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The effect of transaction cost antecedents on control mechanisms: Exporters' psychic distance and economic knowledge as moderators

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ABSTRACT

The purpose of this research is to determine how a manufacturer's reduction in export involvement barriers may moderate the effect of transaction cost drivers on control mechanisms (monitoring and information sharing). Utilizing Transaction Cost Analysis and internationalization literature, asset specificity and environment diversity are the transaction cost drivers and economic knowledge and psychic distance are the moderators. The results indicate that as manufacturers increase export involvement through reduction in economic knowledge differences it strengthens the positive relationship between asset specificity and monitoring and diversity and monitoring and weakens the corresponding relationships with information sharing. Psychic distance reduction weakened the positive effect between asset specificity and information sharing only. The results of the other three hypotheses were in the direction hypothesized but non-significant. Manufacturers may continue export involvement through intermediary usage provided they regulate their monitoring and information sharing practices in accordance with the overall influence of asset specificity, diversity, economic knowledge, and psychic distance.

1. Introduction

Manufacturers who find direct exporting infeasible or undesirable use the services of export intermediaries as a convenient, less costly, and low risk way of handling their export markets. Although this option of exporting may be equally as powerful as operating one's sales office, manufacturers have several complaints. They feel that although these intermediaries are benefiting from such exchanges in terms of market power and market share, the intermediaries do not religiously devote attention to market their manufacturers' products and, instead, behave opportunistically on an as-needed basis. These annoying forms of intermediary behavior may cause export manufacturers' inter-channel strategies to buckle and reduce their channels' agility to promote their brands in the marketplace (e.g., Bello & Gilliland, 1997).

Since these manufacturers cannot resort to the muscle of bureaucratic controls, are there equivalencies available to them to reap the advantages and overcome the challenges of exporting through intermediaries? Proponents of Transaction Cost Analysis (TCA) suggest that the degree of transaction cost (market failure, bounded rationality, information asymmetry, and opportunism) due to the presence of environmental uncertainty and asset specificity motivates the manufacturer to implement equivalencies in the form of control mechanisms. The presence of asset specificity forces a manufacturer to become dependent on its intermediary. Environmental uncertainty creates information asymmetry between the parties with the intermediary having the home advantage of possessing relevant market information. This forced dependence and asymmetric information place opportunistic behavior in the forefront.

Prior research has shown that a manufacturer can resort to monitoring and information sharing as direct and indirect control mechanisms to encourage its intermediary to cooperate and reduce transaction cost. By monitoring, the manufacturer is policing the system to verify agreed-upon behaviors take place. Information sharing is a manufacturer's incentive strategy to influence its intermediary to fulfill the manufacture's goals with reduced transaction cost (Noordewier, John, & Nevin, 1990). These control mechanisms prevent the manufacturer's inter channel strategies from buckling, promote intermediary interest, suppress transaction cost, and capture the advantages of exporting through the intermediary. Verification mechanism and information disclosure are credible commitments by a party in lieu of administrative command and control to promote viability of a business exchange (Williamson, 2005). Moreover, these control mechanisms are means to simulate vertical integration without absorbing its transaction cost (Grossman & Hart, 1986; Stinchcombe, 1985). The

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greater the perceived transaction cost, the more the monitoring and information sharing take place (Bello & Gilliland, 1997; Bello, Celirau, & Zhang, 2003; Noordewier et al., 1990; Sachdev, Bello, & Pilling, 1994).

Proponents of the internationalization view, however, suggest that manufacturers increase export involvement as they overcome communication/information flow and knowledge (experiential and educational) differences measured by psychic distance and economic knowledge. Psychic distance is the difference in the language and values of the people between the home and foreign markets (Bello & Gilliland, 1997). Economic knowledge includes items such as banking practices, exchange rates, and market economic indicators (Soulsby & Clark, 1996). This increase in export involvement enhances manufacturers' ability to cope with bounded rationality and reduces the distortions of the foreign market (Bilkey, 1985; Katsikeas, Skarmeas, & Bello 2009). By overcoming these differences, they improve their decision-making abilities (Johanson & Vahlne, 2006).

Whereas TCA studies focus on the degree of market failure as a motivator to control, internationalization studies focus on foreign market distortion reduction as a path to control (Anderson & Coughlan, 1987; Johanson & Vahlne, 2009). Thus, a major distinction between TCA and internationalization literature is that the former focuses on coping with bounded rationality and opportunism generated from asset specificity and environment uncertainty, and the latter focuses on coping with bounded rationality generated from foreign market exchange difficulties (Sousa & Bradley, 2006). These international communication and knowledge impediments are a manufacturer's inability to overcome problems in its foreign market operations that define its restricted domain of export involvement (Bello & Gilliland, 1997; Williamson, 1991). Whereas psychic distance affects export involvement through international communication differences between the parties (e.g., Dow & Karunaratna, 2006), economic knowledge affects export involvement through foreign market knowledge differences since managing economic activities is the foundation of international exchanges (Mitra & Golder, 2002; Williamson, 2008). Moreover, internationalization is discussed within the frame of economic factors (Johanson & Vahlne, 1977).

