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Export Channel Dynamics: An Empirical Investigation

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We investigate the dynamics of export channel arrangements by modelling foreign operation method decisions as the interplay between factors that motivate switches and factors that deter them. Our model extends previous analyses by looking simultaneously at (1) no change of channel arrangement, (2) replacements of foreign intermediaries (within-mode shifts), and (3) integration of the sales function abroad (between-mode shifts). We use a multinomial logit model on longitudinal data from a sample of Danish exporters that had entered foreign markets through intermediaries. The results suggest that the decision to carry out within-mode shifts (i.e. to replace an existing intermediary) is driven by a different set of factors than the decision to switch to another foreign operation mode (i.e. to in-house operations). **Copyright © 2005 John Wiley & Sons, Ltd.**

INTRODUCTION

International firms commonly service foreign markets through local, independent operators, such as sales agents, merchant distributors, licensees, and franchisees. By 'externalizing' their foreign market activities international firms may avoid costs of foreignness, the penalty costs due to investments in underutilized local marketing or manufacturing capacity, and the deployment of scarce management resources. Previous studies of international distribution channels have focused on the modes of entry into foreign markets (e.g. Anderson and Coughlan, 1987; Klein *et al*., 1990). Nevertheless, there is ample empirical evidence that with the passage of time many firms change their arrangements with the local operators (e.g. Johanson and Wiedersheim-Paul, 1975; Calof, 1993; Clark *et al*., 1997; Pedersen *et al*., 2002). Although various reasons for making changes have been pointed out, our knowledge about change of foreign operation modes remains sketchy and unsystematic.

In this paper we develop and test a model of mode-switch decisions. Specifically, we look at switches related to one particular foreign operation mode; namely, exporting through a foreign intermediary such as a sales agent or merchant distributor. Changes in an export channel arrangement that involves an intermediary can basically be one of two types: either the foreign intermediary is replaced by another (within-mode switches) or the principal switches to another operation mode (between-mode switches). Studies of between-mode and within-mode switches have been reported in the international business literature, but previous studies have several shortcomings. The studies of Calof (1993) and Clark *et al*. (1997) are largely exploratory studies. Although they

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provide valuable insights on the occurrence of switches and of firms' motives for making them, the studies are only loosely grounded on theory and do not present actual tests of hypotheses. Fina and Rugman (1996) present an in-depth study of the pharmaceutical company UpJohn. They report that while that company had usually entered new markets with an agreement with a local distributor or agent, in a majority of markets it had later on shifted to modes providing higher degree of control such as setting up its own sales office. Their findings provide support to the internalization (or transaction costs) theory of international operations, but given their one-case design their findings obviously remain tentative. The studies of Petersen *et al.* (2000) and Pedersen *et al.* (2002) develop and test specific hypotheses based on transaction cost and agency theories, but the empirical scope of the studies is limited. The study by Petersen *et al.* (2000) is confined to replacements of foreign intermediaries, whereas Pedersen *et al.* (2002) focus on the decision to integrate foreign sales operations. It seems generally doubtful that a principal concerned about whether or not to make a change to an existing distribution set up in a foreign market, either due to dissatisfaction with existing local agents or for some other reason, would consider just one particular option. Taking into consideration a wider range of the alternatives available to firms would give a more realistic treatment of export channel dynamics, but to our best knowledge no study has so far rigorously examined between-mode and within-mode switches simultaneously.

Channel arrangement alternatives are usually mutually exclusive, even though one can think of situations where modes are combined (Benito and Welch, 1994; Dutta *et al.*, 1995; Petersen and Welch, 2002).[1] Since there is no reason to expect that firms, generally, have preconceived opinions about whether keeping the existing arrangement (no switch), a within-mode switch, or a between-mode switch should be chosen, they are also real alternatives available to them. Our analysis draws on extant literature on foreign operation methods, especially that based on organizational economics (transaction cost and agency theory) and the internationalization process of the firm, but extends it by developing a model that includes all three options; hence, providing a more reasonable treatment of foreign distribution decisions. Building on Weiss and Anderson (1992) and Benito *et al.* (1999), the model covers change-inducing factors, which are termed switch motivators, and change-impeding factors, the so-called switch deterrents (or switching costs). The inclusion of switch deterrents means that the model takes into consideration the potential importance of path-dependence effects when analyzing companies' efforts at adapting to changed internal and external conditions. We test the model using a comprehensive set of data on 260 Danish exporters, and find good support for the model.

The paper is organized as follows. In the next section, we outline the determinants of export channel dynamics, distinguishing between those factors that motivate switches and those that work against making switches. We then describe the methodology and data of the study, followed by a presentation and discussion of the empirical results. The concluding section points out implications of the findings and makes suggestions for further research.

DETERMINANTS OF EXPORT CHANNEL DYNAMICS

In order to model changes in foreign market servicing, let us assume that at a given point in time t, all in a set of companies exporting to a foreign market use intermediaries as their means of selling to that market. Using intermediaries is a way of achieving scale benefits while retaining the high-powered incentives of markets since their remuneration depends on sales volume. Thus, from an efficiency perspective, the initial use of intermediaries can be regarded as the baseline choice for foreign market entrants. As noted in the preceding section, this may change over time. During a given time interval, say t to $t + \Delta t$, while many companies may have chosen not to make any changes on how they service the market, some companies may have carried out changes; either by replacing the intermediary or by internalizing their operations. The event y_i of one of the three outcomes is defined as

$$y_i = \begin{cases} 0 \text{ no switch,} \\ 1 \text{ switch to new intermediary,} \\ 2 \text{ switch to new operation mode} \end{cases}$$

In principle, changes can, if they do take place, occur at any point in time during the interval $[t, t + \Delta t]$. What factors explain the probability

that a company over a period of time will choose one of the three outcomes as to how it operates in a foreign market?

