

THE TERMINATION DILEMMA OF FOREIGN INTERMEDIARIES: PERFORMANCE, ANTI-SHIRKING MEASURES AND HOLD-UP SAFEGUARDS

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1. INTRODUCTION

For many exporting firms, success in foreign markets hinges to a large extent on the performance of their foreign intermediaries (Albaum, Strandkov, & Duerr, 2002; Ellis, 2000; Root, 1987). In spite of the key role played by intermediaries in foreign markets – i.e. sales agents and independent distributors (Solberg & Nes, 2002) – exporters often regard them as temporary arrangements and second-best alternatives to conducting foreign marketing, sales, and service activities in-house. The typical assumption is that foreign intermediaries are low-control entry modes (Hill, 2003; Root, 1987) that do not have the potential of exploiting the full sales potential of export markets. In other words, foreign intermediary arrangements could have inherent limitations that foster mediocre rather than excellent market performance. Several studies report that exporters generally distrust foreign intermediaries

Relationship between Exporters and their Foreign Sales and Marketing Intermediaries

Advances in International Marketing, Volume 16, 317–339

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ISSN: 1474-7979/doi:10.1016/S1474-7979(05)16013-X

and suspect them of shirking at any given occasion (Beeth, 1990; Nicholas, 1986; Petersen, Benito, & Pedersen, 2000). Poor performance is sometimes expected. On the other hand, foreign intermediaries often find that exporters put in place incentive structures that do not induce them to achieve excellent performance. Hence, it is asserted that foreign intermediaries may deliberately seek mediocrity rather than very poor or outstanding performance.

On this background, our study addresses the following four questions: First, how do different exporter-provided incentives affect the performance of foreign intermediaries? Second, what is the interrelationship between the market performance of foreign intermediaries and exporters' propensity to terminate the relationship, i.e. are foreign intermediaries caught in a termination dilemma? Third, do exporters differentiate the way they terminate the relationship depending on whether the intermediaries are low or high performers? Fourth, is the propensity of exporters to end intermediary relationships affected by the incentives put in place? To answer these questions, we draw on longitudinal survey data about the development – including termination – of relationships between Danish exporting firms and their foreign intermediaries.

The answering of the four questions is of great value to exporters in their efforts to design appropriate incentive structures for foreign intermediaries. In the absence of goal congruence between the two parties the exporters risk sacrificing potential sales revenue in foreign markets, and/or incurring the otherwise avoidable costs of prematurely establishing a sales subsidiary in a given market. The business press regularly quotes exporters for experiencing red digits during the first years of operation of sales subsidiaries, and occasionally reports shutdowns of non-profitable foreign affiliates, supposedly as a result of over-ambitious entries into markets where the sales revenue generated did not support the considerable fixed costs of setting up and running a sales subsidiary. These issues are general in the sense that they are relevant for entries into any market. In this study we look at the behavior of a sample of Danish exporters and their entries into, mainly, other developed markets. The importance of adequate incentive structures for foreign intermediaries is probably even more crucial in relation to entering emerging markets, such as China, India, and Vietnam (Ellis, 2000; Estrin & Meyer, 2004). Exporters may “miss the train” completely in these emerging market because competitors accrue important first mover advantages in terms of pre-emption of sales channels, sales outlets, and shelf space, or in terms of erecting other barriers to entry (Peng, 2000).

The rest of the paper is organized as follows: In the next section (Section 2) we develop our conceptual model, account for the basic incentives that exporters may put in place for dealing with intermediaries, and delineate the

relations between exporter incentives, intermediary performance, and termination of exporter–intermediary relationships. In Section 3 we develop hypotheses pertaining to the four research questions mentioned above. Section 4 accounts for the empirical methodology of the study, and Section 5 reports descriptive statistics and the results regarding testing the hypotheses. Finally, in Section 6 we conclude and discuss the implications of the study.

2. CONCEPTUAL FRAMEWORK

Research on export channels reveals that the relationships with foreign intermediaries are hard to coordinate and high performance is difficult to achieve (Bello & Gilliland, 1997; Rosson, 1984; Rosson & Ford, 1982; Solberg & Nes, 2002). Basically, poor performance can be explained in two ways (Porter & Lawler, 1968): (1) the intermediary does not possess the skills needed for carrying out the marketing and sales responsibilities in a proper way, and as a result the intermediary cannot perform satisfactorily; (2) the intermediary is well qualified, but does not want to devote or invest the time and resources needed to fully exploit the sales potential of the exporter's products, because, say, its interests are misaligned with those of the exporter. Hence, the intermediary under-performs deliberately.

