Channel Structure: Transaction Cost or Structural Contingency Theory?

A Conceptual Paper

By: Adrian Ng Kuan Hwee (Presenter)
Honours Year Research Student
School of Marketing
The University of New South Wales
Sydney, Australia
Email: z3031407@student.unsw.edu.au

Supervisor: Dr Jack Cadeaux
Senior Lecturer
School of Marketing
The University of New South Wales
Sydney, Australia
Email: j.cadeaux@unsw.edu.au

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Abstract

Structural Contingency Theory and Transaction Cost Economics differ in their views on antecedents of channel structure. While criticisms have been levelled at both theories from many fronts, most fail to address certain implicit differences that suggest paradigmatic distinctions between the two. This paper addresses this debate by first discussing how recurring themes in each theory reflect exclusive paradigmatic properties. To then determine the winning paradigm, an outline of a meta-analytic research design is proposed as an effective way of empirically verifying three theoretical propositions, using forward channel integration as the level of analysis. The authors also argue that synthesized empirical support for these three propositions should be requisite for resolution to the debate, at least at that level analysis of marketing channel integration.

Background and Motivation

Until today, a contentious debate persists between the structural contingency theorists and the transaction cost-based view. While criticisms have been levelled at both theories from many fronts, most fail to address certain implicit differences that suggest paradigmatic distinctions between the two. In addition, an imbalanced view of empirical evidence contained within the marketing channels literature is aggravating the issue. The expense has been of managerial consequence, as managers become increasingly confused and misled by the literature. This leads to the paper’s motivation. First, the separation of the two theories as competing paradigms is made explicit within the debate. Second, synthesis of the empirical evidence, via meta-analysis, is argued to be requisite for resolution. The scope of this paper is limited to forward vertical integration within marketing channel design.

Structural Contingency Theory and Transaction Cost Economics

Structural contingency theory (SCT) is deeply rooted in organisational sociology (Brech, 1957; Donaldson, 1985). Central to it is the idea that managers are controllers who orchestrate the adaptation of the channel structure to “fit” with its environment (Donaldson, 1995). And because the environment is seen as constituting different contingencies with varying efficiency requirements, the purpose of ensuring structural “fit” is simply to meet such contingent requirements (Hage and Aiken, 1970). Furthermore, environmental uncertainty is believed to be the major contingent factor. In this respect, the rigidity of marketing channel structure is argued to be negatively related to the degree of environmental uncertainty surrounding it. The argument is that in highly uncertain environments, managements should become better organised by moving towards looser forms with greater coordination with market intermediaries instead (Achrol, Reve and Stern, 1983; Coughlan, Anderson, Stern and El-Ansary, 2001). Firms in uncertain environments retain performance effectiveness when they adopt more flexible organic channel structures (Donaldson, 1995; Burns and Stalker, 1961). Within the scope of vertical channel structure, a proposition hence may be formally stated as...
P1: There is a negative relationship between environmental uncertainty and the degree of vertical integration within a channel

Throughout these arguments, a recurring theme distinguishes the SCT paradigm - the notion of management as a collective entity unified by organisational goals (Donaldson, 1995). Managers are seen as guided by a common consciousness and motive towards the achievement of the greater organisational goal, this being performance. Performance is crucial for the survival and prosperity of the organisation (Hage and Aiken 1970). SCT is therefore argued to be essentially pro-management, because of its positive view of managers as people with the interest of the organisation at heart (Donaldson, 1995). This view is consistent with its roots in organisation sociology, which sees organisations as social institutions that bind managers together cohesively (e.g. Chandler, 1990). In the same way, Barnard formally defines an organisation as a set of roles oriented towards securing a goal (1938). This sociological perspective is a distinct paradigmatic property exclusive to SCT and yet, surprisingly, not well understood in the channels literature.

On the other hand, Transaction Cost Economics, or Transaction Cost Analysis (TCA) is rooted in organisational economics and employs a doctrine of economic efficiency to explain channel structure (Robins, 1987). Figure 1 below provides an overall view of the TCA model on vertical integration.

