It Takes Two To Tango – Buyer-Supplier Relationship Building

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ABSTRACT

The purpose of this case is to demonstrate how industrial norms influence the relationship between exchange parties. Deeply entrenched industrial norms serve as guidelines for behavior within permissible limits for exchange parties in a given industry. They form a common ground for action and constitute an implicit understanding upon which a cooperative relationship can be built. Industrial norms therefore play an important role in reducing conflict in the early stages of the interfirm relationship as they help exchange parties develop successful relationships. In the absence of industrial norms, exchange parties at the initial stages of a relationship may be faced with conflict. Even a detailed contract is usually not sufficient to prevent conflict. However, a contract does help exchange parties pursue the relationship and this continuity will foster the development of relational norms. Relational norms tend to govern long-term relationships and they are unique to the specific relationship, as opposed to industrial norms, which hold for an entire industry. The contribution of this article is as follows: (1) It offers a more extensive discussion of the interfirm relation in a macro social context than has previously been explored in inter-organization research literature, and (2) presents a useful premise for understanding interfirm relationships. This case can be used in conjunction with discussion on marketing topics such as the design of marketing channels (Chapter 6, Designing the Marketing Channel, "Marketing Channels: A Management View," 7th Edition by Bert Rosenbloom, South-Western College Pub, 2003) for senior level marketing seminar.

INTRODUCTION

Industrial norms act as mechanisms to preserve an industry's social structure and to protect the interests of its members. There are a variety of industrial communities such as those within silk, steels, textiles industries in which exchange parties adopt roles and norms. As a result, exchange parties in those industries feel pressured to observe the industrial norms (Sabel and Zeitlin 1985). The inculcation of industrial norms into the practices of exchange parties maintains the industrial community and protects the economic value of the members as a whole. Thus, industrial norms act against an individual member's deceptive behavior for short-term gains.

Industrial norms, in some instances, replace individual contracts between exchange parties. They allow exchange parties to do business effectively without contracts, as the parties are confident that the industrial norms adequately define expected behavior. For instance, relying on entrenched industrial norms, Wisconsin businessmen prefer a verbal promise, a handshake, or common honesty and decency even when serious risks are involved in the transaction (Macauley 1963). This is possible because those business people are experienced professionals who know that the customs of their industry will ensure that their partners exhibit acceptable performance.

Industrial norms also develop within competing environments, such as the airline industry (Thomas and Soldow 1988). In a relationship between competitors, one company's reaction to the activity of its competitors generates patterns, and this prohibits the competing companies from engaging in any kind of cutthroat competition. The patterns become industrial norms, which act as a mechanism to protect the interests of all members of the industry (Schotter 1981).

Industrial norms differ from relational norms. Both types of norms influence the inter-organizational relationship at different levels. Industrial norms are expectations about behavior that are at least partially shared by firms within an industry, whereas relational norms govern a particular exchange relationship under the mutual belief that these norms operate for the mutual benefit of the exchange partners (Heide and John 1992).

Relational norms between exchange firms do not impinge on the rest of the members of an industry. In contrast, industrial norms affect the majority of firms that belong to a particular industry. For instance, diamond sales worth many thousands of dollars are typically sealed by a handshake regardless of the characteristics of individual parties (Ben-Porath 1980). This is possible because each of the exchange partners is a part of the closely-knit community of diamond merchants: strong community bonds enforce the handshake in this instance. Breaking faith with these community conventions risks jeopardizing the solidarity of the community itself and this social enforcement is stronger than any written contract. Thus, industrial norms are customs, traditions, and standards of conduct, which are formalized as a consequence of many interactions between firms.

TAKASHI DEPARTMENT CASE

Takashi is one of the oldest department store chains in Japan. The retailer began operations in Kyoto as a kimono shop in 1831 and opened its first department store in 1922. Presently, Takashi owns 18 stores throughout the country, a business in catalog sales and a credit card division. Though the department stores racks in about 75% of its sales, Takashi is also involved in construction, real estate, restaurant management, and wholesaling through more than 50 domestic affiliates and about 30 foreign affiliates. In 2004, Takashi generated $10 billion in revenue and hired around 10,000 employees worldwide.

