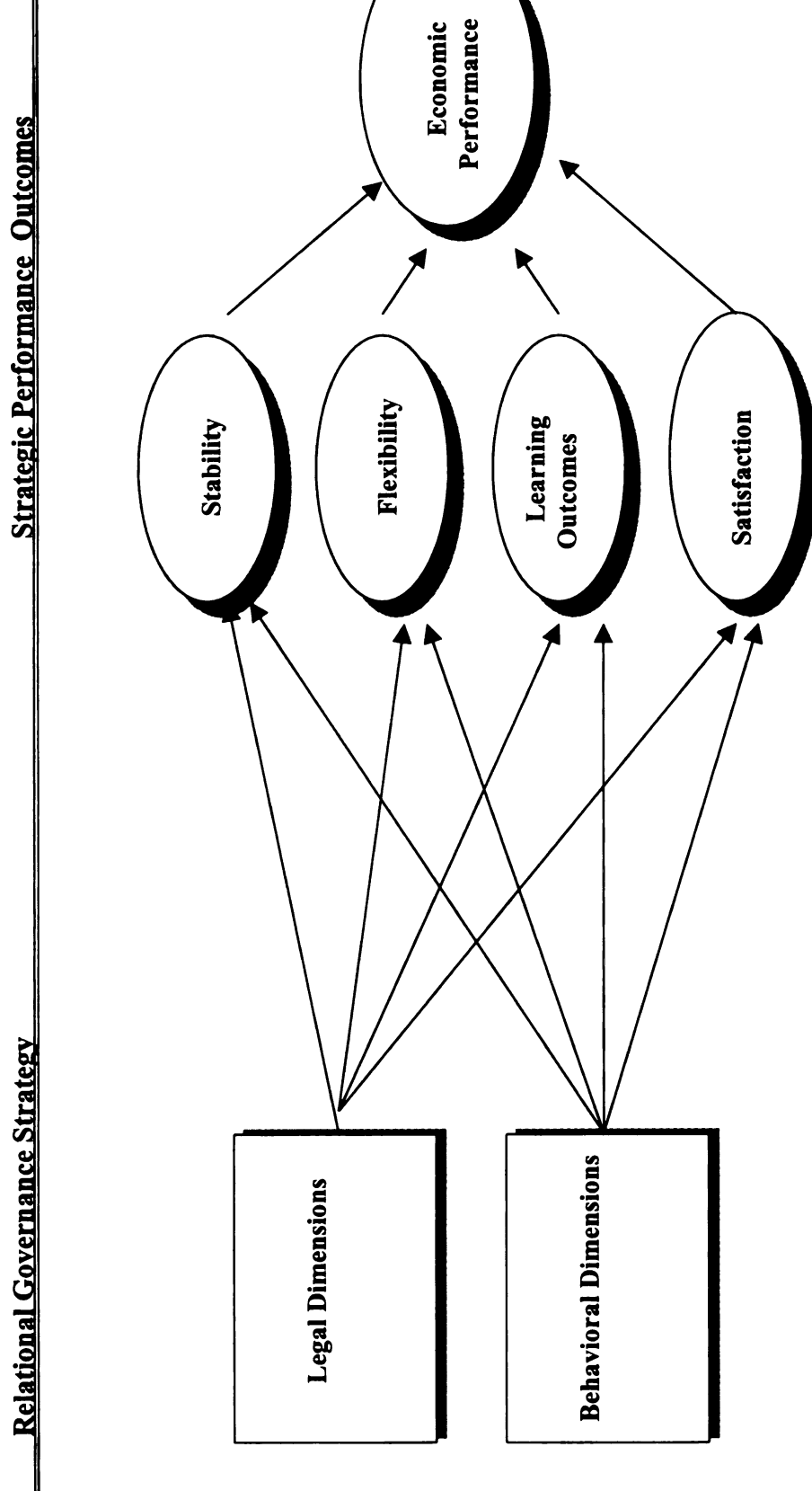


FIGURE 3.1 Proposed Model of Relational Governance Strategy

3.2 RELATIONAL GOVERNANCE STRATEGY FRAMEWORK

The topic in this section covers the firm's capability to organize and manage its resources. It was argued in the previous chapter that relational governance is a strategy that the firm implements in order to gain strategic capabilities that ultimately enhances performance. Managers understand that an organization's capability does not lie solely in its resource strength; it depends upon how the organization invests and utilizes those strengths (Wernerfelt 1984). In a relationship, these resources must be deployed to optimize the combined resources of the partners. Therefore, successful strategy implementation, in the specific case under study, skillful relationship management, occurs when the strategic plan achieves synergy with the goals and expectations of both parties. Otherwise, a lack of success can be traced to poor strategic implementation, poor strategy or both (Thompson and Strickland 1993).

3.2.1 Relational Governance Strategy

The term governance has been defined broadly as a mode of organizing and monitoring transactions (Williamson 1981). Accordingly, researchers have examined different governance structures that are designed to structure and compliment exchanges in market and hierarchy environments (Williamson 1979, Zaheer and Venkatraman 1995). The market and hierarchy polar forms can be distinguished by the nature of contracts they elicit in organizational exchanges. As suggested by Williamson (1991, p. 271), "each generic form of governance needs to be supported by a different form of contract law." Williamson also recognizes that non-economic forms of governance are essential to relationship maintenance, but contends that economic forces (e.g., asset

specificity, asset commitments) support these forms. On the other hand, Macneil (1980) conceived of exchanges in a relationship that were not supported by economic forces.

Zaheer and Venkatraman (1995) investigate this aspect of relational governance using the transaction cost perspective. They argued that the concept of relational governance suggested, "interfirm exchange which includes significant relationship-specific assets." Further, "relational governance is embodied in both the structure and the process of an interorganizational relationship..." (Zaheer and Venkatraman, p. 374). Thus, the relational governance concept is a combination of structure and process, which more completely describes the complexity and dynamics of the relationship. The choice of the form of governance (the structure and process) is defined broadly as the interorganizational strategy of the firm (Zaheer and Venkatraman 1995).

Others have described relational governance as a conceptualization of an organization's active and on-going intent to manage activities by employing governance mechanisms (Heide 1994, Gundlach et al. 1995, Lusch and Brown 1996). This dissertation adopts Zaheer and Venkatraman's (1995) conceptualization that these governance mechanisms are outlined in a formal structure and/or enforced in the partners' social interaction. But, they refer to relational governance as a vertical exchange relationship. This dissertation departs from this idea to refer to relational governance as an interorganizational strategy between autonomous partners.

Management activities result from management's conscious decision to supervise the relationship as a means to achieve desired ends. The focus on managing activities underscores the idea that managers make decisions to achieve organizational goals, which is the definition of strategy. Specifically, strategy is "a specific pattern of decisions and

actions that managers take to achieve an organization's goals" (Hill and Jones, p. 3, 1998). Accordingly, the dissertation explores relational governance strategy as a strategy the manufacturer implements to achieve desired goals. Subsequently, relational governance strategy is defined in this thesis as *a firm's active management of its relationship by establishing contractual mechanisms to affect performance*.

3.2.2 Contractual Dimensions (Legal and Behavioral)

Basically, the contract is the foundation upon which relational governance strategy can be implemented. In order to examine this aspect of the relationship, it is necessary to establish the dimensions of the contract as elemental "tools" that the manufacturer can manage. As implied earlier, agency theory is not concerned with how attitudinal differences between two partners began nor does agency theory address the impact of control mechanisms on the partners to a relationship; agency theory deals with the behavioral consequences associated with partner interaction.

Academically, scholars have recognized that contractual relationships have an economic (in this case, formal/explicit or explicit) dimension as well as a behavioral or attitudinal dimension (Macneil 1980, Dwyer, Schurr and Oh, Eisenhardt 1989, Heide 1994). The formal aspect corresponds to the legal dimension of the contract, whereas the attitudinal aspect comprises the behavioral dimension. The manufacturer can apply the legal and behavioral dimensions separately or in combination to mitigate some of the agency costs associated with the options outlined previously.

As argued in earlier studies, most of the exchanges between exporting manufacturers and foreign distributors (importers) do not exhibit characteristics of the polar forms of markets and hierarchies (Dwyer, Schurr, and Oh 1987, Heide 1994). In

particular, export manufacturer-distributor exchanges, by their nature are recurrent and increasingly likely between autonomous partners, given the current economic environment. Since the manufacturers rely on the foreign firm to market their products and services in the host country, both parties have to make some unique and specific investments to effectively consummate these exchanges (e.g., manufacturers adapt the product and packaging to requirements of the importing distributor, the distributor invests in training salespeople, advertising and promotion specific to the manufacturer's products). Hence, these exchanges do not necessarily follow the market-based exchange model, the one-shot discrete transactions between faceless parties.

Similarly, because export manufacturers and foreign distributors maintain their separate legal identity, these market exchanges cannot be governed by hierarchy-based authority structures. Indeed, manufacturer-foreign distributor exchanges are more of an intermediate form between a market and a hierarchy whereby neither party attains the full benefits or the full costs of the two extremes (Harrigan 1988).

Interorganizational exchanges where transacting parties "maintain [legal] autonomy but are bilaterally dependent to a nontrivial degree" (Williamson 1991, p. 271) are governed by neoclassical contracts (Macneil 1980, Ring and Van de Ven 1992). A neoclassical contract is based on the recognition that the world is complex and that agreements will never be reached unless both parties create some type of mutual understanding and respect (i.e., contracts will have to include elements other than pure legal language and structures). Such contracts facilitate continuity between parties based on elastic mechanisms that promote efficient adaptation in light of future contingencies (Williamson 1991).

The previous discussion reasons for the existence of legal and behavioral dimensions of relational governance strategy. The following hypotheses address the legal and behavioral dimensions of the contract and its influence on strategic performance dimensions.

In summary, the legal dimensions of the contract are those that outline the specific guidelines designed to address as many unforeseen circumstances and contingencies as possible (Moorman, Deshpande and Zaltman 1993, Dwyer, Schurr and Oh 1987). The partners' roles, responsibilities, procedures and sanctions are written into the structure of the relationship because they wish to avoid an incomplete contract. One international lawyer working with international contracts explained the role of the contract succinctly,

“Manufacturers design the contract to address the “what ifs” or the various contingencies and circumstances of the partnership. Therefore, the contract usually will have explicit language, identify partner roles and specific responsibilities.” (Deming 1999)

The behavioral dimensions of the contract reflect the relational norms of the interaction between the partners. These are the dominant norms of behavior that characterize the exchange transactions. They include informal communications, mutual trust and collaboration. Collectively, relational norms represent a higher order construct (Noordewier, John and Nevin 1990, Heide and John 1992, Gundlach and Achrol 1993). The literature's definition and treatment of relational norms, as well as the underlying factors are analogous to the behavioral dimensions. The following comment from a manager working with Japanese distributors captures the spirit of the behavioral dimension,

"There is greater attention to quality and service due to the fact that there is no explicit contractual terms to fall back upon—requiring more emphasis on the

behavioral aspects of the relationship...the companies even work together to identify and overcome potential conflicts."
(Clemen-Hopkins 1999)

Essentially, the contract's *behavioral dimension* is an extension of normative governance, because it adds further by capturing how the manufacturer manages interfirm interactions in order to develop self-enforcing safeguards (Heide and John 1992, Barton and Weitz 1992).

3.3 HYPOTHESES DEVELOPMENT

3.3.1 Proposition 1—Relational Governance Strategy's Influence on Strategic and Economic Performance

The manufacturer's choice of a relational governance strategy (i.e., emphasis on the legal or behavioral dimensions of the contract) will determine the strategic and economic performance outcomes of the relationship.

Much of the recent international marketing literature that has dealt with manufacturer-distributor relationships has explored the effect of the relationship on some aspect of performance (Harrigan 1988, Heide and Stump 1996). Indeed, most of the measures of performance have been economically oriented although researchers have recognized the importance of the multidimensional nature of the performance construct (Chakravarthy 1986, Mathyssens and Pauwels 1998). One definition of performance that has been used to investigate the strategy-performance link is the extent to which a firm's objectives are achieved through planning and execution of the firm's strategy (Cavusgil and Zou 1994). Assuming that partnerships between the manufacturer and distributor are formed to reduce the risks involved in overseas operations, exporting manufacturers should place priority on aspects of strategy, supply chain relationships, and organizational structure.

The multidimensional quality of performance is important to the relational governance strategy-performance link because the relational governance strategy process may lead to favorable outcomes on one dimension and unfavorable outcomes on different performance dimensions. For example, organizations that emphasize communication through information exchange believe that information is one of the keys that strengthen the alliance (Mohr and Nevin 1990). To illustrate further, the emphasis on the legal dimension of relational governance strategy may restrict the relationship's ability to react rapidly to market conditions due to the fact that rules and procedures can restrict and confine decision-making. This may ultimately lead to lower performance because of the reduced ability to reach lucrative markets. Essentially, the potential synergies from the relationship may not be effectively and efficiently employed, which could detract from short- and long-term profitability.

Further, this dissertation's treatment of performance must be explained since it is very difficult to gauge accurately the factors contributing to the performance of firms operating in foreign markets. In order to address the multidimensionality of performance, it is either necessary to investigate the individual indicators of performance or to build a composite factor of performance measures. The export literature that examines performance indicates that most researchers consider performance measures individually rather than as a composite measure (Matthyssens and Pauwels 1997). Therefore, research should consider different dimensions and not confine performance along a narrow dimension of performance. Multiple measures of performance should be used to avoid shortcomings and lack of performance measure robustness (Lumpkin and Dess 1996).

Accordingly, this dissertation measures performance on five aspects of efficiency and productivity: stability, satisfaction, flexibility, and learning outcomes and economic performance. The responses were framed in terms of the relationship's outcomes, what the manufacturer expected from the relationship and the performance relative to other firms in the industry. The performance variables represent the manufacturer's perception of the relationship's performance and the strategic gains the manufacturer believes he is obtaining from the relationship with the distributor. Moreover, the performance dimensions reflect subjective evaluations obtained from interviews with export managers who have expressed their perceptions of the company's achievement of important strategic objectives. Thus, they measure interorganizational effectiveness and efficiency in order to reflect the unit of analysis.

Analyzing relational governance strategy outcomes in this manner follows Kumar, Stern and Achrol's (1992) use of subjective measures as surrogate measures of objective performance and is in line with Lusch and Brown's (1996) application of subjective measures to determine outcomes of contracting and relational behavior in the manufacturer-distributor context.

Finally, research indicates that industry effects on performance are significant (Rumelt 1991). One way to control these effects is to employ measurements that ask respondents to provide a determination of their performance relative to their competitors (Judge and Douglas 1998). This particular aspect has been captured in the performance measure.

Therefore, contrasting and comparing manufacturers that rely on either the legal or behavioral dimension of relational governance strategy should provide a meaningful

analytical framework. If manufacturers are grouped into dimensions based on their relative reliance upon one of the relational governance 'tools,' we could gain a better perspective of the consequences, or outcomes, these tools provide. A 2 X 2 matrix is developed in order to illustrate sharper contrasts among the differences between the legal and behavioral dimensions. This analysis should provide a clearer focus of the effects of relational governance strategy.

Stability. If the manufacturer and distributor are in a relationship that has high goal conflict between them, the manufacturer may well manage the contractual relationship as if to directly control the actions of the distributor (Karunaratna and Johnson 1997). This management style may be appropriate if the distributor is risk-averse in conditions where outcomes are not predictable because the partners do not totally agree on a proposed set of mutual goals. In a relationship where goal conflict is high, the manufacturer will dictate appropriate behaviors through contractual language and impose certain behaviors upon the distributor. These behaviors include, for example, maintaining specified inventory levels, defining territory boundaries, specifying certain products and outlining customer service issues (Lusch and Brown 1996, Bello and Gilliland 1997). Under this scenario, the manufacturer's strict specification of terms for a risk-averse distributor will contribute to the stability of the relationship; the manufacturer will have more direct control and the distributor will know the relationship's expectations.

H1a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the greater the relationship stability.

H1b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the relationship stability.

Flexibility. Strategic flexibility is the ability to modify methods to achieve strategic objectives while lowering strategic opportunity costs in rapidly changing environments (i.e., strategic flexibility reduces path dependencies). Strategic flexibility represents a desired outcome of the contractual relationship, as it is a good-faith effort to modify actions when confronted with changing circumstances. Each party in the partnership must be willing to make variations in their processes and with each other in order to meet variations in demand. Indeed, one export manager from a large automotive supplier commented that the demand in the Brazilian market “fluctuated so much that we had to make the contract rather ambiguous regarding inventory requirements.” This example suggests an attempt to structure the relationship to provide a high degree of latitude for both partners to modify their operations when necessary. The flexibility with which the manufacturer and distributor respond to rapidly changing circumstances ultimately may determine the manufacturer’s survivability. Therefore, the manufacturer who manages the contractual structure using highly legal and restrictive dimensions would bind the partners to rigid responses in changing circumstances.

H2a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the lower the relationship flexibility.

Contrarily,

H2b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the relationship flexibility.

Learning Outcome. Bartlett and Ghoshal (1998) argue that the focus of managers in international organizations has shifted from organizational planning to increased emphasis on organizational learning. In other words, companies’ goals become how to develop an organizational capability to understand, interpret, and respond to

environmental circumstances. Within the context of the international supply chain, knowledge that can be integrated between the firms is one of the most essential ways to develop strategic capability and competitive advantage (Nonaka 1994). Helleloid and Simonin (1997) maintain that developing organizational learning capabilities is critical for guaranteeing core competencies and enhancing competitive advantage. Systematic learning processes designed to enhance a firm's strategic capability are an integral part of the firm's strategic planning and motivation to improve competitive positioning. Hamel (1991) summarizes his view that firms are viewed as portfolios of core competencies that require sustained and systematic renewal. In their model of the Industrialized Corporation, Bartlett and Ghoshal (1998) proposed that organizational learning could be achieved through horizontal information flows by fostering an organizational culture of mutual trust and cooperation. Given that firms' success and failure depend upon the interactions with other firms, then arguably, success and failure may depend upon the firms' application of the lessons they learn from these relationships (Simonin 1997).

Simonin's study of international automotive partnerships revealed that a firm's interfirm collaboration and experience alone did not guarantee that the firm would obtain good performance from future partnerships. From this study's results, Simonin argues that *know-how* rather than *experience* is a more important factor to develop the trust and reputation that is valuable to relationship building and management. In his view, experience gained from interfirm collaboration may be a limiting factor in a firm's desire to gain knowledge from the relationship because experience can be imitated and actually duplicated by allying with firms that have the expertise in a particular area that is

recognized as deficient. Therefore, experience can be a result of time invested in the relationship and not necessarily a factor that contributes directly to knowledge gains.

A structure has to be included via the contractual agreement in order to ensure that knowledge transfer occurs and is protected as a relationship's asset. Therefore, it is proposed in this dissertation that firms apply lessons to new partnerships but their ability to manage effectively the knowledge bases that are crucial to enhancing competitive advantages is accomplished through the contractual structure. Some of the mechanisms of knowledge dissemination include systems for information sharing such as training sessions and periodic benchmarking visits.

The formal or legal dimension of the contract concentrates on certain factors (e.g., specific roles and training requirements) to gain relational benefits and to determine the attainment of performance objectives; albeit, with the distributor's input. Yet, Ohmae's (1989) argument that the financial aspects of performance objectives, as spelled out in the legal structure of the contract, do not fully represent the benefits of the partnership seems to be supported. On the other hand, Crossan and Inkpen (1995) report that managers use performance as an indication of learning; implying that knowledge dissemination or learning must have a behavioral aspect that is not necessarily codified in a contractual agreement. These intangible benefits are posited to be knowledge-based because learning occurs through individual training, personnel exchanges, interfirm operations, and cross-functional teaming between the partners (Hamel 1991, Crossan and Inkpen 1995). The specific identification or performance outcomes of intangible dimensions from interfirm interaction cannot be written into the formal aspect of the contract. Hence, the idea that

some performance aspects cannot be measured objectively and/or motivated through legal contractual language leads to the following hypotheses:

H3a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the lower the learning outcomes.

