THE IMPORTANCE OF BUSINESS RELATIONSHIPS

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Aims of this Chapter

- To explain why business relationships are important for companies and why they are a problem for those who have to try to manage them.
- To develop ideas about how companies interact with each other and how business relationships develop between customers, suppliers and others.
- To examine what business relationships mean for marketing, purchasing and positioning.
- To introduce the concept of the network of relationships within which each business company operates.

The Reality of Business Relationships

Why a book about business relationships?

Business relationships are quite simply the basis of business, and without them no company can operate. Business relationships enable a company to make profitable sales and to buy the products and services that they need. Business relationships enable a company to access the skills and resources of others. Business relationships save time and cost in producing and delivering and they enable companies to develop new products, services and facilities. But business relationships are also the source of many of the problems that managers face: business relationships take a long time to develop, they require investment and maintenance and they mean that a company's success depends not only on its own efforts but also on the efforts and intentions of others. A company may have only a restricted choice of suppliers, customers or development partners with which to establish relationships and this can constrain the company's strategy and development. Once established, a company's relationships mean that the company cannot act independently.

This book is about how companies can manage their business relationships with their suppliers, customers and development partners and about how those relationships operate as part of a complex *network* of relationships that stretches across the business landscape. We are concerned with the processes through which companies buy, sell, adapt, develop, cooperate and gain and provide advantage.

We can start to develop our understanding of business relationships by examining three key characteristics of modern business:

Companies are not complete

No company has control of all of the skills and resources that it needs in order to operate. Often 60–80% of the costs of a company's products are accounted for by the goods and services that it buys from its suppliers.[1] Thus, a large proportion of the value of any company's offering[2] to its customers is provided by the skills and resources of a network of suppliers and by the suppliers to those suppliers and so on. Similarly, no company can deliver products or services to final customers without the involvement of its intermediate customers, its distributors and the final customer itself.

- *Companies are becoming less complete:* Each new generation of a company's offerings is likely to need a wider range of technologies. The escalating costs of developing these technologies mean that companies are forced to concentrate on an increasingly narrow range of skills themselves and hence they become more dependent on the skills and resources of a network of other companies. For example, the technologies necessary to produce a car now range from computer-controlled ignition systems to satellite navigation. No single company could ever afford to develop all of these technologies itself. No single company knows how to produce a car! Similarly, even the technician who services your home heating system now needs a laptop with dedicated software supplied by others to access product details and replacement parts, to update customer records and produce invoices.
- *Many of the ''core competencies'' on which a company depends for its success are outside the company:* The core competencies of a company result from "the creative bundling of multiple technologies and customer knowledge and intuition, and managing them as a harmonious whole" (Prahalad 1993). The range of technologies now required mean that a key skill for a company is the ability to combine its own technologies and resources with those of direct and indirect suppliers, customers and co-developers.
- *Technologies are developed between companies:* In one study, companies estimated that on average about 50% of all their development spending was on projects in which external counterparts played a significant role (Håkansson 1989). Similarly, companies make

[1] For example, 90% of the costs producing Ducati motorcycles are accounted for by purchased items. The effect of this on Ducati's relationships with its suppliers has been described by Bocconcelli and Håkansson (2008).

[2] Throughout this book we will refer to the "offering" that a supplier may provide for a customer. The use of this term emphasises that a business supplier provides far more than just a product to its customers. A typical offering may include a product, but may also include elements of service, advice and logistics. Some or all of the elements of an offering may be adapted by a supplier to address the particular problems of a customer.

many investments and developments that are designed with the requirements of particular customers or suppliers in mind.

Life would be easier for business managers if they just needed their own skills and resources in order to operate and serve their customers. But the reality of business is that companies also need productive relationships to access the skills and resources of their customers, suppliers and development partners. Managers need to be able to work effectively with and through but also sometimes against and in spite of others.

