

Strategic Factors Affecting Export Decisions : The Case of Indonesian Manufacturers

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ABSTRACT

The impact of the South East Asian economic crisis is the stimulus for a reappraisal of operational modes of manufacturers engaged in exports of industrial goods. Employing established theories as a point of departure, two specific variables are evaluated for their relationship to the choice of export mode of operations. The impact of strategic motivations and a particular strategy—differentiation, and how they relate to the employment of three categories of export modes ranging from direct exporting to the use of foreign sales subsidiaries. Our findings show that both strategic motivations and use of a differentiation strategy are positively related to international channel integration decisions.

Background

The economic crisis in South East Asia during the past few years has significantly effected the business environment for firms engaged in international business. Changes in the exchange rates have led to shifts in trade among ASEAN countries and have had an impact on business strategy. Businesses have frequently been forced to revamp their operations to cope with the changing levels of activity and the accompanying increased risk involved. This study assesses specific variables that are seen as effecting the mode of operations of Indonesian exporters of manufactured goods.

Exporting is the most common way for manufacturers to conduct business in foreign markets. Even firms long involved in international business still export on a regular and permanent basis. Exporting will always be a major factor in the economy, and an important ingredient in the growth of many firms (Albaum, Strandskov, Duerr and Dowd 1994). In exporting its products, a firm has to make two strategic decisions: (1) choose the target country market; and (2) identify the most suitable type of export distribution channel structure to use.

The types of organizational systems employed to distribute products into the market can be viewed along varying degrees of channel integration. At one extreme, the firm can integrate forward and perform all the marketing and distribution functions itself by establishing a sales subsidiary in a foreign market. At the other extreme, a firm can choose not to perform any of these functions, and instead leave the tasks to independent firms. A firm may also use intermediate options such as an export management company or forming distribution oriented alliances of a variety of types with foreign firms (Anderson and Coughlan 1987; Klein, Frazier and Roth 1990).

Different degrees of integration in international distribution channel give a firm varying degrees of control as well as require different resource commitments, responsibility and attendant risks (Ahmed 1977; Czinkota and Ronkainen 1996). Therefore, it is important for firms to consider the alternative structural arrangements, evaluate the alternatives and select the most appropriate structure relative to the firm and the market when exporting. Although such decisions are very important, researchers have not paid much attention to investigating

factors influencing exporters' choice of international channels (Cabaniss 1991; Ramaseshan and Patton 1994). Further, most of the available research has focused more on channels of distribution for firms from developed countries. Very little research has been conducted on the decision making process of firms from developing countries (Anderson and Tansuhaj 1990, Da Rocha and Christensen 1994).

In Indonesia, most manufacturing firms continue to find exporting to be quite attractive and still is the most widely used mode of conducting international business (Lecraw 1993). Passive exporting is still common in Indonesian firms and many have actively pursued the export market using agents and distributors in foreign markets. Seemingly fewer have set up sales offices in their target markets.

Statement Of The Problem

Determinants of the extent of forward integration appropriate to conducting international business are numerous and well documented (Stern and El-Ansary 1992, Johanson and Wiedersheim-Paul 1975, Williamson 1975, and Anderson and Weitz 1986). The focus of this paper is part of a broader effort to understand the dynamics involved in the strategic decision concerning this matter. Specifically, two interrelated key question addressed in this report. First, whether strategic motivations can help better predict export channel structure decisions implemented by Indonesian manufacturers. Second, is a positive relationship between use of a differentiation strategy and the export mode employed.

Theoretical Framework

Internationalization theory, which is also referred to as the "stages theory of internationalization", proposes that the firm's export behavior evolves as natural tendency to vertically integrate over time Johanson and Vahlne (1977). Other concepts to include foreign market structure and transaction cost are also relevant in considering how and why specific distribution mode decisions are chosen. These theoretical statements concerning how international strategies evolve, however, are limited in their explanatory power. Regardless, they provide a framework from which to begin more depthful analysis of specific factors/variables.

