

# **NETWORK GOVERNANCE IN MARKETING CHANNELS: AN APPLICATION TO THE FRENCH AOC WINE INDUSTRY (REFEREED)**

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## *Abstract*

This paper examines how a firm's strategy in a marketing channel is contingent on how its related upstream network of embeddedness, outside of downstream customer relationships, is organized. Drawing on the political economy framework, completed by recent research on institutional influences and emerging network perspectives in the field, the author argues that the firm's ability in a marketing channel to adapt to downstream customer relationship changes depends on the governance mechanisms that have been deployed in its upstream network. The governance mechanisms toward the upstream network are driven by two types of strategic goals: (1) to strengthen legitimacy and (2) to reduce the uncertainty of the environment and resource dependence. The study of recent evolutions of marketing channels in the French AOC wine industry helps to identify and specify these mechanisms. The article ends by laying out a research agenda and highlighting some managerial implications.

## **1. The extended comprehensive framework of marketing channels**

Uncertain conditions in a focal dyadic relationship require the use of governance mechanisms that allow for flexible adaptation to changing circumstances (Williamson, 1991) and particularly, as shown by Wathne and Heide (2004) in their extension of the Transaction Costs Analysis model, adaptation to uncertainty depends on how a connected relationship is organized.

In a broad sense, interfirm governance is defined in terms of initiation, termination, and relationship maintenance processes. As recalled by Heide (1994): "the term "governance" is a shorthand expression for the institutional framework in which contracts are initiated, negotiated, monitored, adapted and terminated". In this definition, contract is used in a very broad sense. Essentially, governance includes elements of establishing and structuring exchange relationships as well as aspects of monitoring and enforcement between a set of parties.

Theoretically, governance mechanisms in a supply chain network can correspond to two main strategic goals of the organizations: (1) resources dependence and environment uncertainty reduction and (2) legitimacy strengthening. In the former case, the governance mechanisms will consist either in vertical integration, or in incentive design, participative decision making and relational management of the suppliers. In the second case, they will take the form of image and reputation means of control mainly through the “fit” of the firm embeddedness within the institutional environment.

### **Reducing resource dependence and environment uncertainty in marketing channels**

Most research on marketing channels builds on the political economy framework, in which the channel dyad is a social system influenced by economic and socio-political forces (Stern and Reve 1980). Researchers have focused explicitly on internal economic and socio-political structures and processes, and the external economic environment (Achrol, Reve, and Stern 1983).

Internal economy researchers have examined economic structures. Set within the transaction cost economics framework (Rindfleisch and Heide 1997), this research has found that asset specificity (e.g., Anderson and Coughlan 1987), environmental uncertainty (e.g., John and Weitz 1988), and scale economies (e.g., Klein, Frazier, and Roth 1990) influence the level of vertical integration.

In examining economic processes (i.e., the nature of decision-making mechanisms used by channel constituents; Stern and Reve 1980, pp. 55-56), researchers have found that centralization, formalization, and participation influence the functioning of channel relationships (e.g., Dwyer and Oh 1987; John 1984).

Internal polity research (i.e., the nature of the power-dependence relationships among channel constituents; Stern and Reve 1980, p. 57) has studied socio-political structure as the possession, use, and effects of the power of one channel member over another (e.g., Anderson and Weitz 1992; Frazier 1983b), the implications of the nature of dependence on channel member attitudes (e.g., Kumar, Scheer, and Steenkamp 1995; Lusch and Brown 1996), and the performance consequences of control mechanisms (e.g., Bello and Gilliland 1997; Celly and Frazier 1996).

In understanding socio-political processes after John (1984), (i.e., the dominant channel sentiments), researchers have concluded that conflict (e.g., Frazier and Rody 1991), trust and commitment (e.g., Morgan and Hunt 1994), and social norms (e.g., Heide and John 1992) influence channel attitudes.

Beyond the micro-dyadic issues, channel researchers have scrutinized the implications of the external economic environment and of the institutional aspects of the external polity for dyadic structures and processes.

This approach emphasises the uncertainty and dependence reduction and two separate domains of research that mirror developments in organization theory have evolved simultaneously (Aldrich 1979; Pfeffer and Salancik 1978). The first domain considers the environment as an information source, which results in the problem of uncertainty about external conditions (Aldrich 1979). Research in this tradition has studied the impact of environmental heterogeneity and variability on channel structures and processes (e.g., Achrol and Stern 1988; Dwyer and Welsh 1985). The second domain, based on resource dependence theory, considers the task environment a stock of resources and raises the issue of channel member dependence on the environment for critical resources (Pfeffer and Salancik 1978; see also Achrol and Stern 1988; Dwyer and Oh 1987).

