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Value drivers in supplier relationships – A need for internal alignment

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Abstract:

The role of the purchasing function is changing. Recent research shows that purchasing continues to move from a simple money-saving activity, towards being regarded as strategic in line with manufacturing and sales activities. However, a pre-study including purchasing managers from nine large and medium sized European industrial manufacturers shows that purchasing strategies a still dominated by a cost-focused perspective. Relationship value drivers in these strategies are cost-focused implying a lack of attention towards obtaining possible relationship benefits. To investigate if this is actually the case in practice, two case studies with different supplier settings have been conducted: One case with supplier relationships in an operational setting and one case with collaborative development of new products. The study indicates that despite the focus on cost reductions in formal purchasing strategies, employees interacting in supplier relationships act from a more varied set of priorities moving from core offering value drivers towards customer operations value drivers the more development is part of the relationship.

Keywords

Relationship value drivers, purchasing strategy, supplier relationships.

Introduction

The purchasing function acts as a gatekeeper towards suppliers and therefore has a central role in managing supplier relationships (Leenders et al. 1994). However, purchasing is typically identified in company strategies as a function of cost saving potential, and the value added by the function therefore mainly results from the evaluation of generated savings (Hartmann et al. 2012; Nollet et al. 2008; Van Weele 2005). This is reflected in the goals of purchasing managers, which are typically measured on costs or costs savings, which are short term goals (Nollet et al. 2008). This does not match recent research findings showing that purchasing should be regarded a value-contributing function contributing to the top line as well as the bottom line (Hartmann et al. 2012). Companies will benefit from purchasing being a strategic function including decision-making power and responsibility of the company's overall performance (Carr and Smeltzer 1997; Ellram and Carr 1994).

Being a strategic function includes deriving value through building and improving supplier relationships. Relationship value is considered one of the cornerstones of business market management in regards to both research and practice (Anderson et al. 2009; Lindgreen and Wynstra 2005; Ritter and Walter 2008; Woodruff 1997). Yet, only few empirical research studies focus on relationship value in business markets from a customer perspective (Ulaga and Eggert 2006). While some define value primarily in monetary terms (Anderson et al. 2009), others use broader definitions that include non-monetary benefits and sacrifices, such as competitive gains, competencies, social relationships, knowledge, managerial time spent, etc. (Möller and Törrönen 2003). Relationship value reaches beyond value embedded in exchanged products and services (Lindgreen and Wynstra 2005). A relationship can be of great value for a customer if for example the reputation, location, or innovative capability of the supplier creates new opportunities for the customer, even if this is not reflected in the current of products and services exchanged between the companies (Lindgreen and Wynstra, 2005). Many companies achieve substantial product

innovation and quality improvements by making better use of suppliers (Gadde and Håkansson, 2001). Different research studies have identified sets of relationship value drivers existing in business relationships, which can be used to assess how a supplier adds value in a relationship to a customer (Lapierre 2000; Ulaga 2003; Ulaga and Eggert 2006; Walter et al. 2003). The relationship value drivers shape purchasing practice and thereby determine the potential benefits derived from supplier relationships. This study aims to identify which relationship value drivers are dominant in both purchasing strategies and purchasing practice in todays' industrial companies. It has been chosen to focus on manufacturing business relationships, which has been identified as a relevant segment by related empirical studies (Gibbert et al. 2008; Ulaga 2003).

The next section includes the theoretical basis of the article followed by a section presenting the applied methods. Afterwards, the results and analysis of a pre-study and two case studies are presented including a joint analysis. Finally, the results are discussed including recommendations for further research.