The internationalization theory can be assumed to reflect organizational learning. It proposes that the more international experience the management of a firm have the lower the perceived risk of engaging in foreign operations. Therefore, with seasoned understanding of the business environment the management may be more willing to commit to downstream activities and pursue forward integration (Johanson and Vahlne 1977. This, however, is a generalization. In actuality, business managers with significant experience in international activities may recognize the volatility of the business environment and be effected in their distribution decisions by it. For while further integration may result in an opportunity to lower its transaction costs it may be seen as increasing operational risk; both business and financial. Other factors, therefore, need to be considered in understanding the distribution strategy that is chosen by firms.

In prior research only dichotomous modes of foreign distribution were considered. These included both consideration of a direct export versus indirect modes and whether the channel was integrated or non-integrated (Anderson and Coughlin 1987, Johns and Weitz 1988, Seifert and Ford 1989, and Rasmasesham and Patton 1994). In an attempt to capture more of the impact of this dynamic business environment, this study examines three channel integration choices which cover the whole spectrum of the integration from the nonintegrated or direct, the intermediate modes, and the fully integrated mode of export distribution.

For this study, primary data were obtained from firms in Indonesia that manufacture industrial products, capturing managers' perception of factors affecting the export channel integration decisions. The researchers felt that collecting these data would be more reflective of the concept of bounded rationality of the production cost model. By seeking out managerial perceptions of the situation, better measurements of the various constructs that influence the decision concerning the degree of forward integration employed should be obtained.

Literature Review

Channel Integration. The degree of forward integration an exporting firm uses in serving a target country market is important as it determines the degree of a firm's control over the marketing mix in the target market (Albaum, Strandkov, Duerr and Dowd 1994). This decision is addressed differently by different researchers, with the options classified into indirect exporting and direct exporting mode; or into integrated versus non-integrated

mode. Researchers argue that the degree of forward integration in foreign markets can be viewed as a position along a continuum, based on the functions performed (Klein, Frazier & Roth 1990). Osborne (1996) and Aulakh and Kotabe (1997) investigated 3 levels of direct exporting, which are the use of foreign distributor (market mode), the use of commission agents and joint ventures (intermediate mode), and the use of wholly owned subsidiary (hierarchical mode).

Internationalization Process Theory. The Internationalization process of firms has been subjected to widespread studies and empirical research, and seems generally accepted in the literature (Andersen 1993). The basic proposition of this theory is that the firm's export behavior is a development process involving a sequential stepwise progression (Turnbull 1987). In broad terms, Andersen (1993) classified the firm's internationalization process in two ways. First, the models initially developed by Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1978) which are characterized as the "Uppsala Internationalization" models. In this approach the internationalization decision is affected by both the firm's market knowledge and market commitment. The second, the "Innovation-Related Internationalization" models focus on consideration of internationalization decision as an innovation for the firm. Johanson and Vahlne (1977) propose that the internationalization process is a form of knowledge development. Thus, the more international experience the company has, the lower the perceived risk and cost of operating foreign business activities, and therefore, the more resources the management tend to commit to foreign countries.

Strategic Rationale Perspective. The strategic perspective addresses how firm governance structure is influenced by the firm corporate strategy, and how it affects the competitive position of the firm in the international market. The important role of corporate strategy in foreign market on the distribution structure has been described extensively by Hamel and Prahalad (1984); Watson (1982).

Arguing that firms in any industry seek to gain a competitive advantage that will allow them to outperform rivals and achieve above average profitability, Porter (1980, 1985, 1990) suggests that the path to competitive advantage means the successful implementation of the internally consistent competitive advantage.

Porter (1980) discusses the issue of strategic benefits of marketing channel integration quite extensively. He states that forward integration often leads to more successful product differentiation. Forward integration solves the problem of access to distribution channels and removes any bargaining power of the channels. This means that vertical integration transforms the problem of inter-organizational management into an intra-organizational management problems. It is also argued that vertical integration allows the firm to acquire better market information through the simplified interpretation of customer needs. These informational benefits are obtained through closer access to the ultimate customers that vertical integration allows. Finally, forward integration allows the firm to have more authority to pursue price discrimination across different market segments which have different price elasticities of demand.

The business strategy literature also emphasizes competition and corporate strategic needs (Porter 1980;

Harrigan 1983; Root, 1994). When a firm does business in a foreign market, they may aim to achieve other objectives other than efficiency (Watson 1982).