Changes in the way exporters organize their sales activities in foreign markets depend basically on factors that motivate switches and factors that work against making switches. The former are hereafter called 'switch motivators' while the latter are labelled 'switch deterrents'. The two types of factors work in opposite directions. Motivators are factors that to some extent reduce the perceived utility of continuing with the current setup regarding foreign sales, and which should therefore increase the probability of making alterations to the current organization of export sales. In contrast, switch deterrents are the set of factors that make it difficult or costly to carry out such changes; these factors have hence also been labelled 'switching costs,' see Benito *et al.* (1999). We start with an outline of the switch motivators.

Switch Motivators

Earlier studies of the organization of export channels suggest that important switching motivators are: (i) export market growth; (ii) growth of the exporting company; (iii) the exporter's accumulation of market knowledge; (iv) the selection of intermediaries; (v) controlling issues; and (vi) specific assets.

First, export market growth should work as a switch motivator inasmuch as it is an indication of the expected sales volume in the foreign market in question. Export market growth has been shown to be an important discriminating factor in the choice of distribution channels in foreign markets (Klein *et al.*, 1990; Campa and Guillén, 1999). Since a sales subsidiary entails higher fixed costs for the exporter than using an intermediary, it can only be justified if the sales volume is sufficiently large (Buckley and Casson, 1981).

Second, as an exporting company grows it gets access to more financial and managerial resources. This should work in favor of choosing more high-commitment modes, which can be quite resource demanding both in terms of financial means and managerial capacity (Penrose, 1956; Welch and Luostarinen, 1988; Leonidou and Katsikeas, 1996).

Third, the gradual accumulation of market knowledge reduces uncertainty and may make high-commitment investments in a foreign market appear less risky (Johanson and Vahlne, 1977; Ellis, 2000). Accumulation of market knowledge may also prompt an exporting firm to consider replacing its local representative with a new one. As the exporting firm gets more knowledgeable about the foreign market it may spot other local intermediaries that appear to be more skilful and enthusiastic (Petersen *et al.*, 2000). As we discuss below, such a scenario is particular likely if the selection process leading to the appointment of the first intermediary has been a haphazard one.

Fourth, switches may be a result of the intermediary selection procedures used by exporters. A number of studies report that poor performance by the intermediaries is an important reason why exporters change the ways they operate in foreign markets (e.g. Anderson and Narus, 1990; Calof and Beamish, 1995; Pedersen *et al.*, 2002),[2] but why do exporters appoint intermediaries that apparently have less than adequate qualifications? One reason is that exporters economize on search costs and instead learn about the true qualifications of intermediaries through experience. Managerial decisions on international partner selection are often unsystematic and based on little information (Kobrin *et al.*, 1980). There is no reason to believe that exporters differ in that respect: in fact, there is ample evidence of the 'first come, first hired' principle being commonly used by exporters when recruiting foreign intermediaries (Welch and Wiedersheim-Paul, 1980; Shipley, 1984; Calof, 1993; Katsikeas *et al.*, 1997). Exporters that carry out such learning-by-experience recruitment practices (in contrast to conducting careful screening procedures) will, to varying degrees, anticipate a future switch of the intermediary either in the form of a replacement by another, more qualified intermediary, or by switching to in-house operations. Since careful screening procedures are costly, the value of implementing them will vary across firms. Companies that export differentiated, branded products can be expected to be particularly cautious about their choices of intermediaries since a mediocre or, even worse, an incompetent intermediary may easily jeopardize the reputation of their company and products. Such companies are likely therefore to use more resources identifying qualified intermediaries than are companies that export standardized goods.

Fifth, the level of intermediary shirking will be affected by the extent to which exporters are able to monitor and measure the activities and outcomes of the intermediary (Eisenhardt, 1989; Hennart, 1990; Bergen *et al*., 1992). In a study of Canadian exporters and their foreign intermediaries, Klein and Roth (1993) found that exporters tended to be less content with their intermediaries the higher the level of uncertainty and the lower the ability to monitor them. It is hence likely that exporters experiencing difficulties in monitoring and controlling their foreign intermediary are more prone to consider switches.

Sixth, the decision to replace an intermediary may also be related to the need for *ex post* relationship-specific investments. Even if the exporter is able to identify the most qualified intermediary in the local market through a careful search and selection procedure, the intermediary may have to undertake relationship-specific marketing investments—in training the salespeople, by investing in show rooms and demo equipment, in identifying potential customers, etc.—without which the sales potential of the exporter's products would not be fully exploited in the local market. If undertaken, these relationship-specific investments will expose the intermediary to a hold-up risk (Williamson, 1983; Rubin, 1990; Rindfleisch and Heide, 1997). The exporter may (mis)use the intermediary's unilateral dependency to obtain better terms than were initially agreed upon under the threat of terminating the relationship. In anticipation of such hold-up potential, the intermediary may decide not to undertake the relationship-specific marketing investments. In that situation, the intermediary cannot perform satisfactorily because of its unwillingness to undertake the relationship-specific investments required by the exporter. Based on such concerns, one would expect that the probability of developing dysfunctional relations is especially high for those exporter-intermediary dyads that require non-negligible, non-reciprocal relationship-specific investments.

