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Marketing Environment and governance mechanisms: Focusing on Manufacturer's Interfirm Benevolence

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Abstract

Purpose - Manufacturers in uncertain environments need to depend on governance mechanisms to reduce the inherent risk in these environments. However, few studies have examined which governance mechanisms a given manufacturers will develop in uncertain environments for managing the relationships with its vertical partner. This study explores how different governance mechanisms function under uncertain environmental circumstances. We also try to investigate the contextual effect of interfirm benevolence as moderator.

Research design, data, and methodology - This research provide the conceptual framework of interfirm benevolence on which this research's propositions are predicted. The theoretical background for environmental uncertainty, governance mechanisms and interfirm benevolence will be discussed.

Results - The expected results are as follows. Manufacturers in an uncertain environments rely on different governance mechanisms under conditions of high and low interfirm benevolence. In terms of role of interfirm benevolence, interfirm benevolence provides a better understanding of how governance mechanisms can develop in an uncertain supply markets.

Conclusions - This research suggests several theoretical and practical implications between channel partners, particularly, this research offers that interfirm benevolence is a crucial competitive factor under environmental uncertainty situation. In future studies, it is necessary to investigate the effect of each governance mechanism structure on performance in an uncertain environment and various level of interfirm benevolence.

Keywords: Environmental Uncertainty, Governance Mechanisms, Unilateral Governance, Bilateral Governance, Interfirm Benevolence, Marketing Channels.

JEL Classifications: C42, D3, D81, D83.

1. Introduction

Environmental uncertainty, which refers to the fluctuations in availability and the price of raw resources, provides profound threats with manufacturers (Williamson, 1985; Trevino & Kerr, 2015). Therefore, manufacturers try to rely on interfirm mechanisms as a countermeasure to such uncertainties (Cai, Yang, & Hu, 2009; Santoro & McGrill, 2005). Thus environmental uncertainty is the greatest contextual factor affecting interfirm relationships (Palmatier, Dant, & Grewal, 2007).

Interfirm relationship is a complex network that their environments form many parts of the governance mechanism. Persuasive theories have so far developed in marketing field, which demonstrate how exchange partners develop governance mechanisms in an uncertain situations. One of the most persuasive theories is transaction cost analysis. Transaction cost analysis has proven useful tool in explaining governance mechanism (Stump & Heide, 1996).

Transaction cost theorists argue that the asymmetry of the information exchanged between the manufacturer and the supplier arises from the environmental uncertainty. For instance, the better-informed party is more likely to have opportunistic behavior (Pavlou, Liang, & Xue, 2007; Klein, Frazier, & Roth, 1990). Manufacturers therefore need to reduce supplier opportunistic behavior by adopting unilateral governance, the extent to which manufacturers unilaterally control supplier decisions (Stump & Heide, 1996; Jap & Anderson, 2003; Bello & Gilliland, 1997).

On the other hand, relational contract theorists propose that manufacturers in uncertain environments perform via bilateral governance is defined as the reliance on a shared set of implicit behavioral principles for the coordination of interfirm exchange partners (Heide, 1994; Noordewier, John,

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& Nevin, 1990; Cannon, Achrol, & Gundlach, 2000).

It has not yet been decided which governance mechanism should be chosen to better manage relations with exchange partners in an uncertain environment. The purpose of this study is to iron out two opposing suggestions in the uncertain environment; transaction cost theory (unilateral governance) and relational contract theory (bilateral governance).

This study introduces two governance mechanisms; vertical control, an unilateral governance mechanism and flexibility, a bilateral governance mechanism and suggest that interfirm benevolence serve as a moderating variable in explaining the relationships between environmental uncertainty and governance mechanisms. Interfirm benevolence affects the level of information asymmetry induced by environmental uncertainty and stimulates the exchange of information. In this regard, it is predictable that interfirm benevolence may be a critical factor affecting the adoption of governance mechanisms in an uncertain environment. This paper suggests that party with benevolence to their partners rely on bilateral governance, while those without benevolence may adopt unilateral governance.

This study develops the conceptual framework based on effects of environmental uncertainty on governance mechanisms to investigate the impact of interfirm network factor. In this way, this study contributes to network governance study and network characteristic study at the same moment.

In the next section, the theoretical background for environmental uncertainty, governance mechanisms and interfirm benevolence will be discussed. Then the research propositions are developed. Figure 1. presents the proposed framework.

