Adam J. Fein and Erin Anderson

Patterns of Credible Commitments: Territory and Brand Selectivity in Industrial Distribution Channels

The authors propose a new theoretical rationale that explains the paired existence of both a manufacturer's decision to limit the number of intermediaries operating in a specific geographic market and a distributor's decision to limit brand assortment in a product category. Using transaction cost reasoning, they suggest that channel selectivity agreements can be understood as interrelated exchanges of pledges, or credible commitments, that counterbalance exposure to opportunism and neutralize sources of relationship instability, thereby strengthening an interorganizational relationship. The empirical results, which are based on dyadic data from 362 manufacturer–distributor relationships, are broadly supportive of their framework.

> "Probably the most basic marketing function offered by wholesaler-distributors to their customers is providing for the ready availability of products." (Rosenbloom, 1987, p. 74)

> "Distributors may also find it advantageous to deal exclusively in the products of a single producer, although the benefit from contract provisions compelling them to specialize is dubious." (Scherer and Ross 1990, p. 559)

If indeed a distributor sells availability, why do some distributors agree to limit brand assortment in some product categories? This practice has generated some research attention, principally by economists and legal scholars, but little empirical study.

Conceptual discussions of this issue create confusion by generally covering restraint in the number of brands yet using the term *exclusivity* (which implies the maximum degree of limitation). Here, we use the term *selectivity* to mean what the literature often labels *exclusivity* in a category. Brand selectivity, or depth of assortment, is the degree to which a distributor refrains from carrying brands of competing manufacturers[1] in a specific product category. Therefore, the distributor practice of limiting assortment to a single brand—often referred to as exclusive dealing, brand exclusivity, or the granting of category exclusivity—is simply the extreme point of the selectivity continuum.

Conversely, territory selectivity is the degree to which a manufacturer limits the number of intermediaries operating in a specific geographic market (*territory*), which range from a single distributor (territory exclusivity) to an unrestricted number of distributors within a given market (intensive distribution). Like brand selectivity, territory selectivity seems to violate a basic logic of manufacturer–distributor–customer chains, which is that suppliers use distributors to reach as many customers as possible. Serving all the customers in a market through a limited set of distributors appears to compromise this objective. Although these arrangements are common enough to have generated hundreds of legal cases in the United States (Salop 1993), both territory selectivity and category selectivity largely have escaped empirical examination.

Almost universally in the literature, brand selectivity (the distributor's decision) is treated separately from territory selectivity (the manufacturer's decision). Indeed, the two seldom are discussed in the same article. In this study, we explicitly link the degree of brand selectivity and the degree of territory selectivity in the distribution of industrial products (products purchased and used as inputs by other businesses, rather than purchased and used as is by the ultimate consumer). We advance a new rationale for what we argue is their paired relationship. We suggest that ceding or granting selectivity (by either manufacturer or distributor) can be understood as an exchange of credible commitments, or pledges. We cast channel selectivity as a way to counterbalance the vulnerability of one's counterpart in a manufacturer–distributor dyad. When one party is vulnerable, the other party can strengthen the relationship, paradoxically, by weakening its own position and by taking on a credible commitment that constrains its own actions and imposes a cost on itself if the relationship declines or terminates. Counterbalancing exposure serves to stabilize distribution arrangements by encouraging each party to eschew opportunism (including shirking). As we discuss, pledges of selectivity differ from other types of credible commitments, such as making investments that are specific to a relationship (Anderson and Weitz 1992).

[1]Because the present study considers industrial marketing channels, we use the terms *upstream firm* and *manufacturer* or *supplier*, and *downstream firm* and *distributor*, interchangeably.

Adam J. Fein is a doctoral candidate, The Wharton School, University of Pennsylvania. Erin Anderson is Professor of Marketing, INSEAD. The authors thank Shantanu Dutta, Gary Frazier, Sanjit Sengupta, Tom Robertson, and the INSEAD brown bag research seminar for their comments on a previous version of this article.

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In the following sections, we briefly review literature from marketing, economics, and law that advances explanations for some degree of selectivity (usually considered in isolation of the selectivity offered by the counterpart). We then advance a simultaneous model of the exchange of channel selectivity, focusing on three categories of explanations for selectivity: counterbalancing exposure, countering sources of relationship instability, and opportunity cost. We test our model using dyadic data from 362 pairs of manufacturers and their distributors. We find strong support for the notion of treating selectivity as a discretionary strategic choice and employing it as a way to balance exposure. We also find support for the impact of opportunity cost and sources of relationship instability.

Prior Research on Distribution Channel Selectivity

Research on distribution channel selectivity has developed independently in economics, law, and marketing. Marketing takes a managerial approach yet is largely descriptive and nonempirical and lacks a causally unambiguous theoretical base. Economics has developed numerous competing explanations for the existence of exclusive dealing and exclusive territories, the most limiting forms of selectivity agreements. Much of this work is of an analytical nature and grounded in restrictive assumptions. Moreover, there exists limited systematic empirical work to sort out the conflicting theories. Legal research has focused on the way that exclusivity affects the functioning of the marketplace. However, this research is constricted because it is based strictly on legal cases generated by malfunctioning (and perhaps unrepresentative) relationships. No comprehensive framework exists in any of these literatures that simultaneously considers selectivity agreements from the perspective of both parties in a channel relationship. In the following sections, we briefly review the high points of these literatures.

Channel Selectivity as a Marketing Strategy

Marketing researchers examine the issue of selectivity by focusing on an individual manufacturer's marketing strategy. The degree of distribution selectivity is framed as a strategic channel design issue for a manufacturer (Stern and Sturdivant 1987). Marketing theory parallels the descriptive reality of multiple manufacturers and multiple distributors, providing a realistic context for studying interorganizational channel relations. It is therefore surprising that the influence of selectivity agreements on a *distributor's* business strategy has been virtually ignored in marketing.

Selectivity is conceptualized as a continuum from intensive to exclusive distribution. An intensive distribution strategy places a manufacturer's product in as many outlets as possible in a market area (Stern and El-Ansary 1992), whereas exclusive distribution is equivalent to territory exclusivity. Intermediate degrees of exclusivity (selective distribution) limit the number of outlets in a geographic area in an unspecified manner. Exclusive territories do not necessarily have to be geographic territories. For example, exclusivity for different customer segments can be granted to multiple distributors in a single geographic area (Corey, Cespedes, and Rangan 1989). This restraint will normally be much more difficult to implement and monitor, so that contractual exclusivity and actual achieved exclusivity may differ significantly (Weigand 1991). A related issue is the assumption of a well-defined geographic area or market segment. The definition of territory boundaries poses issues similar to those in defining product market boundaries (Day, Shocker, and Srinivasan 1979). As in product market definitions, the question of how to identify meaningful geographic territories cannot be separated from the ways in which the results are to be used in planning distribution strategy.

Within the marketing paradigm, product type and consumer purchasing behavior are hypothesized to determine the distribution intensity decision. Copeland (1923) supplies an early and influential classification of consumer goods into three categories: convenience, shopping, and specialty goods. Convenience goods are products that consumers will not expend effort to seek out for purchase. A manufacturer should "secure distribution of his product through a large number of stores in each territory" (Copeland 1923, p. 283), that is, intensive distribution for these products. Shopping goods are those for which consumers compare brands and prices across stores. An intermediate degree of distribution intensity is recommended for these products. Specialty goods are those that a customer will seek out at some effort. Exclusive distribution is hypothesized to be appropriate for these products. Several researchers have proposed extensions to Copeland's basic framework (e.g., Aspinwall 1958; Miracle 1965; Murphy and Enis 1986). Although this research focuses on consumer, not industrial, products, it underscores that when buyers are unwilling to search, manufacturers that practice selectivity face a significant opportunity cost in the form of lost business. Webster (1976) lists both product-class and nonproduct factors affecting distribution intensity for industrial products, though the relative importance of the identified factors is not indicated.

