THE INFLUENCE OF INSTITUTIONAL ENVIRONMENT IN THE STRATEGIC MANAGEMENT DECISIONS ON AMERICAN AND BRAZILIAN RETAILERS

CHRISTIANO FRANÇA DA CUNHA
Associate Professor in the Master and PhD in Business Program – Methodist University of Piracicaba (UNIMEP)
Km 156 Açúcar Road – Zip code: 13423-170 - Piracicaba/SP-Brazil
E-mail: chfcunha@unimep.br

MARIA SYLVIA MACCHIONE SAES
Professor in the Master and PhD in Business Program – School of Economics, Business and Accounting at University of São Paulo (FEA/USP)
908 Professor Luciano Gualberto Avenue – Butantã – Zip code: 05508-010, São Paulo/SP - Brazil
E-mail: ssaes@usp.br

DENISE YVONNE MAINVILLE
Senior Associate, ABT Associates Inc.
4550 Montgomery Avenue, Suite # 800, Bethesda, Maryland, USA.
E-mail: denise_mainville@abtassoc.com

Abstract

Nowadays almost 70% of all food sold in some important countries in the world come to consumers from the supermarkets (REARDON, 2006). The products sold are sourced from different suppliers with different contractual arrangements. For this reason, it is important to observe how supermarkets in different countries are making decisions on how to organize their supplies. In order to answer this, the research question to this paper was: Do the supermarkets have the same strategic management decisions in different institutional environment, especially about contractual relationship between them and their suppliers? If no, why not? The theoretical background to develop some ideas of this paper was the importance of institution environment and Transaction Costs Economics (TCE) and its two theoretical approaches (Governance Costs and Measurement Costs). This paper investigated 132 interviews realized in Brazil and in the U.S.A with supermarkets and producers of Fresh Fruits and Vegetables (FFV). The influence of institutional environment in the choice of governance structures, and therefore in the strategic management, was analyzed by comparing these contractual relationships in Brazil and in the U.S.A, using a model adapted from Cunha et. al (2013) and a structural equation in two groups (Brazil and the U.S.A). Some difference in these two institutional environments were found, especially in the difference in the influence of these two approach of TCE, showing that the institution environment matters in the strategic management, especially in the contractual relationship.

Key words: *Retailers, Institutional Environment, New Institutional Economics (NIE)*

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1. Introduction

Nowadays almost 70% of all food sold in some important countries in the world come to consumers from the supermarkets (REARDON, 2006). The products sold are sourced from different suppliers with different contractual arrangements. For this reason, it is important to observe how supermarkets in different countries, such as Brazil and the U.S.A, are making decisions on how to organize their supplies. Moreover, it is also interesting to understand if the business environment that characterizes the two countries can influence such decisions. In order to answer this, the research question to this paper was: **Do the supermarkets have the same strategic management decisions in different institutional environment, especially about contractual relationship between them and their suppliers? If no, why not?**

Several studies have analyzed strategic management decisions in the companies (Porter 1980, 1985, Kim & Maubogne, 2005); others have analyzed the institutional environment (North 1991, 1993, 1994, 1997), and some the relations between strategic and institutions (Peng, Sunny, Pinkham & Chen 2009, Monteiro & Pianna, 2012), but a very few studies have analyzed the influence of institutional environment in the strategic management decisions in the supermarkets. That is why this paper intends to help this gap by studying relevant retailers in the food sector of two institutional environments (Brazil and the U.S.A).

So the main objective of this paper, using the New Institutional Economics, is to understand how different environments can influence the supermarket strategic decision, especially regarding the choice of governance structures, in two different countries.

The specific objectives of this paper are:
1. Understand the retail strategic management in Brazil and U.S.A, especially the decision of choosing a contractual relationship;
2. Compare the strategic management of these two institutional environments, especially the decision of the choosing of contractual relationship;
3. See the importance of each variable in this strategic management decision, and if these influences are different in different institutional environments.

2. Theoretical Background

This section will present some theoretical background to develop some ideas of this paper such as the importance of institution environment and description of Transaction Costs Economics (TCE) and its two theoretical approaches (Governance Costs and Measurement Costs).