H3b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the learning outcomes.

Satisfaction. According to Wilson (1995), satisfaction is one of the critical variables in business relationships. Wilson defines satisfaction in the context of business relationships as the degree to which the transaction meets the performance expectations of the partner. Anderson and Narus (1990) define satisfaction in these relationships as a positive result from an assessment of performance aspects of the desired outcomes of the working partnership. Finally, Dwyer and Oh (1987) and Frazier et al. (1989) argued that satisfaction is a primary factor for evaluating channel performance. Taking the definition of satisfaction as expectations met, contracts defined along legal dimensions would outline the performance expectations and therefore lead to satisfaction with the relationship if the distributor met the manufacturer's expectations.

H4a: The greater the manufacturer's emphasis on legal dimensions of relational governance, the greater the satisfaction.

Nevin (1995) believes that relational exchange is long term and based on preserving or continuing exchanges with the same individuals or firms. According to him, when the parties are committed to maintaining the relationship they strive to make it work, which leads to successful and mutually beneficial exchanges. A contract built upon the behavioral dimensions emphasizes factors that contribute to trust, commitment, and cooperation in the relationship—the basis for relational exchange. From the

manufacturer's perspective, the foreign distributor's demonstrated commitment and cooperative efforts to work with the manufacturer to meet performance objectives would contribute to the manufacturer's satisfaction with the relationship. Satisfaction in a partnership results from the cooperative behavior that is generated and encouraged by a partner who seeks greater efficiency from the partnership (Skinner et al. 1992). Skinner and his colleagues concluded that if satisfaction is a desired outcome of a relationship, then cooperation and commitment—elements of a behavioral orientation-- is important to the relationship.

H4b: The greater the manufacturer's emphasis on behavioral dimensions of relational governance, the greater the satisfaction.

Since in practice, the manufacturer employs both the legal and behavioral dimension elements of his relational governance strategy in order to produce desired outcomes, this research also intends to investigate the interaction effects of these two strategic dimensions. That is, what are the effects of the different dimensions upon the various levels of performance?

Lusch and Brown (1996) point out that it is important to clarify that explicit and normative contracts are not the same constructs in spite of their relation. For example, a discrete exchange does not necessarily mean that an explicit contract is in place. Neither does a normative contract imply a relational exchange; essentially, a discrete exchange can occur if a firm emphasizes a normative contract. Indeed, Celly and Frazier (1996) and Bello and Gilliland (1997) found in their empirical studies of international channel management that economic (legal) and behavior-based governance mechanisms are strongly correlated and hinted that each of the mechanisms may play different roles in the

relationship. For example, Lusch and Brown found that the manufacturer's emphasis on the relational or behavioral aspects of the relationship led to enhanced performance.⁵

Bello and Gilliland (1997) applied the notion of explicit and behavior-based governance to international relationships. Their empirical result indicated that discrete or legalistic forms of governance contributed to higher performance. The scholars' conclusion contrasts Lusch and Brown's (1996) finding that behavior-based control influenced performance. The implication behind these results is that governance is based on different forms; that discrete (legal) and behavior-based controls are separate dimensions that influence the relationship differently, and that these dimensions may be contingent upon the environment.

The basis of strategic choice theory is that management is able to determine strategic outcomes by making "optimal" decisions from a set of alternatives. According to the contingency perspective in organizational theory, firms that have a good organization-environment fit perform better than organizations that do not have a good organization-environment fit (Ghoshal and Nohria 1993). Consequently, management's perception is key because their strategic and operational decisions generally are made without having full knowledge of market conditions (Fama 1980, Hambrick and Mason 1984, Eisenhardt 1989).

3.3.2 Proposition 2 - Strategic Performance to Economic Performance

One goal of the manufacturer in a relationship with a foreign distributor is to attain strategic performance objectives (i.e., stability, flexibility, learning outcomes and satisfaction) because these performance objectives provide competitive capabilities that ultimately enhance economic performance.

⁵ For the purposes of this discussion, explicit and legal dimension is interchangeable. Likewise, normative and

According to the propositions of resource-based theory, performance depends upon the value and the difficulty in imitating a relationship's combined resources and unique capabilities. If the relationship is able to develop these unique capabilities, then the relationship is in a better position to sustain competitive advantage, which will lead to higher performance (Barney 1991, Peng 1998). For instance, within an international context, Rosson and Ford (1982) have shown that performance is positively associated with flexibility and information exchange in relationships. Noordewier, John, and Nevin (1990) empirically support their findings by providing evidence that flexible partnerships underscore the notion that communication and trust-oriented relational processes are being exercised between the partners.

The presence of flexibility also suggests that the partners have dedicated a higher degree of commitment and willingness to invest in the relationship (behavioral attributes) over a partnership that places more emphasis on the legal dimensions of their contractual arrangement. Under these circumstances, flexibility does not disrupt the manufacturer's confidence in managing the partnership when confronted with different scenarios. Thus, flexibility contributes to the partnership's productivity while enhancing economic performance. Similarly, stable relationships enable the firms to monitor better their internal and external performance because they will have a good sense of relationship history and can rely upon a certain relationship future. Furthermore, the degree of satisfaction achieved in a particular situation depends on the difference between the perceived and desired performance outcomes from the relationship (Thierry and Koopman-Iwerna 1984).

behavioral dimension describe the same concept.

H5: Strategic performance has a positive relationship with economic performance (i.e., stability, flexibility, learning outcomes and perceived satisfaction have a positive relationship with economic performance).

3.3.3 Proposition 3- Relational Governance Strategy to Economic Performance

The manufacturer can rely upon different dimensions of his relational governance strategy to reach economic performance objectives. For example, the manufacturer's use of one dimension or a combination of both the legal and behavior dimensions will contribute to economic performance.

Çavuşgil and Zou (1994) found that the manufacturer's involvement with operational aspects of its foreign distributor was related to export performance. They defined export performance as market share, foreign sales, and other measurable indicators of market success. At the same time, Çavuşgil and Zou (1994) propose that export performance depends upon how well strategy is implemented because the impact of the organizations' resources on performance is a result of how well the resources are used. Therefore, they conclude that strategy mediates the link between environment and performance.

Their observation is in contrast to past studies on performance that directly linked product, industry and export market characteristics to export performance (Cooper and Kleinschmidt 1985, Madsen 1989). This dissertation similarly argues for a strategy-mediated link between environment and performance in that relational governance strategy is a contractual strategy the manufacturer employs to effect performance. For instance, the manufacturer's strategic orientation in the relationship may be characterized by tight process control (manufacturer's emphasis on the contract's legal dimensions) or through a normative culture that is indicative of flexible governance mechanisms (manufacturer's emphasis on the contract's behavioral dimensions). This argument

follows Cavusgil and Zou's (1994) assessment that the manufacturer's direct management of the contractual agreement, whether the management is based on legal or behavioral position, will lead to performance.

Because performance is a multidimensional construct (Chakravarthy 1986, Venkatraman and Grant 1986) the variety of processes within the international relationship may lead to different performance outcomes on different dimensions. For instance, a straight transaction where performance objectives are clearly stated may yield high performance, whereas other performance measures (e.g., learning) that are dependent upon the behavioral interaction between the partners may have low performance.

However, one recent study suggests that a manufacturer's emphasis on the legal dimensions of the contractual structure does not lead necessarily to higher strategic or economic channel performance (Bello and Gilliland 1997). They explain this contradictory finding by reporting that the results may be an indication of the manufacturer's inability to invest and commit resources to the relationship. Hence, this dissertation explores two dimensions of performance, strategic and economic performance as a way to address this contradiction. Strategic performance reflects the partnership's desired strategic outcomes, which are intangible measures of performance as perceived by the manufacturer. Essentially, the manufacturer evaluates the interfirm processes for effectiveness in the external environment.

Much of the recent literature that has dealt with manufacturer-distributor relationships has explored the effect of the relationship on some aspect of performance (Harrigan 1988, Heide and Stump 1996). Assuming that partnerships between the

manufacturer and distributor are formed to reduce the risks involved in overseas operations, exporting manufacturers would place priority on aspects of strategy, supply chain relationships, and organizational structure. For example, organizations that emphasize communication through information exchange believe that information is one of the keys that strengthens the alliance (Mohr and Nevin 1990). Therefore, one proposed argument is that as the amount of information exchange between the partners increases as a result of emphasizing behavioral dimensions of the relationship, the better the partners' ability to anticipate each other's needs (Lusch and Brown 1996). This leads to greater relationship flexibility and better overall performance. In other words, the increased ability to communicate eventually will contribute to the relationship's ability to achieve greater flexibility (part of strategic performance) and its ability to adapt to a volatile environment (Mohr and Nevin 1990).

Finally, reliance upon the contract's legal dimensions and flexibility imply a degree of stability within the relationship. Cooperation under legal dimensions may be enhanced if the partners see benefits from the partnership. Stability in the relationship is augmented by flexibility as both parties have demonstrated willingness to succeed. Therefore, both approaches would lead to greater economic performance. This section argues that strategic performance enhances economic performance and is therefore necessary in order to gain and sustain high economic performance.

Since, in practice, the manufacturer employs both the legal and behavioral dimension elements of his relational governance strategy in order to produce desired outcomes, this research also attempted to investigate the interaction effects of these two

strategic dimensions. That is, what are the effects of the different dimensions upon the various levels of performance?

Lusch and Brown (1996) point out that it is important to clarify that explicit and normative contracts are not the same constructs in spite of their relation. For example, a discrete exchange does not necessarily mean that an explicit contract is in place. Neither does a normative contract imply a relational exchange; essentially, a discrete exchange can occur if a firm emphasizes a normative contract. Indeed, Celly and Frazier (1996) and Bello and Gilliland (1997) found in their empirical studies of international channel management that economic (legal) and behavior-based governance mechanisms are strongly correlated and hinted that each of the mechanisms may play different roles in the relationship. For example, Lusch and Brown found that the manufacturer's emphasis on the relational or behavioral aspects of the relationship led to enhanced performance.⁶

Bello and Gilliland (1997) applied the notion of explicit and behavior-based governance to international relationships. Their empirical result indicated that discrete or legalistic forms of governance contributed to high performance. The scholars' conclusion contrasts Lusch and Brown's finding that behavior-based control influenced performance. The implication behind these results is that governance is based on different forms; that discrete (legal) and behavior-based controls are separate dimensions that influence the relationship differently, and that these dimensions may be contingent upon the environment.

One of the assumptions of strategic choice theory is the idea that management influences strategic outcomes based upon their ability to make optimal decisions when

⁶ For the purposes of this discussion, explicit and legal dimension is interchangeable. Likewise, normative and behavioral dimension describe the same concept.

faced with different alternatives. These alternatives are formed out of the consideration for the organization's internal and external environment. Consequently, this implies that the optimal outcome depends upon management making the optimal choice to 'fit' the given scenario. Essentially, this is the contingency perspective in organization theory; that firms with a good organization-environment fit perform better than organizations that do not (Ghoshal and Nohria 1993). Therefore, management's reaction to and interpretation of their environment is key to success.

The arguments above posit different effects of relational governance strategy on strategic and economic performance. These hypotheses are summarized below and illustrated in Table 3.1

H6a: The greater the manufacturer's emphasis on the legal AND the behavioral dimensions, the greater the economic performance, stability, satisfaction and learning outcomes; but the lower the flexibility.

(Scenario A)

H6b: The greater the manufacturer's emphasis on the legal dimension AND the lesser the emphasis on the behavioral dimension, the greater the stability; but the lower the economic performance, flexibility, satisfaction, and learning outcomes.

(Scenario B)

H6c: The lesser the manufacturer's emphasis on the legal dimension AND the greater the emphasis on the behavioral dimension, the greater the economic performance, stability, flexibility, satisfaction, and learning outcomes.

(Scenario C)

H6d: The lesser the manufacturer's emphasis on the legal dimension AND the lesser the emphasis on the behavioral dimension, the lower the economic performance, stability, flexibility, satisfaction, and learning outcomes.

(Scenario D)

Table 3.1 Interaction Between Legal and Behavioral Dimensions

		Behavioral Dimension (degree of emphasis)	
		High	Low
Legal Dimension (degree of emphasis)	High	I Scenario A -- Low flexibility + High satisfaction + High stability + High learning + Performance	II Scenario B -- Low flexibility -- Low satisfaction + High stability -- Low Learning -- Performance
	Low	III Scenario C + High flexibility + High satisfaction + High stability + High learning + Performance	IV Scenario D -- Low flexibility -- Low satisfaction -- Low stability -- Low learning -- Performance

Hypotheses 1 through 6 are tested by the methodology discussed in Chapter 4 and the results will be presented and discussed in Chapters 5 and 6. The model and proposed relationships are illustrated in Figure 3.2.

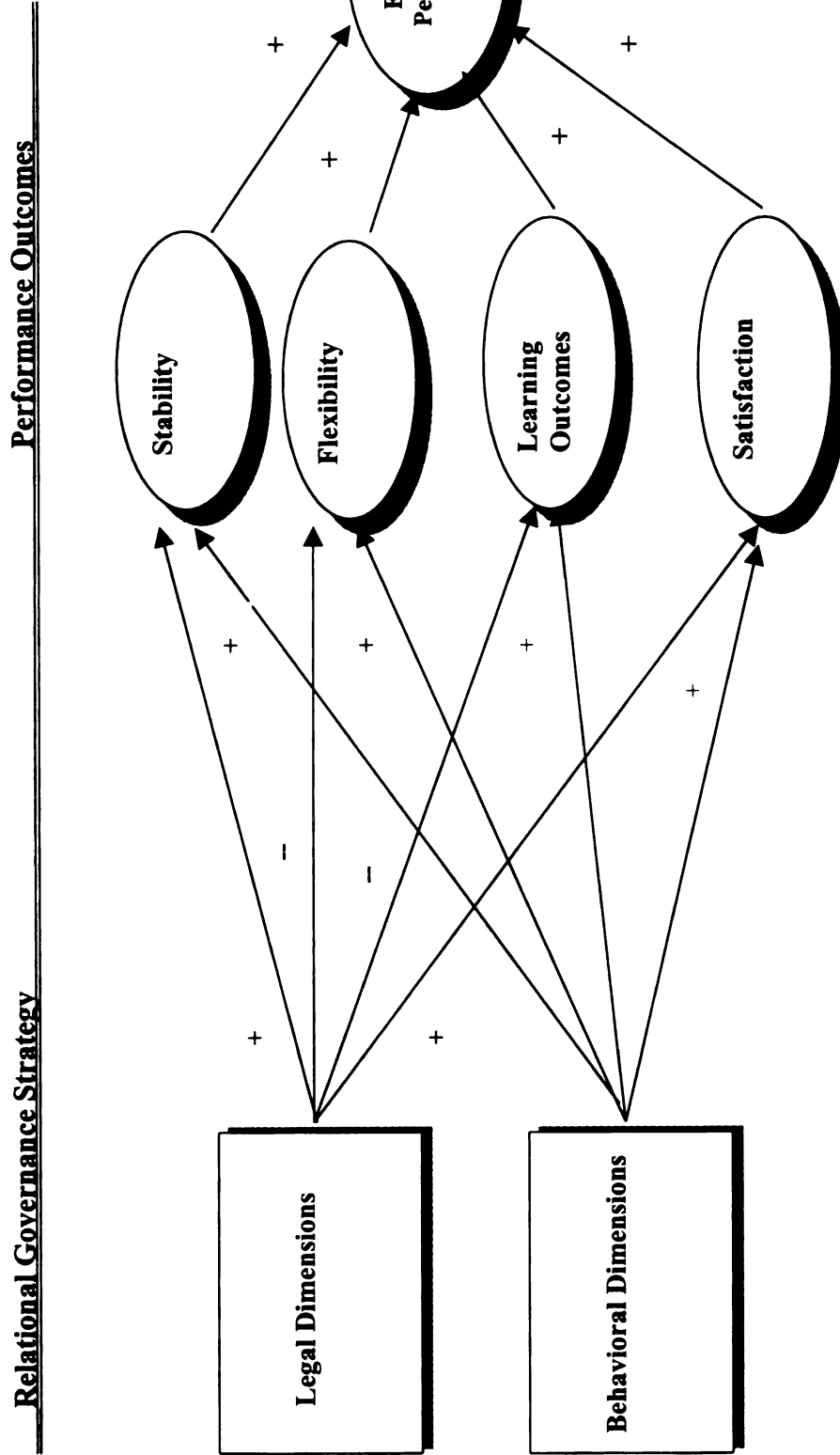


Figure 3.2 Hypothesized Relationships

Table 3.2 Hypotheses Summary

Relational Governance Strategy
H1a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the greater the relationship stability.
H1b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the relationship stability.
H2a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the lower the relationship flexibility.
H2b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the relationship flexibility.
H3a: The greater the manufacturer's emphasis on the legal dimensions of relational governance, the lower the learning outcomes.
H3b: The greater the manufacturer's emphasis on the behavioral dimensions of relational governance, the greater the learning outcomes.
H4a: The greater the manufacturer's emphasis on legal dimensions of relational governance, the greater the satisfaction.
H4b: The greater the manufacturer's emphasis on behavioral dimensions of relational governance, the greater the satisfaction.
H5: Strategic performance has a positive relationship with economic performance (i.e., stability, flexibility, learning outcomes and perceived satisfaction have a positive relationship with economic performance).
Relational Governance Strategy and Performance
H6a: The greater the manufacturer's emphasis on the legal AND the behavioral dimensions, the greater the economic performance, stability, satisfaction and learning outcomes; but the lower the flexibility.
H6b: The greater the manufacturer's emphasis on the legal dimension AND the lesser the emphasis on the behavioral dimension, the greater the stability: but the lower the economic performance, flexibility, satisfaction, and learning outcomes.
H6c: The lesser the manufacturer's emphasis on the legal dimension AND the greater the emphasis on the behavioral dimension, the greater the economic performance, stability, flexibility, satisfaction, and learning outcomes.
H6d: The lesser the manufacturer's emphasis on the legal dimension AND the lesser the emphasis on the behavioral dimension, the lower the economic performance, stability, flexibility, satisfaction, and learning outcomes.

RESEARCH METHODOLOGY

4.1 INTRODUCTION

This chapter details and presents the methodology used to test the conceptual model developed in Chapter Three. The purpose of the chapter is to answer the research question developed earlier. In the second section, the research design, sampling frame and data collection are overviewed. The third section outlines the survey questionnaire, which is followed by construct operationalization. Finally, the techniques and procedures for analyzing the data are presented.

The objective of the research is to test a model that postulates the effectiveness of a managed relationship between a domestic and foreign partner. This objective is addressed by testing the relationships among ten constructs. To ensure sufficient variance in the data, a random sample was selected that included domestic multinational manufacturers from diverse industries. The data that was collected has the desired variance for testing the hypothesized relationships and captures the diversity in the manufacturers' marketing environment, management strategy, structure and performance, thereby enhancing the generalizability of the findings.

4.2 DATA COLLECTION

This study incorporates purposive and random sampling. The first stage of data collection focused on exploring and conceptualizing the research framework. In order to capture the essence of the manufacturer-foreign distributor relationship, a preliminary analysis of exporting US companies was completed to identify representative candidates for study selection. A list of domestic multinational companies was obtained from the

Thomas Export Registry⁷. First, companies likely to be engaged in reaching overseas markets via foreign agents/distributors were selected. Companies with fewer than 50 employees were excluded since these companies typically may not have the resources or sufficiently developed international marketing functions to fulfill the objectives of the questionnaire.

