

Modes of Exporter Governance of Sales Subsidiaries and Distributors in International Markets

A Literature Review and Model²⁸⁴

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Introduction

The purpose of this article is to build an analytical model of HQ governance of foreign marketing activities through their sales subsidiaries and distributors. Although drawing on different streams of management literature, in particular internationalisation process, channel and interorganisational relations and multinational and cross-cultural management, the model is mainly inspired by agency theory. It is the result of a research project carried out in collaboration with a Norwegian consulting group.²⁸⁵

Most managers confronted with foreign sales subsidiaries or distributors complain that it is not always easy to have it their way. Numerous anecdotal evidence reports of “self-governing” local petty kings, or rebellious distributors that make life a real challenge for the international marketer (see for instance Lipman 1987, Ghauri 1990, Forsgren and Holm 1990, Petersen, Welch and Welch 1998, Solberg 2000). Research in other settings (Stenberg 1992) suggests that steering systems (of foreign affiliates) be “a rather dispersed activity” (p. 210) and that most of the steering systems generally are being established as a response to detrimental developments in the relations with daughter companies rather than in an anticipatory way.

There are obvious differences between fully integrated channel systems (like exporter-foreign sales subsidiary) and independent distributors, the main differences residing in the fact that the power balance between the parties – or at least the base on which it rests - may be different in the two cases. First, the contract power of the exporter toward the distributor is not matched by the possibility of the principal in the integrated operation to exert both coercive and legitimate power (French and Raven 1959). Second the distributor often has a disproportionate size relative

²⁸⁴ The research has been made possible by funding from The Research Council of Norway. The author would like to thank Harald Biong for useful comments to earlier versions of this paper.

²⁸⁵ The project was initiated by Geir Storeng at Interforum Partners (IP) – a Norwegian consulting group. A task group was established with Mr. Storeng of IP and the author in order to develop a more comprehensive project. A project team at Norwegian School of Management BI was set up consisting of the following persons (in addition to Mr. Storeng and dr. Solberg): Bjørn Bugge, Tore Mysen, Egil Nordblom, Ulf Ombustvedt.

to the generally smaller exporter, which in this case gives the former the upper hand in the relationship. Indeed it has been found that both importers and exporters perceive the former to have the greater impact on marketing decisions (Leonidou 1989). Also, it has been claimed that organisational structure itself represents a control mechanism; according to Jaworski (1988), organizational structure (like for instance vertical integration) is an additional control mechanism in that it “directs influences and shapes individual and group behavior” (p. 27).

However, there are also some notable similarities. First, they both operate as members of a system to promote the exporter’s products, and therefore aim at creating value in the chain. Secondly, fully owned foreign sales subsidiaries as well as foreign independent distributors are located overseas and have therefore not only a different perspective of the marketing situation than the exporter, but have also in common the expert power of the agent (French and Raven 1959, Sharma 1997). In this context we will later demonstrate that own subsidiaries confronted with orders from headquarters often tend to show muscles and operate independently.

In order to investigate the different aspects of mother-daughter relations²⁸⁶ (for short M-D relations) the research group has carried out three tasks:

- Identification of critical aspects of M-D relations in order to build a model through literature reviews and brain-storming within the group.
- In depth interviews with five companies in order to explore different aspects of the established model.

The rest of the paper will describe the development of the model, referring to relevant literature and using excerpts from the in depth interviews to illustrate certain points.

A Model of Mother Daughter Relations in International Marketing

Whereas numerous studies have sought answers to the questions on different factors’ impact on loyalty and conflict in distribution channels, very few have tried to establish a link between channel governance and the more tangible aspects of performance. Indeed, Solberg (1988), Cavusgil and Zou (1994) have shown that close and supportive relations with distributors in fact give dividends, whereas Bilkey (1984) found that there are limits to the return on dealer support.

Taking a principal-agent view of the channel management issues, Bello and Gilliland (1997) suggest an interesting model where they test how unilateral (through process control or output control) and bilateral governance structures are being influenced by a number of antecedents, and how they in their turn impact on exporter performance. Process or behavioural control may be described as the principal’s influence on the way in which distributors carry out the marketing activities (advertising, sales calls, etc), whereas output control contents itself with controlling the result of these activities (profit, sales volume, market share etc). They found that output control and flexibility of the trading partners correlate positively with performance, whereas no significant relationships were established between process control and performance. This model has inspired us to explore the relationships between three forms of control with export

²⁸⁶ We will consistently use the term “mother-daughter relations” although in many instances we also deal with exporter-distributor relations. When appropriate, the distinction will be made in the text.

performance: output and process control and control through trust. These types of control may coexist but the emphasis placed on the one or the other may depend on the stage in the relationship between the partners (Ford and Rosson 1982, Lye 1998).