### **Emerging complementary perspectives on interfirm governance and networks in marketing channels**

Some scholars have suggested that to understand fully the nature of interfirm relationships in marketing channels, greater attention must be directed to the larger networks in which the relationships exist (Anderson, Hakansson & Johanson, 1994; Iacobucci, 1996). Recently, Wathne and Heide (2004), on the basis of the governance literature, identified two governance mechanisms that a manufacturer can use to structure his relationship with the upstream supplier and by doing so improve his capability of adaptation to market changes: supplier qualification and incentive design. As they point out, current theory has proposed several strategies or governance mechanisms that can be used by organizations to manage relationships with exchange partners. In general, according to Eisenhardt (1985) and Heide (1994), the mechanisms fall into two categories: the firm can ex ante identify or select a partner that possesses the ability and motivation to support his strategy and/or he

can design incentive structures that reward the necessary behaviors and/or penalize non compliance in the ongoing relationship.

Beyond taking into account upper relationship influence, other researchers have extended the level of analysis to upper networks in which channel members are embedded.

Unlike the political economy approach, the institutional approach focuses on the necessity of organizational legitimacy. Institutional environments refer to the processes of institutionalization and corresponding institutions and mechanisms of influence that pertain to legitimacy in a particular societal context.

Legitimacy "is a generalized perception or assumption that the actions of an entity [channel member] are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman 1995, p. 574).

In their research work, Grawal & Dharwadkar (2002) extend the political economy framework by developing three institutional processes (regulating, validating, and habitualizing) that lead to the formation of types of institutions (regulatory, normative, and cognitive, respectively). They suggest that the institutional processes result in institutional pressures (imposition and inducements for regulating, authorizing and acquisition for validating, and imprinting and bypassing for habitualizing) and that these institutional pressures influence channel structures and processes.

While studying status, quality and social order in the California Wine Industry, Benjamin and Poldony (1999) shown that if according to economic models of reputation, customer's expectations about the quality of a producer's products derive of the past, they also derive from affiliation that market actors develop through their exchange relationship. The status-based model of market competition (Poldony, 1993) shows that market actor's status has a dual foundation in both its past demonstrations of quality and the status of its exchange partners. Drawing on that model, they claim that: "a firm's position in the status ordering influences the attention that others pay to quality, their assessment of quality, and their regard for the product more generally. Relative to lower-status firms, higher-status firms therefore derive greater benefit from producing a given quality product. (...) In many cases, reputation differences may not be ascribable solely to differences in the underlying capabilities of producers, but rather, may be ascribable to differences in the pattern of affiliations. That is where the firm is located in the social structure of a market and who the firm

affiliates with may strongly influence the perceived quality of the firm within the market... Specifically, firms receive lower returns to their quality investment to the extent that they fail to establish affiliations that reflect that investment (Benjamin and Poldony, 1999, p.21).

Another interesting insight into channel behavior can be derived from research work on partitioning processes. For example, Swaminathan (2001) suggests a prominent role for an organizational form's identity in resource partitioning. Mature industry typically features a high degree of market concentration. With increasing concentration, generalists tend to compete vigorously for the central part of the market, thus allowing specialists to thrive on the periphery. But his study shows that the success of generalist organization in establishing robust identities (through brand proliferation coupled with higher advertising expenditures) will depress the founding rate and elevate the mortality rate of specialist organizations. The author suggests that useful insights into industry evolution can be obtained by dividing mature industries into two strategic groups: generalists and specialists. He shows that two identity characteristics of specialist and generalist organizational forms play an important role in the evolution of specialist organizational form: smallness and reputation for high quality. In the California wine industry, its longitudinal study shows that wineries that own larger vineyards suffer less mortality, possibly reflecting their greater control over the quality of raw materials. Vineyard ownership also ties up the best-quality grapes and thus disadvantages other farm wineries that do not own vineyards and depend upon such supplies.

Concerning the role of communal support structure in the evolution of specialist organizations, the author, following Piore and Sabel (1984), argues that various forms of institutional cooperation helped in the growth of specialized industrial districts such as those in the textile industry in Italy. "Some institutions, such as trade associations, guilds and unions, serve a socio political purpose, providing collective voice for specialist firms within an industry. Others, such as purchasing and marketing cooperatives, are fulfilling an economic rationale. Specialist organizations in mature industries are likely to co-evolve with other forms of specialist organizations".

Drawing on this recent research work, our claim is that these two research streams are complementary and that their integration could allow us to better understand the marketing channels dynamics. We think that methodologically, when strategic changes arise in a particular industry, the combination of these theoretical approaches (Table1) in the analysis would potentially allow channel members to more fully grasp the real phenomenon and by doing so, would improve their ability to anticipate and manage the on-going changes at stake in their activity.