After initially filtering companies by size, a random sample representing different SIC codes was selected from the Thomas Export Registry list. This step's objective was to encompass a reasonably high level of company diversity and hence, obtain a high level of variance in the data used for testing the proposed relationships.

The initial framework's conceptualization was modified to reflect primary data collected from in-depth interviews with export managers. These managers were directly involved with their companies' export operations and provided a subjective view of the management of the manufacturer-foreign distributor relationship. They also would most likely be knowledgeable and interested in the study. In addition, primary data collection included interviews with lawyers who developed international contracts for exporting manufacturers. The lawyers provided a more objective view of the structure of the relationship. A copy of the interview questionnaire and highlights from the interviews are included in Appendix A.

Secondary data was obtained from export marketing and industry publications, as well as related literature. All data were supplemented with sample contracts that manufacturers created with their distributors. The next stage of data collection was the

⁷ The Thomas Export Registry has a large proprietary database of exporting companies and the managers that subscribe to exporting literature. For a fee, they provide contact information and a brief description of the company (e.g., size, number of employees). The final list was focused to include particular SIC codes and company size.

survey instrument, which was used to generate the data necessary to test the hypothesized relationships.

4.3 QUESTIONNAIRE

This research utilized the survey as the primary method of data collection. A comprehensive review of the literature was conducted to provide a solid basis for the model's constructs. From the review of the relevant literature, previously tested and validated scales were borrowed and adapted to the context of the study. In the instances where no previously developed scales exist, measures were developed using a scale development similar to that described by Churchill (1979).

The questionnaire was designed to ensure the content validity of the survey instrument (Venkatraman and Grant 1986). The survey's design reflects the results of the literature review, the research methodology and initial interviews with ten different company managers and international contract lawyers. In addition, three scholars that have explored international relationship issues were also asked to evaluate the survey questionnaire. Based upon their review and insights regarding theoretical and survey practicality issues, some items were deleted, added or modified.

In the second step, a group of MBA students in the executive program at Michigan State University took and reviewed the survey. They provided feedback regarding the time to complete the survey, the survey's general format and appearance, its perceived length and the potential sensitivity of some of the questions on company information. In the third and final step, export managers and international contract lawyers from different industries were familiar with the contractual agreements between

manufacturer and foreign distributor completed the questionnaire. Based upon this feedback, a few items were changed. For instance, some questions about company information that were not strictly relevant or meaningful to the practitioners were removed in accordance with suggestions. Finally, the survey was completed based on the feedback provided by the academic and practitioners' comments. Pretesting the questionnaire in these three basic steps provided useful information for designing a well-presented instrument that reflected a high degree of content validity.

The questionnaire included a cover letter to 800 managers working with foreign distributors. Some companies received several questionnaires. However, since the objective was to achieve a wide perspective, obtaining data from different business levels helped the overall generalizability of the data. With each questionnaire, a return envelope was enclosed to help the respondents return the completed survey instrument. As further incentive to increase the response rate, an offer to make a small donation to a charity of the respondent's choice and a key chain from Peru was included with each questionnaire. Finally, a copy of the research findings was offered to all participants.

The survey questionnaire contains several sections that are divided according to the relevant constructs in the model. The measures are anchored by 7-point Likert scales, 1 – Strongly Disagree to 7 – Strongly Agree. The Likert scale provides a “multiple-choice item format that is more reliable, gives more stable results, and produces better scales” (Comrey 1988, p. 278).

4.4 SAMPLING FRAME

The unit of analysis is the manufacturer-distributor relationship. The examination of the relationship is perceptual; taken from the perspective of the manufacturing manager. Therefore, the sampling frame consists of high-level managers that are most familiar with the conditions and terms of the contract with their foreign distributor. These informants were asked to identify one of their main foreign distributors with whom they have had a challenging contractual relationship⁸. The requests for an analysis of the most challenging distributor helped to ensure that the manager was familiar with the subjectivity of the relationship's strategic planning and the objectivity of export operation activities.

The general setting for the study investigates United States industries that have a natural tendency to use foreign distributors (i.e., to have independent channel structures) since their primary customers are businesses. Generally, many small to medium-sized companies with few resources are likely candidates. But, many large companies also utilize independent distributors as part of their export strategy. Manufacturers that recognize the importance of coordinating relationships with their distributors characterize these situations. In addition, product technology among the industries varied widely. The industries in the study include machine tools and equipment, industrial tools, appliances, medical equipment, electronic equipment, furniture, chemical, and telecommunications.

⁸ The most challenging agent or distributor would be the one who is not performing to expectations, is inexperienced, is difficult to work with, is one with whom your company has frequent or intense conflicts, and constantly requires contractual amendments or substantial monitoring.

The appropriate sample size for testing structural equation models ranges from 50 to 500. The smaller samples are not recommended because they may lead to nonconvergent solutions and data that cannot be interpreted. Sample sizes greater than 500 may be too sensitive for testing using this statistical approach as sampling fluctuations may be interpreted as differences between the observed and expected covariance matrices leading to erroneous Type I errors regarding the χ^2 statistic (Anderson and Gerbing 1988) and associated indices. Therefore, the targeted sample was approximately 1000 manufacturers. To increase the response rate, the survey included a personalized cover letter that introduces the study and its importance. The cover letter also emphasized the point that all responses will be anonymous and confidential. Finally, the respondents were offered a copy of the survey results and the research conclusions. In addition, a follow-up was sent two weeks after the initial mailing to remind the respondents of their participation.

4.5 CONSTRUCT MEASUREMENTS

The measurement items for the constructs are designed to reflect an active state of management rather than a static outcome of decision-making. The questionnaire, therefore, maintains integrity with the spirit of the dissertation. For example, action statements such as "we invest..." and "we work continuously..." especially are employed in the behavioral dimension measurements.

4.5.1 Relational Governance Strategy

As described in Chapter 3, relational governance strategy refers to the manner in which the manufacturer actively manages interfirm interactions. The respondents were asked whether or not a contract exists between their company and foreign distributor. If a contract existed, they would proceed to a set of questions that deal with the nature of the

contract. If there were no written contract between the parties, the respondents were directed to questions that relate to the characterization of their relationship. In all likelihood, some form of legal agreement should be present between the partners because of the nature of overseas operations. However, partnerships may be characterized by simple discrete transactions that carry little partnership interaction to partnerships that are more complex (Dwyer, Schurr and Oh 1987, Heide 1994, Lusch and Brown 1996).

The source for the operationalization of these scales is from Heide and John (1992), Gundlach, Achrol and Mentzer (1995) and Anderson and Weitz (1992). They are adapted further for this dissertation.

Legal Dimensions: defined as the extent to which manufacturer-distributor exchanges are governed by formal guidelines. A high degree of the legal dimension represents a total reliance on considerable internal regulations, policies, and procedural approaches developed to guide the relationship through future contingencies. This includes role definitions, how conflicts are to be resolved and the duration of the contract; whether it is intended to be a short- or long-term venture. A low degree of legal dimension represents little adherence to internal regulations and policies.

- 1) We state precisely in our agreement the legal consequences for less than satisfactory performance on the part of the distributor.
- 2) We state precisely in our agreement the legal consequences for the distributor if he fails to comply with operational expectations.
- 3) How the distributor deals legally with unforeseen circumstances depends on the distributor's judgment and is not part of the contract.
- 4) We state in our agreement in precise legal terms the operational responsibility of each party.
- 5) Our contract is ambiguous about how disagreements with the distributor will be resolved.
- 6) Our company makes the decisions to handle circumstances that may affect the relationship.
- 7) Our company develops operational processes as circumstances dictate.
- 8) There is no prescribed length for the contractual relationship written into the contract.
- 9) Our company has a vague understanding of the distributor's target sales objectives.

- 10) Our company makes sure the distributor's perspectives are taken into account when developing performance targets.
- 11) The contract is written primarily from our company's perspective, with little input from the distributor.

Behavior Dimensions: As a complement to the legal dimension, the behavior dimension constitutes the partners' complete understanding of how to deal with unforeseen events without reliance on the formalities of a written agreement. The behavioral dimension is comprised of elements such as commitment (Anderson and Weitz 1992, Morgan and Hunt 1994, Gundlach et al. 1995), trust (Anderson and Narus 1990, Hosmer 1995) and information sharing (Heide and John 1990, Nevin 1995, Lusch and Brown 1996).

Commitment is defined as a demonstration of the desire to develop a long-term relationship with an exchange partner by investing in assets that are specific to the relationship (Anderson and Weitz 1992, Morgan and Hunt 1994, Gundlach et al. 1995).

Trust is the expectation by one party of ethically justifiable behavior on the part of the other partner in a joint endeavor or economic exchange. The behavior represents morally correct decisions and actions that are based upon ethical principles (Hosmer 1995). Anderson and Narus (1990) define trust as perceived outcomes: trust is "the firm's belief that another company will perform actions that will result in positive outcomes for the firm as well as not take unexpected actions that result in negative outcomes" (Anderson and Narus 1990, p. 45). This dissertation parallels the definition of trust that Anderson and Narus propose.

Finally, information sharing is defined as the bilateral expectation that parties will proactively provide information useful to the partner (Heide & John 1992, Lusch & Brown 1996). These definitions of the components of behavior have been operationalized and empirically tested in the literature (Lusch and Brown 1996) and have

been modified for the context of the dissertation. Specifically, the measures are from: commitment (Anderson and Weitz 1992, Gundlach et al., 1995), trust (Anderson and Narus 1990), and information sharing (Heide and John 1992, Lusch and Brown 1996).

The operationalization of the construct follows (using Lusch and Brown 1996):

- 1) Any problems that arise in this relationship are considered to be individual problems that are best handled by one party.
- 2) The distributor is dedicated to improvements that benefit the relationship as a whole, not just one partner.
- 3) We constantly work to convince the distributor that it is very important for us to stay together in the face of adversity and challenges.
- 4) Both firms actively work together to carry out our responsibilities and commitments in this relationship.
- 5) Both firms invest considerable resources and time to make the relationship a success.
- 6) Our business relationship is characterized by a high level of trust.
- 7) We trust the distributor to remain within the terms of the contract.
- 8) We frequently question the reliability of the information provided to us by the distributor.
- 9) Whenever the distributor offers us advice, we believe he is sharing his best judgment.
- 10) The distributor has not been evenhanded in his dealings with us.
- 11) We have not developed a strong sense of loyalty to the distributor.
- 12) We provide each other with any helpful information.
- 13) Information exchange in this relationship takes place frequently and informally.
- 14) We provide each other with proprietary information if it can help the other partner.
- 15) We keep each other informed about events or changes that may affect the other partner.
- 16) The partners will exchange information, whether it is positive or negative.

4.5.2 Strategic Performance

The performance measures in this study include *subjective* and *objective* (e.g., financial) components. The subjective component represents strategic performance identified as competitive outcomes that the firm strives to obtain through its relationship with the distributor. The strategic performance component of the performance measure may not be as precise as the objective financial performance measures. However, in spite of their lack of precision, subjective measures are generally found to be fairly accurate and reliable and widely used in the international marketing literature (Cavusgil and Zou 1994, Johansson and Yip 1994, Ganesh et al., 1996) even though they may exhibit

respondent bias (Dess and Robinson 1984, Venkatraman and Grant 1986). Both subjective and objective performance measurement elements are included in this study in order to take advantage of the synergies provided by their different approaches. Examining both forms helps to improve the richness and meaning of the performance measurement. The operationalization of the strategic performance component follow:

Stability: defined as the constancy of the relationship (Noordewier, John & Nevin 1990) and the relationship's commitment to a long-term orientation (Gundlach et al., 1995).

- 1) We have established a solid commitment to our partner and feel that our partner is firmly committed to us.
- 2) Maintaining a long relationship is important to both parties.
- 3) We do not expect the relationship with this distributor to last for many years.
- 4) Renewal of the relationship with this distributor is virtually automatic.
- 5) If our company could find other distributors in this market, we would be likely to switch to a new distributor.
- 6) The relationship continuity with this partner has often been erratic.

Flexibility: defined as the degree to which the relationship is able to adjust to changes in the environment (Heide and John 1992).

- 1) Whenever unexpected situations arise, we prefer to hold each other to the terms of the original contract.
- 2) Both partners are able to make adjustments in the on-going relationship to cope with changing political, economic, or legal circumstances.
- 3) Together, we have developed processes to increase flexibility in response to customer requests.
- 4) We are unable to make adjustments in our relationship to accommodate changing circumstances.

Satisfaction: defined as the degree to which the manufacturer's relationship with the distributor is either better than or worse than previously expected (Cullen, Johnson and Sakano 1995).

- 1) We are highly satisfied with the distributor's performance compared with our initial expectations.
- 2) We intend to continue the relationship with this partner for the foreseeable future.
- 3) The distributor has had trouble meeting customers' service requirements over the duration of the relationship.
- 4) We intend to continue the relationship with this partner for the foreseeable future.
- 5) We believe that the distributor needs to improve operational processes in several areas before we renew our contract.
- 6) We have steadily stepped up our involvement with the distributor.
- 7) We have steadily expanded the number of product lines we sell through the distributor.
- 8) We frequently have to resort to legal sanctions to resolve a dispute with the distributor.

Learning Outcome: defined as the extent to which the manufacturer has routinized or imbedded the learning process into the organizational culture (Lyles 1994, Hult and Ferrell 1998).

- 1) The joint training sessions we have had with the distributor have been very critical to our ability to manage the relationship.
- 2) Our interaction with the distributor has taught us a great deal about doing business in this country.
- 3) Our degree of integration and cooperative relationship with the distributor enables us to capitalize on new opportunities in this market.
- 4) The distributor has not contributed to our ability to increase our market reach.

4.5.3 Economic Performance

The following measurement scales examine financial and market performance in the sense of efficiency. Efficiency is one of three dimensions that Walker and Reukert (1987) outlined as primary performance measure dimensions in their literature review (effectiveness and adaptability are the other two, which are handled in the strategic performance measure). Efficiency is the outcome relative to the firm's employed resources and is referred to as an objective, or operational measure of performance. These measures are supplemented by financial performance measures, which are requested in the questionnaire under the section related to general business characteristics. These performance measures concentrate on export performance and the

percentage of the company's export performance involvement. They are highlighted later in this section under Context.

Economic Performance: defined in terms of efficiency. These performance measures reflect the efficiency of the relationship as well as the relationship's effectiveness in a competitive environment (Cavusgil and Zou 1994).

- 1) The distributor has helped increase our overall performance in this market.
- 2) The distributor has helped increase the performance of our core product in this market.
- 3) The distributor has helped make our company more competitive relative to our competition in terms of **profitability**.
- 4) The distributor has helped make our company more competitive relative to our competition in terms of **customer responsiveness**.
- 5) The distributor has helped make our company more competitive relative to our competition in **responding to changing conditions**.
- 6) The distributor has helped make our company more competitive relative to our competition in **responding to market opportunities**.

4.5.4 Context

The following questions, appearing at the beginning of the questionnaire, were developed to obtain descriptive profiles and background information regarding the contract:

1. Number of years your business has had international activities: _____ years
2. What is your company's top selling export market (based on a 3-year sales average)?

3. Number of foreign countries in which you conduct business: _____ countries
 - The number of distributors you currently have outside the U.S. _____ distributor(s)
 - The number of people in your organization dedicated to managing foreign distributors/agents _____
4. The annual sales of your company are approximately: \$ _____

- Currently, export sales account for _____percent of your total sales revenues.
 - Currently, exports account for _____percent of your total profits.
 - Your export sales growth over the past three years has been approximately _____% per year
5. The approximate number of employees in your company: _____
6. Who makes up the majority of your customers? _____consumers
_____businesses
7. Your primary industry is:
- | | | |
|---|---|---|
| ☐ Household appliances | ☐ Electronic equipment | ☐ Heavy machinery |
| ☐ Automotive | ☐ Pharmaceutical | ☐ Industrial machinery |
| ☐ Telecommunication | ☐ Medical equipment | ☐ Chemical |
| ☐ Paper/Publishing | ☐ Furniture | ☐ Other _____ |

Please think of the *most challenging* distributor when responding to the rest of this survey.

1. Country/region where this distributor is located: _____
2. Number of years you have had a business relationship with this distributor:
_____years
3. How many years has your company been doing business in this foreign country?
_____years
1. Does your company have a written, binding agreement with this distributor? ____yes
____no
2. If **yes**, how many years have you had a contract with this distributor?
_____years
3. How would you best describe the relationship? (A **highly formal** relationship is guided by very specific rules, regulations, and guidelines outlining the behavior and performance expectations of both partners. Partners in a highly formal relationship ensure that regulations are strictly enforced.)

 __ **Highly Formal** __ **Moderately Formal** __ **Formal** __ **Moderately Informal** __ **Highly Informal**
4. Do you allow your distributor to carry competitive products? ____yes ____no
5. Do you have an exclusive **territory** arrangement with your distributor?
____yes ____no

6. Approximately what percentage of this distributor's total business is with your company?
____%
7. Approximately what percentage of your company's business in this market is with this distributor? ____%
8. Does this distributor add any value locally (e.g., local assembly, packaging, custom features/modification, etc.)? ____yes ____no

4.6 DATA ANALYSIS

A multi-step approach to data analysis was adopted in this research study. First, potential non-response bias was evaluated by comparing early and late respondents in terms of annual sales and number of full-time employees. Second, descriptive statistics were calculated and potential non-normality problems were assessed. Third, the reliability of the constructs was tested from an examination of the inter-item correlation in exploratory factor analysis. This was done to specify a valid and reliable measurement model. After purification of the measurement model, the measures underwent a test through a confirmatory factor analysis and the results were analyzed for convergent, discriminant, and nomological validity as well as overall model fit. A second-order confirmatory factor analysis was conducted for the legal and behavioral dimensions. Following this, Anderson and Gerbing's (1982) two-stage procedure of structural models was employed. The two-step procedure is particularly useful for international marketing and strategy research where the models and measures are not well-defined and empirically testable.

The test of the hypotheses included correlational analysis, regression, MANOVA and structural equations modeling. Specifically, the test for Hypotheses 1 through 5 was done through regression while Hypothesis 6 was evaluated through MANOVA and

structural equations modeling. When poor fit was evident, the model was analyzed for theoretical and empirical misspecification and changed when appropriate.

ANALYSIS AND FINDINGS

5.1 INTRODUCTION

Chapter Five reports the correlational relationship between the legal and the behavioral dimensions. The legal dimension corresponds to the formal structure upon which the relationship is built while the behavioral dimension outlines and examines the degree of interrelatedness or partner interaction. These dimensions represent the relational governance strategy the manufacturer adopts to manage the relationship with his foreign distributor. This chapter also reviews the results of the investigation into the implications relational governance strategy has on strategic and economic performance.

First, potential nonresponse bias in the sample is assessed by comparing responding and nonresponding firms on the basis of sales and number of employees. Second, measurement issues are examined to investigate descriptive statistics for the scale items, potential data nonnormality and any other data quality problems. This is followed by tests for construct reliability and validity pertaining to relational governance strategy and performance. Third, separate exploratory and confirmatory factor analyses were completed in order to establish the validity of the legal and behavioral dimensions as second-order factors that represent relational governance strategy. Once this was done, the second-order factors were evaluated and purified for their eventual test in the measurement model. Fourth, the test of the hypothesized relationships was conducted through correlation analysis and MANOVA. Each step is explained in the following sections.