Even for a company such as Takashi, developing relationship with new suppliers can still be a challenge. Mary is the head of the purchase department of Takashi, a branch of a Japanese department store that is located in Manhattan, New York. Mary's experience with one of Takashi's suppliers serves as a demonstration of an inter-organizational relationship which was not influenced by industrial norms. Below is an interview with Mary, carried out to explore her experience in her capacity as a purchasing manager. The relationship between Takashi and the supplier began about 12 years ago. Below is the dialogue that occurred during the interview:

R (Researcher): Can you think of a relationship with a company you have done business with that you would like to talk about?

Mary (Interviewee, M): Well, my company has purchased a great deal of leather products from one company for the past 12 years since we opened the department store in Manhattan.

R: Please tell me about the relationship with the company.

M: We did not have a good relationship with the leather company when we first purchased the leather products. The quality of leather products didn't match our standard of quality. The supplier, also, complained that our demand for the standard of quality was a lot higher than that of other buyers he dealt with at that time.

R: Then what happened after the conflict between the two firms?

M: Well, we persuaded the supplier to accept our standard of quality. We explained that we needed that specific quality of products to sell to customers in Japan and that the high quality product would be advantageous for customers, our company, and the supplier as well.

R: Can you give me a detailed account of the relationship with this supplier?

M: The relationship was not satisfactory at all. We were neither satisfied with the supplier's product quality nor his attitude. At the same time, he could not understand our demand for high product quality. Basically, we perceived the quality of the products supplied as far lower than that required to launch the store's position as a luxurious, high-quality establishment. So their failure was hindering our effort to attain our business objectives.

R: What was the supplier's perception?

M: They probably perceived us as an obstacle to their business goal, too. There really was a low level of compatibility of goals between two firms and this led to a conflict between the two firms.

R: Didn't you have any opportunity to purchase the leather products from other suppliers?

M: Actually, we signed a 3-year contract with that supplier so we had no choice but to purchase leather products from him. Also, we spent quite a bit of money to advertise the leather products in Japan. Therefore, our only option was to persuade the supplier to produce high quality products at that time.

R: So did Takashi keep the supplier after the contract expired?

M: Actually, during the discussion between our company and the supplier's company, we began to get to know the supplier better, and the supplier also began understanding our motives. Sometimes, the supplier would tell us about his family and his hobbies, so a mutual understanding therefore developed between the two companies. The supplier finally understood our demand for high quality and tried to comply with our standard. Eventually, the supplier started providing products of higher quality. Now, we are quite confident in the product quality of that supplier.

R: How's relationship between the two firms nowadays?

M: Sometimes, the supplier asks that it be allowed to delay supply. Three years ago, there was a labor strike in the supplier's company, he explained the situation to us, and showed us how much inventory and materials were left. He also gave a time frame within which he would supply the leather products to us at that time. Therefore, I had enough time to prepare for the shortage of products. Fortunately, the strike didn't last long.

R: Do you regularly share information about markets, prices for materials or products with the leather supplier?

M: I have frequently contacted the leather supplier and obtained information on leather products and existing prices for leather materials. This way, I get better acquainted with leather products. It is quite useful to me as I use the knowledge in adjusting purchasing volume. I, also, give our supplier information not only about the volume of sales of the leather products, but also about the market situation. I think the leather supplier gets useful information from my colleagues and me.

ANAHEIM KITCHEN APPLIANCE CASE

Anaheim Kitchen Appliance is a leading food disposal and kitchen appliance manufacturer, based in Anaheim, California. It is one of the largest food waste disposer manufacturers in the world. Anahiem Kitchen Appliance sells its products to residential and commercial consumers under several domestic and international product brand names including Waste King®, Sinkmaster® and Whirlaway®. The company also manufactures hot water dispensers, water coolers, faucets, as well as bath room fans and range hoods. Anaheim Kitchen Appliance is a leader in new concepts and designs for kitchen appliance, and was the first to use high speed permanent magnet motors and structural composite materials in food disposer design.

In 2000, Anaheim Kitchen Appliance was acquired and operates as a subsidiary of Western Plastics Inc. As of the year 2005, Kitchen Appliance generated revenue of $8.5 millions with 120 employees. Cathy was the head of purchasing for Anaheim Kitchen Appliance. Over the years, Cathy has accumulated many experiences with

Anaheim's electronics suppliers. In this interview, Cathy described an industry where established norms are widely accepted and understood.

R (Reasearcher): Can you think of a relationship with a company with whom you have done business?

C (Cathy): Uhm! One of our suppliers has provided raw materials for the past 9 years. We chose the supplier as a primary supplier out of seven or eight suppliers because the company has a good reputation in our business community.