Relationship value drivers

The concept of value has gained much interest from researchers, consumers and marketers through the last 15 years (Payne and Holt 1999). It has been widely used throughout a number of disciplines within social science including accounting and finance, purchasing and materials management, economics and marketing (Tzokas and Saren 1999; Wilson and Jantrania 1994). The concept is most widely described from a customer's viewpoint within the area of marketing, usually under the term relationship value (Ulaga 2003). Relationship value is a contingent concept, which is constructed by individuals as part of exchanges and relationships (Henneberg and Mouzas 2008), however five characteristics of relationship value prevails throughout the marketing literature (Busacca et al. 2008; Ulaga 2003). Relationship value is: Conceptualized as a **trade-off between benefits and sacrifices** (Zeithaml 1988). A **subjective** concept, meaning that different people or

organizations value different things (Kortge and Okonkwo 1993). **Multidimensional**, since customers evaluate several benefits and sacrifices simultaneously including both functional and emotional elements (De Chernatony et al. 2000; Grisaffe and Kumar 1998). Perceived **relative** to competition, meaning that the value of one alternative is judged in comparison with other alternatives (Gale and Wood 1994). **Dynamic** and dependent on several variables, which are often beyond the control of a single company, as well as being dependent on individual customer learning (Busacca et al. 2008).

Since relationship value is conceptualized as a trade-off between benefits (what you get) and sacrifices (what you give) in a market exchange, value can be added both by reducing sacrifices and by increasing benefits in the relationship (Flint et al. 1997; Ravald and Grönroos 1996; Ulaga and Chacour 2001; Walter et al. 2001; Zeithaml 1988). The most appropriate strategy depends on the specific situation. For instance, it is argued that some companies focus on adding extra technical features to the products and neglect to consider if this fits the actual need of the customers (Ravald and Grönroos 1996). This research focus on the buyer's perspective on relationship value and we adopt a similar understanding of relationship value as described by (Walter et al. 2001) being "*the perceived trade-off between multiple benefits and sacrifices gained through a supplier relationship by key decision makers in the buyer's organization*". This definition is congruent with the five described characteristics of relationship value and is widely used throughout existing literature (Lindgreen and Wynstra 2005; Möller and Törrönen 2003; Ritter and Walter 2008; Ulaga 2003).

From the literature on relationship value in buyer-supplier relationships from the customer's side, the stream of research by Ulaga and Eggert (Ulaga 2003; Ulaga and Eggert 2005; Ulaga and Eggert 2006) emerge as an interesting and rigorous contribution due to testing through multiple research methods and the broad coverage of both benefit and sacrifice dimensions of relationship value. Ulaga and Eggert (2006) divides benefits and sacrifices into three different classes of value drivers; the core offering, the sourcing process or the customer operations (Ulaga and Eggert 2006). Each of

these classes represents different ways in which a company can gain value through supplier relationships. The work of Ulaga and Eggert has been summarized in a framework which is depicted in Figure 1. This framework will be used for analysis of relationship value drivers in this research study.