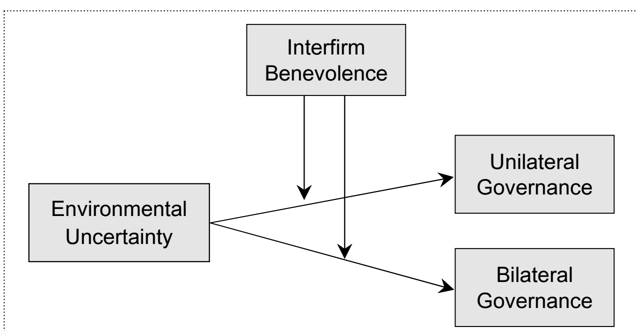

Figure 1: Conceptual Framework

2. Review of Literature and Propositions

2.1. Marketing Environment and Environmental Uncertainty

Generally, marketing environment means that the actors outside marketing affect management's ability of marketing to build relationships with target customers successfully (Kotler & Armstrong 2010). Kotler and Armstrong (2010) explained that the marketing environment consists of a microenvironment and a macroenvironment.

The microenvironment is made up of the actors close to the firm that affect its ability to serve its customers (e.g., the company, intermediaries, suppliers, consumers, competitors, and publics) while the macroenvironment is made up of the larger societal actors that affect the microenvironment (e.g., demographic, natural, economic, technological, political, and culture environments).

2.2.1. The Company's Microenvironment

Marketing managers need to build and maintain relationships with customers by creating customer satisfaction. But, they cannot do this alone. <Table 1> demonstrates the main actors in the microenvironment.

Table 1: Actors in the Microenvironmnent

The company	When marketing managers design marketing plans, they takes other company groups into account (e.g., top management, research and development (R&D), finance, accounting, operating, and purchasing group).
Suppliers	Suppliers provide the company with the resources to produce its goods and services.
Intermediaries	Marketing intermediaries can help the company to sell, promote, and distribute its goods and services to final users (e.g., distribution firms, financial companies, resellers, and service agencies).
Competitors	A company has to provide greater customer value than its competitors do for success.
Publics	A public group means that has and current or potential interest in or affect an organization's ability to achieve its goals (e.g., financial, media, government, citizen-action, local, general, and internal publics).
Customers	Customers are the most important actors in the company's microenvironment. The company might target any or all of five types of customer markets (e.g., consumer, business, reseller, government, and international markets).

Source: Kotler and Armstrong(2010)

2.2.2. The Company's macroenvironment

The macroenvironment consists of larger forces that impact on the actors in the macroenvironment. <Table 2> shows the six main forces in the company's macroenvironment.

Table 2: Main Forces in the Company's Macroenvironment

Demographic environment	Demography is about human populations in terms of gender, age, occupation, location, density, size, and other statistics. The demographic environment is of main interest to marketing managers. Changes in demographic environment have critical implications for business.
Natural environment	The natural environment includes the natural resources that are required as inputs by marketing managers. Managers should consider some trends in the natural environment (e.g., shortages of raw materials, increased pollution, increased government intervention in natural resource management).
Economic environment	The economic environment consists of factors that impact on consumer buying power and spending patterns.
Technological environment	The technological environment is forces that create new technologies, producing new product and market opportunities.
Political environment	The political environment involves government agencies, law, and pressure groups that affect and limit several organizations and individuals in a given society.
Culture environment	The culture environment consists of institutions and some forces that influence a society's basic perceptions, values, behaviors, and preferences.

Source: Kotler and Armstrong (2010).

Table 3: Factors comprising the organization's internal and external environment

Internal environment	
Organizational personnel factor	Technological and educational background and skills Availability of manpower for utilization within the system Individual member's involvement and commitment to attaining system's goals Previous technological and managerial skill Interpersonal behavior styles
Organizational functional and staff units factor	Technological and educational background and skills Availability of manpower for utilization within the system Individual member's involvement and commitment to attaining system's goals Previous technological and managerial skill Interpersonal behavior styles
Organizational level factor	Nature of the organization's product service Organizational objectives and goals Integrative process integrating individuals and groups into contributing maximally to attaining organizational goals
External environment	
Customer factor	Actual users of product or service Distributors of product or service
Suppliers factor	quipment suppliers Labor supply Product parts suppliers New materials supplies
Competitor factor	Competitors for customers Competitors for suppliers
Socio-political factor	ublic political attitude towards industry and its particular product Government regulatory control over the industry Relationship with trade unions with juris diction in the organization
Technological factor	Improving and developing new products by implementing new technological advances in the industry Meeting new technological requirements of own industry and related industries in production of product or service

Source: Duncan (1972).

