

# Are you swaying to the swing in your distribution channel?

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## Abstract

Managing the swing vote is a key aspect of running election campaigns in modern day politics. Distribution channels have a long history of being studied as political economies. This paper uses the structural holes concept of social network theory to illustrate the importance of managing swing retailers when distribution channels are considered as social networks. The high social capital of these retailers plays an influential role in the achievement of collective and individual interests of channel members. A simulation is then conducted using a systems theory tool to illustrate the criticality of managing social networks within channels in contrast to the study of dyadic relationships that dominates extant literature. The results show that under certain boundary conditions managing swing retailers may prove to be as important for firms as managing their core network of loyal customers. The paper ends with managerial implications for firms with mature products operating in countries with distribution channels that are characterized by limited organization and extensive intermediation.

**Keywords:** Social networks, structural holes, trustworthiness, systems theory and simulation

## Introduction

The basic premise of this paper is that the social networks that business dyads are embedded in have an important effect on the relationship characteristics of individual dyads. Embedded refers to the impact of ongoing social relations on institutions and behaviour of economic actors (Granovetter, 1985). This thesis is an extension of Granovetter (1985) classic argument that “standard economic analysis neglects the identity and past relations of individual transactors” while simultaneously eschewing the sociological perspective that “once we know the individual’s social class everything else in behaviour is automatic since they are so well socialized.” Both the under and oversocialized accounts illustrated above were singled out by Granovetter for “their neglect of ongoing structures of social relations” and he argued that any “sophisticated account of economic action must consider its embeddedness in such structures.” This paper uses a social network analysis to illustrate the importance of network structure on the formation of buyer-seller relationships.

There is no dearth of studies on retailing investigating the role of economic action on channel evolution and management. However, as argued by Granovetter economic analysis has frequently assumed away important social structure realities in the interest of sophisticated model building. Distribution channel members are subject to social interactions that not only determine the trustworthiness of the transacting member but also have ramifications for the entire domesticated channel as a whole (Arndt, 1979; Easton and Araujo, 1994). Channel management research and practice has for long recognized the importance of managing networks beyond dyadic relationships (Nevin, 1995; Achrol and Kotler, 1999) involving authoritative, normative or contractual control mechanisms (Weitz and Jap, 1995). However, despite universal acceptance for studying channels as social networks, the number of papers published in this area are extremely few (Wuyts et al, 2004). The need for models explaining relationships between

suppliers<sup>1</sup> and other organizations in the demand chain has been identified as a major area for strategic research in retailing (Dawson, 2000)

Strategic decisions in distribution relate to the selection and design of channels and their subsequent management through relationships and control systems (Weitz and Jap 1995). Extant literature has largely ignored the modification of distribution channels by manufacturers in response to the complex web of relationships that characterize the internal context of the channel (Andersson 1992). Channel decisions involve complex social exchanges (Homans 1958; Blau 1968; Ekeh 1974; Bagozzi 1975). The basic assumption of social exchange is that actors are dependent on each other for valued outcomes (Molm et al 2000). Actors are motivated to obtain more of the outcomes that they value but others control, they provide each other with these valued benefits through exchange and these exchanges between the same actors are recurring over time (Gronroos 1997). Channels fulfill all these assumptions and the internal polity of the channel impacts channel maintenance decisions (Mintzberg 1979; Stern & Reve 1980; Arndt 1983) through the twin sources of money and authority (Benson, 1975).

Exchange processes are embedded in a dense fabric of social relations and economic exchange is rarely able to rid itself of social exchange, kinship, friendship and sociological elements not liable to be reduced to the standardized metric of money (Easton and Araujo, 1994). Björkman & Kock (1995) state the fact that it empirically may be difficult to separate between social, information and business exchanges taking place when actors interact. Thus control of distribution channels needs to account for the network of social interactions between the various members of the domesticated channel. A business network is defined as a set of two or more connected business relationships in which each exchange relation is between business firms that are conceptualized as collective actors (Anderson et al, 1994). The network becomes all the more complex when considering the role of alternate suppliers sharing common intermediaries, opinion leadership amongst retailers and relationship between the intermediary and the seller as perceived by the retailer – triadic effects (Wuyts et al, 2004). Hence studying dyadic relationships in isolation fails to capture the richness of the channel context under evaluation and may overstate the direct control that a supplier has on its intermediary.

Trust defined as the willingness to be vulnerable is the basis of all business relationships. According to the IMP/Interaction approach networks are patterns of relationships within which interaction takes place (Gummesson 2001). The approach incorporates relationships with both economic and non-economic exchange (Easton and Araujo 1992; Wellman & Berkowitz 1988; Johannisson 1994). Relationships are based on economic, legal, technical, social and/or administrative bonds (Hammarkvist et al. 1982). The actors are connected with relationships that are weak or strong (Granovetter 1973). Relationships are the focus of substantial investments in time, money and effort and are the means by which knowledge as well as other strategically important resources are both accessed and created. Furthermore, relations are connected to other relations resulting in systems of interdependent relations - henceforth referred to as business networks (Anderson et al, 1994). These relationships within the networks enhance trust and confidence between firms. Thus the basis of the existence of a network is the presence of trust between the various actors of the network.

