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The power of trust in manufacturer-retailer relationships

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Trust is stronger than fear. Partners that trust each other generate greater profits, serve customers better, and are more adaptable.

In industries as diverse as pharmaceuticals, consumer packaged goods, hardware, apparel, and furniture, the balance of power between manufacturers and retailers is shifting. Thanks to the rise of specialty superstores, the formation of buying alliances, and a consolidating wave of mergers and acquisitions, a relative handful of retailers often now control access to enormous numbers of consumers. Manufacturers that had dominated their retailers are now finding that megaretailers hold the upper hand. In Europe, for example, the sales of each of the top six food retailers exceed the individual sales of all food manufacturers, with the exception of Nestlé and Unilever. And in the United States, Wal-Mart Stores' revenues are three times those of Procter & Gamble Company. (See the insert "Three Forces Fuel Rising Retailer Power.")

This shift raises some important questions. Although powerful companies can, and often do, use their strength to wring concessions from their vulnerable counterparts, is the use of fear or intimidation the most effective way to manage such relationships? Or does trust produce greater benefits? And if trust is more beneficial to both sides, what policies and procedures help breed it?

With the help of colleagues at U.S. and European universities, I have been developing a research database since 1988 to answer those questions. Almost 3,000 U.S. and European executives have responded to our surveys and reported on more than 1,500 manufacturer-retailer relationships. In addition, I have consulted and conducted interviews with several major retailers and manufacturers in the United States, Latin America, Asia, and Europe. Through our efforts, my colleagues and I have collected information on manufacturer-retailer relationships in such industries as automobiles, computers, consumer packaged goods, earth-moving equipment, replacement tires, semiconductors, telecommunications, and vehicle leasing.

We found that although exploiting power may be advantageous in the short run, it tends to be self-defeating in the long run for three main reasons:

Exploiting power to extract unfair concessions can come back to haunt a company if its position of power changes. When they had the upper hand, consumer packaged-goods manufacturers such as Procter & Gamble used to limit the quantities of high-demand products they would deliver to a given supermarket chain, insist that the supermarket carry all sizes of a certain product, and demand that the supermarket participate in promotional programs. Now it's payback time. In the past ten years, supermarket chains have become enormous and manufacturers' battles for shelf space have intensified. As a result, the chains have been able to demand that manufacturers pay them for carrying new products and to force them to participate in the chains' promotional programs.

When companies systematically exploit their advantage, their victims ultimately seek ways to resist. Retailers may form associations or buying groups, develop private labels, or pursue vertical integration or mergers to counteract the power of manufacturers. European retailers such as Carrefour, Casino, J. Sainsbury, and Migros have developed quality private-label brands to compete with internationally renowned manufacturer brands. And one major reason for the recent merger and acquisition activity in the U.S. drugstore industry is the desire of drugstore chains to increase their purchasing clout with pharmaceutical companies.

For their part, many manufacturers are reacting to the pressure tactics of traditional retailers by seeking direct links to end users through the Internet and mail-order operations and by creating their own stores. Apparel and accessory designers such as Donna Karan, Giorgio Armani, and Liz Claiborne have been opening factory outlets and their own downtown stores, and Nike and Sony Corporation have established megastores in cities such as Chicago, London, and Tokyo. Airlines are beginning to let consumers book reservations over the Internet, bypassing travel agents. And many consumer-products manufacturers have created sites on the World Wide Web, hoping this link to consumers will ultimately permit them to reduce or eliminate their dependence on retailers and dealers.

In service industries such as entertainment, one can see a similar "manufacturer" backlash. Such major producers of television programs as Warner Brothers and Paramount Pictures Corporation are spending huge sums on their new TV networks to compete with ABC, NBC, CBS, and Fox. The traditional networks brought this development on themselves by using their monopolistic power coercively in the past.

By working together as partners, retailers and manufacturers can provide the greatest value to customers at the lowest possible cost. Take the supermarket industry, in which adversarial relationships still prevail. Industry experts believe that seamless partnerships between manufacturers and supermarkets would accelerate the deployment of sophisticated systems such as just-in-time delivery, electronic data interchange, and so-called efficient-consumer-response systems that permit manufacturers to monitor sales in stores and to produce and ship their goods in response to actual consumer demand. Such cooperative systems could squeeze $30 billion in excess costs out of the industry by eliminating superfluous inventory, duplicate functions, and various middlemen, Moreover, the results witnessed when manufacturers and supermarket chains do cooperate suggest that both sides could increase sales volume by working together to customize offerings at different stores and for different end users. Cooperation between Kraft Foods and supermarket chains such as Publix Super Markets in Florida and Wegmans Food Markets in upstate New York has generated significant returns for both sides.

The Nature of Trust

Initially in my research, I was surprised by how often manufacturers and retailers mentioned trust when discussing their relationships. What did they mean when they said they trusted someone?

The immediate response of most managers was that trust involved dependability-that they believed that their partners were reliable and would honor their word. The marketing director of a multinational manufacturer of consumer packaged goods observed that the retailers that his company tended to trust fulfilled agreements without always coming back to demand additional concessions or to request greater support. And if the retailers requested promotional funds in exchange for preferred shelf positions, then the manufacturer would find its products in those positions on subsequent visits to the retailers' stores.