Table 1: Combination of Two Main Research Streams in Marketing Channels

<b>Channel Members Organizational Goals</b>	Resource Dependence and Environment Uncertainty Reduction	Legitimacy strengthening
<b>Main References used</b>	Stern & Reve 1980 Wathne & Heide 2004	Grawal & Dharwadkar 2002 Benjamin & Poldony 1999
<b>Unit of Analysis</b>	Channel Dyad	Upstream Network in which the Channel Member is embedded
<b>Research focus</b>	Dyad Economic structure and processes Dyad Sociopolitical structure Implications of the external economic environment on the dyad	Institutions and institutional processes : regulating, validating and habituating and the pressures they exert on channel members
<b>Governance Mechanisms used by channel members implemented in their upstream relationships or Network of embeddedness</b>	Vertical Integration Suppliers Selection and Relationship Management	Reputation Management Institutional Commitment : Regulation governance Validation governance Habituation governance

Then, as a first step toward appreciating the usefulness of this integration, we applied this extended approach to marketing channel in a specific empirical context: French wine merchants activity. The following study must be understood as a first

exploration aimed at globally evaluating the accuracy and the richness of an analysis based on the above general theoretical framework.

## **2. Linking theory and practice in French Rhone-Valley AOC Wines Marketing Channels**

Our research setting focuses on the 43 Wine Merchants and Trading Organizations of the Rhone Valley area (RV).

This empirical context selection is based on two reasons. First, the French wine industry has some unique features that make it an especially compelling context for examining the interaction between socio-political institutions and distributors as well as the legitimacy issue. But since the essential of the French wine activity is structured according to definite areas of production such as Bourgogne, Bordelais, Languedoc-Roussillon, Vallee du Rhone... and since Avignon is the Capital City of Rhone Valley Wines, we focused on Wine Merchants of this area. Such a reduction of the unit of analysis seemed appropriate to our exploratory logic as it was also allowing us to deepen the issues of the interactions of these businesses within the regional institution : Inter-Rhone as well as within the national ones. Second, the French wine merchants industry in the Rhone Valley mirrors major structural changes. Then, our theoretical framework, designed to grasp channel dynamics, could improve our understanding of this process of evolution.

The research methodology is mainly exploratory. It relies partly on a documentary study of the wine industry and partly on a content analysis of qualitative data : 20 half structured interviews of Wine Merchants and 3 deepened discussions sessions with the Inter-Trade Association (Inter-Rhone) experts involved in wine merchants issue.

After the presentation of the research context (A), we focus on the recent strategic changes in this industry which call for further explanation (B). Then, we show that the application of the extended theoretical frameworks highlights the channel member's rationality and beyond, allows a first specification of the hypothetical governance mechanisms that they tend to implement or maintain in their network (C).

## **A. Research Context**

The empirical context for our study is the French AOC Wines Industry. In the last few years, the worldwide market share of French wines, traditionally leaders, decreased by 6%, whilst at the same time, world trade doubled, going from 15 to 30% of the total world trade in still wines.

This is mainly the result of the competition of the “new world” wine producers (Australia, United States, Chile, Argentina and South Africa). These new players committed themselves to true marketing strategies oriented towards a global coverage of international markets, professionals and consumers alike. They rely on a clear positioning of their national offer, but in addition... this positioning has been established with full consensus. Their wines are original, because of their “terroirs”, but also because of the very user-friendly and easy-to-understand design of the product policies. This results in a homogeneous marketing mix: wines and packaging of a new type (a fruity taste, targeted at the taste of the average consumer, which is quite different from that of the experts, more generally wine made out of single grape varieties with amusing or artistic labels...); complete ranges of wines whose brands are easy to identify (Ex : Turning Leaf of Gallo), pricing policies which are coherent with the different quality levels, well conceived advertising campaigns, as powerful as their budgets are big!

In addition, recently, these producers have started to upgrade their ranges so moving the competition threat from table wines and « Vins de Pays » ( lower French category in quality - legally speaking), toward the position of the French AOC wines. Also these wines which correspond to the highest quality norms/standards in the world are the central core of the French range. The 466 AOC wines are produced by 112,000 businesses and represent 80 % of the total turnover of the French wine industry.

French Rhone Valley (RV) Area is one of the largest high quality vineyards in the world. With 77000 ha in AOC wines, it is the second largest French wine area behind Bordeaux area (117000 ha). The AOC of the RV - 480 Million bottles sold in 2001-2002 represent 16% of the total French AOC wine exports in volume; 20% of the total of French wines of quality from determined regions ( legal category ); and 1.3 Billion Euros in value. With 28% of the production of the area, dispatched to over 150 countries (mainly in Europe) for a total amount of 30 Million Euros in 2002, the RV