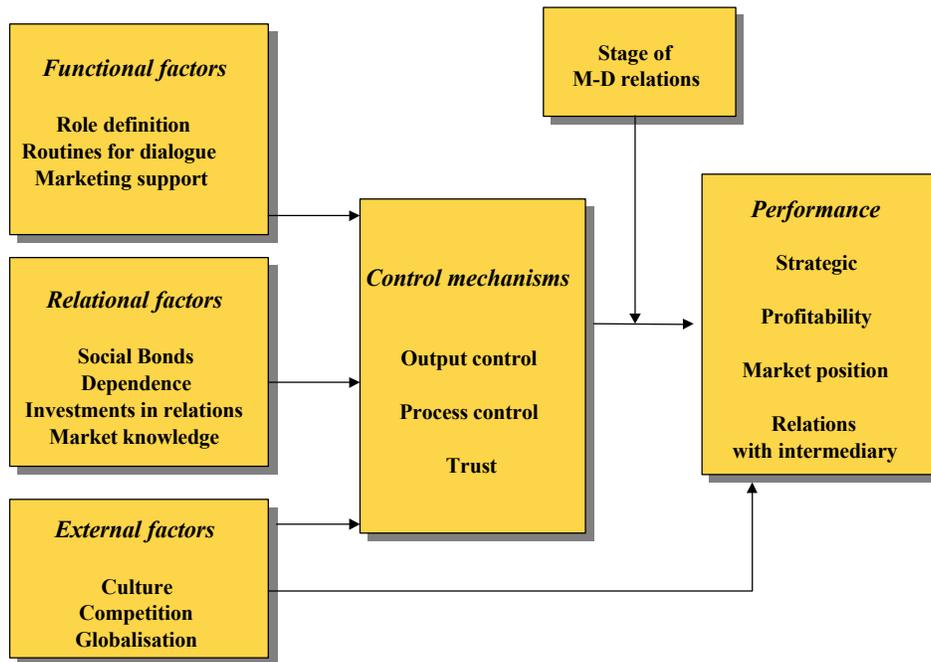


Figure 1: Export governance models and export performance

Dependent variable – Export performance

Since the focal point in any business operation is to yield economic returns, the model will have as its main dependent variable different measures of export performance. This measure has during the late eighties and the nineties been subject to scrutiny by a number of writers (Madsen 1987, Axinn 1988, Aaby and Slater 1989, Selnes et al 1993, Cavusgil and Zou 1994, Bello and Gilliland 1997, Styles 1998, Shoham 1998).

The many factors – both internal and external - impacting on the exporting firm's performance make it utterly difficult to establish reliable measures of their effects. Export operations consist of a mosaic of different ventures and strategic situations which makes the endeavour of gauging export performance exceedingly complicated. For instance, the time lags between the enacted decisions and the expected outcomes may vary considerably depending on the nature of the decision – like tactical decisions on pricing or advertising or decisions pertaining to strategic direction of the firm. In this context some of the exporters maintain during our conversation that it takes between three and five years before the results of the market entry yields any material rewards. Also different decisions will affect differently the various dimensions of performance (for example market share, growth, ROI). Then, depending on the goal preferences of company management, the measures of export performance will be emphasised differently. Therefore the

importance of the various dimensions of export performance may vary according to the concrete situation of each individual firm.

Furthermore, the many elements external to the object under study may disturb the overall performance of the operations even though everything was “done correctly after the book”. One of the managers in the exploratory interviews, commenting on his experience in this context, complained that “I’ll not say that I’m dissatisfied, but I wouldn’t say that we have had too much luck either”. In addition, performance may vary across export ventures - markets and products (Cavusgil and Zou 1994), and even across different marketing campaigns within the same product/markets.

In addition, since the object under study is the effects of subsidiary/distributor control, Karanuramna and Johnson’s (1997) concept of satisfaction with the relationship is relevant to introduce. In this way different aspects of the performance will be analysed. Also, the model measures the performance per market, linking the performance to the relations with the intermediary in each individual market.

The main contention of the model is that:

P1: Exporters using a variety of mechanisms in order to control and monitor the activities and output of their intermediaries in overseas markets will perform better than those who don’t. Different contingencies and antecedents will make the use of the one or the other mechanism more appropriate.

There are many problems associated with the measurement of export performance. Using *perceived* performance is expected to reduce the sources of error of the more accurate measures of performance. For instance exact figures on return on investment drawn from the accounts sometimes reflect other concerns like taxes, provision for extraordinary losses etc. Furthermore, relatively precise estimates of market shares depend more on the way in which the “market” is being defined, than the real market position of the firm (see for instance Leontiades 1984). Also exact growth measures are questionable because they mean entirely different things in different market and competitive environments. By asking management about their degree of satisfaction on each of these performance elements, one gets a relative measure. In the words of Shoham (1998, p. 62): “satisfaction-based measures provide richer assessments of each subdimension, rather than additional, independent subdimensions”. The weakness of this measure is of course that the respondent gives his/her subjective opinion rather than mirroring the real situation of the firm.

Independent variables – governance tools

Bello and Gilliland (1997) discuss two groups of governance mechanisms: unilateral and bilateral. Unilateral governance may in turn be divided into two subgroups: output control and process or behavioural control. In output control the exporter supervises only the result of the activities of the distributor/daughter (like market share, sales volume, profit etc.), leaving the development of the marketing activities to the discretion of the latter. Process control involves a more active participation by the principal in the implementation of the strategy of the agent. Although output control in many ways is the governance mechanism of the independent

distributor (market governance) and process control is much more the domain of hierarchical governance (Eisenhardt 1989), one may conceive of both types of control in both types of governance systems. In both cases of unilateral governance the control of the distributor/daughter is based on information from the representative.

Bilateral governance, on the other hand, implies relationship and co-operation (Nevin 1995) involving communication between the partners. A key construct in this context is that of trust. Trust seems to pervade business relationships (Morgan and Hunt 1994) and is seen by Bradach and Eccles (1989) as an alternative governance mechanism to price (market) and authority (hierarchy). De Mortanges and Vossen (1999) use in their survey of Dutch exporters the closely related concept of relational control, implying involvement of the distributor in planning and informational activities. Bello and Gilliland (1997) introduce in their model the concept of flexibility, implying the willingness of both parties to change the terms of an agreement, as a bilateral “control mechanism”. The relationship between flexibility and trust has, to the author’s knowledge, not yet been explored in academic research. We believe flexibility to be an antecedent to trust rather than a governance mechanism in its own right. For example, Nes and Solberg (1999) found that *communication* between exporter and distributor correlates positively with trust. These constructs reflect or are related to the concept of flexibility as defined by Bello and Gilliland (1997) in that both communication and co-operation are premises for an adaptive attitude characteristic of flexibility. Trust is however a broader construct and has been operationalised by among others Morgan and Hunt (1994) as a key construct in interorganisational relations theory. Basically it encompasses concepts such as willingness to delegate (critical tasks to the partner), confidence, reliance, predictability of one’s expectations (Morgan and Hunt 1994, Dasgupta 1988). Trust is the outcome of long term relationships and is paramount in an international business setting involving high levels of uncertainty through both cultural, economic and political distance between the trading partners.