Bucklin (1963) proposes that the interaction among the three product classifications and three store types (convenience, shopping, and specialty) indicates the most likely distribution intensity (see Stern and El-Ansary 1992, Exhibit 5–2, p. 233). For example, either selective or exclusive distribution is proposed as the ideal strategy if consumers are more loyal to retail outlets than to brands, because brand selection is based on the available assortment at a certain preferred store. Bucklin's work highlights the tug-of-war between suppliers, which build brand loyalty to attract consumers regardless of stores, and distributors, which build store loyalty to attract consumers regardless of brands. Changes in distribution intensity also is associated with the product life cycle. As products mature and gain wider acceptance, manufacturers try to increase density of coverage (Day 1990), spurred by more intense competition and declining consumer willingness to search.

Another approach explicitly models a manufacturer's choice of the number of intermediaries as a profit-maximizing optimization problem subject to certain constraints. For example, Corstjens and Doyle (1979) model sales as a function of the number of intermediaries and price and then solve for the optimal number of intermediaries and optimal price for each channel. Rangan (1987) also uses a decision-oriented approach. However, no comparable decision-oriented models exist for an intermediary determining the number of products carried within a single category.

Therefore, though relatively undeveloped, particularly from an empirical standpoint, marketing research on selectivity frames important issues for manufacturers to consider when planning their distribution strategy. However, this strategic view focuses solely on the isolated decision making of an upstream manufacturer. Research in this area is also limited by a focus on consumer markets and a restricted view of the determinants of exclusivity.

Some textbooks do offer a broader treatment of the issue. An example is Rosenbloom's (1995) text, in which he argues that it is normatively desirable to have different arrangements in different markets. Six basic categories of variables that should be taken into consideration are presented and elaborated: market variables, product variables, company (supplier) variables, intermediary (distributor) variables, environmental variables, and behavioral variables, which cover the nature of relationships between the company and the distributor in question. Rosenbloom (1995) points out that all six categories vary considerably across markets, even the company variables, because the company's objectives and strategies are not fixed in all markets. Hence, the market coverage issue is likely to be market specific and go far beyond the approach of categorizing goods on the basis of marketwide shopping behavior.

Research in Law and Economics

The legal research tradition. United States legislative policy toward exclusionary vertical restraints and its body of judicial interpretations have varied significantly over time. Initial legal decisions viewed restrictive contractual relations as signaling anticompetitive intent, with price restraints being treated with greater hostility than nonprice restraints such as territory exclusivity (Vickers and Waterson 1991). The current "rule of reason" approach views vertical restraints as subject to some measure of the effect of competitive foreclosure on other sellers and not as per se legal or illegal (Samuelson and Balmer 1988). For example, exclusive dealing is generally considered legal if a nondominant manufacturer "urges" a distributor to carry only one brand without using actual coercion (Scherer and Ross 1990).

Stern, El-Ansary, and Coughlan (1996) offer an unusually thorough discussion of the other side of the issue: the distributor's granting of exclusivity in the manufacturer's product category. This is the extreme of category selectivity. They note several court cases involving manufacturers that, as a matter of announced policy, demand category exclusivity in all of their markets. (One may speculate that such manufacturers are particularly tempting targets for lawsuits.) But even here, the text notes that the courts treat the issue not on a companywide basis but at the level of "competition in the relevant competitive market" (p. 365). The illegality of the matter is to be determined as a function of, among other things (italics added),

- the relative strength *of the parties involved*,
- the proportionate volume of commerce involved in relation to the total volume of commerce *in the relevant market area*, and
- the probable immediate and future effects that preemption of that *share of the market* might have on *effective competition within it*.

The authors add that "the type of good or merchandise, the geographic area of effective competition, and the substantiality of the competition foreclosed must all be assessed in determining legality or illegality" (Stern, El-Ansary, and Coughlan 1996, p. 366). Hence, the issue is treated as highly contingent on the specifics of each situation, not on a companywide basis.

The impact of this ever-changing antitrust law on the formation of exclusivity contracts is unclear. Presumably, the threat of antitrust enforcement has limited the development of both blatantly illegal, competition-reducing exclusivity agreements and socially inoffensive, economically efficient arrangements. However, most empirical research on exclusivity is drawn from detailed legal case studies of individual vertical contractual relationships that have been thrown into court because they turned acrimonious or disintegrated. Hence, these case studies provide an unrepresentative sample from which to evaluate the motivations and consequences for exclusivity contracts across a wide range of market and firm circumstances.

The economics research tradition. In contrast to marketing, the economics literature conceptualizes territory exclusivity as a categorical variable in which either one distributor or more than one distributor serves a single market. Although analytically convenient and conceptually reasonable, this approach offers limited guidance for understanding the more general phenomenon of selectivity, of which the "one versus many" issue is only one aspect. Empirically, the more common situation is one in which a manufacturer limits the number of intermediaries, but to more than just one.

Territory and category exclusivity are specific forms of what economists refer to as vertical restraints. A vertical restraint is a contractual restriction that a firm at one stage in a chain of transactions, usually assumed to be the upstream firm, imposes on the conduct of a firm at another stage, usually assumed to be the downstream firm (Scherer and Ross 1990). Vertical restraints have been called a "puzzling departure from the price mediated exchange of conventional markets" (Mathewson and Winter 1984, p. 27), and a considerable amount of literature has developed around the subject, much of it analytical formalization. (For general surveys of vertical restraints, see Katz 1989; Scherer and Ross 1990; Tirole 1989.)

Under the rubric of the more general phenomenon of vertical restraints, economists have proposed several plausible and intriguing rationales for the presence of territory and category exclusivity. For example, exclusive territories can prevent free-riding by low-cost distributors on the services provided by a full-service distributor (Mathewson and Winter 1984). The vast literature on exclusivity arrangements is beyond the scope of this review, though some of the more critical theoretical elements are considered in the model we present here.[2]

Exclusive dealing contracts have been studied analytically as a barrier to entry that restricts the availability of distribution outlets to rival manufacturers (Tirole 1989) or raises entry costs (Krattenmaker and Salop 1986). This provides a rationale for the supplier to ask the distributor to practice brand exclusivity. But as the quote at the beginning of this article suggests, the industrial economics paradigm provides little rationale for a distributor to practice exclusive dealing (Scherer and Ross 1990). Perhaps the distributor's interest has been ignored because, in this paradigm, a distributor is essentially considered to be a customer of a manufacturer (Tirole 1989) or simply a hired link in a manufacturer's channel. For example, exclusive dealing is portrayed as a decision imposed on a distributor by a dominant manufacturer. This perspective contrasts strongly with the literature on channel relationships, which involves viewing a distributor as an independent purchasing agent acting on behalf of anticipated customers rather than as a hired link in a value-added chain on behalf of a powerful manufacturer.

Summary

Both marketing and economics supply an incomplete view of the way exclusivity and selectivity agreements operate. Marketing contributes a useful perspective by focusing on the manufacturer's strategic channel design decision. However, the validity of marketing's normative managerial guidelines is limited by a supplier-oriented view of selectivity, a causally ambiguous relationship between product type and distribution intensity, and a lack of empirical research. Economic theory is also supplier oriented and, in addition, overly focused on powerful suppliers and weak, faceless distributors. Although economics presents several rationales for exclusive contractual arrangements, these are derived from restrictive and conflicting modeling environments that are difficult to translate to the field. The legal research tradition offers speculation about manufacturer motives but is based on dysfunctional arrangements. In this study, we use some elements of these three traditions to construct a model of selectivity—both manufacturer and distributor decisions—that is based on institutional economics and marketing theory.