Companies are not independent

No company is able to develop and implement its own independent strategy based on its own resources, just taking into account its own competencies and shortcomings. Each company in the business world is *interdependent* with many others. These interdependencies affect the strategies, operations, organisations and ways of thinking of suppliers, customers, development partners and government agencies etc. Existing interdependencies form the basis for companies to further adapt, develop and tailor their resources and activities towards each other and hence to create value for themselves and others. For example, the growing interdependencies between supermarkets and their banks enabled both organisations to profit from innovative financial products sold under the supermarkets' brands. This development also involved the participation of software developers, call-centre operators, marketing consultants and advertising agencies.

- *The management process in any company is interactive, evolutionary and responsive:* All companies have a limited ability to understand the world in which they have to operate and the aims and intentions of their counterparts, and they all have a limited ability to act alone. The outcomes of their own actions will be strongly influenced by the attitudes and actions of those with whom they have relationships. Much of business management consists of reacting to the intentions or actions of others. Companies have to identify where there is scope for change or development within the intentions or constraints of others. For example, companies are frequently constrained by technological development controlled by others with whom they have little or no contact; similarly, many companies have a small number of important customers, suppliers or distributors on which they depend and with which they must work, at least in the short term. Some of the changes made by others may be anticipated, but many cannot be foreseen, or have effects that are beyond each company's control. It may take a long time to alter the way that a company relates to its customers, and successful change will depend on the views of those counterpart companies or others.
- *Business strategy is not simply concerned with a company's competitors:*[3] Strategic thinking involves a company in coping with all of those with which it has important relationships or on which its success depends, including its suppliers, customers as well as its competitors. Companies don't face a simple choice between whether to cooperate

[3] This is despite Michael Porter's (1980) assertion that: "The essence of strategy formulation is coping with competition."

or compete with others: business relationships are likely to consist of a varying combination of cooperation, conflict, integration and separation. For example, a company may cooperate with a supplier to develop a new product. It may cooperate with a company with which it otherwise competes in designing a common logistics system or in negotiations with government. In contrast, the same company may compete with one of its own customers to determine which of them will develop a productive relationship with one of the supplier's own suppliers. But throughout this book we will emphasise how interdependence and cooperation are widespread in business and how vital they are to the well-being of companies and us all. This idea echoes the view of Wroe Alderson from as long ago as 1967 about the overemphasis by companies and strategy gurus:

> "Sometimes the element of conflict is so pronounced that an efficient channel can scarcely be said to exist."

All companies depend on the development, logistics or production skills of many others. Each company is dependent on many others. These interdependencies are good for business: interdependencies free each of the companies in a relationship to invest in the things that they do best and mean that they are more likely to develop these skills with each other in mind. But interdependencies also mean that companies need to choose their relationship counterparts carefully and seek to manage their relationship effectively.

Companies don't act

Because business companies aren't complete, they all need the skills and resources of others in order to operate. Because they aren't independent, they are all affected by the wishes and behaviour of the companies that surround them. Of course, this also means that each company contributes its skills and resources to others and each company's intentions can have profound effects on some of those that surround them.

In these circumstances business companies don't *act* against the world around them: they *interact* with particular counterparts. For example, suppliers of fast-moving consumer non-durable products for household use or personal care must interact with a very small number of large supermarket groups that distribute their products in each country (and internationally). These suppliers and supermarkets make proposals to each other on in-store display, price, product range etc. Each adjusts its behaviour in line with its own strategies, but also based on the wishes, intentions and reactions of the other. The process of interaction goes backwards and forwards, involving and affecting many individuals in all the companies. Neither company can realistically walk away from the others, but each can change its approach to particular counterparts, each orientating itself more towards one or other supermarket or supplier. Each of the companies is involved in complex and long-term relationships that are vital to its well-being. Each of these relationships affects others, but each is beyond the complete control of any of them. Each company is affected by the interaction processes in which it is involved to the extent that the character, organisation and economic success of each company is determined by its interactions with specific others.

The companies that we are talking about provide products and services that are ultimately included in the final products bought by thousands or millions of consumers. But we are not directly concerned in this book with the final part of this process, so-called consumer marketing. Instead, we are concerned with a world populated by the companies that make consumer marketing possible. These companies produce equipment, raw materials, components, computer chips, paper, bricks and buildings etc. They include investment bankers, accountants, advertising agencies, trucking firms, car companies and retailers. All of them buy from and sell to other companies and all of them depend on business relationships that they have to try to manage. Companies address complex technical and organisational problems in their relationships and their efforts determine what can be made available to consumers, whether those consumers will like it or not and whether those companies will prosper.