Lewciki and Bunker (1995) have classified research on trust into three categories: (1) trust as individual difference based on personality theorist views, (2) economic sociology perspectives of trust being an institutional phenomenon and (3) social psychology perspective of trust being an expectation of another party in a transaction. The willingness to be vulnerable to a partner is the common theme across all these different conceptions of trust (Bigley and Pearce, 1998). Literature has focused and indeed correctly so on the direct interactions that actors have and the subsequent effect that these dyadic exchanges have on the relationships that are built. However, this has been done by ignoring various social factors that

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<sup>1</sup> Please note that in this entire study the terms manufacturer, supplier and client are used inter-changeably. Likewise intermediary, agent, distributor and wholesaler imply the same actor.

signal the trustworthiness of an actor. The behaviour of an actor within the social network context of the channel can be used as a powerful signal received by the actor's partners on the motives and intentions of the focal actor's business dealings. In the channel context the implication is that client-agent relationships are governed by these network externalities and that any attempt to monitor and administer channels needs to acknowledge and address the role of these externalities.

Modern day election campaigns in many democracies revolve around managing the swing vote. Voters are segmented into different groups such as hard (extremely loyal) supporters, soft (somewhat loyal) supporters, the undecided, soft opposers and hard opposers. The focus of the campaign effort is not on the hard (either supporters or opposers) but on the remaining three (swing) groups (Gary, 2003). Fortunately distribution channels do not have to deal with the undecided, as unlike voters who can choose to be indifferent, retailers need to act and take a decision one way or the other. Thus, channel managers unlike their political counterparts need to contend with only two groups, the soft supporters and the soft opposers. This paper classifies such retailers as boundary spanners and through a simulation using a systems thinking tool shows that they play an important role in the management of distribution channels.

## **Channels as social networks**

Channels in many countries are characterized by numerous channel members often linked through brokers who have short-term profit objectives. Hence, retailers are engaged in regular or sporadic seeking of alternate supply sources (Saimee 1993). This study classifies this phenomenon as the alternate channels available for a retailer in contrast to the administered, legitimate channel governed by the intermediary's supplier (manufacturing firm). The availability of alternate options leads to boundary spanning opportunities for retailers as illustrated in Exhibit 1.

At one end of the spectrum are the legitimate channels consisting of the manufacturer, his officially appointed intermediary (also referred to as wholesaler) and loyal retailers who always buy from the "official" source. At the other end is the alternate channel that consists of dealer/brokers (from now on referred to as semi-wholesalers) who are driven by short-term considerations and run an alternate channel to the legitimate channel set up by the manufacturer firms. These semi-wholesalers carry a greater width of products sourced at discount rates. The sourcing strategy is beyond the scope of this paper. It's sufficient to state that on account of their scale and cross-subsidization between products of different companies the prices of certain lines available at these semi-wholesalers is significantly lower than the official wholesaler catering to that area. They typically use strong brands as loss leaders to promote the sale of higher margin weaker brands. Additionally there is evidence in literature that manufacturer's themselves promote dual distribution as a strategy for multiple reasons such as price discrimination, lack of distributor competition, reducing information costs and facilitation of collusion. (Weignand 1977; Coate and Fratrik 1989; Cespedes et al 1990).

**Switching and loose coupling:** Thus, as depicted in Exhibit 1, for a retailer balancing between the legitimate channel and the alternate channel becomes a significant issue. The official channel is predictable, consistent and is favoured by the manufacturer (implying company support in sales promotion and merchandising), while the alternate channel presents opportunities from time to time for bargains that would reduce his costs. It is under these conditions that boundary spanning becomes critical where the weak ties with the alternate channel are used for search while the strong ties with the legitimate channel facilitate transfer (Granovetter 1982; Hansen 1999) and/or vice versa. Switching is a means of avoiding uncertainty. Strong ties with any of the channels inhibit flexibility and hence boundary spanners use a network of weak ties to affect their objectives. Loose coupling (Weick 1976) becomes the defining characteristic of distribution channels from the perspective of the retailer. The challenge to any

manufacturer seeking control is to discourage boundary spanning. However, faced with a limited interaction with retailers, the manufacturer is forced to affect control by supporting the intermediary in his efforts to improve his perceived trustworthiness by retailers. Perceived trustworthiness implies reliability and an expectation that exchange obligations will be fulfilled (Schurr and Ozanne 1985).

**Structural holes and social capital:** As depicted in Exhibit 2 it is the boundary spanning retailers and not the loyal retailers that ultimately aid the legitimate channel in expanding its reach.  $M_1$  is the focal manufacturer firm under consideration.  $I_1$  is the appointed intermediary for the particular area. The boxed area is the legitimate channel.  $I_2$  is the appointed intermediary for the neighbouring area. G is the grey channel.  $B_1$  and  $B_2$  are two cases of boundary spanning retailers who have high social capital within the depicted network. Social capital exists where people have advantage because of their location within the network (Walker et al 1997; Burt 2004).  $B_1$  is a soft supporter who helps the legitimate channel bridge the structural hole with the other two alternate channels.  $B_2$  is a soft opposer who helps in bridging the legitimate channel with one of the alternate channels. Thus  $B_1$  and  $B_2$  are positioned for brokerage as they provide the legitimate channel access to six more retailers.