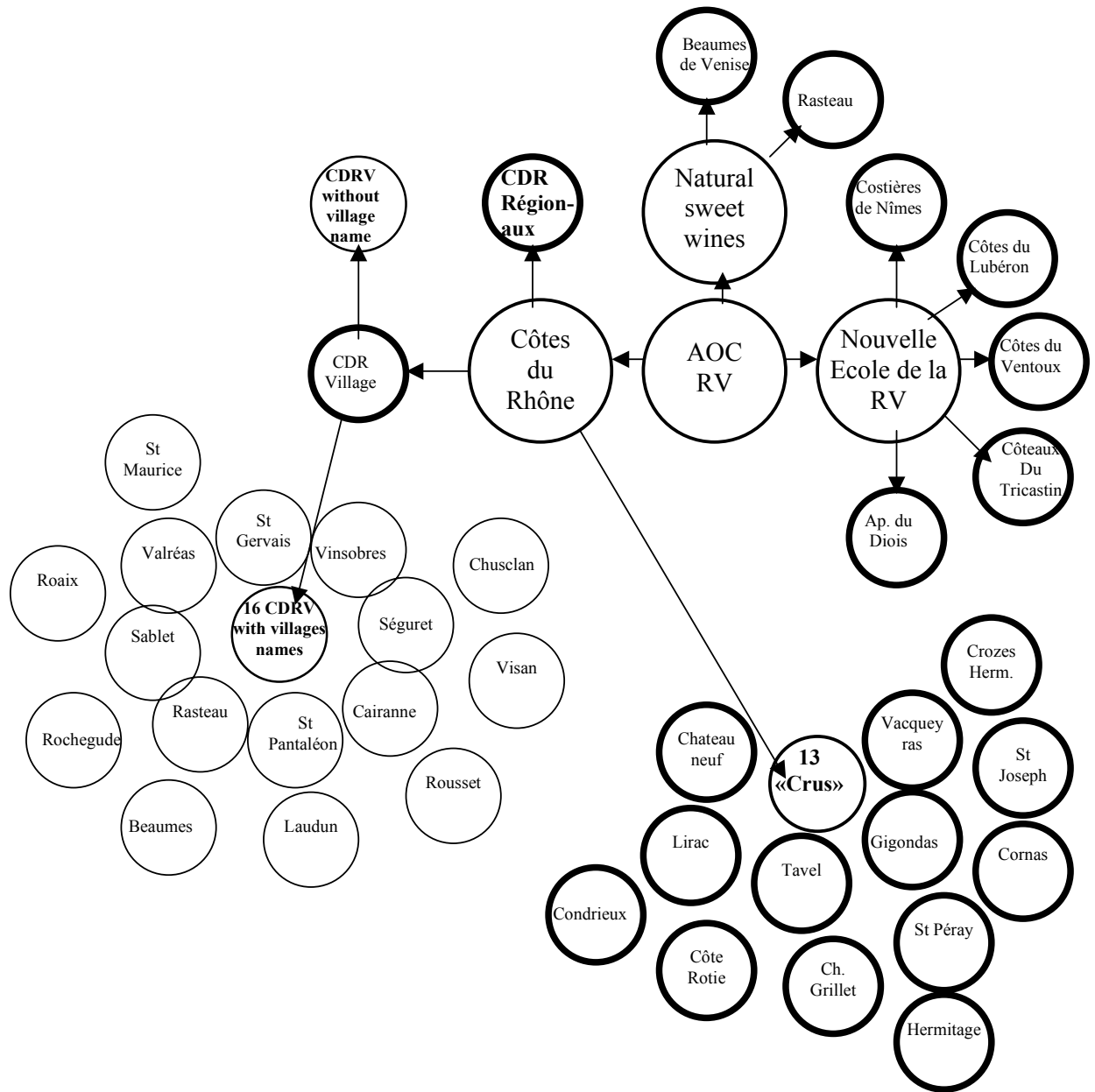
AOC Wines come from a first class tourist area and function as the flag-ship for leading producers.

The wine has been produced and marketed by 1529 private producers, 113 cooperatives, 43 wine traders et 6 cooperative groups. Local wine merchants bottle 50% of the volume produced (i.e. 233 Millions bottles in 2003). Wine merchants from outside the area bottle 24 %. Direct sales by producers represent 24% of the total volume of RV AOC Wines.

On the basis of a classification based on the production regulation criteria, the AOC Wines can be summarised as in Figure 1 below.

The 22 “statutory” AOC s have been classified by the Inter-Trade in three groups for historical and strategic reasons: Natural Sweet Wines, Nouvelle Ecole of the Rhone-Valley, Cotes du Rhone. More complex than the two others, CDR category regroups the wines corresponding to 4 different levels of quality in the AOC category: the 13 “Crus” are supposed to be the best, they are followed by the 16 “Villages Names”, then by the “CDR Villages” (not legally allowed to promote specific villages names) and then by the wines of the CDR AOC category.

