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## Article

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## A Model of Manufacturer-Driven Governing Mechanisms and Distributor Performance

Harash J. Sachdev · Russell G. Merz

**Abstract:** Drawing from relational exchange, dependence, and agency theories the authors explain that it is not only the type of governing mechanisms but also the proper sequencing of them that improves a manufacturer-distributor relationship and performance. Dependence affected relationship continuity positively. Monitoring affected the second order relational norm construct, comprising information sharing and flexibility, positively. Relational norm positively affected relationship continuity. Dependence, relationship continuity, monitoring, and relational norm affected distributor performance positively.

**Keywords:** Agency Theory · Dependence · Relational Norm · Monitoring · Distributor Performance · Relationship Continuity

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## Introduction

Manufacturers avail the services of distributors to develop and maintain a market, but, never-the-less, at the expense of dependency and loss of control. Poor performance may result from mismanaging such exchanges. Therefore, in such non-integrated channels, relationship techniques to control and coordinate the exchange deserve prime attention. In order to establish healthy business practices the manufacturer needs to appropriately apply authoritative and normative controls, with a desire towards maintaining enduring relationships (Weitz and Jap, 1995).

Researchers have acknowledged authoritative and normative controls and long-term, enduring relationships as governing mechanisms to improve channel performance. More specifically, the governing mechanisms of monitoring, information sharing, flexibility, and relationship continuity enhance channel performance (Noordewier, John, and Nevin, 1990; Heide, 1994; Kabadayi and Ryu, 2007). By using such relationship drivers the manufacturer may identify distribution activities not being performed to the manufacturer's expectations. In addition, high levels of these governing mechanisms enable the manufacturer to operate as if the distributor was under its ownership. Low levels of these mechanisms signify spot market transactions (Noordewier et al., 1990).

Yet, not all firms implementing these governing mechanisms have reaped the benefits of non-integrated exchanges, leading Judge and Dooley (2006) to conclude that manufacturers with good relationship management skills prosper, and those with poor skills decline or go out of business. This inadequate performance problem places a manufacturer in a compromising position to find a replacement, and even if it does, the problem may still persist. Retaining and improving current relationships is generally more cost efficient than establishing new ones, considering it is difficult to find new distributors. These issues lead one to question, what is missing in the implementation process of these governing mechanisms that create conditions for poor distributor performance?

In this study, we propose that manufacturers need to not only apply the relationship mechanisms of monitoring, flexibility, information sharing, and relationship continuity but to also properly sequence them in order to improve distributor performance. For example, over-monitoring may be perceived as coercion and lead to opportunism. Over leniency may be perceived as laxity at the manufacturer end of the exchange, and the distributor may not take the relationship seriously. Noordewier et al. (1990) suggest that information sharing would not be fruitful if relationship continuity was not expected. These forms of managerial control support one another and are a group of functionally related elements. Heide and John (1990) note a unidirectional relationship between governing mechanisms. Moreover, they are highly correlated (Bello and Gilliland, 1997; Zhang, Cavusgil, and Roath, 2003).

The context of our study is in an export setting. Drawing from relational exchange, dependence, and agency theories we emphasize the value of properly sequencing the governing mechanisms. Following the relational norms literature, flexibility and information sharing are presented as a second order construct. Doing so will provide the manufacturer with a new perspective of managing relationships towards superior performance. In addition, we measure the relationship mechanisms from the manufacturer's perspective. First, the manufacture is ultimately held responsible for its

brand and company image. Second, since the distributor represents several manufacturers' brands, the manufacturer, whose profitability is dependent on the distributor's performance, should really follow through in sustaining the relationship. Lastly, the manufacturer plays both the buyer and seller roles in such exchanges. The manufacturer sells its products to the distributor and at the same time buys the services of the distributor to sell to the end markets. Thus the manufacturer needs to understand how to exercise managerial control behaviors to enhance the distributor's performance (Crosby, Evans, and Cowles, 1990).

In the following sections manufacturer-distributor (M-D) relationship theories as they apply to the conceptual model are first discussed. Next, hypotheses pertaining to the sequential governing mechanisms are developed with superior performance as the end result. Moreover, flexibility and information sharing are posed as a single, second-order construct. Then, the methodology and the findings derived from the application of a structural equation modeling approach are presented. Finally, the theoretical and managerial implications and limitations of the study are discussed.

## **Manufacturer-Distributor Relationship**

A manufacturer-distributor (M-D) exchange may be described in terms of different contractual agreements and governing mechanisms. Such exchanges have some authoritative and relational elements that may be used to enhance the distributor's performance. In this exchange a manufacturer not only needs the distributor to sell its goods but also to provide distribution service functions for the market. Since services are intangible, inseparable, and perishable, they generally lack the concreteness that may be visible in goods and need a more long-term, enduring relationship focus on the part of the provider, which makes relationship dissemination techniques important in managing the distributor (Crosby et al., 1990).

## **Relational Norm Theory**

Manufacturer-Distribution relationships may be analyzed via their different contractual agreements. These exchanges may be placed along a contractual law continuum with episodic, market contracting and internal hierarchical contracting being the polar ends. Episodic, market contracting implies that the power of perfect competition provides the manufacturer the surety of adequate distributor's performance. Internal hierarchical contracting means that the distributor is a wholly owned subsidiary of the manufacturer and employee-owner contracts govern the exchange. The different contractual forms, however, may not be a good representation of an exchange relationship since they are merely used to enforce promises. Operating within these different categories of contracts are normative controls defined by relational norms such as flexibility and information sharing, which may better represent the exchange. These relational norms may be useful to fulfill the obligations between parties. Relational norms are nonpromising binding actions that provide normative control and make exchange partners comply with acceptable behavior. The M-D exchange, then, may be better

envisioned along a relational exchange continuum with pure discrete transaction on one end of a continuum and complete relational exchange on the other end. Different degrees of relational norms operate along the continuum that makes the manufacturer manage a non-integrated channel like its own subsidiary (Macneil, 1980; Heide, 1994).