**Opportunities for brokerage:** There are multiple levels of brokerage through which the boundary spanners create value. They exert a multiplex role as they facilitate exchange and communication between isolated networks and may also play affective roles as members of the same community. They present the manufacturer with an understanding of the interests of the other networks. An understanding of these interests aids the manufacturer in suitably modifying channel strategies to attract these retailers. News from boundary spanners increases the intermediary's awareness on distribution issues in neighbouring territories. Thus, facilitating the transfer of best practices. They provide the channel manger information on the gaps between intended and emergent strategies (Mintzberg 1982), thereby helping in improving channel governance through feedback. And most importantly they provide the legitimate channel an opportunity to increase its reach by attracting cliques (group that is strongly linked) that the boundary spanner is a part of.

**Trustworthiness and market reputation:** Sociologists have used social network theoretical concepts to understand as to how trustworthiness is updated within channels. Trustworthiness is seen as an aggregate concept and the reputation of a wholesaler is derived from his levels of trustworthiness (Smith and Barclay 1997) generated over time across interactions with different retailers. Thus, his market reputation is a cumulative measure of the trustworthiness reposed by individual retailers and is predicted by the broad perceptions of a large majority of retailers. A model has been developed in the next section to show the role of boundary spanners using this concept of trustworthiness at the aggregate level.

## Model

At the aggregate level the trustworthiness of individual retailers is accumulated to represent the trustworthiness of the intermediary in the market (market reputation). Thus, trustworthiness is represented as shown in the following equation:

$$T = \sum_{r=1}^n t_r \quad \dots\dots\dots \text{Eq (1)}$$

T is the market trustworthiness (market reputation) of the intermediary and n is the total number of retailers.  $t_r$  is the trustworthiness imposed by each retailer on the intermediary and is a function of the tie-

intensity between the intermediary and the manufacturer as perceived by the retailer – triadic effects (Wuyts et al 2004), the trustworthiness of the intermediary as perceived by other members of the retailer's network (opinion leadership) and the tie-intensity between the retailer and the intermediary. There is evidence in literature to show that repeated play in dense social networks facilitates trustworthiness (Glaeser et al 2000). Hence, tie intensity leads to trustworthiness in the intermediary (Nevin 1995). In all these instances tie-intensity refers to the frequency and size of the transaction (Wuyts et al 2004). Exhibit 3 is an illustration of the model that was used to run the simulation. The programme used was itthink (Ver: 3.07). A systems theory tool has been used, as it is an approach that eschews the single organizational focus in preference for analyses at the level of the whole organizational field – channel in this instance.

**Limitations:** The simulation model has been used in light of the limited research on channels as social networks (Bradford et al 2004, Wuyts et al 2004). The endeavour is to stimulate future research conceptualising channels as social networks as such a conceptualisation enables relationships to be studied in the context that they are embedded in.

Unlike Exhibit 2 only two networks are considered in this simulation – the legitimate and the alternate channel. The alternate channel represents the parallel channels, grey channels, dual distribution opportunities and any other alternate source. Some of the assumptions made while modelling are as follows:

1. Total sales are the sum total of the sales made by the legitimate and alternate channels. Domestication is the ratio of sales made in the administered (legitimate) channel to the total sales made in the administered and alternate channels.
2. Purchases from the legitimate and alternate channels are perfectly substitutable and there are no differences in the product attributes i.e., there are no spurious goods.
3. Demand remains unchanged irrespective of source purchased from. Thus, the model only applies to firms that are well entrenched in the market and not to new players which have products with uncertain demand.
4. Intermediary strategies are directed to retailer groups (loyal, disloyal, boundary spanners) rather than individual retailers. Thus it only applies to channels with a large presence of fragmented small retailers making it difficult for firms to strategize separately for each retailer.

## Observations and Results

The network represented in Exhibit 3 is a social network comprising of a channel with nine retailers, one intermediary and one supplier. As already pointed out suppliers have a need to run alternate channels and hence there are two channel systems, the administered channel comprising four retailers, the alternate channel comprising of three retailers and two retailers tr3 and tr4 who utilize the services of both channels by maintaining a network of connections in the market. For instance tr3 maintains ties with all the other retailers and is a central actor in the network. Tie intensity between the intermediary and three retailer groups is the variable that is manipulated in this simulation exercise. As already stated the channel is highly fragmented and hence it is not possible for the intermediary to strategize separately for each retailer. He instead would strategize for each group and IL, ID and IB represent the tie intensity that the intermediary devotes to each of these groups. The simulation is now conducted by observing the results of tie-intensity manipulation between different groups.

The tie intensity for disloyal retailers and boundary spanners is increased by the same extent (.2) and the domestication effects are recorded (Exhibit 4). The same is done for loyal retailers and boundary spanners (Exhibit 5) except that in this case the intensity is lowered as loyal retailers are assumed to be operating at the maximum tie intensity.