Another objective is commonly based on strategic motivation. Strategic motivation has been defined as motivation to fulfill strategic aims set at the firm level for the purpose of overall firm efficiency maximization. To effectively achieve its international strategic motivations, tight coordination through high control over the channel is necessary for effective and efficient execution of strategy (Kim and Hwang 1992). Strategic motivations are identified as: (1) to set up a strategic outpost for the firm's future expansion; (2) to develop an international sourcing site; and (3) to attack actual or potential international competitors (Kim and Hwang, 1992; Aulakh and Kotabe 1997)

Research Hypotheses

Strategic motivations

Strategic motivation has been defined as motivation to fulfill strategic aims set at the firm level for the purpose of overall firm efficiency maximization. To effectively achieve its international strategic motivations, tight coordination through high control over the channel is necessary for effective and efficient execution of strategy (Kim and Hwang 1992). Altogether, this suggests the proposition that :

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H₁: The firm's international strategic motivations is positively related to the degree of forward channel integration.

Differentiation strategy

A differentiation strategy to create more value than competitors can be accomplished along various dimensions : brand image, technology, customer service, product positioning, etc (Porter 1980, 1986). A differentiation strategy requires higher consumer awareness along with high levels of service, therefore necessitate that such activities be performed internally, since high degree of forward integration provides the firm with more control over channel functions (Keegan 1995). A differentiated product usually commands higher profit margins, therefore firms are willing to invest in fixed costs of channel integration (Harrigan 1985, Porter 1986). Furthermore, differentiation strategy require coordination among functional and geographically dispersed units (Porter 1986). These leads to the following hypotheses :

H₂: The greater the differentiation strategy followed by a firm, the greater the degree of forward channel integration in foreign markets

Measurement And Operationalization Of Variables

In this study, the differences between market exchange, intermediate exchange, and hierarchical exchange are based on the economic tradition of "function performed" (Williamson 1975). Although attempts are made to use existing measures, scales have been adapted for the purpose of this study to better assess the range of options available to decision makers. The measures adapted from various past researches in channel structure decision for this study are all multiple item measures.

The dependent variable in this study is the degree of forward integration, but given the variety of specific

channel structures and arrangements which are typically practiced in today's international marketing efforts, it is somewhat difficult to standardize channel structure classifications. In this study, the differences between market exchange, intermediate exchange, and hierarchical exchange are based on the economic tradition of "function performed" (Williamson 1975), which refers to general types rather than specific alternatives. Market exchange mode is reflected by the use of indirect channel structure, whereby firm sells to independent middlemen, agents or distributors in home country who perform most necessary exporting functions to the foreign target market. Intermediate exchange is reflected by the use of foreign middlemen, agents or distributors under contract to market and sell the products to the foreign market. Hierarchical exchange mode refers to the use of sales subsidiary in the foreign target market.

The operationalization of the independent variables, strategic motivation and differentiation strategy are discussed below.

Strategic motivations. Strategic motivations can be defined as motivations to fulfill strategic aims set at the firm level for the purpose of overall firm objectives. Kim and Hwang (1992) developed measures consisting of three-item scale. A seven-point Likert scale was used in their study, ranging from "low/weak" to "high/strong". Cronbach's coefficient alpha was computed to be 0.68. Aulakh and Kotabe (1997) adapted and expanded this measure with Cronbach's coefficient alpha equal to 0.62. Those studies indicated that the measure had sufficient reliability. These items which are : to attack competitors, to establish

strategic outpost for future expansion, and to develop sourcing site are adopted for this study.

Differentiation strategy. Strategy of differentiation is to create unique value for the firm's products and services (Porter 1980). Three-item scale developed by Aulakh and Kotabe (1997) that incorporates the various dimensions of creating a unique image. A seven-point Likert-scale was used, and Cronbach's coefficient alpha from their study was 0.62 indicating that the measure had sufficient reliability. The scales are adapted and expanded in this study to include also after sales service to the customers. The scale used in this study are: technological edge over competitors, higher quality standards for the products, unique image for the products, and after sales service to the customers .