### **Dependence Theory**

Besides the contractual agreements and governing mechanisms a manufacturer-distributor exchange may be incomplete without incorporating the behavioral component of dependence. A manufacturer's dependence on its distributor influences the nature of the channel relationship. Unfamiliarity with a market place increases a manufacturer's dependence on its distributor. The distributor assists the manufacturer by disseminating market knowledge, overcoming political, legal, and economic barriers for the manufacture, offering a low cost market entry strategy, acting as a catalyst for economic development, and managing demand and supply based activities, which entail a switching cost if the distributor's services are terminated. The manufacturer needs to display relationship continuity to motivate the distributor to invest its time and effort in developing the market and accomplish its economic goals. The nature of this dependence will guide the distributor towards acting on behalf of the manufacturer (Weiss and Anderson, 1992; Poppo and Zenger, 2002).

### **Agency Theory**

Agency theorists assert that the principal, the manufacturer, delegate distribution responsibilities to its agent, the distributor, when utilizing its services. By assigning these responsibilities, the manufacturer transfers the distribution risk. In addition, the product portfolio of the manufacture and the distributor is different, which may result in goal incongruity. The manufacturer is also far removed from the market to assess the distributor's effort. These factors may lead the distributor to act on the basis of self-interest (Nooteboom, Berger, and Noorderhaven, 1997). The distributor may draw on the manufacturer's resources to sell complementary or competitive products. Nothing prevents a distributor from learning about its manufacturer's sales training program and transfer the knowledge to another set of manufacturers. The distributor could also knowingly or unknowingly pass on proprietary information to the manufacturer's competitors. For example, if a distributor represents several manufacturers, it may take a tremendous amount of creativity for this distributor to design independent, unrelated strategies for each of the manufacturers. In addition, a distributor may develop markets for the manufacturer only to the extent that the development serves the distributor's future gains in such markets, and it may ignore unprofitable markets (Judge and Dooley, 2006). Thus, manufacturers may encounter both moral hazards and adverse selection. Moral hazard is the lack of adequate representation. Adverse selection is the distributor's inability to perform its distribution activities. These factors may result in the manufacturer's loss of control over the business exchange. Therefore, the manufacturer needs assurance that the distributor is always

representing the best interest of the manufacturer similar to if the manufacturer had its own establishment (Bergen, Dutta, and Walker, Jr., 1992).

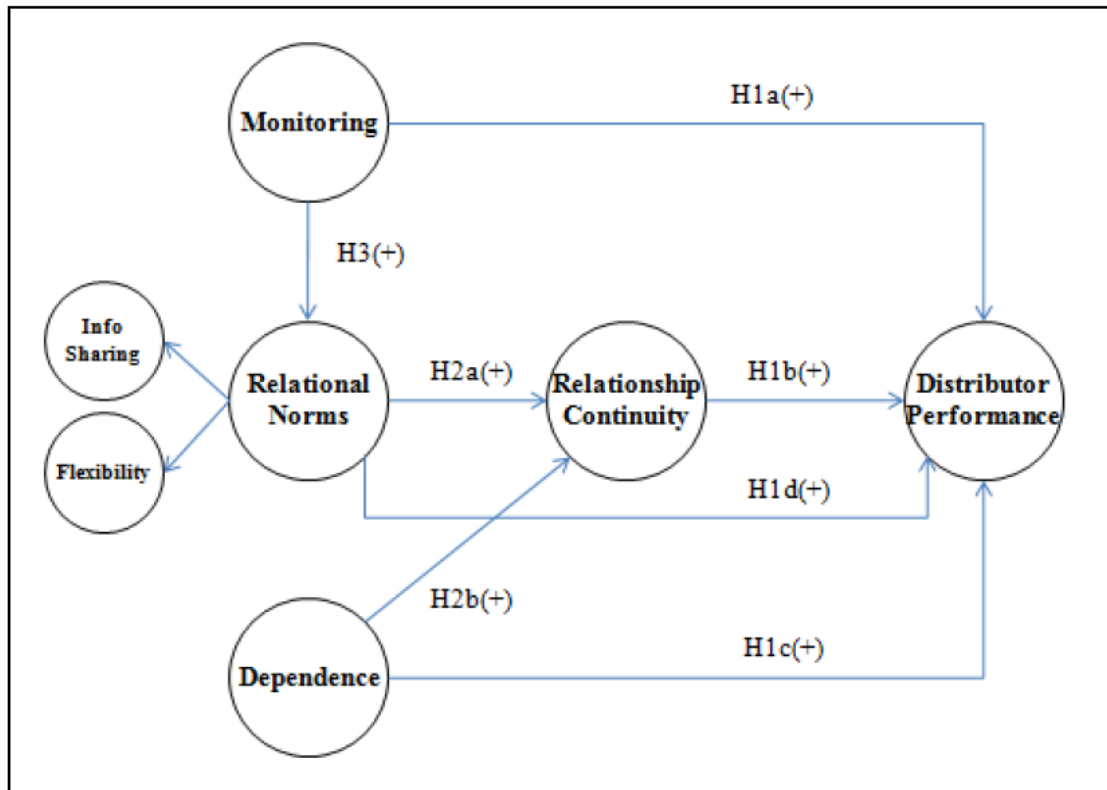
Manufacturers should craft appropriate governing mechanisms, acknowledging that parties to a transaction may behave out of self-interest. The original agency theory proponents discussed two extreme viable managerial actions to overcome loss of control and self-interest: vertical integration and pure market exchanges. Relationship researchers have extended this argument to include authoritative and normative control mechanisms. These relationship mechanisms may be employed to control the distributor's behavior and overcome differential perceptions of risks, goal incongruity, and moral hazards. The manufacturer may collect information about the distributor's activities through monitoring actions and may apply the monitoring results to motivate the distributor to behave in accordance with the interest of the manufacturer (Bergen et al., 1992). The goals of the M-D may be aligned through monitoring actions, and distributor vulnerability may be reduced through relational norms. Thus, the manufacturer obtains authoritative control and the distributor willingly gives into this control mechanism suggesting that the governing mechanisms of monitoring and relational norms may not work in isolation.