R: Did you make a contract when you first deal with the supplier?

C: No. As a purchasing agency, our company doesn't have a specific contract. Mostly, there is a general agreement, but there is no written contract. There are some general conventions in this industry. Therefore, we don't make detailed clauses to cover every situation. It is unusual to have a contract between companies. Both companies however do have a contract in relation to the price for product. Once we agree about price, we continue to do business with the supplier. In this industry, everybody knows everybody. It is just like a family.

R: Isn't it dangerous to have no contract when you deal with suppliers?

C: Look at the photographs of the salesperson's family and his vacation trip. Once I start business with a salesperson or a company, we develop a close relationship. A lot has to do with the relationship I develop with the supplier. It is somewhat like a marriage. There is a commitment, but it is not on paper. I work together with the supplier. I prefer that type of relationship to a strict relationship that is formalized on paper.

R: You express the relationship between your company and the supplier as a marriage. Does that mean you share a lot of information with your supplier?

C: I share as much as I can with my supplier in regard to forecasting our sales volume. If I don't keep them informed about my future sales volume, they cannot provide that product to me in time.

R: what do you do when you find something wrong with the product the supplier provides?

C: I am always very honest with the supplier. When I find the problem I call them and have them correct it. Unless the problem shut down our production line, I tell them I can wait two or three days. I don't scream or cry to them unless the situation is an emergency. I know if I am honest with them I am only going to receive honesty back from them. Sometimes, I need the supplier's cooperation, then I honestly tell the supplier about our problem, and they usually do their best to help our company. That is a healthy relationship.

DECISION POINT

In these interviews, Takashi finally established a healthy relationship with its supplier, whereas Anaheim Kitchen Appliance enjoys a cooperative relationship in the beginning of the relationship. Suppose Mary is to select a new supplier for their leather goods today. What are the factors that Mary has to consider? What are the conflicting considerations in making this decision? Do you think industrial norms could operate in the new relationship?

Mary indicates that she will sometimes allow delayed shipments from the supplier without penalizing the supplier. Why does she do that? Is this an acceptable practice in your industry? Why, or why not?

TEACHING NOTE

Overview

The purpose of this case is to enhance students' understanding of how industrial norms work in the context of the industrial buyer-supplier relationship. By applying an existential-phenomenological description of the interfirm relationship, this case will describe how exchange parties operate in environments where industrial norms are lacking. The students should be able to deepen their understanding on the interfirm relation in a macro social context.

Case Description

These are field cases that describes the supply chain relationship management issues faced by purchasing managers of two companies. The problem for the characters in question is how to establish a healthy relational norm with a new supplier for leather. Several factors complicate the decisions made by the characters in this case. The lack of a previous exchange relationship between the two firms, or of established industrial norms as guidelines all add to the complexity in establishing a healthy relationship.

Case Preparation

There are several approaches in preparing the students before they analyze this case. However, it is strongly recommended that students have some understanding of marketing channel management and the purchasing operations for departmental stores.

Students need to understand the conflicting factors influencing supply chain relationship management decisions, as well as the complexity in managing a global supply chain relationship. Reading assignments before class, e.g. Chapter 3, The Environment of Marketing Channels, and Chapter 6, Designing the Marketing Channel, from "Marketing Channels: A Management View," 7th Edition, by Bert Rosenbloom, South-Western College Pub, 2003, will be very helpful to students in their analysis of the case.

This case has a level of complexity appropriate for graduate level or upper division undergraduate courses. It is designed to be taught in one class period depending upon the instructor's approach. Students are expected to spend between 2 to 3 hours of outside preparation time, depending upon the instructor's choice of preparation.

Case Synopsis

Procurement management involves a number of processes, which include maintaining an appropriate level of quality of the supplied product, obtaining product in a timely fashion, and securing after sales service. Over time, industrial buyers develop cooperative relationships with suppliers, characterized as relational norms (Aulach, Kotabe et al. 1996) to encourage high quality performance from their suppliers. Exchange parties within a cooperative relationship show flexibility in their response to their partners' requests and negotiate mutual adjustments to environmental changes (Noordewier, John et al. 1990).

However, when a buyer initiates a relationship with a new supplier, a cooperative relationship has had no opportunity to develop. There would have been no repeated transactions to permit each party to learn and understand the internal and external environments of the other. Mutually beneficial relationships between a buyer and its supplier simply would not have had the time necessary to grow (Gundlach and Achrol 1993). Therefore, a buyer in the early stage of a relationship with a supplier might have trouble achieving an expected level of performance from the supplier.