Networking

The three key characteristics of business that we have outlined determine the tasks facing the business manager and the contents of this book, as follows:

All companies are dependent for their survival and development on their relationships with their suppliers, customers, distributors, co-developers and others.

No business relationship exists in isolation and all are connected to others in a network across the business landscape: for example, the relationship between a supplier and customer will be affected by its connections to the relationships between the supplier and its own suppliers and between the customer and its own customers.

The ability to access the resources and activities of other companies through these direct and indirect relationships is vital for the success of any company.

All companies are involved in trying to manage the direction and outcomes of their relationships. But no company can completely control its customers, suppliers or other counterparts. No relationship can be wholly managed by just one of the companies involved in it.

Therefore, the task of managing business relationships for all companies is both interactive and complex. Managing business relationships crosses the boundaries of many firms and involves numerous individuals, activities and resources. Managing business relationships is a long-term process and is built on routines and administrative procedures to develop, deliver, receive and use complex offerings. But more importantly, managing business relationships also involves change and development and radical new approaches to the ways that companies operate with others. Companies do not achieve change alone, but by working with others across the business network. We refer to manager's attempts to change and develop their interactions and relationships with others as *networking*.

In this book we will be looking at networking in its many forms, with customers, suppliers and distributors, and we will examine how networking relates to the process of technological development.

Markets, Marketing and Purchasing Management

What do the ideas that we have introduced about business relationships, networks and networking mean for conventional ideas on business management, marketing and purchasing?

The idea of the market

When managers talk about a market they are usually referring to a collection of *similar* things. Sometimes, managers call the total sales volume of similar items produced by all suppliers "the market". Other times, managers refer to all the customers that buy those similar products and who, by implication, have similar requirements as being "part of the market". But the real world of business can't be so neatly categorised into "markets". For example, two customers may buy similar products, but each will do so in order to address their own unique problems. The two customers may require different levels of service and advice. They may ask one supplier to adapt the product or the way that it is delivered to their particular requirements. One of the customers is likely to be more important than the other to some of its suppliers and those suppliers are likely to expect more business from some of their customers, but may want to develop new products together with others.

Each of the customers and suppliers will have a unique relationship and each relationship will need to be managed differently both by the customer and the supplier involved in it.

The landscape that surrounds a manager in a business company is very different from a market. It is a landscape characterised by diversity rather than similarity and throughout this book we will be concerned with how a manager can cope with and capitalise on the diversity of the business landscape.

The idea of marketing

Traditional ideas of marketing are built on the "marketing mix": the set of variables that marketers are said to manipulate and direct at the "market". The mix is composed of the product, the price that is charged for it, the way it is promoted and the distribution methods that are used (or the "place" in which it is sold). Consumer-marketing managers are charged with building and modifying the mix for their products to achieve growth in market share and profitability. Meanwhile, marketing research tries to assess the effectiveness of each mix variable and determine the most profitable price to set, or which promotional techniques will bring the best response from the market. This idea of the mix has also been applied to business-to-business marketing. Business marketing is often considered a "special case" of general marketing in which the mix is likely to emphasise personal selling more than advertising and in which after-sales service is likely to be important.

But this idea of marketing doesn't relate well to the interactive world of business that we have described: business customers are not all the same as each other and some are very much more important to particular suppliers than are others. Business customers cannot all be treated in the same way by applying the same marketing mix. Nor are business customers passive: they don't just respond to a supplier's marketing mix by buying or not buying. They interact with their suppliers. They may want to take a strong hand in determining what they buy and how it is produced; they may develop the offering that they buy and commission a supplier to make it to their design. Nor are manufacturers the only important players in the business landscape, and other companies are not simply part of their marketing mix. Distributors and retailers have an equally important role and a profound influence on manufacturers and final consumers. The purchases and sales of a business company are not isolated events, but part of a continuing process of interaction between companies that may stretch over many years. Each purchase or sale is one of many outcomes of the interaction in the relationships between the companies. Each customer or supplier will network to alter or develop each of its relationships and the connections between them so as to address its particular problems. Thus, we can only make sense of purchases or sales, suppliers or customers of business companies by exploring how they interact and how they network.