Based on the M-D relationship discussions, the three paradigms of dependence, agency and relational norms need to be integrated to explain M-D exchanges (Figure 1). Dependence creates the need for M-D relationship continuity and also enhances the distributor's performance. Monitoring control mechanism enhances performance on its own accord and also through relationship norms, based on agency theory reasons. The relational norms of flexibility and information sharing collectively guide the manufacturer and its distributor towards relationship endurance and enhance distributor's performance. Furthermore, agency theory proponents suggest that the goals of the M-D may be aligned and distributor vulnerability reduced by trading off monitoring with relational norms. Thus the three theories in conjunction and isolation indicate ways to enhance distributor's performance.

## Hypotheses

### Governance Mechanisms and Performance

A manufacturer monitors the distributor's sales reports and marketing activities to ensure whether or not the distributor complies with its end of the bargain to align the goals of the parties. Initially, *monitoring* is necessary to understand whether the distributor is expending the time and effort in actively marketing the manufacturer's product. Does the manufacturer get what it is paying for? Monitoring helps detect and reduce the distributor's self-interest behavior and information asymmetry between parties, which are performance inhibitors (Lal, 1990). By acquiring information about the distributor's efforts towards the manufacturer's brands, the manufacturer may reduce moral hazard and adverse selection as discussed by agency theorists (Eisenhardt, 1989). In the process, the manufacturer may identify the distributor's free



**Fig. 1:** Model Hypotheses

riding behaviors. Ex-ante channel partner selection efforts are generally incomplete and they need ongoing monitoring for continuous positive outcomes of an exchange (Noordewier et al., 1990).

**H1a:** Greater *monitoring* by the manufacturer will lead to higher levels of the *distributor's performance*.

The expected longevity of a relationship is central to all cooperative relationships (Heide and Stump, 1995). Relationship continuity is seen as the anticipation of future transactions. It connotes long-term orientation and durability (Anderson and Weitz, 1992; Ching and Ellis, 2006). For enduring relations the manufacturer and its distributor ignore short-term problems for long-term gains (Sahadev, 2008). In addition, this governing mechanism improves the coordination of activities between parties through the alignment of partner's goal, interest, and value generated from such exchanges (Bergen et al., 1992).

If a distributor foresees relationship continuity, it may hedge its business activities over a longer duration for the manufacturer. It may be able to promise the end user the continued availability of the manufacturer's brand and plan strategies and generate potential sales without the fear of losing future business. Surety of future transactions also enables a party to efficiently allocate its resources without the fear of being exploited in the short run (Heide and Stump, 1995). In addition, extended relationship

signals by one party make the other blend well in its role requirements and engage efficiently in its activities (Kim and Frazier, 1997). The distributor will be more willing to carry a manufacturer's inventory and invest in other strategic initiatives for the manufacturer. It also encourages distributors to be involved by allocating more resources to the relationship and increases performance (Anderson and Weitz, 1992). Relationship continuity increase the chances of a party being less short-run focused, knowing that the overall performance balances out in the long run (Bello et al., 2003).

**H1b:** The greater the degree of manufacturer's practices of *relationship continuity* the greater the *distributor's performance*.

The manufacturer becomes *dependent* on its distributors for developing a market, devoting time and resources, and training its employees to sell the manufacturer's products. The manufacturer's *dependence* on its distributor will positively impact the manufacturer's belief in the distributor's claims (Heide and John, 1988). The very fact that the distributor is investing time and effort in the relationship may increase a manufacturer's initial satisfaction with the distributor's performance. These acts may be construed as reciprocal actions performed by the distributor, and, consequently, lead to more agreements about the developed marketing strategy for the manufacturer (Frazier, Gill, and Kale, 1989). Furthermore, a party's dependence on a relationship may positively influence its desire and level of adaptability to the relationship and have positive performance consequences (Dash, Bruning, and Guin, 2007). A dependent party will likely attribute its performance outcomes to the other party (Blsea and Bigné, 2005).

**H1c:** The greater the manufacturer's *dependence* the greater the *distributor's performance*

The ability of a manufacturer to transfer information to its distributor has been considered an efficient strategic tool (Frazier et al., 2009). *Information sharing* refers to the use of objective information to modify the distributor's behavior in performing market activities and strategies. Through information sharing the manufacturer identifies and defines the activities for the parties to be performed. *Information sharing* covers both the nature and timeliness of information shared (Anderson and Narus, 1990). By sharing information, a manufacturer may identify, understand, and reduce inefficiencies before or during the time they arise. In a dynamic market, information is a valued resource for a firm's survival (Blesa and Bigné, 2005).

Collaborative channel partners have recognized the importance of openness in sharing information and efficient future planning of the market (Sriram, Krapfel, and Spekman, 1992). Moreover, an open flow of information provides timely coordination of activities, market development, and customer retention strategies needed to maintain the manufacturer's existence in the market and enhances exchange efficiencies (Cannon & Perrault, Jr. 1999). The additional benefit of sharing information is that it reinforces the distributor to concentrate on the manufacturer's products which may increase profit margins for the manufacture's brands (Frazier et al., 2009). Through information sharing one expresses shared interests and common goals to



enhance compliance and commitment from channel members, which improves channel satisfaction (Sahadev, 2008).