The node density of boundary spanners is much higher as they prefer ties albeit weak ones between the legitimate (administered channel) and the alternate channel i.e. given  $\delta_{IB} = \delta_{ID}$ ;  $|D_B| > |D_D|$  (Exhibit 4).  $I_B$

is the tie intensity between the boundary spanners and the legitimate channel,  $I_D$  is the tie-intensity between the disloyal retailers and the legitimate network,  $D_B$  is the difference between the administered channel and alternate channel sales (domestication effect) when the tie intensity for boundary spanners is increased while  $D_D$  is the difference between the administered channel and alternate channel sales (domestication effect) when the tie intensity for disloyal retailers is increased.

**Proposition 1: Other things being constant a similar increase in tie-intensity between boundary spanners and the legitimate channel and between disloyal retailers and the legitimate channel leads to greater gains in domestication in the former case as compared to the latter**

The same can be observed in Exhibit 5 where the tie intensity for loyal and boundary spanning retailers have been reduced by the same margin. The role of boundary spanners is found to be more significant than the loyal retailers i.e. given  $\delta I_B = \delta I_L$ ;  $D_B > D_L$  (Exhibit 5).  $I_B$  is the tie intensity between the boundary spanners and the legitimate channel,  $I_L$  is the tie-intensity between the loyal retailers and the legitimate channel,  $D_B$  is the difference between the administered channel and alternate channel sales (domestication effect) when the tie intensity for boundary spanners is decreased while  $D_L$  is the difference between the administered channel and alternate channel sales (domestication effect) when the tie intensity for loyal retailers is decreased.

**Proposition 2: Other things being constant a similar decrease in tie-intensity between boundary spanners and the legitimate channel and between loyal retailers and the legitimate channel leads to greater losses in domestication in the former case as compared to the latter**

Hence, any change in tie-intensity between the boundary spanner and the legitimate channel is found to be of greater influence than the case of either loyal or disloyal retailers. The next section will show that this result has certain important implications for manufacturers, intermediaries and retailers operating in channels with limited organization and extensive intermediation.

## Implications

**Manufacturers:** Distribution channels in many countries consist of the legitimate channel administered by the manufacturer and alternate channels that are illegitimate on account of two reasons. They are either intentionally supported by the manufacturer to control its intermediary (dual distribution) or are truly illegitimate grey channels that are beyond the direct control of the manufacturer. The channel objective of manufacturers is to ensure that they retain control over all these channels distributing their products. The extent of domestication i.e. the sale of their products through their legitimate channels determines the extent of control that they have managed to exert on independent channel members such as intermediaries and retailers. This kind of channel leadership is possible when they consider the role of networks in influencing their partners.

Certain retailers on account of their location within the distribution networks aid the manufacturer in monitoring and increasing its control. These retailers classified as boundary spanners bridge the legitimate channel with the alternate channels. Direct contact with boundary spanners helps manufacturers make the trade-off between supporting and controlling their intermediary. They support their intermediary by using boundary spanners (soft supporters) to increase the intermediary's trustworthiness in the market while they employ the soft opposers as a source of information on market exchanges, thereby curtailing any opportunistic behaviour displayed by the intermediary. Higher order information and knowledge involving strategic implications are more likely to be interceded early through the use of such networks (Kumar 1996).

**Intermediaries:** As for intermediaries their market reputation is paramount in ensuring their success. Reputation is the valuable asset that conditions individuals in the network towards co-operative behaviour (Annen 2003). They need to pay special attention to boundary spanning retailers to ensure that their reputation remains intact and sales happen through their channel. Any slack on this front would be a vicious cycle that could threaten the entire business model of an intermediary. Decreases in domestication would lead to price-differentials on account of a slippage in economies of scale, which would further lead to increased sales by alternate channels. Relationship with manufacturers would hence be strained; their support would reduce, leading to deterioration in the intermediary's market reputation (trustworthiness). This would further decrease domestication and the cycle would continue and be difficult to reverse.

Boundary spanners have a high node density (number of connections with other actors). Hence, they act as important opinion leaders for establishing the trustworthiness of an intermediary in the market. Trustworthiness is asymmetric in nature. Damage is instantaneous while redressal is time consuming. Hence, paying attention to boundary spanning is a critical success factor for an intermediary as he would be in a position to pro-actively contain any damage to his reputation before it affects his core group of loyal retailers.

**Retailers:** Retailers need to consider the role of weak ties in negotiating with manufacturers. They need to retain flexibility by not being domesticated by any particular channel. Loose coupling would help them in exploiting brokerage opportunities. These opportunities are multiplex involving communication as well as exchange. They aid them in conducting searches before buying and bargaining tough during negotiations. One way of dealing with the environmental uncertainty of fast paced changes is to ensure that sourcing advantages are fully utilized. Additionally bridging structural holes and the resultant gains in social capital enables retailers to position themselves as future prospects for manufacturers who may want to replace intermediaries at a latter stage.

## Conclusions

The defining characteristic of channels in developing countries is the fragmentation of retailers (Kale 1986). Thus the often explored and sited phenomenon of power diffusing from manufacturer to large organized retailers in more developed contexts is less relevant in these markets. Additionally as already evidenced with Japan (Goldman 1991) a modern institutional structure does not imply a modern internal political economy. Hence, organization may not change the role of internal context in influencing channel decisions.