The various switch motivators point toward a change of the current foreign intermediary: either switching to another foreign intermediary or to an in-house operation. In the absence of switch motivators the exporter will most likely maintain the existing channel arrangement. The two switching alternatives differ with respect to risk, commitment and required resources. As a result, different switching motivators should be expected to determine whether an exporting company just makes a replacement of the current foreign intermediary or whether the operation mode itself is changed. In the former case, one would expect the motivation for changing to be very much related to uncertainty about the true effort and qualifications of the current intermediary, but not with changes in internal (company) or external (environmental) conditions.

Physical and cultural distance to a foreign market generate problems as to disclosing whether a particular intermediary has the characteristics the exporters are seeking and to what extent the intermediary is in fact carrying out the activities agreed upon. Cases of relationship termination indicate that such problems often underlie dysfunctional relationships (Karunaratna and Johnson, 1997), which in turn increase the exporters' desire to switch to intermediaries with properties more aligned with their own interests. Accumulation of market knowledge, ability to monitor the current intermediary, and learning-by-experience practices are all issues associated with the hidden information problems of recruiting the right intermediary. Consequently, these factors should be expected to have an impact on the likelihood of replacing an intermediary with another. In contrast, export market growth and growth of the exporting company are both change factors that erode the economic rationale of using intermediaries *per se*, but that have little to do with the characteristics of the individual intermediary. Similarly, asset specificity expectations can primarily be seen as an important make-or-buy determinant (Rindfleisch and Heide, 1997): high asset specificity expectations pull in the direction of in-house operations, but should have little impact on the identity of particular intermediaries (unless one assumes that intermediaries differ substantially in terms of their attitudes to hold-up risks). Hence, as displayed in Table 1, we hypothesize that only a sub-set of the mentioned switch motivators are expected to invoke replacements of intermediaries, whereas switches to in-house operations are likely to be affected by the full range of motivators. Reduction of uncertainty about the characteristics of foreign intermediaries will not necessarily reveal better alternatives. Becoming more knowledgeable about the characteristics of all relevant intermediaries in a foreign market may lead the exporters to the conclusion

Table 1. Expected Effects of Switch Motivators on the Choice of Distribution Channel

	Switch to another intermediary	Switch to in-house operation
Export market growth	No effect	+
Growth of exporting company	No effect	+
Accumulation of market knowledge	+	+
Selection of intermediary	+	+
Control difficulties	+	+
Asset specificity	No effect	+

that they are better off switching to an in-house operation.

Switch Deterrents

In our model, 'the flip side of the coin' consists of a range of switching deterrents, i.e. factors that hinder or make it costly to make changes in the distribution channel. Hence, the chosen way of operating in the foreign market may become difficult and costly to change (Anderson and Coughlan, 1987; Buckley and Casson, 1998; Benito *et al.*, 1999), and demand thoughtful consideration by top management.

In this way, switching deterrents hold the potential of creating path-dependence effects of firms' foreign operation methods. We expect that decision makers assess current foreign operation methods in terms of their remediable efficiency (Williamson, 1996), i.e. the decision makers compare current organisational forms with feasible, rather than hypothetical, alternatives. Inspired by Coase (1964), Williamson introduced the notion of remediable efficiency in the context of the politics and economics of redistribution:

> 'The appropriate test of 'failures' of all kinds—markets, bureaucracies, redistribution—is that of remediableness: *An outcome*, *for which no feasible superior alternative can be described and implemented with net gains*, *is presumed to be efficient*. (...) Thus, even if mode A is judged to be inefficient in relation to mode B on a simple side-by-side comparison, if mode A is in place and mode B incurs setup costs, then mode A may prevail.' (Williamson, 1996, p. 195—italics as in original)

Interpreted into our context of foreign operation methods, an alternative organizational form—such as a sales subsidiary—appears superior only if its net gains (e.g. gauged as the present value of future income streams less any incurred take-down and setup costs) exceed the net gains of the current organizational form. However, Williamson pushes the remediable efficiency argumentation even further by arguing that what may seem as an inefficient form of organisation in a private sector where property rights are well defined, may not be so in a remediable sense when property rights are poorly defined and costly to enforce. In the absence of well defined, easily enforceable property rights the most cost effective way to protect property rights in a business relationship involving specific investment (and a concomitant hold-up risk) is to impose take-down or setup switching costs on one, or both, parties in case of termination. Hence, what may seem as 'inefficiency by design' (Williamson, 1996, p. 198–199) in comparison with some ideal but unrealistic property right regime could actually be efficient organizational solutions in a remediable sense. To illustrate the point, Williamson (1996, p. 198 referring to Heide and John, 1988) provides the example of manufacturers' agents that sometimes incur added expenses, over and above those needed to develop the market, because such added expenses are a cost-effective way of strengthening customer bonds. As a result, the manufacturers are deterred from expropriating the agents' quasi-rent of market development investments by entering into the distribution stage.