Agency theory explains such shirking behavior by the reservation utility of the agent (Jensen & Meckling, 1976; Levintahl, 1988). Because agents find other activities (or leisure time) to be more rewarding, the sales effort they are willing to make is usually less than optimal from the viewpoint of the principal. In many principal–agent relationships the principal prevents the agent from shirking through monitoring. Since monitoring is both difficult and costly to employ in exporter–intermediary relationships, the anti-shirking instrument *sine qua non* that has traditionally been used is outcome-based compensation. Intermediaries get their income mainly, and sometimes exclusively, through outcome-based compensation, i.e. resale profits or sales commissions. This is in contrast to behavior-based compensation or fixed-salary schemes (Anderson & Oliver, 1987). To the extent that the sales performance is a direct function of the intermediary's effort, such arrangements should discourage shirking (Anderson & Oliver, 1987; Bergen, Dutta, & Walker, 1992). Hence, the “no-effort/no-compensation” principle is the baseline anti-shirking instrument used in exporter–intermediary relationships characterized by a fundamental information asymmetry and numerous alternative income opportunities for the intermediary. Nevertheless, asymmetrical information also implies that exporters may have serious difficulties in

verifying to what extent the actual sales performance in the foreign market is a result of the intermediary's effort or should be ascribed to fortunate or adverse exogenous factors. In some cases, intermediaries undeservedly take credit for sales generated through customers' familiarity with an exporter's product due to experience with it gained in another market, by word-of-mouth effects, from the exporter's website, etc. Conversely, intermediaries may blame poor sales performance on adverse exogenous factors, such as special local customer preferences, particularly tough competition, slow and protectionist local bureaucracy etc. In both cases, some degree of monitoring of the intermediary serves as an important anti-shirking supplement to outcome-based compensation, and hence a measure that potentially improves the performance of the foreign intermediary (Hennart, 1991). Furthermore, monitoring reduces the information asymmetry gap that exists in the exporter–intermediary relationship (Wathne & Heide, 2000) and makes it easier to assess and – if so needed – to exit the relationship with the intermediary.

Anti-shirking measures, including outcome-based compensation, monitoring, but also dual distribution (Dutta, Bergen, Heide, & John, 1995) and short notice of termination (Beeth, 1990), constitute only a part – although an important one – of the entire range of incentive mechanisms that is available to exporters. Likewise, outcome-based compensation, and a certain degree of exclusivity in terms of sales territory and/or product lines are standard parts of agency and distributor contracts. Exclusivity is granted with the purpose of encouraging the intermediary to undertake marketing investments with public good characteristics, such as advertising campaigns aiming to increase the awareness of the exporter's brand. Without the exclusivity rights, the intermediary assumes the risk of free-riding by other vendors in the trading area (Corey, Cespedes, & Rangan, 1989). In contrast, it is the exception that intermediaries are protected against adverse, exogenous factors. Agency theory prescribes that in relationships where the agent is risk adverse relative to the principal, behavior-based compensation should substitute for outcome-based. As a result, the risk neutral principal rather than the agent carries the risk burden of a volatile environment (Bergen et al., 1992). Presumably, the reduction in risk premium is traded-off against the anti-shirking benefits offered by outcome-based compensation.

Whereas foreign intermediaries almost by definition enjoy protection against free-riding, but not against adverse exogenous factors, it is largely up to the individual exporters whether or not the intermediary should be granted protection against opportunistic hold-up attempts of the exporters themselves.¹ Exporters may provide hold-up safeguards in order to induce intermediaries to engage in dedicated marketing and sales activities (Bello &

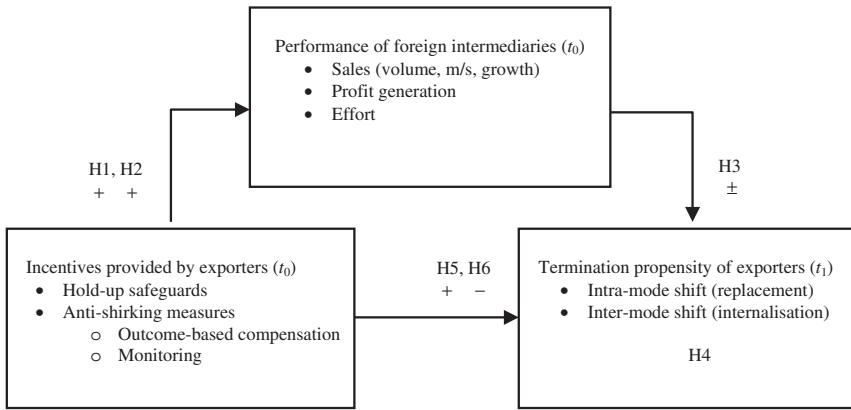


Fig. 1. Conceptual Model of the Study.

Gilliland, 1997). With safeguards in place, the intermediary can make the requisite relationship-specific marketing investments without risking getting held up by the exporter. Because of the safeguards the exporter is denied the potential short-term gain of exploiting the intermediary’s dependency. Ideally, the safeguards establish a common interest of the two parties in maintaining a long-term business relationship. As with monitoring instruments, hold-up safeguards potentially affect intermediary performance in a positive way, and thereby also the propensity to terminate the relationship. Nonetheless, the direct effect of hold-up safeguards on exporters’ propensity to terminate a relationship is opposite to monitoring; by their very nature, safeguards make it more difficult and costly to terminate relationships.

To sum up, the various exporter incentives have as a common objective to enhance intermediary performance. In addition, the incentives also affect exporters’ propensity to terminate relationships both directly and indirectly. This triad of exporter incentives, intermediary performance, and relationship termination is illustrated in Fig. 1, which shows the conceptual model of the study.