2.1 The institution environment and its importance for the business.

It is important to observe that this research question could be better answered using the theoretical framework of the New Institutional Economics (NIE). This could be seen especially because the central message of NIE is that institutions matter for the analysis of

economic performance. So this approach does not neglect the institution and transaction-costs in the search for answers, like the neoclassical economics (Walrasian) approach does (Furubotn & Richter 2000).

That is why it is very important to better understand these two elements. Let us start with institutions. The institutions characterize constraints on human interactions, which could be formal (rules, laws, constitutions, etc.) or informal (norms of behavior, conventions, codes of conducts self-imposed, etc.), and their enforcement characteristics (NORTH, 1994). So, in this paper institutions could be composed by laws that regulate the standards of behavior of those involved in supply chains of these products (farmers, grocers and consumers).

These institutions structures could reduce the uncertainty (North, 1990, 1991, 1993) and establishing the incentive structures for society, particularly for the economy (North 1991, 1994, 1997). More specifically in economic institutions, these systems deal with behaviors that restrict the potential of individuals through the use of sanctions, whether established by law or custom (including enforcement and social ethical code of moral conduct) (Fururbon & Richter, 2000).

So is possible to see that institutions define and delimit the choices of individuals, establishing what is allowed or not in some situations, similar to the "game rules" (North, 1990) and providing the essential structure where human actions and/or exchanges could happen (Klein, 2000).

The institutional environment is the second level of savings institutions, exercising influence on governance structures and the allocation of resources in the economy (Williamson, 2000). According to Furubotn & Richter (2000) institutions evolve over time and may have different balances on different occasions. The institutional balance consists of an original set of formal rules and a set of informal rules, which complements the first grouping. There are two ways to achieve balance: a) "automatically" in the sense that the informal rules reach a stable point of a new, comprehensive, institutional arrangements, formal structure without destroying the original and b) after an initial disturbance in the balance, a new institutional balance, not necessarily the original, is reached. Therefore, it is not enough to change the formal rules to produce the expected result. There must be a change of informal rules, as well as they have a perfect enforcement or at least consistent with expectations for the changes to occur (North, 1997).

These changes in the institutions mainly serve to reduce transaction costs in relations between actors (North, 1991). That is because for the creation and/or operation of any institution and to ensure obedience to its rules resources are necessary, i.e., involve costs, which are widely referred to as transaction costs. Thus, property rights and/or contract cannot be defined, monitored and have enforcement immediately and without the use of these resources (Furutbon & Richter, 2000). Therefore, the efficiency of institutions and ways of their enforcement, including the technology employed in this, determine the transaction costs (North, 1991).

These costs among agents could be seen in Douglas (1992), who shows that there is increase in difficulty, and consecutively in costs, that consumers could have in evaluating the quality of a product at the time of purchase. This happens because there are three basic types of goods and services: research, experience (Nelson, 1970) and credence (Darby & Kami, 1973). Due to this difficulty in assessing the attributes in these different kinds of products, information costs are lower for the consumer in the search goods and higher for credence goods, such as organic products, since its organic attribute has a high degree of difficulty in measuring the consumer even after consumption (Darby & Kami, 1973). This characteristic of

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the organic products generate information asymmetry (Akerlof, 1970) and makes it necessary for the market to develop some mechanism to reduce this disproportionateness, such as institutions (Furutbon & Richter, 2000).

2.2 Transaction Cost Economics (TCE) and its contributions.

The definition of the firm as "a complex of contracts coordinated centrally, with the aim of saving on transaction costs" (Coase, 1937 p.389) is the basis of TCE. To better understand TCE is necessary to know the difference between the orthodox neoclassical analysis (Walrasian) and institutional analysis. The first one sees the firm as a production function governed by the price mechanism while the second analysis comprehends the universe of organizations and economic institutions using researches on efficiency of contractual relationships within and between organizations (Zylbersztajn, 1995). This concept makes it possible to study organizations as "institutional arrangements" that govern transactions either by formal contracts, protected by law; or informal agreements, supported by reputational safeguards and other social mechanisms. So, using TCE, it is possible to predict governance forms of the firms with the analysis of some variables, conducted by institutional rules (Zylbersztajn, 2005a).