Fig 1: The « bunch » of AOCs of the Rhone Valley



## B. Recent Significant Strategic Changes in the RV Wine Merchants Industry

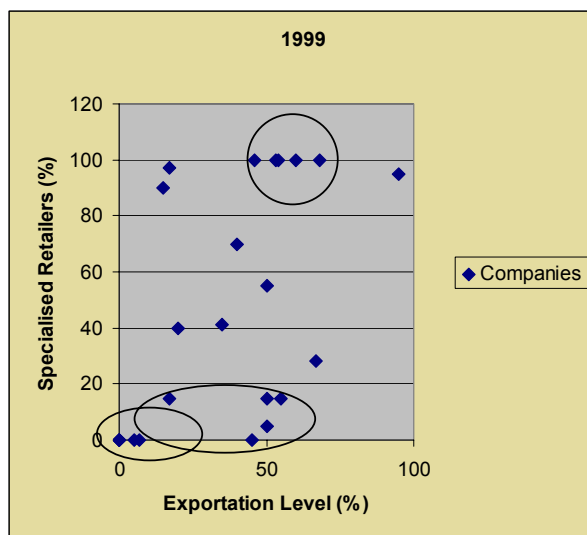
### *Latter Strategic Groups Movements*

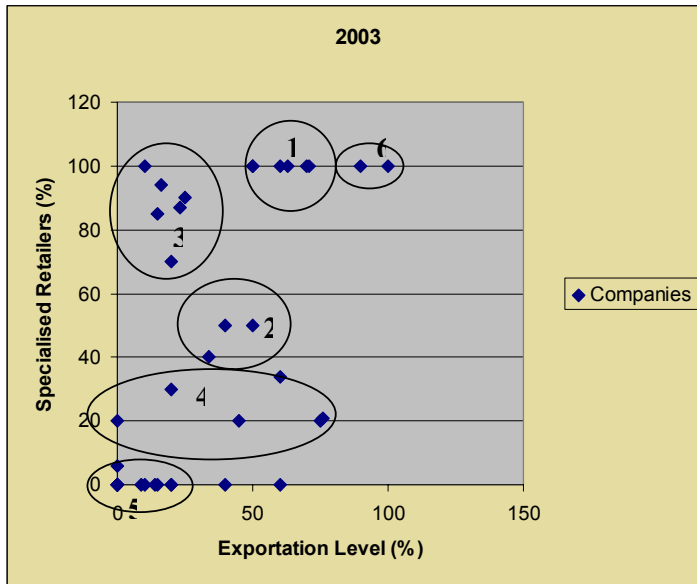
According to a classical Porterian strategic analysis, two criterions seem to structure the French AOC Wines Channels Industry:

- the percentage of exportation,
- the sales percentage made without big retail stores in France.

Five to six strategic groups could then be distinguished in 2003 versus three in 1999.

Fig 2: Strategic Groups Evolution in RV AOC Wines Marketing Channels in 1999 and 2003





#### 1. Ambassadors: 100000 hl, 94% RV AOC Wines

- 4 wine merchants occupying high quality wines markets less sensitive to the price: e.g. tasting and art segments.
- Family owned companies except one bought by Deutz Champagne ten years ago but quite autonomous
- Selective distribution: they try to keep their products away from major retailing and use specialized retailers who do not respect their agreements and sell to major retailers

In the last five years, these companies have continued their spatial expansion: they tend to occupy all foreign markets demanding for luxury goods. They also invested in high quality vineyards, locally but also abroad. They practise a luxury good marketing and maintain their positions on higher quality expectations segments.

#### 2. Challengers: 320000hl, 90% RV AOC Wines

- External investments and control : all 4 of them except one (bought by employees with the help of Australian funds) have been bought in the last years by large companies from outside the area
- Investments in local vineyards
- Redesign of marketing strategies
  - Brand development
  - Signatures development

- More generally an attempt to move toward upper quality segments and escape from middle and lower quality segments
- Securization of buying through relationship development with winemakers and enhanced selection of suppliers

This group appeared in the last five years after the investments of external large companies. They tend to move up to market segments offering higher value.

### 3. Wine Producers or “Domains”: 50000 hl, 63% AOC

Even though the volumes and value of AOC exchanges are about one fourth of these of the Ambassadors, the group has been growing. It is constituted of 8 domains, with relatively important level of production and with such good performance on their markets that they are able to improve their offer. In this group wine trade is considered mainly as a complementary service for current clients. Two of them sell 100% on foreign markets. We can notice that 2 domains in the group are specialised in export markets and present an AOC level in the portfolio up to 97%.

In this group wealthy domains recently entered (practically 50% of the actual group size). Compared to the others, they operate on “niche” markets but the wine merchant side of their activity allows them to achieve better performance in the sales of their own wines.

### 4. Major Retailing Suppliers: 1.300.000 hl

- For this group of 8 companies, competition is getting harder. Especially with the entrance on the market and the marketing development of cooperatives some of which have come together. In the mean time, major retailers (largest retail stores) are seeking to establish direct relationships with producers.
- In this strategic group two family owned companies try to escape by the upper end and catch up with the challenger group

5. “Volumists” – i.e. companies leading volume strategies as opposed to differentiation strategies - can be divided into two groups: 6 bulk traders and 4 Wineries. As in the « basic » market segment, the group is declining. The activity is more and more difficult and negotiations with clients get harder.

6. “Confidentials”: A sixth group has been identified by experts of the activity: three wine merchants representing 15000 hl altogether and operating on top quality wines either in France or abroad.

### *Marketing development of channel members and repositioning*

Globally the analysis shows a global repositioning of channel members in the French Wine Industry. At the region level, new strategic groups appear on the upper quality segments while on lower quality segments, former groups try to survive or to evolve toward upper positions. More sophisticated marketing strategies based on this new market segmentation are implemented in all groups. This segmentation comes from a qualitative study conducted in more than 100 countries and broadcasted in the local network by the regional Inter-profession organization.