3. DEVELOPMENT OF HYPOTHESES

3.1. Effects of Incentives on the Market Performance of Intermediaries

When optimizing their reservation utility opportunistic intermediaries may concentrate on sales and marketing of other principals’ lines and just cash in

on the windfall gains that the line of the focal exporter yields (Bergen et al., 1992). In order to mitigate such moral hazard problems exporters may choose to supplement the outcome-based compensation with another anti-shirking measure, namely monitoring (Nicholas, 1986). For those intermediaries that achieve below-average market performance monitoring implies an increased risk of being terminated. Under the threat of outright termination of the relationship that exporters impose intermediaries will shun below-average performance, which pulls in the direction of better performance. Therefore,

H1. Exporters that use monitoring of the intermediary as an anti-shirking measure will experience higher performance in the foreign market.

Foreseeing a risk of being held up by the exporter, i.e. being terminated or forced to accept less-favorable terms under the threat of cessation (Heide & John, 1988; Williamson, 1983), the foreign intermediary may under-perform deliberately and effectively breach the distributor agreement. The exporter, on the other hand, has an evident interest in taking advantage of the full sales potential of the export market, since this means maximum sales revenue and usually lower average unit costs due to economies of scale in production and other value chain activities at home.

Hold-up risks tend to discourage the intermediary from doing a whole-hearted sales and marketing effort. As long as the safeguarding costs are not exceeding the resulting additional revenue from export sales and/or lower unit costs in production, it is in the exporters' own interest to safeguard the foreign intermediaries against the hold-up risks invoked by the exporters themselves.

Ideally, the foreign intermediary should receive a hold-up risk-adjusted payoff that increases proportionally or progressively with the sales generated in the foreign market, and that could even surpass the turn-over threshold that the exporter would need to run a sales subsidiary in that market. Exporters commonly offer their foreign intermediaries remuneration schemes that increase progressively with the sales volume generated in the local market. In the case of a sales agent the commission rate usually increases with sales growth, whereas independent distributors are often offered increasing resale profits via lower ex-factory buying-in prices as a result of quantity discounts extended by the exporter. Although such sales-varying compensation schemes spur the sales effort of the foreign intermediary, the attenuated risk of being replaced by a sales subsidiary has a countervailing effect that – in the absence of safeguards – may completely offset the incentives provided by the compensation scheme. The hold-up

risks of foreign intermediaries are increased by unilateral exporter-specific investments, of which a full writing-off of the specific investment depends on continued cooperation with the exporter. Hence, when intermediaries are safeguarded they should be able to perform well without having to assume the risk of a hold-up, which in turn would pull in the direction of better performance (Jap & Anderson, 2003). Accordingly,

H2. Exporters that extend hold-up safeguards to their foreign intermediaries will experience higher performance in the foreign market.

3.2. Intermediary Performance and Exporters' Termination Propensity

Several empirical studies have shown that it is not uncommon for exporters to exit their relationships with foreign intermediaries (Benito, Pedersen, & Petersen, 2005; Calof, 1993; Johanson & Wiedersheim-Paul, 1975; Rosson, 1984). In the marketing literature dealing with distribution channels, dissatisfaction is pointed out as a fundamental reason for manufacturers and distributors to part their ways (Anderson & Narus, 1990; Shamdasani & Sheth, 1995; Stern & El-Ansary, 1992). Also, in the internationalization literature Calof and Beamish (1995) report that exporters' dissatisfaction with their foreign distributors over a prolonged period is an important reason for terminating a relationship. In all, previous studies, and what one may call "conventional wisdom", suggest that exporters' termination propensity increase proportionately with the degree of dissatisfaction.

Exporters may replace the foreign intermediary with another intermediary in the same market. In this case, some degree of dissatisfaction with the intermediary is usually a triggering factor. In other words, poor performance of the intermediary, as conceived by the exporter, increases the likelihood that the collaboration comes to an end. Alternatively, the exporter may replace the intermediary with his/her own sales organization operating from the home country or located in the export market. In this case, it is less obvious that dissatisfaction with the intermediary is the only decisive motivator for the termination. The exporter's decision to integrate the sales and marketing responsibilities may be triggered by a large sales volume in the local market, which could in fact mainly be the result of the effort made by the intermediary (Klein, Frazier, & Roth, 1990; Nicholas, 1986). To the extent that ending the intermediary relationship can be ascribed to the successful sales generation of the same intermediary, this is an unfortunate and somewhat paradoxical consequence for the intermediary.

Presumably, intermediaries are, by and large, aware of the termination risk they are facing. In order to keep the assignment (i.e. the sales agency or the distributorship) intermediaries are therefore likely to aim for a medium performance. However, intermediaries cannot know exactly what the exporters consider as conditional for termination. Put differently, there are limits as to how well foreign intermediaries know the utility functions of their exporters. Furthermore, exogenous factors may affect the foreign market performance in an unforeseeable positive or negative direction. The sales revenue achieved in the foreign market, being only partially controlled by the intermediary, may turn out to be less than acceptable to the exporter, but also more than sufficient for establishing a sales subsidiary. In both cases, a likely result is termination.

Hence, both low and high performance will put the foreign intermediary at risk of being terminated. If performing poorly, the exporter may lose patience, terminate the relationship, and then appoint another intermediary in the foreign market (Beeth, 1990; Petersen et al., 2000); if the intermediary is doing well and boosting the sales in the foreign market, the exporter may find it lucrative to terminate the distributor contract and take over the sales and marketing responsibilities (Benito et al., 2005; Pedersen, Petersen, & Benito, 2002). Caught in this dilemma the foreign intermediary is better off staying “in the middle of the road”, i.e. generating a certain level of local sales, but not reaching a volume that economically justifies the exporter’s establishment of a sales subsidiary in the foreign market. As an alternative to conventional wisdom we therefore conjecture a “termination dilemma” of foreign intermediaries as follows:

H3. Exporters’ propensity to terminate relationships with their foreign intermediaries is first a decreasing function of intermediary performance, but then an increasing function of intermediary performance, i.e. U-curved.