Acknowledging the remediable efficiency of foreign operation methods as the relevant criterion, we identify four forms of switching deterrents, whereof two relate directly to the problem of engaging the foreign intermediary in relationship-specific investments.

In their study of relationships between US electronic component manufacturers and their US intermediaries ('representatives') Weiss and Anderson (1992) found that relationship-specific ('idiosyncratic') investments by the intermediaries increased manufacturer satisfaction. Conversely, manufacturers tended to get frustrated if idiosyncratic investments were expected, but did not materialize. 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 (Williamson, 1983; Anderson and Weitz,

1992; Rindfleisch and Heide, 1997). When safeguarded against hold-up, intermediaries become more willing to meet the exporters' expectations about relationship-specific investments, and this will in turn lower exporters' proclivity to make intermediary replacements or to change to in-house operations. However, the introduction of hold-up safeguards also works as a switch deterrent in a more direct way: exporters that are considering to make switches—say, for example, due to strong growth in the export market—may generally be reluctant to do so because the hold-up safeguards that have been put in place make switches excessively costly. The self-imposition of switching or 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. Exporters seemingly agree that contractual restrictions can be barriers to exit. It is common that distributor contracts include clauses that make it difficult for the exporter (or for both parties) to walk out of the collaboration (Rosson, 1984; Root, 1987); in particular, long periods of notification or a stipulated right to compensation upon termination (severance payment). Another switch deterrent in the form of hold-up safeguards is the handing over of after-sales activities to the local intermediary. By doing so, the exporter imposes a potential loss of local sales revenue as a result of customer loyalty residing with the terminated intermediary (Corey *et al*., 1989). As earlier referred to, Heide and John (1988) observed that intermediaries engaged in 'offsetting investments,' including customer loyalty creating measures, thereby holding the local customers hostage as a hold-up safeguard.

In addition to these two 'take-down' barriers we can also identify two 'setup' barriers that may deter exporters from making switches (Weiss and Anderson, 1992). In case exporters decide to go in-house, i.e. decide to employ their own staff to carry out the marketing activities in the foreign market, new marketing personnel need to be recruited and trained. The setup costs related to recruitment and training of new salespeople can be substantial (Jackson, 1985; Corey *et al*., 1989). Again, this switch deterrent is to some extent associated with a hold-up safeguard. Exporters may decide not to develop any contacts with the local market other than through the appointed local intermediaries, thereby rendering themselves largely ignorant about how to set up in-house operations. Alternatively, exporters may organize markets contacts around the intermediary, e.g. through the establishment of dual distribution channels, thereby attaining a bridgehead in the intermediaries' sales territory that would facilitate a future switch to an in-house operation. In the latter case, exporters increase their opportunities for holding up the foreign intermediaries instead of safeguarding them (as in the former case).

The other 'setup' barrier has to do with the exporter firm itself rather than the relationship with an intermediary. When 'going direct' the exporter may incur foreign operation learning costs. Being a novice in international business an exporter must expect to make several initial failures (Welch and Wiedersheim-Paul, 1980). For example, revenue losses must be expected until the new staff has gained adequate experience from conducting customer-related activities in the foreign market.

Table 2 summarizes our hypotheses regarding the expected effects of the various switching deterrents on the choice of foreign distribution channel. The expected impacts of these four types of switching deterrents differ depending on the type of switch that a firm makes. On one hand, contractual restrictions as well as potential losses of sales revenue are clearly relevant to take into account when considering whether a foreign intermediary should be replaced. On the other hand, recruitment and training costs as well as foreign operation learning costs pertain principally to establishing in-house operations. As a consequence, such costs should mainly affect the decision to switch from an intermediary to using an in-house sales-force.

Table 2. Expected Effects of Switch Deterrents on the Choice of Distribution Channel

	Switch to another intermediary	Switch to in-house operation
Contractual restrictions	—	—
Loss of sales revenue	—	—
Recruitment and training costs	No effect	—
Foreign operation learning costs	No effect	—

METHODS

Research Design

In order to examine the dynamics of export channels based on the model sketched out earlier, longitudinal data are needed. For that purpose, data were collected 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 possibilities and problems related to switching operation modes. The collection of these entry data was conducted in 1992. The next step was taken in 1997, when information was obtained about the occurrence of actual switches of foreign operation modes. The switch data basically consist of information about changes, if any, in the distribution channel on the particular markets since 1992, and the year of a switch given that it had taken place.

Step 1: Entry Data

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 1365 companies.[3] In 1992, the identified export managers, or—as a second choice—managing directors of all companies in this population received a detailed, mailed questionnaire. The questionnaire had been tested twice prior to distribution on the export managers of two companies. Before answering the thirty questions included in the questionnaire, the companies were asked to select 1 export market that had been served by an independent intermediary over a continuous period of at least 1 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 from 349 companies were received.[4]

Step 2: Switch Data

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 Danish exporter still served in 1997 the foreign market via an independent intermediary, or whether it had changed the entry mode on the particular market. In case they had changed the entry mode, 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 89 companies from the initial sample of 349 companies.[5] The final sample consists therefore of 260 companies.