Whereas trust between partners is mainly obtained in the interaction between individuals (of an organisation) the two other governance mechanisms are less personified and may be carried out by (individuals of) one organisation to control and monitor another²⁸⁷. Trust is therefore a much more difficult area to study because it encompasses a complex web of relations between members of the contracting parties, both inside each organisation and between them. One may well perceive of relationships featured by embedded relations and trust between some members of the two organisations and arms’ length relations and somewhat “cooler” sentiments between other members. Trust may furthermore be based on institutional arrangements (legislation, political stability, contracts etc), which reduces the external uncertainty surrounding the relations (Zucker 1986). Antecedents of trust will be further discussed in later sections.

Control variable – stages of relationship

The use of one form of control mechanism does not exclude the use of either of the other forms. On the contrary, although they are distinct from one another, they are strongly correlated (Bello and Gilliland 1997, Celly and Frazier 1996, de Mortanges and Vossen 1999). In other words, all

²⁸⁷ Young (1993) claims that individuals can “feel” for other individuals in other organisations, or even for other organisations as such. However, she maintains, organisations cannot give affective expressions of another organisation and the concept of trust between organisations will therefore be qualitatively different than between individuals.

three forms seem to coexist, but no attempt has been done to untangle the conditions under which one form is more preferable than the two other. The basic assumption of the Bello/Gilliland model is that the more control (output/process) or cooperation (flexibility), the better the performance. However, they did not find support for the hypothesized relationship between process control and performance, suggesting that “inadequate knowledge about the foreign transformation process may prevent optimal manufacturer specification of marketing behaviours for overseas distributors” (1997, p. 34). This plausible explanation leads us to introduce stages of relationship (Ford and Rosson 1982, Lye 1998) as a moderating variable. Ranging the three governance mechanisms it seems as though there is an escalating order of commitment to the market starting with output control, then passing by process control and ending up with trust as the most committed mode of control by the exporter. Borrowing from Lye (1998) and Ford and Rosson (1982) we will generally postulate that the more entrenched the relationships between the partners, the more the exporter has to recur to *trust* as its main mode of governance. This is akin to the relationship development process taking place between buyer and seller as suggested by Dwyer, Schurr and Oh (1987) where they describe a gradual process of increasing commitment and shared value systems between the trading partners.

Figure 2 shows that at each stage in the relationship between the exporter and its local representative - although all probably will coexist - different modes of control will prevail. The rationale for this differentiation of governance mechanisms lies primarily in the antecedents to control. We believe that - in the early phases of the relationship - the market knowledge of the exporter new to the market is rather limited, given the fact that its experience in the market is nil. Therefore it is deemed difficult for the exporter to exert any influence on the distributor with regards to the way in which it should formulate its strategies (behavioural control). Also the dependence of the exporter of the distributor in the initial phases of the relationship is normally limited, at least if related to the total sales volume of the firm. Therefore one may assume that the exporter will content itself with the arms length supervision mode represented by output control. As the exporter gains market knowledge and increases its general skills in international business operations, it is suggested that it will try to influence the local marketing activities more effectively by making use of different elements of process control. Also, “it is likely that the principal will learn about the agent and so will be able to assess behavior more readily” (Eisenhardt 1989, p. 62).

Trust is supposed to derive from among other things social bonds and investment by the exporter in relations, and will therefore be demonstrated only after several years of collaboration, when the relationship between the partners is in a mature stage. Of course the inert stage described by Ford and Rosson (1982) is in this context a difficult one as it may occur at any time in the continuum emerging-decline stages. We suggest that is expected to occur between the growth and maturity stages and that governance of this kind of stalled relationship is characterised primarily by output control. The reason for this is the stalled nature of the relationship and the limited efforts that the exporter is expected to carry out in order to control the partner. Finally in the late stages of the relationship the exporter will only manage through output control because of reduced dependence of the partner.