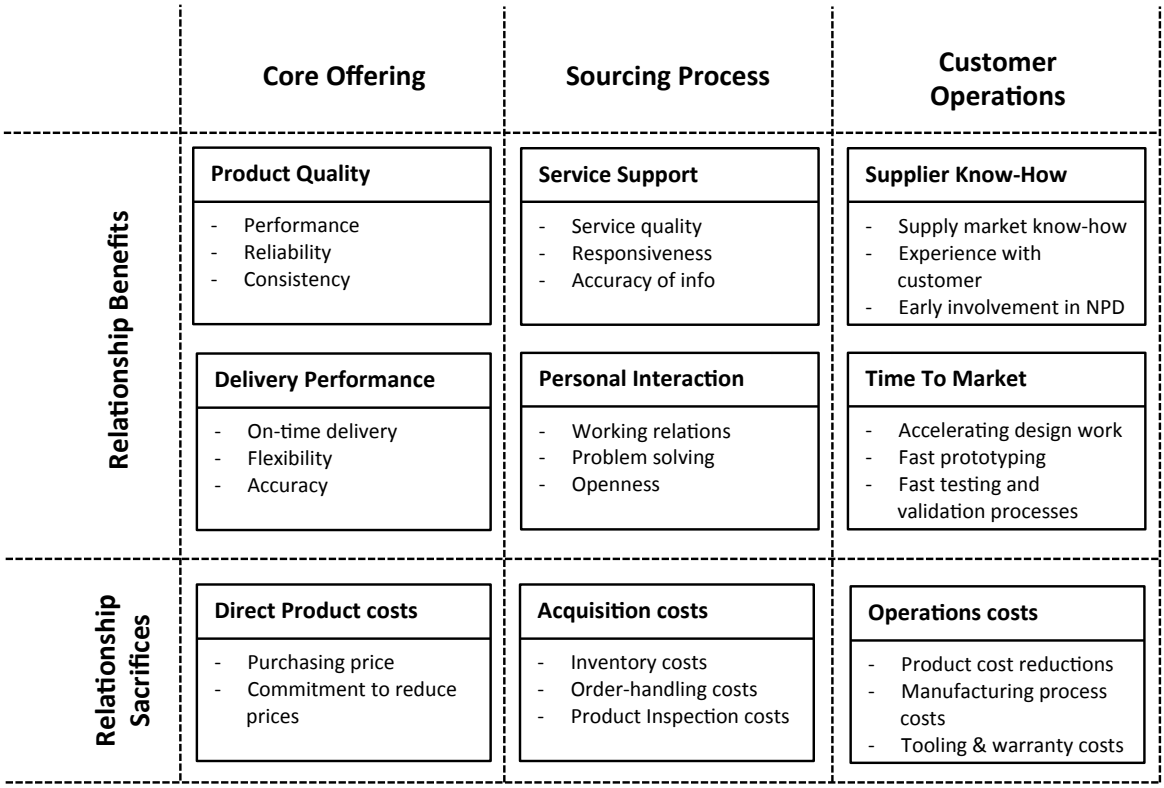

Figure 1 Relationship Value Drivers. Inspired by Ulaga and Eggert's research (Ulaga and Eggert 2006).

Value creation through **the core offering** represents the value of the supplier's offering, and is thus strongly related to the perceived value of the exchanged product(s). The core offering is argued to be of vital importance to the perceived value of the relationship since no relationship can be satisfactory, if the exchanged offering is not. The elements of this dimension are also described as "must-haves" meaning that they are mandatory parts if the buyer and supplier are to do business, and they therefore constitute the very core of the relationship. Beyond value obtained through the core offering, buyers obtain value in **the sourcing process** itself, which represents the value generated in the process of obtaining materials and components. Such value might be quite important for purchasing managers, while being less important for the remaining organization. This

type of value is related to the supplier's ability and willingness to provide a high level of service, openness to the buyers needs and requests and the general ease of making business with the supplier. To some degree this dimension also relates to the buyers experience and perception of the supplier and his employees. The third and final source of relationship value is the **customer operations** dimension, which represents the effect that the relationship has on the buyer's operations. Improving operations refers to both optimizing existing manufacturing processes as well as providing the buying organization with ideas or input to new products. This dimension therefore involves inter-organizational learning, transforming the operations in place to produce and distribute the products and components. The relationship sacrifices; direct product costs, acquisition costs, and operations costs are what a company must sacrifice in order to receive the relationship benefits. For instance, in order to achieve the core benefits of product quality and delivery, a company must "sacrifice" the direct product costs.

Collaborative vs. Cost-focused Perspectives On Supplier Relationships

The importance of collaborative supplier relationships in enhancing competitiveness is supported by many scholars especially within the marketing discipline (Nollet et al. 2012; Ulaga and Eggert 2006; Walter et al. 2003; Wong et al. 2010). From a collaborative perspective companies are increasingly interested in managing their supplier relationships to extract as much value from these relationships as possible in order to gain a competitive edge (Fliess and Becker 2005; Soosay et al. 2008). The role of purchasing from a collaborative point of view is to build and maintain supplier relationships in relation to dynamic customer needs. This approach includes price considerations and thus also cost-related aspects, but with main focus on building the relationship for competitive advantage.