2.3 Governance Costs (GC) and its influences

Consequently, TCE allows the development of testable hypotheses and empirical applications to problems in the real world. To do this elaboration it is necessary to know the two basic assumptions in the analysis of TCE: a) bounded rationality of agents, in other words, the impossibility of foreseeing all future possibilities; and b) opportunistic behavior, a result of bounded rationality and because of asymmetric information between the parties. Another important factor to these tests are the two different types of costs according to TCE: a) ex-ante costs: to seek, prepare, negotiate, and protect an agreement; b) ex-post costs: to monitor, adjust, and adapt these because of variations in implementation generated by faults, errors, omissions, and unexpected adaptation; in other words, the cost of driving the economic system. These costs could be different in distinctive transactions and there are three determinants in the forms of the relationships and the types of transactions: asset specificity, uncertainty, and frequency (Williamson, 1985).

The asset specificity means a particularity related to the transaction, especially when an investment is required in this relationship, which can be lost if this transaction does not occur. The uncertainty refers to the institutional environment that ensures that contracts are honored, in other words, if there is a guarantee of purchase at a given transaction, not allowing this relationship to be held up. Frequency focuses mainly on how often this transaction is repeated in a given time (Williamson, 1985).

There are three possibilities of organization, according to the attributes of transactions, to minimize the transaction cost: a) market (coordinated by price); b) a hierarchical form; and c) hybrid forms (e.g. contracts). These organizational forms are support for transactions that control variability and mitigate risks, improving the value of a transaction or a set of transactions (Zylbersztajn, 2005b). The main determinant to the change in the governance structure is the asset specificity. So if there is no change in the asset specificity the governance structure will not be modified, even if the uncertainty in the transaction changes (Williamson, 1991). Another possible determinant to these variations of governance structure is measurements costs, being this one the next topic.

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2.4 Measurement Cost Theory (MCT) and its influences

Measurement cost theory (MCT) is a branch of TCE (Langlois, 1992). Its fundamental proposition is that attributes of transactions that are more easily measured are contracted outside the company, given the definition of the legal system and enforcement at low cost using the courts. The attributes that are difficult to measure remain within the firm, due to the risk of expropriation of values and their dissipation (Zylbersztajn, 2006). MCT differs from the governance costs approach because the former sees the possibility of value appropriation when the property right is defined in a given transaction (Barzel, 1992), while the latter is concerned with the minimization of transaction costs. But these two theories must be interdependent (Williamson, 1985).

It is important to observe that transactions can be broken down into different dimensions and attributes (Barzel, 2002). For example, the purchase of an agricultural product (e.g. a tomato) involves the transaction of some attributes such as color, if is organic or not, freshness, and so on. Besides, according to Barzel (1997), the firm is a nexus of guarantees of products, which could be exchanged, together with the quality and the attributes, by contracts. Transaction costs are produced to transfer, capture and protect the property rights of products. In the absence of information and/or transaction costs, the designs of these rights are perfect.

It is important to observe that contracts could be formal or informal agreements between agents, which transfer property rights (Alchian & Demsetz, 1972). This exchange of property happens only if individuals receive more than what they have. To know this, it is necessary to measure the attributes of the goods and their respective values, which is not easy because of high measurement costs in some of these (Barzel, 1982). That is why measurement and information costs need to be considered in the analysis of institutions and governance of organizations (Barzel, 2001). Therefore, choosing the most efficient form of governance is a function on the possibility of measurement in the attributes and the cost related to this. But there is no need to measure the value of the measurement cost to identify the most efficient form of governance: this can be done by simply ascertaining the possibility of measuring these attributes in the transaction (Barzel, 2002).

Since the products are characterized by different attributes (Barzel, 1997), data acquisition is essential, because it enables the realization of the transactions and exchange of ownership for each of the attributes. According to Barzel (1997) the property rights must be well established to avoid the capture of value, when the original owner doesn't receive the total values for this exchange, so part of this will be captured by the other part. But there are some situations that make it impossible for these rights to be traded, such as high measurement cost, which results in an inefficient allocation of resources, because it prevents assets staying with agents that can give more efficient and higher value for these (Barzel, 2004b).