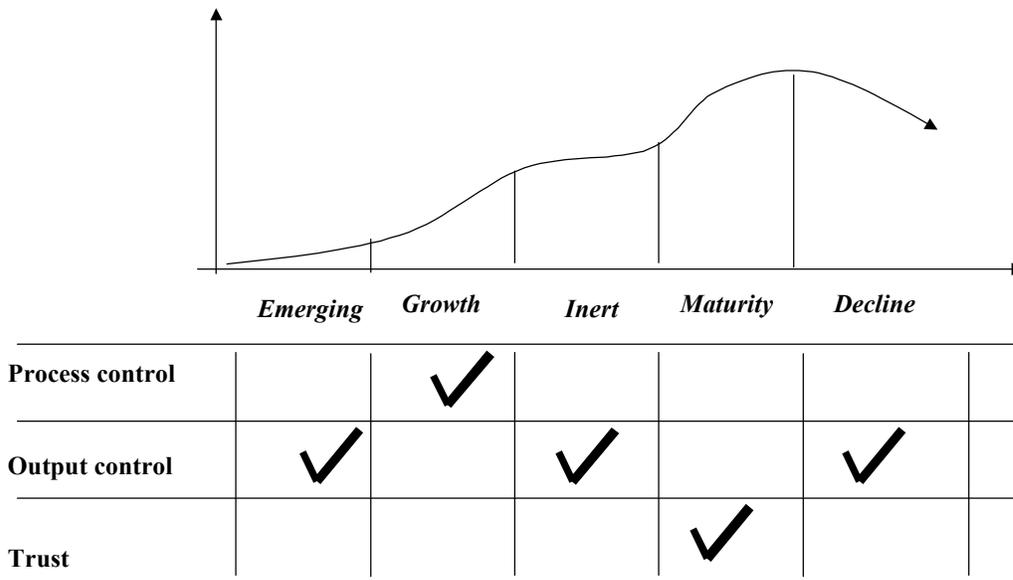


Figure 2: Forms of control at different stages of exporter-distributor relationships

This train of argument is contingent on many factors. First, the situation of the exporter establishing a sales subsidiary, rather than exporting through an independent distributor, is supposed to be slightly different. In this case it is suggested – based on the conclusions drawn by writers like Ghauri (1990) and Prahalad and Doz (1981) - that the exporter in the early phases of the relationship will exert hierarchical power through combined process and output control. Second, the relationship between the exporter and the distributor/sales subsidiary may well be the result of a change in entry mode (Benito et al 1999) rather than a de novo market entry. Therefore the market knowledge factor will in casu modify the governance form in the early phase of the relationship to more emphasis placed on process control. Also, how far the exporter has climbed “internationalisation ladder” will determine its ability to manage its relationships with its partners(s) (Johanson and Vahlne 1977). The model epitomises the case of the early exporter rather than the well established one, the latter being supposed to resort to more behavioural control mechanisms also in the early phases of the relationship.

Notwithstanding the different weights of the control mechanisms at different stages of relationship development, we will propose that trust in general leads to better overall performance than do either of the two other control mechanisms. Uzzi (1997, p. 37) state that “embeddedness creates economic opportunities that are difficult to replicate via markets, contracts, or vertical integration.” He later on (p. 43) shows how trust promotes access to “privileged and difficult to price resources that enhance competitiveness but are difficult to exchange in arm’s length ties.” We shall later show that trust is being enhanced by factors like social bonds, cultural closeness, communication and so forth. In other words trust is facilitated in cases where the partners feel comfortable with one another. Heide (1994, p. 83) emphasises that “to the extent that initial socialization efforts are ineffective, a failure to engage in systematic monitoring efforts represents exposure to opportunism”. One conclusion of this observation is that unilateral monitoring vehicles must be organised to reduce the propensity of the partner to behave selfishly (Bello and Gilliland 1997). On the other hand, it also suggests that the possibilities of socialising with individual key members of the partner organisation should be

considered a key concern in precontractual screening of partners. The backside of the coin is that trust may also become a liability: it constitutes a fertile soil for company paradigm which seldom is challenged and thus represents a threat to competitiveness by the mere neglect of important market signals outside the embedded network .

In our exploratory discussions with companies we perceive a general sentiment of trust between the partners (at least seen from the exporters' standpoint). As one company manager expresses it: "When the company earns money, it is easy to trust your subsidiary management". And when results are not up to expectations, they will certainly try and persuade local management to rectify it by giving concrete advice on customers to be served, or number of sales people employed etc. In other words the poorer the results the more the exporters will recur to unilateral (process) modes of control. One important outcome of trust between the partners was mentioned by one of the companies: the subsidiary manager dares to challenge HQ on their viewpoints. "In a country like the US where people are afraid to lose their job, this is of utmost importance". In this way trust not only is a mode of governing subsidiaries, it also becomes an important vehicle to develop an atmosphere of exchange of viewpoints and ideas. Trust is also perceived by one of the interviewees to have an aspect of culture; he observed that "French people tend to give misleading information" and are as a consequence not so easily trusted as their more Nordic counterparts.²⁸⁸ Although this may tell the story of a culturally inexperienced exporter, it is nevertheless an account of the importance of cultural familiarity in the creation of trust (Nes and Solberg 1999).

To sum up this section, we will propose that,

P2: The efficient use of control mechanisms of foreign channel members (sales subsidiaries or distributors) depends on the stage of the relationship between the trading partners. More specifically we posit that

- a) put control will prevail in the emerging, inert and decline stages of the relationship
- a) process control will prevail in the growth stage of the relationship, and
- b) trust as a control mechanism will prevail in the maturity stage of the relationship.

The antecedents

We have identified a number of antecedents impacting on the three levels of control. Some of these antecedents have already been discussed in the previous section. However a more systematic discussion is required to understand their impact on the different modes of governance. De Mortanges and Vossen (1999) seek to identify antecedents to the three types of control mechanisms, but include partly different kinds of antecedents than the ones used in the present research (asset specificity, volatility, diversity, resource dependence, market knowledge and distributor experience). Two of their variables – market knowledge and (resource) dependence overlap two of our variables. They found that market knowledge correlate positively with all three modes of control mechanisms, whereas resource dependence correlates negatively with both process and outcome control and exhibits only limited correlations with what they term relational control. The antecedents used in our model have been identified as a result of in depth

²⁸⁸ France and Norway score quite differently on the Hofstede dimensions: power distance - 68 (F) and 31 (N), uncertainty avoidance – 86 (F) and 50 (N), masculinity – 48 (F) and 8 (N). The score on individualism is quite similar (Hofstede 1980).

interviews with five Norwegian exporters, and have been refined through group discussions among the members of the project team. In the following we have classified the antecedents in three categories: functional, relational and external drivers, and we discuss a number of propositions related to them.