From a cost-focused perspective the role of purchasing is primarily minimizing sourcing related costs (Hartmann et al. 2012; Nollet et al. 2012; Van Weele 2005). Cost-focused purchasing typically seeks improvements of three distinct types; price down, cost down, and cost out

(Anderson and Katz 1998; Hughes et al. 1998). Initially, savings are sought through price reductions for purchased products typically through supplier negotiations. When prices eventually drop to a certain level, additional savings are sought on product costs rather than price (Hughes et al. 1998). At this point product costs are reduced through an active effort from the buying and selling party, to optimize both the design of the product themselves and all processes involved in transporting, producing and selling these products (Anderson and Katz 1998). While the collaborative perspective includes building long term supplier relationships for supply chain competitiveness, the cost-focused perspective has a short term monadic viewpoint. In this way, the collaborative and cost-focused perspectives have a different focus, and it is expected that value drivers in supplier relationships differ accordingly.

In the following section, the methods used in this research study are presented. Afterwards, the research results are presented and analyzed in a joint section, followed by a section including discussion of the findings.

Method

For this research study, the explorative case study approach has been chosen in order to develop an in depth understanding of the relationship value drivers in supplier relationships. The segment of large and medium sized European manufacturing companies in B2B relationships with manufacturing suppliers has been chosen. A pre-study was conducted to identify the dominant focus in purchasing strategies and relationship value drivers in this segment including perceived future challenges. The pre-study includes purchasing managers from 9 different companies within the segment. Afterwards, two dyadic case studies were conducted including one case with joint product development and one with an operational focus both from the water control industry, to investigate the dominant value drivers and underlying paradigm of the supplier relationships. The two case studies have been chosen to represent the extremes within the segment, which includes a

case with an operational mode and a case with a development mode. Operational mode implies purchasing with regular materials planning in manufacturing, while development mode implies new product development outside ordinary operations management. Case study A, the operational setting, includes a large European manufacturing company and three of their regular suppliers. The suppliers are one small and one large company delivering strategic components, and a third being a large packaging supplier. The case study includes interviews with strategic and operational supply managers, production planner, product manager, and regional supply manager. Case study B includes four companies that have all recently engaged in joint product development with their common supplier. The supplier is a large European manufacturer of components for the segment, while the customers are two medium-sized and two large manufacturing companies. The methods are depicted in *Figure **2***.

	Pre-study	**Case study A**	**Case study B**
Data collection method	9 company interviews 3 sourcing workshops	7 interviews 1 buying company 3 supplier relationships	Observations & 8 interviews 4 buying companies 1 shared supplier
Focus of study	The purchasing functions general value drivers	Value drivers of operational oriented supplier relationships	Value drivers of development oriented supplier relationships
Actors organizational position	Chief Purchasing Officers & category heads	Strategic and operational purchasers.	Key account and purchasing managers of buyer-supplier relationships

Figure 2 Overview of the three cases including method, focus and interviewees position.

In the pre-study, data collection was done through both interviews and workshops. Firstly, visits were made to each of the nine participating companies. The agenda during these visits was to observe the working environment of purchasing, and to conduct interviews with purchasing directors and leading employees of the purchasing function. Secondly, all companies participated in a series of three full-day sourcing workshops, where additional information on purchasing value drivers and supplier relationships was collected and discussed within the group. Through the

interviews subjects such as the company's past, functional organization, status of the department, industry characteristics, sourcing strategy, view on suppliers, and future challenges were discussed. Moreover, the interviews were kept in an informal tone to provide rich opportunity for the interviewees to express themselves on other secondary topics. Each interview was recorded and transcribed to text, making thorough analysis possible. In both following case studies, semi-structured interviews were conducted individually including managers responsible for the specific supplier relationships. All interviews were recorded and transcribed for analysis of existing value drivers. The interviewees were asked to describe the buyer-supplier relationship, the interaction process in practice and focus on what was valuable in the process and which things could be improved by both buyer and supplier. Furthermore, the managers responsible for the supplier relationships were presented with the value driver framework after their interviews and asked to rate the importance of the nine relationship value drivers. Rating included awarding one point to each of the three most important value drivers and withdraw one point for the three least important value drivers.