Flexibility in trading relations helps the manufacturer make quick adjustments in better allocating resources and improves performance (Wang and Kess, 2006). By maintaining flexibility, the manufacturer can respond to demand changes and competitive strategies appropriately in the markets. It also helps a manufacturer maintain customer loyalty and enhance its distributor's performance. If the manufacturer is flexible to the distributor's requests for change, it compels the distributor to more likely adapt to the dynamics of the market place (Noordewier et al. 1990). The manufacturer may adjust its product attributes (e.g., color) and target market to better accommodate the "just-in-time" needs of the distributor. A manufacturer may make exceptions to policies for the distributor. As a result of this action, the distributor may deploy more of its times and resources. Being flexible increases the efficiency in the exchange arising from last minute changes in activities (Poppo and Zenger, 2002). Since contracts cannot provide solutions to all unforeseeable contingent claims in advance, by being flexible the manufacturer may better assist its distributor in implementing the channel's strategic and sales plans (Heide, 1994). Being flexible to a distributor's special request is an incentive that a manufacture is working in the distributor's best interest and aligns goals and risks among the parties (Bello and Gilliland, 1997). These two correlated relational elements of information sharing and flexibility integrate into a higher order relational norm construct. As discussed subsequently, relational norm is described as a single second-order construct the gives rise to information sharing and flexibility. The hypotheses pertaining to flexibility and information sharing are framed in the form of high levels of relational norm (Zhang et al., 2003).

**H1d:** The greater *the relational norm* in the M-D dyad the greater the *distributor's performance*

## Relational Norms and Relationship Continuity

One of the main linkages to relationship continuity is *information sharing*. When the manufacturer and its distributor openly share information, they gain insight about (a) each other's modes of operating a business in their respective environments, (b) each other's commitment to the market, (c) specific technical and nontechnical information needed to produce and market the product lines in the market, and (d) ways to strengthen their beliefs for conducting future transactions. Through information sharing one expresses shared interests and common goals to enhance compliance and commitment from channel members (Sahadev, 2008). A wider range of topics at a deeper level is shared with the distributor because of this interaction (Weitz and Jap, 1995). This on-going relationship is signaled through mutual sharing of information (Bello et al., 2003).

*Flexibility* also signals *relationship continuity* to the distributor. The intermediary feels that its needs are being specifically met, and the manufacture is willing to take short-term loses to maintain the relationship. Initial *flexibility* is essential to establish commitment in conducting business (Claycomb and Frankwick, 2005). *Relationship continuity* is the extent to which a manufacturer is willing to adjust to a distributor's

requirement to market the manufacturer's product and being flexible to the intermediary's needs in this regard (Adamson, Chan, and Handford, 2003). Being flexible helps partners to make quick adjustments which signals continuity (Wang and Kess, 2006). Since flexibility and information sharing rarely work in isolation and are part of a higher level second order construct, we pose them as an integrated single relational norm construct.

**H2a:** The greater the *relational norm* in the M-D relationship the greater the *relationship continuity*.

### **Dependence and Relationship Continuity**

Because the distributors are expending considerable time and effort for creating and maintaining a market, they may need assurance of continued dependence by the manufacturer through relationship endurance. Relationship continuity is one such signal and is a key managerial action for ensuring an enduring relation (Noordewier et al., 1990; Heide and Stump, 1995). Through this action the distributor is assured that it will not be bypassed once the manufacturer gains an understanding of the market. By signaling relationship continuity the manufacture is recognizing the importance of distributor's effort towards representing the manufacturer's interests (Bandyopadhyay and Robicheaux, 1997). Perceptions of dependence also increases replacement cost and is a strong signal by the dependent party to forge relationship continuity (Sriram et al., 1992).

**H2b:** The greater the manufacturer's *dependence* the greater its demonstration of *relationship continuity*

### **Monitoring and Relational Norms**

Control from a managerial standpoint is the ability to influence systems, methods, and decisions (Anderson and Coughlan, 1986). Although the manufacturer simulates vertical control by monitoring the distributor's activities, agency theorists suggest that the distributor needs to be convinced that this monitoring action will not create a condition of vulnerability since the manufacturer has already transferred the risk to the distributor by employing its services. Since the distributor represent several manufacturers' products, it is constrained from providing a road map of the inner workings of its organizations or sharing all market-related information with the manufacturer. From an agency theory's perspective, performance may suffer from the separation of ownership and control if proper risk taking or risk avoidance strategies are not devised to manage such channels (Eisenhardt, 1989). Such business exchanges may also have cost implications and may make a distributor cautious about becoming an integral part of any one manufacturer's business (Frazier et al., 2009).

The distributor needs assurance that the manufacturer's monitoring efforts will not be misused and make the intermediary relatively vulnerable to the exchange; that is, why should it give the manufacturer monitoring rights, considering that it is bearing the risk for the product's performance? Since what a firm communicates directs and shapes perceptions for understanding a situation, manufacturers need to communicate

the information being monitored. Proper monitoring requires adequate levels of information sharing by the manufacturer (West III and Meyer, 1997). The manufacturer may provide this assurance through information sharing about its internal strategy and flexibility in distribution activities necessary to improve distributor performance (Zhang et al., 2003). Flexibility is the manufacturer's ability to change its procedures and methods quickly and at a low cost. It is one of the managerial tools for making beneficial tradeoffs (Anderson and Coughlan, 1986). Trading authoritative control with normative control allows the manufacturer to share the results of their monitoring results in the market place for its product. The distributor, in turn, accepts the monitoring method as a matter of strategic choice (Heide and John, 1992).

**H3:** The greater the manufacturer's *monitoring* practice the greater its level of *relational norm* exhibited with its distributor.

## Methodology

The questionnaire items were developed using export and buyer-seller exchange literature and industry experts. Seven experts from the lumber, poultry, and high tech industries were selected to increase generalizability of the findings. These industry experts were either the export/distribution manager or the owner of the firm. Using participants from such diverse industries strengthened our belief that some element of agency theory properties was always present in export markets. The resulting instrument was pre-tested for content validity using a sample of judges who had some expertise in this area. These judges were asked to check each question for clarity and ambiguity.

A convenience sample of 100 exporting firms was used from these industries. A telephone pre-notification protocol was used to identify key informants. Using a snowball approach a senior executive (e.g., export/distribution manager or owner of the firm) was identified. Additionally, these managers were screened regarding their export market job responsibility, willingness, and ability to fill out the survey. Sixty-three of these firms used distributors on a regular basis to export. The surveys were mailed out for an initial response rate of 57%. Cronbach's alphas were calculated for these items and questionnaire refined based on Nunnally's (1978) suggestions that coefficient alphas above 0.5 are sufficient for exploratory research.