Moreover, the theory suggests that measurement cost is a key aspect in defining the scope of a firm, because agents will engage in collaborative efforts, using private or public mechanisms to control the capture when there is some possibility of the positive gain of the transaction to dissipate or be captured (Zylbersztajn, 2006). Furthermore, there is some theoretical and empirical evidence that the difficulty of measuring attributes can strongly increase the performance cost in the companies (Poppo & Zenge, 2002). Two aspects can change the measurement costs: a) the measurement technology of some attributes; and b) the definition of standards for these (Barzel, 2001, 2002). Technological development is an important alternative to institutional innovations, because the transaction cost is reduced through more efficient organization and protection of rights (Foss, 1996). Standardization is

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useful to reduce the double measurement of some attributes, thus saving measurement costs (Zylbersztajn, 2006). This provides an economy of scale to the terms of contracts, because the commodities are measured in the same way and with repeated applications (Barzel, 2004b). According to Barzel (2004b), when the measurement cost of one attribute is reduced and this process can be applied to several products then the probability of this becomes a new standard is very high. Therefore, according to Barzel (2004a), standardization is one step closer to "perfect competition" and farther from non-cooperation and repeated games. This concept of "perfect competition" is different from the concept of perfect competition in the Walrasian world, because in this latter there is no transaction (measurement) cost in the system. The author's idea is that suppliers are all "equal" to the buyers when a new standard is established.

Thus, when the view of MCT is incorporated, it is possible to have a greater flexibility in the analysis, because the institutional arrangement is not predetermined for the transaction attributes (frequency, uncertainty, and asset-specific), but is a dynamic model that allows analysis in each case. In this it is necessary to identify which attribute is the key one, and whether it has the possibility of measurement or not. Moreover, this cost may change over time, which can rearrange efficient coordination of transactions (Caleman, 2005). So there are two possible theories to explain the chosen form of transactions. The first one is Williamson's approach (governance cost) and the second is Barzel's approach (measurement costs). To see how TCE can be used to explain what happens in the organic market, let us see how the most important variable in this market, the certification, is seen in these two approaches. Certification is an institution that can influence market relations, establishing the rules for a product be organic, thus increasing the brand specificity, in the Williamson's view (Governance Cost), and reducing the difficulty to get information, and consecutively, the measurement costs in this relationship according to Barzel's view (MCT). After this analysis of the effects of certification in market relations, the next topic will show the methods used to analyze the similarities and distinctions in the strategies, especially in the contractual relationship, between these two institutional environments studied - Brazil and the U.S.A.

3. Methodology

This paper investigated 132 interviews realized in Brazil and in the U.S.A with supermarkets and producers of Fresh Fruits and Vegetables (FFV). The influence of institutional environment in the choice of governance structures, and therefore in the strategic management, was analyzed by comparing these contractual relationships in Brazil and in the U.S.A. The proposed methodology to answer the research question in this paper is presented in the Figure 1.

