In a distribution network, a punishment event not only affects the disciplined distributor but also changes the attitudes and behaviors of others in the network (i.e., observers). By moving beyond a dyadic view of punishment, this article considers the effects of punishment on observers and integrates insights from social learning, fairness heuristic, and social network theories. The resulting framework of the observer effects of punishment in a distribution network, empirically tested with a survey in China, reveals two mechanisms through which punishment leads to reduced observer opportunism: (1) a direct deterrence effect and (2) a trust-building process. Moreover, two information-related constructs moderate the observer effects differently. The disciplined distributor’s relational embeddedness, which motivates greater information flow to observers, aggravates the problem of information asymmetry against the manufacturer, making punishment less deterrent for observers. In contrast, the manufacturer’s monitoring capability, which reduces information asymmetry, strengthens observer effects. The authors discuss both theoretical and managerial implications of using punishment to achieve collaboration from a wide network of channel members.

Keywords: punishment, opportunism, observer effect, marketing channels

Online Supplement: http://dx.doi.org/10.1509/jmr.12.0142

Observer Effects of Punishment in a Distribution Network

In virtually every marketing channel, disciplinary actions or punishments are unavoidable because incoherence and belief discrepancy often arise among channel members. Building on theoretical perspectives such as power dependency, transaction cost economics, and relational exchange, prior researchers have explored when and how punishment is appropriate as a means of rectifying a channel member’s dysfunctional behavior (Antia and Frazier 2001; Hibbard, Kumar, and Stern 2001; Kumar, Scheer, and Steenkamp 1998).

With few exceptions (e.g., Antia and Frazier 2001), however, this previous research has taken a bilateral perspective to understand punishment events in a manufacturer—distributor relationship. Although this is an important perspective, distributors outside the focal dyad are also part of the distributor network, and yet little is known about their reactions to punishment. This research gap is concerning given the interdependence between the various entities of a distribution channel and the strong possibility of network consequences arising from a punishment event (Heide and John 1992; Wathne and Heide 2004).

Therefore, in this study, we go beyond the dyadic view and investigate the effects of punishment on observers—that is, other distributors in a channel network that take an interest in the punishment of a peer. We argue that the punishment affects not only the disciplined party but also the attitudes and behaviors of others in the network. Indeed, when punishment is viewed in a network context, it takes on a different set of meanings. For example, it can imply...
social norms within the network, identify appropriate and inappropriate behaviors to observers, and create perceptions of the punisher as fair or unfair (Trevino 1992). Consequently, the “observer effect” of punishment (Kumar, Scheer, and Steenkamp 1998, p. 234), which involves a greater number of participants in a distribution channel, is more significant for a firm’s overall channel strategy and competitiveness.

We focus on observers’ reactions to a punishment event, in particular their ex post opportunism. In view of the obvious linkage between punishment and ex post opportunism, researchers have called for an investigation of their relationship (e.g., Antia et al. 2006). Yet previous research has largely focused on the antecedents that establish punishment as a response to dysfunctional behavior (Antia and Frazier 2001; Hibbard, Kumar, and Stern 2001; Kumar, Scheer, and Steenkamp 1998). Compelling evidence, as well as advice, about how punishment deters channel members’ opportunism remains limited.

In this study, we draw from social learning theory, fairness heuristic theory, and social network theory to develop a framework that describes the observer effects of punishment. Specifically, the study delineates a direct deterrence mechanism of punishment and a trust-building process through which fairness judgment of the punishment influences an observer’s trust in the manufacturer, which in turn affects its ex post opportunism.

Moreover, we investigate two network-level moderating variables in the process: the disciplined distributor’s relational embeddedness (Rindfleisch and Moorman 2001) and the focal manufacturer’s monitoring capability (Heide, Wathne, and Rokkan 2007; Stump and Heide 1996). In a manufacturer–distributor relationship, distributors typically possess more or better information about the market and customers than the manufacturer (Desiraju and Moorthy 1997; Gu et al. 2010). Such information asymmetry creates incentives for opportunism (Mishra, Heide, and Cort 1998). When a distributor with embedded ties is punished, it is motivated to transmit information that is potentially harmful to the manufacturer to its peers. Peer distributors, due to the information surplus, are better able to act opportunistically, leading to reduced observer effects. In contrast, the manufacturer’s monitoring capability reflects its ability to alleviate information asymmetry between itself and downstream distributors and to detect future violations in the network (Wathne and Heide 2000). Thus, it should strengthen the observer effects of punishment.

This study is based on a survey of distributors from multiple industries in China. Although the study implications may be applicable to marketing channels in general, China provides an ideal context for our empirical test for two reasons. First, transition economies are often characterized by insufficient legal protection (Sheng, Zhou, and Li 2011), so behaviors are embedded in local networks and social connections (i.e., guanxi; Gu, Hung, and Tse 2008), which makes it difficult for manufacturers to detect and punish dysfunctional behavior. In such a setting, a network-based view of punishment with a focus on relational embeddedness and monitoring capability is particularly relevant.

**CONCEPTUAL FRAMEWORK: OBSERVER EFFECTS**

We focus on the attitudes and behaviors of observers in response to a punishment event undertaken by a principal and enforced on an agent in a channel network. Although any channel member can be the initiator or receiver of punishment, in this study, we define the focal manufacturer as the initiator (principal), its independent distributor as the recipient of the disciplinary act (agent), and other distributors in the channel network as observers.

A punishment event likely results from a distributor’s dysfunctional behavior, which we define here from the manufacturer’s perspective as falling short of expectations in the focal relationship. Given this definition, distributor gray marketing, dumping behavior, noncompliance, and below-standard sales performance may all qualify as dysfunctional behavior. From an observer’s point of view, these behaviors can be intentional or unintentional. For example, unfinished sales targets can be a focal distributor’s intentional reduction of efforts or can be unintentional due to an abrupt decline of market demand. Dumping can be a malicious act or just a way out of a fierce price war waged by competitors.

We investigate punishment effects on an observer’s ex post opportunism as our final dependent variable. Typically defined as self-interest seeking with guile (Williamson 1975), opportunism is common in interfirm transactions. Previous research has typically relied on transaction cost analysis and relational exchange theory to devise formal and informal mechanisms to deter opportunism. In this study, we consider how a punishment event prompts an observer to engage in cognitive appraisals of the event, which in turn limits its ex post opportunism. We begin by considering the effects of two cognitive appraisals—punishment severity and punishment fairness, as perceived by the observer—on its ex post opportunism. Then, we describe how the relational embeddedness of the disciplined distributor (Rindfleisch and Moorman 2001) and the focal manufacturer’s monitoring capability (Stump and Heide 1996) moderate these mechanisms. Figure 1 presents the overall framework of observer effects of punishment in a distribution network.

**Punishment Severity and Observer Opportunism**

Punishment has differential effects on the recipient party and observers. Research in social psychology has long recognized the “actor–observer difference” in evaluating an event (Jones 1979; Jones and Nisbett 1972). People tend to view others’ behaviors as being caused by their personal disposition while perceiving their own actions as being due to situational factors. The difference in attribution is explained partly by the greater amount of information available to actors than to observers, partly by the differences between actors and observers in perceptual focus, and partly by self-enhancement motivations (Jones and Nisbett 1972; Watson 1982). According to this attribution asymmetry, in judging their dysfunctional behavior (e.g., poor sales performance), actors will justify it with external factors, such as changing customer needs, entry of a new competitor, and insufficient manufacturer support. In contrast, observers are likely to focus on the behavior itself and ascribe causes to actors’ internal and controllable factors, such as a lack of focus, poor time management, and even opportunism.

This attributional difference between an actor and an observer is intensified when punishment follows the actor’s
behavior. This is because, in general, punishment decreases the actor’s (i.e., the disciplined party’s) economic outcomes, eliciting negative emotions such as frustration, tension, and disagreement (Geyskens, Steenkamp, and Kumar 1999). These negative emotions further bias the actor’s evaluation of the incident, limiting its behavioral change after the punishment. When opportunities arise, the actor may continue its opportunistic pursuit, especially the lawful type of opportunism that violates relational contracts but is difficult to detect and punish (Wathne and Heide 2000).