2.2.3. Internal and external environments

When the environment is defined in this way, there are factors within the boundaries of the organization that should be considered as part of the environment. Therefore, a differentiation is made between internal and external environment (Duncan, 1972). The internal environment means that relevant social and physical factors within the boundaries of the organization which are taken directly into consideration in making decision. The external environment means that relevant social and physical factors outside the boundaries of the organization which are taken directly into consideration (Duncan, 1972). The list of environmental factors presented in <Table 3>.

Following Anderson et al. (1994)'s definition, environment is defined as anything not part of the organization itself. In this study, environmental influence includes all impact which is not arose from the organization itself in exchange relationships. The environment includes everything that can affect the company in any way. Therefore, it can exist inside or outside of the network surrounding the focal company.

2.2.4. Environmental Uncertainty

Environmental uncertainty is an important characteristic of the environment (Stump & Heide, 1996). In this study, environmental uncertainty is defined as the extent to which environments rapidly, as well as the difficulty in predicting about the environments accurately (Klein et al., 1990; Jeon, 2018). Because of having these features, the manufacturer in uncertain environment is likely to make predictions of resources inaccurately, and thus there is no certainty about the amount of resources or when the resource will arrive (Roh, Kim, Yoo, & Kim, 2015).

Exchange parties confront an uncertain environment experiences uncertainty when it does not have relevant information or when there are too numerous situations that are coincidental or hard to predict (Eisingerich, Bell, & Tracey, 2010; Argote 1982; Stump & Heide 1996). As a result, it is difficult for the parties to forecast accurately about the real status of the environment (Frazier & Antia 1995).

Environmental uncertainty often causes opportunistic behavior among exchange partners for its interest by taking advantage of this uncertainty (Luo, 2007). Opportunism is self-interest-seeking behavior along with guile (Williamson, 1985). Opportunistic behavior includes subtle forms of dishonest behaviors such as withholding or avoiding responsibility, cheating, and distorting information of market. For example, if there is an unexpected shortage of parts in the market, perhaps the supplier may impose an overinflated price on the manufacturer. In turn, opportunism can raise total transaction costs.

In case of an exchange partner's potential opportunism under uncertain market conditions, exchange partners have to adapt to uncertainty rapidly (Stump & Heide, 1996). Exchange partners should rely on an interfirm governance mechanism that is best proper for conditions reflecting uncertainty (Stump & Heide, 1996). For instance, environmental uncertainty enables exchange partners to monitor closely and control the exchange partners' potential opportunism. Also norms are developed among exchange partners in such an uncertain environment.

2.3. Interfirm Governance Mechanisms

Various researches have explored the governance mechanisms existing between firms (e.g. Heide, 1994; Judge, 2010) and within firms (Ouchi, 1979). Research has identified two major types of governance mechanisms: unilateral and bilateral governance mechanisms.

The difference between unilateral and bilateral governance mechanisms is based upon the extent to which both exchange parties influence another partner's decision-making (Bello & Gilliland, 1997). While the bilateral governance mechanism is based on the premise that the both exchange partners will participate in decision-making, the unilateral governance mechanism relies only on manufacturer's decision-making ability (Gilliland, Bello, & Gundlach, 2010).

This study adopted two governance mechanisms such as vertical control and flexibility. Vertical control indicates the unilateral governance mechanism, on the other hand the norm of flexibility indicates the bilateral governance mechanism. Because these two governance mechanisms help manufacturer with obtaining information on the suppliers, they play a role as proper methods for reducing the risk related with vested benevolence.

The unilateral governance mechanism is based on the efforts of the controlling parties influencing the behavior of the partner and uses external measures, such as results or actions of the partner (Heide & John, 1988; Bello & Gilliland, 1997; Stump & Heide, 1996; Celly & Frazie, 1996). Vertical control involves examining the performance of suppliers in terms of inventory or delivery levels. As a result, vertical control of the supplier provides the manufacturer with safeguards that are critical to detecting the supplier's opportunistic behavior, thereby protecting the manufacturer's interests.

Manufacturers in environmental uncertainty have difficulty in accurately forecasting the supply of resources from their suppliers. This uncertain environment makes it possible for suppliers to take opportunistic behavior by taking advantage of the uncertainties that manufacturers have (Luo, 2007). Opportunism is self-interestseeking behavior coupled with guile (Williamson, 1985). This opportunism increases the total transaction cost, so manufacturers must closely and directly control their partners' behavior. Thus, the following is proposed.