5.2 RESPONSE RATE AND NONRESPONSE BIAS

On the basis of the selection criteria and pretest results, 800 potential respondents were chosen. A pre-notification letter was sent explaining the research purpose. Calls were also made to approximately 75 export managers requesting their support for participation in the study. During this phase, a cover letter with the questionnaire was mailed to explain the purpose of the research together with a promise to provide a copy of the research summary. In addition, the survey included a request that the respondent supply a business card and indicate a charity to make a donation in their behalf. Included with the questionnaire was a pre-paid return envelope. Two weeks later, we followed with a reminder letter and a copy of the questionnaire. We determined that 14.5% of the mailings were undeliverable (e.g., incorrect address or person, respondent no longer with the firm). From these undeliverable questionnaires, 5.9% were undeliverable due to company policy that refused to accept surveys and a small percentage (1.8%) of the companies no longer exported. Consequently, the effective sampling frame was reduced to 623. Of these, 162 (141 usable) firms participated in the study, producing an effective response rate of 22.6% (Table 5.2.1).

A common method of determining nonresponse bias is to compare early versus late responding firms based on the profiles of their annual sales, number of employees (Armstrong and Overton 1977) and firm experience. This has been accepted as a method to test nonresponse since research has shown that the characteristics of late respondents are likely similar to those of nonrespondents (Anderson and Overton 1977). To assess nonresponse bias, the responses were divided into two groups based on the date they were received. The two response groups were tested using t-test analysis to detect

potential differences in means between early and late respondents among the three categories introduced previously. The results are displayed in Table 5.2.2. The tests show that no significant difference exists between the early and late respondents.

Even though the Armstrong and Overton (1977) procedure is widely used, it is a relatively weaker test than examining and comparing the respondents to the nonrespondents. Ideally, to contact the nonrespondent firm for information related to these variables (e.g., sales, employees, and firm experience) in order to compare the data to respondents would have provided a more rigorous assessment of this particular bias. Yet, it is difficult to gather data from firms that do not respond, especially given that many companies have legal, confidentiality or other policies that prohibit them from responding to surveys. Other firms are downsizing or managing recent mergers, which reduce the number of staff resources that could respond properly or in a timely manner. Firms under these circumstances choose not to participate.

Table 5.2.1 Mail Survey Outcome

Outcome		
Eligible Sample	800	
Less: Unsuitable Respondents	177	
Moved, no forwarding address		116
Refused, company policy		47
No longer exporting		14
Effective Sample Size	623	
Less: Unusable questionnaires	461	
Unusable		18
Did not return		443
Remaining sample	162	
Valid responses (usable questionnaires)	141	
Response Rate	22.6%	

Table 5.2.2 Nonresponse Bias – Early vs. Late

Variable	Early response mean (in \$M) (n)	Late response mean (in \$M) (n)	2-tail significance
Sales	1011.5 (84)	1223.5 (56)	.535
Employees	3723.8	2656.1	.697
Firm Experience	25.4	20.9	.140

5.3 SAMPLE CHARACTERISTICS

A profile of the survey's respondents is presented in Table 5.3.1 (all values are reported in means). The respondents primarily represent export managers, vice presidents, and international directors that work extensively with export operations. The export managers provide operations insights while the higher-level executives share their views from a strategic vantage. The years of international experience range from 1 to 85, with a mean of 23.3 years. The wide range in experience indicates that the respondents are likely to be in various stages of international experience and would provide good variance regarding their insights into international relationships. The average experience also implies that the companies have good knowledge of the international environment and appreciate the complexity of global issues. Important to this study is that the survey captured the most correct group of respondents in that the managers are in a very good position to provide valid and reliable responses to the survey questions.

The numbers of managers that are dedicated to working with international distributors are few and represent a relatively small percentage of company personnel in many cases. However, the small to medium-sized firms in this sample tend to have a greater ratio of personnel working with export operations relative to the larger companies. This suggests that the resources invested in international operations may be greater as a percentage of the company's overall investment with smaller companies than

larger companies. Another possible explanation for the higher ratio is that smaller companies may place more emphasis on the behavioral dimension due to having fewer resources that can be committed to monitoring and controlling their distributors. Larger companies with greater resources may have fewer independent distributor relationships, preferring instead to establish proprietary distributors for the purpose of exercising more control of their assets.

As illustrated in Table 5.3.2, a large percentage of responding firms are small to medium-sized firms that have moderate international experience. Most responding firms operate in fewer than 40 foreign markets (69.3%). The larger firms, sales greater than \$100 million in this sample, tend to have highly formal structures, suggesting that they rely upon detailed rules and procedures to manage and control their operations. A bivariate correlation analysis shows that firm size is negatively correlated with the degree of relationship formality. Relatively smaller firms may tend to emphasize more social aspects of the relationship. What is interesting is that in spite of the formal contractual structure, the large companies tend to describe their relationships as informal.

Table 5.3.1 Respondent Characteristics

Industry	Years Experience (Avg)	# of Export Person	# of Distributors (Avg)	Country/Region of Distributor ^
Household Appliances	14.3	1.6	2.0	Europe
Automotive	23.4	3.6*	9***	Europe
Telecommunication	14.3	4.6	31.6	Middle East/Africa
Paper/Publishing	5.6	2.0	16.3	Pac Rim/China
Electronic Equip	22.0	3.5**	24.6	Pac Rim/China
Pharmaceutical	26.6	3.8	5.0	Pac Rim/China
Med Equipment	9.3	6.0	73.3	Europe
Furniture	28.8	3.0	14.3	Pac Rim/China
Heavy Machinery	28.8	19.7	48.8	Pac Rim/China
Industrial Machinery	29.1	3.2	24.1	Pac Rim/China
Chemical	26.9	20.7	38.2	Europe
Other	21.5	7.5	30.2	Pac Rim/China

* One company has 350 people dedicated to foreign operations

** This mean does not include 2 companies with more than 100 personnel dedicated to foreign operations

***Two companies have more than 250 distributors

^ Respondents reported the region where their "most challenging" distributor was located. This number reflects the highest percentage (concentration) for the particular industry. The Pacific Rim/China area is reported as the region of the most challenging distributor (40%) by almost all industries. This area is followed by Europe (23.7%) and Mexico/Central America (12.6%).

Table 5.3.2 Sample Characteristics

Dimension	Mean	Median	Range	% of Firms
Firm Size (# of employees)	3375	165	Less than 50	11.8
			50 - 499	62.7
			500 - 4999	17.6
			5000 or more	9.9
Annual Sales	815	75	Less than 10M	8.5
			10 - 49M	38.0
			50 - 99M	26.4
			100 - 199M	20.9
			200M or more	6.2
Export Sales	22.7	20	Less than 10M	25.2
			10 - 29 M	50.4
			30 - 49M	14.0
			50 - 79M	8.4
			80M or more	2.0
Years of International Experience	23.5	20	Less than 5 years	5.1
			5 - 10	21.5
			11 - 24	42.6
			25 - 39	20.6
			40 or more	11.3
Number of Distributors	32.9	19	Less than 10	34.5
			10 - 19	16.6
			20 - 29	9.3
			30 - 49	20.2
			50 or more	19.4
Number of Markets	34.2	22	Less than 5	7.3
			6 - 24	50.4
			25 - 39	11.6
			40 - 59	13.2
			60 or more	17.5

5.4 MEASUREMENT MODELS

Determining the means, standard deviations, kurtosis and skewness of each item assessed data quality. The largest kurtosis value is 1.48, which is below the recommended level of 2.00, a point beyond which nonnormality becomes a concern. The skewness of the items is acceptable and below 5.00. In general, all items fall within the specified range of normality. However, one measure in particular is an exception to univariate normality. This measure, which questions whether the manufacturer has to resort to legal sanctions to resolve a dispute, is highly skewed (mean 6.5, which is close to 7-Strongly Disagree on a 1-7 Likert scale). The respondents disagreed with the statement, suggesting that some type of arbitration mechanism is built into the contract, the manufacturer relies upon relational means to handle the relationship's disagreements, or that legal sanctions are too costly.

Before checking the quality of the data, systematic tests were undertaken to refine and validate the scales. The item-to-total correlation for each of the items in the proposed scales was examined following Churchill (1979) and Anderson and Gerbing's (1988) suggestions. Low correlations were eliminated if they did not contribute to the construct's explanation or provide added insight into the domain of interest. Initial reliabilities were assessed through Cronbach alpha calculations. In addition, exploratory factor analysis on theoretically related constructs was computed in order to help fulfill requirements for unidimensionality (Moorman et al., 1992). On this basis, items that had cross-loadings less than 0.3, did not load on relevant factors, or did not theoretically add to the construct were discarded.

After an initial exploratory factor analysis (EFA) approach, confirmatory factor analysis (CFA) was used to refine and validate the measurement scales. The EFA was designed to outline the initial general form of the relationships among the variables (Ahire and Golhar 1996). In particular, the EFA is a useful instrument to frame the legal and behavioral dimensions of relational governance strategy and is especially relevant since it helps to provide some basis for measurement scales that have demonstrated differing results in the literature. The majority of the other constructs (e.g., satisfaction, trust, performance) were developed from existing scales. The properties of the proposed constructs were evaluated through a series of CFA procedures, subsequent to which reliabilities for the final scales were computed. The measurement models were developed and tested using the maximum likelihood estimation method under EQS version 10.0.

1. **Relational Governance Strategy:** The theorized structure of these key constructs was tested in two parts: the legal and behavioral dimensions. First, the legal dimension and behavioral dimensions were modeled separately as covarying first order factors with appropriate items as manifest indicators. The variables for the legal dimension of relational governance strategy that were tested are: contract existence, contract language, performance measure orientation, time orientation, conflict resolution, and goal compatibility. The behavioral dimension is theorized to be a latent measure of: collaborative communication, relational commitment, relational trust, relational cooperation, and cultural sensitivity. Following this, an iterative process to achieve satisfactory model fit and to assess convergent, discriminant and nomological validity was accomplished in order to examine the relational governance strategy concept in the international context.
2. **Strategic and Economic Performance:** The performance constructs were tested in a separate CFA. Strategic performance is a subjective performance concept

composed of stability, flexibility, learning outcomes and perceived satisfaction. Economic performance consists of objective financial performance variables.

3. **Full CFA:** All first-order constructs and their manifest indicators were modeled in one comprehensive CFA as covarying factors to test the evidence of a higher order factor.

The detailed results of each CFA are now discussed.

5.4.1 CFA for Legal Dimension (Formal Relationship Structure)

The multivariate normality of the data is acceptable with Mardia's normalized estimate of 6.52 (Mardia 1970, Byrne 1994). Therefore, maximum likelihood estimation was used as an appropriate method for model fit. Reviewing the model iterations, some measures based on the multivariate LM Test indicated that different loadings on other factors would improve the model somewhat. This is reasonable, considering that it is theorized that the measures represent a higher order factor. However, the relative small improvements did not justify model changes. Table 5.4.1 illustrates the fit indices for the first-order confirmatory factor analysis.

Table 5.4.1 Goodness-of-Fit Indices for First-Order Legal Dimension CFA

Chi-Square	47.22
Degrees of Freedom	24
CFI	.940
IFI	.942
BBNFI	.911
RMSEA	.084

Convergent validity is strong as all loadings are above 0.516. Yet, the reliabilities for the first-order factors are fair, ranging from 0.614 for the contract language factor to

0.869 for performance measure orientation (Table 5.4.2). Although the reliabilities in general are fair, a threshold of 0.60 is acceptable as an exploratory reliability (Nunnally 1978, Hair et al., 1998). The time orientation and conflict resolution factors, which were proposed to be part of the formal relationship structure, were not significant. Overall, the CFA provides support for different measures of a formal structure in relational governance strategy.

Table 5.4.2 Measurement Reliability for First-Order Constructs of the Legal Dimension

Dimension	Measure	Reliability
Contract Existence	Does your company have a written, binding agreement with this distributor? *	n.a.
Contract Language	How the distributor deals legally with unforeseen circumstances depends on the distributor's judgment and is not part of the contract. Our contract is ambiguous about how disagreements with the distributor will be resolved. There is no prescribed length for the contractual relationship written into the contract.	.6135
Performance Measure Orientation	We state precisely in our agreement the legal consequences for less than satisfactory performance on the part of the contract. We state precisely in our agreement the legal consequences for the distributor if he fails to comply with operational expectations. We state in our agreement in precise legal terms the operational responsibility of each party.	.8694
Time Orientation	Not significant	< .6000
Conflict Resolution	Not significant	< .6000
Goal Compatibility	Our company makes the decisions to handle circumstances that may affect the relationship. Our company develops operational processes as circumstances dictate.	.6583

*Dichotomous variable

However, one measure of the contract language factor has a low standardized loading of 0.326, which is significant. The measure reflects the fact that the manufacturer does not outline the distributor's sales objectives in the contract. Subsequent follow up interviews indicate that most manufacturers require that the distributor develop and detail his sales objectives. Accordingly, this measure was not omitted because it was theoretically and practically feasible to keep the measure as part of an explanation for the legal dimension. The inter-factor correlations, ranging from 0.33 to 0.44 are significant, indicating nomological validity. An important assessment of discriminant validity involves reviewing the confidence intervals around the inter-factor correlations at significance level of 0.05. An interval that includes 1.0 is an indication of failed discriminant validity. These values are also different from 1.00, helping to support discriminant validity.

Furthermore, discriminant validity was tested via the LM multivariate test in order to identify significant cross-loadings on factors that were not hypothesized. In this case, only two significant loadings were indicated, but are explainable given the nature of the contract language and performance orientation factors. Overall, the tests indicate adequate confidence in the four first-order factors empirically and theoretically.

5.4.1.1 Second-Order CFA

The results for the second-order confirmatory factor analysis are displayed in Table 5.4.3. The item loadings on the first-order factors remain high and significant. The standardized loadings on the four first-order factors are: contract existence (dichotomous variable, 0.95), performance measurement orientation (0.65), contract language (0.41), and goal compatibility (0.40). All loadings are significant, yet the latter

two are low. In summary, the confirmatory factor analysis indicates that there is empirical and theoretical evidence to support the claim that a higher order legal dimension may exist. The discussion for these results follows.

Table 5.4.3 Goodness-of-Fit Indices for Second-Order Legal Dimension CFA

Chi-Square	99.118
Degrees of Freedom	40
CFI	.905
IFI	.907
BBNFI	.870
RMSEA	.103

The legal dimension construct originally was conceptualized as a second-order factor with six first-order factors (Figure 5.4.1). Two factors, time orientation and conflict resolution, were not significant and subsequently eliminated from the second-factor analysis.

Although respondents consistently reported that time was a consideration in maintaining the relationship and was a standard inclusion in many contracts, time was very closely tied to performance objectives and therefore, most likely captured in the language of the contract, which emphasized meeting a performance objective within a determined time period. In cases where the distributor represents small transaction volumes relative to the manufacturer's overall business, the manufacturer may adopt a “wait and see” attitude regarding the distributor’s performance and therefore not establish a definitive time period in the contract. Indeed, when time became a driving factor in the relationship, it was due to the distributor's relatively poor financial and/or distribution performance. Under these circumstances, time became more important as a tool the

manufacturer could employ as an enforcing mechanism to terminate a poorly performing relationship. For example, several respondents commented that a time period was placed on the distributor if the distributor developed poor credit habits. The manufacturer's orientation towards a short- or long-term relationship does not seem to be an overt part of the relationship's legal structure. Essentially, time appears to be an element that is part of the domain of the relationship's behavioral aspects (e.g., relationship commitment) and could be construed as a "reward" to gain the distributor's trust.

In addition, conflict resolution was not significant as an element of the legal structure. Again, conflict resolution may not be a structural part of the relationship's formality, but rather may be captured best as a behavioral dimension under trust and cooperation issues. Some exporting manufacturers have established territory or product exclusivity clauses (70% of the respondents) as a way to mitigate opportunistic behavior through establishing trust mechanisms (such as territory exclusivity). In an international setting with various cultural elements, these options may be the only tangible methods to address the potential for relationship conflict. Thus, conflict resolution may be considered a relational aspect of the partnership. For example, relational cooperation addresses the partner's willingness to interact and resolve problems for the good of the relationship's operating integrity.

5.4.2 CFA for Behavioral Dimension (Relationship Interaction)

The test for data multivariate normality under Mardia's estimate of 8.8 indicates acceptable levels for the data (Mardia 1970, Byrne 1994). Table 5.4.4 displays the fit indices of the first-order EQS confirmatory factor analysis. The global fit measures (BBNFI: 0.893, CFI: 0.918, and IFI: 0.920) together with a RMSEA value of 0.078 indicate adequate model fit (Hair et al., 1998).

Table 5.4.4 Goodness-of-Fit Indices for First-Order Behavioral Dimension CFA

Chi-Square	160.924
Degrees of Freedom	80
CFI	.918
IFI	.920
BBNFI	.893
RMSEA	.078

Convergent validity is strong with all loadings above 0.548 and significant. All construct reliabilities for the first-order factors are sound and within recommended reliability levels (Nunnally 1978, Hair et al., 1998). These range from 0.74 for the relational cooperation factor to 0.86 for relational trust (Table 5.4.5) and are consistent with prior research (Anderson and Weitz 1992, Gundlach et. al., 1995). All inter-item correlations for the five factors (range from 0.29 to 0.76) are significant and positive. Because they are significantly different from 1.00, they also indicate discriminant validity.

The LM multivariate test suggests that several items, if freed, would load on other factors. Most notably, the test indicated that some relational commitment and relational cooperation items would improve the fit of the overall confirmatory factor analysis model if allowed to load on the relational trust factor. However, this was not an option. Part of the objective to identify behavioral dimensions in a relational strategy was to follow and verify previous literature that has examined these two concepts (Gundlach et. al., 1995). However, it is noteworthy to see how problematic it is to identify distinct measures for these concepts. In summary, the test for discriminant validity is supported. Overall, the tests indicate adequate confidence in the five first-order factors empirically and theoretically.