[2]Katz (1989, p. 696), in his review of the economics literature on vertical restraints, notes, "The situation most often encountered in actual markets, but least seen in economic journals, is that of multiple manufacturers, each of whom has many dealers." This observation points to an important limitation in the formulation of testable propositions derived from this research stream. In particular, key results are sensitive to idiosyncratic modeling frameworks and restrictive assumptions that limit both the comparability of competing hypotheses and the ability to cast the ideas into empirically testable form. An analytic focus on the isolated decision making of upstream and downstream firms also limits the generalizability of conclusions.

A Model of Selectivity in Industrial Distribution Channels

To derive useful implications for managers interested in structuring effective vertical exclusivity agreements, we shift the analytic focus from *when* exclusivity agreements occur to *how* the structure of vertical channel relationship influences the degree of selectivity. We develop a descriptive model of "pledging" (offering credible commitments) grounded in a normative framework of relations between manufacturers of industrial products and their distributors. We cast patterns of pledging as the reciprocal outcome that occurs in the business environment described in transaction cost analysis (Williamson 1985). In other words, each party deals in a world of bounded rationality and potential opportunism. Both sides wish to design an interorganizational relationship that protects its own interests, so some effort is made to foresee both the environment and the actions of the counterpart. Opportunism may or may not be prevalent, but it does exist to a nontrivial degree.

The transaction cost view argues that boundedly rational actors recognize and respond to the need to create relationship governance mechanisms to forestall opportunism. Even if opportunism is rare, it is difficult to distinguish ex ante the degree to which any player is inclined to use guile to pursue its self-interest. Therefore, the other party is assumed to be potentially opportunistic at the start of the relationship. This assumption is subject to modification using knowledge about the other party. As the (nonzero) risk of opportunism increases, the parties deliberately set up countervailing opportunism-blocking mechanisms.

Firms on either side of a relationship can choose to impose limits on their own activities to promote exchange. These constraints, or *credible commitments* (Williamson 1983, 1985), alter the party's *own* incentive structure in such a way as to make opportunism unappealing. Thus, if transaction-specific investments occur, they are at risk and should be protected by the posting of hostages, that is, the making of credible commitments. This normative statement generates the descriptive prediction that in a competitive environment and over the long term, stable and long-lasting relationships with transaction-specific investments will have a robust governance structure characterized by credible commitments accumulated over the years (Williamson 1985). These commitments signal willingness to eschew opportunism and encourage reciprocal behavior by the other party. This is consistent with Dwyer, Schurr, and Oh (1987), who argue that strong relationships do not spring up quickly, easily, or frequently. Instead, they are crafted slowly, passing through several stages in which the partners must deepen their investments and prove their trustworthiness and commitment.

To investigate whether credible commitments signal goodwill and invite reciprocal action, Anderson and Weitz (1992) empirically examine relationships between industrial distributors and manufacturers. They distinguish two types of credible commitments, which they call "pledges," that either side can make. One pledge is making investments that are specific to the relationship. For example, a manufacturer could invest in learning about its distributor, dedicate personnel specialized to the distributor, customize software to fit the distributor, or connect its name and image with the distributor's in the minds of customers. Distributors could do the same vis-à-vis a manufacturer. These investments serve to enhance the effectiveness and efficiency of each party, as well as signal goodwill.

Another type of pledge involves choosing the "degree of selectivity" in a category or territory. A manufacturer can make a credible commitment (to a distributor) by limiting the number of distributors representing its brand within the distributor's market. Conversely, a distributor can make a credible commitment (to a manufacturer) by limiting the number of competing brands carried in the manufacturer's product category. Both channel selectivity and asset specificity are credible commitments because they give the party that makes them an incentive to live up to its end of the bargain, that is, to perform in good faith, eschewing opportunism. Anderson and Weitz (1992) do not examine either side's motives for pledging; instead, taking pledging as exogenous, they find evidence that offering pledges functions as an effective signal of goodwill and increases each party's commitment to their relationship.

In contrast, our model focuses on channel selectivity as a decision variable, casting selectivity as a discretionary credible commitment that serves to counter the governance problem surrounding specific assets. This discretionary character differentiates this form of pledge from transaction-specific investments. Williamson (1985) points out that specific investments are made primarily for the purpose of creating value in a transaction. In other words, the party making the investment does so to become more effective, so that these investments may not be discretionary, an idea that Buchanan (1992) develops in the context of retail department stores' dealings with suppliers. Specific investments often are made for production cost or market demand reasons but have the side effect of incurring transaction costs due to asset specificity. The task-driven nature of specific investments implies that such assets are exogenous factors that influence the channel selectivity decision. For example, a distributor must learn the unique features of a brand to ensure that it is used appropriately and in the process, develops relationship-specific knowledge. Specific assets can create such grave contractual hazards that a firm could decide either to use general-purpose assets at a considerable loss of efficiency or even to abandon the transaction entirely (Williamson 1985).

However, granting selectivity is not necessarily essential for business effectiveness. It is an unusual action, as suggested by the many legal cases and large volume of research in economics. A manufacturer that deliberately limits market coverage for its brand within a prescribed geographic area excludes itself from other distributors and their customers. A distributor that deliberately limits the assortment of brands offered to its customers cuts off alternative suppliers and potentially limits its appeal to customers. In contrast, transaction-specific investments represent actual expenditures of resources that are difficult or impossible to redeploy in another channel relationship. If the relationship ends, the investor can lose much of the value of the assets. These investments can be made in multiple relationships simultaneously, though when made, they are difficult to redeploy to other relationships. However, a selectivity arrangement imposes an opportunity cost because it restricts the choice of partners. Consistent with this perspective, Sengupta (1995) finds that exclusivity is negatively associated with perceived effectiveness in co-marketing agreements between firms with complementary products.

A key premise of our model is that both manufacturers and distributors have leverage in their business relationship. This is consistent with our focus on what the marketing literature labels "conventional channels" (Stern and El-Ansary 1992). These channels are composed of multiline independent wholesalers that represent a variety of manufacturers, stocking and selling goods to other businesses (industrial sales) rather than to consumers (retail sales). Industrial distributors seek to provide a broad assortment of products tailored to the needs of a particular market. Their sales efforts are augmented by ancillary services such as credit provision, delivery, installation, and repair services. A manufacturer could theoretically perform distribution, and some manufacturers do. However, many distributors have superior appeal to customers because of the comprehensiveness of their assortments and superior expertise and efficiency in carrying out the distribution function. Indeed, many distributors enjoy high customer loyalty and profitability, placing them in a strong position vis-à-vis suppliers (Corey, Cespedes, and Rangan 1989). Ordinarily, distributors in such channels neither grant brand exclusivity nor receive territory exclusivity in any of the potentially hundreds of product lines they sell. Decisions regarding selectivity are discretionary and relatively unusual.[3]