The two alternative predictions, “conventional wisdom” versus “the termination dilemma”, are displayed graphically in Fig. 2.

3.3. Different Forms of Relationship Termination

The international marketing literature is full of accounts of the risks and problems associated with entry into foreign markets, and exporters do not expect foreign ventures to be totally trouble-free (Karunaratna & Johnson, 1997; Leonidou & Katsikeas, 1996). They anticipate and accept that entry

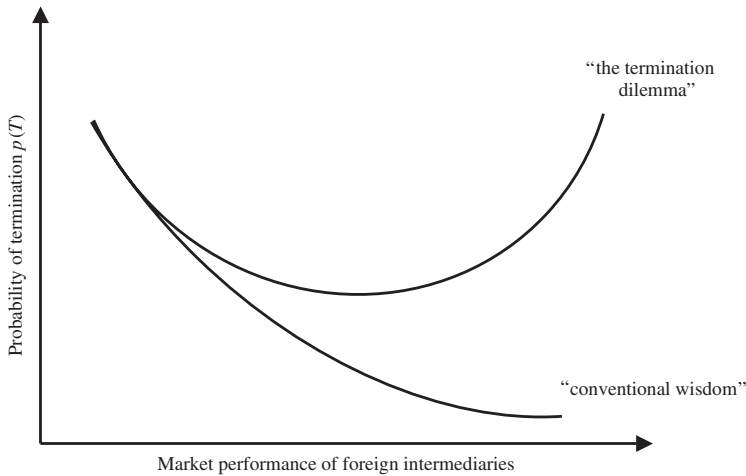


Fig. 2. Hypothesized Relationships between Performance of Foreign Intermediaries and Exporters' Propensity to Terminate.

into a market may take some time and that sales growth may be slow initially. Most exporters also recognize that foreign sales partly depend on a range of factors that are beyond the control of particular firms, such as exchange rates, changes in laws and regulations, weather etc., for which the appointed foreign intermediaries should not be blamed. They are nevertheless not prone to accept what could be regarded as consistent under-performance. Intermediaries that under-perform are hence likely to have their contracts terminated at some point. As pointed out earlier, well-performing intermediaries are also likely to see their contracts terminated since their market development work may turn out sales in excess of what is needed to cover the fixed costs of servicing the market through a sales subsidiary (Buckley & Casson, 1981). As a result, exporters may see the opportunity to set up their own businesses in the market.

While both low- and high-performers may therefore face higher likelihood of contract cessation than medium-performers, as hypothesized in H3, the type of switch is likely to differ depending on the behavioral characteristics of the intermediaries. Given that the exporter decides to stay in the market despite the unsatisfactory results,² poorly performing intermediaries are principally likely to be replaced by other intermediaries that the exporter believes will perform better (Benito et al., 2005). Such switches are of an intra-mode kind since they do not entail any change away from the original

mode of operation. Conversely, high-performers, having made the groundwork in the market, may see themselves substituted by a sales subsidiary set up by their former export contractor. These are inter-mode switches as they bring about a change in the operation method used in the foreign market:

H4. Low-performing foreign intermediaries are the most likely to be replaced by other intermediaries (intra-mode switch), and high-performing foreign intermediaries are the most likely to be replaced by a sales subsidiary (inter-mode switch).

3.4. Effects of Safeguards on Exporters' Termination Propensity

Exporter–intermediary relationships are characterized by a fundamental information asymmetry between the two parties. The asymmetrical information implies that exporters encounter serious difficulties in verifying to what extent low- or high-sales performance in the foreign market is a result of the intermediary's effort or should be ascribed to various adverse or positive exogenous factors (Bergen et al., 1992; Wathne & Heide, 2000). Taking advantage of exporters' widespread ignorance about local market conditions intermediaries may well piggyback on windfall sales gains that really are positive spillovers from other markets. Conversely, intermediaries may justify poor sales results by negative factors on which they have little or no influence, e.g. sluggish demand in the local market, pre-empted sales channels, or fierce price competition. Monitoring holds the potential of reducing the fundamental information asymmetry between exporters and foreign intermediaries (Wathne & Heide, 2000). Accordingly, monitoring makes it easier to evaluate and – if so needed – to exit the intermediary relation. As shown in Fig. 3, for any given performance level we propose that monitoring efforts shift the exporters' termination propensity upwards. Therefore,

H5. Exporters that apply monitoring as an anti-shirking measure have a higher propensity to terminate the relationships with their foreign intermediaries.

