

# **Toward Channel Relationships Enhancement by Using Nontraditional Control Mechanisms to Boost Retail Chain Member's Commitment and Trust**

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## **ABSTRACT**

*The conventional wisdom tells that the more control the supplier has over the chain retailer, the easier it is for the supplier to reach its operation goals and gain better performance. Taking a different viewpoint, this research proposes a conceptual perspective when the more control the supplier has the lower commitment and trust the company-owned retailer will have toward the supplier. Using two nontraditional control mechanisms, transaction-specific investments (TSIs) and relational norms, the supplier could improve this negative relationship. Both control mechanisms give the supplier the chain retailer's commitment and trust, even if the supplier gives high control.*

## **INTRODUCTION**

A supplier can increase its market share by expanding company-owned stores and increasing the number of franchise stores (Kotler, 2002). The above two approaches have both advantages and disadvantages. Compared with franchise stores, the supplier invests more operated cost in company-owned stores, has more control power in marketing strategy and protects product quality and brand name reputation (El-Ansary and Stern, 1972; Carney and Gedajlovic, 1991). However, company-owned stores limit the rate of chains expansion and have no power and revenue incentive to work hard. Franchise stores have more decision power in operation strategy and contribute to expand chains speedy. The supplier, nevertheless, has less control in them for protect product quality and brand name reputation and easily has agent problems between the supplier and franchise stores (Carney and Gedajlovic, 1991). As a whole, both expansion models can cause power and conflict problems in management between channel members (Anderson and Narus, 1984; Rosenberg and Stern, 1971; Wilkinson, 1981), making it hard to maintain a successful long-term channel relationship.

These kinds of problems make it difficult to maintain a long-term relationship between supplier and retailer (Nelson and Cooprider, 1996). First, on the one hand channel members should be partners rather than enemies, and on the other hand commitment and trust are factors extremely crucial to the cooperative relationship (Ghoshal and Moran, 1996), as the healthy partner relationship is formed and maintained through cooperation. Second, if channel partners have commitment and trust toward each other, they can resist the allure of short-term profit and pursue long-term benefits together. Third, if partners have trust in each other, they will not be opportunistic in business transactions, and rather will properly handle potential risk (Morgan and Hunt, 1994). Therefore, this research suggests that whether a cooperative relationship between the supplier and retailer exists can be explained by the commitment and trust shared between the two parties.

The control mechanism is designed to restrain opportunistic behavior and induce behaviors which help to maintain a relationship. Suppliers use the control mechanism to ensure that retailers execute the correct strategies (Anthony, 1988) and reach their expected goals (Tannenbaum, 1968). This research suggests that using the control mechanism appropriately can enhance the retailer's commitment and trust toward the supplier and improve the relationships among channel members.

To address these issues, this research proposes a conceptual perspective that discusses (1) the influences of different kinds of management models on retailer's commitment and trust toward the supplier, and (2) the influences different control mechanisms have on retailer's commitment and trust toward the supplier under different management models.

## **MANAGEMENT MODEL, COMMITMENT, and TRUST**

The retailer's management model often is a key to the supplier's success or failure. Each retail chain model, whether it is company-owned or franchise, has its own characteristics and both have pros and cons (Anderson and Narus, 1984). The supplier chooses one or both as its chain model, depending on its growth strategies and goals. However, the retailer is the supplier's channel partner rather than an instrument for achieving the supplier's goals. Channel members need to develop mutual commitment and trust if they intend to have a good long-term relationship

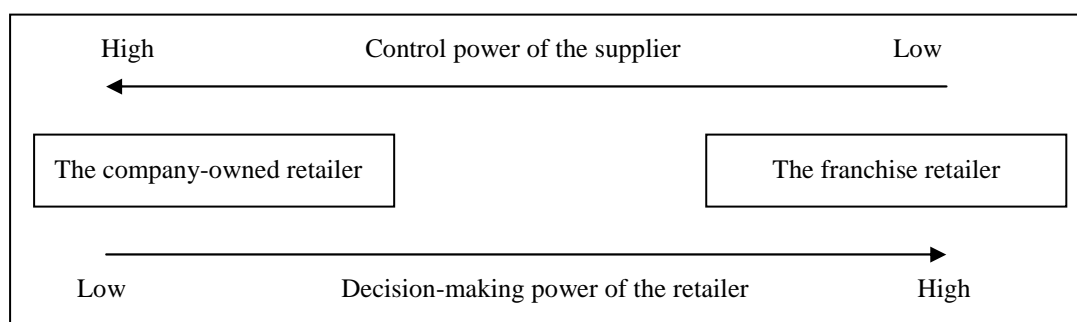
(Morgan and Hunt, 1994). The following first discusses the influences of different retailer management models on commitment and trust between supplier and retailer.