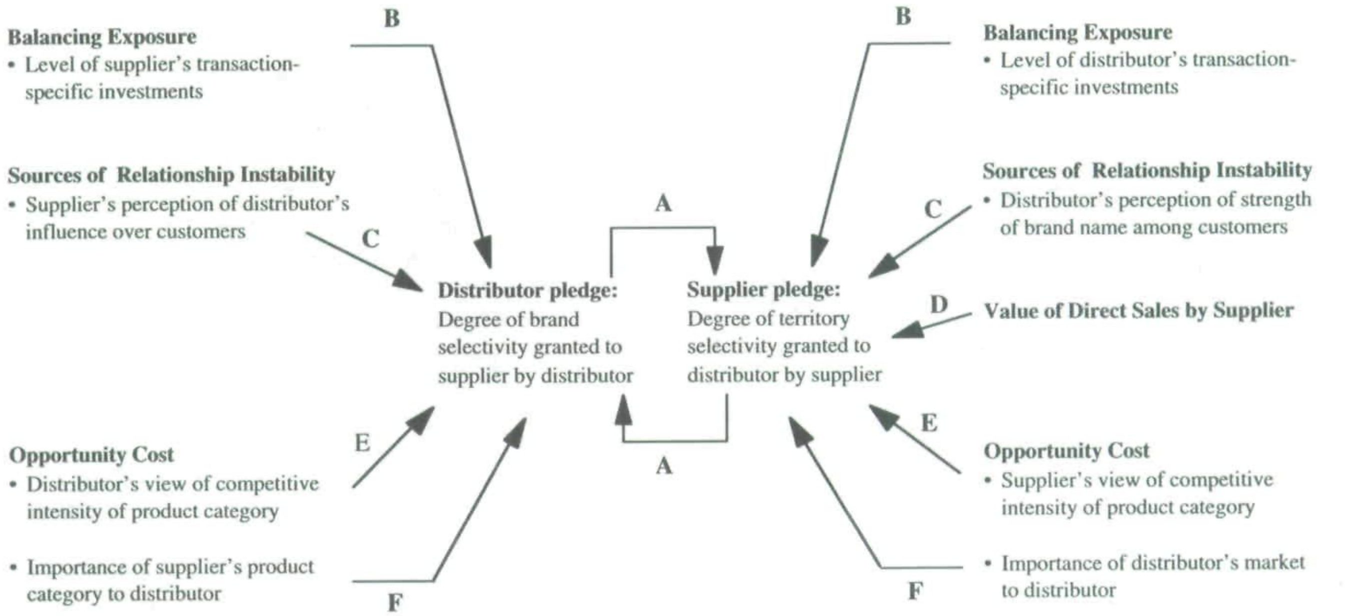
In this study, we build a model of patterns of pledging in distribution channels by setting forth a series of propositions (summarized in Figure 1) about when distributors and manufacturers make pledges in the form of granting some degree of selectivity to each other. Most of our reasoning is symmetric in that the same logic applies to both the manufacturer and distributor.

Balancing Exposure

Pledges of channel selectivity (Paths labeled A in Figure 1). As noted previously, transaction cost analysis argues that firms on both sides of a relationship can choose to impose limits on their own activities to promote exchange. However, the pledging party is exposed to some risk when making a pledge. Therefore, pledges will not be made freely or without reason. A party that is at risk of opportunism will desire, perhaps demand, that its counterpart take on a coun-

[3]Note that this picture is in contrast to the image of a powerful manufacturer dictating terms to a powerless distributor. In our view, the distributor is an independent purchasing agent, acting on behalf of anticipated customers, not a hired link in a value-added chain. Our premises are also counter to the view, present in much of the interorganizational literature, that opportunism is rare and that most parties can safely be assumed to be trustworthy (e.g., Granovetter 1985). This latter view suggests that mechanisms designed to forestall opportunism, such as credible commitments, are not only unnecessary but wasteful and even undesirable, because they could signal suspicion and thereby undermine the relationship.

FIGURE 1
Model of Selectivity



terbalancing risk of its own. By balancing exposure, the more exposed party receives some assurance that its vulnerable position will not be exploited. The party that agrees to take on the counterbalancing risk not only reassures its partner that it will not be opportunistic (this is no longer to its advantage) but also obliges itself to live up to its promises. If parties have an incentive to honor their agreement, a contract can be said to be self-enforcing (Telser 1981). The process by which exposed parties impose a reciprocal exposure on their counterparts has been labeled "dependence balancing" by Heide and John (1988) and has been described as a way to achieve a "mutual reliance relation" by Williamson (1985).

In short, the literature suggests that discretionary actions constituting pledges will occur in reciprocal patterns. The parties will seek a balance to facilitate efficient trade (Katz 1989). This fits with Klein and Murphy's (1988) study, in which they interpret vertical exclusivity restraints as contract enforcement mechanisms in the context of self-enforcing agreements. It is also consistent with Overstreet's (1983) study, in which he provides evidence that category exclusivity is often associated with other types of vertical restraints, including territory exclusivity. His sample included 203 nonfranchise distribution agreements that were litigated on antitrust grounds.

In the context of an industrial channel relationship, a distributor's pledge of brand selectivity (at the limit, exclusivity) places it at risk of a manufacturer's opportunism. For example, the manufacturer may not honor its agreement (explicit or implicit) to provide ancillary support because it knows that its brand is shielded from competition in the category. By making a reciprocal pledge of territory selectivity (at the limit, exclusivity), the manufacturer reassures the distributor by enhancing its own incentive to maintain a relationship with a distributor that grants brand selectivity and is one of few suppliers for a geographic area. Therefore, we expect that the greater the degree of brand selectivity granted by a distributor to a manufacturer's product line, the greater the degree of territory selectivity granted by a manufacturer.

However, a manufacturer is also at risk when it grants a territory to one or a few distributors. Restricting market coverage in a prescribed geographic area (ultimately, to a single distributor) places the manufacturer in a small-numbers bargaining position with the distributor. A distributor could exploit this position by reneging on its promises (e.g., by charging monopoly prices for the manufacturer's brand while continuing to offer an assortment of competing brands at various prices). The manufacturer suffers from the resulting decline in unit sales, because the monopoly rents are not necessarily passed along through the distribution channel. A countervailing pledge of brand selectivity aligns the incentive structure within the relationship. Even though the distributor gains pricing flexibility, it must derive all category sales from fewer (at the limit, one) brands. Therefore, we expect that the granting of territory selectivity by a manufacturer increases the granting of brand selectivity by a distributor.

Transaction-specific investments (Paths labeled B in Figure 1). When a party makes an investment specific to its ongoing transaction with a counterpart, the party makes itself vulnerable to opportunism. If the counterpart is aware that a specific investment is at stake, it can practice opportunism to some degree, in full knowledge of the other party's inability to redeploy the asset in question. Therefore, the party that makes a specific investment needs a safeguard (Williamson 1985). Channel selectivity is a discretionary pledge that can serve as such a safeguard.

In distribution channels, the manufacturer is at risk from the distributor's opportunism when the manufacturer has made transaction-specific investments in the distributor. The manufacturer may fear that the distributor will free-ride on any redeployable portion of these investments to sell competing brands. A pledge of brand selectivity by the distributor could help to ensure that the manufacturer's investments are not appropriated for competing brands by providing the manufacturer with a property right on its investments (Marvel 1982). Furthermore, the manufacturer could lose much of the value of these investments if the relationship ends. This gives the supplier a strong motive to press for brand selectivity as a concession from the distributor. Hence, we expect that the greater the manufacturer's transaction-specific investments in the distributor, the greater the degree of brand selectivity the distributor grants the manufacturer.