Table 2: International segmentation based on consumers expectations (SOLVING - 2003)

<b>Price In Euros</b>	<b>Type of segment</b>	<b>Consumer Expectations</b>	<b>% of worldwide demand</b>	<b>Trends</b>
1-3	Food	Food complement	21%	decrease
3-7	Fun	Seeking standards & enjoyment	56%	N/A
7-20	Tasting	Seeking special tastes, particularities	18%	increase
>20	Art	Seeking an emotion	5%	Stable

Four segments are distinguished:

**The Food** segment should be logically demanding regularity, a safe buy, consistency, easy to handle packaging with wide distribution at reasonable prices;

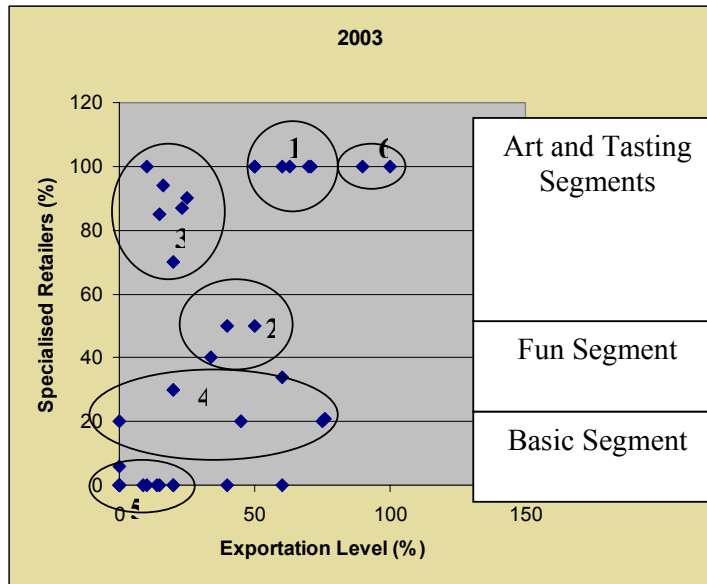
**The Fun** segment should correspond to standard wines. It is the « Soda » model of consumer habits. What is of value for the consumer is a universal and durable, precise taste, and the ability to find it easily in a crowded supply context.

**The Tasting** group covers people who probably look for something special, specific or different tastes marked by its “terroir” & origins ;

**The Art** segment looks for particular emotions, or an exceptional or unique sensation.

By crossing strategic groups with recent international market segmentation (Table 2), the coherence of positioning strategies appears clearly. Obviously, strategic groups are heading toward a better adaptation to markets.

Fig 3. Market Segment Fit of Wine Merchants Marketing Strategies in 2003



Through wine trade, the “Wine Producers” are extending their product ranges to better sell their own production. The Challengers are clearly separating ranges with brand names for major retailing - and major retailer’s brands, as well - from upper quality products with signatures addressed to tasting and art segments and designed to mimic and attack the Ambassadors. Volumists are in a concentration process aligned on the expectation of their own decreasing segment while Major Retailing Suppliers are trying to rebalance their portfolios and reduce their dependence on Major Retailers by internationalisation strategies.

At the lower end of the fun segment and on the food segment, channel members are submitted to the pressure of direct sales of cooperatives (either regrouped or not) and of direct purchases of major retailers (2%) who also try to improve the quality and move up to fun and tasting segments.

**C. Understanding the channel dynamics through the extended theoretical framework**

Drawing on the integration of the two main theoretical approaches of marketing channels, we argue that in the case of marketing channels for goods with strong

identities in mature markets, like French wines marketing channels, the market adaptation ability of a marketing channel organization largely depends on how it is dealing with the “upstream network” in which it is embedded (Granovetter, 1984). More precisely, the governance mechanisms that this organization has deployed in its network will greatly influence its strategic ability to adapt to market changes.

*Environment Uncertainty and Dependence Reduction  
and corresponding governance mechanisms*

The recorded market adaptation of channel members is closely linked to their ability to reduce uncertainty and dependence in their relationships with the production network. In a context of counter performances of French wines sales on foreign markets due to the repeated attacks of new producing countries and a decrease of national demand, there is an increasing need for product quality management and precise positioning strategies on the part of Wine Merchants (75% of the sales of French AOC Wines). Wine Merchants are then facing the need to maintain or improve their control on the supply network. Two main governance mechanisms appear to be used in this purpose: vertical integration and relational supply management.

Vertical integration

It is one of the most decisive governance mechanisms. Lately, Ambassadors have made huge investments in high quality vineyards in the area and abroad : Guigal the Leader in the group, bought Grippa Saint Joseph Vineyard, one of top ten of this AOC; Chapoutier recently bought vineyards in Australia etc...

They are followed by Challengers for their upper ranges. Historically, in the latter group, companies were not producers or wine makers. Facing uncertainty and dependence, they invested in this new activity, at least for strategic products of their ranges i.e. prestige wines. They tend to buy famous vineyards and domains whenever they can.