Transaction cost economics predicts that business relationships in which non-reciprocal investments in specific assets are required are more likely to develop successfully when suitable hold-up safeguards are introduced to support the relationship (Anderson & Weitz, 1992; Rindfleisch & Heide, 1997; Williamson, 1983). When safeguarded against hold-up, intermediaries become more willing to meet the exporters' expectations about relationship-specific investments, and this may in turn lower exporters' proclivity to terminate the

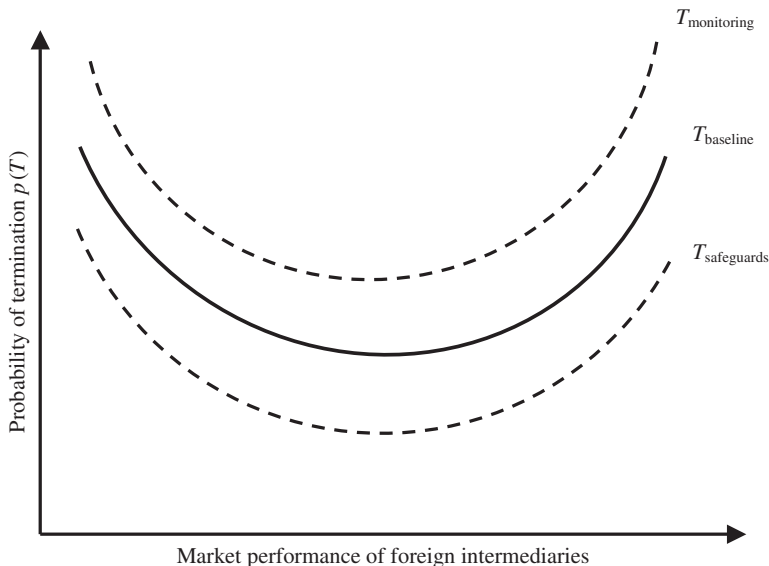


Fig. 3. Hypothesized Effects of Monitoring and Safeguards on Exporters' Propensity to Terminate.

relationship (Weiss & Anderson, 1992). By the same token, exporters' introduction of hold-up safeguards also works as a termination barrier in a more direct way: exporters that consider exiting intermediary relationships for other reasons than dissatisfaction (say, for example, due to unexpectedly strong export market growth) may be reluctant to do so because the hold-up safeguards that have been put in place make switches excessively costly (Benito, Pedersen, & Petersen, 1999). The self-imposition of termination costs is essentially what hold-up safeguards are about, and exporters may need this self-punishing mechanism to signal a credible commitment to the establishment of long-term relationships with foreign intermediaries. Contractual restrictions constitute barriers to exit, and it appears that distributor contracts regularly include clauses that make it difficult for the exporter (or for both parties) to walk out of the collaboration (Root, 1987; Rosson, 1984). Typical examples are long periods of notification or stipulated rights to compensation upon termination (severance payment).

Although exporters' safeguards may differ considerably as to the design of specific instruments, they share a common purpose of protecting the foreign intermediaries against opportunistic cessation or exploitation under

the threat of termination. Hence, as shown in Fig. 3, irrespectively of their actual performance intermediaries are expected to be at lower risk of being exited when exporters provide safeguards. Therefore,

H6. Exporters that provide hold-up safeguards have a lower propensity to terminate relationships with their foreign intermediaries than those that do not.

4. METHODS

4.1. Research Design

Because our model of the dynamics of export channels explicitly incorporates a time dimension, longitudinal data are needed to test it. For that purpose the data collection was conducted in two steps. The first step was to collect data about the distribution channels being used in the various foreign markets, and to map respondents' perceptions on a range of issues related to the relationship between exporters and their foreign intermediaries. These entry data were collected in 1992. The next step was taken in 1997, when information was again obtained about the status of operation modes in foreign markets. These data basically consist of information about changes in the distribution channel on the particular markets since 1992, the type of changes, and the year of a change given that it had taken place.

4.2. Data Collection

Data were collected in a survey of Danish manufacturing companies with export activities. The sampling frame consisted of basically all Danish exporters of some size and significance, in total 1,365 companies.³

In 1992, the identified export managers or, alternatively, managing directors of all companies received a detailed, mailed questionnaire. An earlier version of the questionnaire had been tested twice on export managers of two companies. Before answering the thirty questions, the companies were asked to select one export market that had been served by an independent intermediary over a continuous period of at least one year. In those cases where several export markets fulfilled the criteria, the respondents were asked to choose the market representing the largest sales potential (see Petersen (1996) for a detailed discussion of the selection criteria). Usable replies were received from 349 companies.

In 1997, the 349 companies were again contacted for a telephone interview on possible changes since 1992 in the operation mode used in the particular foreign market. Most of the interviewed persons were export managers responsible for the activities on the particular market. The aim of the interviews was to check whether the foreign market was still served in 1997 through an independent intermediary, or whether the Danish exporter had changed the operation mode on the particular market. In case they had carried out a mode change, we asked the respondents to list all changes of operation mode on that market from 1992 to 1997. For various reasons we had to exclude 91 companies from the initial sample of 349 companies.⁴ The final sample consists therefore of 258 companies.

4.3. Changes in Firms' Foreign Distribution from 1992 to 1997

Table 1 shows changes in foreign distribution channels from 1992 to 1997. The data provide interesting information about the frequency of switches of foreign operation mode: in 1997, 183 companies (about two-thirds of the sample) were using the same intermediary as in 1992. However, the remaining 75 companies had made some kind of change since 1992 in how they serviced the focal market. Of these, 40 companies (16 percent) were still represented in the foreign market by means of an independent intermediary, but had shifted to a new agent/distributor. Internalization had occurred in 35 companies (14 percent): These switches involved going from an independent intermediary to setting up their own sales organization (such as a establishing a sales subsidiary, a local sales office, or a home-based sales force), thereby "internalizing" the sales and marketing activities in the foreign market. All in all, the data show that changes in entry mode and shifts of foreign partner are quite frequent events.