From a network perspective, however, because observers are not the ones to receive negative sanctions, they do not experience these negative feelings as the direct target of punishment. Rather, their relatively neutral emotional status, together with a focus on internal locus of control, helps them “learn” from the incident.

Social learning theory (Bandura 1977) conceptualizes an observer’s learning process. It states that people (or organizations) learn their social behavior primarily by observing and imitating the actions of others. Organizations that observe their peers being punished are less likely to engage in punishable activities (Akers et al. 1979; Schnake 1986). For example, when a distributor receives a penalty for failing to fulfill an obligation, observers should become more compliant and diligent in satisfying the requirements of the punishing manufacturer.

It is important to note that the effectiveness of the learning process is dependent on the perceived severity of punishment (Antia et al. 2006; Frazier and Summers 1984). In observing a punishment event, observers will form punishment (cost) expectations, a direct function of perceived risks of detection and punishment outcomes (Frazier and Summers 1984). Although observers may have an optimistic bias when assessing their own risks compared with those of others (Weinstein 1989), if punishment outcomes are severe enough, observers’ overall cost expectations will be sufficiently high as to outweigh the potential gains from punishable behavior. Thus, observers will have reduced incentive to commit future violations. In other words, the perceived severity of a punishment draws observers’ attention, motivates them to form punishment expectations, and makes the learning process sufficiently salient to influence their behavior (Trevino 1992). Therefore, in contrast to the non-significant direct effect of deterrence severity on opportunism at the dyadic level (Antia et al. 2006; Kashyap, Antia, and Frazier 2012), we propose a significant effect at the network level. Thus:

$$H_1: \text{An observer’s perceived severity of punishment negatively affects its } \text{ex post } \text{opportunism.}$$

Punishment Fairness, Observer Trust, and Opportunism

A widely recognized mechanism for protecting exchanges from opportunism is trust (Jap and Anderson 2003). Consistent with the work of Mayer, Davis, and Schoorman (1995), we define trust as the observer’s willingness to be vulnerable to the actions of others, regardless of its monitoring or control capabilities. Our empirical operationalization similarly emphasizes the honesty (i.e., credibility of a manufacturer’s promises) and benevolence (i.e., sharing best judgment) aspects of trust (Kumar, Scheer, and Steenkamp 1995).

The observer’s perception of the fairness of a punishment event should increase its trust in the manufacturer and thus inhibit its \text{ex post} opportunism. Two theories help explain this trust-building mechanism. First, fairness heuristic theory (Lind 2001; Van den Bos 2001; Van den Bos and Lind 2002) states that people are sensitive to appearances of (un)fairness in relationships with others. Because of bounded rationality (Fein and Anderson 1997) and the limited information at hand, observers are unable to fully explore all the possible causes of a punishment. Instead, they form fairness judgments on the basis of social comparisons (Adams 1963); they evaluate punishment outcomes that seem consistent across peers as fairer than outcomes...
that are harsher or more lenient than those that similar others have received. Observers then rely on these fairness perceptions as important cognitive shortcuts to determine the manufacturer’s trustworthiness (Gu and Wang 2011; Lind 2001). In accordance with the level of trust they grant the manufacturer, they then regulate their subsequent cooperative behaviors.

Second, relational exchange theory (Heide and John 1992; Macneil 1980) suggests that relationship quality among members in a channel network persists because of a system of shared norms and beliefs. A dysfunctional behavior that violates these norms threatens the cohesion and stability of the network members (Wang, Kayande, and Jap 2010). To restore fairness, observers want rule violators to be punished (Fehr and Gächter 2000). Thus, if a manufacturer uses punitive actions appropriately, it reinforces the standards and signifies norm conformity to observers. This fair handling of dysfunctional behavior wins trust from observers (Kumar, Scheer, and Steenkamp 1995), which then inhibits their ex post opportunism. Taken together, we hypothesize the following:

\[ H_{2a} : \text{An observer’s perceived fairness of punishment positively affects its trust in the manufacturer.} \]

\[ H_{2b} : \text{An observer’s trust in the manufacturer negatively affects its ex post opportunism.} \]

**The Role of the Disciplined Distributor’s Relational Embeddedness**

When dysfunctional behavior occurs, the manufacturer should take disciplinary actions to uphold the integrity of the channel and suppress observers’ ex post opportunism. However, the effectiveness of deterrence and trust-building mechanisms might be mitigated if the misbehaving distributor has strong relational embeddedness in the network.

We define the disciplined distributor’s relational embeddedness as the extent to which it develops close and personal relationships with other distributors in the channel network (Granovetter 1985; Rindfleisch and Moorman 2001; Uzzi 1997; Watthe, Biong, and Heide 2001). In contrast with the impersonal nature of a structural perspective, which emphasizes the configuration of an actor’s network of relationships (Nahapiet and Ghoshal 1998), the relational perspective of embeddedness illustrates the benefits brought by concrete, intense personal relationships, such as sharing of sensitive information, interpersonal trust, feelings of closeness, mutual gain, and reciprocity (Larsen 1992; Uzzi 1996).

A central feature of distribution channels is that distributors are closer to the market than the manufacturer and thus possess more information about how customers respond to products and the amount of effort required to serve them (Desiraju and Moorthy 1997; Gu et al. 2010). This information asymmetry is among the key causes of distributor opportunism (Watthe and Heide 2000). In a punishment event, highly embedded ties between distributors imply the aggravated problem of information asymmetry against the manufacturer. This is because when a manufacturer punishes a distributor with strong relational embeddedness, the latter has increased motivation to transmit sensitive information to its peers (Rindfleisch and Moorman 2001). The information is strategically important because it places peer distributors in advantageous positions against the manufacturer (Granovetter 1973; Uzzi 1997). With the enlarged information asymmetry, distributors are better able to engage in prohibited behaviors with lower detection rates. Therefore, their tendency for opportunism will not be effectively curtailed after observing the punishment.

Moreover, when a punishment is administered on an embedded distributor, it not only provides information to its peers but also arouses negative emotions such as sympathy, frustration, and dissatisfaction in the network. These emotions tend to bias observers’ judgment in line with the disciplined one, reducing the actor–observer difference in reaction to the punishment. In light of the shared goals and values, observers may feel a “moral imperative” (Elster 1989; Etzioni 1975) to support the disciplined peer. In this case, a severe punishment will not serve the deterrence goal of the manufacturer. Instead, the potential risks of distributors’ unified retaliation may counterbalance the benefits for the manufacturer (Antia and Frazier 2001).

Finally, from an economic standpoint, if an observer believes that the disciplined party has strong relational embeddedness in the network—that is, the disciplined distributor enjoys overall high popularity in the network—it is in the observer’s interest to ally with the disciplined party. The deterrence effect of punishment diminishes because sharing the same stance with a majority of agents is more in line with the observer’s long-term interest than supporting the single principal’s disciplinary action. Taken together, we hypothesize the following:

\[ H_3 : \text{The disciplined distributor’s relational embeddedness weakens the negative effect of punishment severity on an observer’s ex post opportunism.} \]

Similarly, although fairness perceptions of punishment enhance observers’ trust in the manufacturer in general, this effect will decline if the disciplined distributor is closely connected with others in the network. A prominent feature of embedded ties is a high level of interpersonal trust (Uzzi 1997). On the one hand, trusting relationships between the disciplined distributor and its peers in the network imply that observers will show greater support to the disciplined party even if they view the punishment as fair. On the other hand, the high level of trust and the interdependencies that mark strong ties between the disciplined party and its peers serve as barriers to the development of trust in the manufacturer through fairness perceptions. That is, even if observers attribute responsibility to the disciplined distributor and view the punishment as fair, they may still side with the disciplined distributor, with which they have a long-term, entrenched relationship. Thus, the effectiveness of building trust through fairness perceptions declines. We hypothesize the following:

\[ H_{4a} : \text{The disciplined distributor’s relational embeddedness weakens the positive effect of punishment fairness on an observer’s trust in the manufacturer.} \]

We further hypothesize a three-way interaction between punishment severity, fairness perception, and the disciplined distributor’s relational embeddedness. We argue that the mitigating effect of the disciplined distributor’s embeddedness on an observer’s fairness—trust link (\( H_{4b} \)) should be greater when the punishment is severe. This is because a severely punished distributor, experiencing a loss of face,
will further exploit its embedded position to transmit sensitive information and provoke more negative feelings against the manufacturer. Observers thus may have a stronger psychological reactance toward the manufacturer. As a result, they will grant even less trust to the manufacturer, even though they may consider the punishment itself fair. In contrast, when the severity level of punishment is low, the disciplined distributor has less motivation to retaliate against the manufacturer by influencing others’ opinions to its advantage. Thus, the moderating effect of embeddedness on the fairness–trust link will not be salient. That is, an observer’s trust judgment based on its fairness perceptions will be less affected by the embedded level of the disciplined distributor. In practical terms, we suggest that when punishing a highly embedded distributor, the manufacturer should adopt a more lenient and private approach. Thus, we hypothesize the following:

H4c: The more severe the punishment, the stronger the mitigating effect of the disciplined distributor’s relational embeddedness on the link between punishment fairness and an observer’s trust.

