Supplier Relationships
Lecture 7

Briony Boydell
Managing Business Relationships
Objectives of lecture

- Identify the types of relationships within the supply chain
- Discuss the benefits of improved relations between buyer and supplier
- Describe the practices that promote alliance creation
- Consider behaviour that prevents successful relationships in the supply chain
- Conclusion and Reading
Supply Chain Relationships

- Current and future success depends on the ability to identify outstanding supply chain partners and develop appropriate relationship with them.
- Supply Chain managers must learn how to define and manage a diverse set of relationships up and down the supply chain.
Why form supply chain relationships?

• Functional
  – Cost Minimisation - Efficiency and Synergies
  – Reciprocal benefits – share risks and rewards
  – Competitive positioning – Joint Venture strategy
  – Resource aggregating and sharing – economies of scale

• Strategic
  – Firms may need to gain access to new competencies, markets, technologies, or specific resources.
A core principle of SCM is that not all relationships are created equal.

Transactional relationships are driven by the need to efficiently conduct operations with a number of low value suppliers.

Strategic alliances seek to create a long-term mutually beneficial relationship where both risk and rewards can be shared.
The Relationship Continuum

- **Transactional Relationship**
  - Transitory
  - Cost Driven
  - Arms-Length

- **Basic Alliance**

- **Operational Alliance**
  - Long-term relationship
  - Mutual Benefits
  - Open Communication
  - Joint Planning
  - Shared Risk/rewards
  - Cross-Organisational Teams
  - Top Mana

- **Business Alliance**

- **Strategic Alliance**

*Fawcett et al (2009)*
Relationships approach to purchasing

- The relationship continuum will affect the organisations purchasing negations.
- There will be a significantly different emphasis on what is required from the contract depending on the level of the relationship.
- Circumstances will vary depending on the number of relationships and the products characteristics.
- The following two slides compare the extreme ends of the scale.
### Transactional v Relationship purchasing

<table>
<thead>
<tr>
<th>Transactional</th>
<th>Relationship</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus on Short Discrete purchasing</td>
<td>Focus on supplier retention</td>
</tr>
<tr>
<td>Short-Term Orientation</td>
<td>Long-Term Orientation</td>
</tr>
<tr>
<td>Arms Length</td>
<td>Closeness</td>
</tr>
<tr>
<td>Simple Buyer Seller relationship</td>
<td>Complicated, including internal Relationships</td>
</tr>
<tr>
<td>Emphasis on price, quality and delivery – NO INNOVATION</td>
<td>Emphasis on improving price, delivery and quality PLUS innovative design as a collaboration between supplier and purchaser</td>
</tr>
<tr>
<td>Moderate supplier Contact</td>
<td>High Level of supplier contact, with each contact being used to gain information and strength</td>
</tr>
<tr>
<td>Little Sharing of information - OPAQUENESS</td>
<td>Significant information cost information - TRANSPARENCY</td>
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</table>
### Characteristics of Arm’s-Length Relationships and Strategic Partnerships

<table>
<thead>
<tr>
<th></th>
<th>Arm’s-length Relationships</th>
<th>Strategic Partnerships</th>
</tr>
</thead>
<tbody>
<tr>
<td>**Product/Input</td>
<td>• Commodity/standardised products</td>
<td>• Customised, non-standard products</td>
</tr>
<tr>
<td>Characteristics</td>
<td>• Open architecture products</td>
<td>• Closed architecture products</td>
</tr>
<tr>
<td></td>
<td>• Stand alone (no or few interaction effects with other inputs)</td>
<td>• Multiple interaction effects with other inputs</td>
</tr>
<tr>
<td></td>
<td>• Low degree of supplier-buyer interdependence</td>
<td>• High degree of supplier-buyer interdependence</td>
</tr>
<tr>
<td></td>
<td>• Low value inputs</td>
<td>• High value inputs</td>
</tr>
<tr>
<td>**Supplier</td>
<td>• Single functional interface</td>
<td>• Multiple functional interfaces</td>
</tr>
<tr>
<td>Management Practices</td>
<td>• Price benchmarking</td>
<td>• Capabilities benchmarking</td>
</tr>
<tr>
<td></td>
<td>• Minimal assistance (minimal investment in inter-firm knowledge sharing routines)</td>
<td>• Substantial assistance (substantial investments in inter-firm knowledge sharing routines)</td>
</tr>
<tr>
<td></td>
<td>• Supplier performance can be easily contracted for ex ante</td>
<td>• Supplier performance on non-contractibles (e.g., innovation, quality, responsiveness) is important</td>
</tr>
<tr>
<td></td>
<td>• Contractual safeguards are sufficient to enforce agreements</td>
<td>• Self-enforcing agreements are necessary: (e.g., trust,</td>
</tr>
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<td></td>
<td>adapted from Dyer et al. 1998</td>
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</tbody>
</table>
Managing Transactional Relationships

Management of transactional relationships should seek to satisfy two objectives:

1. maximum efficiency and handling transactions
2. good relations, both parties feel they are treated fairly.