Mode Switches from 1992 to 1997

Table 3 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, 182 companies (two-thirds of the sample) were using the same intermediary as in 1992. However, the remaining 78 companies had made some kind of change since 1992 in how they serviced the focal market. Of these, 42 companies (16%) 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 36 companies (14%). Such 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 far from infrequent occurrences.

Table 3. Changes of Foreign Market Servicing Method from 1992 to 1997

Categories	No. of cases
(a) No major change in foreign distribution since 1992	182
(b) Had replaced the intermediary	42
(c) Had switched to in-house operation	36
Total	260

Measurement

Our first set of variables comprises the various switching motivators (M). The two variables 'growth of market' (M_1) and 'growth of company' (M_2) were both based on secondary data. A lagged specification (2 years lag) was used because it is reasonable to expect a certain time lag until changes in growth rates affect decisions about foreign operation methods. Thus, the growth rate of GDP from 1990 to 1995 in the foreign market was used as a measure of market growth. This is a rough proxy covering the general development in the foreign country, and not the growth in the market of the particular product *per se*. Unfortunately, it was not possible to get a more disaggregated, and hence better, measure of early market growth. The growth of the company was measured as the employment growth (number of employees) over the period 1990–1995.

Following other studies on firms' internationalization process (Welch and Luostarinen, 1988; Eriksson *et al.*, 1998), the time spent in a particular foreign market was used as a proxy for 'accumulation of market knowledge' (M_3). The variable was measured as the number of years since the company had made the first agreement with the particular foreign intermediary. This variable was entered in logarithmic form in order to capture the decreasing rate of knowledge accumulation.

The variable 'intermediary selection' (M_4) was captured on the basis of splitting the sample in two: one group consisting of producers/vendors of consumer goods, and the other group including producers/vendors of industrial products. The judgment underlying the distinction between those two broad categories of firms is that producers/vendors of consumer goods will generally be more careful in their selection procedure because the integrity of their international brands is at stake. Substandard intermediaries may not only fail to exploit the local sales potential, but may also cause damage to the international reputation of the producer and provoke a deterioration of the brand values. In general, branding is more important to producers/vendors of consumer goods than to producers/vendors of industrial goods (Kotler, 2001). Providers of industrial and intermediate goods and services are less motivated to invest time and money in crafting careful screening procedures and to be more inclined to content themselves with learning-by-experience practices.

'Control difficulty' (M_5) was constructed on the basis of the questionnaire. Respondents were asked to assess the extent to which they found it difficult to control the effort of the foreign intermediary (a 7-point Likert scale was used).

Finally, the switch motivator 'asset specificity' (M_6) was also constructed on the basis of the questionnaire. The respondents were asked to what extent (indicated on a 7-point Likert scale) the foreign intermediary was expected to make investments in marketing assets in order to service the given exporter.

Our second set of variables comprises the various switch deterrents (D). 'Contractual restrictions' (D_1) were measured straightforwardly as the period of time the intermediary should be notified in advance in case of termination of the agreement. Whether the foreign intermediary was taking care of after-sales activities was used as a proxy for 'loss of sales revenue' (D_2). Following Heide and John (1988), the reasoning is that foreign intermediaries that offer such services are more likely to get loyal customers, which in turn increases the exporter's loss of sales revenue in case of termination. As in the Weiss and Anderson (1992) study, the companies were asked directly about their assessments of the 'recruitment and training costs' (D_3) involved in setting up their own sales force for the foreign market. The share of total turnover originating from the Danish home market (i.e. the inverse of foreign sales) was used as a proxy for 'foreign operation learning costs' (D_4).

In addition to the aforementioned variables, 'cultural distance' to the focal, foreign market and the degree of 'law enforcement' in that market were included as control variables (C) in the empirical model. The two variables are included in order to capture external as well as internal uncertainty (Anderson and Gatignon, 1986) as perceived by the exporter. Cultural distance (C_1) may be seen as a general measure of foreign market uncertainty in general. Cultural distance was measured by the Kogut–Singh index (Kogut and Singh, 1988), which is a composite index based on Hofstede's (1980) four cultural dimensions (power distance, uncertainty avoidance, individualism–collectivism, and masculinity–femininity). The index gives a metric for the

cultural distance between Denmark and the various foreign markets.

The degree of law enforcement relates specifically to the exporter's uncertainty about property rights definition and protection—including contract enforceability—as performed by the local judicial authorities. As such, the law enforcement conditions of the host country may determine the need for bilateral organizational arrangements that mitigate opportunistic behavior of the contract parties, *in casu* the exporter and the foreign intermediary. To control for differences in law enforcement a Rule of Law index was included as a second control variable (C_2). The Rule of Law index is constructed by The World Bank as a composite index based on a number of different governance indicators, such as Standard and Poor's DRI on enforceability of contracts and costs of crime and the World Competitiveness Yearbook on confidence in administration of justice and protection of property, etc. (Kaufman *et al.*, 1999). The operationalization of the explanatory variables is summarized in Table 4.

A correlations matrix and descriptive statistics on the independent variables are presented in Appendix A. The correlation matrix displays relatively few significant correlations and very few that are highly significant. The correlation between cultural distance and law enforcement is the highest with a coefficient of −0.62. This indicates multicollinearity problems in a model that includes both cultural distance and law enforcement.