Findings and Analysis

In this section the findings and analysis of the pre-study and the two case studies are presented. The dominant purchasing strategy and value drivers are first examined during a pre-study. Afterwards the relationship value drivers are identified in the two cases and the supplier relationships are analyzed to identify the underlying purchasing perspectives.

Pre-study

Purchasing strategies are developed individually in each of the companies participating in the pre-study. They include different aims for purchasing management ranging from implementing formal sourcing management procedures to managing purchasing risks. Through the workshops, purchasing managers unanimously agree that purchasing strategies are saturated by a cost-reduction

focus. This is supported by the interview studies, where cost is the most mentioned topic throughout all interviews, indicating that cost is the dominant focus area. The value drivers presented in the framework by Ulaga (2006) are all considered in the purchasing departments included in the pre-study. However, through the pre-study three value drivers emerge as dominant in the purchasing strategies of the included companies, which are the value driver sacrifices; direct product costs, acquisition costs, and operations costs. Hence, purchasing strategies promote value drivers that will not increase relationship benefits, and thus not retrieve the possible competitive advantage of supplier relationships.

During the workshop sessions, purchasing managers argue that top management generally still has an 'old view' on purchasing as a cost reducing function. The managers agree that the most challenging and interesting aspects of purchasing is to engage in active collaboration with key suppliers, which is in opposition to the cost-reduction perspective promoted by the purchasing strategies. Thus, the pre-study identifies a difference between desired aims of the purchasing managers and the purchasing strategy developed by top management. The purchasing strategies include cost-related relationship value drivers, while purchasing managers generally acknowledge that supplier relationships are of increasing importance and desire to focus on relationship benefit value drivers. This realization leads to two case studies of value drivers in supplier relationships, in order to identify which value drivers are applied in practice.

Case A

Case A includes three supplier relationships in an operational setting. The three suppliers are managed by the purchasing function, but in practice also production and product managers play active parts in the relationships. The value drivers are therefore affected by the internal collaboration between functions. Production and product related value drivers like delivery time and quality are deemed important by managers of these functions, which affects managers in the purchasing function to a less cost-focused approach in order to meet the needs of the internal

stakeholders. To identify the value drivers, the three purchasing managers in charge of the supplier relationships were asked to rank the value drivers presented in the framework by Ulaga (2006). As mentioned in the method section, one point is awarded for the three most important value drivers while one point is withdrawn for the three least important value drivers for each purchasing manager. The results are shown in Figure 3.

Supplier A, Standard Items

Product Quality	Service Support	Supplier Know-How
3	-1	-3
Delivery Performance	**Personal Interaction**	**Time To Market**
2	-2	-3
Direct Product costs	**Acquisition costs**	**Operations costs**
3	1	0

Supplier B, Strategic Items

Product Quality	Service Support	Supplier Know-How
3	-2	1
Delivery Performance	**Personal Interaction**	**Time To Market**
3	-1	-1
Direct Product costs	**Acquisition costs**	**Operations costs**
1	-2	-2

Supplier C, Strategic Items

Product Quality	Service Support	Supplier Know-How
3	-1	-2
Delivery Performance	**Personal Interaction**	**Time To Market**
3	-1	0
Direct Product costs	**Acquisition costs**	**Operations costs**
2	-2	-2

Figure 3 - Importance of value drivers for three supplier relationships

Through the analysis, the three dominant value drivers are found to be identical for all three suppliers. The two main value drivers are product quality and delivery performance, while the third is direct product cost. These three relationship value drivers constitute the core offering category of the framework. That core offerings are the actual value drivers applied in practice is supported by findings during interviews. Interviewees argue that in order to secure quality and delivery time to their customers, the supplier has to be reliable on these two parameters, which is important for the company. Direct product cost is also relevant, however quality and delivery is prerequisites for the operation to function, which in practice overrules the cost-focus prescribed by the purchasing strategy of the company. Hence, even though the purchasing strategy is cost-focused, the value drivers are in operational relationships centered on the core offering value drivers rather than cost.