Table 1. Changes of Foreign Market Servicing Method from 1992 to 1997.

Categories	No. of Cases
a. No major change in foreign distribution since 1992	183
b. Had replaced the intermediary	40
c. Had switched to in-house operation	35
Total	258

4.4. Measurement

Performance of intermediary, one of the dependent variables of the study, was measured as the exporters' perception of the focal intermediaries' performance. It was constructed on the basis of their responses to three questionnaire items: How does the company perceive the performance of the intermediary in terms of; (i) market penetration; (ii) profitability of export; and (iii) the effort made? The three items were then added to one single variable providing a summary measure of performance. Cronbach's coefficient α for the variable is 0.83.

Termination of intermediary relationship, the other dependent variable, was measured as a dummy taking the value of 1 if changes had occurred in the foreign distribution arrangement in the period covered by the study and 0 otherwise.

The monitoring variable was constructed on the basis of the questionnaire, where respondents were asked to assess the extent to which they found it difficult to monitor the effort of the foreign intermediary. Obviously, this is a proxy and not a direct measure of exporters' monitoring efforts. It is far from trivial to measure monitoring activities directly, and perceptions of the extent and intensity of monitoring may differ substantially among managers – in particular across industries. With increasing difficulties in monitoring agents, principals get diminishing returns to scale in conducting such activities. Accordingly, it should be expected that exporters who perceive significant monitoring difficulties would make relatively modest use of monitoring.

Two different hold-up safeguards were used; contractual restrictions and severance payments. Contractual restrictions were measured, as the period of time the intermediary should be notified in advance in case of termination of the agreement. It was coded as a binary variable with the value 1 if the notification period exceeded one year and 0 otherwise. Severance payment was measured by asking the exporters whether the intermediary was entitled to a portion of sales revenue for a specified period after termination of the contract. This was also coded as a binary variable with the value 1 if the intermediary should receive severance payment and 0 otherwise.

The level of asset specificity and characteristics of the focal markets were included as control variables in the empirical models. The two market variables were included in order to control for market developments outside the scope of the intermediary, such as a particular strong growth in a market. Thus, a lagged compounded growth rate of GDP in the foreign market was used as a measure of market growth. Sales potential was measured as the perceptions held by exporters of the sales potential in the foreign market.

Table 2. Description of Variables and Data Sources.

Variables	Measurement	Data Sources ^a
Termination of intermediary	Dummy: same intermediary as in 1992 (0), otherwise (1)	Telephone interview
Performance of intermediary	Exporters' perception of the performance of the intermediary in terms of: (a) market penetration, (b) profitability, (c) effort made (Scale: 1 = very dissatisfactory, 6 = very satisfactory)	Questionnaire
Monitoring	Question: "It is rather simple to monitor the effort of the intermediary" (Scale: 1 = fully agree, 6 = completely disagree) ^b	Questionnaire
Contractual restrictions	Advance notice in case of termination of the agreement (Dummy: 0 = less than one year, 1 = one year or more)	Questionnaire
Severance payments	Provision of severance payment in case of termination of contract? (Dummy: 0 = no, 1 = yes)	Questionnaire
Market growth	Growth in GDP at constant prices in the particular market, 1990–1995	World Marketing Data and Statistics 1997
Sales potential	Question: "Sales potential in that country is such that it could support having one's own sales organization for that market" (Scale: 1 = fully agree, 6 = completely disagree) ^b	Questionnaire
Asset specificity	Question: "To what extent are the sales of the intermediary contingent on marketing investments specific to the lines of the exporter?" (Scale: 1 = not at all, 6 = very much)	Questionnaire

^aQuestionnaire data were collected in 1992 and telephone interviews were conducted in 1997.

^bReversed scales.

Finally, asset specificity was also constructed on the basis of the questionnaire. The respondents were asked to what extent the foreign intermediary was expected to undertake investments in marketing assets in order to service the given exporter. The operationalization of the variables is summarized in Table 2.

5. RESULTS AND DISCUSSION

The correlation matrix and descriptive statistics of the variables are shown in the appendix. All correlations coefficients are relatively small, and do not

give any indication of potential multicollinearity problems. In fact, the highest coefficient is found between the two safeguards ($r = -0.27$), but perhaps surprisingly, this correlation is significantly negative. This suggests that these two safeguarding instruments are substitutes rather than complementary.

The first two hypotheses (H1 and H2) regarding the impact of monitoring and safeguards on intermediary performance were tested in an OLS-regression model (see Table 3). The first model only includes the three control variables, while the second model is a full model that includes all explanatory variables. Both models are significant ($F_{\text{base}} = 2.37$, $p < 0.10$, $F_{\text{full}} = 2.70$, $p < 0.05$), but the full model has substantially higher explanatory power, albeit still a modest one ($R_{\text{full}}^2 = 0.06$). In model 2, monitoring turns out to have a significant positive effect on intermediary performance thereby supporting H1. Conversely, none of the two safeguards seem to affect the intermediary performance. Hence, H2 is not supported by the data in the study. Asset specificity is the only control variable that is significant in the full model; the results indicate that relation-specific investments made by intermediaries have a negative impact on intermediary performance.