Functional drivers of control mechanisms

We have identified three such drivers: role definition, routines for dialogue, marketing support. The common denominator of these precursors is their operative character.

Role definition

Well defined institutions will lead to increased trust (Zucker 1986), not necessarily vis-à-vis the partner as such, but rather vis-à-vis the system. The benefit of institutions lies primarily in the predictability of actions between the partners and as such they reduce the internal ambiguity which exists in the relations. One such institution may be the “rules of the game” between the partners, like for instance a clear definition of roles between them. Well defined and mutually approved responsibilities between the partners help alleviate potential conflicts of interest and reduce possible misunderstandings, ultimately creating an atmosphere of co-operation and trust. A general division of labour where HQ leaves to the subsidiary/intermediary the responsibilities of local marketing and HQ only provides general guidelines concerning use of brand name, pricing policies, preferred customer groups and so on is indisputably easy to conceive of. The conflicts arise when HQ gets impatient with results and wants to take a more active part in the implementation of local activities, or when HQ for other reasons – like increased global competitive pressures - feels compelled to take charge (Solberg 2000). Also conflicts seem to arise in the wake of redefinition of roles by multinationals, partly because of uncertainty among the actors about their new roles (Marschan 1993).

On the other hand, Larson (1992) has shown that in cases of lack of control and monitoring devices between firms (that is in cases where trust is an important governance tool), the roles between the partners are often blurred and shift. Also, Macauley (1963, p. 64) found that some businessmen object to elaborate contracts (in which agreed upon roles are defined), because such planning “indicates a lack of trust and blunts the demands of friendship, turning a cooperative venture into an antagonistic horsetrade.”

The distributor contract is normally the vehicle through which roles are defined in an exporter-distributor relationship. However, the negotiation process to arrive at an agreed division of responsibilities has probably more impact on the relationship between the partners than the content of the final contract itself. Through a process of socialisation between the partners, exchange of information and objectives constitutes the starting point of what eventually may lead to a trusting relationship. This process has been observed by Khuri (1968) who – referring to the Middle East - states that: “bargaining is not for fun, nor merely for the sake of bargaining. Through the manipulation of cultural norms and symbols, a bargainer, whether seller or buyer, aims to eliminate suspicion of commodity or price and establish instead an atmosphere of trust often leading to client-relationship and occasionally friendship” (p. 704).

Along this line of reasoning, it is likely that the distribution of roles between the partners evolve over time. In fact, in four of the five companies this seems to have taken place. In these

companies the division of roles is to some extent the result of personal capabilities of the contracting partners, in addition to the more or less “objective requirements” dictated by the needs of headquarter (distance to the market, resources etc). One may therefore in this instance talk about a reverse loop of causality, whereby trust leads to definition of roles. In only one of the interviewed companies, we found that roles were strictly defined and independent of the persons involved. This company is relatively young in terms of international business. Summing up this section we postulate that:

P3: Role definition is more frequently used in the emerging and growth stages of MD-relationships where social bonds have not yet had the chance to develop.

Routines for dialogue

Communication has been found to correlate with trust (Morgan and Hunt 1994). Indeed, Nes and Solberg (1999) show that communication is the single most important factor leading to trust between the exporter and its partners in foreign markets. Moorman, Deshpandé and Zaltman (1993) found that especially *timely* communication fosters trust. In an attempt to decompose the communication construct into elements that can be acted upon by management, we suggest that some form of institutionalisation of the communication process will lead to enhanced trust between the partners. One may contend that this line of argument is part of the same construct, institutions (Zucker 1986), as the role definition discussed above. However, one thing is the way in which information is transferred from one exchange partner to the other; how the partners agree to share the responsibilities of the marketing and sales activities in the local market is another matter, distinct from information sharing. Also, one may assume that different routines for dialogue apply to different modes of governance.

A great deal of informal communication may well be linked to trust. On the other hand it may also reflect troublesome relations, whereby HQ constantly interferes with local affairs, following up on decisions and controlling – both formally and informally – that decisions are being implemented. Therefore, when measuring communication, not only the level, but also the “temperature” should be gauged.

The companies in our study maintain that they have regular and active communication with their intermediaries in foreign markets – both formal and informal. However, in one of the companies the subsidiaries operate to a large extent on their own, without much communication with HQ. They do indeed send quarterly sales reports (formal), but do not discuss operative matters on a regular, frequent basis over the phone, e-mail and so on (informal). This company has established strict routines for performance and process controls, suggesting that there indeed may be a link between formal routines for communication and unilateral control mechanisms.

Based on the above discussion we propose that:

P4: Informal modes of communication are typical of relationships based primarily on trust, whereas more formal methods of communication will prevail in unilateral governance relationships.

Marketing support

Marketing support is defined by Bergen, Dutta and Walker (1992) as functional incentives or additional payments made to the local intermediary if it engages in specific activities, such as advertising, participation at trade fairs, initiating business with particular customer groups, financing of spare parts storage facilities etc. We believe in general that:

P5a: The use of functional marketing support will foster an atmosphere of trust.

Furthermore as its use and effects are more or less directly measurable, we propose that

P5b: Functional marketing support is positively linked to use of behavioural control instruments.

Relational drivers to control mechanisms

In this article we deal with basically five such drivers: social bonds, dependence, investment in relations with intermediary and market knowledge.