**Figure 1: A Sequential Explanation of Efficiency in Transaction Cost Economics**

Reading from left to right above, Williamson (1975) argues that when a vertical exchange relation within a marketing channel is characterised by a high degree of transaction-specific investments (A1), a “small numbers bargaining” scenario (B1) emerges. High environmental uncertainty (A2) also breeds an asymmetry of information and accentuates bounded rationality (B2). Thus, both conditions increase opportunism (C) inevitably. To guard against this, costly measures of surveillance and enforcement have to be deployed (Anderson and Weitz, 1986). Such measures reduce the overall efficiency of the market option (Klein, Frazier and Roth, 1990), thus failing the market option and inviting vertical integration as the next best alternative. The argument is that under managerial authority, efficiency can be reinstated (Dixon and Wilkinson, 1986). Based on these arguments, transaction cost theorists propose that:

P2: There is a positive relationship between the level of asset specificity (Box A1) and the degree of vertical integration (Box E) within a channel design

P3: There is a positive relationship between environmental uncertainty (Box A2) and the degree of vertical integration (Box E) within a channel design
An implicit paradigmatic theme may be extracted from these arguments - a negative modelling of managers as untrustworthy individuals guided by self interests. They are seen as constantly engaging in rational calculations of individual gain, hence the concept of opportunism (see Williamson, 1975, Klein, Frazier and Roth 1990). TCA therefore studies individual action and motivation, then postulates how channel structure is ultimately affected. It is also claimed to be anti-management because it invokes no concept of management as a single entity, no unification through organisational goals, only individual managers involved with maximising self-interests (Donaldson, 1995). This reflects a distinct paradigmatic property exclusive to the transaction cost-based view and strongly differentiated from structural contingency theory, again something not generally made explicit in the marketing channels literature.

The Incompatibility of Economic Thought with Sociological Concepts

Most criticisms levelled on either theory have largely remained within constructive content that sometimes hint at possible pathways into extensions, refinements or integration for the sake of theory development. However, arguably, many of such constructive views have ignored certain implicit properties of each theory that distinctly separate them as competing paradigms as opposed to alternative yet compatible theories (see Kuhn 1970). SCT borrows from sociological perspectives and has a positive view of management as a single, collected entity. TCA borrows from microeconomics and in doing so implicitly rejects organisational sociology (Donaldson, 1995). The roots of each theory are arguably so deeply contrasting that they should be seen as competing paradigm alternatives. If so, criticisms suggesting further individual theory development may only lead to further fragmentation of understanding and knowledge, as may currently be the case. Not until the “winning” paradigm is determined may we advance possible pathways for further theory development into the triumphant paradigm. (Kuhn, 1970).

Criticisms: The Minority Who Realise

The minority who do recognise the two theories as competing paradigmatic alternatives put forth several arguments. For example, Silverman (1968) asserts that an “organisation” is essentially a social construct that does not exist in reality, but only in ideology. And so by attributing human motivations to the “organisation”, SCT attributes them to an inanimate object i.e. reifying it. Moreover, such critics claim that “organisations” do not have goals, only individuals do. What requires further analysis then are individual motivations behind those goals, since everything in organisations is done by humans. Others also argue that channel structure should not be understood simply as rational adaptations to task contingencies (following, for example, Pfeffer and Salancik, 1978). Rather, greater regard must be given to the broader institutional environment within which a given organisation and its channels are embedded. Entities in this institutional environment have individual demands/expectations that managements are forced to comply with (see Meyer and Scott, 1983; Powell and Dimaggio, 1991). These views argue in effect that SCT is an inferior paradigm.

On the other hand, Donaldson (1995) attacks TCA for over-extending microeconomic principles into organisational theory. Similarly, Robins (1987) and Perrow (1986) explain that TCA too ambitiously tries to explain the complex macro origins of organisational structure by using simple efficiency concepts. To see all managers as self-interested actors who do not intend to act decently unless bounded by incentives is too narrow and negative a model of man. This views rejects sociological concepts by rubbishing the view of organisations as social institutions capable of unifying managerial behaviours and aligning self-interests. The very definition of an organisation is defied (see Barnard, 1938) because TCA does not expect reasons for channel
design to arise from any general collective managerial or super-organisational motive, but only from individual interests. Furthermore, Arndt (1985) believes that TCA disregards the role of qualitative relational elements like trust, which is a control mechanism over opportunism. As evidence, Larson (1992) shows that the newer forms of hybrid\(^1\) channel structures, such as relational contracting and networks, all contradict the transaction cost efficiency explanation of governance. Instead, these views indicate that relational trust and cooperation are factors that sustain the market option.