Table 5.4.5 Measurement Reliability for Behavioral Dimension

Dimension	Measure	Reliability
Collaborative Communication	We strongly encourage our employees to share fresh ideas with distributors. Our company works with distributors to continually improve capabilities. Joint training programs with our distributors are designed to improve mutual learning.	.8244
Relational Commitment	The distributor is dedicated to improvements that benefit the relationship as a whole, not just one single partner. Both firms actively work together to carry out our responsibilities and commitments in this relationship. Both firms invest considerable resources and time to make the relationship a success.	.8453
Relational Trust	Our business relationship is characterized by a high level of trust. We trust the distributor to remain within the terms of the contract. Whenever the distributor offers us advice, we believe he is sharing his best judgment.	.8626
Relational Cooperation	The distributor has kept us well informed about operations and market circumstances. We have been successful in convincing the distributor to make necessary investments that fully exploit the market's potential. The distributor has promoted our products very aggressively.	.7399
Cultural Sensitivity	Our firm is very comfortable working in foreign environments. Our staff is very knowledgeable about foreign distributors. Our staff is uneasy with other cultures.	.7406

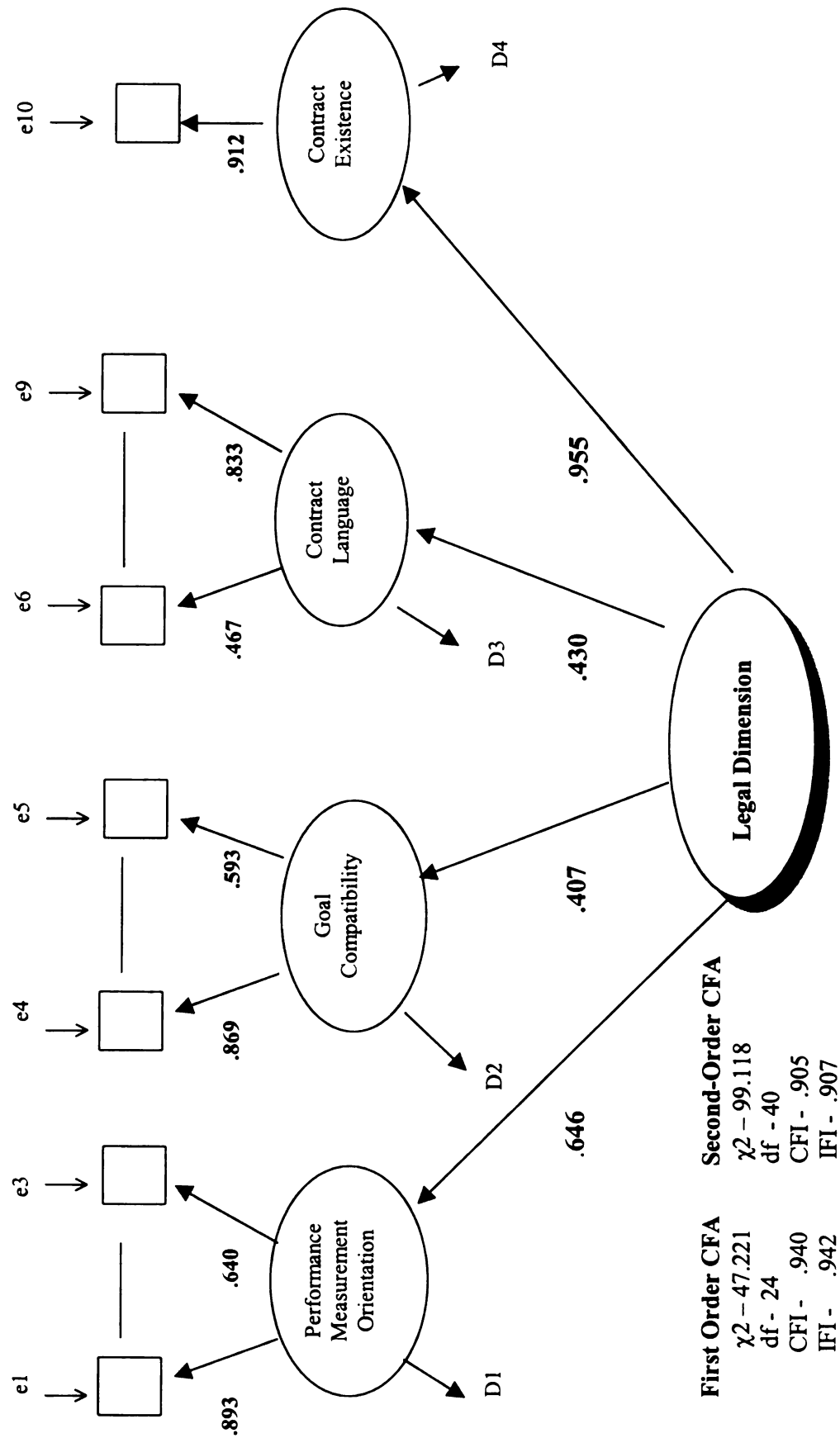


FIGURE 5.4.1 First and Second-Order Factor Results for Legal Dimension

5.4.2.1 Second Order CFA

The results for the second-order confirmatory factor analysis are displayed in Table 5.4.6. The fit indices are fine, although they are just higher than the recommended 0.90 threshold for CFI (Anderson and Gerbing 1988, Hair et al., 1998). This index compensates for the NFI's tendency to underestimate model fit due to small sample sizes and is therefore reported in this study (Bentler 1990). The item loadings on the first-order factors remain high and significant. The standardized loadings from the confirmatory factor analysis of the five first-order factors on behavioral dimension are: collaborative communication (0.30), relational commitment (0.92), relational trust (0.79), relational cooperation (0.95), and cultural sensitivity (0.39). The discussion for these results follows in Chapter 6. In summary, the results help support the proposition that behavioral dimension exists as a second-order factor that is measured with five first-order factors.

Previous scholars have argued for relational elements of interaction between parties (Dwyer, Schurr and Oh 1987, Weitz and Jap 1995, Gundlach et al., 1995) and empirical findings support this view (Lusch and Brown 1996, Bello and Gilliland 1997). The results in this study lend further support to the behavioral elements of a relationship. The test also supports the behavioral dimensions' and their application to the international context. An interesting aspect of this finding is that the behavioral elements of the relationship may be relied upon more in an international setting. Approximately 47% of the respondents reported that their relationship was moderately informal or very informal. The majority of the firms that reported these, however, were small- to medium-sized firms. Indeed, some legal or structure aspects of the relationship may be incorporated

into behavioral aspects (e.g., relationship cooperation, relational commitment and collaborative communication).

For further empirical analysis, the first-order factors for the legal and behavioral dimensions were aggregated and combined into an equally weighted composite score for the hypotheses tests (Heide and John 1992). The decision to employ summated scale over factor scales or a single surrogate was a compromise among different advantages and disadvantages related to each approach. For this study, the desire was to follow previous methods application (Heide and John 1992, Bello and Gilliland 1997) and to ensure a degree of generalizability. Therefore, summated scales reduce the degree of influence from measures that have low loadings (given this study's relatively small sample size and required significance to claim an 80 percent power level) and it helps to portray concepts in a single measure while reducing measurement errors (Hair et al., 1998).

Table 5.4.6 Goodness-of-Fit Indices for Second-Order Behavioral Dimension CFA

Chi-Square	178.711
Degrees of Freedom	85
CFI	.905
IFI	.907
BBNFI	.883
RMSEA	.090

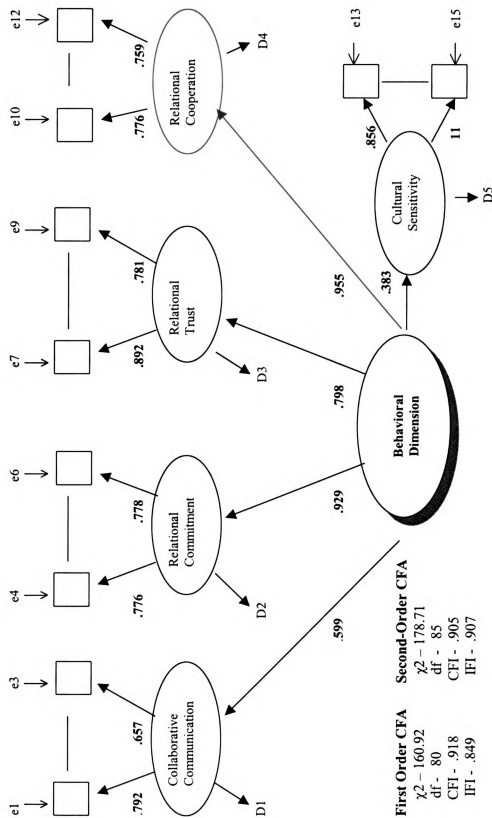


FIGURE 5.4.2 First and Second-Order Factor Results for Behavioral Dimension

5.4.3 CFA for Performance

The strategic performance variables represent the manufacturer's perception of the relationship's performance and the strategic gains the manufacturer believes he is obtaining from the relationship with the distributor. The constructs items included in this measure are stability, flexibility, satisfaction, and learning outcomes. In addition, economic performance is an indication of the manufacturer-distributor relationship's effectiveness in the market. The exploratory analysis results suggested that the confirmatory factor analysis test could be done. The results are outlined in Table 5.4.7. The global fit measures (BBNFI: 0.891, CFI: 0.917 and IFI: 0.918) together with a RMSEA value of 0.077 indicate an acceptable model fit (Hair et al., 1998).

Table 5.4.7 Goodness-of-Fit Indices for Performance CFA

Chi-Square	187.328
Degrees of Freedom	80
CFI	.917
IFI	.918
BBNFI	.891
RMSEA	.077

Convergent validity is strong as all loadings are above 0.565. All factor loadings are significant ($p < .01$) and strong. All reliabilities for the first-order factors are high, ranging from 0.72 for flexibility to 0.91 for economic performance (Table 5.4.8). These reliabilities (Cronbach alphas) are consistent with prior research that examined performance in relationships (Anderson and Weitz 1992, Gundlach et. al., 1995). All inter-item correlations for the five factors (range is from 0.29 to 0.76) are significant and

positive. Because they are significantly different from 1.00, they also indicate discriminant validity.

Table 5.4.8 Measurement Reliability for Performance

Dimension	Measure	Reliability
Stability	We have established a solid commitment to our partner and feel that our partner is firmly committed to us. We do not expect the relationship with this distributor to last for many years. If our company could find other distributors in this market, we would be likely to switch to a new distributor.	.8265
Flexibility	Together, we have developed processes to increase flexibility in response to customer requests. We are unable to make adjustments in our relationship to accommodate changing circumstances.	.7251
Satisfaction	We are highly satisfied with the distributor's performance compared with our initial expectations We intend to continue the relationship with this partner for the foreseeable future. The distributor has had trouble meeting customers' service requirements over the duration of the relationship. We believe that the distributor needs to improve operational processes in several areas before we renew our contract.	.7954
Learning Outcome	The joint training sessions we have had with the distributor have been critical to our ability to manage this relationship. Our interaction with the distributor has taught us a great deal about doing business in this country. Our degree of integration and cooperative relationship with the distributor enables us to capitalize on new opportunities in this market. The distributor has not contributed to our ability to increase our market reach.	.8191
Economic Performance	The distributor has helped increase our overall performance in this market. The distributor has helped make our company more competitive relative to our competition in terms of customer responsiveness. The distributor has helped make our company more competitive relative to our competition in responding to changing conditions. The distributor has helped make our company more competitive relative to our competition in terms of profitability	.9152

Table 5.4.9 Construct Correlations (Legal and Behavioral Dimension 1st Order Factors)

	EXIST	PORIENT	GCOMPA	CLANG	BCOLLAB	COMMIT	RETRUST	RECOOP	CSENS	SSATIS	SSTAB	SFLEX	SPERF
1	1.00												
2	.473**	1.00											
3	.167	.164	1.00										
4	.210*	.325**	-.240	1.00									
5	.151	.114	.257	.072	1.00								
6	.028	.224*	.070	.137	.200*	1.00							
7	.012	.026	.064	-.033	.233**	.674**	1.00						
8	.064	.065	.123	.059	.243**	.736**	.617**	1.00					
9	.101	.145	.180*	.106	.357	.217	.249**	.275**	1.00				
10	-.128	-.081	-.055	.097	-.049	.648**	.613**	.526**	.120	1.00			
11	.005	.059	.063	.081	.002	.670**	.578**	.571**	.166	.713**	1.00		
12	.056	.116	.172	.179*	.291**	.612**	.553**	.610**	.368**	.536**	.554**	1.00	
13	.007	.100	.080	.088	.183*	.732**	.467**	.635**	.070	.601**	.565**	.597**	1.00
14	.124	.193*	.181*	.074	.312**	.536**	.353**	.556**	.289**	.330**	.477**	.680**	.638**

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

5.5 HYPOTHESES TESTING

The first four hypotheses test relational governance strategy and its influence on strategic performance indicators (e.g., stability, satisfaction). It is hypothesized that the legal and behavioral dimensions of relational governance strategy have different affects on performance. In a preliminary test of the statistical relationships, correlation analysis (Table 5.5.1) shows that the legal dimension is not correlated significantly (at .01 level of significance) with any of the performance variables. However, with a lower level of significance (0.10), the legal dimension is correlated significantly with learning outcomes ($r = .150$, $p = .08$) and negatively with satisfaction ($r = -.149$, $p = .09$). Basically, there is no relationship between the legal dimension and performance. These results prompted a correlation analysis for the first-order measures of legal dimension and performance for comparison. The results in Table 5.4.10 show something different. At .05 level of significance, performance orientation and goal compatibility (first-order measures of the legal dimension) are correlated with learning outcomes ($r = .193$, $p = .02$) and ($r = .181$, $p = .04$), respectively.

However, correlational analysis (Table 5.5.1) for the behavioral dimension and performance are all highly correlated and significant. Again, testing the first-order factors of behavioral dimension indicates some exceptions. Cultural sensitivity is not correlated significantly with satisfaction ($r = .120$, $p = .16$) or performance ($r = .070$, $p = .42$). In addition, relational collaboration is not correlated significantly with stability ($r = .002$, $p = .98$) and is negatively correlated with satisfaction ($r = -.049$, $p = .57$) although the correlation is not significant.

Table 5.5.1 Construct Correlations (Legal and Behavioral Dimension 2nd Order Factors)

	ELIFLEG	ELIFBEH	SSATIS	SSTAB	SFLEX	SPERF	SLOUT
ELIFLEG	1.00						
ELIFBEH	.122	1.00					
SSATIS	-.149	.521**	1.00				
SSTAB	.000	.561**	.713**	1.00			
SFLEX	.017	.694**	.536**	.554**	1.00		
SPERF	.041	.588**	.601**	.565**	.597**	1.00	
SLOUT	.150	.583**	.330**	.477**	.680**	.638**	1.00

** Correlation is significant at 0.01 (2-tailed).

In summary, the correlation analysis provides some indications of the relationships among the constructs. The legal dimension shows little relationship with performance, whereas, the behavioral dimension has a high relationship with performance.

Using regression analysis, all performance variables were regressed individually as separate regression models on legal and behavioral dimension (results in Table 5.5.2). The significance of the models (using second-order factors) and their R^2 , or percent of variance explained, follows:

1. stability: $R^2 = .324$, $p = .000$
2. flexibility: $R^2 = .462$, $p = .000$
3. satisfaction: $R^2 = .191$, $p = .000$
4. learning outcome: $R^2 = .359$, $p = .000$
5. performance; $R^2 = .322$, $p = .000$

Table 5.5.2 Regression Results – Relational Governance Strategy on Performance

	Independent Variable	Regression Beta (std)	t-value	Sig. Level
Stability				
Model $R^2 = 0.324$ F = 31.472 p = .000	Legal Dimension	-0.073	-0.995	.322
	Behavioral Dimension	0.548	7.934	.000
Flexibility				
Model $R^2 = 0.462$ F = 56.521 p = .000	Legal Dimension	-0.065	-1.005	.317
	Behavioral Dimension	0.693	10.628	.000
Satisfaction				
Model $R^2 = 0.191$ F = 16.130 p = .000	Legal Dimension	-0.072	-0.902	.369
	Behavioral Dimension	0.897	8.079	.000
Learning Outcome				
Model $R^2 = 0.359$ F = 34.868 p = .000	Legal Dimension	0.156	1.116	.267
	Behavioral Dimension	0.582	8.079	.000
Performance				
Model $R^2 = 0.322$ F = 31.055 p = .000	Legal Dimension	-0.027	-0.371	.711
	Behavioral Dimension	0.580	7.862	.000

However, even though the individual models show significant results, individual analysis of the regressed performance variables reveals that only the behavioral dimension is significant in each model.

Hypothesis 1a, which argues for greater stability with manufacturer emphasis on the legal dimension is **not supported** ($B = -0.073$, $t = -0.99$, $p = .322$). The result shows no relationship between the legal dimension and stability and is opposite the initial

hypotheses. Hypothesis 1b, that emphasis on behavioral dimensions is associated with greater relationship stability, is **supported** ($B = 0.584$, $t = 7.93$, $p = .000$).

Hypothesis 2a, a high presence of contractual regulations leads to lower relationship flexibility, is **not supported** ($B = -0.065$, $t = -1.00$, $p = .317$). The relationship is negative and in the hypothesized direction and therefore implies no relationship between the degree of legal formality and flexibility. On the other hand, emphasis on the behavioral dimensions leads to greater relationship flexibility ($B = 0.693$, $t = 10.63$, $p = .000$), thus **supporting** Hypothesis 2b.

Hypothesis 3a, high formal structure reduces learning, is **not supported** ($B = 0.080$, $t = 1.11$, $p = .267$). However, a high emphasis on the relational norms does have a positive relationship on the ability to learn ($B = 0.582$, $t = 8.08$, $p = .000$), which **supports** Hypothesis 3b.

Hypothesis 4a is **not supported**, but is significant in the opposite direction than was proposed originally ($B = -0.217$, $t = -2.89$, $p = .005$). The original argument was that satisfaction depended upon the fulfillment of performance objectives. If the distributor were able to comply, then the manufacturer would be satisfied with the distributor's efforts. Yet, it appears as if the presence of a high legal structure reduces the satisfaction in the relationship, thereby implying that satisfaction depends on variables that go beyond fulfilling contractual objectives. Contrarily, Hypothesis 4b follows the logic of satisfaction as a function of the intangible elements or interrelatedness of the relationship. The results ($B = 0.540$, $t = 7.21$, $p = .000$) **support** the hypothesis.

Finally, Hypotheses 5 is only partially supported. The regression analysis ($R^2 = 0.581$, $F = 45.79$, $p = .000$) indicates that strategic performance represents competitive

capabilities that ultimately influence the economic performance, that these capabilities have some impact on the ability to be competitive in the market. However, individual analysis shows that stability ($B = -0.006$, $t = -0.068$, $p = .946$) and flexibility ($B = 0.017$, $t = 0.19$, $p = .843$) are not significant. The model results are illustrated in Figure 5.4.3.

5.5.1 Interaction of Legal and Behavioral Dimension

In order to gain more insight into the manufacturer-distributor relationship and explore the nature of interaction between the dimensions, combinations of legal and behavioral dimensions were tested against each performance measure as proposed in Hypotheses 6. These hypotheses suggest that a high level of either independent variable (the legal or behavioral dimension) of relational governance strategy may be sufficient to result in a high level of the dependent variable (performance variables). At the same time, the joint occurrence, or interaction between the predictor variables may do much to increase the level of the dependent variable or it may do little.

Accordingly, Hypotheses 6a through 6d examine the manufacturer's management of his relationship with a distributor in an international environment. The legal and behavioral dimensions were dichotomized into high and low to denote the extent by which the manufacturer emphasizes the different dimensions. The legal dimension's distribution is bimodal, providing a natural difference in high versus low formal structure. A score of 3 and below indicates a high structural emphasis, whereas a score of 4 and above represents a low emphasis on structural formality. The behavioral dimension was divided into half based on the mean. Below 3.5 indicates an informal relationship, whereas 3.5 and above represents a formal relationship.

MANOVA was used to evaluate contrasts among the different levels of formality and relationship interaction. These differences are illustrated as mean scores via different cells in a 2 X 2 matrix designed to illustrate export performance. The cells composing the matrix outline the different combinations of formal structure (legal dimension) and relationship interrelatedness (behavioral dimensions) that are used to influence performance. The MANOVA test follows the assumption that interaction effects exist. Therefore, the procedure suggests that a high level of either independent variable (legal or behavioral) may be sufficient to result in a high level of the dependent variable.

The actual MANOVA test results for the legal and behavioral dimensions and their interaction are displayed in Tables 5.6.1-3 and 5.6.4. The 2 X 2 matrix illustrates the interaction between the legal and behavioral dimensions. The numeric figures in the cells are the means of the performance variables. A mean closer to 1 indicates a high score, whereas a high mean indicates that the company has produced a low score (note that this is a reverse scale: performance decreases with increasing score).

The MANOVA test results indicate no significant difference between the legal dimension's high and low levels among the performance groups (F range from 0.03, $p < .856$ to 3.2, $p < .075$). In other words, the emphasis on legal dimension has no significant difference in the mean scores of the strategic performance variables. However, there are significant differences between the behavioral dimensions high and low levels among the performance groups (F range from 31.03, $p < .000$ to 74.05, $p < .000$). In addition, there are significant differences in the interaction between the legal and behavioral dimensions on both high and low levels (F range from 5.46, $p < .020$ to 6.63, $p < .011$). A summary of the models' results is displayed in Table 5.6.1a-c. The following discuss some of the

findings and consequences regarding the use of legal and behavioral dimensions in the relationship.

The combination of high legal emphasis and high behavioral emphasis leads to high performance (13.3% export profitability), high learning, high satisfaction, high stability and high flexibility. These results **support** Hypothesis 6a. However, flexibility is high even though it was hypothesized to be low (Cell I, mean = 2.42). This may be a reflection of the interaction between the legal and behavioral dimension, which together may increase flexibility. The impact of the legal dimension on flexibility without influence of the behavioral dimension is negative.