All three suppliers have a long history of collaboration with the company, and the supplier relationships are identified to be of a collaborative nature rather than cost-focused. Meetings are held every quarter to improve delivery and quality if needed, and in situations where a supplier is

not living up to the expectations, additional time is invested in solving the issues together with the supplier. The supplier relationships are, besides the legal buyer contracts, informal and based on mutual understanding and trust. Based on the analysis it is found that the supplier relationships in case A are based on a collaborative perspective, which is not in line with the cost-focus prescribed by the purchasing strategy. Thus, a mismatch has been identified which supports the findings in the pre-study that purchasing managers experience a daily challenge in managing the differences between a cost-focused strategy and a collaborative purchasing practice.

Case B

This case includes four companies and their shared supplier. Common for all four companies is that they have all recently engaged in new product development with their common supplier. The companies have no joint collaboration with each other; neither do they purchase the same components from the supplier. All four companies have a yearlong history of collaboration with the supplier, where they have purchased standard items in an operational setting. Recently all four companies switched to a development setting in regards to the supplier, because they had a need to improve their product or manufacturing process, requiring development of a new component from the supplier. In this case, purchasing managers were in close collaboration with internal product development. Two of the product development processes resulted in development of strategic items, making the supplier relationship strategic. The other two projects were terminated during the development period making one of the companies change supplier while the other company remained with the current supplier. Interviews were conducted with the responsible manager of the supplier relationship in all four companies after the process had been conducted. The results of the four interviews with purchasing managers are ranked according to the value framework by Ulaga (2006). Like in Case A one point is awarded for the three most important value drivers in the supplier relationship while one point is withdrawn for the three least important value drivers from each of the four companies. The result is depicted in Figure 4.

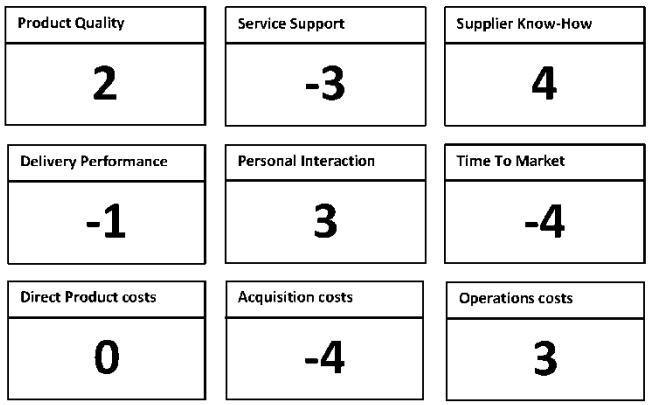

Figure 4 Importance of value drivers in supplier relationship in case A.

The results show that the three dominant value drivers in case B are supplier know-how, personal interaction and operations costs. In the development setting, supplier know-how and personal interaction becomes more beneficial to the companies than quality and delivery, which according to the interviewees used to be most important when the supplier relationships were in operational modes. The supplier's ability to understand the company's production and technology is essential for successful product development, and the personal relationship is a dominant value driver when developing new products together because of necessary knowledge sharing and close interaction. The supplier has a higher price than other suppliers of the same quality, but personal interaction, their knowhow and ability to save cost in the companies' operations is deemed more important than short term monetary gains. An additional interview study was made at the supplier company, which supports the findings of relationship value drivers in the supplier relationship. The supplier agrees that the three dominant value drivers are essential to customers engaging in joint product development, and they argue that close collaboration is essential for suppliers to stay competitive in today's marketplace. This proposes that the identified value drivers are general for the market in question. Like in Case A, the supplier relationships are found to include a collaborative perspective, matching the dominant value drivers, which does not follow the cost-focused purchasing strategy.