Conversely, the distributor's need for a pledge of territory selectivity from the manufacturer will increase with the level of transaction-specific investments made by the distributor to sell or service the manufacturer's brand. The voluntary acceptance of a vertical restraint by the manufacturer protects the value of the transaction-specific investments made by the distributor in the manufacturer's brand. The distributor gains greater pricing flexibility due to the reduction in competition and is protected from the opportunism of competing distributors that seek to free-ride on market development and education efforts (Telser 1960). Therefore, the distributor that makes specific investments has a motive to demand territory selectivity from the supplier. Hence, we expect that greater distributor transaction-specific investments increase the degree of territory selectivity the manufacturer grants the distributor.

Sources of Relationship Instability

Some characteristics of one's counterpart can heighten perceived potential for opportunistic behavior. When these characteristics are present, one member of the relationship requires a pledge of selectivity from the other member as a hedge against the heightened threat of opportunism. In general, we expect that the greater the possibility of opportunism posed by one party, the greater the degree of selectivity offered by that party.

Customer pull (Paths labeled C in Figure 1). Both supplier and distributor can enjoy a favorable position, or pull, with the ultimate buyer, the customer (Corey, Cespedes, and Rangan 1989). This pull can be a threat to the other side because it opens the possibility of reneging on understandings by supplanting the other side (Steiner 1993). From the distributor's perspective, the possibility of being supplanted by a manufacturer is heightened when the supplier's brand name is strong (Albion and Farris 1981). For example, the brand could have unique attributes and be hard to replace. Moreover, a strong brand can generate positive externalities for the distributor in other product categories by creating demand pull effects. A strong brand name increases the supplier's power in its relationships with channel members (Frazier 1983). Hence, the distributor that believes the brand name is powerful will demand a pledge of selectivity as reassurance that the supplier will not use its brand name pull to hold up the distributor or will not give its best efforts. Therefore, we expect that the greater the distributor's perception of a supplier's brand name strength among customers, the greater the degree of territory selectivity granted by a supplier.

Conversely, the power of the distributor increases when the customer relies on the distributor for information or other value-added and transactional services to make a purchase decision (Steiner 1993).[4] The supplier is less able to bypass such a distributor and is more affected by the distributor's efforts (or lack thereof) to generate brand demand. Hence, the supplier that perceives it is facing a distributor that "owns the customer" will insist on a pledge of brand selectivity to ensure that the distributor will not opportunistically use its small-numbers bargaining power or will not give its full support. We expect that the greater the supplier's perception of a distributor's influence on customer brand selection within the supplier's product category, the greater the degree of brand selectivity granted by the distributor.

Value of direct sales (Path labeled D in Figure 1). If the manufacturer presents a credible threat of forward integration into distribution, the distributor requires a pledge to ensure against market foreclosure or competition from the supplier. We view the value of direct sales as a signal of the credibility of the threat. Direct sales are sales within a distributor's territory made directly by the supplier to customers, bypassing the distributor. Direct sales are an ongoing source of tension in the manufacturer–distributor relationship (Webster 1976) and the manufacturer–sales agent relationship (Dutta et al. 1995). From the distributor's perspective, the motive for these sales is not clear. The manufacturer may simply be surrendering to the demands of high-volume accounts that have bargaining power. However, the distributor is unsure whether the supplier is "cherry picking" the best customers or is preparing to do so in the future. For example, the supplier could be developing the capabilities that will enable direct competition with independent distributors or even the elimination of an independent channel. Because it is difficult to discern whether the supplier's motives are innocent or opportunistic, the distributor will demand more pledging in the form of selectivity from the supplier as the level of direct sales increases. Therefore, we expect that as the value of direct sales by a supplier increases, the supplier will grant the distributor greater territory selectivity.

This reasoning underlies the decision by Compaq to refuse to sell direct on grounds that this would constitute competing with its own dealers. Dealers interpreted this refusal as a sign of Compaq's commitment to them and reciprocated by giving the brand greater support and shelf space (Day 1990).

Opportunity Costs

Our reasoning in the previous section centers on how each side perceives the other, both in terms of the other's potential for opportunism and the other's ability to carry away valuable investments should the relationship end. We com-

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[4]Although most of Steiner's (1993) exposition makes explicit reference to the retail level, he suggests that the arguments are equally valid for industrial markets.

plete our model with two factors that the marketing literature suggests should account for some important elements of the context in which the relationship occurs. These elements involve the size of the opportunity cost that is imposed by limiting oneself to fewer distributors (the supplier) or fewer brands (the distributor).

Decision importance (Paths labeled E in Figure 1). If either side has little to gain or lose by making a pledge of selectivity, the decision of whether to limit oneself is of little importance. Granting some degree of selectivity becomes easier because the decision does not entail significant foreclosure of other opportunities. It is nearly costless to pledge by granting selectivity when the alternate opportunities do not amount to much. Pledging also can offer the opportunity to gain the confidence of the other side. Hence, we expect that if a distributor considers a product category to be unimportant, it might not carry multiple brands in the category anyway, so the degree of brand selectivity it will grant to a supplier is greater. Likewise, a minor territory for a supplier might not merit the effort to recruit and supply multiple distributors. Therefore, a greater degree of territory selectivity will be granted to a distributor.

Competitive intensity (Paths labeled F in Figure 1). A more competitive, price-conscious, and heterogeneous product category makes pledges of selectivity less attractive to both sides, because any individual brand's rent-generating potential is lower. For the distributor, limiting assortment to a few brands in a highly competitive market could mean a high cost of lost business, as consumers can and will find good substitutes with little effort (Steiner 1993). For the supplier, reducing availability of the product in a highly competitive market could be counterproductive, because availability, rather than distributor effort, is the major factor driving sales in such markets (Farris, Oliver, and de Kluyver 1989). Therefore, the greater the supplier's perception of competitive intensity in the product category, the lower the degree of territory selectivity it will grant the distributor. Equivalently, the degree of brand selectivity granted by the distributor should be lower when the distributor's perception of competitive intensity in the product category is greater.

Summary of Theoretical Model

Our model of pledging between independent manufacturers and distributors in industrial markets, represented in Figure 1, is based on the idea that both sides—not just the supplier—have leverage and choices. Each side loathes to limit its choices by granting some degree of selectivity to the other. Each side hesitates to place investments that are idiosyncratic to the counterpart (and hence to the relationship) at risk. Each side attempts to craft a way of governing the relationship to protect itself from opportunism while economizing on its own bounded rationality. Selectivity is pledged when the other side demands protection against opportunism, the threat of which becomes greater when the other side has high customer influence. This threat also becomes greater to distributors when suppliers sell direct.

Therefore, we propose that pledging by granting selectivity is used to reduce opportunism in circumstances conducive to self-interest seeking with guile. We argue that selectivity is also practiced in pairs because each side reciprocates the selectivity of the other side. More generally, we argue that exposure is balanced between parties in a relationship. Finally, we suggest that pledging depends on the opportunity cost to the manufacturer of restricting outlets and to the distributor of restricting brands. Minor decisions make granting selectivity nearly costless, whereas intensely competitive markets make selectivity exceedingly costly. Operationally, all relationships in Figure 1 are expected to be positive except those involving opportunity cost, which should be negative.

Method

Data Collection

To test the model expressed in Figure 1 requires that independent distributors and manufacturers provide matched reports. This, in turn, requires a high level of cooperation. The Marketing Science Institute assisted in obtaining participation from 12 divisions of five large U.S. suppliers of a range of products used in business-to-business markets. Each division believed its relationships with its distributors varied considerably, a belief borne out by the data. On the basis of field interviews, the unit of analysis was determined to be the branch level, where policies were focused, directed, and implemented.[5]

Campbell (1955) demonstrates that knowledgeable informants provide high-quality data that coincide with archival data. Therefore, companies were asked to nominate the employee most knowledgeable about the relationship, typically the local sales representative or district sales manager (who tends to have the most frequent contact with the distributor), as their key informant. Companies also were asked to name the person in the distributor organization most familiar with their relationship, generally the branch manager (or, for smaller distributorships, the owner).