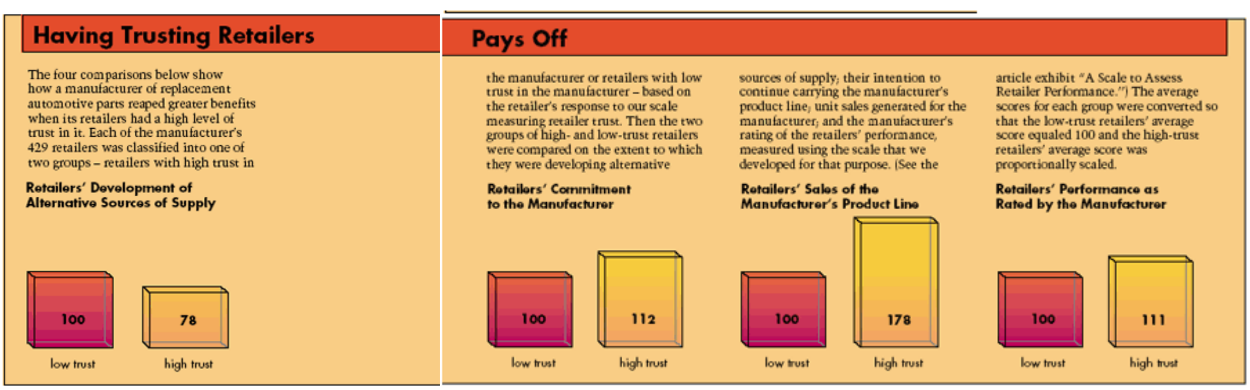
Of course, honesty and dependability do not always promote trust. A partner that frequently promises to punish you and always follows through is honest and dependable but is not a company in which you place your trust. What really distinguishes trusting from distrusting relationships is the ability of the parties to make a leap of faith: they believe that each is interested in the other's welfare and that neither will act without first considering the action's impact on the other.

Because of shifts in competitive dynamics in recent years, many companies are growing increasingly concerned about the level of faith that their distribution channel partners have in them. One study that I conducted with Lisa Scheer of the University of Missouri at Columbia and Jan-Benedict Steenkamp of the Catholic University of Leuven in Belgium measured the extent to which automobile retailers in the United States believed that the manufacturer whose product line they carried would honor its commitments (dependability) and consider the best interests of the retailer (faith). The manufacturers included U.S., European, and Japanese companies. The results demonstrated that Ford Motor Company generated greater trust among its dealers than General Motors Corporation or Chrysler Corporation did. However, the Japanese manufacturers earned a higher level of trust than any of the U.S. or European companies. The executives of the U.S. automobile manufacturer that commissioned the study were concerned about the lack of faith that their dealers had in them because they believed that the support and service that dealers provided to end users would become increasingly important in attracting and retaining customers.

During my field research, I observed that manufacturers and retailers tend to believe that the partners they trust also trust them. However, an analysis of the database demonstrated that such an assumption is not always warranted. In a study I conducted with Jonathan Hibbard of Boston University and Louis Stern of Northwestern University, we examined the relationships between a major manufacturer of replacement automobile parts and 429 of its retailers. It turned out that the manufacturer had a high level of trust (an average of 5.8 on a 7-point scale) in 218 of the retailers that distrusted the manufacturer (an average of 2.6 on the same 7-point scale).[1] A further investigation revealed the pitfall of this blind trust: Many of those 218 retailers were actively seeking and developing alternative sources of supply, whereas the manufacturer, which assumed that its trust in the retailers was mutual, was not exploring alternatives to those retailers.

The Benefits and Limits of Trust

A crucial question is whether powerful manufacturers or retailers receive more tangible benefits from building trusting relationships with partners than from exploiting their clout. Is trust more than just a feel-good phenomenon? The results of the study that I just described certainly suggest that it is: the retailers that trusted the manufacturer were 12% more committed to the relationship (as measured by their intent to carry the manufacturer's products in the future), were 22% less likely to have developed alternative sources of supply, and performed at higher levels for the manufacturer than the retailers that did not trust it. (See the table "Having Trusting Retailers Pays Off.")



I used two different metrics to evaluate the retailers' performance for the manufacturer. One was the sales generated for the manufacturer and the second was a more holistic but more subjective evaluation. (See the insert "A Scale to Assess Retailer Performance.") The results showed that retailers with a high level of trust in the manufacturer generated 78% more sales than those with a low level. The results using the holistic evaluation were less dramatic. Still, retailers that reported that they trusted the manufacturer highly were rated as performing 11% better, a percentage that is statistically significant. When my colleagues and I used the two metrics in other industries, including vehicle leasing and computer peripherals, the results were similar.

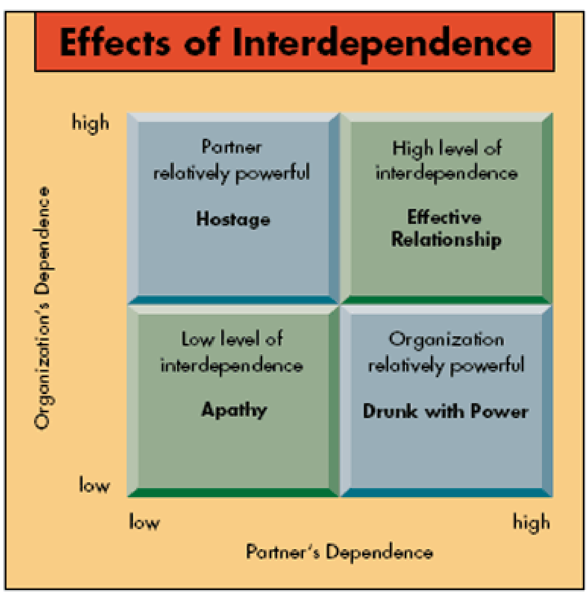
Trust brings other benefits as well. It creates a reservoir of goodwill that helps preserve the relationship when, as will inevitably happen, one party engages in an act that its partner considers destructive. The growth of multiple-channel distribution systems has made such situations much more common in recent years. For example, manufacturers such as Compaq Computer Corporation and Goodyear Tire and Rubber Company are aggressively wooing faster-growing distributors, including so-called category killers such as Circuit City Stores and mass merchandisers such as Sears, Roebuck and Company and Wal-Mart. These moves are infuriating their traditional independent dealers, who resent the better price and delivery terms that their rivals are receiving. Our research shows that in such situations, trusting retailers tend to be understanding and blame competitive conditions, whereas distrustful retailers tend to hold the manufacturer personally responsible. Consequently, trusting retailers are less likely to retaliate by dropping or neglecting the manufacturer's product line than distrustful retailers are.