### Management model

Company-owned retailers are operated directly by the supplier who makes investment in the retailer with total ownership of the retail stores and is financially responsible for profits or losses of the chain (Gal-Or, 1995). The supplier also is in full hierarchical control of company-owned stores regarding the expansion and handling of channels as well as ensuring product quality and brand reputation. In contrast to the franchise retailer, the supplier has both higher financial and operational costs associated with having a company-owned retailer. As this kind of retailer has less decision-making power so it is easy to have power conflict between the supplier and retailer.

On the other side, having a franchise retailer allows the supplier not only to decrease operation costs but also to expedite channel expansion (Kehoe, 1996). In addition, suppliers can have franchise royalties as part of profits so that it is a good way for the supplier to gain market share and make a profit in a timely manner. Nevertheless, the main defect of having a franchise retailer is that it is not easy for the supplier to control the behavior of the franchise retailer, making it vulnerable to the potential peril of brand reputation loss.

Consequently, the more the ownership of the supplier, the better control the supplier has over the retailer, yet the more decision-making responsibility is for the supplier as well. On the other hand, the greater the ownership of the supplier, the less decision-making power is available for the retailer (Table 1).



**Table 1. the decision-making power of the**

### Commitment

Commitment reflects the belief held by channel members related to the degree the members feel important to maintain a stable cooperative relationship with channel partners (Morgan and Hunt, 1994). As a result of this belief, members are willing to voluntarily make short-term sacrifices in order to keep a long-term, stable, and cooperative relationship. When the supplier and retailer recognize that the other party is committed to the relationship (Anderson and Weitz, 1992), they would like to keep that relationship healthy. This means that commitment to maintaining the cooperative relationship exists only when channel members consider the relationship to be important. If the commitment recognition is asymmetrical, there is a negative effect on the channel member relationship. When a retailer is unwilling to fully commit to its supplier, the poor relationship may jeopardize both the supplier's and retailer's business performance. Thus it is inferred that, compared to franchise retailers, the company-owned retailer is directly invested by the supplier and its ownership are held by the supplier overall. The company-owned retailer may perceive that the cooperative relationship is initiated and held by the supplier who then gets to have the most control and even to decide whether or not a cooperative relationship should continue. Therefore, the company-owned retailer would be more passive to the cooperative relationship, and would have less commitment to the supplier. Hence, the proposition is derived as the following:

*Proposition 1: The retailer who has less decision-making power will hold less commitment to the supplier and the cooperative relationship than the retailer who has more decision-making power.*

### Trust

Trust refers to that one party of the channel members believes the other to be sincere and responsible (Young and Wilkinson, 1989). Members in a cooperative relationship trust their partner in three situations when: (1) the partner is willing to share equivalent resources; (2) the partner provides normal and regular communication and exchange; and (3) in past cooperative experiences, no party has tried to consciously take advantage from the other (Morgan and Hunt, 1994). Trust is a pivotal factor that determines whether a relationship succeeds or not (Mohr and Spekman, 1994). Only when the trust from the other party is recognized, a channel member is willing to maintain the cooperative relationship.

It is postulated that since the supplier has 100% control over the company-owned retailer given the nature of ownership, the company-owned retailer would have less automatic decision-making power as compared to the franchise

retailer. The company-owned retailer may perceive that the supplier would always have the power to rip off and push for extra advantages. Thus the company-owned retailer who is forced and demanded to follow the supplier's control would have less trust toward the supplier. Consequently, the proposition is developed as follows:

*Proposition 2: The retailer who has less decision-making power will hold less trust in the supplier and the cooperative relationship than the retailer who has more decision-making power.*

## THE INFLUENCE OF CONTROL MECHANISMS

Control mechanisms are important to an organization (Snell, 1992), as they are designed to manage business activities and then ensure that the expected goals are achieved (Gencturk and Aulakh, 1995; Jaeger and Baliga, 1985). An organization can use control mechanisms to influence another organization's behavior and output through power, authority, and bureaucratic mechanisms (Geringer and Hebert, 1989). Traditional control mechanisms are based on formulation and supervision mechanisms. However in the current dynamic business environment, the increasing uncertainty and flushing information must be handled when an organization runs. Thus, business organizations need to rely on efficient control mechanisms which emphasize normative control and self-management rather than supervision. In this case, having commitment and trust from partners is a good way for the organization to have good control and reduce management costs (Leifer and Mills, 1996).

In the preceding inference, the use of different management models by suppliers is proposed to cause retailers to have different levels of commitment and trust. When the supplier has high control, the commitment and trust of company-owned retailer to the supplier will drop followed by a deteriorated mutual relationship. In this situation, the supplier faces the issue to have a better control mechanism to either remedy or prevent the problematic relationship with the retailer. To redress this issue, this research proposes two control mechanisms, TSIs (transaction-specific investments) and relational norms, for raising the company-owned retailer's commitment and trust toward the supplier and to redirect the relationship between the two into a healthy cycle.