The Role of the Manufacturer’s Monitoring Capability

Although observer effects are weakened when the focal distributor is highly embedded in the network, a manufacturer’s monitoring capability can strengthen these effects (Wathne and Heide 2000). In our study context, monitoring capability refers to the manufacturer’s ability to assess and “meter” its distributors’ performance in the network (Ghosh and John 1999; Heide, Wathne, and Rokkan 2007). In contrast to the disciplined distributor’s embeddedness, which aggravates the problem of information asymmetry, monitoring serves as a control mechanism that reduces information asymmetry in favor of the manufacturer. In practical terms, monitoring increases the manufacturer’s ability to detect opportunism and, thus, its ability to inflict punitive actions when necessary on distributors (Antia et al. 2006; Kumar, Scheer, and Steenkamp 1995; Wathne and Heide 2000).

This monitoring capability should strengthen the deterrence effect of punishment severity on observers’ ex post opportunism because the observer’s opportunistic tendency ultimately depends on both the perceived costs imposed by a severe punishment and the perceived likelihood of detection of its potential opportunism (Antia et al. 2006; Dutta, Bergen, and John 1994; Dutta, Heide, and Bergen 1999; Ghosh and John 1999). In a way, punishment needs to be complemented with mechanisms that reduce information asymmetry between exchange parties (e.g., monitoring). In other words, Axelrod’s (1984) “tit-for-tat” strategy to promote cooperation can only be realized when one party knows that its defection would be revealed and retaliated against. Using the gray market as an example, Antia et al. (2006) find that punishment severity alone is not enough to curb ex post opportunism. If an observer expects that its violation might remain undetected, the manufacturer’s punitive threat cannot achieve a deterrence goal. Only when the observer expects detection of its opportunistic behavior and believes the penalty will be severe will it refrain from acting opportunistically.

Consistent with the relationship marketing literature (Stump and Heide 1996), we focus on the manufacturer’s monitoring of distributors’ outputs (e.g., delivery, quality, price) because monitoring behavior could create uncomfortable social pressures and cause reactance (Heide, Wathne, and Rokkan 2007). For example, a manufacturer’s use of on-site inspections for quality control might be perceived as intrusive by distributors and lead to defensive attitudes and noncompliance. All else being equal, however, an effective monitoring exercise of outputs increases the detection rate of opportunism. The heightened risk pushes the observer to be more compliant (Frazier and Summers 1984; Murry and Heide 1998). Thus:

H5c: The manufacturer’s monitoring capability strengthens the negative effect of punishment severity on an observer’s ex post opportunism.

This monitoring capability also might strengthen the effect of fairness perceptions on the observer’s trust in the manufacturer. First, the purpose of monitoring is not just to safeguard the manufacturer’s resources but also to ensure a level playing field for all members of the channel network (Bucklin and Sengupta 1993). Effective monitoring substantially reduces the problems of free riding and moral hazard (Lal 1990). As a result, the manufacturer can establish a favorable reputation for maintaining a consistent standard to justify any rewards or sanctions among its distributors. When administering punishment, this reputable status strengthens the signaling effect of fairness. Observers will be more confident in deriving trustworthiness judgments of the manufacturer given a certain level of fairness perceptions of the punishment.

Second, through monitoring, the manufacturer can screen distributors a priori. Less competent distributors or those that are opportunistically inclined can be excluded. This “second-order effect” of monitoring (Wathne and Heide 2000) facilitates norm congruence among the remaining distributors. In a disciplinary situation, because observers’ values and beliefs have already been aligned with those of the manufacturer, fairness perceptions of the punishment should exert a greater effect and facilitate trust development in the manufacturer. With these two analytical perspectives, we posit the following:

H6c: The manufacturer’s monitoring capability strengthens the positive effect of punishment fairness on an observer’s trust in the manufacturer.

Finally, we predict a stronger effect of monitoring capability on the fairness–trust link when the punishment is more severe. With a severe punishment that matches the criticality of the dysfunctional behavior, the manufacturer signals its power to enforce discipline, which in turn boosts its reputation for upholding a consistent standard through effective monitoring. The punishment event and the manufacturer’s strong position in controlling the distribution network will draw greater attention from observers. Thus, the manufacturer’s monitoring capability strengthens the fairness–trust link to a greater degree.

In contrast, if the punishment is only mild, the manufacturer’s monitoring capability will have a declining moderating effect. That is, even if the manufacturer is capable of extensively monitoring distributors, observers’ confidence in its likelihood of upholding justice can be undermined by a weak enforcement. For example, in gray marketing, weak enforcement toward a violation may lead the distributor...
team to doubt the seriousness of the matter and the manufacturer’s work standard. As such, the manufacturer’s reputation for maintaining a level playing field for all distributors is eroded. Consequently, its monitoring capability will have a weaker effect on observers’ trust development based on fairness perceptions. Taken together, we expect a positive three-way interaction:

\[ H_{\theta c} : \text{The more severe the punishment, the stronger the strengthening effect of the manufacturer’s monitoring capability on the link between punishment fairness and an observer’s trust.} \]

**METHOD**

Research Design and Data Collection

To test our hypotheses, we used data collected from distributors in three industries (household electronics, cosmetics and personal care, and furniture) in China. Although the multi-industry setting may limit the possibility of tapping into industry-specific phenomena, we were able to achieve greater variance in the study variables and increase the potential generalizability of our results. In prestudy interviews, we determined that these three industries commonly meted out manufacturer-initiated punishment and thus were suitable for our study focus. Moreover, their relatively dense channel networks ensured that distributors had sufficient opportunity to observe or recognize a manufacturer’s punitive action against other distributors in the same network. For example, in the cosmetics and personal care industry, manufacturers often employ multiple intertwined distribution channels across department stores, franchised stores, supermarkets, drugstores, salons, online shops, infomercials, teleshopping, direct mail, and so on (Chinese Industry Analysis Institution 2010). The extensive, intense channel networks facilitate information exchanges by channel members, so this industry offered a proper context for investigating observer effects.

As key informants, we used senior managers (e.g., chief executive officer, president, general manager, director, senior procurement manager) in distribution firms who had responsibility for contact with suppliers. These respondents recalled punitive actions by their largest collaborating manufacturers against another distributor in the previous year. They were asked to focus on one such incident for which they had the most vivid memory and best knowledge. These naturally observed events, involving an actual channel network and punishment, help respondents specify their perceptions and attitudes in a realistic setting, without demanding much imagination (Gu et al. 2010; Hibbard, Kumar, and Stern 2001).

We developed the questionnaire using Gerbing and Anderson’s (1988) recommended procedures. First, we conducted in-depth interviews with six senior managers in manufacturing firms and six senior managers in distribution firms in the three industries to gain an understanding of industry practices. Second, we developed our measures (in English) from an extensive review of prior literature and the interviews. Third, we translated the English version into Chinese and then commissioned a back-translation by two independent translators to ensure conceptual equivalence. Fourth, we refined the measures in a pretest with 50 managers (2 per firm) from 25 distribution firms. These managers completed the survey in the presence of the researchers and were encouraged to ask for clarification if needed. The pretest generated high interrater reliability (\(r > .70\)), though we also modified several terms slightly on the basis of their feedback. The final survey was conducted in Chinese.