Trust helps manufacturer-retailer relationships realize their full potential. When both sides trust each other, they are able to share confidential information, to invest in understanding each other's business, and to customize their information systems or dedicate people and resources to serve each other better. A trusting party typically will not feel it needs to monitor its counterpart's behavior; thus it can cut its monitoring costs. Last but not least, trust allows a company to capture the hearts and minds of channel partners so that they will go the extra mile. The relationship between Procter & Gamble and Wal-Mart illustrates how even powerful adversaries can benefit from deciding to base their relationships on trust. (See the insert "Two Tough Companies Learn to Dance Together.")

Can a company have its cake and eat it, too? Can a company build trust while seeking to retain or increase its leverage or power over a partner? My research suggests not. Rather, trust requires companies to relinquish some of their independence, or, to put it another way, to become more dependent on each other.

In one study, $cheer, Steenkamp, and I separated more than 400 manufacturer-retailer relationships into four categories of differing levels of interdependence. On average, a company's level of trust and its satisfaction with the relationship (as measured on the 1-to-7 scale) were the highest and the level of perceived conflict was lowest in the relationships in which there was a high level of interdependence. (See the exhibit "Effects of Interdependence.")

Effects of Interdependence



If one thinks about it, this finding is logical. Effective relationships require both parties to make contributions. A hostage company often will try to reduce its dependence on its partner, an effort that only moves the relationship into the apathy quadrant. A hostage would gain much more by becoming a more valuable resource to the partner, thereby moving the relationship toward the high interdependence quadrant. Although people in many societies are socialized to prize independence, self-sufficiency, and unilateral control, no company is an island. Effective companies build networks based on interdependence.

Although I advocate relationships based on trust, I recognize that there are underlying tensions in any manufacturer-retailer relationship. The trust strategy works only with those partners that are willing to play the trust game. Furthermore, regardless of how deeply two partners trust each other, there will always be areas of difference because the two parties inevitably will have some goals that are different.

The limits of trust are especially obvious when the manufacturer and the retailer do not have a mutually exclusive relationship. It is easier to develop trust when manufacturers offer territorial exclusivity and when retailers do not carry product lines of competing manufacturers. But if a product needs to be distributed widely, as most consumer packaged goods do, or if a retailer needs to carry a wide variety of brands, as supermarkets and mass merchandisers do, then such exclusivity is impossible.

Operating in numerous relationships with different practices is a challenge for the best of companies. They may be tempted to apply what they have learned in one relationship to other relationships. Procter & Gamble, for example, has tried to use two pillars of its successful dealings with Wal-Mart to support its relationships with other retailers. The pillars are multifunctional customer teams-each of which focuses on a single customer-and everyday low pricing (lower standard prices and an end to special promotions). P&G discovered, however, that some retailers were not large enough to warrant such teams-or even a full-time person. And some retailers have retaliated against P&G's everyday low pricing policy by reducing shelf space for P&G products.

Finally, trust is rarely all-encompassing. One may trust the partner on some issues but not on others, just as I trust my neighbor to take care of my plants but not my car while I am on vacation. Employees who interact with their company's partners must understand which information, skills, and technologies are to be protected and which are to be shared. Partners have to understand that the information they receive is to be treated in confidence. McDonald's Corporation's contract with its franchisees gives McDonald's the right to take over a franchisee's operations if the latter discloses confidential information. However, such concerns must not be allowed to impede the sharing of the information and skills required for the relationship to flourish.

Creating Trust

Of course, the vast majority of manufacturer-retailer relationships are unbalanced. Huge manufacturers such as Mercedes-Benz sell their products through small mom-and-pop dealers; and major retailers such as' France's Carrefour, Japan's Ito-Yokado, Britain's Marks & Spencer, and America's Toys R Us buy from numerous relatively small manufacturers. In a relationship of unequals; how can the powerful party build a trusting relationship? The key is to treat the weaker, vulnerable partner fairly. Fairness encompasses two types of justice: distributive justice, or the perceived fairness of the outcomes received, and procedural justice, or the perceived fairness of the powerful party's process for managing the relationship.

Distributive Justice. This type of justice deals with how the pie is shared, or how the benefits and burdens are divided between partners. Although some companies use their power to maximize their own benefits, others realize they have some responsibility for their partner's profitability. An outstanding example is Marks & Spencer, the British retailer. One of its guiding principles is to work closely with suppliers in long-term partnerships.

Marks & Spencer believes that manufacturers, especially those in the Far East, are often so keen to get its business that they will accept prices that are too low to warrant the investments necessary for improving their operations and products further. Because Marks & Spencer seeks long-term relationships with suppliers, it views that situation as unacceptable-as one that hurts both sides.