2. Purpose of the study

Since an export manufacturer faces different degrees of market failure and differences in foreign market practices simultaneously (Klein & Roth, 1990), monitoring and information sharing due to market failure may need to be altered for foreign market impediments. Preparing for adjustments in control mechanisms is essential because dissimilar methods of simulating vertical integration use different organization workflow, information flow, and processes (Heide & Wathne, 2006; Noordewier et al., 1990). In addition, conscious coordinating adaptations that are similar to administrative control also have costs, which vary with the attributes of the transaction (Williamson, 2005). Furthermore, export scholars state that international knowledge and communication differences have their individualistic effect on bounded rationality and opportunism, which may interfere with transaction cost properties (Klein & Roth, 1990; Wu, Sinkovics, Cavusgil, & Roath, 2007; Zhang, Cavusgil, & Roath, 2003). However, virtually no research has empirically studied the joint effect of foreign market differences and transaction cost on control mechanisms. The purpose of this study is to determine how overcoming psychic distance and economic knowledge differences may strengthen or weaken an export manufacturer's use of these control mechanisms. Therefore, psychic distance and economic knowledge are included as moderators in this export research.

This research makes three contributions to the export literature: First, the TCA framework is extended to the manufacturer–intermediary relationship in an export exchange by incorporating the internationalization view of incremental foreign market involvement. Second, this research tests how psychic distance and economic export knowledge moderate the effect of manufacturers' anticipated transaction cost reflected by asset specificity and market uncertainty on control mechanisms (monitoring and information sharing). Third, based on the results of the study, managerial insights are provided for exporters on ways to handle their export activities. In the following sections, the advantages of using intermediaries and control mechanisms are discussed. Next, the TCA literature is explored with respect to control mechanisms. Then, the moderators are introduced using the internationalization literature, and hypotheses are developed. Subsequently, the methodology is discussed. Finally, the results are presented followed by Section 8.

3. Intermediary usage and control mechanisms

Intermediary usage is a popular way for manufacturers to export. First, the vertical integration route, such as a sales office, may be infeasible for manufacturers that lack the resources (financial and managerial capability) or the sales volume for their management to devote their time (Bello & Gilliland, 1997). In addition, restrictions imposed by the foreign government or the norms of an industry may prevent manufacturers from vertically integrating (Sachdev, Bello, & Verhage, 1995). Second, vertical integration may be undesirable for some because owning a sales office is not without its problems. For instance, it is common knowledge that employees of a manufacturer's foreign subsidiary may be hired away by competitors; employees have been known to leave and start their own business or work as consultants to other global competitors. In addition, ownership has its attached bureaucratic costs (Phillips, 1982). Intermediaries, on the contrary, possess specialized information about their respective country's markets, spread their fixed costs by performing the distribution function for several manufacturers, and build a client base for their manufacturers' brands. Furthermore, they shield their manufacturers from harm related to legal issues and political upheavals in their respective foreign markets.

However, a major challenge for exporter manufacturers that prefer using intermediaries is to detect transaction cost and determine whether their intermediaries are diligently fulfilling their end of the bargain. Several factors may be contributing to transaction cost. For example, once the intermediaries expend the time, capital, and energy in developing markets, they become vulnerable to being bypassed by their manufacturers. In order to reduce this bypass possibility, the intermediaries may build strong bonding behaviors with their own customers to reduce customer abandonment and may resort to tactics to cloud the manufacturers' vision from developing complete market knowledge (Bello & Gilliland, 1997; Heide & John, 1988). In addition, intermediaries handle several manufacturers' products and their business objectives and market risk preferences may not be in synchronism with any one manufacturer on a consistent, longitudinal basis (Celly & Frazier, 1996; Kumar, Heide, & Wathne, 2011).

Another major challenge is that intermediaries have been known to become complacent, overcommit their resources to several manufacturers, and behave opportunistically if occasions arise. For example, Anderson, Lodish, and Weitz (1987) found channel members to allocate their time to a manufacturer relative to the manufacturer's influence strategy. In addition, intermediaries are not experts in every product category and industry; yet, they take on such tasks because they feel that they can transfer their knowledge and persuade their customers to buy all goods