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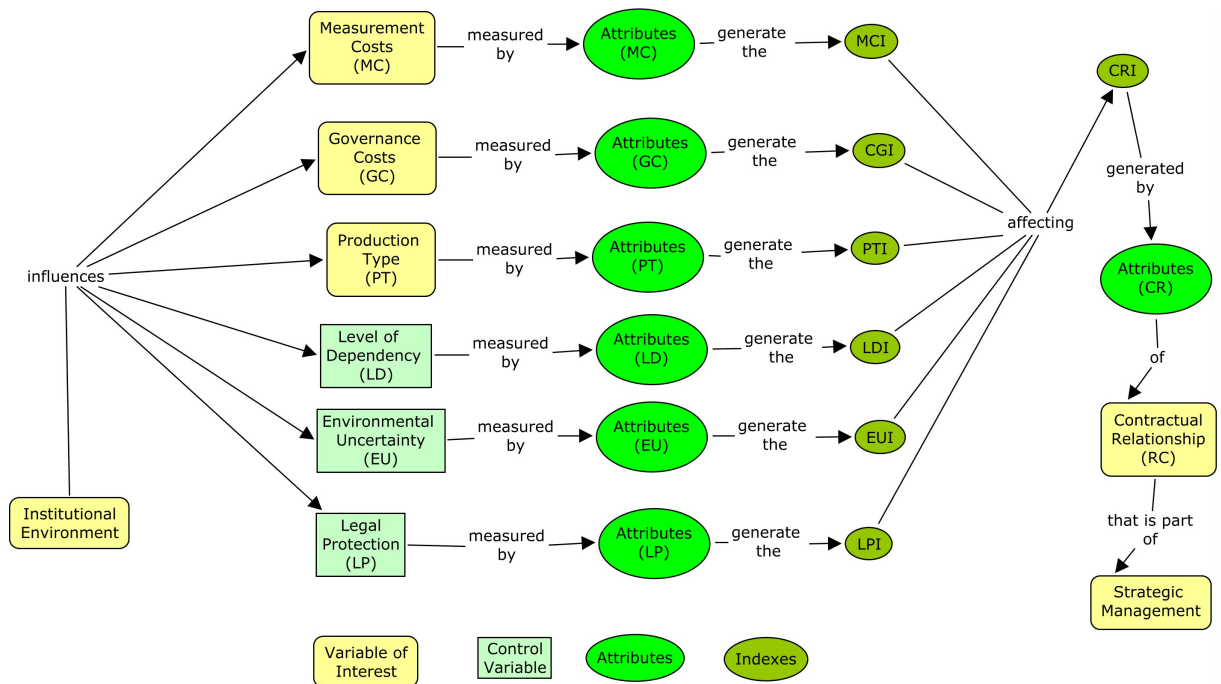
Figure 1: Model to answer the research problem presented in this paper
Source: Adapted by authors from CUNHA *et. al* (2013).

Therefore it is necessary to understand what can be the influence in choosing one strategy over another in these two countries. One of these potential influences is the transaction cost, in its two approaches (governance and measurement costs). That is why this paper intended to investigate this new institutional economics variable in these two institutional environments, to observe if there is any difference between them and if this potential difference could generate different strategies implemented in the supermarkets, especially in the contractual relationship with their suppliers.

But, since these influences and variables are made of several dimensions and attributes, as could be seen in Figure 1, it is necessary to observe which statistical analysis made it possible to get this influence. After studying some possibilities, the best type of statistical analysis was structural equation (Hamilton, 2006; Hair, Anderson, Tatham & Black 2005).

To measure the several dimensions and attributes in these variables in these two countries some questions in a questionnaire were used. These questions were treated, in the analyses, as interval data because "data on attitudes obtained by rating scales are often treated as interval data" (Malhotra 2006, p.240). The authors, based on the theoretical framework, especially in Cunha *et. al.* (2013), adapted Model 1:

The proposed model, adapted from Cunha *et. al* (2013), will be:

$$CRI = \sum_{i=1}^{6} \beta_0 + \beta_i * X_i$$

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Where:

Contractual Relationship (CRI) = linear and standardized combination of answers on issues related to the relationship between supplier and supermarkets. This index measures the complexity of the contractual relationship between these agents. So a higher CRI means a more complex strategy of relationship. Thus, the development of this index attempted to capture the theoretical differences between organic and conventional producers, especially in the transaction costs, whether in governance and/or in measurement costs. Besides that, this index helped to explain the theoretical distinction between contractual relationships in two institutional environments (Brazil and the U.S.A.), due to several different characteristics in each one;

β_0 = Intercept of regression;

$\beta_1 * X_1$ = Measurement Cost Index (MCI) = linear and standardized combination of answers to questions related to this variable. Thus, the higher this value, the higher the measurement cost in the transaction;

$\beta_2 * X_2$ = Governance Cost Index (GCI) = linear and standardized combination of answers to questions related to this variable. Because this is the most important determinant of governance costs according to the literature (WILLIAMSON, 1985) this index will capture the involved asset specificity in the strategy of the contractual relationship. Thus, the higher this value the higher the asset specificity in the strategy of the contractual relationship. Two types of asset specificity were considered in this index: the time (perishable products) and brand (certified products) one;

$\beta_3 * X_3$ = Product Type Index (PTI). This index is a dummy variable that captures the production type in the farms. This value is zero (0) for conventional producers and one (1) for organic producers;

$\beta_4 * X_4$ = Level of Dependency Index (LDI) = linear and standardized combination of answers to questions related to this variable. So, the increase in this index represents a producer's higher level of dependency in this strategy of relationship with supermarkets.