## Sampling Procedure

A systematic sample of 600 manufacturers (every 10<sup>th</sup> manufacturer) was selected from the U.S. export manufacturers' directory. Based on the pretest it was expected that approximately one-third of these manufacturers would not qualify for this study because they may export directly to end users. Key informants in this study were export managers or a senior executive familiar with the firm's export distribution. After they were identified through telephone calls, the nature of the study was discussed with them, and a verbal agreement to participate was obtained. In order to increase generalizability of this study the sample included hi-tech products, hi-tech machine

manufacturers, heavy duty machine manufacturers (e.g., tufting machines and lathes), and electronic component manufacturers. Also, a majority of these manufacturers used distributors to export, and some of these product categories have been identified by prior researchers.

Three weeks after the initial mailing, respondents were reminded via telephone calls to fill out the survey. Of the 266 returned surveys, a total of 248 completely answered questionnaires resulted in a 62% response rate. This response rate is considered extremely high in an export context, especially for manufacturers selling industrial products. A comparison of early and late respondents resulted in no significant differences across individual or organizational characteristics of the study (e.g., annual sales, number of employees, etc.) suggesting that non-response bias was not a problem.

## Measurement

Supportive norms were measured from manufacturers' perspective about the relationships with their distributors. The relationship norms of *flexibility*, *information sharing*, *monitoring*, and *relationship continuity* are measured on a 7 point Likert agree/disagree scale using items from Noordewier et al. (1990). *Flexibility* is the degree to which manufacturers have room to make adjustments for unforeseen needs not specified in contracts. *Information sharing* is measured as the extent to which manufacturers provide their intermediary with detailed explanations of plans. These plans include information on product and marketing strategy changes. *Monitoring* refers to the extent to which manufacturers evaluate distributors' progress in foreign markets through operating control or performance criteria. *Relationship Continuity* is the degree of expectation of continued transactions with the intermediary. *Dependency* is measured using items from Heide and John (1988), on a 7 point Likert agree/disagree scale regarding the manufacturer's perceptions about the difficulty in replacing its intermediary (Appendix A).

Perceptual measures of performance may be better for firms involved in strategic alliances because they have an immediate bearing on the process outcomes (Judge and Dooley 2006). These soft measures also do not have the undesirable confounding characteristics of typical financial performance measures such as sales and profits (Heide and John 1988). In addition, satisfaction-based measures of *performance* provide a richer assessment of the construct. Perceptive measures are closely related to objective measures (Venkatraman & Ramanujam 1987). Moreover, strategic thinking, actions, and resource allocations are guided by perceptions rather than objective measures of a firm's performance (Day & Nedungadi 1994). Managers also have detailed knowledge and are more willing to reveal perceptual measures. Perceived export success based on satisfaction with export activities has been used as a noneconomic measure of performance (Katsikeas, Leonidou, and Morgan 2000). Finally, since firms need to achieve certain strategic goals, satisfaction with such export operations is important to success in exporting (Zou, Taylor and Osland 1998). In this study, *distributor performance* is measured by asking manufacturers to judge how effectively their distributors perform basic export marketing activities on a six point semantic scale (poor, adequate, somewhat good, moderately good, very good, and

extremely good). These activities pertain to issues concerning developing and servicing a market and marketing strategy. Items are obtained from Bello and Williamson (1985).

## Data Analysis and Findings

The sample characteristics were examined across self-reported classification type variables reflecting the respondent's export activities and size in terms of sales and numbers of employees (Table 1).

<b>Descriptive Variables</b>	<b>N</b>	<b>Mean</b>
Total firm sales last year	243	\$162,382,913.72
Export dollars	243	\$5,014,276.50
% total firm sales from exporting	245	19.25
% Worldwide sales from this product	243	28.21
Years of firm export activity	248	23.19
Number of employees	248	418.59
Number of employees FT in exporting	248	13.38

**Table 1:** Sample Characteristics

To test the hypotheses shown in Figure 1, a structural equations model (SEM) with latent variables was estimated using a latent variable partial least squares (LV-PLS) algorithm (Ringle, et al. 2005). LV-PLS is used for several reasons. First, the data was collected across a variety of industries and is not large enough from a diversity perspective. Under such conditions LV-PLS provides measurement model and structural path estimates without distribution assumptions and may be used with small sample sizes compared to the complexities of the model. It also operates quite well with skewed and non-normal data. Second, the model tested is exploratory and is not measuring all of the constructs of a robust theory but only a subsection of it as defined by the LV-PLS parameters. Third, LV-PLS can handle second order constructs more easily than other SEM methods. Forth, consistent with the exploratory nature of the study, the objective of this analysis is to test the sequential predictive relationships between the variables in the hypothesized network, not to test whether the data "fits" a predefined theory. Finally, PLS estimates are less prone to errors from weakly defined constructs since it measures constructs as blocks and studies the predictive paths between these blocks (Chin, Peterson, and Brown 2008). The reader is reminded that the construct items used in this study have been validated in other research studies.

The measurement model in PLS is assessed in terms of item loadings, reliability coefficients (composite reliability), convergent, and discriminant validity. An essential test of measurement model adequacy is based on the loadings of the individual indicators onto hypothesized latent variables. Measures that have greater than 0.7 loadings on their respective latent variables are considered to have acceptable levels of association with their latent variables (Fornell and Larcker 1981). In addition, for convergent validity to be manifested, the latent measures should be more highly loaded on a single latent and not exhibit cross-loadings greater than 0.6. Interpreted

like a Cronbach's alpha for internal consistency reliability, a composite reliability of 0.7 or greater is considered an acceptable level of reliability (Fornell and Larcker 1981). The composite reliability measure is a more accurate measure of reliability for SEM analyses because it takes into consideration the path structure in its computation. The average variance extracted (AVE) measures the variance captured by the indicators relative to the measurement error and should be greater than 0.5 to justify using a construct (Barclay, Thompson and Higgins 1995). The discriminant validity of the measures (the degree to which the items differentiate among constructs or measure distinct concepts) is assessed by examining the correlations between the measures of potentially overlapping constructs. Items should load more strongly on their own constructs in the model, and the average variance shared between each construct and its measures should be greater than the variance shared between the constructs and the other constructs. The structural model in LV-PLS is assessed by examining the path coefficients (standardized betas) and associated t-statistics. In addition, R<sup>2</sup> is used as an indicator of the overall predictive strength of the model.