But what is striking concerning vertical integration is the fact that all companies in the challengers group were independent 5 years ago. All of them except two have been bought by large French wine trade groups from outside the area: Boisset, Jean-Jean, Picard, Skalli. As well as in the major retailing suppliers group: the three members



are also large group's properties: Tailhan, Marie-Brizard, and another one from the Beaujolais area.

This vertical integration has also recently been reinforced by the creation of Rhone Originals. This association, launched in January 2005, is the result of the alliance of five wine merchants of the area: Ferration Pere & Fils, Meffre, Chapoutier, Grandes Serres and du Peloux. Its mission is to coordinate and strengthen the promotion of RV AOC wines on foreign markets and by doing so there is no doubt that the members are in position to improve their control on the supply network.

### Suppliers Selection and Relationship Management

The other governance mechanisms that wine merchants develop to better control and secure relationships with AOC Suppliers network are harder selection and relationship management. It seems that with higher expectations of quality on the markets, wine trade is not so much a matter of pricing strategy anymore as a matter of quality and product strategy. The Wine Merchants tend to implement or develop and maintain long term relationships with strategic winemakers.

As a matter of fact, in all strategic groups, relational mechanisms are implemented toward the upper network. Channel members tend to rationalize their supplier portfolios and develop - with selected winemakers - ongoing cooperative relationships. For example, they provide advising services: teams of oenologists regularly visit the winemakers. Channel members try to identify and encourage winemakers who invest in quality and then help them with their projects. For example more than before, they remain loyal even in the bad years and refrain from switching as they did before. In return, they expect the supplier to be loyal to their company, to be transparent and refrain from cheating, for example by mixing good grapes with lower quality grapes from untended plots...

Expectations of commitment and trust in buyer-seller relationships are becoming a tacit rule and locally, it seems that the prospect of economic difficulties has strengthened loose ties among the network members. Decision making is getting more participative while wine merchants become or want to become more wine makers than before. More than before, Wine Merchants in the Rhone Valley tend to manage the risk of losing the suppliers by creating interdependences that will allow them not to damage the quality level of the supply market.

*Legitimacy Strengthening  
and corresponding governance mechanisms*

The recorded market adaptation of channel members is also linked to their legitimacy i.e. "a generalized perception or assumption that the actions of an entity [channel member] are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman 1995, p. 574). A concept closely linked to the status and identity issues which, as shown previously, are amplifiers of quality perceptions for the former and activity risks reductor for the latter. The more legitimate a wine merchant is perceived to be in the network, the more likely he will be in position to influence network orientations and then be flexible to market fluctuations. Two main interdependent governance mechanisms can be identified in this regard: Reputation Management and Institutional Commitment

Reputation Management

Among Wine Merchants, reputation is considered as a real asset. All actions seem to be considered according to the impacts on company reputation and image. For example, some Ambassadors withdrew from the Russian market because of their lack of capacity to manage it in an ethical way. Another one is suing specialised retailers who are secretly selling his wines to major retailing thus creating conflicts within the full network of specialised retailers and affecting the luxury image of the company wines. The leaders of this group are also involved in ethical actions. Stickers for blind people on bottles, bio dynamic processes of production whenever it is possible... illustrate the point. They will also participate to selected prestige actions like sponsoring, or commitment to special events.

Nevertheless, the key issue in this reputation matter remains the shared values whose combination is constitutive of the French winemakers "culture". Among these values, the quality of the products comes first. In a sense then, all actions which are engaged to improve quality are linked to economic concerns but pertain to socio-professional recognition as well. A wine merchant producing upper class wines, with international recognition, is likely to be spontaneously respected by all members of the network and be quite influent.

## Institutional Commitment

The second governance mechanism deployed by wine merchants to initiate, develop and/or maintain their legitimacy pertains to their behaviors in institutional affiliations. Drawing on Grawal and Dharwadkar framework of institutional environment influences and more specifically on the three processes they identify, we have distinguished three dimensions in the responses of channel members to these kinds of pressure: regulation governance, validation governance and habituation governance.

### Regulation governance

Regulating processes result in the evident interactions between channel members and regulatory institutions. They take two forms: imposition and inducement. In the first case, regulative institutions use coercive power when they perceive that channel members' efforts are in conflict with the larger societal good. When this occurs, the societal response is to create institutional elements with the coercive ability to manage the socially illicit aspects of channel functioning.

It has to be noticed that French wine merchants are leaders in lobbying movements toward political authorities in France and that they are also introduced at the European level. One recent success of the French Wine Industry and specifically of the French Wine Merchants is the moderation of the Law on Advertising for alcohols which prevented advertising about wines.

In the second form inducement mechanisms create structural changes by providing incentives (or disincentives) to channel members for conforming (or not conforming) to the demands of the agency that is offering the inducement. And in this case also, wine merchants are playing an important role as advising government through their responsibilities in a bunch of existing state organizations: INAO, CNAOC, ONIVINS... For example they recently wrote "white papers" at regional and national levels on the wine industry situation and prospects in response to the findings of the French Senate Study. It is to be noticed that the person in charge of this senatorial mission was a former wine merchant.