Coded surveys (to permit matching responses) were sent to each informant from each side of the relationship. The coding was not concealed. Informants received a cover letter on academic stationary explaining the independence of the research from the cooperating companies and stressing that all responses would be held in confidence. An accompanying letter from the supplier reiterated these points. A postage-paid envelope addressed to the researchers was included. One follow-up was made to nonrespondents.

[5]Extensive prestudy interviews at the corporate level, followed up and confirmed by district-level interviews, stressed that the 12 divisions involved treated *each* distributor's market area as a separate market and *each* distributor as a unique entity. The divisions stressed that they did not practice standardized marketing (though they could have). They considered that everything could be different in each geographical market. Factors that varied include the relative strength of the competition, the nature and needs of the customer base, the set of possible (available) distributors, the company's own strategy and tactics (including which elements of the product line were sold and how), and the company's commitment to the market. We also interviewed a set of the suppliers' distributors, which confirmed that, from their point of view, these manufacturers were not uniform in how they went to each market.

Initially, the 12 manufacturers provided names for 583 dyads. However, one firm declined to permit the researchers to survey its side after its distributors had been surveyed (their 65 distributor responses were used only for measure development). This reduced the number of potential dyads to 518. Of these 518 dyads, nonresponses from one or both sides led to 417 returned pairs, a response rate of 81% of possible pairs. Of the returned pairs, 362 pairs provided completely usable information and are the basis for the test of Figure 1.[6]

Measure Development

Following standard psychometric procedure, as summarized in Churchill (1979), a pool of items was written to correspond to each construct. Items were extensively field tested for clarity, simplicity, and answerability by respondents. Most items were written in parallel form, one for the supplier vis-à-vis the distributor and one for the distributor vis-à-vis the supplier. Factor analysis was used to verify the expected unidimensionality of each set of items written to reflect a construct. This analysis, plus an examination of means, intercorrelations, and standard deviations, was used to purify the scales. A small number of items were dropped because of lack of variance in responses or multiple interpretations of the item possible. After purifying the scales, unidimensionality was assessed again by the presence of a substantial first factor in a principal components analysis and loadings of at least .4 with the theoretically correct sign on the first factor. Internal consistency was assessed by calculating Cronbach's alpha, and most scales surpassed Nunnally's (1978) minimum standard of .7 for exploratory research. Each analysis was performed separately per side. Most of the resulting scales are parallel for both sides. In Table 1, we provide a summary of the properties of each scale, with a sample item from each. Table 2 is the correlation matrix of the scales. A brief discussion of the measures follows.

Degree of selectivity reflects the degree to which the parties refrain from doing business with competitors of their channel partners. Items reflect the idea that selectivity is continuous, not merely binary (exclusive or intensive). Suppliers report the extent to which the distributor refrains from carrying other brands in this supplier's category. Distributors report the extent to which the supplier refrains from selling through other distributors in this distributor's market. Thus, each side reports the extent of the other side's concession. Each side is motivated to monitor on a continuous basis the extent to which its counterpart supplies its competition. Thus, the same information is readily available and salient to the informant. Using the counterpart as the informant provides a "harsh" measure of concession, because the recipient of the concession will not be generous in assessing the extent of the concession. Suppliers are quick to suspect distributors of pushing competing brands, whereas distributors, with all good intentions, tend to construe product categories narrowly so that many manufacturers can be told the distributor is "giving an exclusive" to each of them. Conversely, distributors are quick to note when their customers appear able to source their "exclusive" brands from another distributor, whereas manufacturers, with all good intentions, tend to construe territories narrowly so that many distributors can be told the supplier is "giving an exclusive" to each of them. Using each side to report the concession of the other serves to remove the effects of good intentions. Furthermore, such a report is likely to be up to date, because each side continuously monitors the other and is quick to detect an empirical slippage from what the other side intended or agreed on. In summary, using the observer to report on the actor's behavior should reduce reported brand or territory selectivity based on good intentions, positive affect, or historical patterns.

Transaction-specific investments made by the counterpart is each side's estimate of the extent of specific investments made for its counterpart, that is, investments that are not readily transferable to another party. Distributors offer their estimates of investments made in their suppliers, and suppliers offer estimates of specific investments made in their distributors. Items tap a range of investments, which include specialized knowledge, training, and efforts to build the counterpart's business and align the two businesses in the minds of customers.

Value of direct sales is an index of the fraction of business in the distributor's market that is done by the supplier, weighted by the quality (desirability) of that business. Higher scores occur as either the fraction of direct business increases or the accounts the manufacturer serves become more desirable. This highly sensitive information was provided by the manufacturer and may not be known to the distributor (though the distributor certainly speculates about it).[7]

Each side's *influence over customers* is reported by the counterpart. For the supplier, this is the distributor's influence on customer choices. For the distributor, it is the customer's attraction to the brand name.[8] Each side reports its own perception of the other's influence because each side is posited to demand pledges as a function of what it believes.

[6]In some cases, manufacturers provided more than one informant name for the distributor. Eight of the 362 pairs represented distributors with more than one informant, in which case the informants' responses were averaged to represent the distributorship. Many of the pairs deleted because of incomplete information were missing the information on direct sales, which respondents considered to be highly controversial and sensitive.

[7]Ideally, we would have asked the distributors about the quality and quantity of direct business they suspected their suppliers of doing in their territories, on the assumption that distributors would demand higher pledges the more they thought their suppliers competed with them. However, the manufacturers threatened to withhold cooperation if we put such questions to their distributors, on grounds that (as one manager put it), it would be preferable not to "encourage" distributors to "remember" this issue.

[8]Most scales are composed of items that are parallel in wording, merely requiring reversals of subjects and objects in the same sentence. However, the influence scales are not parallel because a distributor's influence over customer choices arises through the totality of the distributor's actions and customer reactions. The strength of a brand name is reflected in how much customers will insist on a brand. However, both sets of items do reflect the extent to which the customer is swayed (by either the distributor or the brand).

TABLE 1
Properties of Measures

Scale (Informant)	Representative Item[a]	Number of Items	Cronbach's Alpha	Scale (Informant)	Representative Item	Number of Items	Cronbach's Alpha
Degree of territory selectivity granted to distributor by supplier[b] (Distributor)	1. This supplier has given us an exclusive territory for their products. 2. This supplier voluntarily refrains from adding distributors that would compete with us. 3. This supplier has so many distributors that its distributors are bound to compete with each other when selling this supplier's products. (R)[c] 4. Of distributors in your territory capable of carrying this supplier's line, how many carry this supplier's line? ____ distributors (R)	4	.69	*Degree of brand selectivity granted to supplier by distributor*[b] (Supplier)	1. This distributor carries only our brand for the type of product we make. 2. This distributor voluntarily refrains from adding suppliers that would compete with us. 3. This distributor has so many suppliers that its suppliers are bound to compete with each other. (R) 4. How many companies that make products competitive with your line does this distributor carry? ____ suppliers (R)	4	.81
Level of supplier's transaction-specific investments (Supplier)	If we decided to stop using this distributor, we would be wasting a lot of knowledge that's tailored to their method of operation.	10	.80	*Level of distributor's transaction specific investments* (Distributor)	If we decided to stop representing this supplier, we would be wasting a lot of product knowledge that's tailored to their brands.	11	.81
				Value of direct sales (Supplier)	Quality of direct business × percent of sales made directly		NA
				Quality of direct business:	If you have some direct sales, how would you describe that segment of your customers? Best customers–Worst customers (1–7)	3	.87
				Percentage of sales made directly:	In this distributor's territory, about what percent of all your sales does your division make directly? (0 = none, 100 = all)	1	NA