A contract is one alternative a buyer might use to manage a budding exchange relationship. It provides legal incentives to achieve a certain level of performance. However, the effectiveness of contracts is limited because contracts cannot possibly anticipate all future contingencies (Ford, Gadde et al. 1998). Thus, a contract is not a perfect solution for managing relationships with suppliers in the early stages. Managers would require an alternative in order to achieve the goal of high purchasing performance. The question thus is: what other regulatory tool can managers rely on in order to establish and continue high-quality supplier relationships?

Macaulay (1963) introduced the concept of industrial norms, using the example of practices prevalent among business communities in Wisconsin area. Industrial norms have come to refer to patterns of behavior that become institutionalized among companies and serve to guide and constrain subsequent behavior of the companies (Thomas and Soldow 1988). Since industrial norms act as a control mechanism to produce a certain level of performance, manufacturers in Wisconsin start business relationships with their suppliers without heavy reliance on written contracts. These manufacturers often enter contracts whose provisions contain very limited details of an exchange. Exchange partners do not try to take advantage of this vagueness because they already have industry guidelines for performance. These guidelines have been in place for a prolonged period and suppliers and manufacturers expect them to be observed.

Intended Audience and Course Placement

This case is primarily created for graduate level or upper division undergraduate students taking a supply chain management course. The case should be introduced after the students have read the relevant chapters on supply chain management or buyer-supplier relationship management (Chapter 3, The Environment of Marketing Channels, "Marketing Channels: A Management View," 7th Edition by Bert Rosenbloom, South-Western College Pub, 2003). Since this case covers multiple consideration factors in supply chain relationship management, this case is recommended as a comprehensive case. An undergraduate course instructor may also use this case for an end-of-chapter discussion in supply chain management.

Learning Objectives

The overall purpose of this case is to introduce students to the complex considerations in procurement management. In this case, students experience the difficult management decisions faced by managers in real business situations, namely, those that require making a decision as to whether one should continue to build and enforce an exchange relationship or rather, seek another supplier. Students will explorer the decision factors for analysis. Specific learning objectives are as follows:

- For students to obtain an understanding of factors influencing interfirm relationship.
- For students to understand and appreciate the difficulties in making decisions under insufficient information and uncertainty.
- For students to understand the factors influencing inventory management.
- For students to understand the challenges in coordinating conflicting interfirm relationship.
- For students to understand the importance of social mechanisms in managing the supply chain upon occurrence of natural disasters such as hurricanes.

Case Analysis

This study has demonstrated how the industrial norms influence the relationship between exchange parties. The embedded industrial norms provide exchange parties with a common base upon which they interact and they facilitate cooperative relationships. They serve as guidelines prescribing accepted behavior and specify permissible limits on behavior. Thus, industrial norms play an important role of reducing conflict in the early stage of the relationship, and help exchange parties build long-lasting relationships. As transactions between two parties multiply, they tend to produce relational norms, which characterize the particular relationship between the two.

Through the analysis of the cases of Mary and Cathy, the importance of industrial norms in the initial relationship stages is illustrated: Where such norms are not in place, conflict resolution is an issue and contracts or transaction specific investments (TSI) may be needed to keep a relationship between two parties long enough for the development of relational norms. In industries where industry-wide norms are accepted, these norms become the shapers of initial relationships. In both cases, prolonged interactivity between the parties gives rise to relational norms that tend to govern relationships in the long run.

By advertising the products of the offending supplier to its customers, Mary's company had linked itself to the supplier with TSI. TSI are physical or human assets that are dedicated to a particular relationship and cannot be redeployed to another relationship (Williamson 1985). Thus, transaction specific investments make it costly to exit the existing relationship (Gundlach, Achrol, & Mentzer 1995).

Mary did not consider terminating the relationship with the leather supplier due to the investment made in advertising the supplier's products. Given the existence of the TSI, she did not have any other choice but to settle the problem with the supplier.

Cathy described the electronics industry in Southern California as family. Just as families tend to do, members of an industry may develop conventions to follow. Through observing the conventions (industrial norms), exchange parties maintain their close relationships. Buyers and suppliers in the electronics industry know each other very well, and they also know who is doing business with whom. If one company harms another, everyone else in that industry soon knows it. The company will have a bad reputation and may have difficulty doing business in the electronics industry in the future. The industry where industrial norms are widely accepted will be characterized by relationships, even new ones, where these conventions rather than written contracts shape behavior.