When its relationship with an existing supplier becomes inequitable, Marks & Spencer's managers strive to restore the balance. The story of a kitchen product that Marks & Spencer had developed jointly with a manufacturer is a case in point. Four months after the product's introduction in 1995, the manufacturer realized that it had miscalculated the amount of labor required to make the product and, as a result, had underpriced the product and was losing money on the deal. Because of the miscalculation, however, the product provided outstanding value for Marks & Spencer's customers and was a big hit.

When the manufacturer brought the problem to the attention of Marks & Spencer's managers, the managers explained that they could not change the retail price because it was already listed in their catalogue. Instead, Marks & Spencer helped the manufacturer to reengineer the product. By cutting a few labor-intensive steps and reducing packaging, the two companies were able to lower the manufacturer's costs without jeopardizing the product's performance. In addition, Marks & Spencer cut its own gross margin on the product and gave that money to the manufacturer.

Although highly unusual, Marks & Spencer is not unique. Another organization that understands the long-term importance of allowing channel partners to earn a fair return is Toyota Motor Corporation's Lexus division. When Lexus established itself in the United States in the 1980s, it decided it wanted its dealers to be able to invest in the facilities, systems, and personnel required to deliver extraordinary customer service. As a consequence, Lexus makes it possible for dealers to make several thousand dollars on the sale of each new car-considerably above the industry average.

Procedural Justice. Research on justice in a variety of settings indicates that due process, or the fairness of a party's procedures and policies for dealing with its vulnerable partners, has stronger effects on relationships than distributive justice does. Managers find this idea rather counterintuitive. In one instance, my colleagues and I were working with executives of a major automobile manufacturer that wanted to enhance the level of trust that its dealers had in it. The executives were skeptical that dealers cared about anything other than margins or outcomes and decided to raise the margins they offered to their dealers. But they also were willing to support a study of how the two types of justice affect trust.

This study of 800 automobile dealers in the United States and the Netherlands supported the contention that although both distributive and procedural justice enhance trust, the latter is considerably more important. The outcomes from a relationship are affected by many factors (including competitive conditions), only some of which are under the control of the more powerful partner. However, the more powerful partner is always considered in control of its policies and procedures. The weaker partner, therefore, sees the powerful partner's system of procedural justice as reflecting more accurately the latter's real attitudes toward the former. Systems that are procedurally just are built on the following six principles:

Bilateral Communication. The more powerful party is willing to engage in two-way communication with its partners. Marks & Spencer views an open and honest dialogue as a sign of a healthy relationship and encourages its suppliers to be proactive and frank in pointing out the company's weaknesses. It has a number of procedures in place to encourage such communication. The CEO of Marks & Spencer meets his counterparts in suppliers' organizations periodically. Regular suppliers are given a keycard to enter Marks & Spencer's head offices, enabling them to drop by at any time to discuss issues. Although most make appointments first, having the card makes them feel that they are members of the Marks & Spencer family. In addition, Marks & Spencer organizes joint trips with its suppliers to trade shows and to visit foreign suppliers of raw materials. The trips enhance mutual understanding and help both parties identify new products that they could develop together.

Other companies have different practices to solicit input from partners. At Anheuser-Busch Companies, the chairman makes it a rule to meet with a 15-member panel of wholesalers four times a year in order to hear their suggestions and complaints. Oldsmobile allowed its car dealers to sit on a committee to review its advertising contract with Leo Burnett Company.

Impartiality. The more powerful party deals with channel partners equitably. Although it is impossible to treat all channel partners identically, it is important to give partners equitable opportunities. When Marks & Spencer has multiple manufacturers supplying a single product category, it attempts to ensure that everyone gets a fair share of the business. It also tries to minimize major changes in the volume of business awarded to suppliers from one year to the next. Any major shifts' take place only over a period of years, so that suppliers have time to adjust their production capacities and do not feel unfairly treated.

Some powerful manufacturers, including Kraft, have started to create flexible programs or service menus that allow even the smallest retailers to participate in promotional programs. Such innovations, which allow for customization within established boundaries, are necessary because retailers operate under different conditions and strategies. Kraft sets up individual funds to help retailers develop their joint merchandising programs. A retailer may use the money to feature Kraft products in its own store circulars, to advertise on local television, or to offer discount coupons. And different retailers may use their funds to feature different Kraft products. Kraft and the retailer make the spending decision together, relying heavily on market-research data.

Impartiality is a very sensitive issue for many dealers. In the U.S. publishing and pharmaceutical industries, there have been numerous lawsuits over this issue during the past few years. Many book retailers and independent pharmacies complain that manufacturers do not use the same pricing and promotion schedules for all retailers.

Refutability. The smaller or more vulnerable partners can appeal the more powerful party's channel policies and decisions. Manufacturers such as Caterpillar, DuPont, and 3M have dealer advisory councils at which dealers can air their concerns. Marks & Spencer has a rule that a supplier always can appeal a decision to a higher level in the company. The way in which a recent potentially divisive disagreement between a Marks & Spencer buyer and an upholstery manufacturer was resolved provides a good example. The buyer thought that allowing customers to take home small fabric swatches would make it easier for them to make a selection. Accordingly, the buyer asked the manufacturer to provide more swatches. Initially, the manufacturer did not mind. But so many customers wanted the swatches that giving them away became a considerable cost. The manufacturer tried to convince the buyer that it should be reimbursed until it was proved that the program would generate sufficient additional sales to justify the extra cost. When the buyer refused, the manufacturer contacted the head of the division, who invited the manufacturer to meet with him and asked the buyer to attend. At the meeting, the division head appeased the manufacturer, assuring it that Marks & Spencer would compensate it if the program did not soon produce enough sales to cover the additional costs.