Social bonds

Social bonding has been defined as “the degree of mutual personal friendship and liking shared by the buyer and seller” (Wilson, 1995, p. 339). Our basic proposition that strong social bonds lead to trust is partially based on writings on social embeddedness in transactions (Granovetter 1985, Uzzi 1997). Contrary to the assumption by neoclassic economists, Uzzi (1997) in his study of New York textile manufacturers’ network found that embedded relationships indeed are rational through positive effects like trust, fine grained information transfer and joint problem solving arrangements. This in turn leads to advantages such as economies of time, integrative agreements, complex adaptation and allocative efficiency. Later, Uzzi (1999) has found that social attachments lead to more favourable terms of agreement by the SME in obtaining bank loans²⁸⁹. Social bonds have also been postulated to lead to trust by writers in the IMP²⁹⁰ tradition (see for instance Håkanson et al 1982). Also it has been shown that commitment between buyers and sellers increases with strong personal relationship (Wilson and Mummalaneni 1986, Mummalaneni and Wilson 1991). We will propose that social bonds between members of the exporter organisation and those of the daughter company or the distributor will lead to increased trust. Or as Uzzi (1997, p. 45) states: “Trust is fundamentally a social process, since these psychological mechanisms and expectations are emergent features of a social structure that creates and reproduces them through time.” On the other hand, the back-side of the medal is when key members of either organisation for some reason move out of the organisation or merely to a new function within it. Then the risk is that what earlier has been a resource for the relationship, is turned into a liability. In Uzzi’s words: “Under these conditions, social processes that increase integration combine with resource dependency problems to increase the vulnerability of networked organizations” (Uzzi 1997, p. 57).

²⁸⁹ But he does not discuss the other side of the coin, the bankers’ loss. One may maintain that bankers run a lower risk lending to businesses whose leaders they know well, and that this is the economic rationale for accepting lower interest rates.

²⁹⁰ IMP=Industrial Marketing and Purchasing, an informal group of researchers who focus on interactions between companies in buyer-seller relationships.

All the five firms state that they are more or less close friends with many of their sales representatives in overseas markets. Some managers state that “we have a nice time when we are together in business”, or “when we meet we are like friends”. Others claim that they are *personal* friends with the manager of the subsidiary, which may constitute a “danger”, in that it is difficult to separate business and friendship. On certain occasions this may cause problems, like for instance when unpleasant decisions have to be made. However we observe some discrepancies between HQ and subsidiaries, the latter sometimes feeling more at unease with the so-called “friendship” of HQ. Still we expect to find:

P6: The denser the social bonds between key members of the exporter organisation and those of the daughter company or the distributor, the more the governance will be based on trust.

Dependence

Dependence has been treated by a number of researchers of marketing (Hunt and Nevin 1974, Gaski 1986, Heide and John 1988, Anderson and Narus 1990). Dependence has been linked to investments in specific assets (Heide and John 1988) as well as other sources of power like the ones treated by French and Raven (1959). Agency theory assumes the notion of a powerful principal that has the power to design and enforce contracts. In contrast, in an exporter-intermediary relationship power balance will vary according to the situation. One may assume that the exporter has more power over the sales subsidiary than over the distributor, partly because of mere hierarchical power (a blend of reward, reference, legitimacy and coercion). On the other hand, the expert and informational power (Raven 1992) of the subsidiary may – at least in the early phases of market presence by the exporter – may supersede the importance of these other power bases. Also, we have seen how subsidiaries at a later stage of the relationship have a tendency to become independent in their implementation of business strategies in the local market – principally because of expert-informational power (Ghauri 1989, Prahalad and Doz 1981). The distributor, furthermore, is often the stronger party in an exporter-distributor relationship – at least within the boundaries of the relevant market – partly because it normally represents a number of different principals in the market, thereby being less dependent on each individual principal. The extent to which this power plays a role will then depend on the importance attached by the exporter to attain a certain share in the market in question.

The degree of dependence of one of the partners on the other is therefore assumed to impact on the mode of governance by the principal. Anderson and Narus (1990) suggest that the less dependent firm can enforce various strategies on the other party. Hence, it is proposed that the less dependent the exporter is on the next channel member, the more it is likely that it will content itself to recurring to output control (see also Frazier and Antia 1995). On the other hand, complete dependence on the partner invites the principal to carry out trust enhancing measures, thereby increasing trust, in order to compensate for the lack of power. Heide (1994) suggests that the dependent party should try to establish a “negotiated environment”, in which the burden of dependency is alleviated and the risks of opportunistic behaviour lessened. These propositions are partly consistent with de Mortanges and Vossen (1999) who found that resource dependence correlates negatively with outcome control, but not with relational control. Their definition of dependence was however more akin to Bello and Gilliland’s (1997) construct of resource inadequacy, rather than dependence on partner.

P7: The more dependent the exporter is on the intermediary, the more it recurs to trust-enhancing activities (such as functional drivers to control mechanisms or relational drivers: social bonds, investments in relations, development of market knowledge at HQ).

Investment in relations

Relationship commitment (Morgan and Hunt 1994) and commitment to partner companies (Nes and Solberg 1999) have been discussed and subsequently operationalised. Both have found strong correlations between trust and commitment. Morgan and Hunt (1994, p. 23) define commitment: “as an exchange partner believing that an ongoing relationship with another is so important as to warrant maximum efforts at maintaining it; that is the committed party believes the relationship is worth working on to ensure that it endures indefinitely”. Moorman, Zaltman and Deshpandé (1992, p. 316) defined it as “an enduring desire to maintain a valued relationship”. The way in which it has been operationalised (intentions, commitment, merit, desire) indicate that commitment is an attitudinal variable. We believe that the concept of investment in relations is more tangible, and therefore easier to relate to as an operational variable for company management. The two should however be strongly correlated and we propose that trust ensues from investment in the relationship.