Hypotheses H3, H5 and H6 were tested by estimating a logistic regression model with termination of intermediary as the dependent variable. The results are shown in Table 4. In all, we run four models: one that only includes

Table 3. OLS Regressions of Effects on Foreign Intermediary Performance.

	Parameter Estimates (Standard Errors in Parentheses)	
	Model 1	Model 2
Intercept	2.98*** (0.22)	2.31*** (0.56)
Market growth	0.01 (0.01)	0.01 (0.01)
Sales potential	0.08** (0.03)	0.05 (0.04)
Asset specificity	-0.07* (0.04)	-0.07** (0.03)
Monitoring		0.12*** (0.04)
Contractual restrictions		0.04 (0.25)
Severance payment		0.12 (0.19)
Model statistics		
<i>F</i> -value	2.37*	2.70**
Adjusted R^2	0.03	0.06
Number of cases	258	258

*Significance at the 10% level.

**Significance at the 5% level.

***Significance at the 1% level.

Table 4. Logistic Regression Estimations of Exporters' Propensity to Terminate Foreign Intermediaries ($n = 258$).

	Parameter Estimates (Standard Errors in Parentheses)			
	Model 3	Model 4	Model 5	Model 6
Intercept	0.29 (0.48)	2.92*** (1.13)	3.35*** (1.16)	-0.50 (1.84)
Market growth	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)
Sales potential	0.01 (0.08)	-0.02 (0.08)	-0.03 (0.08)	-0.04 (0.08)
Asset specificity	0.11 (0.08)	0.08 (0.08)	0.08 (0.08)	0.07 (0.08)
Performance		-1.55** (0.70)	-1.50** (0.71)	-1.52** (0.72)
Performance ²		0.20* (0.11)	0.20* (0.11)	0.20* (0.12)
Monitoring			0.18* (0.10)	0.17* (0.10)
Contractual restrictions				-2.39*** (1.06)
Severance payment				-0.76* (0.42)
Model statistics				
χ^2	2.62 (3 <i>df</i>)	12.29** (5 <i>df</i>)	15.51** (6 <i>df</i>)	26.13*** (8 <i>df</i>)
Pseudo R^2	0.01	0.07	0.08	0.14
Hosmer-Lemeshow	7.20 ($p = 0.52$)	12.73 ($p = 0.12$)	6.49 ($p = 0.59$)	4.26 ($p = 0.83$)

*Significance at the 10% level.

**Significance at the 5% level.

***Significance at the 1% level.

the three control variables (model 3), and which does not reach an acceptable χ^2 value, and three that include predictors (models 4–6).

Models 4–6 are all significant, but it is evident that the model including the full set of explanatory variables (model 6) is by far the best in terms of fit.⁵ Results are very consistent across models, and adding predictors did not produce any substantial changes in the estimated relationships. To test the hypothesized U-shaped effect of performance on termination propensity (H3), the performance variable was also entered in quadratic form. The first-order effects of performance turn out to be significantly negative, while the second-order effects are significantly positive. This gives support to the hypothesis of a U-curved relationship between performance and the propensity to switch, i.e. a termination dilemma.

The regressions reveal that monitoring has the expected positive effect on termination propensity, while both safeguards have the expected negative effects. This provides support for both H5 and H6.

Hypothesis H4 was tested in an ANOVA-analysis testing for differences in the mean performance for inter-mode and intra-mode switches, respectively. While the average performance was found to be higher for inter-mode

shifts (2.84) than for intra-mode shifts (2.68), which is as expected, the difference in performance was not significant ($p = 0.47$).

6. CONCLUSIONS, IMPLICATIONS, AND FUTURE RESEARCH

Some recent studies, in particular Calof (1993), Clark, Pugh, and Mallory (1997), and Benito et al. (2005), demonstrate that foreign distribution arrangements are considerably more dynamic than what has traditionally been portrayed in the literature dealing with companies' choice of entry modes into foreign markets (Anderson & Coughlan, 1987; Anderson & Gatignon, 1986; Klein et al., 1990). This study adds to the increasing evidence that changes are commonplace in foreign distribution. Changes typically involve either that exporters replace a foreign intermediary with another (intra-mode change) or that they chose to integrate forwardly, i.e. carry out the sales, distribution and service tasks in a particular foreign market themselves, usually by setting up an affiliate in that country (inter-mode change). This study of a sample of 258 Danish exporters finds that about one-third of the studied cases had made such changes, fairly evenly split between the two types of changes just mentioned. The study has limitations – especially with regard to the restricted empirical context that was investigated and the somewhat crude measures that were used for some variables – and restraint should therefore be observed when interpreting and generalizing the results. The findings are nevertheless essentially consistent with the conceptual framework for the study.

The main contribution of this study is above all its extension of previous investigations of export channel dynamics by giving particular attention to the so-called termination dilemma in foreign distribution: because not only low but also high performance may increase the risk that a foreign intermediary faces regarding having its contract with the exporter ended, it makes sense for the foreign intermediary to settle for a moderate rather than excellent performance. This study indicates that there is indeed such a termination dilemma, but the analysis also investigates various ways in which exporters may deal with it. While it may be difficult to fully resolve the dilemma, at least there are measures that can alleviate problems to some extent.