We considered two potential pitfalls of retrospective data: inaccurate recall and social desirability bias (Golden 1992; Huber and Power 1985). Following Miller, Cardinal, and Glick (1997), we took the following steps to improve data validity: First, the punishment event must have happened in the past year, rather than in the distant past, to reduce the potential of recall error. Second, the questionnaire was about others being punished rather than the informants themselves, which was less likely to cause the social desirability problem. Third, the informants were asked to recall a concrete punishment event by listing the disciplined distributor’s dysfunctional behavior and the punitive action it received. The punitive actions they listed (e.g., verbal reprimands, fines, cease-and-desist warnings, termination, reduced incentive premiums, withheld bonuses) were sorted and used as an alternative measure of punishment severity, following the method Antia and Frazier (2001) use. The correlation between this objective measure and our measure of punishment severity was \(.61 (p < .001)\), indicating that the informants’ retrospective perceptions were not significantly biased. Fourth, the face-to-face interview method facilitated the respondents’ recall through warranted confidentiality and rich explanations of the project.

For the distribution of the formal survey, we identified the most influential national trade fair for each industry and obtained lists of distributor participants. We randomly selected 150 distributors from each trade fair (450 in total). At each of the industry-specific trade fairs, ten trained research assistants approached the selected distributors to request interviews. They explained the academic purpose of the project and promised respondents confidentiality. Compared with a traditional mail survey, this interview method is more effective for generating valid information and high-quality data because it ensures access to the right respondents and their correct understanding of the questions (Sheng, Zhou, and Li 2011).

Our data collection effort yielded 177 responses, though 5 were incomplete or unusable. Specifically, we obtained 61 usable responses in the household electronics industry, 54 in the cosmetics and personal care industry, and 57 in the furniture industry, for response rates of 40.7%, 36.0%, and 38.0%, respectively. The overall response rate of 38.2% compares favorably with those obtained in prior channel research. To evaluate nonresponse bias, we compared the means of key characteristics (e.g., number of branches, number of employees, business areas) between firms that...
responded to the survey and those that did not (Armstrong and Overton 1977). We detected no significant differences. The 172 usable surveys also showed a fair distribution across industries and geographic locations. Most (82.6%) came from small to medium-sized enterprises (fewer than 200 employees), consistent with the fragmented nature of China’s distribution system (Gu, Hung, and Tse 2008). The firms varied in the length of their relationships with the focal manufacturer. Approximately half (45.9%) described their relationship length as two to five years. Respondents were knowledgeable informants, holding titles of president or chief executive officer (25.6%), general manager (54.1%), or procurement manager (20.3%). We report the profiles of our sample in Appendix A.

**Measures**

We adapted existing scales to our research context using insights from our fieldwork interviews. The final items used to indicate each construct in our study, their composite reliability (CR), and average variance extracted (AVE) values all appear in Appendix B. The multi-item measures all used seven-point response scales. We provide an interconstruct correlation matrix and descriptive statistics in Table 1.

Following Williamson’s (1975, p. 6) classic definition of opportunism as “self-interest seeking with guile,” we adapted four items from previous research to measure an observer’s ex post opportunism (e.g., Brown, Dev, and Lee 2000; Heide, Watne, and Rokkan 2007). The distributors rated each item to describe the extent to which they potentially would engage in opportunistic behaviors with the manufacturer.

For punishment severity, we used three items adapted from Antia and Frazier (2001). The scale asked respondents to assess the severity of the observed punishment according to their own perceptions.

Previous research has suggested that two types of fairness perceptions are relevant in evaluations of punishment events: distributive and procedural (Ball, Trevino, and Sims 1994). Distributive fairness refers to the outcomes (Deutsch 1985; Homans 1961), and procedural fairness focuses on the process and decision-making procedures (Leventhal 1976; Thibaut and Walker 1975). In our study context, the process underlying the punishment incident is likely visible only to the punished distributor; observers might not know the details, which prevents them from judging the procedural fairness of the punishment. Therefore, we asked our observer respondents to evaluate the distributive fairness of the incident only, which is based on the comparison between punishment outcomes and the dysfunctional behavior in question, violated obligations, punishment in previous similar cases, and so on. We adapted the measure of punishment fairness from Kumar, Scheer, and Steenkamp (1995).

We employed a composite definition of trust (Mayer, Davis, and Schoorman 1995) that reflects the distributor’s willingness to be vulnerable to the manufacturer. In line with this definition, we operationalized two aspects of trust, honesty and benevolence, using items adapted from Jap and Anderson (2003) and Kumar, Scheer, and Steenkamp (1995).

Relational embeddedness of the disciplined distributor captures the close and personal relationships that the disciplined distributor has developed with other distributors in the channel network. We operationalized this construct using items from Moran (2005) and Rindfleisch and Moorman (2001) to emphasize the nature of the social bond and the benefits brought by concrete, intense “personal relationships.” In particular, the seven-item scale measures the extent to which closeness, emotional bonding, mutual gain, reciprocity, and shared goals characterize the disciplined firm’s relationships with other firms in the network (Larson 1992; Moran 2005; Rindfleisch and Moorman 2001; Uzzi 1996). Hereinafter, we refer to this construct as “distributor embeddedness.”

Finally, our measure of monitoring capability of the manufacturer reflects the manufacturer’s ability to verify its distributor’s performance in the whole distribution network (Heide, Watne, and Rokkan 2007). We derived this measure from Stump and Heide (1996) and adapted it to our network context. The four-item scale focuses on execution aspects of output monitoring, including sales, delivery, customer service, and price.

We also included several control variables in the analysis to account for their potential to explain substantial variances in the dependent variables. Specifically, we included manufacturer reputation, benefits of future cooperation, transaction-specific investment, market uncertainty, legal enforceability, relationship length, firm size, and industry dummies. For manufacturer reputation, we adapted three items from Ganesan’s (1994) measure. We assessed the benefits of future cooperation by asking the respondents to rate the attractiveness of the economic payoffs of cooperating with the manufacturer in the future (Sa Vinhas, Heide, and Jap 2012). For transaction-specific investment, we used three items from Jap’s (1999) scale. We measured market uncertainty with three items adapted from Kumar, Scheer, and Steenkamp (1995). Because legal enforceability may vary in different industrial settings, we adapted Zhou and Poppo’s (2010) perceptual scale of this construct. We used the logarithm of firm size (number of employees) and relationship length (duration of the observer’s association with the manufacturer) because of the high variation in these values across firms in our sample. Finally, we transformed the industry variable into two dummies to represent the industry of the sample with one holdout. For the detailed survey instruments, see the Web Appendix.

**Construct Validity**

Because of the large number of measures included, we conducted two confirmatory factor analyses using IBM SPSS Amos 6 statistical software (Arbuckle and Wothke 1999), one for the focal constructs and one for the controls (Bentler and Chou 1987). The results indicated satisfactory fit (focal model: $\chi^2 = 531.32, \text{d.f.} = 284, p < .01$; comparative fit index = .92; incremental fit index = .92; root mean square error of approximation = .07; control model: $\chi^2 = 51.77, \text{d.f.} = 29, p < .01$; comparative fit index = .96; incremental fit index = .96; root mean square error of approximation = .06). As Appendix B shows, all the measurement items (except two items pertaining to legal enforceability and manufacturer reputation, which we deleted from further analysis) exhibited significant factor loadings on their corresponding constructs ($p < .001$), in support of convergent validity. The CR of each construct measure exceeded the .70.
Table 1

