



## Business to business governance structure and marketing strategy

Audhesh K. Paswan<sup>\*</sup>, Francisco Guzmán<sup>1</sup>, Charles Blankson<sup>2</sup>

Department of Marketing & Logistics, College of Business, University of North Texas, P.O. Box 311396, Denton, Texas 76203-1396, USA

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### ABSTRACT

This study tries to find an answer to the question: Are different marketing channel governance structural dimensions equally conducive for different marketing strategies? The results from an empirical study suggest that different dimensions of channel governance structure may not be equally conducive for different marketing strategies. Specifically, a high level of centralization in channel governance has no significant association with any of the marketing strategies; whereas a high level of formalization is positively associated only with a focus strategy. In comparison, participation is positively associated with both differentiation and price leadership strategies, but negatively associated with a focus strategy. Furthermore, a post hoc analysis was conducted to get more clarity of these relationships. A discussion of the findings along with their implications and limitations are also presented.

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### 1. Introduction

While the importance of matching strategy and structure for the success of any organization is amply acknowledged in strategy literature (cf. Des & Davis, 1984; Galbraith & Kazanjian, 1986; Miller, 1987; Powell, 1992; Slater & Olson, 2000, 2001; White, 1986; Yin & Zajac, 2004; Zheng, Yang, & McLean, 2010), most authors examine this relationship within an intra-organizational context. Some exceptions include Lassar and Kerr (1996); Li and Dant (1997, 1999); Homburg, Workman, and Krohmer (1999); and Mentzer and Williams (2001); however, most authors take the stance that strategy influences channel governance. While, this directionality—i.e., first formulating a strategy and then designing and implementing an appropriate inter-organizational structure—may hold true for firms starting with no pre-existing channel network structure, this may be problematic for firms operating in or entering an ongoing marketing channel network with a pre-existing inter-organizational structure. While most authors acknowledge that a firm's relationship with others in the network influences implementation of marketing programs and strategy (Heide, 1994; Reukert, Walker, & Roering, 1985), to the best of our knowledge no one has empirically investigated the relationship between existing channel governance structure and the strategic dimension of marketing—a blueprint of how a firm competes in the marketplace (e.g., Porter, 1980; Slater & Olson, 2000, 2001). To that end, this study investigates the relationship between an existing marketing channel governance structure (i.e., Hage & Aiken, 1967; Hall,

1962, 1977) and the firm's marketing strategy (i.e., Porter, 1980). Specifically, this descriptive study empirically examines the relationships between existing channel governance mechanisms—centralization, formalization, and participation—and different marketing strategies—cost leadership, differentiation, and focus strategies.

The impetus for this study stems from the fact that firms often have to function and make the best of an existing channel network without the possibility of changing the channel network with every change in marketing strategy. Under these conditions, firms need to be cognizant of the unique characteristics of channel governance structure dimensions and how they may impact different marketing strategies. Sometimes, firms may be able to fine-tune the governance structure of an existing channel system in terms of de/emphasizing some of its dimensions—centralization, formalization, and participation—to capitalize on the benefits that accrue from the strategy–structure synergy. This is critical in a changing marketplace where firms often form and operate within a complex network of supply chain partners (Achrol, 1997; Achrol & Kotler, 1999) to attain greater efficiency and effectiveness. Moreover, in view of the fact that competition is between one network and another network, when firms enter or operate in an existing channel network, understanding the relationship between the existing network's characteristics (e.g., governance structure) and a firm's strategy is critical for the firm's success. In this study, we focus on the nature of compatibility between channel network governance structure and firm marketing strategies. We then empirically test a descriptive model capturing the relationships between dimensions of existing channel network governance structure and firm marketing strategy types. We acknowledge that when firms have the luxury of starting from scratch, they would be guided by the existing knowledge base, and will first develop a strategy that will determine the channel network governance structure. However, when firms enter an existing channel network or formulate a strategy within an existing channel

<sup>\*</sup> Corresponding author. Tel.: +1 940 565 3121; fax: +1 940 565 3837.

E-mail addresses: audhesh.paswan@unt.edu (A.K. Paswan),

francisco.guzman@unt.edu (F. Guzmán), charles.blankson@unt.edu (C. Blankson).

<sup>1</sup> Tel.: +1 940 369 7966.

<sup>2</sup> Tel.: +1 940 565 3136.

network, they must take the existing channel network governance structure into consideration while formulating and implementing their marketing strategies.

Another driving force behind this study stems from the writings which assert that the interrelationship between marketing and supply chain management (SCM) provides the foundation for enhancing customer value and competitive advantages for the firm (cf. Davis & Mentzer, 2006; Ellinger, 2000; Jüttner, Christopher, & Baker, 2007; Kahn & Mentzer, 1996, 1998; Kotzab, 1999). According to Kahn and Mentzer (1996), integration between different functional areas of a firm improves performance in terms of better customer service, better management of inventory levels, higher forecast accuracy, and greater customer and employee satisfaction. Further, Pfeffer (1993) and Alvarado and Kotzab (2001) encourage new research into effective ways to manage the supply chain network and its relationship with marketing as a whole. Apart from the importance of integration and collaboration between various functional units of the firm, the exact nature of integration that exists between marketing and supply chain networks is fuzzy (see Kahn & Mentzer, 1998). However, in view of the fact that the primary goal of both supply chain networks and marketing is to satisfy the needs and requirements of consumers (cf. Alvarado & Kotzab, 2001; Mentzer et al., 2001), it is logical to expect supply chain and marketing activities to complement each other.