Table 4. Description of Independent Variables and Data Sources

Variable	Measurement	Data sources[a]
Switch motivators		
M_1 Growth of market	Growth in GDP at constant prices in the particular market from 1990 to 1995 (in %)	World Marketing Data and Statistics 1997
M_2 Growth of company	Growth in employment (in 100 s) from 1990 to 1995 (in %)	CD-Direct's database on Danish companies
M_3 Accumulation of market knowledge	Log of number of years since the company made the first agreement with a foreign intermediary in the market	Interview
M_4 Selection of intermediary	Dummy variable: 0 = producer/vendor of consumer products; 1 = producer/vendor of industrial products	CD-Direct's database on Danish companies
M_5 Control difficulties	How difficult is it to monitor the effort of the intermediary? (Likert-scale: 1 = very simple, 7 = very difficult)	Questionnaire
M_6 Asset specificity	To what extent are the sales of the intermediary contingent on marketing investments specific to the lines of the exporter? (Likert-scale: 1 = not at all, 7 = very much)	Questionnaire
Switch deterrents		
D_1 Contractual restrictions	The period of time the intermediary should be notified in advance in case of termination of the agreement	Questionnaire
D_2 Loss of sales revenue	Is the foreign intermediary taking care of after-sales activities? (dummy: 0 = yes, 1 = no)	Questionnaire
D_3 Recruitment and training costs	What would be the costs if the company had to recruit and train its own sales force for the particular market? (Likert-scale: 1 = expecting minimal costs, 7 = expecting significant costs)	Questionnaire
D_4 Foreign operation learning costs	Domestic sales/total turnover	CD-Direct's database on Danish companies
Control variables		
C_1 Cultural distance	Kogut–Singh index	Own calculations based on questionnaire data
C_2 Law enforcement	Rule-of-law index	The World Bank

[a] The questionnaire data were collected in 1992 and the telephone interviews were conducted in 1997.

Model Specification and Estimation Results

Based on our conceptual framework, changes in the organization of foreign distribution are considered to be a function of the following sets of factors;

$$y_i = f[\mathbf{x}_M, \mathbf{x}_D, \mathbf{x}_C], \quad i = 0, 1, 2, \tag{1}$$

where $\mathbf{x}_M$ is the vector of switching motivators $\{M_1, \ldots, M_6\}$, $\mathbf{x}_D$ denotes the vector $\{D_1, \ldots, D_4\}$ of switching deterrents, and $\mathbf{x}_C$ represents the control variables $\{C_1, C_2\}$.

Since our response variable has three levels with no inherent ordering we can perform a logistic regression analysis on the generalized logits (multinomial logit model). A logit is formed for the probability of each succeeding category over a base response category. In our case, the no shift outcome ($y_i = 0$) is defined as the base category, so the generalized logits for our three-level response variable are

$$\text{logit}_{y1} = \log\left(\frac{\pi_{y1}}{\pi_{y0}}\right), \quad \text{logit}_{y2} = \log\left(\frac{\pi_{y2}}{\pi_{y0}}\right), \tag{2}$$

where π_{y0} denotes the probability of no shift, π_{y1} denotes the probability of the outcome shift to a new intermediary, and π_{y2} denotes the probability of shift to a new operation mode. The model fitted for the generalized logits is

$$\text{logit}_{yik} = \alpha_k + \mathbf{X}_{yi}\beta_k, \tag{3}$$

where k indexes the two logits, the matrix $\mathbf{X}_{yi}$ is the set $\{\mathbf{x}_M, \mathbf{x}_D, \mathbf{x}_C\}$ of explanatory variable values for the yith group, and α and β denote the intercepts and regression coefficients, respectively. We estimate this multinomial logit model using PROC CATMOD in SAS (1999). Since we found a high correlation between the control variables cultural distance and law enforcement, thus indicating potential multicollinearity problems, we run two separate models: one including the cultural distance variable (model 1) and the other including the law enforcement variable (model 2). Table 5 shows the results of the model estimations.[6]

For each of the models, the first column (a) reports the coefficients for the explanatory variable for the event of 'switch to another intermediary', while the second column (b) looks at the determinants of replacing foreign intermediaries with in-house operations.

The chi-square coefficient associated with the model expresses the probability that the configuration represented by the whole model could have been obtained randomly. Both the models have excellent fit with chi-square values of 46.0

Table 5. Overall Model Results: Multinomial Logit Models, Regression Coefficients

Independent variables	Model 1		Model 2	
	(a) Switch to another intermediary	(b) Switch to in-house operation	(a) Switch to another intermediary	(b) Switch to in-house operation
Intercept	−0.15	1.52	−1.06	1.06
M_1 Export market growth	−0.02	0.002	−0.02	0.006
M_2 Growth of the exporting company	−0.02	0.002	−0.01	−0.001
M_3 Accumulation of market knowledge	**0.03***	0.02	**0.03***	0.02
M_4 Selection of intermediary	0.13	**0.63***	0.05	**0.65***
M_5 Control difficulties	**0.25****	**0.19***	**0.28****	**0.19***
M_6 Asset specificity	0.06	**0.24****	0.04	**0.25****
D_1 Contractual restrictions	**−1.36*****	−0.64	**−1.32****	−0.64
D_2 Loss of sales revenue	0.37	**−0.60***	0.28	**−0.63***
D_3 Recruitment and training costs	0.09	**−0.49*****	0.11	**−0.48*****
D_4 Foreign operation learning costs	−0.004	−0.01	−0.005	−0.01
C_1 Cultural distance	−0.09	−0.01		
C_2 Law enforcement			0.42	0.30
−2 log L (Chi-square) No. of observations	258 46.0*** (24 d.f.)		258 54.4*** (24 d.f.)	