Explanation. The more powerful party provides its partners with a coherent rationale for its channel decisions and policies. Although those in power often feel that they have the right to make decisions without explaining them, that attitude has a detrimental impact on trust. For this reason, Marks & Spencer takes pains to explain its policies and actions to its suppliers. At an annual meeting attended by its 300 store managers and its major suppliers, members of Marks & Spencer's board of directors explain their vision and strategies. In addition, Marks & Spencer's personnel go with individual manufacturers to Marks & Spencer stores to help explain how the retailer is presenting and selling the manufacturer's merchandise. Decisions and policies are more likely to be accepted by partners when the logic behind them is apparent.

Familiarity. The powerful party understands or is aware of the local conditions under which its channel partners operate. Before Marks & Spencer enters into a relationship with a new manufacturer, it will make a number of visits to the manufacturer's plants and will host meetings between its buyers, merchandisers, and designers and their counterparts in the manufacturer's organization. Marks & Spencer believes that this interaction is critical because it permits the retailer to ascertain the ability of the manufacturer to meet its requests or demands.

Similarly, Square D Company, a U.S. manufacturer of electrical and electronic products, encourages its salespeople to call on the dealers' customers jointly with its dealers' salespeople. Other companies purposely recruit personnel from customers and suppliers to work in the jobs in which understanding those customers or suppliers is essential.

Courtesy. Treating a partner with respect is crucial for building the interpersonal chemistry that is the foundation of most successful manufacturer-retailer relationships. Ultimately, relationships between companies are actually relationships between teams of people on either side. As companies recognize this fact, they are changing the way they assign personnel to various accounts. Some companies assign employees to accounts based on the match between employees' personalities and the culture of the customer or supplier. Sherwin-Williams Company, the paint manufacturer, lets managers from Sears, Roebuck and Company help select the Sherwin-Williams people who will handle the Sears account.

Opportunities for attractive returns are usually the magnet for a relationship, but procedural fairness is the glue that holds the relationship together. It is expensive and risky to try to retain partners by giving them higher margins than competitors give them. In contrast, developing procedurally just systems requires greater effort, energy, investment, patience, and perhaps even a change in organizational culture. But for precisely those reasons, developing such systems is more likely to lead to sustainable competitive advantage.

Moving from the Power Game to the Trust Game

Many companies that want to move from conventional adversarial relationships to channel partnerships based on trust find that they do not yet possess the capabilities necessary to make the transition. It is not enough for powerful manufacturers or retailers just to start calling their channel counterparts partners. The culture, people, management systems, and attitude that the trust game requires are fundamentally different from those used in the power game. Past practices have to be unlearned before the new approach to managing relationships can be adopted. (See the insert "How Ekornes Turned Its Retailers into Partners.")

Companies that want to develop trust pay greater attention to partner selection. They select partners that bring distinctive competencies but similar values. As who the partner is becomes more important, traditional methods of selecting partners become less appropriate. When J.E. Ekornes, the Norwegian furniture manufacturer, decided to move from a traditional power relationship with its retailers to partnerships based on trust, it "fired" those retailers that did not share its values in their strategies, their views of their roles, and their views on how to treat customers. It reduced its number of retailers in France by a third and in Sweden by half.

For relationships to bloom and achieve their full potential, they must be flexible and informal. Long, detailed contracts are inconsistent with building relationships based on trust and simply get in the way. Companies that base their relationships on trust either have minimal contracts or do away with contracts altogether. A majority of wholesalers in Japan operate without contracts. Caterpillar dealership agreements can be terminated without cause by either party with' 90 days' notice. What holds these relationships together is not legal force but mutual obligations and opportunities. Marks & Spencer regards its relationships with its suppliers as morally binding and does not have legal contracts. Yet there is almost no turnover in its suppliers and some of its relationships are more than 100 years old.

Companies should encourage employees assigned to an account to learn the partner's business and to work together with the partner to discover opportunities that will benefit both. Companies often find that they have to reorganize to achieve this type of focus or orientation. Kraft, for example, did away with its disparate sales forces for Kraft, General Foods, and Oscar Mayer Foods Corporation and assigned its people to 200 cross-functional business teams, each of which is dedicated to a single major retail customer. Those teams-whose members include category managers and information specialists as well as marketing, operations, and finance and accounting personnel-work much more intimately with partners than the sales forces did.

Often, the teams function as consultants to' the retail partners. In one instance, a Kraft team conducted a six-month study of a retailer's dairy case. The team made recommendations on how to reorganize the shelf space and suggested new items that the retailer could add to take advantage of consumer trends. As a result, the retailer enjoyed a 22% gain in volume and suffered fewer stock-outs. Kraft benefited from the improved positioning of its high-demand products: its sales to the account increased by a similar magnitude.[2]

Companies that play the power game often prefer their employees not to develop personal relationships with their counterparts at channel partners, fearing such ties will weaken employees' resolve to push hard for the best possible deal. To prevent that from happening, Jose Ignacio Lopez, GM's former purchasing czar, reassigned buyers to suppliers with whom they had not dealt. He found that procurement prices declined. In contrast, companies that play the trust game encourage personal ties with their channel partners. Because they know that it takes a long time to build and maintain a relationship based on trust, many of these companies attempt to minimize employee turnover. Of course, some employee turnover is inevitable. One advantage of dedicating a cross-functional team to an account is that the relationship is less dependent on any one employee.