Supplier's perception of distributor's influence over customers (Supplier)	Our customers are highly loyal to this distributor.	7	.85	Distributor's perception of strength of brand name among customers (Distributor)	Our customers are highly loyal to this supplier's brand name. (R)	6	.68
Distributor's view of competitive intensity of product category (Distributor)	Please describe the market for the *type* of products (example: X-ray film, explosives) you distribute for this supplier. Intensely competitive–Not very competitive (1–7)	4	.73	Supplier's view of competitive intensity of product category (Supplier)	Please describe the market for the *type* of products (example: X-ray film, explosives) you sell through this distributor. Intensely competitive–Not very competitive (1–7)	4	.68
Importance of supplier's product category to distributor (Distributor)	The type of product this supplier supplies is not one of the more important product categories we carry. (R)	1	NA	Importance of distributor's market to supplier (Supplier)	The territory this distributor covers is not one of the more important territories for our products. (R)	1	NA

[a]All items were recorded on a 1–7 Likert scale (strongly disagree–strongly agree), unless otherwise noted.
[b]All items in scale are listed in table.
[c](R) indicates that the item was reverse worded.

TABLE 2
Correlation Matrix of Scales (n = 362)

	Mean	Standard Deviation	a	b	c	d	e	f	g	h	i	j	k
a	–.01	.79	1.00										
b	–.08	.69	.33	1.00									
c	4.56	.96	.16	.28	1.00								
d	3.76	.92	.25	.02	.13	1.00							
e	.49	.84	.24	.07	–.09	.00	1.00						
f	4.81	1.07	.32	.06	–.02	.49	.10	1.00					
g	.02	.61	.15	.17	.26	–.03	–.10	.02	1.00				
h	5.38	1.13	–.15	–.20	–.04	–.06	–.01	–.10	–.07	1.00			
i	5.69	.96	–.35	–.14	–.06	–.13	–.03	–.05	–.07	.17	1.00		
j	–2.04	1.27	–.02	.09	.33	.08	–.11	.09	.22	.02	.09	1.00	
k	–2.41	1.51	–.08	–.14	–.02	.10	–.11	.19	–.01	.07	.11	.00	1.00

Note: All correlations greater than .10 are significantly different from zero at $p < .05$.

Key

Notation	Scale	Informant
a	Degree of brand selectivity granted to supplier by distributor	Supplier
b	Degree of territory selectivity granted to distributor by supplier	Distributor
c	Level of distributor's transaction-specific investments	Distributor
d	Level of supplier's transaction-specific investments	Supplier
e	Value of direct sales	Supplier
f	Supplier's perception of distributor's influence over customers	Supplier
g	Distributor's perception of strength of brand name among customers	Distributor
h	Distributor's view of competitive intensity of product category	Distributor
i	Supplier's view of competitive intensity of product category	Supplier
j	Importance of supplier's product category to distributor	Distributor
k	Importance of distributor's market to supplier	Supplier

Each side also reports the *competitive intensity* of the market for the product category in question. As we indicate in Table 2, there is limited agreement between these reports (r = .18). This is not unexpected, because each side reports this information from different perspectives. In general, the correlation should be expected to be less than unity because no two sides possess precisely the same information, nor do they process it in precisely the same way (John and Reve 1982). In this sample, distributors report on competitive intensity within an individual territory, whereas suppliers report on competitive forces across many U.S. markets. We hypothesize that each side calibrates its willingness to pledge on the basis of what it believes to be the true situation.

Finally, each side reports the *importance* of the issue under question to them. Distributors report the importance of the product category in which the supplier competes, and suppliers report the importance of the market that the distributor serves.

Of these scales, transaction-specific investments is the same scale used in Anderson and Weitz (1992), and brand and territory exclusivity are similar. The remaining scales have been developed in accord with discussions of these constructs as they appear in the literature.

Model Estimation

We posit that the relationship between the pledges of channel selectivity is simultaneous. Therefore, the two-equation model shown in Figure 1 is estimated by three-stage least squares. To control for possible corporate headquarters effects, we include dummy variables for four of the five parent corporations in the model of the supplier's concession of territory selectivity. These effects are not large and, for simplicity, are not reported.

Results

The results of estimating the model in Figure 1 are shown in Table 3. They indicate that reciprocity in pledges of selectivity indeed seems to occur between distributors and suppliers in terms of refraining from dealing with the counterpart's competitors. Distributors give a greater degree of brand selectivity to suppliers that give them greater territory selectivity ($\hat{\beta} = .573$). Conversely, suppliers give greater territory protection from intrabrand competition the more distributors refrain from selling competing brands ($\hat{\beta} = .229$). Hence, suppliers and distributors appear to restrict their set of alternatives in reciprocal fashion.

Manufacturers also appear to condition their granting of some degree of selectivity on the distributor's investments specific to the manufacturer ($\hat{\beta} = .159$). In a similar fashion, distributors grant a greater degree of brand selectivity to suppliers that have made larger idiosyncratic investments in the distributor ($\hat{\beta} = .071$). Therefore, it appears that distributors and suppliers balance exposure in ways that are consistent with our theoretical model.

Our propositions regarding the sources of relationship instability also fare well. Direct sales have an influence on the supplier's granting of territory selectivity ($\hat{\beta} = .010$), which is consistent with the notion that the distributor extracts a pledge to forestall manufacturer opportunism. Perceptions of the other party's influence over customers

TABLE 3
Three-Stage Least Squares Estimation Results (n = 362)

Scale	Degree of Brand Selectivity Granted to Supplier by Distributor Coefficient (t statistic)	Degree of Territory Selectivity Granted to Distributor by Supplier[a] Coefficient (t statistic)
Intercept	–.967*** (3.595)	–.716*** (2.496)
Balancing Exposure		
Degree of brand selectivity granted to supplier by distributor	N.A.	.229** (1.775)
Degree of territory selectivity granted to distributor by supplier	.573*** (4.602)	N.A.
Level of distributor's transaction-specific investments	N.A.	.159*** (4.764)
Level of supplier's transaction-specific investments	.071** (1.725)	
Sources of Relationship Instability		
Value of direct sales	N.A.	.100** (2.213)
Supplier's perception of distributor's influence over customers	.186*** (4.844)	N.A.
Distributor's perception of strength of brand name among customers	N.A.	.146*** (2.687)
Opportunity Costs		
Distributor's view of competitive intensity of product category	–.049* (1.534)	N.A.
Supplier's view of competitive intensity of product category	N.A.	–.108*** (2.413)
Importance of supplier's product category to distributor	–.054** (2.001)	N.A.
Importance of distributor's market to supplier	N.A.	–.052*** (2.850)

*$p < .10$.
**$p < .05$.
***$p < .01$; one-tailed t-tests for independent variables.
[a]Coefficients of corporate supplier dummy variables not shown. See text for details.
N.A. = coefficient not estimated.
System-weighted R-square = 25%.

also operate as expected. Greater degrees of brand selectivity are granted when the manufacturer believes the distributor has a stronger influence over customers ($\hat{\beta}$ = .186), a counterintuitive result that is consistent with our framework. In parallel, the distributor's estimate of the strength of a supplier's brand name appears to play a role in granting territory selectivity ($\hat{\beta}$ = .145).