The case indicates that the dominant value drivers shift from left to right in the matrix when moving from an operational setting to a development mode.

Value drivers in supplier relationships

The analysis of all three cases indicates that manufacturing companies today have cost-focused purchasing strategies, which does not match the dominant value drivers applied by purchasing managers in practice. Furthermore, the study indicates that core value drivers are dominating when purchasing has a traditional operational setting, while the dominant value drivers shift towards customer operations value drivers when engaging in collaborative product development. An overview of the results of is presented in Figure 5.

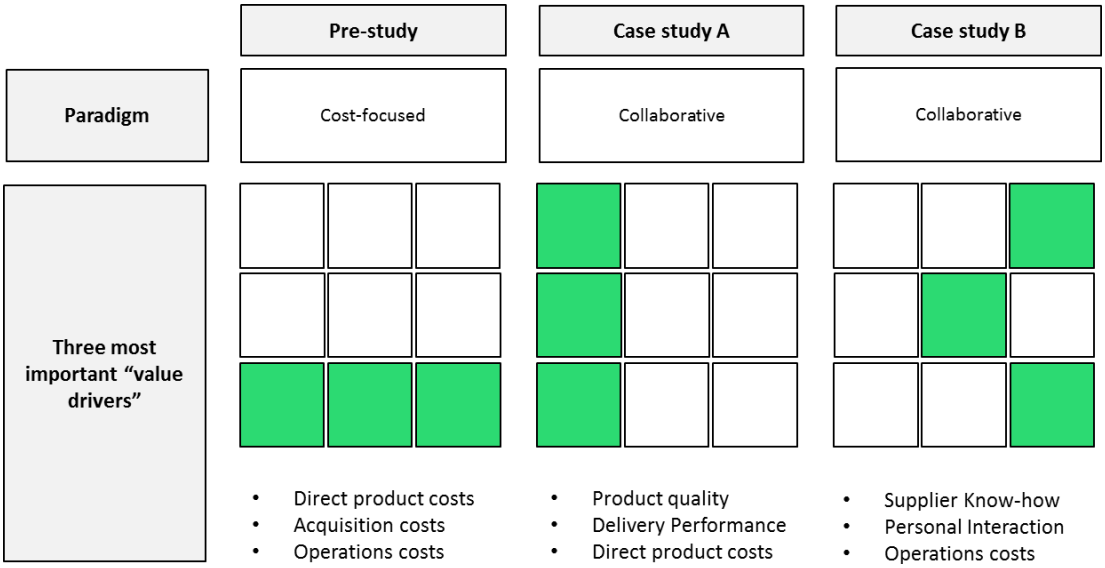

Figure 5 Overview of the identified value drivers in the three studies.

Both case studies are based on a collaborative perspective, which is different than the purchasing strategies which are identified to be cost-focused. In the operational setting it is more important for the company to secure high quality and delivery on time than a cheap price, and purchasing managers choose to act according to these needs rather than follow the prescribed cost-focus. Likewise, in a development setting companies choose a supplier with know-how and good personal relations, with a potential to decrease operations cost through new product development, rather than

to have the cheapest product prices and acquisition costs. Hence, these two value drivers are 'sacrificed' in order to retrieve the relationship benefits related to collaborative product development.