Sampling Frame and Data Collection

All manufacturers with export operations listed in the Directory of Indonesian Exporters 1999 published by the National Agency for Export Development, Ministry of Industry and Trade, Republic of Indonesia and from the Standard Trade and Industry Directory of Indonesia 1999 published by PT Kompasindo were identified. A questionnaire was developed based on the variables previously described previously. The instrument was translated into Indonesian language and back translated for assurance of appropriateness. A pretest of the questionnaire was conducted with 10 selected exporting firms producing different products.

Primary data were requested from 1046 Indonesian manufacturers in industrial product. The participants were asked to focus on one foreign country that was the most

important market to them and answer questions related to the channel decisions in that country. A response rate of 27% was received.

Testing of Hypotheses

The individual hypotheses were tested through multinomial logit model. Multinomial logit model has been used in previous entry mode research, e.g. Agarwal and Rawasmawi (1992), Gatignon and Anderson (1988), Kim and Hwang (1992), Klein, Frazier and Roth (1990), Aulakh and Kotabe (1997). A multinomial logit model estimates sets of coefficients to reflect different levels of the dependent variable. The size of the various coefficients indicates the extent to which individual predictor variables contribute to the utility of choosing the level of channel integration beyond the contribution to the utility of the market exchange mode which is used as a base mode (Malhotra 1984).

Results of Hypotheses Tests

Hypotheses about the factors encouraging or discouraging forward integration in the export market were tested using a multinomial logit model that estimated the impact of the independent variables on the probability that each channel mode would be selected.

Hypothesis One The first hypothesis relates the firm's international strategic motivations to the degree of forward integration in export market and is stated as follows:

H₁: The firm's international strategic motivations is positively related to the degree of forward channel integration.

The estimated coefficients and p-value for both modes are shown in Table 1 and are in the positive direction and statistically significant (B= 2.949, p= .000 for hierarchical exchange mode and B= 1.285, p= .001 for intermediate exchange mode). The findings indicate that with the increase of strategic motivation, firms tend to use higher integrated channel than market exchange mode. Thus, the firm's international strategic motivations is positively related to the degree of forward channel integration

Table 1
Parameter Estimates - STRGMOTV

DFORINTG		B	Std. Error	Wald	Df	Sig.	Exp(B)
1.00	STRGMOT V	2.949	.550	28.702	1	.000	19.092
1.00	STRGMOT V	2.949	.550	28.702	1	.000	19.092
2.00	STRGMOT V	1.285	.387	11.025	1	.001	3.614
2.00	STRGMOT V	1.285	.387	11.025	1	.001	3.614

Hypothesis Two The second hypothesis considers how a differentiation strategy relates to channel integration and is stated as follows:

H₂: The greater the differentiation strategy followed by a firm, the greater the degree of forward channel integration in foreign markets

The estimated coefficients shown in Table 2 are both positive and significant (B= 1.599, p = .001 for hierarchical exchange mode and B= 1.220, p = .001 for the

intermediate exchange mode). The findings suggests that as firms following more differentiation strategy, they tend to use higher integrated channels than in the market exchange mode. Thus, the firm's differentiation strategy is positively related to the degree of forward channel integration.

Table 2
Parameter Estimates - STRDIFFE

DFORINTG		B	Std. Error	Wald	Df	Sig.	Exp(B)
1.00	STRDIFFE	1.599	.500	10.220	1	.001	4.948
1.00	STRDIFFE	1.599	.500	10.220	1	.001	4.948
2.00	STRDIFFE	1.220	.378	10.426	1	.001	3.386
2.00	STRDIFFE	1.220	.378	10.426	1	.001	3.386

Conclusions

These findings provide new perspective on the value of attempting to apply traditional theories to dynamic situations. The business environment of the recent past in South East Asia has created significant challenges for managers in exporting firms. Adjustments in coping with dynamics of the market place have resulted in strategies that may not be consistent with those appropriate to more predictable and stable conditions.

While it is not expected that the findings here are generalizeable to other situations, they do provide a basis for questioning established thinking. Specifically, the finding of a positive relationship between international strategic motivations and degree of forward integration is consistent with the earlier findings by Kim and Hwang (1992). Another important finding was the positive

relationship between differentiation strategy and degree of channel integration, confirming the results obtained by Aulakh and Kotabe (1997).

These findings also provide managers with a better understanding of the importance of strategy variables and how they influence channel integration decisions. Hence, managers should be able to better align strategic shifts with channel decisions made in international markets.

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