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<td>-0.02</td>
<td>0.04</td>
<td>0.06</td>
</tr>
<tr>
<td>2. Trust</td>
<td>-0.29**</td>
<td>—</td>
<td>0.37**</td>
<td>0.30**</td>
<td>0.17*</td>
<td>0.44**</td>
<td>0.45**</td>
<td>0.37**</td>
<td>0.29**</td>
<td>-0.06</td>
<td>-0.13</td>
<td>-0.11</td>
<td>-0.04</td>
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<tr>
<td>3. Punishment severity</td>
<td>-0.26**</td>
<td>0.37**</td>
<td>—</td>
<td>0.34**</td>
<td>0.02</td>
<td>0.25**</td>
<td>0.26**</td>
<td>0.24**</td>
<td>0.26**</td>
<td>0.08</td>
<td>-0.07</td>
<td>0.09</td>
<td>0.04</td>
</tr>
<tr>
<td>4. Punishment fairness</td>
<td>-0.02</td>
<td>0.30**</td>
<td>0.34**</td>
<td>—</td>
<td>0.05</td>
<td>0.24**</td>
<td>0.25**</td>
<td>0.15</td>
<td>0.15</td>
<td>0.12</td>
<td>-0.09</td>
<td>-0.14</td>
<td>0.19*</td>
</tr>
<tr>
<td>5. Distributor embeddedness</td>
<td>0.21**</td>
<td>0.17*</td>
<td>0.02</td>
<td>0.05</td>
<td>—</td>
<td>0.27**</td>
<td>0.29**</td>
<td>0.06</td>
<td>0.14</td>
<td>0.04</td>
<td>0.07</td>
<td>0.04</td>
<td>0.02</td>
</tr>
<tr>
<td>6. Monitoring capability</td>
<td>-0.14</td>
<td>0.44**</td>
<td>0.25**</td>
<td>0.24**</td>
<td>0.27**</td>
<td>—</td>
<td>0.51**</td>
<td>0.21**</td>
<td>0.37**</td>
<td>0.15</td>
<td>0.05</td>
<td>-0.06</td>
<td>0.12</td>
</tr>
<tr>
<td>7. Manufacturer reputation</td>
<td>-0.10</td>
<td>0.45**</td>
<td>0.26**</td>
<td>0.25**</td>
<td>0.29**</td>
<td>0.51**</td>
<td>—</td>
<td>0.27**</td>
<td>0.33**</td>
<td>0.18*</td>
<td>-0.13</td>
<td>-0.05</td>
<td>0.04</td>
</tr>
<tr>
<td>8. Benefits of future cooperation</td>
<td>-0.12</td>
<td>0.37**</td>
<td>0.24**</td>
<td>0.15</td>
<td>0.06</td>
<td>0.21**</td>
<td>0.27**</td>
<td>—</td>
<td>0.16*</td>
<td>0.02</td>
<td>-0.09</td>
<td>-0.06</td>
<td>-0.10</td>
</tr>
<tr>
<td>9. Transaction-specific investment</td>
<td>-0.05</td>
<td>0.29**</td>
<td>0.26**</td>
<td>0.15</td>
<td>0.14</td>
<td>0.37**</td>
<td>0.33**</td>
<td>0.16*</td>
<td>—</td>
<td>0.01</td>
<td>-0.09</td>
<td>0.01</td>
<td>0.05</td>
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<tr>
<td>10. Market uncertainty</td>
<td>0.12</td>
<td>-0.05</td>
<td>0.08</td>
<td>0.12</td>
<td>0.04</td>
<td>0.15*</td>
<td>0.18*</td>
<td>0.02</td>
<td>0.01</td>
<td>—</td>
<td>-0.17*</td>
<td>-0.09</td>
<td>-0.15</td>
</tr>
<tr>
<td>11. Legal enforceability</td>
<td>-0.01</td>
<td>-0.12</td>
<td>-0.06</td>
<td>-0.08</td>
<td>0.07</td>
<td>0.05</td>
<td>-0.12</td>
<td>-0.08</td>
<td>-0.08</td>
<td>-0.16*</td>
<td>—</td>
<td>-0.13</td>
<td>0.24**</td>
</tr>
<tr>
<td>12. Relationship length</td>
<td>0.04</td>
<td>-0.10</td>
<td>0.09</td>
<td>-0.13</td>
<td>0.04</td>
<td>-0.05</td>
<td>-0.04</td>
<td>-0.05</td>
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<td>-0.12</td>
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<td>0.08</td>
</tr>
<tr>
<td>13. Firm size</td>
<td>0.06</td>
<td>-0.03</td>
<td>0.04</td>
<td>0.19*</td>
<td>0.02</td>
<td>0.12</td>
<td>0.04</td>
<td>-0.09</td>
<td>0.05</td>
<td>-0.14</td>
<td>0.24**</td>
<td>0.08</td>
<td>—</td>
</tr>
<tr>
<td>14. MV marker (risk preference)</td>
<td>-0.05</td>
<td>0.10</td>
<td>0.04</td>
<td>0.01*</td>
<td>-0.00</td>
<td>0.14</td>
<td>0.08</td>
<td>-0.12</td>
<td>0.02</td>
<td>0.16</td>
<td>0.03</td>
<td>-0.10</td>
<td>0.06</td>
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<tr>
<td>M</td>
<td>3.74</td>
<td>5.41</td>
<td>4.84</td>
<td>4.74</td>
<td>4.61</td>
<td>4.85</td>
<td>5.17</td>
<td>5.48</td>
<td>4.95</td>
<td>4.55</td>
<td>3.77</td>
<td>0.64</td>
<td>1.77</td>
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<tr>
<td>SD</td>
<td>1.26</td>
<td>1.02</td>
<td>1.27</td>
<td>1.20</td>
<td>1.06</td>
<td>1.22</td>
<td>1.16</td>
<td>1.14</td>
<td>1.15</td>
<td>1.28</td>
<td>0.45</td>
<td>0.30</td>
<td>0.76</td>
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</table>

*p < .05.
**p < .01.

aThe lowest positive correlation (r = 0.05 between the MV marker and punishment fairness) is used to adjust the construct correlations and statistical significance.

Notes: Zero-order correlations are below the diagonal, and adjusted correlations for potential common method variance (Lindell and Whitney 2001) are above the diagonal.
threshold. To assess discriminant validity, we also ran chi-square difference tests for all the constructs in pairs to determine whether the constrained model (correlation fixed at 1) was significantly worse than the unconstrained model (correlation estimated freely). All the chi-square differences were highly significant ($p < .01$), in support of discriminant validity (Gerbing and Anderson 1988). We also calculated the shared variance between all possible pairs of constructs; they were lower than the AVE for any individual construct (see Appendix B). Overall, the results indicated that the measures possessed satisfactory reliability and validity.

**Common Method Bias**

Because we gathered distributors’ self-reported data, we recognized the potential for common method bias and took several steps to minimize its effects. First, in designing the survey instrument, we followed Feldman and Lynch’s (1988) recommendations for countering “self-generated validity” through the careful placement of survey questions, extensive pretesting with the subject population, and the use of linguistic terms and phrases that the respondents would naturally use. The focal constructs never appeared in the hypothesized order (antecedents $\rightarrow$ mediating variables $\rightarrow$ consequences).

Second, a pretest with 50 managers from 25 distribution firms indicated high interrater reliability for all measures ($r > .70$). Therefore, despite our key informant approach, which helped us reduce the survey costs, we remained confident that a high correlation actually reflected an organizational characteristic, not systematic response bias.

Third, we applied the method variance (MV) marker method and used a scale theoretically unrelated to at least one other scale in the analysis, which provided a proxy of common method variance (Lindell and Whitney 2001). We chose a five-item scale that measured the observer’s risk of making an error in general ($\alpha = .82$), which provided the lowest positive correlation ($r = .005$) between the MV marker and other variables to adjust the construct correlations and statistical significance (Lindell and Whitney 2001). Only one correlation (i.e., the correlation between monitoring capability and market uncertainty) turned nonsignificant after the adjustment, but with the same correlation coefficient ($r = .15$; see Table 1). Therefore, we determined that common method bias was unlikely to be a serious concern.

**RESULTS**

Because our model contains two- and three-way interaction effects, we ran moderated regression models to test our hypotheses. To avoid the potential threat of multicollinearity and to clarify the interaction effects, we inspected bivariate correlations and variance inflation factors, neither of which indicated multicollinearity problems. The largest variance inflation factor in the full moderated regressions was 2.31, substantially less than the threshold of 10.