### Validation governance

Processes of validating subsume the midrange processes that represent the interactions between normative institutions (such as trade associations, professions and professional associations, and mimicking behaviors) and channel members and give rise to standards for socially acceptable behaviors (Baum and Oliver 1991; Meyer and Zucker 1989). Institutions, such as professional associations, may emerge to promote the interests of their members or create accreditation standards for their profession.

Wine merchants are deeply involved in the Inter-trade Rhone Valley Association: Inter-Rhone. Locally, in the last five years the role of the Inter-trade and its influence in the AOC Wines producing network has increased with the growing involvement of wine merchants. As far as they are concerned, wine merchants use it as a way to communicate or cooperate with AOC's producers. For example, they recently designed and formalised in cooperation with them, secured agreements for wine trades as well as a strategic plan for the AOC Cote du Rhone development for the next ten years.

This professional organism is based on a participative functioning and structured discussion groups between the diverse AOC's associations (about 1500 independent producing units) and the Wine Merchant Section (41 companies). The latter are automatically represented in each AOC's syndicate. Inter-Rhone enacts decisions such as the annual level of collective reserves or the procedures of control for each AOC of the area. In the discussions groups, marketing or quality problems are also transparently discussed.

Beyond professional institutions some Ambassadors are members of and participants in selected non profit associations like, for example the "Slow Food" Association (named by opposition to "fast food"). Through this type of cross professional bodies, they potentially enhance their field of operations as well as their legitimacy image.

### Habituation governance

Habitualizing refers to the invisible, base-level institutional processes in which actions that are repeated become cast into a particular pattern that then can be reproduced

with minimal effort and is recognized by its performer as the particular pattern (Berger and Luckmann, 1967). Habitualizing institutions emerge for two primary reasons: First, the creation of social order requires the adoption of routines that can be easily reproduced, which leads to habitualizing. Second, psychological economies that result from the organizational ability to manage repetitive situations also require habitualizing (Berger and Luckmann 1967). Habitualizing makes it possible for channel constituents to develop informal psychological contracts that are based on common understandings and decreases the need for channel members to articulate structures and processes explicitly and regularly (Zucker 1983).

French AOC Wines Professional networks have a long history and are carrying a system of tacit codes that orient member's actions. These tacit rules can be pointed out when problems appear. An illustration in this case study comes from the tacit and largely non concerted boycott of certain AOC's producing networks who misbehaved from the wine merchant's perspective. Two RV AOC networks specially have been let down by the most important wine merchants because of their former opportunistic behaviors and the short term interest actions they decided 5 or 6 years ago, thereby placing wine merchants in bad position on their export markets. As a consequence, even if these AOC's sales potential remains interesting, wine merchants still refuse to deal with the producers.

Altogether, the governance mechanisms can be understood as the specification of a general governance strategy implemented by channel members in their upstream network. Fully aware that "no business is an island", these organizations design incentive structures in which, for the network, the long term gains from maintaining them in position exceed the short-term pay offs from excluding them. But, in order to do that, channel members have to reduce the perceived expropriation risks endured in return by their network and match the "investment" or the contribution of the latter to their own marketing strategies. It seems that they achieve this equilibrium not only through vertical integration or relationship management but also through reputation and institutional commitment management.

## **Conclusion**

Compared to the usual political economy approach to marketing channel, the extended theoretical framework mobilised through this case analysis enables researchers to more completely specify channel members behaviors. It also offers a

larger insight into the hypothetical sources of their strategic ability to adapt to market changes.

By taking into account the legitimacy concern of this type of organizations, beyond their general aim at reducing uncertainty and resource dependence, reputation and institutional commitment management in the upstream network can be identified as two governance mechanisms, as important as vertical integration or relationship management of suppliers.

Particularly, considering the richness of the empirical illustrations when thinking of “regulation”, “validation” and “habituation” governance of upstream network by channel members, this application offers a good support to the tri-dimensional conceptualisation of institutional environment suggested by Grewal and Dharwadkar (2002).

This work then calls for further research on external validity and measurement issues. For example it raises questions such as: What role does “culture” play in network management? Are these governance mechanisms specific to a particular industry? What is related to the product category?

From a managerial point of view, the study points out the growing complexity of the wine merchant job by highlighting the necessary governance mechanisms they have to deploy in their upper professional and supply networks if to perform on their markets. Successful positioning strategies through product, price, distribution and promotion seem to be more and more dependent on the wine merchant ability to acquire a strong position and recognition in its upstream networks. It then appears that only those who have soon enough taken into account the legitimacy issue and have deployed mechanisms to govern it effectively will survive the current internationalisation processes and the decline of the “traditional” markets at stake in the wine industry. So this research illustrates that the very nature of wine merchants core competencies shifts from tasks related to being a link in the supply chain toward effectively “governing” their network of embeddedness and becoming a key pilot organization in this context.

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