- These are generally transitory in nature meaning that managers should invest little time, money, or resources in developing them.

- The focus with these suppliers is to reduce cost. Cost reduction can be accomplished by use of reverse auctions and global sourcing; however, all SC members (even transactional relationships) should be treated in a fair and honest manner.
The outcomes sought from transactional relationships include:

- Lower administrative costs
- Lower product and/or service costs
- Better quality, innovation, and responsiveness
- Enhanced technical support
- Delivery of special services
- Opportunity to collect competitive intelligence
- Fewer complaints and better industry reputation
- More profitable relationships
- Opportunity to build closer, more collaborative relationships in the future
Managing Strategic Alliances for Success

- Strategic alliances are formed in an attempt to coordinate complementary core competencies in an on-going basis.
- As these are the most highly evolved types of business-to-business relationships (B2B), they are closely scrutinized and carefully managed.
- Effective operation of a strategic alliance requires intensive and open communication supported by linked information systems; additionally, cross-organisational teams drive cooperative planning.
Factors that suggest an appropriate relationship for alliance include

- Relationship represents a significant financial volume, in either sales or purchases.
- SC member represents a large share of the company’s business, either sales or purchases.
- Potential partner possess skills, technology, or another unique aspect that cannot be found elsewhere.
- Strategic component, service, or upstream/downstream relationship is affected.
- Potential scarcity governs the marketplace.
- Intensive collaboration can create advantage by offering better quality, lower costs, shorter cycles, or unique service.
Both companies in an alliance should receive benefits

These benefits include the ability to;

• focus on individual strengths, potentially leveraging them into core competencies
• manage the chain as a value system, optimizing resource usage across the chain,
• offer unique product/service packages and one-of-a-kind satisfaction opportunities
• increase flexibility while spreading risk, and
• learn from SC partners.
Up and Downstream benefits

- **Customers** in the alliance can generally expect lower costs, improved product quality, enhanced responsiveness, decreased order fulfillment times, higher levels of innovation, and improved allocation of scarce resources.

- **Suppliers** generally receive long-term, large volume contracts that provide schedule stability and lower costs. Long-term contracts with stable demand allow for the investment in new technologies and may result in access to buyer’s expertise and access to buyer financing for materials or equipment.
**Relationship Formation Five Aggregation Levels**

Relationship integration is likely to evolve and emerge rather than become strategic straight away (although there are some exceptions)

<table>
<thead>
<tr>
<th></th>
<th>Actions</th>
<th>- Individual initiatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Episodes</td>
<td>- Groups of interrelated actions</td>
</tr>
<tr>
<td>3</td>
<td>Sequences</td>
<td>- More extensive entities of interactions</td>
</tr>
<tr>
<td>4</td>
<td>Relationships</td>
<td>- All sequences that comprise in one relationship</td>
</tr>
<tr>
<td>5</td>
<td>Partner base</td>
<td>- Relationship portfolio</td>
</tr>
</tbody>
</table>
The Cox Model

- Adversarial
- Arms length
- Preferred supplier
- Single sourcing
- Network sourcing
- Strategic alliances
- Internal contracts – mergers, acquisitions

A step-ladder of external and internal contractual relations
Which is appropriate

Transactional/ strategic alliance

- Determine strategic elements of a relationship
- Many undifferentiated Suppliers providing interchangeable commodities
- Supplier possess economic power
- Recognition of potential benefits by both parties?
- Supplier exceeding rivals in innovation, flexibility etc.
- Strategic to the buyers businesses
- Benefits be higher if greater integration with a particular supplier
- High buyer dependency
**Alliance Success factors**

Whipple and Frankel (Journal of Operations Management 2000) Identified 18 favourable Characteristics and their research independently ranked 5 critical factors;

<table>
<thead>
<tr>
<th>Buyer Response</th>
<th>Supplier Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Trust</td>
<td>1. Senior Management Support</td>
</tr>
<tr>
<td>2. Senior Management Support</td>
<td>2. Trust</td>
</tr>
<tr>
<td>3. Ability to meet performance expectations</td>
<td>3. Ability to meet performance expectations</td>
</tr>
<tr>
<td>5. Partner Compatibility</td>
<td>5. Clear Goals</td>
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</table>
Integration