**Disjointed Empirical Evidence – The Need for Empirical Synthesis**

The inability to determine the winning paradigm is further aggravated by the lack of consistency in the empirical evidence. There is a disappointing lack of support for TCA proposition P3 (e.g. Klein, Frazier and Roth, 1990, John and Weitz, 1988 and Wilkinson and Nguyen, 2002), a sentiment echoed by Krickx (2000) and even Klein, Frazier and Roth (1990) themselves. Instead, empirical studies provide more support for SCT proposition P1 (e.g. Hage and Aiken, 1967; Terreberry, 1968, Hollenback et al, 2002; Drazin and Van de Ven, 1985). Through a meta-analysis examining specific dimensions of uncertainty, Krickx (2000) also provides some convincing evidence that subsequently verifies P1. These evidences indicate that SCT’s sociological perspective of the structural phenomenon is superior to TCA’s microeconomic view.

Yet at the same time, there is strong evidence that verifies P2, the other condition that validates the Williamsonian cost-based school of thought (e.g. John and Weitz, 1988; Wilkinson and Nguyen, 2002; Bello and Lohtia, 1995). Anderson (1985) shows that the higher the level of asset specificity in an exchange relation, the more likely that the firm integrated its salesforce function. Anderson and Coughlan (1987) and Klein, Frazier and Roth (1990) have also found positive relationships between asset specificity and integration in international markets. These lend support for P2, and for the controversial view of managers as self-interested individuals without organisational goals as unifying objectives. Similarly, they seem to validate the rejection of organisation sociology.

To resolve these apparent inconsistencies requires a synthesis of empirical knowledge concerning P1-P3. Such empirical synthesis can be best performed through meta-analysis, or a quantitative synthesis of research findings (Wolf, 1986). By putting previous studies through a formal process of statistical “distillation”, it allows a researcher to tease out hidden features observed from common data points (Lindsay and Ehrenberg, 1993; Franke, 2001). Meta-analysis is superior to cross sectional designs for the purpose of theory comparisons because it captures a larger number of observations, larger variance in conditions, and accumulated through an archive of studies instead of just one. Through the review process, meta-analysis can provide formal verification for P1-P3 and give synthesis of knowledge.

However, theory comparison through meta-analysis must be taken with caution. Meta-analysts tend to invoke extensive use of formal statistical procedures to study effects sizes (see Rosenthal, 1984; Hunter and Schmidt, 1990). But effects size measurements assume prior agreement on the nature of a given relationship, this obviously not being the case in this field. Specifically, there is lack of strong agreement regarding directionality of the relationship of P1 and P3 and this renders effect size measurements rather premature at this stage (Krickx, 2000). Agreement on

\(^1\) Hybrids combine the advantages associated with markets and hierarchies in a single organizational form (Powell 1990).
directionality must be reached first. And to accomplish this, more straightforward meta-analytic techniques like categorical modelling should be employed.

Conclusions and Future Research

Donaldson reflects Kuhn’s theory of paradigm revolutions (1970) and aptly states: “Paradigm revolution becomes a major impediment to serious integration of thought – unless one paradigm completely triumphs over the other, that is, the paradigm revolution is successful” (1995, p. 18). In this statement, two thoughts are provoked. The first is that of paradigm revolution being of major impediment to thought integration. This paper argues that this situation may be implicitly observed in the debate between SCT and the Williamsonian cost-based view of structure antecedents. But until more marketing channel academics recognise the competing differences between the two as paradigmatic distinctions, the debate will remain unresolved and the revolution will go unnoticed. The second is the idea that for a paradigm revolution to be successful, one paradigm must completely triumph over the other. This paper strongly agrees and is suggesting a way of accomplishing this through an empirical synthesis i.e. meta-analysis. Although, it will ultimately take more than the solitary effort of one empirical synthesis study to resolve the debate entirely, it is believed that the marketing channel literature nevertheless serves as an invaluable starting point. From this, we move closer towards finding a resolution and reinstating managerial confidence in the field.


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