The trust game also has implications for the type of people that a company recruits to work with channel partners and how those people are managed. Traditional manufacturers' salespeople and retail buyers have had a volume or price focus. They need to be replaced by relationship managers with appropriate bedside manners. Incentive and performance measurement programs often have to be changed as well. For example, P&G used to reward its U.S. sales managers for transferring inventory from its production site to the retailer's warehouse or stockroom, regardless of what was best for the retailer. Now P&G rewards them for maximizing the profits of both P&G and its retailers. And Wal-Mart now measures P&G's performance by tracking improvements in inventory turnover and stock-outs.

Joint educational programs can help break down the barriers between manufacturers and retailers. The retailing giant Royal Ahold-which owns more than 1,500 supermarkets, department stores, and other outlets in the Netherlands as well as Giant Food Stores, Bi-lo, Stop & Shop, Tops Markets, and Finast in the United States-is attempting to collaborate on an executive education program with manufacturers such as Heineken, Sara Lee Corporation, and Unilever. The program would include four or five upcoming executives from each company and focus on value-chain management.

Philip Morris runs about 20 two-day seminars annually for loyal retailers in France, where the law requires it to sell its cigarettes exclusively through 36,000 small morn-and-pop tobacconists. About 50 retailers attend each seminar, the focus of which is not on Philip Morris but on how these owners can become better retailers. Upon completion, each participant is awarded a certificate from the "Philip Morris University." The retailers are so proud of their certificates that they often display them in their stores. More important to Philip Morris, its sales and share increase at these retailers' stores.

By developing trust, manufacturers and retailers can exploit their complementary skills to reduce transaction costs, adapt quickly to marketplace changes, and develop more creative solutions to meet consumers' needs. Vertically integrated companies are too inflexible and traditional manufacturer-retailer relationships too adversarial to promote such behavior and skills. When one considers the effort it takes to manage a relationship with even one company, the competitive advantage that can flow from the ability to manage relationships with several companies is apparent. Success in rapidly changing environments will go to those who learn to make the leap of faith.

1. To measure trust in the various studies cited in this article, we submitted four to ten statements to the retailers. Two examples are "We can rely on the manufacturer to keep the promises it makes" and "We can count on the manufacturer to act sincerely in its dealings with us." Then we asked retailers to score on a 1-to-7 scale the degree to which they thought the statement reflected their view of the manufacturer (l=strongly disagree and 7-strongly agree). The average of the scores equaled each retailer's level of trust in the manufacturer, with 1 representing the lowest and 7 the highest. Similar statements submitted to manufacturers were used to measure the manufacturers' trust in their retailers.

2. Ken Partch, "'Partnering': A win-win proposition... or the latest hula hoop in marketing?" Supermarket Business, May 1991, pp. 29-34.

Inserts:

Three Forces Fuel Rising Retailer Power

Emergence of Megaformats	Mergers and Acquisitions	Horizontal Alliances
Megaretailing formats include: *Category killers* Border Book Shops, Circuit City Stores, Home Depot, Office Depot, Staples, Toys R Us *Warehouse clubs* Price Club, Costco Wholesale Club, Sam's Wholesale Club *Discount supercenters* Super Kmart Centers, Wal-Mart Supercenters	Previously independent department-store chains now belong to retailing conglomerates. *Federated Department Stores* Macy's, Bloomingdale's, Stern's, Rich's Goldsmith's, Lazarus, Burdines, the Bon Marche *May Department Stores Company* Lord & Taylor, Foley's, Robinsons-May, Hecht's, Kaufmann's, Filene's, Famous Bart, Meier & Frank. Similar conglomerates have also emerged outside the United States: Coles Meyer (Australia) Metro (Germany) Royal Ahold (Netherlands) Ito-Yokado Company (Japan)	Some European retailers have organized themselves into cross-border buying alliances to bargain more effectively with manufacturers. *European Retail Alliance* Royal Ahold (Netherlands) Argyll Group (United Kingdom) Casino-Guichard Perrachon & CIE (France) *Eurogroup* BML (Austria) Coop Switzerland Rewe-Handelsgruppe (Germany) Vendex International (Netherlands)

A Scale to Assess Retailer

Most manufacturers periodically evaluate the performance of the retailers or dealers that they use to reach the market. Many manufacturers, however, depend on a single measure to make the evaluation - sales generated through the retailer or dealer. Unfortunately, this measure is not reliable, because a retailer's or dealer's location often has a major influence on how many sales it makes.

Moreover, the sales that a dealer or retailer generates are just one aspect of its performance. Understanding that fact, many manufacturers have tried to supplement sales-performance data with customer-satisfaction data for each dealer or retailer. Unfortunately, such data often is not available and can be manipulated when it is.

To provide manufacturers with another means of assessing and comparing their retailers' or dealers' performances, my colleagues and I developed a qualitative, multiple-dimension scoring system, which I call a scale to assess retailer performance (SARP). Although it is a more subjective measure than sales figures, it is more comprehensive. The scoring system shown here rates retailers in seven dimensions, each of which is determined by obtaining scores on three statements. Dimensions may be added or subtracted to suit a manufacturer's circumstances, and the same holds for the statements that make up each dimension. However, using too few dimensions or statements risks undermining the validity or usefulness of this type of tool.

To help reduce bias, two members of the manufacturer's organization who are familiar with the retailer being evaluated should perform the assessment.