## Measurement Model

Table 2 displays the reliability, convergent, and discriminant validity indicators for the constructs in the model, while Table 3 displays the loadings and cross loading of the modeled components. All of the constructs shown in Table 2 possess acceptable levels of composite reliability (> 0.7). This indicates that the measures associated with each latent show consistent association with the latent. In addition, the respective Cronbach's Alphas also meet the minimum standards needed for good measurement reliability of > 0.6. An examination of the average variance extracted (AVE) values reveals that four of the constructs exceed the minimum 0.5 level for acceptable construct validity. The AVE for the *relational norm* second order construct is less than 0.5, however since its square root is larger than the off diagonal inter-correlations it meets the test for discriminant validity, as do the other constructs in the model.

	Constructs				
	Continuity	Dependence	Monitoring	Norms	Perform
Continuity	<b>0.8599</b>	0	0	0	0
Dependence	0.4386	<b>0.7811</b>	0	0	0
Monitoring	0.0129	-0.0406	<b>0.7861</b>	0	0
Norms	0.3955	0.1714	0.306	<b>0.6415</b>	0
Perform	0.3983	0.3568	0.2878	0.4297	<b>0.7660</b>
Composite Reliability	0.8948	0.8601	0.8656	0.8361	0.9084
Cronbach's Alpha	0.8244	0.7856	0.7961	0.7722	0.8829
Average Variance Extracted (AVE)	0.7395	0.6101	0.618	0.4115	0.5868
R-square	0.2981	0	0	0.0937	0.3309
Redundancy	0.1389	0	0	0.0392	0.0679

Diagonal elements are the square root of the variance shared between the constructs and their measurement (AVE).  
Off diagonal elements are the correlations among the constructs.  
Diagonal elements should be larger than off-diagonal elements in order to obtain the discriminant validity.

**Table 2:** Indicators of Structural Equation Modeling Quality

In Table 3, it is apparent that not all of the measures load at 0.7 or greater. There are several indicators in the *flexible*, *information sharing* and *dependence* latent variables with slightly lower loadings. Also, as shown in Table 4, for the second order *relational norms* construct, the loading of the *information sharing* latent is higher (.950) than the loading for the *flexibility* construct (.540). This differential probably contributes to the lower AVE noted above. Despite the magnitude differences they are both significantly related to the higher order construct. Overall, if the cross loadings are smaller and the discriminate validity test is met (as indicated above), then the construct validity is acceptable for exploratory analysis (Fornell and Larcker 1981).

	Loadings and Cross Loadings					
	Monitoring	Flexible	InfoShare	Rel Cont	Dependence	Perform
Monitoring1	<b>0.841</b>	0.017	0.290	0.029	-0.004	0.211
Monitoring2	<b>0.747</b>	-0.048	0.187	-0.012	-0.064	0.155
Monitoring3	<b>0.712</b>	0.159	0.242	0.021	-0.030	0.218
Monitoring4	<b>0.843</b>	0.098	0.282	-0.005	-0.040	0.290
Flexible1	0.047	<b>0.659</b>	0.144	0.044	0.073	0.175
Flexible2	0.060	<b>0.651</b>	0.088	0.203	0.210	0.135
Flexible3	0.072	<b>0.894</b>	0.288	0.353	0.169	0.234
InfoShare1	0.258	0.218	<b>0.821</b>	0.254	0.121	0.366
InfoShare2	0.309	0.239	<b>0.877</b>	0.325	0.064	0.356
InfoShare3	0.390	0.186	<b>0.851</b>	0.250	0.111	0.346
InfoShare4	0.095	0.137	<b>0.614</b>	0.170	0.094	0.188
InfoShare5	0.153	0.240	<b>0.747</b>	0.351	0.103	0.301
RelCont1	0.092	0.258	0.370	<b>0.835</b>	0.343	0.345
RelCont2	-0.039	0.233	0.238	<b>0.840</b>	0.348	0.261
RelCont3	-0.027	0.323	0.286	<b>0.903</b>	0.433	0.404
Dependence1	0.002	0.242	0.154	0.478	<b>0.893</b>	0.391
Dependence2	-0.027	0.077	0.103	0.200	<b>0.618</b>	0.209
Dependence3	-0.090	0.128	0.059	0.324	<b>0.838</b>	0.217
Dependence4	-0.036	0.138	0.043	0.287	<b>0.748</b>	0.241
Perform1	0.219	0.182	0.216	0.293	0.281	<b>0.732</b>
Perform2	0.253	0.238	0.291	0.298	0.268	<b>0.762</b>
Perform3	0.151	0.216	0.256	0.301	0.246	<b>0.776</b>
Perform4	0.147	0.203	0.297	0.204	0.193	<b>0.715</b>
Perform5	0.256	0.119	0.375	0.353	0.381	<b>0.799</b>
Perform6	0.286	0.222	0.361	0.293	0.299	<b>0.813</b>
Perform7	0.180	0.184	0.350	0.372	0.206	<b>0.760</b>