$\beta_5 * X_5$ = Environmental Uncertainty Index (EUI) = linear and standardized combination of answers to questions related to this variable. Thus, the higher this value the higher the environmental uncertainty;

$\beta_6 * X_6$ = Legal Protection Index (LPI) = linear and standardized combination of answers to questions related to this variable. So, the increase in this index represents more legal protection in the relationship; and

ε = stochastic error.

The last three indices (LDI, EUI and LPI) will be used in this model as control variables for a greater distinction and less interference in the other three indices (MCI, GCI and PTI). This model will be done with two different groups (Brazilian and American data). Therefore with the development of this model some results are expected to be found. These expected paper research results will be shown in the next topic.

Several hypotheses, about the research question, were tested. These hypotheses are:

H_1: The governance cost has a positive influence in the contractual relationship in both institutional environments.

H_2: The governance cost has a higher influence in the Brazilian contractual relationship, because the temporal specificity (be perishable or not) are in the contract and are not in the American one.

H_3: The measurement cost has a positive influence in the contractual relationship in both institutional environments.

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H_4: The measurement cost has a higher influence in the American contractual relationship, because the attributes, especially the organic one, could be better measured in this country due to several mechanisms, especially by the organic system and laws, that are older than in Brazil.

4. Results and Discussion

One structural equation was done to analyze these influences. This statistical analysis was done using two different groups: the first one with Brazilian data and the second one considering American data. The results are showed in the Table 1.

Table 1: Results of Structural Equation

Structural	Brazil	U.S.A
MCI => CRI	$-0,38^{ns}$	$0,24^{***}$
GCI => CRI	$1,55^{***}$	$0,66^{ns}$
PTI => CRI	$-1,20^{***}$	$-1,01^{ns}$
LDI => CRI	$0,20^{*}$	$0,13^{ns}$
EUI => CRI	$-0,35^{***}$	$0,11^{ns}$
Constant	$1,06^{***}$	$-0,48^{ns}$
Variance	1,31	3,71

Source: Authors

Another way to see these results are to observe the whole structural equation and its respective coefficients, constants and variances, as could be seen in Figure 2 (to Brazilian data) and Figure 3 (to American data). All the coefficients that are shown near the arrows linking the variables to the CRI, the estimated constants are inside the box on the top and the variance of these estimations are inside the box on the bottom. Besides these data about the variables, the estimated constant in the CRI are included inside the box on the bottom and its error are represented by the ε_1.
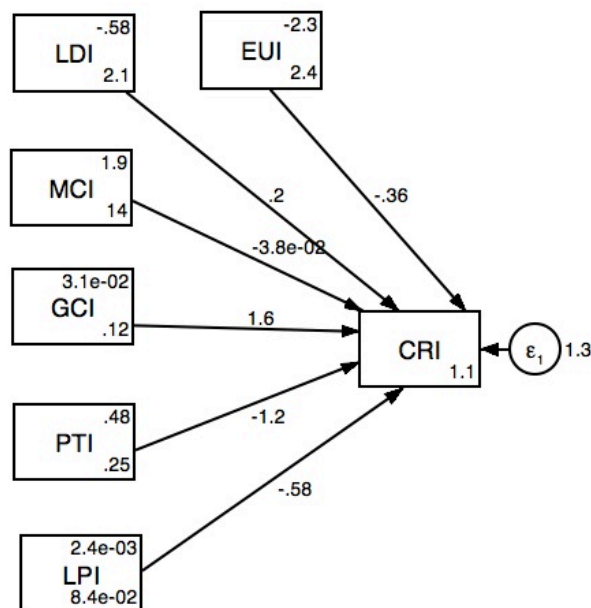