Other researchers have dealt with investments as adaptations to accommodate the partner (Håkanson 1982, Hallén, Johanson and Seyed-Mohamed 1991). For instance, Hallén, Johanson and Seyed-Mohamed (1991) found that investments in adaptation “tie the firms together in strong customer-supplier relationships, [forming] the basis for both business expansion and for securing current sales or supply sources” (p. 35). They maintain that adaptation behaviour will vary over the life time of the relationship: in the early phases of the relationship it is expected to be a way to develop trust, whereas in the more mature stages it will be a means of solidifying and expanding the relationship.

P8: The more the exporter invests in the relationship, the more trust will constitute the main control mechanism.

Market knowledge

In the words of Sharma (1997), “Not knowing *how* the agent does a job is distinctly different from and compounds the problems of not knowing *what* the agent does” (p. 768, Sharma’s emphasis). The contention is here that market knowledge facilitates control and monitoring by the principal. Indeed, Gripsrud, Solberg and Ulvnes (1999) suggest indirectly that the way in which market knowledge is built at HQ may have an impact on the way in which relations between HQ and its channel intermediaries develop. Market knowledge may be built through own experience in the market (Johanson and Vahlne 1977), through co-operation with the intermediary, or through market information from third parties/secondary data or the like.

Market knowledge was found by de Mortanges and Vossen (1999) to correlate with all three forms of governance mechanisms. Again, borrowing from Sharma (1997), “..[A]lthough principals can ‘purchase’ commodity information of the know-what kind so as to monitor and control agents, they are unlikely to be able to narrow similarly the asymmetry of expertise that is based in a specialized *and* dynamic body of knowledge – which is not a commodity” (p. 769, Sharma’s emphasis). Although there will be asymmetry of expertise (in our case market

knowledge), we believe that the narrower this asymmetry is, the better the relations between HQ and intermediary.

We propose in our research that the better the market knowledge, the better able the exporter will be to set benchmarks for output control and guidelines for behavioural control of the local representative. Furthermore, the greater its market knowledge, the more credible the exporter will be in developing a trusting atmosphere between the partners. Contrary, lack of market knowledge leads to uncertainty in the relational climate between the trading partners as the exporter is deemed to feel uncomfortable with market knowledge asymmetry.

P9a: There is a correlation between the market knowledge at HQ about local marketing factors and the use of unilateral control mechanisms

P9b: Increased market knowledge at HQ about local marketing factors leads to increased trust by the exporter in its local representative.

External drivers to control mechanisms

Environmental factors, such as economic climate, technological change, competitor actions etc. lead to uncertainty about the outcome of the operations. The ensuing risks have to be borne by someone. In cases where the outcome uncertainty is high behaviour control is generally believed to be preferred (Eisenhardt 1989). We have introduced three external factors which we deem are relevant to the exporter: cultural, competitor and global factors.

Cultural distance

Bello and Gilliland (1997) found that psychic distance reduces the use of output control because “as psychic distance increases, monitoring and enforcement costs also increase” (Klein and Roth 1990, p. 32), ascribing the cost increases to difficulties in obtaining and processing control information from unfamiliar cultural settings. Even though this might well be the case, we propose that dealing with distributors and sales people from distant cultures it is easier to measure their performance than to influence their behaviour. Also, Morgan and Hunt (1994) found in their study a correlation between shared values and trust. Extending the concept of shared values to that of closeness in national cultures, Nes and Solberg (1999) show that cultural distance – using Hofstede’s (1980) four cultural dimensions – correlates negatively with trust and commitment. We therefore propose that

P10a: The larger the perceived cultural distance the more the exporter will recur to output control, than the other forms of channel governance in international markets.

An interesting dimension not captured by Hofstede (1980) is the dichotomy “organisation as a task - organisation as a social group” (Trompenaars 1993). Trompenaars’ research of managers in 53 countries found that some countries are more task oriented (Czechoslovakia and Hong Kong at the end of the scale) than others (Malaysia, South Africa at the other end). In a middle group we find countries like Australia, Belgium Netherlands, Norway. Task orientation involves a disposition to “get the job done” rather than looking after the well being of the members of the organisation. Hence

P10b: The more task oriented the culture of the principal, the more the principal will tend to use unilateral control mechanisms (as opposed to trust).

One may also assume that firms having reached a high level of internationalisation (Johanson and Vahlne 1977) will differentiate their intermediary control systems between various host countries, because they are better able to take into account cultural differences between them. Thus it is posited that well developed exporters will use unilateral control mechanisms in countries scoring high on task orientation and bilateral control mechanisms in the more socially oriented cultures.

P10c: Differentiation of control mechanisms based on cultural differences of intermediary operations will increase with degree of internationalisation of the firm.

Competition and globalisation

The competitive climate typically varies from one country to the other. This is particularly true in multidomestic industries (Porter 1986), but even in industries that are perceived as being global, an important element of local competition in each of the major markets in the Triad is customary. Thus, the exporter is confronted with a variety of different competitive situations around the globe. Solberg (1997) maintains that the competitive structure in international markets will frame the main strategic orientation of the firm, and shows that firms confronted with global market forces will react differently depending on their “preparedness for internationalization” (p. 15). Companies with low preparedness will typically adopt defensive strategies, whereas companies with high preparedness will act more aggressively. Along this line of reasoning, it is conceivable that control mechanisms will vary according to the degree of global competition and the ability of the firm to cope with the same

As managers gain experience (increase their “preparedness for internationalisation”), they also increase their confidence and tend to recur to behavioural control mechanisms (Jackson, Deith and Schlacter 1983, Ouchi and McGuire 1975). In a multidomestic market environment they are still believed to mainly recur to trust as the prevailing mode of governance, as unilateral forms would require too much resources in a very differentiated market environment. Furthermore, in this position (high “preparedness for internationalisation”) the exporter scores high on most of the relational factors treated in the previous section, thus creating a fertile soil for a trusting relationship. This leads us to posit that

P 11a: Internationally experienced firms operating in multidomestic markets will predominantly use trust as their main mode of governance.