The combination of high legal emphasis and low behavioral emphasis leads to low economic performance (8.1%), low learning, low satisfaction and low flexibility. However, stability is low (Cell II, mean = 4.13) although it is posited that stability is high due to the idea that a detailed contract would set forth a structure by which the partners could count upon. Even though the contract establishes clear guidelines, the fact that low relationship interaction exists between the partners may indicate that they do not feel comfortable with each other, share information, or collaborate. Overall, Hypothesis 6b is **supported**.

The combination of low legal structural emphasis and high behavioral emphasis (Cell III) contributes to high economic performance (11.2%), high stability, high flexibility, high satisfaction and high learning outcomes. Thus, Hypothesis 6c is **supported**.

Finally, the combination of low legal emphasis and low behavioral emphasis contributes to the lowest performance outcomes. Economic performance (7.5%),

flexibility, satisfaction, stability, and learning outcomes all have high means, indicating low performance in comparison to the other combinations of legal and behavioral dimensions (Cell IV). The results **support** Hypothesis 6d. The 2 X 2 matrix (Table 5.6.5) displays the interaction between the legal and behavioral dimensions.

Table 5.6.1 Comparisons Between Legal and Behavioral Dimensions

Dependent Variable	LEGAL DIMENSION	BEHAVIORAL DIMENSION	Mean	Std. Error
SSATIS	.00	.00	3.250	.212
		1.00	3.931	.236
	1.00	.00	2.512	.240
		1.00	4.364	.221
SSTAB	.00	.00	3.111	.237
		1.00	4.069	.264
	1.00	.00	2.524	.269
		1.00	4.798	.248
SFLEX	.00	.00	2.403	.175
		1.00	3.534	.196
	1.00	.00	2.250	.199
		1.00	4.364	.183
SPERF	.00	.00	3.185	.185
		1.00	4.057	.207
	1.00	.00	2.524	.210
		1.00	4.646	.194
SLOUT	.00	.00	2.861	.202
		1.00	3.776	.225
	1.00	.00	2.607	.229
		1.00	4.538	.211

**Table 5.6.2 Comparisons Within Group Means
(Legal Dimension)**

Dependent Variable	(I) LEGDIM	(J) LEGDIM	Mean Difference (I-J)	Std. Error	Sig.
SSATIS	.00	1.00	.153	.227	.503
	1.00	.00	-.153	.227	.503
SSTAB	.00	1.00	.000	.255	.781
	1.00	.00	.000	.255	.781
SFLEX	.00	1.00	-.338	.189	.075
	1.00	.00	.338	.189	.075
SPERF	.00	1.00	.000	.199	.856
	1.00	.00	.000	.199	.856
SLOUT	.00	1.00	-.254	.217	.245
	1.00	.00	.254	.217	.245

The levels are 0 (high degree of formal structure)
and 1 (low degree of informal structure)

**Table 5.6.3 Comparisons Within Group Means
(Behavioral Dimension)**

Dependent Variable	(I) BEHDIM	(J) BEHDIM	Mean Difference (I-J)	Std. Error	Sig.
SSATIS	.00	1.00	-1.266	.227	.000
	1.00	.00	1.266	.227	.000
SSTAB	.00	1.00	-1.616	.255	.000
	1.00	.00	1.616	.255	.000
SFLEX	.00	1.00	-1.623	.189	.000
	1.00	.00	1.623	.189	.000
SPERF	.00	1.00	-1.497	.199	.000
	1.00	.00	1.497	.199	.000
SLOUT	.00	1.00	-1.423	.217	.000
	1.00	.00	1.423	.217	.000

The levels are 0 (high degree of formal structure)
and 1 (low degree of informal structure)

Table 5.6.4 MANOVA Results of Relational Governance Strategy on Performance

Source	Dependent Variable	Type III Sum of Squares	df	F	Sig.
Overall Model	SSATIS	59.44	3	12.29 <i>a</i>	.000
	SSTAB	94.54	3	15.56 <i>b</i>	.000
	SFLEX	95.66	3	28.76 <i>c</i>	.000
	SPERF	80.77	3	21.74 <i>d</i>	.000
	SLOUT	74.50	3	16.87 <i>e</i>	.000
Intercept	SSATIS	1540.30	1	955.94	.000
	SSTAB	1639.44	1	809.58	.000
	SFLEX	1227.99	1	1107.60	.000
	SPERF	1619.39	1	1307.65	.000
	SLOUT	1480.71	1	1006.15	.000
LEGDIM	SSATIS	.72	1	.45	.503
	SSTAB	.15	1	.07	.781
	SFLEX	3.56	1	3.21	.075
	SPERF	.04	1	.03	.856
	SLOUT	2.01	1	1.36	.245
BEHDIM	SSATIS	50.00	1	31.03	.000
	SSTAB	81.43	1	40.21	.000
	SFLEX	82.10	1	74.05	.000
	SPERF	69.92	1	56.46	.000
	SLOUT	63.11	1	42.89	.000
LEGDIM * BEHDIM	SSATIS	10.68	1	6.63	.011
	SSTAB	13.50	1	6.67	.011
	SFLEX	7.51	1	6.77	.010
	SPERF	12.18	1	9.84	.002
	SLOUT	8.04	1	5.46	.021

a Adjusted R Squared = .213 b Adjusted R Squared = .259 c Adjusted R Squared = .400

d Adjusted R Squared = .332 e Adjusted R Squared = .276

Table 5.6.5 Interaction of Legal and Behavioral Dimensions

		Behavioral Dimension (degree of emphasis)	
		High	Low
Legal Dimension (degree of emphasis)	High (formal)	I Scenario A High Economic Performance (13.3%) Strategic Performance Low flexibility (2.42) High satisfaction (3.21) High stability (3.12) High learning (2.80)	II Scenario B Low Economic Performance (8.1%) Strategic Performance Low flexibility (3.54) Low satisfaction (4.12) High stability (4.13) Low learning (3.71)
	Low (informal)	III Scenario C High Economic Performance (11.2%) Strategic Performance High flexibility (1.89) High satisfaction (2.26) High stability (2.23) High learning (2.51)	IV Scenario D Low Economic Performance (7.5%) Strategic Performance Low flexibility (4.35) Low satisfaction (4.28) Low stability (4.82) Low learning (4.54)

The means are based on the 7-point Likert scale with 1 as Strongly Agree -- 7 Strongly Disagree. The lower the number, the closer the respondent is to the extreme.

Interaction plots between the legal and behavioral dimensions are displayed to help illustrate the interaction between the legal and behavioral dimensions as well as their influence. These interactions are highlighted in Figure 5.6.1. The performance variables are plotted against the legal dimension (horizontal axis) and the behavioral dimension (vertical axis). The numbers for the legal dimension represent a high degree of emphasis on the rules and regulations (0.0) as opposed to few rules and regulations (1.0). Likewise, the 0.0 line characterizes a relationship that has a high degree of interaction. On the other hand, the 1.0 behavior line indicates a relationship with little to no interaction. The numbers on the vertical axis are the means, which correspond to the 2X2

matrix. A high mean show a low performance score, whereas a low mean indicates high performance. In other words, the scale is reversed.

Comparing **Cells I (Scenario A)** and **III (Scenario C)**, the combination of high legal dimension emphasis vs. low legal dimension emphasis with the behavioral dimension (informal relationship) indicates that a highly informal relationship with a high formal structural relationship results in higher strategic performance across all performance variables (i.e., flexibility, satisfaction, stability, and learning). However, flexibility is the exception. One reason why flexibility is higher than hypothesized may be that the informality the relationship enjoys compensates for a high content of rules and relationship guidelines. In addition, the partners may have a relationship whereby the explicit contract guides rather than detracts from the relationship. This situation may reflect a manufacturer's extensive international experience, which allows the manufacturer a greater sense of handling cross-border relationships.

The flexibility performance variable in **Cell III** has a significantly higher mean than flexibility in the other groups. This reflects the low formal structure or a low emphasis on the legal dimension. The contractual structure is not as explicit in defining operational terms as the scenario in **Cell I**. However, performance is lower in this combination than the one with high legal dimension and high behavioral (informal) relationship. This finding is consistent with Bello and Gilliland's (1997) result that manufacturer effort to monitor distributor results lead to enhanced channel performance. One reason why the economic performance may not be as high could be that the contract does not expressly state a certain distributor performance standard that must be met. Not including a precise performance clause in the contract is an indication that the partners

have developed a relationship where both parties share the risks involved in meeting performance objectives. The implication is that they have created an atmosphere of mutual trust, collaboration, and commitment to the relationship. On the other hand, the manufacturer may defer the performance issues to the distributor because the manufacturer may not have good host market knowledge.

Cells II (Scenario B) and IV (Scenario D) do not share the same result regarding the low informal behavioral structure (e.g., the relationship has low trust, commitment, and cooperation). In this situation, under the presence of a formal contractual structure, performance indications for Cell II are higher than the performance indications for **Cell IV (Scenario D)**. The combination of high contractual content and low relationship interaction (**Cell II-Scenario B**) illustrates a relationship that is based on a formal structure where the manufacturer may dictate terms unilaterally. There may be little relationship commitment, trust, cooperation and information sharing in this relationship. This is indicative of a hierarchal relationship. The relationship may characterize one that is within the first few building stages, where the long-term effects of relational norms have not evolved. On the other hand, the presence of a long-term relationship does not mean that the partners have developed relational or social norms (Lusch and Brown 1996). **Cell II** may also represent the relational governance strategy of an exporting firm that does not have much international experience.

As proposed, **Cell IV (Scenario D)** has the lowest overall performance. There is very little formal relationship structure; neither is there evidence of high trust and commitment between the partners in the relationship. Accordingly, learning and relationship flexibility are low. Satisfaction is low also because the manufacturer may

not perceive that he is receiving the performance expected from the relationship. In addition, relationship stability is low, reflecting the idea that since the relationship does not appear to have much benefit, the partners' commitment to remain in the agreement is weak. Basically, the manufacturer has not put into place any processes or systems that would indicate a willingness to share risks or commit resources. Given this scenario, agency theory predicts that low performance will result.

The findings suggest that the manufacturer's emphasis on the legal dimension of the relationship (the explicit procedures, rules, etc.) would not make a significant difference on performance. Contrarily, a manufacturer who does emphasize the behavioral aspects of the relationship will perform better. What is interesting is that the combination of formal structure and informal relationship contributes to higher performance. Indeed, an informal approach to a relationship combined with a high or low emphasis on the legal dimension has higher performance. In general, the manufacturer's emphasis on some forms of behavioral elements seems to enhance overall performance.

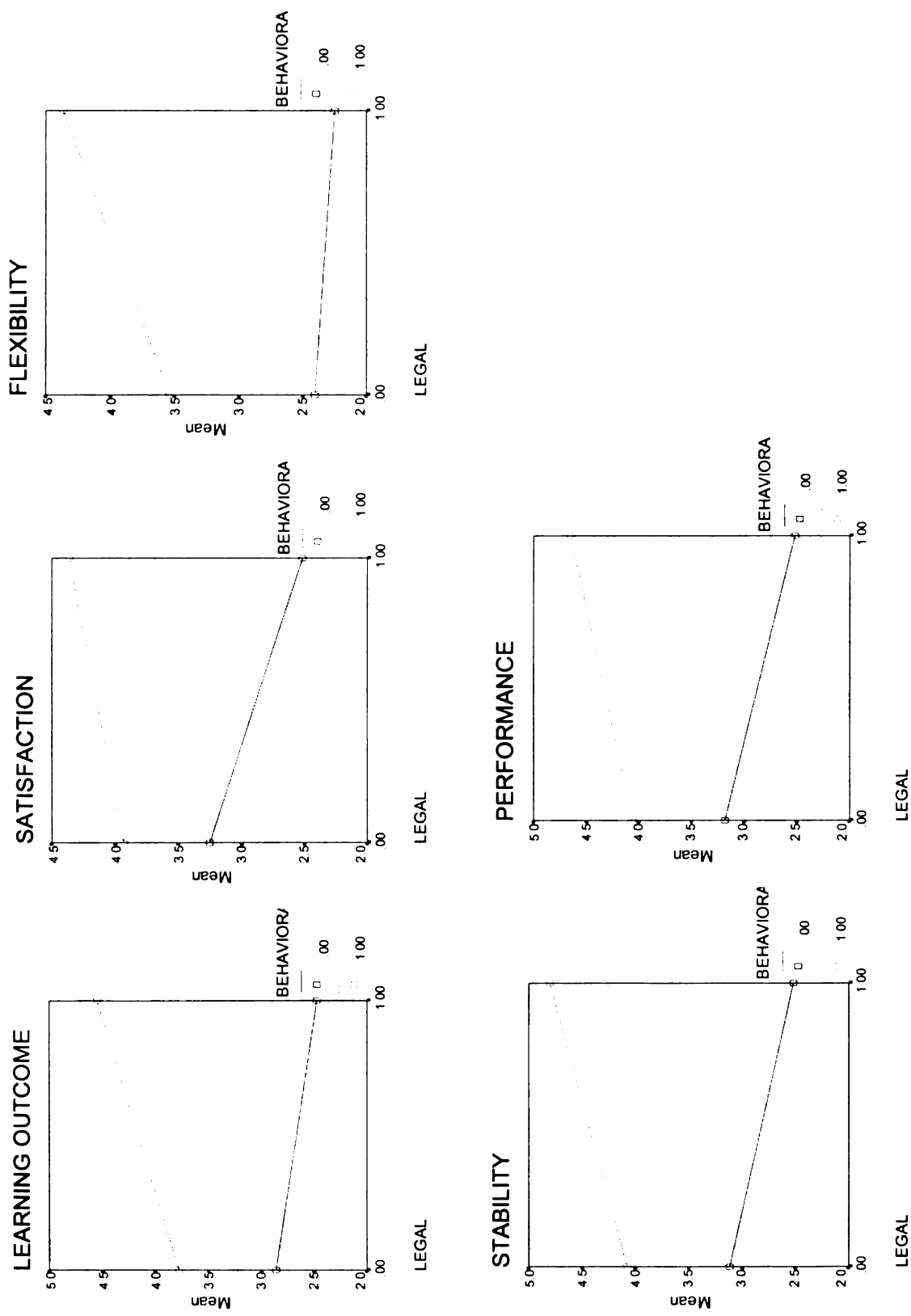


Figure 5.6.1 Interaction Plots for Performance Objectives on Legal and Behavioral Dimensions

Table 5.6.6 Summary of Hypotheses Results

	Proposed	B	t-value	Actual
Relational Governance Strategy to Performance				
H1a: Legal dimension leads to relationship stability	+	-.073	-0.99	not supported
H1b: Behavioral dimension leads to relationship stability	+	.584	7.93	+
H2a: Legal dimension negatively related to flexibility	--	-.065	-1.00	not supported
H2b: Behavioral dimension positively related to flexibility	+	.693	10.63	+
H3a: Legal dimension leads to low learning	--	.080	1.11	not supported
H3b: Behavioral dimension contributes to high learning	+	.582	8.08	+
H4a: Legal dimension leads to high satisfaction	+	-.072	-0.90	(-) not supported
H4b: Behavioral dimension leads to high satisfaction	+	.897	8.18	+
H5: Strategic performance influences economic performance	+	F=45.8	R ² = .581	<i>partial support</i>
Joint Effects of Relational Governance Strategy on Performance				
H6a: High legal and High Behavioral dimension influence on strategic performance	F		R ²	
H6b: High legal and Low Behavioral dimension influence on strategic performance	Satisfaction = 12.297 Stability = 15.562 Flexibility = 28.762 Learning = 16.876 Performance = 21.741		.213 .259 .400 .332 .276	support support support support support

CONCLUSIONS, DISCUSSION AND IMPLICATIONS OF RELATIONAL GOVERNANCE STRATEGY

6.1 INTRODUCTION

Recently, research has placed greater emphasis on exploring the behavioral elements of interfirm relationship (Hill 1990, Ring and Van de Ven 1992, Heide 1994, Bello and Gilliland 1997). From their work on relational governance, Zaheer and Venkatraman (1995), call for research into the process (or behavioral) elements of relationships in order to better understand interorganizational behavior. The implication from this dissertation's results, combined with practical insight, is that the behavioral elements of cross-border relationships are very important to success in the international environment.

In this chapter overall conclusions are drawn about the dissertation's examination of relational governance strategy. This is followed by conclusions about the specific research findings. The theoretical and managerial implications regarding the employment of relational governance strategy are presented, which are succeeded by research limitations and future research suggestions.

6.1.1 Overall Model Significance

The first objective of this study is to *develop and explore the role of the contract as the key element of relational governance strategy* in manufacturer-foreign distributor relationships. The dissertation argues that research could examine relational governance strategy as a concept that embodies two dimensions. This perspective is an alternative to that within the international marketing literature's tradition, which generally holds that relational governance lies along a one-dimension continuum. In addition, the approach in

this dissertation deviates slightly from neoclassical theories, assuming that even the most formal, or discrete, arrangements have relational elements (Zaheer and Venkatraman 1995). The two dimensions of relational governance strategy represent relationship structure (legal dimension) and relationship interaction or interrelatedness (behavioral dimension). Two, the dissertation bases the argument upon agency theory propositions. Doing so takes the foundation of the relationship away from exchanges built not only upon transaction-specific assets but also into an arena where the relationship is established upon relational or behavioral terms. A unique factor of relational governance is that parties to a relationship are interested in combining mutual-specific resources that will contribute to performance and/or value creation.

These ideas then motivate the question of the impact these relational governance strategy dimensions have on the firm's ability to obtain satisfactory performance. Addressing this question leads to the second and third research objectives, which are to a) *examine the dimensions of relational governance strategy in a framework* from which to b) *model the outcomes of relational governance strategy*. Hence, the underlying proposition that the relationship is concentrated around a contract guides the premise that relational governance strategy is comprised of a legal (or relationship structure) dimension and a behavioral (or relational interrelatedness) dimension. The manufacturer can emphasize one or a combination of both dimensions in order to positively influence performance. The dimensions of relational governance strategy guide the interaction between cross-border partners.

The fourth and last research objective is to *extend the generalizability of the model* theoretically and practically. Overall, the proposed model is a representation of

the relational governance strategy concept and its extension to the international context. The confirmatory factor analysis tests indicated that the legal and behavioral dimensions are good higher order representations of their respective measures. However, even as the reliability measures for the behavioral dimension (e.g., relational trust, collaboration, commitment) were strong and consistent with previous research (Noordewier, John and Nevin 1990, Gundlach, Achrol and Mentzer 1995), the legal dimension reliability measures were noticeably weaker. The findings of the overall model have some hypothesized relationships that are not significant or not supported, but the majority of the relationships were generally in the hypothesized directions. The measures for the first-order factors of legal dimensions were duplicated and modified from previous research that investigated the structural aspects of manufacturer-distributor relationships (Lusch and Brown 1996, Karunaratna and Johnson 1997).

One point that is interesting from follow up interviews is the emphasis that many companies place on the behavioral aspects of the relationship over the structural, or formality issues; approximately 47% of the respondents reported that their relationship was moderately informal or very informal. Indeed, some exporting companies have recognized that behavioral factors of their interorganizational relationships are tied positively to performance. Data analysis appears to support this strong implication as many relational variables are correlated highly with performance variables. Moreover, from a statistical standpoint, LM multivariate test recommendations suggest model modifications that allow relational measures to load on performance constructs in order to improve significantly the model.