Discussion

Through the research study, three dominant value drivers have been identified in three different cases including; purchasing strategies of European manufacturers, supplier relationships in an operational setting, and supplier relationships including product development. The study indicates that there is a general mismatch between value drivers of the purchasing strategy and the value drivers in practice in B2B manufacturing companies today. A possible reason is that strategies are still developed based on the traditional paradigm of purchasing as a money-saving function (Chen et al. 2004; Gadde and Hakansson 1994; Reck and Long 1988), while purchasing managers follow a collaborative approach, which has been identified as a source of competitive advantage (McLaren et al. 2002; Storey et al. 2005). This mismatch places purchasing managers in a difficult situation, where they must maneuver between contradictory paradigms at a daily basis. One thing is what management expects of the purchasing function, another is which actions are valuable for the company, including supplier collaboration and relationship management (Nollet et al. 2012; Ulaga and Eggert 2006). Development of long term supplier relationships is likely to prove more beneficial for the company than short term monetary gains. Based on these findings it is recommended that purchasing strategies are updated and aligned with the practical purchasing challenges to support managers in acquiring relationship benefits increasing the overall value of supplier relationships.

Another relevant finding is the difference in relationship value drivers in operational and development settings. Both settings were based on a collaborative approach towards the supplier, but differed in which value drivers were dominant. The study indicates that benefits are not fixed in

supplier relationships and may shift from core value drivers towards customer operations when engaging in collaborative product development. This knowledge is relevant for purchasing managers in relationship management, aligning this according to relationship value drivers deliberately focusing on potential the relationship benefits. Suppliers can use this knowledge on customer value drivers to gain competitive advantage by matching their sales activities accordingly. For instance, suppliers can chose a product development strategy by focusing on increasing know-how and customer collaboration as opposed to price competition. This is supported by Ulaga and Eggert (2006) arguing that sourcing benefits are effective differentiating factors, whereas it is difficult to obtain differentiation based solely on core offerings (Ulaga and Eggert 2006).

Like all research studies this study has its limitations. The study is based on the value driver framework developed from a single research stream, and thus the study does not cover other value driver models (Ulaga 2003; Ulaga and Eggert 2005; Ulaga and Eggert 2006). However, the framework setup of value drivers utilized in this study enables illustration of the difference between cases contribution with relevant findings to existing research. The framework is based on manufacturing companies in business relationships, which has also been chosen as segment in this study. Thus, from a contingency perspective, the findings are only applicable to this setup (Morgan 1997), and will not be generalizable to other settings. The value drivers found in the development setting includes two of three customer operations value drivers, excluding the time-to-market value driver. This might be due to the cases being in the water control industry, which generally have long product lifecycles and therefore time-to-market aspects are less relevant than other industries. The time-to-market value driver might be deemed more important in industries with shorter product lifecycles like the mobile or fashion industry (Heikkilä 2002; Jacobs 2006).

As stated by Ulaga (2003) only little empirical research has been conducted regarding relationship value drivers. It is recommended that further research includes investigating how purchasing can use relationship value drivers to improve purchasing management. Furthermore, future research is

recommended to investigate how suppliers can use collaborative customer value drivers for competitive advantage especially when shifting between operational and developmental settings. Finally. This study uses case studies for the empirical grounding. It is recommended to test the findings through quantitative studies increasing generalizability of the research results.

Conclusion

The study contributes with an overview of the dominant value drivers found in three different case studies. The cases include purchasing strategies in European manufacturing companies, supplier relationships with operational settings, and supplier relationships including product development. The study identified a mismatch between the dominant value drivers of purchasing strategies in manufacturing companies and relationship value drivers in practice. While value drivers of purchasing strategies were found to be cost-focused, the operational and developmental relationship value drivers are based on a more varied set of parameters. The study indicates that purchasing with an operational focus favors core values including product price, delivery performance, and quality. On the other hand purchasing in a development setting including collaborative product development includes the value drivers; supplier know-how, operations costs, and personal interaction. The findings add to the body of literature on relationship value drivers from a purchasing perspective. Practitioners can benefit from the results of the research study, in applying the methods to identify dominant value drivers in purchasing for evaluation and alignment with company strategies.

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