For a supplier, managing a relationship means more than simply trying to achieve profitable sales of products or services. Managing a relationship requires a supplier to assess the requirements of potential customers and to relate these to the company's resources and abilities and problems. For example, a particular customer may potentially be important to a supplier for the joint development of a new product or service. Another customer may provide large orders and be the source of a good cash flow, even if it is not very profitable. Another customer may be much smaller, but highly profitable. Networking for a supplier involves choosing the most appropriate *portfolio* of customers and managing the unique and often complex interaction processes with each of them over time. We will examine how companies can manage a portfolio of customers or suppliers in Chapter 2.

The idea of purchasing

Traditionally, purchasing departments were just responsible for obtaining the right products at the right price and at the right time. What was "right" was often determined by others in the company. Nowadays, the performance of a purchasing department is not judged by the negative criteria of minimising delays and reducing costs. Instead, purchasing now has a much stronger role in deciding which activities should be carried out inside a company and which should be carried out for it by others. Purchasing is increasingly responsible for researching the potential of suppliers and developing that potential within complex relationships.

Business customers don't simply aim to purchase a pre-specified *product* from the best or lowest-priced supplier. Business customers seek *solutions* to specific problems by using the skills of particular suppliers and the wider network of those suppliers' suppliers. There are many possible solutions to most business problems and only rarely are these provided simply by buying an off-the-shelf product or service. Instead, a company may have to interact with several suppliers, both new and old, in order to address a particular problem. This interaction may lead to the development of several different offerings within different relationships, each based on unique combinations of product, service, advice and logistics and each addressing a particular problem or set of problems for the customer.

A business customer is likely to have two types of problems that will drive its relationships with suppliers:

1. The first type of problem concerns carrying out its basic activities efficiently and economically. We refer to this as a problem of "rationalisation". Problems of rationalisation include those to do with waste in production, poor utilisation of expensive staff or an unacceptable failure rate in components.
2. The second type of problem arises for more positive reasons, such as when a customer is experiencing a shortage of supplies because of the rapidly growing sales of its own offerings. We refer to this sort of problem as one of "development".

All companies in the business landscape are simultaneously customers and suppliers and a company's sales and purchases are inextricably linked together. Companies in the business world modify, add to, combine, distribute and sell what they buy from other companies. Some of these other companies will be vital to what a company buys and what it can sell.

Business purchasing and business marketing are essentially the same: all business companies face similar tasks in their day-to-day interactions in each of their relationships and in their networking to change or develop their portfolio of relationships, whether as the "customer" or as the "supplier". Networking by customer and supplier can lead to wide variety in the internal structures of a company's relationships and in the connections between them:

- Either the customer or the supplier, or both, in a relationship may design the products and services that pass between them.
- Either or both may determine the price or carry out logistics.
- Either or both may be involved in relationships with the customer's customers and the supplier's suppliers.
- Either or both may adapt their operations to accommodate their counterpart.
- Either or both may have direct relationships with some of their suppliers and customers but deal with others via intermediaries.

Business customers need to be able to assess the resources, operations and the intentions of a range of potential suppliers and be able to relate a supplier's offerings, skills and resources to their own particular problems. Customers need to network with suppliers in order to develop their relationships with those suppliers to achieve benefits for themselves, for their counterpart and for others in connected relationships.

The idea of positioning

A company is often described in terms of its "market position", and exploiting or changing this market position is considered a key managerial activity. A company's position has traditionally been described in terms of the products or services it provides, the markets it sells to and the degree to which it is isolated from direct competition from others (Rumelt 1980).

But the idea of position needs to be adapted if it is to be useful in the reality of the business landscape. Many business companies do have large numbers of customers and suppliers. But within those large numbers, most companies have a small subset of customers and suppliers that are of major importance to them. Some companies have only a very few customers in total:

> For example, the manager of one furniture manufacturer claimed that his operations were perfectly tailored to his *market's* requirements. When asked what his market was, he replied, "Ikea"!