In Table 2, we summarize the regression results for the tests of the main and moderating effects, for which we used a two-stage hierarchical regression approach. We standardized the relevant variables before calculating the interaction terms (Cohen et al. 2003). In Stage 1 (main effect model), we examined the effects of the control variables and main effects on our dependent variables. In Stage 2 (main + interaction effect model), we added the two- and three-way interaction effects. Thus, we could calculate R-square increments attributed to the interaction effects. With only the main effects included, the independent and control variables collectively explained 41% of the variance in observer trust and 23% in observer opportunism. Including the interaction terms increased the R-square values to 52% for observer trust (significant) and 24% for observer opportunism.

In the main + interaction effect model, punishment severity was negatively related to observers’ ex post opportunism ($b = –.16, p < .05$); the more severe the punishment, the less likely observers were to engage in opportunism, in support of the direct deterrence effect we proposed in $H_1$. Punishment fairness exerted a positive effect on observers’ trust ($b = .13, p < .05$); in turn, trust negatively affected opportunism ($b = –.18, p < .05$), in support of the trust-building mechanism of observer effects we proposed in $H_2$.

Regarding the moderating role of distributor embeddedness, we predicted a weakened effect of punishment severity on opportunism when distributor embeddedness is high ($H_3$). In line with the hypothesis, the interaction between punishment severity and distributor embeddedness revealed a positive, though marginally significant, effect ($b = .14, p < .10$). We postulated a negative moderating effect of distributor embeddedness on the relationship between punishment fairness and observer trust in $H_{4a}$. As Table 2 shows, the two-way interaction between punishment fairness and distributor embeddedness exerted a significantly negative effect on trust ($b = –.19, p < .01$), in support of $H_{4a}$. We also found support for $H_{4a}$, as captured by the significant three-way interaction effect of punishment fairness, punishment severity, and distributor embeddedness on observer trust ($b = –.22, p < .01$). The negative sign suggests that punishment severity further weakened the fairness effect along with a high level of distributor embeddedness.

In $H_4$, we predicted that monitoring capability would strengthen the deterrence effect of punishment severity on ex post opportunism. Although the sign of the interaction term was negative, as we predicted, the strengthening effect was nonsignificant ($b = –.09$, n.s.). In support of $H_{4b}$, monitoring capability had an enhancing effect on the positive relationship between punishment fairness and observer trust; specifically, in Table 2, the two-way interaction between punishment fairness and monitoring capability exerted a significantly positive effect on trust ($b = .26, p < .01$). Our prediction in $H_{4b}$ was captured by the three-way interaction effect of punishment fairness, punishment severity, and monitoring capability on observer trust ($b = .22, p < .01$). We found support for $H_{4b}$, as captured by the significant three-way interaction effect of punishment fairness, punishment severity, and monitoring capability revealed a significant and positive effect on trust ($b = .22, p < .01$). Our prediction in $H_{4b}$ was captured by the three-way interaction effect of punishment fairness, punishment severity, and monitoring capability on observer trust. We expected that the enhancing effect of monitoring capability would be greater under severe punishment; the significant, positive three-way interaction ($b = .26, p < .01$) confirmed this expectation, together with the positive two-way interaction.

To gain more insights into our contingency hypotheses, we plotted the significant interaction effects following Aiken and West’s (1991) procedure, as Figures 2–6 illustrate. Specifically, we plotted the slopes at one standard deviation below and above the mean levels of the moderator variables. As Figure 2 shows, when distributor embeddedness is low, punishment severity has a stronger negative effect on opportunism. However, when the disciplined distributor achieves stronger embeddedness, punishment
severity has a smaller deterrence effect on observers’ *ex post* opportunism (H3). Figure 3 plots the two-way interaction between punishment fairness and distributor embeddedness. The role of fairness in enhancing observers’ trust only emerges when the distributor embeddedness is low, further confirming H4a.

Figure 4 depicts the three-way effect of punishment severity, punishment fairness, and distributor embeddedness on observer trust. The figure illustrates the effect of punishment fairness on the observer’s trust under four conditions: (1) high severity and high embeddedness, (2) high severity and low embeddedness, (3) low severity and high embeddedness, and (4) low severity and low embeddedness. H4b suggests that the weakening effect of distributor embeddedness on the positive link between fairness and trust is stronger when punishment severity is high rather than low. As Figure 4 shows, when severity is high (Lines 1 and 2), punishment fairness increases trust under the low embeddedness condition (Line 2) but decreases trust under the high embeddedness condition (Line 1), implying the strong weakening effect of embeddedness at the high severity level. In contrast, when punishment severity is low (Lines 3 and 4), fairness increases trust to a similar extent under the high and low embeddedness conditions, indicating the nonsignificant moderating role of embeddedness at the low severity level. A comparison of the moderation effect of embeddedness under the high and low severity conditions shows that its weakening effect is stronger when severity is high, consistent with H4b.

We also plotted the two-way interaction between punishment fairness and monitoring capability in Figure 5 to reveal the contingency prediction underlying H6a. The slope is positive under the high monitoring capability condition but slightly negative under the low monitoring capability condition, revealing that monitoring capability strengthens the linkage between punishment fairness and observer trust. Figure 6 illustrates the three-way interaction between punishment fairness, punishment severity, and monitoring capability (H6b) with four lines reporting the effect of punishment fairness on the observer’s trust: (1) high severity and high monitoring, (2) high severity and low monitoring, (3) low severity and high monitoring, and (4) low severity and low monitoring. Lines 1 and 2 show that at the high severity level, fairness positively affects trust to a similar degree under both low and high monitoring conditions, implying the nonsignificant moderating role of monitoring capability when severity is low. These comparisons as a whole confirm H6b.

### Table 2

<table>
<thead>
<tr>
<th>Trust</th>
<th>Main Effects: Standard Coefficient</th>
<th>Main + Interaction Effects: Standard Coefficient</th>
<th>Hypotheses Supported?</th>
</tr>
</thead>
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<tr>
<td>Punishment fairness (FAIR)</td>
<td>0.12**</td>
<td>0.13**</td>
<td>H2a (Yes)</td>
</tr>
<tr>
<td>Punishment severity (SEV)</td>
<td>0.15**</td>
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<tr>
<td>Distributor embeddedness (DE)</td>
<td>0.00</td>
<td>0.06</td>
<td></td>
</tr>
<tr>
<td>Monitoring capability (MC)</td>
<td>0.26***</td>
<td>0.13</td>
<td></td>
</tr>
<tr>
<td>Interactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEV × FAIR</td>
<td></td>
<td>−0.07</td>
<td></td>
</tr>
<tr>
<td>AIR × DE</td>
<td></td>
<td>−0.19***</td>
<td>H4a (Yes)</td>
</tr>
<tr>
<td>SEV × DE</td>
<td></td>
<td>−0.09</td>
<td></td>
</tr>
<tr>
<td>SEV × FAIR × DE</td>
<td></td>
<td>−0.22***</td>
<td>H4b (Yes)</td>
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<tr>
<td>FAIR × MC</td>
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</tr>
<tr>
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<tr>
<td>SEV × FAIR × MC</td>
<td></td>
<td>0.26***</td>
<td>H6b (Yes)</td>
</tr>
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<tr>
<td>Manufacturer reputation</td>
<td>0.20**</td>
<td>0.21***</td>
<td></td>
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<td>Benefits of future cooperation</td>
<td>0.17**</td>
<td>0.17**</td>
<td></td>
</tr>
<tr>
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</tr>
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</tr>
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<td>Relationship length</td>
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<td>R-square change</td>
<td>11***</td>
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</table>

**Notes:** Hypothesized effects are one-tailed tested. The variables were standardized before calculating the interaction terms.
For the control variables, the effect of manufacturer reputation on trust was positive and significant ($b = .21, p < .01$), consistent with prior research (Ganesan 1994). In addition, benefits of future cooperation had a positive and significant effect on trust ($b = .17, p < .05$). Market uncertainty had a positive, significant effect on opportunism ($b = .17, p < .05$) and a negative, significant effect on trust ($b = -.17, p < .01$), which suggests that an uncertain environment can bring challenges to a relationship. Firm size exerts a negative and significant effect on trust ($b = -.14, p < .05$). The other variables, including transaction-specific investment, legal enforceability, relationship length, and industry, had no significant effects on either trust or opportunism.