Unlike channels in more developed contexts where outcome based monitoring is particularly pervasive (Spriggs 1994) formal explicit written contracts between channel members are absent in developing countries. Contracts are implicit with performance measurement often based on behaviour, interspersed with promotional schemes that are outcome based (Narayandas and Kasturi Rangan 2004). Intermediaries use this information asymmetry to indulge in opportunistic (self seeking with guile) behaviour (John 1984; Nunlee 2005). Thus from the manufacturer's perspective the internal context of the channel becomes the most important institutional mechanism to influence behaviour and actions of the channel members (Pandya and Dholakia 1992; Grewal and Dharwadkar 2002).

Social networks function as a collateral or assurance that economic transaction will proceed as agreed by the parties involved (John 1984; Biggart and Castanias 2001; Annen 2003; Nunlee 2005). Thus, further reinforcing the need to study dyadic relationships in the context of the network that they are embedded in. Embedded refers to markets where social relations alter market operations (Frenzen and Davis 1990).

The contribution of this paper is to illustrate the importance for channel research to look beyond the immediate organizational field of partners and customers. Channel members who are apparently disloyal have an important role to play in the management and extension of the manufacturer's control over its distribution efforts. Efforts directed at them reduce information asymmetries and thereby keep a check on the display of opportunistic behaviour by either manufacturers or their intermediaries. Thus, engaging boundary spanners enables the legitimate channel to achieve its collective goal of extending reach while simultaneously protecting individual interests of manufacturers and their intermediaries. In this manner networks illustrate the mutual dependencies that characterize channels rather than the dominant channel leadership position advocated by prior research. An approach to acknowledge the centrality of these relationships helps manufacturers administer networks in their distribution channel that are beyond their direct control.

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**Exhibit 1: Boundary spanning in distribution channels**