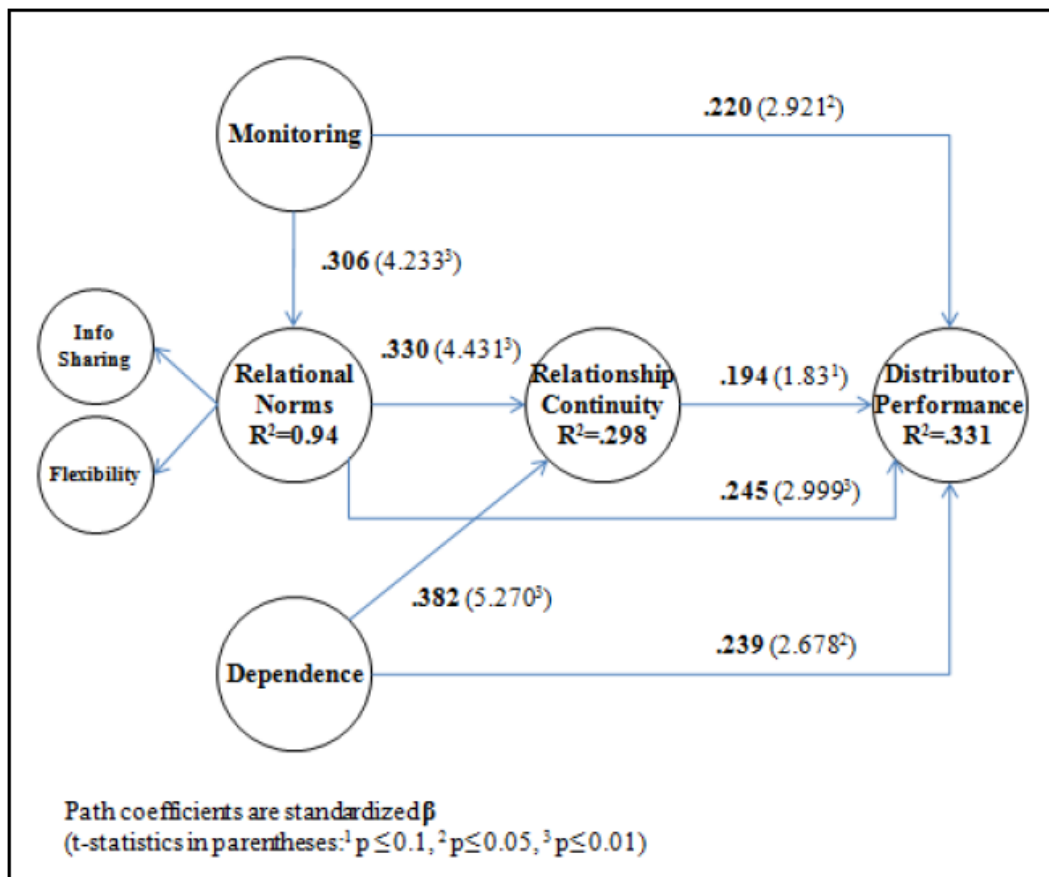
**Table 3:** Measurement Model – Loadings and Cross Loadings

Indicators	Loading	Std Error	T Stat	p
Norms -> Flexible	0.540	0.096	5.599	0.000
Norms -> InfoShare	0.950	0.017	55.420	0.000

**Table 4:** Relational Norm Second Order Loadings

**Structural Model**

The path coefficients from the PLS analysis are shown in Figure 2. All seven of the hypothesized paths are significant indicating a strong degree of support for the underlying theoretical model (Table 5). The second order *relational norms* component (comprised of *information sharing*, and *flexibility*) along with *dependence* are significant predictors of *relationship continuity* explaining 30% of the variance. In addition, *monitoring* is a significant predictor of *relational norms*, explaining 0.94% of the variation. *Distributor performance* is significantly predicted by *monitoring*, *relationship continuity*, *relational norms* and *dependence*, explaining 33% of the variation.



**Fig. 2:** Modeling Results—Path Coefficients, R<sup>2</sup> and t-Statistics



The significance levels of the path coefficients generated from the LV-PLS analysis results were assessed by running a bootstrapping routine to generate estimated t-statistics. Three hundred cross-validation samples of 150 cases were drawn with replacement from the total sample and used in a bootstrapping procedure that generated the standard errors of the estimates displayed in Table 5. The resulting standard errors were then used to calculate a t-statistic for the estimated parameters.

Hypothesized Path	H	Std Coef	Bootstrap Results		p
			Std Error	T Stat	
Monitoring -> Perform	<b>H1a</b>	0.220	0.075	2.921	0.050
Continuity -> Perform	<b>H1b</b>	0.194	0.106	1.830	0.100
Dependence -> Perform	<b>H1c</b>	0.239	0.089	2.678	0.050
Norms -> Perform	<b>H1d</b>	0.245	0.082	2.999	0.010
Norms -> Continuity	<b>H2a</b>	0.330	0.075	4.431	0.000
Dependence -> Continuity	<b>H2b</b>	0.382	0.073	5.270	0.000
Monitoring -> Norms	<b>H3</b>	0.306	0.072	4.233	0.000
Note: The hypothesized paths in bold font are supported					
T statistics estimated from a bootstrapping routine with n=150 resampled 300 times					

**Table 5:** Bootstrapping Results with Path Coefficients, Standard Errors and t-Statistics

## Conclusion

Empirical studies have emphasized integrating relational norms into a second order relational syndrome construct to understand relationships between manufacturers and their distributors and performance implications thereof (e.g., Noordewier et al. 1990; Bello et al., 2003; Zhang et al., 2003). Yet, even after such published studies researchers have found export buyer-seller relationships to be on tenuous theoretical grounds. One of the key factors may be that even though export manufacturers are realizing the importance of governing mechanisms as simulated hierarchical governance, they may not be implementing these mechanisms in proper sequence. In this study we break up classify governing mechanisms into authoritative and normative controls and study their effect on the distributor's performance. In the M-D dyad we sequence *monitoring*, *information sharing*, *flexibility*, and *relationship continuity* to examine their individual and sequential impact on the distributor's performance.

The findings suggest that manufacturers need to signal *relationship continuity* through *dependence* as measured by replaceability. Frazier et al. (1989) and Sriram et al. (1992) found similar results in their study on channel participant relationships. This dependence signal may reduce the distributor's fear of sudden termination after

bearing the risk for the manufacturer's product, relieve the manufacturer from switching cost burdens, and also help promote distributor's performance.