The two people separately rate the retailer or dealer on a 7-point scale for each statement. (1=strongly disagree; 2=disagree; 3=mildly disagree, 4=neither agree nor disagree, 5=mildly agree, 6=agree, and 7=strongly agree.) Each person arrives at a score for each of the seven dimensions in the example by averaging the scores obtained for its three statements. If their scores for any statement differ greatly, they should discuss the difference and try to agree on a rating. Each calculates a total score by averaging the scores he or she obtained for the seven dimensions. Then the two total scores are averaged to produce the retailer's or dealer's final score.[1]

Performance

1. The retailer's or dealer's sales performance for us is good.

a) Over the past year, the retailer or dealer has been successful in generating high revenues for us, given the level of competition and economic growth in its market.
b) Compared with competing retailers or dealers in the district, this retailer or dealer has achieved a high level of market penetration for our products.
c) Last year, the revenues that this retailer or dealer generated for us were higher than those our other retailers or dealers within the same territory generated for us.

2. The retailer's or dealer's financial performance for us is good.

a) The cost of servicing the retailer or dealer is reasonable, given the amount of business it generates.
b) The retailer's or dealer's demands for support, have resulted in adequate profits for us.
c) Over the past year, we made adequate profits from this retailer or dealer relative to the amount of time, effort, and energy that we had to devote to assisting it.

3. The retailer or dealer successfully generates growth for us.

a) The retailer or dealer will continue to be or will soon become a major source of revenue for us.
b) Over the next year, we expect the revenues this retailer or dealer generates for us to grow faster than the revenues our competitors' retailers or dealers within the same territory generate for them.

c) Over the past three years, the market share we have achieved through the retailer or dealer has grown steadily.

4. The retailer or dealer is competent.

a) The retailer or dealer has the business skills to run the kind of operation that we need.
b) The retailer or dealer demonstrates deep knowledge of the features and attributes of our products and services.
c) The retailer or dealer and its personnel have considerable knowledge of our competitors' products and services.
5. The retailer or dealer complies with channel policies, procedures, and the terms of the contract.

a) Over the past year, we have usually had success getting the retailer or dealer to participate in the following important program:
b) The retailer or dealer almost always conforms to our accepted procedures.
c) The retailer or dealer usually abides by stipulations or terms and conditions contained in its contract or agreement with us.

6. The retailer or dealer adapts to marketplace changes.

a) The retailer or dealer is in touch with long-term trends in its territory and frequently adjusts its selling practices.
b) The retailer or dealer is innovative in its marketing of our products and services.
c) The retailer or dealer makes an effort to meet competitive changes in its territory.

7. Customers are satisfied with the level and quality of services that the retailer or dealer provides in support of our products.

a) We rarely receive complaints about the retailer or dealer from customers.
b) The retailer or dealer goes out of its way to make customers happy.
c) The retailer or dealer assists customers or end users when any problems involving our products or services arise.

1. For more information on how to conduct such an assessment and to test its statistical validity, see Nirmalya Kumar, Louis W. Stern, and Ravi S. Schrol, “Assessing Reseller Performance from the Perspective of the Supplier,” Journal of Marketing Research, May 1992, pp. 238–53.

Two Tough Companies Learn to Dance Together

The word on the street has always been that Procter & Gamble and Wal-Mart are two tough companies with whom to do business. Historically, Procter & Gamble has used its enormous power to dominate the trade. P&G would bring its breathtakingly comprehensive research on consumers to retailers and use it to argue for increased shelf space for its brands. Before retailers developed sophisticated point-of-sale systems, which generate a wealth of information on consumers, they were unable to dispute P&G's analyses and resented P&G's control over the retail trade. Over the years, P&G built up a reputation for being a "self-aggrandizing bully of the trade."[1]

For its part, Wal-Mart was renowned for demanding that its supplying manufacturers offer it rock-bottom prices, extra service, and preferred credit terms. In 1992, it instituted a policy of dealing directly with manufacturers, rendering intermediaries such as brokers and manufacturer representatives superfluous. It would do business only with vendors that invested in customized electronic-data-interchange technology and put bar codes on their products. However, because of the volume and growth Wal-Mart delivered, manufacturers had little choice but to fall into line.

Over the last ten years, however, these two giants have developed a partnership that has become the benchmark for manufacturer-retailer relationships. It is based on mutual dependence: Wal-Mart needs P&G's brands and P&G needs Wal-Mart's access to customers. The relationship took time to mature and has gone through its share of growing pains, but mutual trust has been instrumental in the companies' development of an effective long-term relationship.

In the bad old days, P&G would dictate to Wal-Mart how much P&G would sell, at what prices, and under what terms. In turn, Wal-Mart would threaten to drop P&G merchandise or give it poorer shelf locations. There was no sharing of information, no joint planning, and no systems coordination. Prior to 1987, Wal-Mart had never been contacted by a corporate officer of P&G. As Sam Walton, the founder of Wal-Mart, put it, "We just let our buyers slug it out with their salesmen.[2]

It was not until the mid-1980s that this adversarial relationship began to change. A mutual friend arranged a canoe trip for Sam Walton and Lou Pritchett, P&G's vice president for sales. On this trip, the men decided to reexamine the relationship between the two companies. They began the process by assembling the top ten officers of each company for two days to develop a collective vision of the future. Within three months, a team of 12 people from different functions in each company was established to convert that vision into an action plan. It examined how the companies could use information technology to increase sales and lower costs for both parties.