The case of Mary illustrates that exchange parties in industries without industrial norms depend on written contracts. However, in the absence of the substantial social structure that gives rise to industrial norms, one may expect dyadic conflicts (Granovetter 1985). Since there are no guidelines governing behaviors, especially during the early stages of the relationship, exchange parties have to make rules by making a contract. However, Mary had a conflict with her leather supplier, since the contract did not cover all the contingencies the both parties could face (Ford et al 1998). For instance, Mary's contract did not specify the quality of the leather goods and the parties disagreed over quality issues. "Quality" is an excellent example of the difficulty of specifying expectations in a contract. The evaluation of the quality is subjective to some degree. Thus, the parties to a contract may well perceive quality differently, given each one's particular needs. This may cause conflict within the relationship.

In contrast, Cathy did not experience any conflict with her partner because the existing industrial norm in the electronics industry of California provided a solid base for mutually beneficial business exchanges. Industrial norms dictate what buyers and suppliers should do, so internalized industrial norms help exchange parties predict their partners' behavior and extend their relationships (Granovetter 1985). Rather than attempting a detailed contract covering all possible contingencies, the parties rely on incomplete contracts to deal with unexpected changes in industries where norms are in place (Haugland & Reve 1993). The existence of industrial norms effectively limit self-interest seeking behavior (Granovetter 1985), so Cathy can achieve her procurement goal without being exposed to contractual hazards. Cathy and her supplier do business with few conflicts and resolve the few that do arise. This leads to an on-going and successful relationship between the two.

The contract they signed was another factor in the continuation of the relationship. The buyer had signed a 3-year contract with the leather supplier for 3 years. Had the buyer discontinued purchasing the products, they would have had to pay a penalty. Since conflict prevents a party from drawing cooperation from its partner, the contract worked as a mechanism to push both companies to resolve the conflict.

As time goes by, exchange parties start to understand the unique situation of the partner and the partners develop relational norms (Gundlach & Achrol 1993). Through frictionless exchange between Cathy and her partner, they develop relationship norms. In the case of Mary, the leather supplier finally understood the requirements of Mary's company and tried to meet these requirements. Since then, the exchange relationship has continued successfully and relational norms have developed. Thus, even though there was a conflict, exacerbated by the lack of industrial norms, the exchange parties eventually developed relational norms.

As the relationship developed over time, both the leather supplier and the department store buyer began to understand the situation of its partner. The repeated exchanges and the dialogue these exchanges engendered gave the parties a chance to develop rules and regulations to guide their conduct (Gundlach and Achrol 1993). Mary shows that the interaction between two firms for the past 12 years has served to develop relational norms. Relational norms are not just the way firms actually behave, but the way they ought to behave as well (Macneil 1980). Mary and her partner keep exchanging information on the market situation for leather products. Through repeated behavior, this exchange of information becomes a norm for the parties.

These exchange parties have developed the norm of flexibility and the norm of information sharing. The need for flexibility arises because the business world is constantly changing (Macneil 1980). Flexibility means that the relationship will be subject to a good faith modification if some particular practice proves detrimental in the light of changed circumstances (Heide & John 1992). For example, Mary was flexible about the deadline of supplying products and accepted the supplier's explanation about labor strike because she had an intention of pursuing the mutual interest of both companies. She could have taken advantage of the supplier's problem by taking the initiative to lower prices of leather product at that time. However, the norm of flexibility made her agree to accept late shipment.

Both companies have continued to share information. Information sharing is a party's expectation of proactively providing information to its partner. Information sharing serves as a safeguard for the buyer in the sense that the supplier can be expected to provide unforeseen information that may affect buyer operations (Heide & John 1992).

Mary specifically mentioned that this mutual information sharing had proved to be useful to both companies. Relational norms stimulate the efforts for mutual benefits between the manufacturer and the supplier (Weitz and Jap 1995). Through the adoption of the norm of flexibility, both companies are protected from the negative consequences of uncertain environments. In the case of the labor strike, the leather supplier was able to get some leeway on supplying products. The buyer's information on customer demand for leather products enables the leather supplier to adjust production volume appropriately. Mary also could prepare for the shortage of leather products through raw material market information provided by her supplier.

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