Our findings also suggest that both *monitoring* and the second order construct of *relational norm* positively affect a distributor's performance. *Monitoring* has both an independent effect on performance and indirectly through *relational norm*. *Dependence* is also positively related to distributor's performance consistent with the findings of Bello et al. (2003). This result demonstrates that when manufacturers spin off functions to distributors based on their dependency, they can export successfully.

*Relational norm* has both an independent effect on *performance* and also through *relationship continuity*. *Monitoring* is positively related to *relational norm*. These results provide support to the earlier discussion in the study that governing mechanisms work with each other in a cause and effect fashion. Heide and John (1990) also suggest that establishing relationships is a sequential process. For example, they found supplier verification to result in joint action.

Using agency theory, the results of this study further suggest that the governing mechanisms of *monitoring* and *relational norm* are used to equalize the manufacturer and its distributor's vulnerability. The manufacturer feels loss of control and thus monitors the distributor. The distributor allows itself to be monitored for strategic reasons because through such a process the distributor can receive strategic information about the manufacturer's business plans and also enjoy the business efficiencies from the manufacturer's flexibility. Manufacturers signal that through "X" amount of monitoring and giving up "Y" amount of their proprietary information pertaining to monitoring data will enable the distributors to achieve superior performance. Thus manufacturers may no longer fear loss of control while exporting through distributors. Using agency theory to effectively and efficiently trade off information sharing and flexibility with monitoring may offset the control barriers to exporting. The positive relationship between *monitoring* and *relational norm* is another example of how agency theory may be utilized in buyer-seller exchanges (Bergen et al., 1992) and applied to risk and uncertainty management in future channel research. *Monitoring, information sharing, and flexibility* are governing mechanisms to reduce moral hazards and differential levels of risks across channel partners (Kabadayi and Ryu, 2007). By properly deploying these governing mechanisms the manufacturer may better manage the distributor and reduce performance inhibitors.

## Limitations and Directions for Future Research

This study has inherent weaknesses, as most studies pertaining to export settings. The adverse selection and moral hazards assumptions of agency theory were not directly measured. In addition, this study was undertaken from the manufacturer's perspective. In M-D exchanges the manufacturers are playing both the buyer and seller role. The manufacturer is selling its products to the distributor and at the same time buying the services of the distributor to sell to the end markets. Data from a dyadic perspective may provide additional insights into such buyer-seller relationships. For example, the manufacturer may understand how to be dependent on its distributor, but the distributor may not respond to this dependency in a positive light. Reciprocal

actions may be equally important in relationship development and jointly contribute to the exchange performance.

The results of this study suggest that manufacturers can compete in markets without completely integrating into distribution. *Monitoring*, *flexibility*, and *information sharing* are beginning steps in understanding the value of a relationship. As the manufacturer observes improvement in performance through basic *monitoring* measures, it may willingly to reveal more *information* to their distributors and become *flexible* to the distribution needs and signal *relationship continuity*. Understanding that manufacturers may be in different phases of relationship development and inefficient practices may never be ruled out, the results of this study strengthens the notion that it is not only the types of governing mechanisms but the ways of sequencing these mechanisms that are effective for a manufacturer to compete. Agency theory plays a key role in M-D relationships in terms of risk and vulnerability issues. Future studies should explore the incorporate the underlying elements of agency theory such as the type and degree of risk that is transferred between a buyer and seller and its impact on the goal alignment of M-D relationships.

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## Appendix

Questionnaire Items	Label	Mean	StDev	Alpha
We supply information about our operations so the intermediary can plan long-term	<i>InfoShare1</i>	4.76	1.72	0.8357
We inform the intermediary well in advance of any changes in our marketing strategy	<i>InfoShare2</i>	4.74	1.65	
We provide the intermediary with detailed explanations of our future plans	<i>InfoShare3</i>	4.12	1.79	
We seldom inform the intermediary about impending product design changes [r]	<i>InfoShare4</i>	5.11	1.66	
We keep the intermediary informed of new developments in our company	<i>InfoShare5</i>	4.90	1.65	
To judge its performance we require periodic reports about the intermediary's activities for our product	<i>Monitoring1</i>	4.07	2.00	0.7842
We assess the intermediary's performance through a formal evaluation process	<i>Monitoring2</i>	2.98	1.86	
To evaluate its performance, we monitor what our intermediary is doing for us in the foreign market	<i>Monitoring3</i>	4.96	1.76	
The relationship we have with the intermediary makes use of many controls	<i>Monitoring4</i>	3.83	1.89	
We expect our relationship with the intermediary to last a long time	<i>RelCont1</i>	6.04	1.24	0.8471
Renewal of our relationship with this intermediary is virtually automatic	<i>RelCont2</i>	5.63	1.50	
Five years from now we will probably be using the same intermediary	<i>RelCont3</i>	5.69	1.45	
The intermediary would be hard for us to replace	<i>Dependence1</i>	4.77	1.86	0.7843
There are many alternative intermediaries we could use to export to this market [r]	<i>Dependence2</i>	4.44	1.74	
It would take a lot of time and effort to find a suitable replacement for this intermediary	<i>Dependence3</i>	5.16	1.68	
If we had to switch to another intermediary, our export sales to this market would probably fall	<i>Dependence4</i>	4.53	1.82	
We are flexible in our response to last minute requests made by the intermediary	<i>Flexible1</i>	5.70	1.35	0.6322
We are open to the intermediary's request to modify a prior agreement	<i>Flexible2</i>	5.06	1.44	
We can handle change well when dealing with this intermediary	<i>Flexible3</i>	5.13	1.40	
Arranging after-sale service for a customer is...	<i>Perform1</i>	4.82	1.24	0.8816
Getting current customers to buy more is...	<i>Perform2</i>	4.47	1.21	
Analyzing the product needs of customers is...	<i>Perform3</i>	4.55	1.27	
Identifying new customers for our products is...	<i>Perform4</i>	4.14	1.31	
Developing marketing strategy for a foreign market is...	<i>Perform5</i>	4.02	1.43	
Providing information on market opportunities is...	<i>Perform6</i>	4.05	1.50	
Providing feedback on needed product changes is...	<i>Perform7</i>	4.08	1.51	