

## **Market Knowledge and Governance Choice in International Marketing Alliances: Implications for Export Performance**

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### **Short Abstract:**

Academics note the importance of market knowledge and supplier specific investments on governance choice in international marketing alliances. While the role of property-based assets as a driver of formal governance selection is well documented, little work has been done on the impact of knowledge-based assets (market knowledge) on the selection of formal governance mechanisms. The impact of knowledge-based assets on the selection of relational governance mechanisms is also under attended in the literature. We investigate the selection of formal and relational governance mechanisms among European Buyer – Asian Seller dyads in the textile industry. Employing SEM to analysis 131 dyads we find that 1) market knowledge drives both relational coordination and formal contracting 2) supplier specific investments *do not* drive formal contracting but *do* drive relational coordination 3) the role of relational coordination is unique in explaining export performance in international buyer-seller scenarios. Implications for theory and practice are described.

*Keywords: Market Knowledge, Relational Governance, Marketing Alliances*

## **Introduction and Research Aim**

One of the critical constraints that augment the degree of uncertainty in international exchanges is the lack of host market knowledge (Johanson and Vahlne, 2009). Market knowledge expresses insight and understanding of foreign markets by means of the cognitive, normative, and regulatory domain of their local institutions (Zaheer and Zaheer, 2006). It is similar to what Johanson and Vahlne (2009) describe as the knowledge about a certain market's business practices that are acquired through actions and experiences. We investigate the function of market knowledge as an example of knowledge-based assets in the selection of governance mechanism. Additionally, we consider the impact of property-based assets, in this study we use supplier specific assets on the selection of governance mechanism.

Extant literature suggests that superior international market knowledge reduces the degree of uncertainty improving the options for internationalization into new markets and mitigating risks associated with opportunism (Cesinger et al. 2014). Formal coordination through contracts is considered alongside relational coordination as we map out the antecedent role of market knowledge and supplier specific investments. In this study, market knowledge refers to the extent to which a firm has understanding of the foreign market in terms of institutional (language, laws and rules) and market specific business knowledge (Johanson and Vahlne, 2009). Property-based assets refers to supplier specific assets such as investment in machinery or inventory.

This paper contributes to an understanding of the antecedent conditions of the buyer seller relationship in international inter-organizational exchange while empirically testing the role of governance types in driving performance. Specifically we: 1) examine whether market knowledge drives both relational coordination and formal contracting; 2) identify conditions under which supplier specific investments *do not* drive formal contracting but *do* drive relational coordination and; 3) demonstrate that the role of relational coordination is unique in explaining export performance for these cross cultural international buyer seller scenarios.

## **Background and/or Conceptual Model**

Firms achieving high market knowledge build normative assimilation, effectively reducing the 'liability of foreignness' (Johanson and Vahlen, 2009). This generates a more similar cultural understanding and empathy generating efficient social, clan-like control (Ouchi 1980). The resulting buyer seller behaviors are characterized by solidarity and flexibility. Market knowledge has the effect of facilitating better decisions on further investment, price setting and product adaptation. It also facilitates contact with buyers and some level of cultural assimilation resulting in the development of affective dimensions to the relationship (Blonska et al. 2013). Market knowledge therefore operates as a facilitator of trust and relationalism. Hence market knowledge contributes to relational coordination.

We consider that within the context of Asian suppliers exporting to European buyers, market knowledge plays a role in the selection of formal governance mechanisms. The terms of the contingent claims contract must be established between the buyer and seller and this is based upon an understanding of the market and conditions therein. Suppliers must gain market knowledge before they can satisfy themselves that the formal contract is accurate and will serve its intended purpose of protecting against opportunism (Cao and Lumineau, 2015).

Relational coordination requires mutual commitment. Forbearance under asymmetric asset investment is a behavior that aligns well with solidarity between buyer and seller (Cadaeux and Ng, 2012). Where the buyer has the possibility to act opportunistically one might expect the presence of the contract to prevent this. While in large part this is true, there is a level of cooperation represented by solidarity within relational coordination that is not explicitly accounted for in the terms of the contract and includes voluntary efforts by the buyer, where they are not obligated to act and where doing so is not in their immediate interests. These efforts are a clear signal that the buyer is not inclined to exploit any advantage offered by the presence of supplier specific investments and so under these circumstances supplier specific assets may lead to the selection of relational coordination mechanisms.

Formal contracting brings the negative aspects of a contingent claims contract that cannot carry all pertinent clauses under such complexity. The mechanism may also lack acceptance or compatibility in a society characterized by the prevalence of social contracts as is the case in the suppliers' context. In many ways, formal contracting stands as a monument to poor market understanding with associated poor export performance (Stoian, Rialp, and Dimitratos, 2017). Formal contracting further compels the supplier to operate managerial processes in ways that are culturally alien and thus inefficient. Inefficient working practices will reduce volumes, reduce revenue and increase costs, leading to a decrease in profitability.

### **Methodology**

A survey sample was drawn from Pakistan-based textile exporting firms and European importers. The data set is comprehensive in nature as it represents large and small private business groups in Pakistan, all the public listed textile firms on the local stock exchange, and all the respondent firms earned annual export revenues of more than US \$2 million. The survey used scales that we adapted measures from previous studies and modified them using scale development and pretesting to ensure validity. Each of the multi-item constructs was analyzed by inspecting the item-to-total correlation. Next, we calculated reliability of multiple items for each construct. The composite reliability of each construct is measured by Cronbach alpha and it ranged from 0.91 to 0.66, indicating acceptable levels of reliability for constructs. Next, confirmatory factor analysis (CFA) for the whole measurement model was carried out to verify unidimensionality (i.e., internal consistency) by using AMOS 24. The fit indices of the measurement model were within the acceptable limits ( $\chi^2/df = 1.64$ , CFI = 0.94, IFI = 0.94, TLI = 0.93, and the RMSEA = 0.07).

### **Results and/or Discussion and Contributions**

The empirical findings show that market knowledge leads to stronger relational coordination and that this in turn leads to better export performance. This indicates that Asian exporters consider strong relational coordination based on the norms of solidarity and flexibility will act as better governance solution in managing export related problems. The results indicate that relational coordination provides the required bilateral governance solution in managing export relationships. The relationship between market knowledge and formal contracting highlights European buyers' reliance on formal contracting to solve any ex-post transactional issues with Asian exporters. Hence, Asian exporters also rely on formal contracts with European buyers to show the legality of a business deal, attain social acceptance and fulfilling concrete export outputs.

An important contribution is the importance of relational coordination, based on solidarity and flexibility on export performance. These findings show that when export partners have strong relational links, export performance is enhanced. Even when Asian exporters unilaterally invest in specific assets, the quality of relationship act as a key determinant in export performance. Better relationship quality implies better coordination which enhances export performance. We interpret a compatibility of these two sub-dimensions, solidarity and flexibility as important and consider that solidarity builds relational capital while flexibility maintains it.

### **Implications for Theory and Practice**

The data was collected from a single exporting industry which limits the generalizability of the results. Our research findings are based on single emerging economy and single industry that may diverge from other emerging economies and industries. Future research could validate our findings in other emerging economies and manufacturing industries.

Managers should be aware that relational governance is possible across culturally different alliance partners and may go some way to address shortcomings in the contingent claims contract. Counter to some existing studies, we provide evidence that supplier specific investments may not be a limitation for the supplier in the international context with high initial institutional distance.

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