In the context of the dissertation's international focus, the research model and accompanying hypotheses illustrate the behavioral component's importance in the relationship. Likewise, the legal dimension is a vital part of establishing the structural foundation of the cross-border relationship because the results also imply that merely adopting one form of the governance mechanism (either legal or behavior) does not necessarily guarantee successful performance. This finding is consistent with Lusch and Brown's (1996) conclusions. It is evident that applying both aspects may certainly increase the manufacturer's ability to attain strategic objectives.

6.1.2 Hypotheses Significance

The first part of Hypotheses 1-4, which posit that the legal dimensions aspect of relational governance strategy contribute significantly to various aspects of performance, do not indicate that the legal dimension alone influences the relationship's ability to attain some of the strategic capabilities that influence performance. Instead, exporting manufacturers may view the contract as a necessary formality that merely safeguards the manufacturer's position and assets. Indeed, one lawyer remarked that the core role of the contract had been reduced to such a degree that "one could download a boilerplate form from the internet" (Deming International Lawyer-1999). Many managers made the comment that they "needed to ensure [the distributor's] payment" or that "...force majeure was a necessary clause..." in the contract to protect themselves from unforeseen circumstances. The overall sense is that the formal structure of relational governance strategy is not a vehicle by which to attain strategic objectives or performance if relied upon solely.

Specifically, a manufacturer's emphasis on the legal dimensions of relational governance does not help the relationship's stability, flexibility or its satisfaction. Even though the contract may spell out the structure, the length of the relationship or the performance requirements that must be met in order to avoid some sort of sanctions imposed upon the agent, these sanctions do not guarantee that the partner will commit to make the relationship work. This lack of commitment also is evident in the relationship's inability to react to changing market conditions if the manufacturer placed greater emphasis on the legal structure.

Even though contractual obligations are fulfilled as a result of the manufacturer's emphasis on the legal structure, this does not mean that the manufacturer is satisfied with the relationship. The low relationship stability and reduced capability to adjust to environmental conditions may eventually lead to dissatisfaction with the relationship's inability to reach strategic goals.

The legalities of the relational structure also placed detailed performance guidelines in the contract. Doing so reduced the manufacturer's exposure to risk. Indeed, export growth and export profitability is higher with a manufacturer's greater emphasis on legal dimensions. This finding is consistent with Bello and Gilliland's (1997) finding that manufacturer's efforts to monitor distributor results lead to enhanced channel performance. One of the implications that can be drawn from this is that the formality or legal structure of the contract is an important element to motivate the distributor because it places greater risks on the distributor. Moreover, if the legal rules, procedures and regulations are designed as decision-enablers, rather than compliance devices, they will more than likely contribute significantly to flexibility, stability, satisfaction and learning.

The manufacturer's emphasis or reliance upon relational interaction has helped to increase performance in many aspects. Relationship stability, satisfaction, flexibility and learning are higher with increased relationship interaction. Basically, the manufacturer has placed an emphasis on fostering social norms to protect resources and create value through synergies recognized as part of the relationship. This connotes the concept of mutual-specific assets, which is important because it reflects the partners' willingness to invest in the relationship by demonstrating trust-building mechanisms (Axelrod 1984).

The behavioral dimension is also associated with the idea that the manufacturer understands the relational aspect's importance to the ability to create and develop competitive capabilities. One of the products of this relationship is the manufacturer's increased capability to work with foreign distributors as well as their ability to maneuver within the host environment. Social barriers may be more easily overcome through a behavioral approach.

These conclusions may be valid for small- to medium-sized companies since much of their international business may rely upon foreign distributors taking some form of "product ownership" (e.g., the correlation between firm size and the existence of a contract is negative and significant, $r = -0.223$, $p = .022$). In this situation, smaller companies emphasize the behavioral aspect of relational governance more than larger companies. Large companies are in a better position to dictate strategic and operational procedures to foreign distributors because of their size and market power potential. Exporting manufacturers in this position are not as dependent upon the benefits from nurturing relational norms with their relatively smaller foreign partners. Therefore, they

are more apt to emphasize legal dimensions that protect their assets and that reduce their risk exposure.

Legal and Behavioral Effects. The interesting aspect of the relation between the legal and behavioral dimensions of the relational governance strategy is their interaction. For example, the manufacturer that emphasizes the behavioral or interrelatedness of the relational governance strategy will have better performance regardless of the formality of the relationship's contractual terms.

A high degree of relationship informality normally is associated with a greater degree of information sharing and collaboration such as joint training. This seems to lead to a greater sense of loyalty, trust and relationship commitment, which appears to be essential to performance. Satisfaction and learning are also increased with the higher behavioral emphasis.

When a manufacturer emphasizes the legal formality, he typically enjoys higher performance results in all performance measures. One of the exceptions is flexibility. The interesting exception to this situation is the case where a high degree of legal formality is combined with a high emphasis on the behavioral issues. Under these relationship conditions, performance is actually *lower* with a high degree of emphasis on contractual regulations. The lower contractual structure probably permits the companies to better adjust to changing environmental situations because the partners do not have to rely upon referencing specific rules, etc. Having to refer constantly to the "letter of the law" may dictate certain handling of situations and ultimately cause delays and reduced capability to react to changing conditions. The manufacturer must rely upon the

distributor's knowledge and cultivated networks in the host country in order to conduct business. Frequently, export managers expressed frustration with having to "know someone" or be subjected to potential bribe situations. Hence, the most effective way to deal with these scenarios is to create relational trust, commitment and cooperation as means to monitor and govern the distributor's actions.

The economic component of performance, as a measure of export sales growth and profitability, is the highest with the combination of high formality and high informal behavioral dimension. This is interesting because it suggests that the presence of formal rules and procedures are not detrimental to a relationship that has a high degree of interaction or social norms. Indeed, if definitive performance objectives are written into the contract, there is greater manufacturer monitoring-meaning that the manufacturer can monitor and assess the distributor's performance. This, then, places the burden of risk on the distributor to perform, which ultimately leads to higher performance. On the other hand, a low contractual structure implies that there may be a greater reliance on self-governing mechanisms and consequently, a greater opportunity for the distributor to shirk (or behave opportunistically under certain circumstances), which may be just enough to lower overall performance. A formal contract may be necessary in order to place more risk upon the distributor and a way to increase distributor compliance with the manufacturer's goals.

Finally, a relationship with little formal contract structure and little behavioral interaction is very similar to a pure market-based exchange where transactions are rather discrete. The stability and learning aspects of performance are absent. Likewise, satisfaction and flexibility are low. As expected, performance is low since the partners

are not truly investing in the relationship. However, the performance difference between this type of situation and the one with a formal contractual structure indicates that performance is slightly better with a formal contractual structure. Again, the addition of definitive contractual terms helps to safeguard the manufacturer by placing greater risk upon the distributor. Doing so helps absolve the manufacturer of the added costs of monitoring as the manufacturer mitigates the costs associated with information asymmetry through the use of the formal contract structure.

6.2 THEORETICAL AND MANAGERIAL IMPLICATIONS

Theoretical Contribution. A fundamental issue forms the backbone of this dissertation, namely, how do manufacturers manage their cross-border relationships in order to influence performance? The conceptualization of relational governance strategy helps to answer this question and makes a theoretical contribution because it extends the concept of relational governance to a strategic option by considering an alternative theoretical perspective. The dissertation frames this question under the propositions of agency theory instead of TCE. Both theories are based in organizational economics, but agency theory is applicable because of its inclusion of relational variables to investigate relationships among autonomous partners. Contrarily, TCE forces a limit to relationship research in the sense that the theory is asset-based and therefore concentrates on eventual hierarchical control. Current theoretical research is headed in the direction of exploring and explicating relational dimensions (e.g., trust, commitment, and cooperation) while incorporating more dynamic elements of interorganizational interaction. This dissertation is timely in answering those calls to research. In addition, the dissertation investigates

the concept of relational governance strategy in an international context, which again, extends the literature.

The existence of the legal and behavioral dimensions as second-order factors helps to verify the proposition that a structural and a behavioral process exist as governance mechanisms. The idea that they can be utilized as tools to manage a relationship also has some empirical support from the fact that performance outcomes vary significantly with different combinations of relational governance strategy "tools." As posited in Chapter Three, the performance from these different dimensions can have favorable or unfavorable outcomes.

Finally, this dissertation has attempted to examine cross-border relationships as an active process, rather than a static state. Subsequently, an attempt to increase understanding of interfirm dynamics is to examine the influence of managerial behavior, which Buckley and Casson (1998) posit contribute to the dynamism of the relationship. A dynamic state perspective recognizes that the attributes of the relationship cannot be studied in isolation; rather, many factors interact to create the complexity underlying relationships. Moreover, Buckley (1996, p. 21) suggests "it is essential to move away from... states to ...processes and that doing so would increase the flexibility of international theories."

Managerial Contribution. The relevance of this dissertation's topic is reflected by the activities among exporting firms. Interviews with exporting managers indicate that developing and managing cross-border relationships are a necessity for survival. This is especially true in countries that have different legal infrastructures or cultures that value interpersonal relationships. Coupled with this is the realization that managing

international alliances is difficult with alliances failing at a high rate (Rosson and Ford 1982, Conn and Yip 1997). Exporting companies that have made significant investments to integrate international distribution channels are not finding the "holy grail" as readily as they would undoubtedly like.

Through the international marketing and strategic literature, interviews with several different companies and a comprehensive questionnaire, this dissertation has identified some of the dynamics of relationship management and the underlying problems associated with cross-border relationships by focusing on the contractual structure of relational governance. A well-designed contract enables an exporting company to outline the relationship's structure and expectations while guiding the partners' interaction. The point is that the contractual structure can be a conduit for a relational strategy that preempts a multinational's exposure to risks while mitigating much of the global pressures the relationship encounters. If the manufacturer develops the legal dimension as a compliance mechanism, rather than an effective structure for decision-making, performance will eventually suffer, the relationship may not have long-term viability or performance capabilities will not be realized.

Succinctly, relational governance strategy helps to increase a company's operational and strategic flexibility. Relational governance strategy helps to stimulate learning in the form of foreign understanding and process development. Furthermore, relational governance strategy can increase the probability that the manufacturer will be satisfied with the relationship's overall performance. More important, a manufacturer that has developed the ability to use the contract has created a competitive advantage.

6.3 LIMITATIONS

The dissertation focused on formulating a concept of relational governance strategy that was composed of two dimensions. The intention was to address research findings, which suggest that relational governance is not necessarily a single higher order construct of relational norms. The model of relational governance developed in this study supports the previous findings and makes some inroads, but falls short of fully extracting the formal and behavioral dimensions of the relational governance strategy.

One approach may have been the measurement scales that are used to develop the legal dimensions. Some scales were established in the literature to measure the degree of explicitness within the interorganizational exchange, but these scales were not designed to specifically address the role of relational governance as a strategy. For instance, the attention that exporting companies place on creating mutual-specific resources is not captured in the legal dimension element of relational governance strategy. Indeed, some comments from respondents during follow up interviews suggest that some measures are ambiguous or not completely applicable to their particular situation.

Future research should investigate and develop these scales in order to capture the changing nature of relationship management, particularly in an international setting. For instance, some of the measurement scales do not accurately capture the intent of relationship management or the subtleties of culture that underlie relational norms. What do trust and commitment mean in different cultures? This indicates a valuable opportunity in the scale development process, especially in the areas of commitment, trust, and cooperation.

Besides the need to examine these relationships longitudinally or as dyads, the performance measures should be developed to look more closely at strategic objectives

such as organizational flexibility and learning. These are perceptual performance measures that would be difficult to verify using archival data. However, statistical tests could be employed to test the differences between the archival data and the perceptual measures.

A fundamental need exists to examine the foreign distributor's perspective. One of the basic premises of this dissertation is that the partners in the relationship are autonomous which implies that the distributors have the potential to influence greatly the strategic objectives of the relationship in general and the manufacturer, specifically. Heide and Stump's (1996) study on the supplier's opportunism is a worthy step in this direction and should be extended to an international context.

6.4 RESEARCH DIRECTIONS

One of the more immediate directions that would provide a great value to the international channel literature is to develop a definition of relational governance strategy. As outlined earlier, many scholars have examined governance issues. The different approaches of these studies have gradually evolved from the perspective of a one-dimension continuum to governance that incorporates separate dimensions. Typically, the utilization of governance mechanisms has been studied from the perspective of asset-based issues. With increased company emphasis on nurturing partnerships, the literature has included behavioral concepts. Even though the concept of relational governance is well recognized, the next step would be to develop and define the notion of relational governance strategy. This dissertation has made a step towards that definition by exploring the different dimensions of relational governance strategy. It

has also moved the concept of relational governance strategy into the realm of a relational strategy that has appropriate governance tools with definite outcomes.

Levinthal (1995) and Burgelman (1996) advocate their believe that an evolutionary model framework holds great potential as an explanatory dimension for international market entry and exit. Their model analyzes the approach to inter-firm selection of strategic development paths (Levinthal 1995, Burgelman 1996). Managers may well believe that relational governance provides a degree of flexibility to enter and leave a market with relative ease in a dynamic global economy. If this is the case, then how does relational governance strategy change longitudinally to adapt to different relationship evolutions?

An evolutionary model approach goes precisely to the question of where the differences in distinctive competitive capabilities lie to place the analysis of organizational capabilities center stage in explaining organizational behavior. The evolutionary framework considers the firm to be a continuing process of growth and re-identification. Learning and choosing among a set of alternatives are managerial activities that drive this evolutionary process and may be an approach that underscores relational governance strategy as an alternative approach to enter, operate within, and eventually exit markets. A firm that understands, adapts, and maneuvers well in foreign markets has a definite competitive advantage (Kogut 1986).

A similar approach that merits attention because it investigates strategic alternatives and their interaction with the environment is institutionalization theory. Institutionalization theory assumes that organizations are social as well as technical phenomena. The theory examines the environment's social context to focus on

identifying isomorphism within the institutional environment (Zucker 1987, p. 443). Institutionalization theory proposes that organizations adopt patterns external to their environments that are defined as appropriate. These adopted patterns are then reinforced in their interactions with other organizations. In an interesting twist, the theory assumes that the environment itself is organized and is populated by organizations that have relationships, not simply transactions. Subsequently, the environment is the source of normative pressures on organizations and of normative and cognitive constraints on their consideration of alternative structures (Zucker 1987). The environment basically provides the building blocks for organizations.

The theory can be complementary to resource-dependence theory and it can also complement TCE or supplement agency theory's examination of relational governance as strategy because it embodies behavioral concepts that are adaptive measures to a relationship based on social norms. An intriguing alternative to examining this perspective of governance is to determine if and how the relational governance strategies evolve for different environments. This motivates a research stream that examines relational governance as a viable strategic option that adapts to its environment over time.

The previous discussion motivates research to identify the industry profile and the combinations of relational governance strategy that would contribute best to the company's success in that environment. For instance, which types of industries emphasize the legal or behavioral dimensions and how do they perform in the different types of environments? In high tech industries, firms may seek contractual agreements over other forms of relational governance in order to develop interfirm trust. High-tech organizations, as reflections of the rapid pace of innovations, typically would change

frequently and have less developed interorganizational infrastructures. The implication is that the industry's relational governance strategy is inclined to place more emphasis on the legal dimensions.

Another research direction to examine is the influence of opportunistic intention and opportunistic behavior. An example that illustrates this research direction is the question of whether the manufacturer is able to develop a contract that either mitigates or eliminates opportunistic intention. Moreover, which aspect of relational governance strategy does the manufacturer emphasize, the legal or the behavioral dimension? In the management of the relationship, which of the dimensions, legal or behavior, leads to the greatest incidence of opportunistic behavior? Finally, what is the impact of opportunistic intent and opportunistic behavior on strategic performance?

Finally, the influences of cyberspace upon the channel's structure cannot be ignored, especially since contracts can be downloaded from the internet. Due to the international scope of the internet, countries are finding it difficult to keep pace with changing legalities. What influence would this have on a company's ability to establish and manage a relational governance strategy? The following comment applies to manufacturer-foreign distributor relationships and is very illustrative of the importance of relational governance strategy to exporting manufacturers.

"Well, for starters, manufacturers might want to tear up those divorce papers and re-ingratiate themselves with their retail partners -- at least for now. The new channel dynamic, like the old channel dynamic, is a marriage borne of necessity" (Vartanian 1999).

The research suggestions outlined above should help fill a void in international marketing channel research regarding the development of relational governance strategy and its impact on the company's capability to develop competitive attributes.

APPENDIX
CASE INTERVIEWS

International Law Firm
International Lawyer Profiles

Stuart Deming – International Contract Lawyer (small- to medium-size firms)
(616) 382-8080 (202) 347-6806 (10/99)

Steve Debold – International Contract Lawyer (small- to medium-size firms) (616)
427-8815 (10/99)

The international contract lawyers predominately represent small- to medium-size firms from diverse industries exporting to various foreign markets. A firm's size may influence the contract because smaller companies do not necessarily possess resources for monitoring the contractual relationship as do larger companies. Neither may they have the leverage, in terms of assets, political or market reach that larger companies have.

Manufacturers design their contracts to address the "what ifs" or various contingencies and circumstances surrounding the partnership. Therefore the contract may have explicit language, identify partner roles and specific responsibilities, and outline expected performance objectives. However, addressing contingencies via the contractual structure can only go so far as contract creation is a two-edged proposition. In general, the manufacturer would like to be as explicit as possible, yet simple and easy to follow. For example, even though explicit language regarding roles, responsibilities, and performance objectives are present, most aspects of the contract can be negotiated under the working parts of the relationship. The contract essentially viewed as an instrument of negotiation.

The contracts follow a general guideline, which reflects the strategic goals of the manufacturer, yet the contracts differ from country to country due to the influences of the foreign distributor and host market environment. Once the contract is set and agreed upon by both parties, the manufacturer's primary goal is to manage the relationship through trust and mutual commitment to the relationship's goals rather than rely upon resolving problems through litigation. In general, companies wish to avoid litigation in an international setting.

"The trick is to keep the lawyers out of the relationship, unless the transactions involve a lot of business or the product is very high-tech/sensitive" (Stuart Deming).

As an economic environment, the United States is the most open country for its approach to business and contractual agreements. Because of favorable conditions, many contracts are written to take advantage of the common law in the US, rather than the civil law approach that is prevalent in other countries such as the European. The common law approach is desirable because it is the most flexible in law interpretation and uses tools such as “precedent” in order to resolve disputes that do not necessarily fall within the purview or the strict interpretation of a statute. The civil law, which the majority of the other countries in which the US maintains business, follows the civil law. As stated earlier, the civil law code is a strict interpretation of the law and does not allow for as much flexibility; there are no “precedents” as in the common law approach. Because jurisdiction is a high consideration with US manufacturers doing business abroad, the common law approach is the one that would guarantee the most protection in the case of litigation and US manufacturers attempt to place the contract in the language of the common law (i.e., place jurisdiction within the U.S. courts). Again, one of the principal purposes of the contractual document is to address the “what ifs” of various unforeseen contingencies and to protect the manufacturer in the event that something “unforeseen” occurs.

A number of specific features about the contract and the manufacturers’ approach to the contractual structure are relevant to the dissertation study and are issues that the US manufacturer will look for in their contract development/management:

- The first part of the contractual relationship is to ensure that adequate protection exists for the manufacturer. Some protection is developed through the establishment of trust-like behaviors, such as asset commitment and goal compatibility. These address the strategic part of the contractual relationship. The second phase or part of the contract is to ensure that operations, such as sufficient inventory are available. (**agency theory-bonding costs**)
- Some of the main items in the contract include: assigning responsibility and roles for different aspects of the relationship, terms for how to react to different competition, product promotion, etc.
- **Flexibility**—the manufacturer will demand the ability to get into and out of the relationship. The emphasis is on the ability to terminate the relationship quickly and succinctly if the need arises. This is especially important in uncertain or unstable foreign environments or if the partner is not performing to standards that

the manufacturer believes the distributor/agent should. (*speaks to using the contract as a strategic tool*).