Figure 2. Structural equation to the group 1 (Brazil)
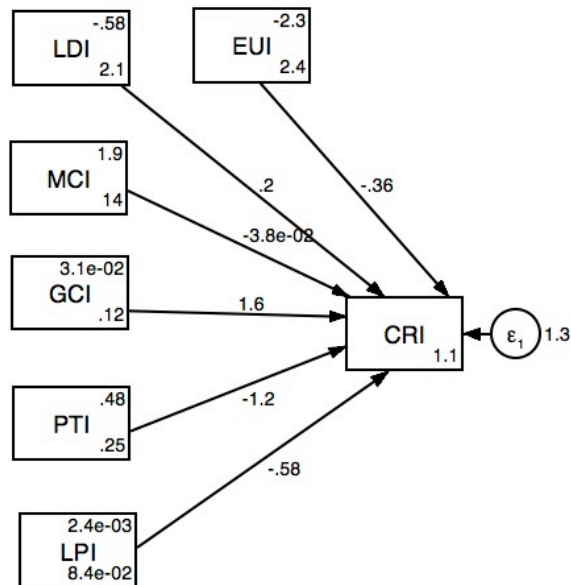Source: Authors

Figure 3. Structural equation to the group 2 (U.S.A)
Source: Authors

As could be seen some hypotheses could be rejected and some could not. The first hypothesis (H_1) was rejected because there is no influence, according to this structural equation, of the GCI on CRI in the American data. This could be explained because some attributes, especially about the temporal specificity are negotiated in the contract in Brazil and are not negotiated in the contract in the U.S.A. Another hypothesis (H_3) was rejected because the measurement costs had influences only in the U.S.A, according to this structural equation, which could happen because an important attribute (organic or not) are not negotiated and measured in the contract. The supermarkets only mention that the product must be organic and the supplier needs to have certification, which is measured and given by another organization (certifier).

On the other hand, hypothesis H_2 was not rejected because the governance costs in Brazil are higher than in the U.S.A. and also H_4 was not rejected because the measurement costs are higher in the U.S.A than in Brazil.

5. Conclusion

The strategic management decision could be influenced by several variables, such as the sector (Schmalensee, 1985), industry (Rumelt 1991), business unit/segment (McGaham & Porter, 1997) or country (Vasconcelos, 2004). But the influences are not limited in these variable, so is important to study another possible influences in this kind of decisions, such as governance costs (Williamson, 1985; Williamson, 1991) and measurements costs (Barzel, 1982, 2002, 2004), being both of these variable potentially influenced by the institutional environments (North 1991, 1994, 2004). So this paper intended to analyze, empirically, the possible influence of the institutional environment in the governance and measurements costs, and then the potential influences of these two variables in the strategic management decision, as could be seen in Figure 1.

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After the estimation of the structural equation used in this paper is possible to have some potential conclusions such as:

a) There is a different in these two different institutional environments (Brazil and the U.S.A), especially in the influence of governance costs (just in Brazil) and measurement costs (just in the U.S.A);

b) These found differences could have some explanation, such as be explained by the attributes that are present or absence in the contract in these two countries, especially in the organic attributes;

c) In this paper was possible to see, empirically, the potential influence of the institutional environment in the governance and measurement cost;

d) With the results showed here is possible to see more clearly how the governance and measurement costs could have influence in the strategic management decisions, especially in the contractual relationship between supermarkets and suppliers;

e) Since was possible to observe some difference in the influence of these two new institutional variables (governance and measurement costs) in these two institutional environments (Brazil and the U.S.A) is possible to analyze, empirically, how the institutional environments have influence in the strategic management decisions, especially in the contractual relationship.

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October 07-08th, 2013
Center for Organization Studies (CORS)
USP (University of São Paulo); FGV (Getúlio Vargas Foundation); Insper (Institute of Education and Research);
UFBA (Federal University of Bahia); UFRJ (Federal University of Rio de Janeiro) and UFSCar (São Carlos Federal University)