Similarly, many companies are dependent on a small number of key suppliers for critical elements of their operations, such as their raw materials, their logistics or the technical content of their offerings. Many companies have particular relationships with only one major counterpart for a particular set of problems. For example, Migros, the large Swiss supermarket group, relies exclusively on Cisco for the systems to manage all its business operations and to help it analyse and keep track of its data on customer purchase behaviour.

Thus, our idea of a company's position in the business landscape will need to reflect the importance to it of a small number of important counterparts. For example:

> A major supplier could be the source of valuable technical innovation through joint development that combines the different skills of the two companies.
>
> Another supplier could be important because it enables the company to access the technical resources of a range of innovative sub-suppliers located in a particular country.
>
> A major customer could provide access for the company's offering to a number of important customers with particular problems that it hoped to address.
>
> Another customer could be very demanding commercially, requiring low prices, consistently high service levels or complex distribution to multiple locations.

Business companies vary widely in their own problems and in the contributions that they can make to the problems of others. The way that a company networks and the relationships that develop between the company and its customers or suppliers will depend on the problems and motivations of each of the companies involved in those relationships. A company's relationships will also be intimately connected to the company's experience and to its resources. Each of these relationships is unique and each is interconnected with others. A company's own relationships, particularly its important ones, and the interdependencies that develop within them *define a company's position* within a wider network of other relationships. These relationships enable a company to operate and are the keys to its success or failure.

Each business company occupies a unique position in the network and we cannot accurately describe that position by using conventional labels. For example, many of the companies that we conventionally call "manufacturers", such as Nike and Clarks in shoes, actually do little or no manufacturing. They design shoes, but have all of them manufactured by others. In contrast, ECCO designs its own shoes, produces the leather to make them, manufactures the shoes and retails them in its own stores. Some retailers simply resell the branded products that they buy from a wide range of suppliers. But others design all their own products, specify the materials to make them and supervise the production process and the working conditions of those who make them.

Thus, a company's network position consists of its set of relationships and the benefits, restrictions, obligations and reputation that it has acquired through its unique interactions within those relationships.

A company's network position is not solely the result of its own strategy. Instead, each company's position evolves through its networking with other companies, each of which has its own position in the network and its own strategy. Each company's network position is affected by changes in those around it, so that if one company has a problem, this is likely to affect others. For example, if a large customer takes over a major rival, then it is likely to impose its network of suppliers on that customer to the exclusion of its previous suppliers.

The Substance of Business Relationships

A business company is likely to be involved in very routine relationships with some of its customers and suppliers. These relationships may consist of no more than a few phone conversations or an email order or confirmation for a simple product or service. But the same company is likely to have more complex relationships with others. Interaction in these relationships will go much further than just conversation or negotiation. The companies will meet and find out about each other and their problems; they may adapt a product or service package to suit each other, or agree a special price or delivery schedule or change some aspect of their own operations specifically for the other. Some of these relationships may last only a short time, perhaps centring on a sudden problem or a single major purchase. But a business company is also likely to have relationships with some of its customers and suppliers that involve extensive investments and adaptations directed towards each other, often over many years. These relationship-specific investments lead companies to become increasingly dependent on each other. Traditionally, companies have been wary of becoming too dependent on any of their customers or suppliers. They were concerned that a customer may try to force down the price it paid if they were a dependent supplier, or perhaps their supplier would simply become lazy if they were a dependent customer. But, as we will see in Chapter 7, the increasing technological intensity of business means that companies have little choice but to rely on the skills and resources of others. It is only by becoming interdependent on their counterparts that companies can gain access to the skills, resources and adaptations that they need but cannot supply for themselves.

Managing Business Relationships for Customers and Suppliers

Companies face the same challenges in managing their business relationships whether as the customer or supplier:

Both customers and suppliers have to search for and assess potential counterparts.

Both have to decide on their aims for each of their relationships and if and when these should be achieved at the expense of the other party or in cooperation with it.

Both customer and supplier bring their own resources to a relationship and invest in it. Both benefit from the resources of their counterpart.