### Transaction-specific investments (TSIs)

TSIs are special investments which are invested for business transactions (Jap and Ganesan, 2000). These investments include both tangible and intangible assets that only benefit channel members with cooperative relationship, and a common example of TSIs is the electronic data interchange (EDI) established by the supplier (Lohtia and Krapfel, 1994). By using EDI, both the supplier and the retailer can transmit commercial data from one computer to the other computer with low cost. The TSIs used as control mechanism are a two-edged sword, depending on whom is the one to offer. If the supplier, for its own good, overuses its power to request the company-owned retailer to spend in TSIs, this although could increase the supplier's sales volume and market share, leading to a decrease in sales expenses (Lohtia and Krapfel, 1994), yet it is at the expense of the retailer's benefit and increases its sunk cost. Therefore, this conflict would cause a negative relationship between the supplier and company-owned retailer. However, this unbalanced scenario is less likely to happen between the supplier and the franchise retailer in that the supplier lacks the power to ask the franchise retailer to make TSIs. Hence, there will be less such kind of conflict between the supplier and the franchise retailer due to TSIs request. In this instance, the franchise retailer is expected to have a better relationship with the supplier than does the company-owned retailer.

Taking the other way around, if the TSIs are offered by the supplier, then it would have a positive influence on the retailer's commitment to the supplier (Jap and Ganesan, 2000). The act that the supplier provides TSIs to help the retailer would make the company-owned retailer to believe the supplier's benevolent intention in sharing the operational risk and creating a long-term relationship. Interestingly, this balanced scenario between the supplier and the franchise retailer would not happen either because the supplier bearing on its costs has no incentive to fund the franchise retailer whom it has less control over. The franchise retailer then would have less commitment and trust toward the supplier. For the case that company-owned retailers get to receive TSIs from the supplier, this study considers that the supplier's TSIs as carrot can boost the retailer's commitment and trust even if the supplier practices more control (stick). Accordingly, two propositions are presented as the following:

*Proposition 3: When the supplier offers TSIs, the retailer who has less decision-making power will increase its commitment to the supplier than when the supplier does not offer TSIs.*

*Proposition 4: When the supplier offers TSIs, the retailer who has less decision-making power will increase its trust to the supplier than when the supplier does not offer TSIs.*

### Relational norms

A norm is a type of behavioral expectation (Heide and John, 1992). In an organization, managers apply organizational culture and climate as norms instead of creating rules to establish employees' shared value, and then guide the employees to behave properly according to those expectations (Leifer and Mills, 1996). For channel partners,

solidarity, information exchange, and participation can be used to shape up the relationship between the supplier and retailer (Jap and Ganesan, 2000). Solidarity is a two-way expectation held by cooperating partners that they will maintain a long-term relationship. Information exchange indicates the degree to which the partners can freely and actively exchange related information, which is believed positive to increase trust and commitment between the cooperative partners (Lee and Kim, 1999). Participation refers to the depth and scope that the partners can make strategies together and set common goals (Dwyer and Oh, 1988).

This study suggests solidarity, information exchange, and participation as relational norms that the supplier can utilize to improve the cooperative relationship between itself and retailers. Given the nature that in an ownership hierarchy the supplier has more control and decision-making power over the company-owned retailer, if the supplier values its relationship with the retailer and intends to ease out any possible conflict as aforementioned, it can use relational norms to grow employee shared beliefs and organizational climate. By applying the relational norms, the supplier can share information freely and actively with the company-owned retailer, discussing and co-making goals and strategies, and letting the retailer believe that the two are formulating a long-term cooperative relationship. After such practices, the company-owned retailer will believe the supplier's sincerity in the formation of a long-term relationship. Thereafter, the company-owned retailer will have more commitment and trust toward the supplier. But for the franchise retailer, the relational norms will be exerted with some difficulty since the franchise retailer has relatively greater autonomy which results in less control capable of the supplier. Thus, it will be more challenging for the supplier itself to direct the cooperative relationship by conducting the relational norms. Therefore, two propositions are developed as follows:

*Proposition 5: When the supplier practices relational norms, the retailer who has less decision-making power will increase its commitment and trust to the supplier than when the supplier does not practice relational norms.*

*Proposition 6: When the supplier practices relational norms, the retailer who has less decision-making power will have higher level of commitment and trust to the supplier than the retailer who has more decision-making power.*

## CONCLUSION

The types of company-owned and franchise retailing are commonly used by suppliers to expand channels and increase market share. Although the supplier has more control over the company-owned retailer, this study infers that, compared to the franchise retailer, the company-owned retailer will have less voluntary commitment and trust toward the supplier due to its hierarchical disadvantage and restriction in autonomy. This study thus suggests the supplier to use TSIs and relational norms to fortify the relationship with the company-owned retailer. This would help headquarter managers to better understand their cooperation with retailers and to know how to build a long-term cooperative relationship.

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