H1. Environmental Uncertainty will positively influence on the unilateral governance mechanisms of channel firms.

The bilateral governance mechamism is based on community rather than the individual goals of both parties (Khan, 2011; Gundlach & Achrol, 1993). The bilateral governance mechanism depends on relational norm (Weitz & Jap, 1995; Lusch & Brown, 1996) to encourage efforts for mutual benefit between the manufacturer and the supplier (Weitz & Jap, 1995).

Bilateral governance regulates proper behavior of the manufacturer and the supplier (Heide, 1994). That is, bilateral governance gives order to what otherwise might be uncertain and ambiguous situations. Therefore, the bilateral governance guides partners to act in a cooperative manner to achieve common goals.

Bilateral governance is based on a manufacturer-supplier relationship that verifies which types of behavior are advisable or unadvisable, rather than on directly monitoring partner's behavior (Griffith & Myers, 2005). Therefore, bilateral governance promotes the formulation of relational norms that compel parties to pursue mutual benefit for both manufacturers and suppliers (Gundlach & Achrol, 1993). For example, a typical relational norm is the flexibility. The exchange partners who select bilateral governance have a shared principle, so they are flexible in coping with the sudden demands of their partners in an uncertain environment (Noordewier et al., 1990). The flexibility indicates the expectation that each party will try to adapt to a series of new contracts and attempts to change the situation without renegotiation (Young, Sapienza, & Baumer, 2003). For instance, if a strike or flood prevents the supplier from keeping up with the equipment part deadline, the supplier will ask the manufacturer to accept the late delivery.

A manufacturer in an uncertain environment might find it difficult to keep up the transaction if the supplier makes unstable supply. Bilateral governance cannot develop between manufacturers and suppliers in this uncertain environment because manufacturers can attempt to switch between multiple suppliers to secure parts.

H2. Environmental Uncertainty will negatively influence on the bilateral governance mechanisms of channel firms.

2.4. The Moderating Effect of Interfirm Benevolence

Interfirm benevolence, the belief of a manufacturer that the exchange partner will not only behave leading to positive outcomes, but will also avoid behaviors leading to negative outcomes (Aurifeille & Medlin, 2009). Interfirm benevolence increases the willingness to rely on an exchange partner whose action is not directly under other control (Moorman, Zaltman, & Deshpande, 1992). Also interfirm benevolence increases the willingness to take care of other partner's needs (Medlin & Quester, 2002). Benevolence develops the relationship effectively between manufacturer-supplier relationships by reducing the costs of negotiation (Zaheer, McEvily, & Perrone, 1998), enhancing information change (Zand, 1972), encouraging cooperation (Schurr & Ozanne, 1985), facilitating the long-term orientation among partners (Doney & Cannon, 1997; Ganesan, 1994), and leading to better performance (Jap, 1999).

Interfirm benevolence is part of a vulnerability in the manufacturer's relationship with the supplier (Şengün, 2010). For example, manufacturers who trust suppliers to supply on time might experience negative consequences if suppliers fail to fulfill the contract. Benevolent party has potential vulnerabilities in the opportunistic behavior of exchange partners (Elangovan & Shapiro, 1998; Andaleeb, 1992). Suppliers can gain short-term benefits from opportunistic behavior. For example, when a component has a volatile supply, it can be an edge of uncertainty by selling it to alternative buyers in the market. While the manufacturer believes that the supply of the parts is still scarce, a suggestion to increase profit margin can be sold to alternative buyers when purchasing parts. The result of such opportunistic supplier behavior is to make it difficult for manufacturers to reach optimal results and to lower the level of commitment offered by manufacturers within the relationship.

Benevolent party must implement mechanisms to prevent the other party from violating their benevolence, because a benevolent party is vulnerable to the exchange party (Yoon & Kim, 2014). Exchange parties need to consider interfirm governance mechanisms to protect themselves from unbelievable exchange partners (Stump & Heide, 1996; Heide, 1994).

Interfirm benevolence function as a moderator that influences the effect of environmental uncertainty on governance mechanisms. When the manufacturer expects its supplier to be reliable, the perception of uncertainty is reduced (Moorman et al., 1992). The opposite is also possible. If the manufacturer does not have interfirm benevolence for the supplier, the manufacturer will vertically control whether the supplier behaves opportunistically. Thus,

H3: Interfirm benevolence will moderate the relationship between environmental uncertainty and unilateral governance mechanism.