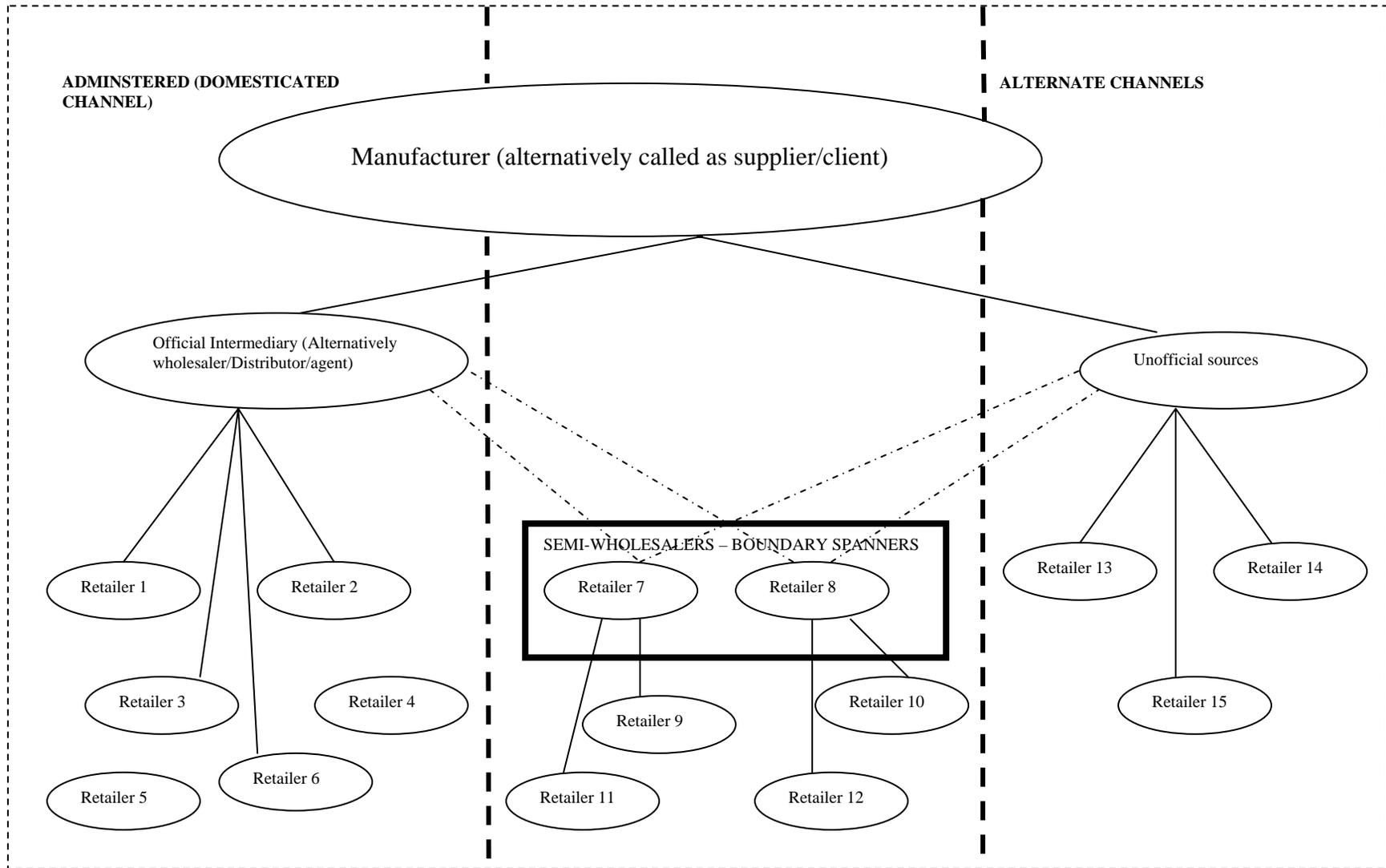


Exhibit 2: The social network view of distribution channels

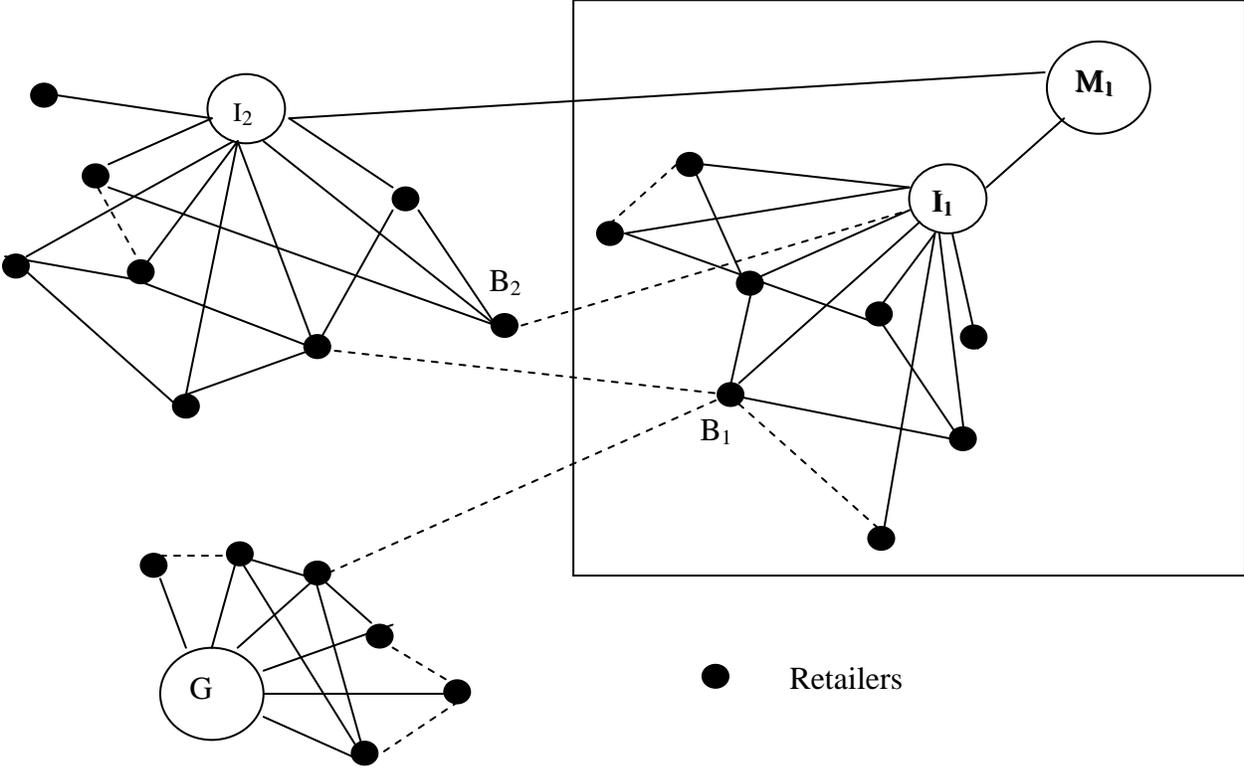


Exhibit 3: The model used in simulation

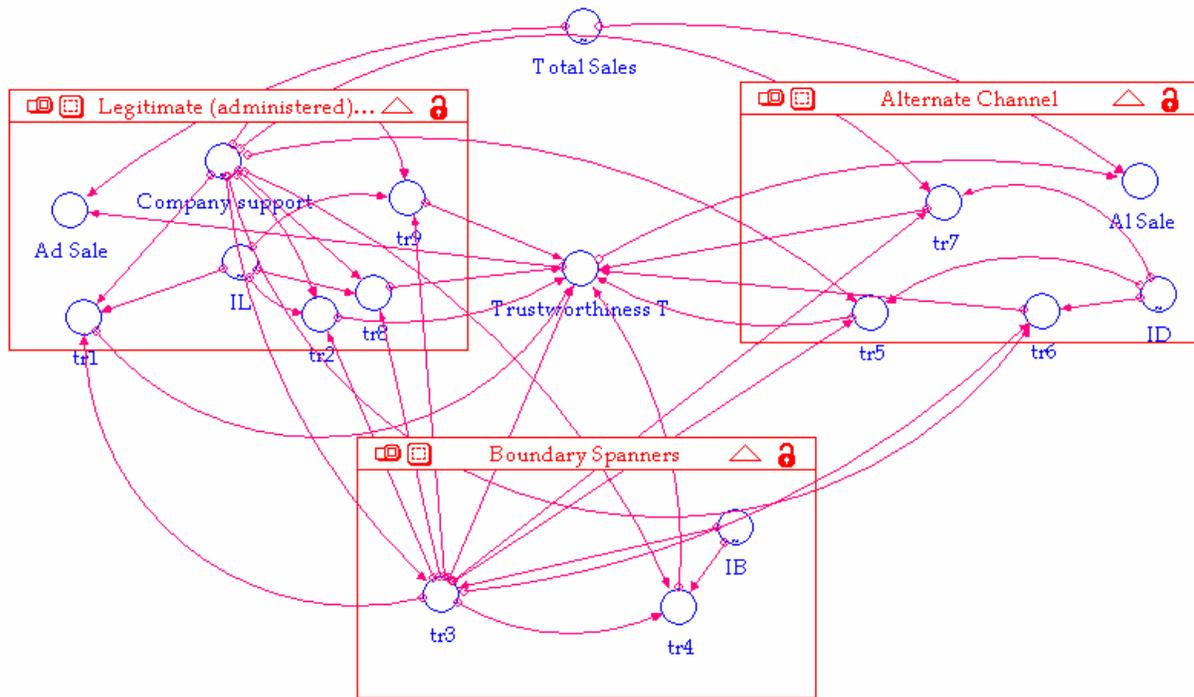
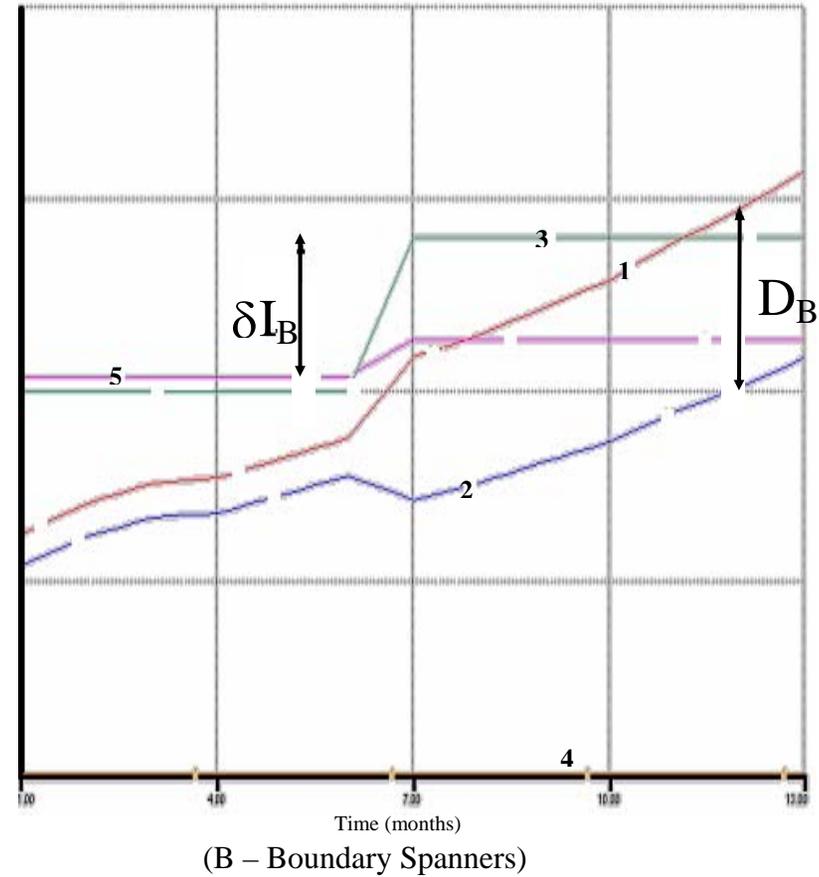
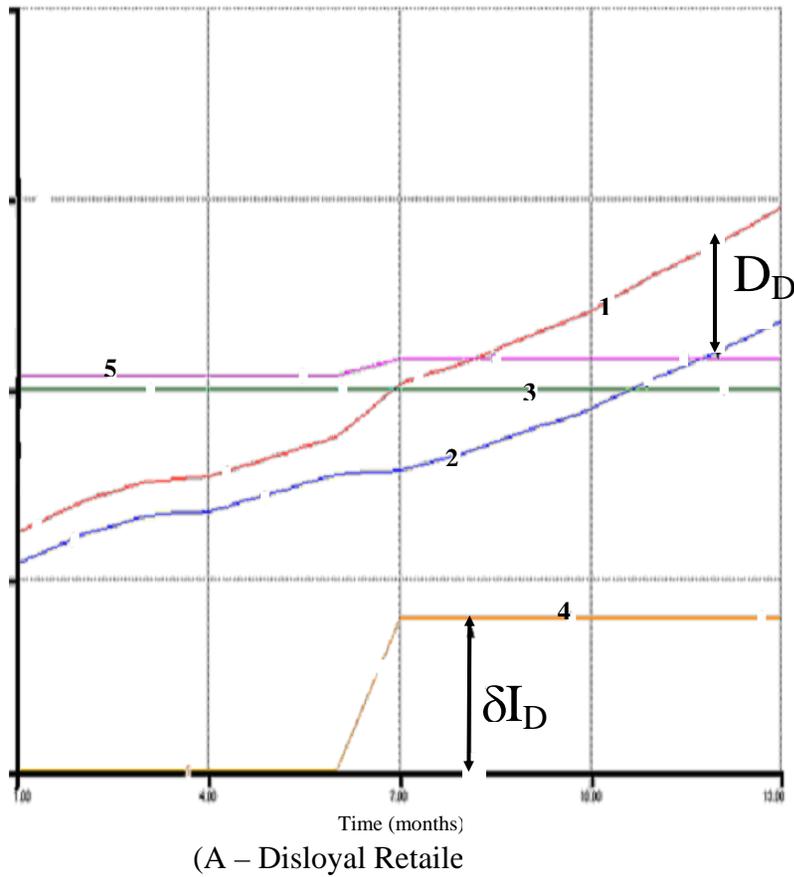