Note: ***, **, and *, denote significance at 1, 5, and 10% levels, respectively (Chi-square value). Significant coefficients are in bold.

(24 d.f.) and 54.4 (24 d.f.), respectively. The probability that such configurations occur by chance is less than 0.01.

DISCUSSION OF RESULTS

The results are almost identical for models 1 and 2 including cultural distance and law enforcement, respectively, and we base the report of findings on the estimation of model 1. On the whole the findings suggest that the prediction of mode shifts is found in the interplay between changes in organizational and environmental conditions that act as switching motivators and the switching costs associated with making a switch. In some instances, switching costs appear to be self-imposed by the exporters in order to safeguard the intermediary against holdup. Hence, the mode switch decisions seem to implicate a cost–benefit analysis. However, the components of switching motivators and switching deterrents are seemingly affecting the choice of either switching to another foreign intermediary or to an in-house operation in different ways.

One switching motivators apply—as expected—to both kinds of switches: 'control difficulties' explains the shift to another intermediary ($\beta_{M5} = 0.25$, $p < 0.05$) as well as the shift to in-house operations ($\beta_{M5} = 0.19$, $p < 0.10$). The switching motivator 'accumulation of market knowledge' (M_3) turns out to be significantly (albeit weakly) and positively associated only with the switch to another intermediary. The coefficient of this variable is 0.03 ($p < 0.10$). Conversely, two other switching motivators are significantly and positively associated only with the switch to own in-house operations: 'selection of intermediary' (M_4) and 'asset specificity' (M_6). The coefficients of these two variables are 0.63 ($p < 0.10$) and 0.24 ($p < 0.05$), respectively. The two remaining switching motivators, 'export market growth' (M_1) and 'growth of the exporting company' (M_2), have no significant effect neither on switches to another intermediary nor on switches to an in-house operation.

Among the switching deterrents only one had a significant effect on intermediary replacements. As expected, the estimation produced a negative and highly significant coefficient for the variable 'contractual restrictions' ($\beta_{D1} = -1.36$, $p < 0.01$). The other switching deterrents did not have any significant influence on shifts of intermediaries. Counter to our expectation, the anticipated loss of local sales revenue did not significantly impede exporters' replacement of local intermediaries, but it did deter switches to in-house operations; 'loss of sales revenue' is weakly significant with a coefficient $\beta_{D2} = -0.60$, $p < 0.10$. A possible explanation is that an important reason for exporters to replace local intermediaries is the poor sales performance of the latter. If the sales generated in a foreign market turn out to be quite limited, the economic consequences of a potential loss of customers caused by a termination of the intermediary may, accordingly, be trivial. However, the situation could be rather different when the switch is from using an intermediary to setting up an in-house sales organization. Internalization could then be a direct result of the large sales volume achieved in the local market, since it is doubtful that an exporter will venture into an in-house arrangement (such as a sales subsidiary) unless a substantial sales volume has been generated by the local intermediary. Since the establishment of a sales subsidiary incurs considerable fixed costs, the exporting firm will be more vulnerable to (and observant about) potential losses of sales revenue.

For switches to in-house operations, the most important switching deterrent turns out to be 'recruitment and training costs', which is highly significant with a coefficient $\beta_{D3} = -0.48$ ($p < 0.01$). As to the two control variables 'cultural distance' (C_1) and 'law enforcement' (C_2) they did not have significant effects on the switching behavior of the firms in our sample.[7]

CONCLUSION AND SUGGESTIONS FOR FURTHER RESEARCH

This study demonstrates the dynamic nature of the organization of export activities. Drawing on previous literature on foreign operation methods based on organizational economics (transaction cost and agency theory) and the internationalization process of the firm, we develop a framework that includes change inducing as well as change impeding factors. In order to test the model, data on the organization of foreign distribution channels were collected from a sample of Danish exporting companies.

These data, which were measured at two different points in time—1992 and 1997—record actual switches made by the companies. Using this longitudinal data set, we find that within the observed 5-year period almost one-third of the exporters completed some kind of change away from using the independent intermediary they entrusted initially. Decisions regarding how to organize export channels should therefore be seen as recurring events rather than being taken once-for-all.

The analysis suggests that the within-mode and between-mode switches are not determined by identical sets of factors. Our findings indicate that intermediary replacements are foremost driven by control difficulties and to some extent the exporter's accumulation of market knowledge, while the main obstacle to implementing such changes is the existence of contractual restrictions like termination clauses in the contract with the current intermediary. In all, intermediary replacements seem to be determined by a relatively small number of factors.

The set of factors that influence the switch from an independent intermediary to an in-house operation is seemingly larger. The main reasons for making such changes are the perceived difficulties of controlling the intermediary, and that expectations about asset specificity endanger the satisfaction with the intermediary. Also, our findings indicate that industrial vendors are more prone than vendors of consumer goods to switch away from independent agents, perhaps due to less considerate intermediary selection procedures at the point of entry. The main deterrents for carrying out a change to in-house operations are the expected recruitment and training costs of establishing own foreign operations, and the fear of loss of local sales revenue (as a consequence of handing over after sales responsibilities) in case of displacing the existing intermediary.