Two crucial issues for managers of exporting firms are: (i) how to provide incentives that stimulate their foreign intermediaries to aim for above-normal performance and (ii) how to ensure that foreign intermediaries are willing to commit resources to relation-specific investments. Both these issues can be of vital importance for succeeding in foreign operations, but if

left unresolved the termination dilemma facing intermediaries is likely to be an effective barrier to achieving superior returns. Providing safeguards against contract termination is an apparent way for exporters to induce intermediaries to make the requisite efforts and investments. One could hence expect that exporters by using safeguards of various kinds, i.e. generous advance notification clauses and/or severance payment schemes, were also able to reap the potential benefits of smoother, longer-term, and possibly more trust-based relations with their foreign intermediaries. The findings of this study demonstrate that such reasoning – even if appealing in its positive vision of inter-firm relationships – is based on a one-sided and too optimistic view of the relationship between exporters and intermediaries. Providing safeguards without curbing intermediaries' self-interested behavior with appropriate anti-shirking measures, may well be in the interest of the intermediaries, but seemingly not helpful in achieving superior performance in the market place. As it turns out, the data in this study suggest that whereas monitoring is a major driver of performance, neither severance payment nor contractual restrictions have significant effects on performance. On the other hand, the results of this study do indicate that safeguards indeed reduce exporters' propensity to replace their intermediaries. Hence, safeguards help solving the termination dilemma that foreign intermediaries may face when entering into the higher end of performance. The key implication of the analysis is hence that managers should take both safeguards and anti-shirking measures into careful consideration when designing their governance of foreign intermediary relationships.

Safeguards have not been investigated in much detail so far. There are potentially many kinds of safeguards and this study has focused on two particular instruments: contractual exit impediments in the form of (i) advance notification and (ii) severance payment. As it turned out, these safeguards were negatively correlated with each other, which indicates that they are truly different types. Other types of safeguards are also used by firms, including offsetting investments (Heide & John, 1988) and development of personal ties across firms (Jap & Anderson, 2003). However, the full range of safeguards has not yet been mapped and there is evidently a need to explore such inter-organizational governance instruments in much more detail.

NOTES

1. Commercial law in many countries provide indemnification as a safeguard for sales agents against hold-up by a principal – in casu the exporter. In contrast,

merchant distributors, who usually take title to the goods and are being remunerated by the resale profit of these goods, often have limited protection from being held up by other parties. Because we cannot subdivide our sample of foreign intermediaries into categories of sales agents (commission agents) and independent merchant distributors, we cannot take this potentially important institutional safeguard into consideration.

2. Unsatisfactory results may of course also lead exporters to exit from the market altogether, at least temporarily. For analyses of market-withdrawal processes, see Welch and Wiedersheim-Paul (1980), Matthysens and Pauwels (2000). Since our data contain very few reported cases of total withdrawal from a market, we do not consider this option further.

3. Companies that in 1992 had only limited experience with exports (i.e. they only exported to neighboring countries) or had equity below US\$ 15,000 (at the 1992 DKK/USD exchange rate) were excluded from the sampling frame.

4. The three main reasons for sample dropout were: (i) liquidation or acquisition by another company (23 cases), (ii) lack of market information (22 cases), and (iii) cessation of sales to the particular market (15 cases). Additional reasons were, inter alia, that companies refused to answer (7 cases), and that we could not get in touch with the right person (6 cases).

5. The Hosmer-Lemeshow statistics is based on the difference between observed and expected frequencies for groups of intermediaries. The model is first used to calculate each intermediary's predicted probability of switch, and then to rank the intermediary according to this risk. The intermediaries are then grouped into "deciles of risk" and the goodness-of-fit statistics is calculated as a comparison of the expected and observed frequencies for the groups. If the Hosmer-Lemeshow statistics is low and the corresponding p value is large, the model is well-calibrated and with good fit to the data.

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APPENDIX. THE CORRELATION MATRIX AND DESCRIPTIVE STATISTICS OF THE VARIABLES ARE SHOWN IN TABLE A1.

Table A1. Correlation Coefficients (p Values in Parentheses) and Descriptive Statistics for Independent Variables.

	1.	2.	3.	4.	5.	6.	7.	8.
1. Market growth	1.00							
2. Sales potential	0.13** (0.03)	1.00						
3. Asset specificity	-0.06 (0.31)	-0.20*** (0.01)	1.00					
4. Contractual restrictions	-0.10 (0.13)	0.06 (0.35)	0.03 (0.63)	1.00				
5. Severance payment	0.01 (0.95)	-0.06 (0.37)	0.01 (0.98)	-0.27*** (0.01)	1.00			
6. Monitoring	0.05 (0.45)	-0.11* (0.08)	-0.01 (0.87)	-0.05 (0.41)	0.04 (0.53)	1.00		
7. Intermediary performance	-0.01 (0.88)	-0.09 (0.13)	-0.11* (0.07)	-0.02 (0.78)	0.05 (0.44)	0.19*** (0.01)	1.00	
8. Switch of intermediary	-0.04 (0.49)	0.01 (0.86)	-0.09 (0.16)	-0.15** (0.02)	-0.06 (0.32)	0.14** (0.03)	0.09 (0.13)	1.00
Mean	27.7	2.94	3.59	0.08	0.86	3.06	2.50	0.29
Standard deviation	14.1	1.81	1.85	0.26	0.35	1.46	1.01	0.45

*Significance at the 10% level.

**Significance at the 5% level.

***Significance at the 1% level.