• Organisations in a supply chain can have varying degrees of cooperation and integration.
• In order of increasing ownership the options are:
  – Market relationship,
  – Strategic partnerships and alliances
  – Virtual organisation
  – Vertical integration
Market Relationship/Spot Trading

• Here each purchase is treated as a separate transaction and the relationship between the buyer and seller lasts as long as this transaction takes.
• There can be some additional arrangements around this relationship such as the use of electronic data interchange (EDI) facilities to share information, combining orders in a single delivery to reduce transportation costs, agreements on packaging standards to improve materials handling and other factors.
• This approach does have a number of advantages in that it permits flexibility in that suppliers can be changed or discontinued if demand drops or a supplier introduces a new product.
• However there can be disadvantages in this arrangement in that either side can end the relationship at any time.
The form of an organisation’s relationship within its supply chain is increasingly being affected by developments in e-business systems. E-business involves electronically mediated information exchanges, both within an organisation and between organisations.

Kraut (1998) suggests that the features of a virtual organisation are:

- Processes transcend the boundaries of a single form and are not controlled by a single organisational hierarchy
- Production processes are flexible with different parties involved at different times
- Parties involved in the production of a single product are often geographically dispersed
- Given this dispersion, coordination is heavily dependent on telecommunications and data networks.
**Vertical Integration**

- Complete integration is achieved by an organisation when they take ownership of other organisations in the supply chain.
- The amount of ownership of the supply chain by an organisation is termed its level of vertical integration.
- When an organisation owns upstream or supply-side elements of the supply chain it is termed **backward** vertical integration.
- For ownership of downstream or demand-side elements of the supply chain is termed **forward** vertical integration.
- When a company owns elements of a different supply chain, for example a holding company which has interests in organisations operating in various markets, the term used is horizontal integration.
Vertical Integration

Advantages
• Is the ability to secure a greater control of the competitive environment.
• Backward integration, implemented by owning suppliers, can secure supplies of components whose availability and price to competitors can be controlled.
• To keep distinctive competence or capability in-house and not available to competitors.

Disadvantages
• Perhaps the major reason for outsourcing is the cost incurred in owning major elements of the supply chain.
• There is a risk in that trying to do everything will mean that the company is not competitive against companies who are focusing their resources and skills.
• Also the increased flexibility available when using a number of suppliers to meet fluctuations in...
The character of internal operations activity

- Do everything important
- Do everything
- Do nothing

**Type of inter-firm contact**

- **Transactional** – many suppliers
- **Virtual spot trading**
- **‘Partnership’ supply management**
- **Long-term virtual operation**
- **Vertically integrated operation**

**Traditional supply management**

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### Factors for rating Suppliers (Slack 2007)

<table>
<thead>
<tr>
<th>Short-term ability to supply</th>
<th>Longer-term ability to supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Range of products or services provided</td>
<td>• Potential for innovation</td>
</tr>
<tr>
<td>• Quality of products or services</td>
<td>• Ease of doing business</td>
</tr>
<tr>
<td>• Responsiveness</td>
<td>• Willingness to share risk</td>
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<tr>
<td>• Dependability of supply</td>
<td>• Long-term commitment to supply</td>
</tr>
<tr>
<td>• Delivery and volume flexibility</td>
<td>• Ability to transfer knowledge as well as products and services</td>
</tr>
<tr>
<td>• Total cost of being supplied</td>
<td>• Technical capability</td>
</tr>
<tr>
<td>• Ability to supply in the required quantity</td>
<td>• Operations capability</td>
</tr>
<tr>
<td></td>
<td>• Financial capability</td>
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<td>• Managerial capability</td>
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</table>
Strategic Relationship Positioning Model

- **Dependency/Power**: Independent
  - Asset-specific investment
- **Certainty/Risk**: Certain
  - High
- **TACTICAL COLLABORATION**
- **ADVERSARIAL**
- **OPPORTUNISM**
  - Uncertain
  - Low
  - Inter-dependent
Conclusion & Reading

• The buyer supplier relationship will depend on several factors and sit under certain conditions
• It is key to identify
  – Number of Suppliers in the market
  – Uniqueness of the product required
  – How much the operation is ready to undertake (make or buy)
• Relationships require trust and collaboration for long term effectiveness i.e. ‘win win’ scenario
• Read Lysons et al and Slack et al and case study attached