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Efficiency of governance mechanisms in China's distribution channels

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ABSTRACT

As multinational enterprises increasingly enter the Chinese market, channel researchers are paying increasing attention to the efficiency of channel governance mechanisms in this nontraditional market. Yet current research neglects different distributor characteristics, such as risk preferences and long- or short-term orientations. In China, an emerging market with continuously evolving legal institutions, distributors' core business orientations (risk preference and long-term orientation) may affect their channel relationship with suppliers (distributor trust and channel conflict). The efficiency of hierarchical and relational governance mechanisms also may depend on distributor orientations. Using a national sample of distributors in China, this study confirms that both governance mechanisms exert significant main effects on channel relationships. In addition, the two core distributor orientations moderate the effects of the manufacturer's hierarchical governance mechanisms on relationship quality, though they do not for relational governance mechanisms. The results suggest that multinational enterprises should tailor their governance mechanisms to distributors with different risk and long-term orientations.

1. Introduction

Since 1992, the long and robust economic growth of China has drawn widespread attention in its progression to becoming the world's fastest growing market. Multinational firms from various countries have poured into China to market their products and services (Li & Ng, 2002). Although some of these firms thrive, others experience failure and must exit (Child & Tse, 2001). Multinational manufacturers typically enter overseas markets through independent distributors and agents (Ghobril, 1997), and as Stern, El-Ansary, and Coughlan (1996, p. 502) point out, the "distribution channel is the key to any company's success in China." Jaffe and Yi (2007) similarly highlight the challenge of distribution in China. Thus, the ability to maintain stable and enduring relationships with independent local distributors can provide an important competitive advantage for multinational manufacturers (Zhang, Cavusgil, & Roath, 2003).

Yet developing and maintaining a stable, effective distributor network is not easy. China's underdeveloped infrastructure, scattered across its vast terrain, slows the physical distribution of products and thus strains the channel relationships of any firm operating in the country. In addition, China's evolving legal institution is less than effective as a means to regulate trade and distributor trust (Ambler, Styles, & Wang, 1999). In this complex and dynamic market

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environment, a strong channel relationship can enhance firm performance through reduced transaction costs, while rich bilateral information exchanges could boost a firm's ability to respond quickly to the local operating environment (Wu, Skinkovics, Cavusgil, & Roath, 2007). However, cultural dissimilarity and market vulnerability in the country challenges multinational manufacturers to effectively manage channel relationships with local distributors (Deligonul & Cavusgil, 2006; Zhang et al., 2003). Governing distributor networks thus becomes a critical issue for firms in China. Can governance mechanisms created in developed markets, such as the United States and Western Europe, ensure stable and enduring channel relationships with China's local distributors, given the country's distinct institutional and cultural environment? Few studies provide direct answers to this question (Lee, 2001).

Extant studies on channel governance, conducted mostly in developed markets, employ transaction cost analysis (TCA) and relational exchange theory as the two dominant theoretical perspectives (Li & Ng, 2002). According to TCA, channel partners prefer hierarchical to market mechanisms to reduce their transaction costs. The relational exchange perspective instead suggests that relational norms are central to managing interfirm channel interactions (Zhang et al., 2003). Adopting both theories, researchers have suggested that governance mechanisms, such as monitoring, incentives, interpersonal relationships, and socialization efforts, may suppress opportunistic behaviors and enhance exchange performance. Yet in China's unique market structure, the applicability of these two theoretical perspectives and their implications for governance mechanisms may not apply for two reasons.

First, when markets and cultures differ, governance mechanisms may offer variable effectiveness because of the distinct risk preferences of the distributors. Some researchers (e.g., Chiles & McMackin, 1996) attempt to address the issue by incorporating risk preference and trust within the TCA paradigm, though without direct empirical support. From a cultural perspective, Hsee and Weber (1999) find that Chinese firms tend to take more risks than American firms, perhaps because of China's market structure and environment (Weber & Hsee, 1998). Marshall (2003) also notes that distributors' cultural orientations influence their expectations of channel relationship, which in turn influence the effectiveness of supplier governance. Henisz and Williamson (1999) further propose that cultural and institutional differences prompt economizing consequences that may alter the effectiveness of interfirm governance strategies. In response, we posit that the distinctive features of the Chinese market and its nonlinear institutional reforms (Child & Tse, 2001) suggest the need to consider distributor risk preferences when assessing the effectiveness of different governance mechanisms.

Second, though most hierarchical or economic governance mechanisms supported by TCA depend on firms' short-term transaction cost calculations, researchers note that firms in China often assume a long-term orientation. In this developing market, contractual and transaction laws remain incomplete (Deligonul & Cavusgil, 2006), and its rapid economic growth has been achieved in an environment characterized by government interference and an absence of the rule of law (Park, Li, & Tse, 2006). Therefore, calculating transaction costs based on complete and mature transaction systems may not be appropriate. Accordingly, some firms operating in China choose to adopt a longer-term orientation rather than focusing on the short-term efficiency. In addition, China's high growth potential requires firms to consider future development rather than just current profits and costs. As Barkema and Vermeulen (1997) argue, in collectivist societies, people tend to have a longer-term orientation, whereas in individualistic societies, they often adopt a shorter-term orientation. This difference in time orientation suggests that Chinese distributors may consider transaction costs differently than researchers would assume, challenging the effectiveness of hierarchical or transaction-specific governance mechanisms. In contrast, distributors' long-term orientation may imply that relational governance mechanisms, which tend to focus on long-term gains, would be more effective. Therefore, as a core tenet of our study, we assess the salience of distributors' long-term orientation as a contingent factor for different channel governance mechanisms.

To investigate the efficiency of different types of governance mechanisms systematically in the presence of varied risk preferences and long-term orientations in emerging markets, we consider multiple mechanisms simultaneously. Although a few researchers examine a firm's simultaneous use of different governance mechanisms (e.g., Wathne & Heide, 2004), studies rarely consider the contingency effect of the simultaneous use of these different types of governance mechanisms. Because channel managers often employ multiple types of governance strategies simultaneously, we examine both the hierarchical governance approach suggested by the TCA framework and the relational governance method suggested by the relational exchange paradigm. We hope to determine which type of governance aligns better with the contexts of local distributors, and China provides an appropriate research context for this effort because it offers good long-term growth potential but significant market uncertainty—the two core constructs of our study.

2. Theoretical framework

2.1. Governance mechanisms

Following Heide (1994, p. 72), we view governance as "a multidimensional phenomenon which encompasses the initiation, termination, and ongoing relationship maintenance between a set of parties." *Governance mechanisms* are tools used to establish and structure exchange relationships (see Heide, 1994, p. 72, no. 2). Whereas research on governance traditionally centers on hierarchical governance mechanisms (e.g., incentives, monitoring) and adopts a formal compliance perspective, more recent research increasingly recognizes relational governance mechanisms (e.g., relational norms, socialization) (Gu, Hung, & Tse, 2008).