An interesting aspect of the presented framework is its inclusion of factors that may discourage firms from making changes to existing arrangements; the so-called switch deterrents or switching costs. Our findings indicate that managers should take such deterrents into account when deciding on how to organize the international operations of their firms. Nevertheless, the concept of switching costs remains somewhat vague, and more theoretical work ought to be done. Transaction cost theory, especially the notion of 'remediable efficiency,' should serve as a fruitful starting point for further conceptual elaboration. For example, it can be noted that switch deterrents such as 'contractual restrictions' and 'loss of sales revenue' may discourage switches in both direct and indirect ways. Severance payments and loss of sales in the local market result in quite evident and measurable effects that firms would avoid, *ceteris paribus*, and that curb initiatives regarding intermediary switches in a very direct manner. However, by creating hold-up safeguards that encourage the intermediary to invest time, money and effort in the relationship it gets increasingly difficult and costly to accomplish any changes to the existing setup. Future studies should look more closely at what drives switching costs and at the implications of such costs.

Previous studies of foreign operation methods and international distribution channels have tended to take on a static approach focusing mainly on the initial choice of foreign entry modes. The framework presented here builds on that literature, but extends it by explicitly recognizing the dynamic nature of foreign market servicing decisions. Being among the first to investigate foreign distribution channel decisions in a longitudinal perspective, this study has some shortcomings and the results should therefore be regarded as tentative. While several limitations should be noted, the very same limitations open interesting avenues for future research. First, even though the reasoning underlying the framework presented here was by and large supported by the empirical analysis, some hypotheses failed to receive statistical support. Somewhat crude measurements may have had some part in this. In particular, growth in GDP is an imprecise proxy for market growth, and efforts should be made in future studies to collect data on more disaggregated levels. Also, multi-item measures on multifaceted variables such as accumulation of market knowledge would increase measurement reliability. Second, the findings presented here pertain to the behavior of a particular sample of Danish exporters, and future studies should examine to what extent our findings can be generalized to other empirical settings.

APPENDIX. CORRELATION MATRIX AND DESCRIPTIVE STATISTICS

	M_1	M_2	M_3	M_4	M_5	M_6	D_1	D_2	D_3	D_4	C_1	C_2
M_1	1.00											
M_2	−0.04	1.00										
M_3	−0.05	−0.04	1.00									
M_4	0.01	−0.05	0.04	1.00								
M_5	0.05	0.07	0.09	−0.05	1.00							
M_6	0.06	0.09	0.10*	−0.17***	0.01	1.00						
D_1	−0.07	−0.02	0.02	−0.01	−0.04	0.01	1.00					
D_2	−0.03	0.01	0.08	−0.09	−0.01	−0.01	0.06	1.00				
D_3	−0.08	0.06	0.04	−0.05	0.02	0.09	−0.04	0.05	1.00			
D_4	−0.09	−0.08	0.01	0.20***	−0.06	−0.15**	0.09	−0.13**	0.02	1.00		
C_1	0.40***	0.01	−0.03	0.04	0.08	−0.04	−0.09	−0.07	−0.07	−0.16***	1.00	
C_2	−0.36***	0.09	0.07	−0.01	−0.08	−0.04	0.05	0.11*	0.03	0.15**	−0.62***	1.00
Mean	27.7	28.3	11.3	0.3	3.1	3.4	2.0	1.8	5.5	26.1	2.9	1.3
Standard deviation	14.1	62.6	9.9	0.5	1.5	1.9	0.4	0.4	1.3	22.9	1.8	0.5

Note: ***, **, and *, denote significance at 1, 5, and 10% levels, respectively.

NOTES

1. An example of mode combination is a firm that appoints a new local intermediary (or keeps an existing one) and, at the same time, internalizes some of the distribution channel activities thereby establishing a dual distribution system. Because there are only six cases of dual distribution in our data set we disregard this possibility in our analysis.
2. Assuming that perceptions of poor performance by foreign intermediaries are not simply misconstructions of the exporters, it seems warranted to take a closer look at the underlying reasons for why intermediaries may perform poorly. Basically, poor performance can be explained in two ways (Porter and 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 and Meckling, 1976; Levintahl, 1988). Since 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.
3. Companies that in 1992 had only limited experience with exports (i.e. they exported to neighbouring countries only) or had equity below US$ 15 000 were excluded from the sampling frame.
4. The database of the 349 Danish exporting firms includes basic information (such as total sales, number of employees, and industry), as well as more specific data on the activities on the particular foreign market where an independent intermediary represented the exporter.
5. The three main reasons why companies had to be taken out of the sample were (i) that the exporters had been liquidated or merged into another company since 1992 (23 cases), (ii) lack of information about which market the original questionnaire covered (22 cases) and (iii) that sales to the particular market had ceased (15 cases). Additional reasons include companies that refused to answer (7 cases), and that we could not get in touch with the right person (6 cases).
6. Owing to missing values, 2 cases had to be excluded from the statistical analysis, hence bringing the number of observations down to 258.
7. As a robustness check of our results we also ran models with interaction terms between our two control variables and the variables for switching motivators and switching deterrents. In general, the interaction effects turned out to be insignificant.

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