On the other hand, in global markets, dictated by the co-ordinated actions of global competitors, the company needs to have some control of the way in which operations are run in each market (Isdell-Carpenter 1986). This involves some kind of centralisation and formalisation (Nohria and Ghoshal 1994). It has been suggested that some sort of “clan” control (Ouchi 1979) - implying investments in shared values - is preferable to the more mechanistic output control in multinational enterprises (MNE) (Chakravarty and Lorange 1989, Marchan 1993). Clan control is distinct from behavioural control in that it presupposes socialisation of the partners and that they share the same values, thus reducing the scope for conflict. This is particularly critical in

MNEs as it helps reduce the detrimental effects of cultural distance. Also clan control embodies elements of trust. In the words of Kim and Mauborgne (1993),

“to implement global strategies, multinationals need subsidiary managers with a sense of commitment, trust, and social harmony. Organizational commitment inspires these managers to identify with the multinational’s global objectives and to exert effort, accept responsibility, and exercise initiative on behalf of the overall organization - despite potential ‘costs’ at the subsidiary unit level.... [Trust] inspires subsidiary managers to more readily accept in good faith the intentions, actions, and decisions of the head office instead of second guessing, procrastinating, and opportunistically haggling over each directive”. (p. 602).

Moreover, Nohria and Ghoshal (1994) demonstrate that companies using a combination of shared values and differentiated fit perform better than companies that use either of the control forms. They define differentiated fit as a

“strictly contingent approach that relies on a strong link between formal structure and action. Thus, adopting a formal structure (the right combination of centralization and formalization) that fits the different circumstances of the subsidiaries responds to both control issues as well as to the differences across the various subsidiaries” (p. 494).

The concept of differentiated fit then represents different aspects of unilateral control (behavioural and output). To conclude: given the competitive imperative of global markets and also the relatively more uniform market environment of global markets, and given the ability of experienced firms to set benchmarks for their partners, we propose that

P 11b: Internationally experienced firms operating in a global market environment will use a combination of different modes of governance.

Following the same line of argument we believe that the less experienced firms will take a more “ethnocentric” and less resourceful stance to control. They lack the experience to carry out behavioural control (Jackson, Deith and Schlacter 1983., Ouchi and McGuire 1975), and lack the resources to control through trust. Therefore in both competitive settings (multilocal and global) we believe that:

P 11c: Companies with limited international experience will recur to output control as their main mode of governance of partners in international markets.

Summary

The literature on governance of international partners have mostly emanated from the strategic management tradition (Bartlett and Ghoshal 1989, Hedlund, 1986, Chakravarty and Lorange 1989, Prahalad and Doz 1990, Nohria and Ghoshal 1994). There is an emerging literature using agency theory to explain governance of channel intermediaries (Bello and Gilliland 1998, de Mortanges and Vossen 1999). This article endeavours to introduce contributions from different fields of research in order to develop a comprehensive model of governance of foreign sales subsidiaries and distributors. In particular, using basic concepts of agency theory (control

mechanisms) and supplementing by contributions from as different fields of study as for instance sociology, cross-cultural management, internationalisation school of thought, global competition the model aims at capturing basic elements of both channel governance and international management.

Most managers have established their own “truths” or “half-truths” concerning different aspects of international marketing strategy and how to control and monitor the activities of their partners in international markets. Also, each company has established a certain management style according to the beliefs expressed by these truths. These management styles are being articulated through both functional and relational factors, some of which of which have been captured by the presented model. The latter suggests that there are a number of different contingencies attached to the “best solution”. Among other factors, these relate to the stage of the relationship between the relational partners, to the level of international competencies/experience at HQ, to the nature of competition and to different cultural aspects in the intersection between the home and different host countries.

The proposed model should easily lend itself to hypothesis testing through mass distributed questionnaires to exporters. This article has developed 11 propositions and a number of sub-propositions. Yet it is possible to perceive of other propositions based on the model. For instance, different emphasis on various kinds of control may impact differently on the individual measures of performance (strategic, economic, market position, relations with partner). These possible variations have not been explored in this article.

Also, the model has excluded important factors. The most manifest one is the issue of channel integration, the argument being that integrated and independent channel members alike will have to be governed through more or less the same instruments. However, the different governance mechanisms may be used differently in the two situations, where factors like for instance power balance and cultural aspects come into play. One may moreover argue that it is easier to develop a clan atmosphere (Ouchi 1979) and to achieve mutual commitment between the partners in integrated systems. Indeed, preliminary research from Norway indicates that trust seems to be established more easily in integrated than in independent systems (Nes and Solberg, 2000 forthcoming). Furthermore, it is conceivable that it is easier for HQ of fully integrated channels to make use of unilateral governance systems than in channels consisting of independent intermediaries. So one conclusion may be that the same instruments are being used in both cases, but in integrated channels they are being used with more strength. Still, we do speak about dealing with relations between people or groups of people, and in both cases management systems have to take into consideration the flaws of human nature.

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Appendix

<i>Company</i>	<i>Industry</i>	<i>Sales Mill. NOK</i>	<i>Export share %</i>	<i>Entry mode in markets under study</i>
Company A	Sports equipment	150	70	Sales subsidiary (10%) and sales joint venture
Company B	Software	500	10	Sales subsidiaries
Company C	Software	500	15	Sales subsidiaries
Company D	Mechanical eng.	150	90	Sales subsidiaries and distributors
Company E	Electronics	250	80	Sales representatives