The major contribution of this study to the industrial marketing literature is that it enhances our knowledge about the complementary relationship between existing channel governance structure and marketing strategies—an important agenda for both marketing scholars and practitioners. This investigation is timely because ‘good’ integration between strategy and channels enhances customer value and superior competitive advantages (Olson, Walker, & Ruekert, 1995; Srivastava, Shervani, & Fahey, 1999; Urban & Hauser, 1993). Further, this study investigates the exact nature of the relationship between different channel governance mechanisms and different marketing strategies. We believe that this level of specificity will help channel, supply chain, and marketing managers compete effectively in the marketplace by aligning their marketing strategies with the existing channel governance mechanisms.

To achieve these goals, first, the literature on the channel governance structure is examined (Section 2). This is followed by a discussion on marketing strategy (Section 3) and the theoretical rationale for the research hypotheses (Section 4). The method section (Section 5) is presented next. The last sections of this paper include the discussion of the findings, their implications (Section 6), and the limitations of the study (Section 7).

## 2. Channel governance structure

As noted by Fugate, Sahin, and Mentzer (2006), academic research on governance mechanisms presents economic and/or normative models that help predict what should happen when applying particular coordination mechanisms. Governance mechanisms are applied to eliminate supply chain sub-optimization (Stern, El-Ansary, & Coughlan, 1996) and achieve desirable performance outcomes (Kumar & Seth, 1998). Extant studies on marketing channels (cf. Dwyer & Oh, 1987, 1988; Dwyer & Welsh, 1985; Paswan, Dant, & Lumpkin, 1998) identify two aspects of managing a network of organizations. The first one deals with the instituted governance structure, while the second one deals with the emergent relational norm based governance structure of a supply chain. While a relational norm based governance structure has been proposed as an effective governance mechanism, relational norms are said to evolve over a period of time (cf. Dwyer & Oh, 1987, 1988; Dwyer & Welsh, 1985; Williamson, 1999). In this study, we focus on the instituted form of governance structure, because, we believe that managers may have more control over its design, implementation, and management [this in no way undermines the importance of relational norm based governance structure]. For conceptualizing the

instituted inter-firm governance structure, extant studies have relied on the works by Hall (1962, 1977) and Hage and Aiken (1967). Moreover, extant studies on channel governance within the political economy framework (Achrol, Reve, & Stern, 1983; Arndt, 1983; Stern & Reve, 1980) have also relied on these seminal works on governance structure and have alluded to this as the economic structure of the political economy framework.

This stream of research proposes that the instituted governance structure (also referred to as bureaucratization) is multidimensional, with its dimensions being formalization, centralization, and participation (Dwyer & Welsh, 1985; Paswan et al., 1998). Formalization captures the degree to which the explicit rules and procedures are used by decision makers within a firm or the network of firms; centralization is the extent to which the decision making is concentrated in the hands of few individuals; participation captures the degree to which other firms are involved in the decision making. The literature also indicates that the higher order of bureaucratization is positively affected by centralization, and negatively by formalization and participation (Dwyer & Welsh, 1985; Paswan et al., 1998). However, further scrutiny of the dimensions of centralization and participation shows that centralization and participation are in fact negatively correlated (Paswan et al., 1998). Consistent with the extant literature in organizational structure (cf. Dwyer & Welsh, 1985; Hage & Aiken, 1967; and Hall, 1962, 1977), we use the dimensions of *centralization*, *formalization*, and *participation* as distinct dimensions of supply chain governance structure.

*Centralization* is one of the basic dimensions of organizational structure and captures the extent to which decision making is concentrated in the hands of the few, often people at the top of the power hierarchy. Jaworski and Kohli (1993) define centralization as the “inverse of the amount of delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision-making” (p. 56). *Formalization* has been defined as “the degree to which rules define roles, authority, relations, communications, norms, sanctions, and procedures” (Jaworski & Kohli, 1993, p. 56). Firms high on formalization seek to control behaviors and processes by setting rules and standards. It provides control and guidelines to problem solving, and enhances organizational commitment by reducing role ambiguity and conflict, and enhancing transparency in the work environment (Auh & Menguc, 2007). Finally, *participation* is defined as the extent to which everyone in the organization is free to participate and be involved in the decision making process. Consistent with the existing literature (Dwyer & Welsh, 1985; Hage & Aiken, 1967; Hall, 1962, 1977; Paswan et al., 1998), we conceptualize participation as the degree of actual decision making involving members of an organization from all levels. However, we argue that unlike centralization and formalization, it may be difficult, if not impossible, to implement participation as part of the organizational structure. We argue that participation is likely to be an outcome of efforts on the part of channel leaders to make its members trust and feel comfortable with one another. Similar sentiments have been alluded to in emergent structure and relationalism literature (cf. Dant & Schul, 1992; Li & Dant, 1997, 1999; Paswan et al., 1998). Based on this evidence, we use the dimensions of *centralization*, *formalization* and *participation* as dimensions of emergent governance structure in an ongoing channel network—i.e., the extent to which channel members perceive the presence of centralization, formalization, and participation in the channel network.

This study deviates from the majority of extant strategy–structure literature and argues that the perception of centralization, formalization, and participation in a channel network will either aid or abate the implementation of a strategy—i.e., we treat these as exogenous constructs. This is particularly true for channel networks that are already existing and ongoing, where it may be difficult to adapt to suit the needs of every product marketed by multiproduct firms. This is in line with the thinking presented in recent works such as Yin and Zajac (2004). Furthermore, SCM literature suggests that

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