The result was a sophisticated electronic-data-interchange link, which enables P&G to take responsibility for managing Wal-Mart's inventory, of, say, P&G's Pampers disposable diapers. P&G receives continuous data by satellite on sales, inventory, and prices for different sizes of Pampers at individual Wal-Mart stores. This information allows P&G to anticipate Pampers sales at Wal-Mart, determine the number of shelf racks and quantity required, and automatically ship the orders - often directly from the factory to individual stores. Electronic invoicing and electronic transfer of funds complete the transaction cycle. Because of the speed of the entire order-to-delivery cycle, Wal-Mart pays P&G for the Pampers very shortly after the merchandise is sold to the end consumer.

This partnership has created great value for consumers in the form of lower prices and greater availability of their favorite P&G items. (Stock-outs have been virtually eliminated.) Through cooperation, superfluous activities related to order processing, billing, and payment have been eliminated; the sales representatives do not need to visit stores as often; and paperwork and opportunities for errors have been dramatically reduced. The orderless order system also means that P&G produces to demand rather than to inventory. Furthermore, Wal-Mart has succeeded in simultaneously reducing the inventory of Pampers and the probability of stock-outs, thereby avoiding lost sales for both parties. By working together, the two have turned what used to be a win-lose proposition of each striving to lower its own costs regardless of the effect on the other's costs into a win-win proposition of reduced costs and greater revenues for both parties. Wal-Mart is P&G's largest customer, generating more than $3 billion in business, which is about 10% of P&G's total revenues.

To unleash the benefits of their partnership, Wal-Mart had to trust P&G enough to share sales and price data and to cede control of the order process and inventory management to P&G. P&G had to trust Wal-Mart enough to dedicate a large cross-functional team to the Wal-Mart account, adopt everyday low prices (lower standard prices and the elimination of special promotions), and invest in a customized information link. Instead of focusing on increasing sales to Wal-Mart, the P&G team concentrates on finding ways to increase sales of P&G products to consumers through Wal-Mart and to maximize both companies' profits.

1. Pritchett on Quick Response, Discount Merchandiser, April 1992, p. 64-65.

2. Sam Walton and John Huey, Sam Walton, Made in America: My Story (New York: Doubleday & Company, 1992, p. 186.

How Ekornes Turned Its Retailers into Partners

Until 1993, when J.E. Ekornes, a Norwegian home-furniture manufacturer, decided to overhaul its distribution system in Europe, it suffered from the problems common in traditional adversarial manufacturer-retailer relationships. Its experience in France, where it sold its products through 450 furniture dealers, was typical. A sales mentality meant that any retailer that wished to carry Ekornes's Stressless product line had access to it. Because of overdistribution, retailers did not trust Ekornes, and, in turn, Ekornes believed that the retailers were not committed to making the brand succeed. There were the usual disagreements over the support that each party was sup-. posed to provide to the other. Meanwhile, the brand was suffering in the marketplace.

For the brand to achieve its potential, Ekornes felt it needed to work more closely with its retailers to make distribution more efficient and to increase the marketing and service support that retailers provided to the brand. So in early 1993, Ekornes decided to move away from traditional adversarial relationships to deeper, more intense relationships.

Ekornes's managers realized that there were two obstacles to developing such relationships: the inability of retailers to make satisfactory profits on the Stressless product line and the process by which Ekornes was managing its relationships with retailers. First, Ekornes focused on improving the returns to retailers, a process that meant having fewer retailers and awarding the survivors exclusive territories so that each could generate adequate sales volumes. Accordingly, over the next three years, it reduced its number of retailers in France to 150 and gave them new contracts that promised them exclusive territories. In addition, Ekornes slightly increased retailers' margins to ensure that the retailers had enough resources to support the brand with local advertising.

Ekornes also took steps to involve retailers in the change process and to make them feel like members of the Ekornes family. It arranged for them to visit its innovative factory in Norway in order to deepen their appreciation of the quality and distinctiveness of Ekornes's products. Using computerized software, it worked with retailers to figure out the optimal territory size for each. When Ekornes dropped retailers, those remaining agreed to sales goals that more than made up for the volume that would be lost by eliminating the others. At the request of the retailers, Ekornes arranged regional training sessions for the retailers' sales forces. Since the retailers were not competing with one another anymore, they were more willing to share their successful and unsuccessful sales strategies both with one another and with Ekornes's sales representatives during the training sessions.

Finally, Ekornes had to change the role of its sales force from one of selling to one of providing marketing assistance to the retailer. To do so, the company dumped the sales commission that had made up the sales force's entire pay. Instead, it began paying salespeople a fixed salary and instituted a bonus, most of which depended on the quality of the assistance that they provided to retailers.

The change process continues at Ekornes, but the results are already spectacular. Retailers have responded by increasing local advertising and dropping competing lines. Stressless sales in France have tripled over the past three years-and continue to increase at a 50% annual rate.

Power and Trust

	The Power Game	The Trust Game
Modus Operandi:	Create fear	Create trust
Guiding Principle:	Pursue self-interest	Pursue what's fair
Negotiating Strategy:	Avoid dependence by playing multiple partners off against each other Retain flexibility for self but lock in partners by raising their switching costs	Create interdependence by limiting the number of partnerships Both parties signal commitment through specialized investments, which lock them in
Communication:	Primarily unilateral	Bilateral
Influence:	Through coercion	Through expertise
Contracts:	"Closed," or formal, detailed, and short-term Use competitive bidding frequently	"Open, or informal and long-term Check market prices occasionally
Conflict Management:	Reduce conflict potential through detailed contracts Resolve conflicts through the legal system	Reduce conflict potential by selecting partners with similar values and by increasing mutual understanding Resolve conflicts through procedures such as mediation or arbitration

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