Opportunity costs operate as expected. Neither party is likely to cede selectivity in intensely competitive product categories. The distributor refuses to limit its assortment of brands in a hotly contested product category ($\hat{\beta}$ = –.049). The supplier refuses to limit coverage when the category is highly competitive ($\hat{\beta}$ = –.108). As expected, a manufacturer is more likely to grant territory selectivity when the territory is relatively unimportant ($\hat{\beta}$ = .052). Category importance also has a significant effect on a distributor's selectivity decision ($\hat{\beta}$ = –.053).

Discussion

These results indicate that manufacturers and distributors behave in a manner that balances exposure. All else being constant, category selectivity and territory selectivity tend to appear in tandem. Each side seems to reciprocate the practice of selectivity by the other. Distributors and suppliers *each* reduce their choice set, allowing their contacts to wither and increasing their dependence on each other. Although this finding fits well within a transaction cost framework, it squares poorly with the powerful manufacturer/feeble dealer paradigm that dominates most of the literature on exclusivity. Indeed, the marketing channels perspective (that distributors have genuine value added and are not interchangeable) is more congenial to the finding that selectivity is something of a reciprocal action.

These results also suggest that a party that places specific assets at risk demands a reciprocal pledge. This is consistent with Kronman's (1985) arguments that there are many kinds of credible commitments and that not all kinds possess the same properties. A major difference between selectivity and specificity is that specificity tends to evolve in a relationship, often slowly, for reasons of task effectiveness and efficiency. In contrast, selectivity is more discretionary, which makes it a useful hostage to offer to balance the exposure created when the task dictates the development of transaction-specific assets.

Our hypotheses about the sources of relationship instability are supported. Direct selling by the manufacturer appears to oblige the manufacturer to offer selectivity to reassure distributors. Bypassing the distributor on a large scale, especially for better grades of business, gains revenue in the short run but appears to alienate distributors in the long run. These results suggest that short-run gains could be offset by the need to reassure distributors by making it more difficult for the customer to find another outlet for the brand.

As expected, each side appears to fear the other's influence over customers, viewing it as a source of power that could be used to supplant the counterpart. These results show that manufacturers grant territory selectivity to distributors whom they believe can influence customer choice strongly. Conversely, distributors appear to grant brand selectivity to brand names they see as strongly preferred by customers. This behavior is prudent when viewed as an effort to inspire the confidence of one's counterpart, which has reason to fear potential opportunism. Viewed in terms of power and conflict, however, the behavior is counterintuitive. A distributor is vulnerable to abuse from suppliers with considerable influence over its customers. In power terms, a sensible reaction would be to reduce dependence on that supplier by diversifying into selling other brands. Similarly, a supplier can be abused by distributors that "own the customer." A logical reaction from a power/conflict standpoint would be to reduce dependence on the distributor by selling through other distributors as well. That both distributors and suppliers take the opposite tack suggests that parties to a relationship may be willing to actually *increase* their vulnerability in a calculated effort to reassure their counterparts that opportunism is unlikely.[9]

[9]These findings also belie the notion that each side uses its power over customers to hurt the counterpart. If so, suppliers with powerful brand names would oblige their distributors to accept multiple competing distributors. Distributors with strong influence on consumer decision making would force the manufacturer to accept being sold alongside many competing brands. These results are quite the opposite.

Opportunity costs appear to play the role suggested by marketing theory (though, to our knowledge, not empirically tested). In highly competitive product categories, neither side will limit its options. Distributors will not reduce their brand assortments, and manufacturers will not limit their number of outlets in a market. Marvel (1982) suggests a mechanism to account for the manufacturer side of this behavior by arguing that customers will not go to great lengths to search for a preferred brand in such categories, simply because they don't need to: Many brands are "good enough." Although Marvel refers to the retail level, the same mechanism is likely to operate on the wholesale level. Buyers in a hotly contested market may not make a trip to search for a brand but will switch brands if they cannot find it in stock. Hence, manufacturers seek to maximize coverage to minimize the buyer's travel.

If buyers are unwilling to make special trips to find brands, distributors might, at first glance, be inclined to limit their brand assortment and oblige the customer to choose from what they stock. However, by stocking many brands the distributor could play off multiple brands quite successfully in a competitive category, using interbrand competitiveness to gain more favorable treatment from each supplier. Furthermore, the distributor can improve its image and increase its traffic if it is known to stock many brands, each of which competes intensely for customer favor.

Conversely, it appears easy to make concessions for minor business. Distributors more readily limit brand assortments in product categories that mean little to them anyway. Suppliers more readily limit their set of distributors in minor markets. We suspect that selectivity is a "cheap pledge" in these cases because the business does not merit much attention; hence, the opportunity cost of selectivity is low.

In summary, these findings suggest that patterns of selectivity resemble patterns of pledging. Each side uses selectivity to balance what it sees as the vulnerability, or exposure, of its counterpart. In particular, when a counterpart is seen to make specific investments or to grant selectivity in its domain, a player reciprocates by offering its own form of selectivity. For suppliers, this means territory selectivity; for distributors, brand selectivity.

There are other ways to balance against exposure, some of which are intriguing. For example, in the context of relationships between manufacturers and their suppliers, Heide and John (1992) focus on the manufacturer side. They note that if the manufacturer (the buyer) makes investments tailored to its supplier (e.g., tooling, equipment, systems, training), the buyer is now vulnerable to the supplier's opportunism. Transaction-cost analysis suggests that the buyer demand a pledge from the supplier. Although Heide and John (1992) do not address this possibility, they do find another way for buyers to alleviate their dependence problem. They find that suppliers cede an unusually high degree of influence in the relationship to those vulnerable buyers (vulnerable by virtue of having made specific investments) *if the relationship is buttressed by strong relational norms*. The combination of norms and specificity is one in which suppliers will cede control to their buyers.

This research is subject to several limitations, one of which is measurement error. Given the exploratory nature of this study, not all scales meet conventional standards of reliability. However, we note that the usual effect of lower reliability is low statistical power and hence lack of findings—which is not our case. Another limitation is a range restriction on the supplier side. That all suppliers are well-known, national companies limits the generalizability of the supplier conclusions.

Our analysis is also limited by the cross-sectional nature of the data. We observe one moment in time for what is undoubtedly a dynamic process of relationship development. This also raises the possibility that exogenous factors, such as customer pull, have been influenced by patterns of pledging over time. These data limitations are common to almost any large-scale empirical study using dyadic data.

Note that we do not explicitly consider anticompetitive explanations for brand selectivity. For example, it is not hard to see why a manufacturer would prefer that a distributor adopt brand selectivity in order to preempt or limit upstream competition. However, we expect that our model of reciprocity also applies to efforts by a supplier to impose exclusive dealing on a distributor. Because the distributor has some degree of leverage in the relationship, it will only accept this type of contractual vertical restraint when the supplier offers a countervailing pledge of territory selectivity.

Conclusion

This research provides a new explanation for why manufacturers and distributors refrain from doing business with an appropriate player. It is surprising that *any* manufacturer would limit coverage or that *any* distributor would limit brand assortment. Such decisions would appear to contradict the most basic reason that suppliers use distributors: to gain high coverage at low cost. Selectivity also contradicts the most basic business reason for customers to patronize distributors—namely, assortment in one place. Theory development in this area is at an early stage, with empirical testing even further behind. The range of potential explanations for channel selectivity is rich and intriguing. Customer behavior, market conditions, features of the supplier and its competitive set, features of the distributor and its competitive set, and the regulatory environment offer fertile ground for development and testing of theories of selectivity. As firms seek sustainable competitive advantage in increasingly contested markets, selectivity could prove to be a tool that merits greater usage.

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