**DISCUSSION**

**Theoretical Contributions**

Conventional wisdom in marketing highlights the negative outcomes of punishment, suggesting that it should be used only as a last resort, when more positive approaches have failed (Frazier and Rody 1991; Frazier and Summers 1984, 1986; Scheer and Stern 1992). As Kotler (1986, p. 122)
Figure 6
THREE-WAY INTERACTION BETWEEN PUNISHMENT FAIRNESS, PUNISHMENT SEVERITY, AND MONITORING CAPABILITY (H_{ob})

Notes: The figure maps the standardized scores of all variables.

This study contributes to the marketing channels literature by extending the dyadic view of punishment to a network level of analysis and establishing the positive outcomes of punishment on observers. Previous research has focused primarily on the “actor” of punishable behaviors, using the hypothesized deterrence effect of punishment. Although this perspective is important, understanding of how punishment, as a dyadic event, spills over to observers in the network is limited. By taking an “observer” perspective, our study shows that punishment can, in effect, significantly reduce observers’ ex post opportunism, as opposed to the nonsignificant direct effect on the actor in previous studies (Antia et al. 2006; Kashyap, Antia, and Frazier 2012). This significant deterrence effect is due to the actor–observer difference in evaluating the punishment event. Whereas the disciplined distributor tends to externalize the causes of its behavior and experience negative emotions, observers focus more on the internal factors, calculate the benefits and costs of the prohibited behavior, and formulate expectations on appropriate and desirable behavior.

We theorized that two important punishment characteristics instigate the observer effects of punishment: severity and fairness. As Zaheer, Gözübüyük, and Milanov (2010) note, questions remain regarding the processes that manifest when relationship management at the dyadic level has network consequences. Our results suggest two particular types of network processes. First, through social learning, punishment severity deters observer opportunism. Second, punishment fairness promotes observer trust, which in turn deters opportunism. Researchers could conduct a deeper investigation to unravel other processes. For example, how do attributions of the dysfunctional behavior affect observer behavior? Do attribution dimensions, such as locus of control, stability, and intentionality, interact with punishment severity to influence observers’ behavior? Do they lead to different levels of fairness perceptions? If severity is important, what is an appropriate severity level—beyond or consistent with observers’ expectations? This research offers a new perspective and puts forth more questions that research could address to fully comprehend the observer effects of punishment.

Moreover, this study identifies the important role of information in varying the observer effects. Information asymmetry exists not only in a dyadic relationship but also at a network level. We focus on two important moderators in favor of either distributors or the manufacturer. The disciplined distributor’s relational embeddedness, which is based on its concrete, intense, and personal relationships with other distributors in the network, captures its ability to transmit sensitive information to other distributors when being punished. In contrast, monitoring capability highlights the manufacturer’s ability to reduce information asymmetry and maintain a level playing field in the distribution network. Peer distributors influenced by these information dynamics will adjust their reactions to the punishment event and their future behaviors. Additional research is necessary to complement this information perspective with other theoretical lenses (e.g., power dependency) to further delineate when the observer effects of punishment are stronger or weaker.

This study sheds additional light on opportunism. Previous work has largely focused on positive mechanisms, such as monitoring, incentives, and socialization, to safeguard against opportunism (Wathne and Heide 2000). Our findings highlight the possibility of using negative sanctions, such as punishment, to influence network members’ opportunism. In a way, this research echoes recent developments in Science positing that institutional arrangements for administering punishment can significantly induce cooperative behaviors in human societies (Henrich 2006; Henrich et al. 2006). Although punishment may be less effective than positive mechanisms in controlling opportunism at the dyadic level, our study shows its strong potential when administered in a network context. By observing a punishment event, distributors’ attitudes, interests, and behaviors realign with the manufacturer’s expectations. In this way, the manufacturer not only achieves specific goals through punishment but also establishes norms that govern acceptable and unacceptable behaviors in its channels. From an efficiency standpoint, administering punishment can achieve
greater efficiency than providing positive incentives in a large network. This is because cost increases as positive incentives are provided to an increasing number of participants, whereas the cost of punishment decreases as observers learn what is important and desirable simply by observing what actions are punished. Thus, this study contributes to the opportunism literature by showing that punishment can be a highly viable and effective tool, on par with, if not more important than, incentive mechanisms to curtail opportunism in managing a network of channel partners.

Managerial Implications

Traditionally, managers have been trained to think about the (generally negative) impact of punishment on the punished firm, such as heightened conflict and lower satisfaction. We recommend that they also treat the behaviors, thoughts, and feelings of observers as equally, if not more, important. The spillover effects of punishments on observers’ attitudes and behaviors may have greater strategic importance than any effects on the disciplined actor alone because they involve more firms, could change the structure of the network, and likely persist for a long time. From the strong deterrence effect of punishment severity that we find in this study, we suggest that manufacturers should carefully evaluate the criticality of a dysfunctional behavior and respond with clear enforcement to deter other distributors’ ex post opportunism in the network.

Moreover, compared with perceptions of punishment severity, which directly deter ex post opportunism, fairness perceptions facilitate the development of more long-term trustworthiness beliefs about the manufacturer. For that reason, managers should be particularly concerned about observers’ fairness judgments. How do observers perceive this incident? How do they form fairness perceptions? The manufacturer should understand the expectations and norms shared by distributors in its network. When the punishment is consistent with expectations, observers will perceive it as fair and grant the manufacturer greater trust. When the punishment contradicts the norms held by channel members, any punishment may act as a stimulus for backlash, leading to feelings of inequity and causing observer dissatisfaction. Thus, to avoid normative discrepancy with observing firms, the manufacturer should adopt an effective communication strategy that clearly describes the criteria it uses to judge distributor performance. The extent to which the manufacturer succeeds in this regard should enhance observing firms’ perceptions of punishment fairness. Fairness perceptions direct and motivate human behavior, with far-reaching effects beyond an isolated event. This impression can influence observers’ trust in the manufacturer and produce a variety of beneficial effects for the productive functioning of a channel network.

Finally, our results about the boundary conditions of observer effects of punishment shed light on how and when punishment should be implemented to prompt favorable reactions. In particular, manufacturers should assess the situation by weighing the degree of relational embeddedness of the focal distributor and their own monitoring capabilities. If a misbehaving distributor has deep connections with other distributors in the network, severe punishment may go against the manufacturer’s interest, due to the negative reactions from interconnected distributors. Thus, a certain level of tolerance or a more lenient and private approach of punishment may be necessary. Alternatively, the manufacturer could work proactively to identify with the majority of distributors and gain their trust before attempting to punish important members. At the same time, manufacturers should actively develop their monitoring capabilities to reduce information asymmetry, align with distributor interests, and build a reputation for fairness and consistency. Strong monitoring capabilities enable managers to impose severe punishment in an attention-getting manner while gaining positive reactions from channel members.

Limitations

Several limitations of this study offer opportunities for further research. For example, we developed our theoretical model to apply to all distribution networks, and thus we enhance generalizability of the underlying theoretical relationships. However, our empirical sample is limited to distributors in China. We have no empirical evidence that our results apply to other national contexts. In particular, our results regarding the role of distributor embeddedness may be quite different in other contexts because close and personal relationships have different cultural connotations across countries. In China, personal relationships such as guanxi carry strong moral implications such that interconnected people consider it necessary to defend one another even if a true moral standard has been violated. These seemingly blurred moral values in embedded, close relationships may help explain why distributor embeddedness significantly weakens the effect of perceived punishment fairness on observers’ trust in the manufacturer. We speculate that in cultures with more sharply defined moral standards, observer effects may be less affected by the degree of embeddedness. Further examinations in such countries would enrich our understanding.