Both have to decide how a relationship fits within a wider portfolio. Both have to assess how much to adapt their own offerings or operations to suit the requirements of the relationship. Both have to network effectively in the relationship and between it and others.

Thus, it is only possible to make sense of what happens in a business relationship by studying both of the companies involved in it and the process of interaction between them. Similarly, it is only possible to manage a relationship by understanding how it looks from the perspective of both companies, rather than by taking a one-sided view of "supplier-assessment" or "customer relationship management" alone.

Business interaction is not confined to salespeople, marketers and buyers. A business relationship may involve a wide variety of contributions from different functions and individuals in the two companies. Each may provide advice to others. Their interactions may lead them to adapt products, services, logistics, facilities, administration or in their prices. People from design, development, operations, finance and logistics in both companies may be involved. Marketers and purchasers are also likely to interact with their direct counterparts: purchasing people need to become involved with the purchasing of their suppliers, and marketing people need to be aware of the relationships between their immediate customers and those customers' customers. In managing their business relationships, companies have to try to coordinate all of these complex interactions and the attitudes and motivations of the different people involved in them.

All business companies have to manage the combination of their own resources and activities with those of their suppliers and their customers. Companies are neither faceless nor homogeneous and vary in the extent to which they can or will contribute to particular relationships. Companies also have to choose the extent to which they devote their own internal activities and resources to a relationship or depend on those of their suppliers.

Relationship management is a continuing process. Sales and purchasing people don't just meet, make a deal and then never see each other again. There may be many interactions between a number of staff before a first purchase takes place, months of initial meetings, negotiations and product and production development. The first purchase may also be the forerunner of others, often taking place infrequently over many years. In other cases, such as the supply of production components or business services, deliveries are likely to be continual, perhaps for several years, involving frequent contact between operations and logistics people as well as marketing and purchasing in both companies. Some other purchases will not be very important to the supplier or customer, and both companies will try to reduce the costs and time involved in them. In these cases the interaction between customer and supplier may be limited to a phone call each time a purchase is made.

But in all cases, the customer and supplier will interact on the basis of their experience of any previous purchases between them and on their expectations of any possible future purchases. Each interaction between a customer and a supplier is a single *episode* in the *relationship* between them. Each episode, be it the exchange of product, service, finance, advice, information or social interaction, is affected by the relationship of which it forms part and each interaction, in turn, affects the relationship itself. We can only understand each interaction and each purchase or sale in the context of that relationship.

Many business relationships are close, complex and long term. But this does not mean that the parties know everything about each other, or that they always act in each other's best interests. Many business relationships are full of conflict as the companies battle to gain immediate or future advantage. Some relationships centre on a single important transaction that could take months or years to complete, such as the purchase of a major piece of equipment or operating software. Sometimes the supplier or customer may dominate a relationship or one or both may be deceitful. The two companies involved in the relationship will almost always have different ideas of what they want from the relationship or about what they or their counterpart should be doing in it. Some relationships simply become inert or end in divorce. Others are only brief encounters, such as when one of the companies takes short-term advantage of the other. Both companies are likely to be highly involved in some of their relationships, but others may be more distant and the only contact between the two companies is impersonal, by advertising or mail.

Each business relationship is part of a wider network of relationships and no business relationship can be understood or managed in isolation. Each relationship forms part of a process within which products, services, logistics, advice and information are developed, bought, sold, added to, refined, combined and sold on to others until they reach a final consumer. This network does not exist for the benefit of a single company or to solve a single problem. It is far more than the supply chain or distribution channel of a single company. No single company is at the centre of the network and no one controls it.

No type of relationship is "right" for either buyer or supplier in all circumstances. Hence, there is no single measure of the "quality" of a company's relationships. Business companies cannot just develop a marketing or purchasing strategy that includes a single "design" for all of its relationships and expect it to be acceptable to all its counterparts. The central task of relationship management is to manage a *diverse* portfolio of customer–supplier relationships over time to maximise the long-term value from them for their companies.

Relationship management requires sound analysis, patient investment and a clear view of the value that can be gained from each relationship for all those involved in it. But most of all, relationship management requires a clear understanding of the complex and fascinating characteristics of business relationships, to which we turn in Chapter 2.

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