- **Due diligence**—the manufacturer wants to examine to the fullest extent possible the distributors ability and potential to increase the manufacturer's market presence and competitiveness before making a commitment. The most important function the manufacturer can do prior to entering a relationship is to evaluate the distributor before making the contractual agreement. Included in this due diligence effort is the assessment of the distributor's reputation, financial standing, market knowledge and reach, distribution channel activity and related partnerships with the local businesses.
- In addition, the manufacturer would like to have an idea of its ability to work with the personnel on strategic, operational and personal levels. (*reputation—also an adverse selection under agency theory*).
- **Conflict resolution**—any contractual problems, whether strategic or operational are usually handled through mediation and consultation. Much of the problems that could potentially occur in the partnership are filtered through a careful wording of the contract, which includes the legal jurisdiction (addressing of the "what ifs"). Although the foundation of the contract may be written to reflect the common law practices as well as U.S. jurisdiction, the U.S. manufacturer understands that some things must be handled using the local content of its foreign partner host. In other words, the U.S. manufacturer must know the local rules well in order to function and anticipate changing economic conditions in the host country.
- **Product complexity**—To some degree, different approaches to the contract's management depend upon the manufacturer's product. One of the more tangible aspects that the product can influence is contract exclusivity. Contract exclusivity is evidenced in the manufacturer demanding that the distributor only deal with the manufacturer's product and/or the manufacturer granting territorial exclusivity to the distributor. However, one interesting aspect of the product is that it does not seem to have as much impact upon the *establishment* of the contract as it does on the *management* of the contract. The approach to the contractual agreement depends upon the partner and the host country's economic/legal environment rather than upon the product. (*product complexity*).
- **Arbitration clause**—this is the part of the written agreement between the partners that is designed to ensure the two conform to a set of rules. The main purpose of the arbitration clause is to be a first-line of defense against formal litigation. Hence, the clause helps to alleviate the need for dispute resolution (this is not necessary in a contract, yet is added much of the time as a "good faith" way of handling conflicts).

- **Force majeure clause** – this clause originally is designed to account for “acts of God,” although it is being used more to protect the manufacturer for daily operations. In other words, more issues are added under the umbrella of the **force majeure clause** to help protect the manufacturer against the different political/economic/legal risks, etc., that are encountered in the different countries. In other words, this clause is a surrogate for the “what ifs” while covering the contingencies that are not addressed in the bulk of the contract.
- **Power** is one of the main drivers of contract negotiation in the partnership’s beginning as well as throughout the management of the relationship. Power is manifested through resource inequities, product placement and attributes, and market exclusivity and reach. These are just a few examples of the importance of the perceptions of both tangible and intangible aspects of power in the relationship. Usually a large company has very few problems with gaining the concessions they desire.
- Interestingly, Asian contracts are difficult to create and manage because they usually do not have paper agreement or specific guidelines that are common with contractual agreements U.S. manufacturers have had with foreign distributors from other countries. In general, Asian companies tend to consider the contract to be more an instrument of communication, rather than a litigation instrument (the U.S. views the contract as a litigation instrument).

Dickens & Wright - International Law Firm
International Lawyer Profile

Bruce Thielen – (15/10/99)

This perspective is a review of contractual agreements developed from large manufacturers. The basis behind contractual agreements and writing is the same for large companies as it is for the small- to medium-sized firms. However, power does not seem to play as large a role, since the perception of power is more prevalent in the relationship. For example, the distributor inherently understands that the manufacturer possesses the resources to dictate much of the contract's terms, especially since the manufacturer is typically much larger. On the other hand, the manufacturer understands that market entry will depend upon the distributor's distribution channel and political contacts. Therefore, power is evident and perceived, yet not as readily exercised.

English is the language of choice in developing contracts. Common law is also the best approach to writing and developing contractual agreements since it provides much more flexibility. However, even though the "preferred" choice of contracts is common law, there is a convergence between common and civil law. Common and civil law are tentatively approaching a consensus due to the many different contracts and international contractual agreements that are being developed. On the one hand, the global economy is dictating some type of consensus. On the other hand, foreign distributors are gaining more power in their relationships with manufacturers. This subtle shift in power comes from the manufacturer's realization that they must be closer to the customer in the foreign market and the distributor is in the best position to offer that "closure." Underlying this evolution is the perception that distributors are demanding more inclusion of their local laws into the contractual agreement. As a result, civil law is becoming a greater part of the contract's standard writing. Common law allows for longer and more detailed contracts should they be necessary to cover the relatively greater complexities of larger companies.

Common law fulfills the same role as in the smaller company approach, yet with larger companies common law allows for greater detail and ability to address each contingency more completely (in an effort to avoid the incomplete contract). Civil law is more cumbersome in that if the law is not specifically stated for a certain contingency,

the interpretation is much more difficult to manage. This could have greater repercussions with larger companies because of the greater complexities of communication that have to occur throughout the company's internal and external network. Thus, operational flexibility may be reduced.

One interesting thing is that some strategic options can be developed through contract writing. Strategic options include processes that make the manufacturer (and therefore, the relationship) more flexible, clauses that allow more maneuverability in the host market (regarding distribution channel arrangements, legal and financial adjustments).

"The best contract is the one that is placed in the drawer..."

Some of the relevant points and characteristics regarding large company approaches to contractual agreements include the following:

- US manufacturers have been known to have a bad reputation with foreign distributors because they do not honor long-term contracts (from the foreign distributor's viewpoint). Foreign companies consider US manufacturers to be shortsighted and fixated on the profit potential of any relationship as their primary objective. Unfortunately, the US approach is contrary to many of its overseas partners.
- Additionally, US companies are not known to be savvy traders. Their main objective is perceived to profit oriented, which makes their transactions and market moves very predictable. Because other countries are focuses on the relationship-building aspects, which are more complex, these host country companies feel that they are able to predict and outmaneuver the US company. On the other hand, the sheer asset (resource) power of the US company appears to eliminate some of the foreign distributors' advantage.
- Sometimes, US manufacturers bypass their distributors and usually do not inform them about their moves to make contracts with some of the distributors competitors. On the other hand, many US companies demand that their distributors remain exclusive to the manufacturers' products and to not introduce competing product lines. The distributors power has increased to the point that they are able to introduce competing product lines or at the very least negotiate for areas in which they can benefit. The trend for manufacturers and distributors jockeying for a position that provides them more leverage in the relationship has increased.

- Usually, if the contract is an exclusive one, it will have some type of performance factor.
- Many times, some aspects of the local law will have to apply to the contract, therefore it is very important to establish US jurisdiction in the beginning of the contract. This philosophy reflects US propensity to retain the ability to litigate the relationship.

Allied Signal-Honeywell ***Corporate and Contract Profile***

Licinio Garcia (Allied Signal-Honeywell)

Allied Signal is a large company and dominant Tier I supplier in the auto industry. It is a company that has overseas operations in sourcing and distribution. Although Allied Signal has merged with Honeywell, yet their strategy, which includes overseas expansion, remains intact. This particular segment of Allied Signal produces and exports aero components. These components consist of generators, air compressor units, aircraft instrument systems that are used on commercial aircraft. The primary export market is Europe.

The common contract between Allied Signal and the independent warehouses is usually written to be vague. This is done so that the manufacturer (Allied Signal) can be as flexible strategically and operationally as possible. Instead of a contract, the document is called an “operational agreement.” Interestingly, the objective of establishing and managing the contract is succinctly “we do not always want to come back to the contract [once it is established].” Although there are numerous areas in which this company is of interest for the purposes of this study, some are highlighted below:

- Allied Signal bases their contract primarily on performance; the distributor must meet standard performance set by Allied Signal, which may not necessarily be a mutual goal. Allied Signal does work with its distributors, however. They have regional service and support programs that are designed for interorganizational efficiency and gathering and understanding market knowledge. **(learning)** In addition, the company concentrates on technical and process-related support. A primary area of emphasis is communication systems.
- Allied Signal stipulates in their contract that inventory be on consignment. **(manufacturer risk reduction)**
- Areas the contract covers include purchase parts and sections for specific units, which reflect the nature of the product. Some governments have certain stipulations regarding aircraft safety and handling of aircraft components. Consequently, these different ways of handling products are part of the contract. **(product complexity)**
- Allied Signal, in keeping with their philosophy of flexibility, has created a covenance section that opens the company to address issues that would make the relationship a long-term prospect. **(flexibility)**
- Regular board meetings are held in order to keep information flowing. One interesting aspect of these meetings is that it is stipulated in advance who should

attend and what the specific agenda would cover. Many times, the meetings' agendas are dictated by Allied Signal with little input from the distributor.

- Allied Signal has placed much emphasis in their termination class—"it is the most important section of the operational agreement."
- They also have "force majeure" clause that addresses any miscellaneous areas that have been left out of the contract.

Brunswick Industrial Inc.
Corporate and Contract Profile

Jerry Graham- VP International Ops– Brunswick Industrial Corporation

Brunswick aggressively and systematically expanded their export operations to follow an overall strategy of having an international presence. Much of their expansion occurred in Europe and Southeast Asia. Part of the stipulations for their expansion was the requirement to work with distributors who would be exclusive, or work for no other competing lines. In turn, Brunswick would grant them exclusivity in market territory. The reason for going with distributors was flexibility in the sense that the company could enter and leave a market when they determined it was within their strategic plans to do so. In other words, when confronted with ownership or working with independent distributors, Brunswick chose the latter due to many factors, which were not limited to investment. Initially, Brunswick followed this plan of working with independent agents due to their limited experience and resources. Initially, Brunswick would require that each bidding distributor develop a business plan that was a three to five year plan. They do so in order to help assess the distributor's business experience and ability to perform in the market.

Brunswick's basic approach to contracting was formal. They established a formal contract that was oriented towards monitoring the agent and ensuring the agent reached a pre-determined level of performance. The contract is a generic guide that managers working with foreign distributors could follow, essentially because the managers were not experienced in international operations. Interestingly, the distributor did not have to act under U.S. contract law or jurisdiction, although Brunswick pushed to have contractual terms according to U.S. common law. However, even though the idea was to have a simplified, flexible contract, the contract had to be specific to the market. This caused a few problems with contract interpretation and implementation.

One of the major items that is emphasized when entering into a contractual situation is due diligence. The company spends a large investment in time and effort to determine the distributor's ability before entering the contract. This includes assessing the distributor's ability through a requirement that the distributor develop and present a business plan, the company seeks information about the distributor through industry

contacts and market information, and Brunswick's management requests financial information from the distributor in order to determine its long-term viability as a partner.

Briefly, Brunswick's strategy was to consistently expand overseas, although they did not have much international experience. To compensate for their lack of experience, the company wrote contracts that were more specific and oriented towards performance objectives. They included the distributors, yet were sure to keep the distributors in place by monitoring them through exclusivity (e.g., market, territory). They wanted to have flexible contracts in the sense of ensuring an easy exit from undesirable or nonperforming relationships.

Some of the key characteristics and contributions to the study of contract management from Brunswick follow:

- High emphasis on due diligence: Brunswick spent resources on knowing the capabilities of the distributor before making a contract; usually the company has the distributor prepare a 3-5 year business plan. The specific things that the manufacturer looked for in the plan included advertising, selling goals, export sells, market penetration. This approach is done in order to determine the distributor's business savvy, ability and financial standing. While executing due diligence, Brunswick uses market knowledge, word-of-mouth (reputation) and prior distributor performance in order to determine the ability of the distributor and even assess its willingness and commitment to agreements with the exporter. One interesting thing that Brunswick required from the distributor prior to entering into an agreement was information about any of the distributor's partners. (quantitative, qualitative and strategic areas). *This is **adverse selection** under agency theory*
- Brunswick also stipulated that the distributor carry inventory and have some assets, preferably assets that could be used in the partnership. They also looked at the distributor's asset size/portfolio to help their financial assessment of the distributor's overall attraction as a potential partner. One of Brunswick's approaches to help guarantee commitment from the distributor was a payment as part of entering into the agreement. Commitment and **reduction of agency costs** (*bonding*).
- Once the contract was signed, Brunswick managed the partnership through a combination of relational and formal behavior. Their distributor was required to meet mutually agreed upon performance standards. Meeting specific performance goals was the main way that Brunswick evaluated its distributors. This was a basis upon which the distributor was evaluated. Because Brunswick was oriented towards a performance contract, they conducted annual joint training with their distributor. Training sessions also occurred whenever new products were introduced. (building long term relationships)
- As stated earlier, Brunswick installed a yearly renewal clause (performance expectation clause) into their contract. If the distributor did not meet these performance standards, Brunswick retained the option of continuing or terminating the

partnership. In order to avoid substandard performance or some type of misinterpretation (probably due to lack of international experience), Brunswick included much language that outlined performance. In addition, there are usually stiff penalties included in the contract (e.g., if the distributor was caught with product from a competitor, Brunswick had the option of terminating the contract).

Some problems that Allied Signal encounters while working with their distributors include:

- Brunswick found that their distributors, in general, normally do not trust US companies and the way they deal with the international. U.S. companies foster little attempt to develop lasting or relational terms. Most are oriented towards economic goals.
- Brunswick encountered many problems with distributors seeking other markets. This included taking on and selling competitor's products from other manufacturers and distributors actually seeking markets other than what was outlined in the original contract. Some distributors found that they were not able or simply did not pay their bills. This was from a combination of local circumstances or environmental risks, which include political, legal, and economic conditions in the host market.
- Dealers always asked for lower prices. Brunswick was not sure if the requests were due to market demands or whether the dealer was taking advantage of the situation by actually reselling these products at the same price in order to receive larger margins. Brunswick found that this was difficult to determine due to lack of access to their distributor's contracts with others. One of the reasons for not having access to the distributor's contacts was simply due to cultural conditions and lack of familiarity with the host region. Another major problem that was rather frequent was service after the sale. Brunswick was not very confident with their distributors' commitment to after service sale. (*mgr experience*)

TRW
Corporate and Contract Profile

Steven Williams (TRW)
Export operations in Mexico and Brazil

TRW has different approaches to distributing their product; through their distribution network, though third party providers (freight forwarders), or through host market distributors. The different approaches depend upon the market differences (e.g., market infrastructure, perceived resource dependency, market infrastructure, distribution). TRW believes that different contractual arrangements provide a higher degree of strategic flexibility.

One of the striking aspects of establishing and managing the contractual relationship in Latin American markets was the degree of informality. In contrast to the contractual relationships in Europe, Latin American contracts were very informal and much more open to interpretation from both partners. Usually, TRW tries to work the contractual terms to their advantage. Because of the market conditions in Latin America (political, legal, economic, distribution infrastructure), one of the main conditions of the contract concerns pricing. This is especially important in Latin America where many of the countries' economies are constantly fluctuating. In some cases where this is prevalent, TRW allows the host distributor to pay using their currency, yet they must also pay a premium to do so. On the other hand, credit and payment terms in Europe were much more rigid.

Several themes make TRW an interesting case for inclusion in this dissertation:

- One of the problems TRW faces when working with Latin American distributors is Latin America's general lack of technology and infrastructure. For example, TRW has had to send representatives to Brazil to work with the distributors on a personal basis when email or other electronic communication is available. Brazilian distributors do not have the technical infrastructure that would support many of the demands that a multinational business makes. Particularly distressing to TRW is the fact that demand in the host market fluctuates greatly, which reduces the host's ability to forecast. Instead of forecasting, the distributor merely tries to meet existing demand. Therefore, they insist on having an open and flexible contract in which they can order product whenever it is needed. This in turn, causes problems with TRW's ability to forecast, because it upsets their production and distribution schedule. In order to counter this particular problem, TRW has stipulated training in their contract. Namely, that training will be a periodic part of the interaction between the partners.

- Interestingly, in spite of the contract, TRW still has to make “concessions” to customs or other political agencies in order to keep the product flowing smoothly.
- TRW does have separate contracts representing different areas with their distributors. For example, they have R&D or product development contracts and distribution contracts. These were necessary due to the nature of the host market in Latin America. In contrast, TRW was able to consolidate the different areas within one contract for European distributors. The development contracts have more restrictive or formal language, whereas the distribution contracts contain relatively informal and open language to reflect the openness of the relationship.
- One of the continuing problems with the open contract is that TRW is concerned that the distributors are not meeting customers’ needs. This is a problem, because TRW realizes that the distributor is much closer to the customer and therefore is relatively dependent upon the distributor. This is a continuing concern, which does not seem to have a good solution. The use of technology was one way of serving or at least helping the distributor to better serve the customer, yet many distributors have not or are unable to make the necessary investment in technological/communication resources.
- One other way of trying to resolve this problem is through the separate contract structure (e.g., distribution contracts).
- TRW has tried to push the export responsibility to their Tier I and II suppliers, but this has caused many problems because these suppliers have been found to lack a lot of the international experience that is needed to do the job well. They are not equipped technically nor managerially to handle the exporting duties. This has caused concerns with TRW’s strategic plans because of their emphasis on pricing. The ability to push many of the exporting duties and contracting to suppliers eliminates much of the necessity and costs involved for TRW to contract, manage, and monitor the distributor. Additionally, the direct supplier/distributor link would reduce costs. Unfortunately, TRW is not able to do so with much success and must therefore expend their resources.

American Health & Nutrition, Inc.
Corporate and Contract Profile

Heather Hopkins-Clement
American Health & Nutrition, Inc.

American Health & Nutrition, Inc. is a small export company that primarily has business in Japan. This company is different in that the clients appear to have more resources and can therefore dictate (informally) many terms of the contractual relationship. Essentially, the company exports to several Japanese clients while basing their exchanges upon an informal contract structure. Often, the company relies entirely upon relationship, rather than a contract that explicitly outlines operational and performance objectives. However, the American company and its Japanese clients are increasingly developing some form of contract that has legalistic and formal language.

Japan's legal structure is very different from that of the U.S. There are far fewer lawyers, which contribute to the Japanese desire to reduce "legalese" between the companies. Any reference to the legalistic part of both verbal and nonverbal contracts avoids the strict legal components of the relationship. For example, the force majeure clause of the contract is avoided because it is cumbersome and counter to Japanese culture to list all contingencies not covered specifically in the contract under a general heading. However, due to some of the complexities of the global economy,

"some items of the relationship are being written into a contract in order to elicit a response from the distributor."

American Health and Nutrition contributed to a better understanding of contractual agreements. Some of the most striking areas are included:

- The relationship is important and therefore calls for efficient and effective management. Relationships are built on honesty, integrity, and trust (all have to be displayed to some degree at the beginning of the relationship. Any contingency situations are dealt with fairness and honesty, which is expected from both sides. English is difficult with the Japanese, but the AH&N manager speaks Japanese helping to facilitate better relationship management.
- However, any claims or problems that arise that cannot be resolved amicably are handled through a third party like the Japanese organization NKK. Having to rely on the third party to monitor certain aspects of the relationship actually dampens it: "puts a black cloud over the relationship."
- Relationship management leads to stable relationships and provides a great degree of flexibility. Frequently, AH&N have run out of inventory or simply could not provide the client with a requested product at the requested time. Usually, a phone call to the client can resolve the problem.
- The company has frequent business contact with its Japanese distributors and ensures that they make a visit every two years.

- The informal relationship has provided great benefits to AH&N, Inc. The company can work better with its clients because of the informality. Quality, in terms of service and responsiveness, is high. There is greater attention to quality and service due to the fact that there is no explicit contractual terms to fall back upon—requiring more emphasis on the behavioral aspects of the relationship. The companies even work together to identify and overcome potential conflicts. Having outlined the benefits, however, the partners have recognized that a contract could outline concerns (such as how each will deal with customs) that could be used for future working basis.
- Some of the biggest concerns with the Japanese clients are the language barrier time spent developing a relationship structure to increase the benefits gained from self-governing mechanisms.

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