The presence of interfirm benevolence among exchange partners allows for more accurate and timely information (Denize & Young, 2007). The information allows manufacturers to better understand their suppliers. Manufacturers who have no interfirm benevolence on suppliers do not provide appropriate information to their suppliers, but they also provide distorted information, making it difficult to cooperative problem solving (Dirks & Ferrin, 2001). In this situation, bilateral governance is difficult to develop due to the distrust of the information the manufacturer has obtained from the supplier. As a result, Manufacturers who do not have interfirm benevolence on suppliers cannot rely on bilateral governance in dealing with uncertain environments. Therefore, it is proposed that

H4: Interfirm benevolence will moderate the relationship between environmental uncertainty and bilateral governance mechanism.

3. Discussion

The main purpose of this study is demonstrates situations in which different mechanisms function under uncertain environmental conditions. The paper proposes that the environmental uncertainty will have a positive impact on unilateral governance. However, the environmental uncertainty will have a negative impact on bilateral governance.

In terms of role of interfirm benevolence, interfirm benevolence provides a better understanding of how governance mechanisms can develop in an uncertain supply markets. First, if the manufacturer has no interfirm benevolence for the supplier, the manufacturer will respond to market uncertainty with unilateral governance (i.e., vertical control). When the manufacturers have interfirm benevolence in the suppliers, however, the effect of environmental uncertainty on unilateral governance is mitigated. Next, when there is no interfirm benevolence in the relationship between the exchange partners, flexible bilateral governance is unlikely to develop in an uncertain environment. However, when interfirm benevolence is included in the relationship between exchange partners, environmental uncertainty will no longer interfere with the development of bilateral governance (i.e., flexibility).

In summary, the results of this study suggest that manufacturers should consider the level of interfirm benevolence that they give to their suppliers to choose the proper governance mechanism to address environmental uncertainty. In an uncertain environment, manufacturers should consider choosing a unilateral governance if they do not have benevolence to their suppliers. Conversely, if a manufacturer has a benevolence for their suppliers, then bilateral governance should be considered to respond timely to uncertain markets.

3.1. Theoretical Implications

On the contrary to previous network researches, this study has several contributions to research in this field. First, while previous network researches in this field bassed on the interaction of business relationships to achieve individual interest (Wuyts & Van den Bulte, 2012), the current study focuses on the effect of network structure. By focusing on a specific network structure, this study make it easy to understand how macro-level environment influences firm's actions. Second, transaction cost analysis suggests that exchange partners should choose proper interfirm governance mechanism to cope with an uncertain environment. Exchange partners in an uncertain environment must control their partners vertically to improve performance. This study developed a more comprehensive theoretical framework by presenting the transaction cost theory with relationship contract theory. The framework proposes that those theories affect interfirm governance mechanisms together. The results suggest that manufacturers should keep in mind not only environmental uncertainty, but also the interfirm structure so as to build an appropriate governance mechanism.

3.2. Practical Implications

Manufacturers need to select and apply the most appropriate governance mechanisms according to their circumstances. Especially, for manufacturers who have interfirm benevolence to their suppliers, the manufacturer must use the relational norm of flexibility to respond to market changes in a timely manner. In order to cope with uncertain market demand, manufacturer should use the flexibility in their relationships with suppliers. Based on the interfirm benevolence between exchange partners, they will be able to response flexibly to uncertain demand for markets. As a results, bilateral governane contributes to better channel performance for manufacturers (Noordewier et al., 1990; Aulakh, Kotabe, & Sahay, 1996).

3.3. Limitations and Further Research

This study includes some limitations and several future researches. First, this study focuses only on the moderating effect of interfirm benevolence in the impact of environmental uncertainty on manufacturer's decisions of governance mechanisms. However, manufacturers' governance decisions can be influenced by other factors (i.e., network embeddedness, strong tie, weak tie).

Second, even though this paper concentrates on improving the governance mechanism selection process, it does not assess the performance of manufacturer under conditions of uncertain environments. Because the propositions are based on the assumption that the Exchange parties adopt the most efficient governance mechanism structure, it may be better to evaluate how each governance mechanism structure contributes to the manufacturer's performance. Therefore, in future studies, it is necessary to investigate the effect of each governance mechanism structure on performance in an uncertain environment and various level of interfirm benevolence.

Finally, This study does not explicitly suggest what is the most appropriate governance mechanism in situations where environmental uncertainty is low or environmental uncertainty is high. Thus, future research needs to be conducted as a continuum rather than a choice of governance mechanisms. The continuum is located where it can contribute to optimal governance mechanism in the present ambiguous location halfway between vertical control and flexibility.

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