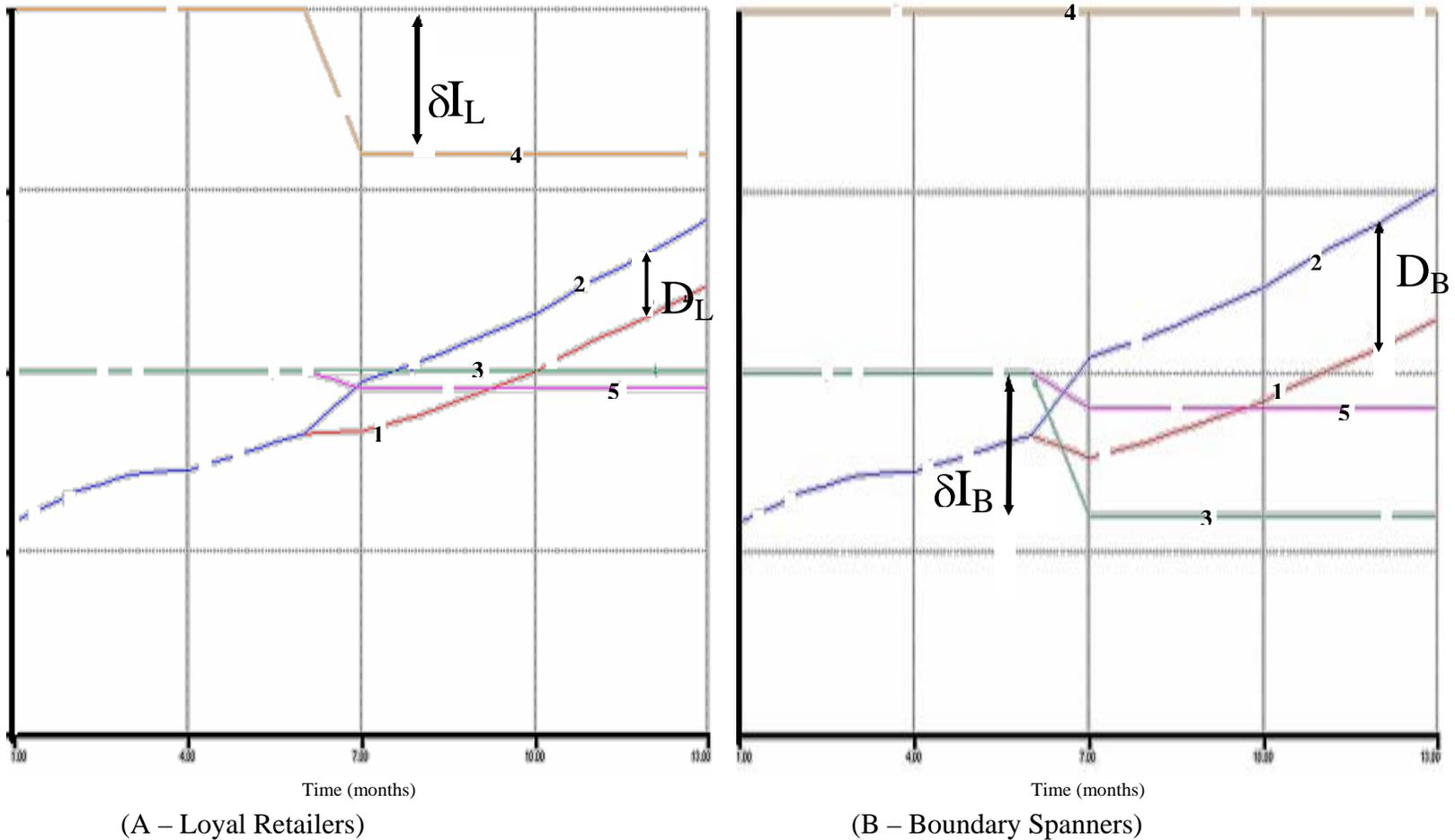


Exhibit 4: Domestication effects on increasing tie-intensity



1: Administered Channel Sales 2: Alternate Channel Sales 3: Tie-intensity (of intermediary) with Boundary Spanners 4: Tie-intensity (of intermediary) with Disloyal Retailers 5: Trustworthiness of the Intermediary as perceived by all retailers in the market

Exhibit 5: Domestication effects on decreasing tie-intensity



1: Administered Channel Sales 2: Alternate Channel Sales 3: Tie-intensity (of intermediary) with Boundary Spanners 4: Tie-intensity (of intermediary) with loyal Retailers 5: Trustworthiness of the Intermediary as perceived by all retailers in the market