Moreover, although we made efforts to control for the potential threat brought by retrospective data collection, we call for other methods, such as behavioral experimentation, longitudinal studies, and multisource data collection, to complement our findings. In particular, further research could consider how various causes of dysfunctional behavior affect observers’ assessment of the punishment. Because we use observing firms as respondents, we do not have data on the actual causes of each dysfunctional behavior. By obtaining data from the focal dyad involved in a punishment or through experimental manipulations, researchers could investigate the causes or attributions leading to observer evaluations. Moreover, the nature and terms of the contract between a focal dyad may help further explain a manufacturer’s punishment strategy and observers’ reactions. Additional research that evaluates the manufacturer’s responses with a time lag from the punishment event could more objectively determine observers’ ex post performance, such as their cooperative actions or opportunism. Finally, we ask observers to evaluate the focal dyad’s network attributes, including distributor embeddedness and monitoring capability. Further research could gauge these attributes from the perspective of the manufacturer, which is in a better position to evaluate the network. These methodological advances could validate and extend our research findings to unpack additional theoretical perspectives related to this challenging topic.
Our findings suggest that punishment as a common but controversial strategy to address dysfunctional behavior in a channel context has significant and beneficial effects on observer attitudes and behaviors. In addition, we identify the relational embeddedness of the disciplined actor and the punisher’s monitoring capability as two critical moderators that vary the effectiveness of punishment. Additional research is required to more fully understand the complex relationships between dysfunctional behavior, punishment, and network consequences.

Appendix A
PROFILES OF THE SAMPLE DISTRIBUTORS (N = 172)

<table>
<thead>
<tr>
<th>Sample Characteristics</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industry</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Household electronics</td>
<td>61</td>
<td>35.5</td>
</tr>
<tr>
<td>Cosmetics and personal care</td>
<td>54</td>
<td>31.4</td>
</tr>
<tr>
<td>Furniture</td>
<td>57</td>
<td>33.1</td>
</tr>
<tr>
<td><strong>Geographic Location</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East China</td>
<td>65</td>
<td>37.8</td>
</tr>
<tr>
<td>South China</td>
<td>51</td>
<td>29.7</td>
</tr>
<tr>
<td>North China</td>
<td>39</td>
<td>22.7</td>
</tr>
<tr>
<td>West China</td>
<td>17</td>
<td>9.9</td>
</tr>
<tr>
<td><strong>Number of Employees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt;20</td>
<td>55</td>
<td>32.0</td>
</tr>
<tr>
<td>20–49</td>
<td>45</td>
<td>26.2</td>
</tr>
<tr>
<td>50–199</td>
<td>42</td>
<td>24.4</td>
</tr>
<tr>
<td>200–999</td>
<td>21</td>
<td>12.2</td>
</tr>
<tr>
<td>≥1,000</td>
<td>9</td>
<td>5.2</td>
</tr>
<tr>
<td><strong>Relationship Length</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt;2 years</td>
<td>38</td>
<td>22.1</td>
</tr>
<tr>
<td>2–5 years</td>
<td>79</td>
<td>45.9</td>
</tr>
<tr>
<td>5–10 years</td>
<td>45</td>
<td>26.2</td>
</tr>
<tr>
<td>&gt;10 years</td>
<td>10</td>
<td>5.8</td>
</tr>
<tr>
<td><strong>Respondents’ Position</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>President or chief executive officer</td>
<td>44</td>
<td>25.6</td>
</tr>
<tr>
<td>General manager</td>
<td>93</td>
<td>54.1</td>
</tr>
<tr>
<td>Procurement manager</td>
<td>35</td>
<td>20.3</td>
</tr>
</tbody>
</table>

APPENDIX B: MEASURES

Standardized loadings follow each measurement item. All items are on a seven-point scale (1 = “strongly disagree,” and 7 = “strongly agree”) unless specified otherwise.

**Punishment Severity** (Antia and Frazier 2001); CR = .76, AVE = .53

1. How severe was this manufacturer’s punishment toward the distributor who conducted the prohibited behavior as you mentioned before? (1 = “no sanctions imposed,” and 7 = “highest levels of sanctions imposed”) (.72)
2. This manufacturer took strict disciplinary action against this distributor. (.66)
3. Stern punitive action was taken against this distributor. (.77)

**Punishment Fairness** (Kumar, Scheer, and Steenkamp 1995); CR = .89, AVE = .61

The punishment outcome that focal distributor received was:

1. Fair compared to its dysfunctional behavior. (.83)
2. Fair compared to the violated obligations. (.79)
3. Fair compared to what other distributors with the same dysfunctional behavior received. (.80)

4. Fair compared to the manufacturer’s loss caused by this dysfunctional behavior. (.77)
5. Fair considering the effort and investment that it had made in the cooperation. (.71)

**Trust** (Jap and Anderson 2003; Kumar, Scheer, and Steenkamp 1995); CR = .90, AVE = .76

1. Whenever the manufacturer offers us advice, we believe it is sharing its best judgment. (.84)
2. Our business relationship with the manufacturer is characterized by a high level of trust. (.91)
3. The promises between the manufacturer and us are credible. (.86)

**Opportunism** (Brown, Dev, and Lee 2000; Heide, Wathne, and Rokkan 2007); CR = .86, AVE = .60

1. We may ignore some aspects of the contract that are designed to increase the manufacturer’s ability to reach and service customers. (.78)
2. We may interpret terms of the contract in our favor at the manufacturer’s expense. (.76)
3. We may not keep all promises that were made when we began the relationship with the manufacturer. (.85)
4. We may violate some contractual terms in certain circumstances. (.71)

**Distributor Embeddedness** (Moran 2005; Rindfleisch and Moorman 2001); CR = .97, AVE = .82

1. The disciplined distributor shares close social relations with other firms in our distribution network. (.86)
2. The disciplined distributor is emotionally close to many firms in our distribution network. (.92)
3. Relationships between the disciplined distributor and other firms in our distribution network can be generally described as “mutually gratifying.” (.90)
4. The disciplined distributor does not mind if other firms in our distribution network owe it favors. (.92)
5. The disciplined distributor is quite willing to give favors or provide help to other firms in our distribution network. (.90)
6. The disciplined distributor shares goals and values with other firms in our distribution network. (.90)
7. The disciplined distributor is expected to be working with other firms in our distribution network far into the future. (.94)

**Monitoring Capability** (Stump and Heide 1996); CR = .92, AVE = .74

If the manufacturer wanted to, it has the capability to:

1. Extensively monitor the sales performance of all distributors in the network. (.81)
2. Extensively monitor the delivery timeline and accuracy of all distributors in the network. (.90)
3. Externally monitor the customer service of all distributors in the network. (.89)
4. Extensively monitor the price competitiveness of all distributors in the network. (.84)

**Control Variables**

1. Manufacturer Reputation (Ganesan 1994); CR = .92, AVE = .85

1. The manufacturer has a reputation for being honest. (.89)
2. The manufacturer has a reputation for being concerned about the distributors. (We deleted this item from further analysis due to low factor loadings.)
3. Most distributors think that this manufacturer has a reputation for being fair. (.95)

2. Benefits of Future Cooperation (Sa Vinhas, Heide, and Jap 2012)
How attractive is this manufacturer compared to your next best alternative manufacturer in terms of generating profits? (1 = “much less attractive,” and 7 = “much more attractive”)

3. Transaction-Specific Investment (Jap 1999); CR = .86, AVE = .68
1. If this relationship were to end, we would be wasting a lot of knowledge that’s tailored to the relationship. (.73)
2. If either company were to switch to a competitive buyer or vendor, we would lose a lot of the investments made in the present relationship. (.83)
3. We have invested a great deal in building up the joint business. (.91)

4. Market Uncertainty (Kumar, Scheer, and Steenkamp 1995); CR = .89, AVE = .73
1. It is difficult to monitor the market environment trends in our sales area for the manufacturer’s products. (.82)
2. The sales forecasts for the market in our sales area for the manufacturer’s products are quite inaccurate. (.92)
3. The market environment in our sales area for the manufacturer’s products is unpredictable. (.81)

5. Legal Enforceability (Zhou and Poppo 2010); CR = .77, AVE = .64
1. The legal system protects our interests. (.60)
2. The legal system ensures suppliers or customers fulfill contracts. (We deleted this item from further analysis due to low factor loadings.)
3. The legal system ensures our interests will not be harmed by unfair competition. (.96)

6. Relationship Length
Logarithm of the duration of the observer’s association with the manufacturer.

7. Firm Size
Logarithm of the number of employees.

8. Industry
We transformed the three industry categories (household electronics, cosmetics and personal care, and furniture) into two sets of dummy variables to represent the industry of the sample with one holdout.

REFERENCES


