

CHALLENGING CUSTOMERS

Driving Competitiveness through
Customer Relationship Optimization

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**CHALLENGES
AHEAD**



COPENHAGEN BUSINESS SCHOOL
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CBS COMPETITIVENESS PLATFORM

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CHALLENGING CUSTOMERS

**DRIVING COMPETITIVENESS THROUGH
CUSTOMER RELATIONSHIP OPTIMIZATION**

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CHALLENGE

(the situation of being faced with) something
that needs great mental or physical effort
in order to be done successfully and
therefore tests a person's ability
an invitation to compete or take part,
especially in a game or argument

(dictionary.cambridge.org)

PROLOG / PREFACE / FOREWORD

Challenging Customers not only responds to increasing demands among customers challenging their suppliers but also to the suppliers' drive to challenge customers. Challenging each other in a customer-supplier relationship helps both parties stay sharp, alert, and agile. Challenging in relationships – and challenging the relationship itself – are therefore sources of competitiveness for customers and suppliers alike.

A business without customers is not a business. All firms need to interact with “the one who pays”, “the one for which they are valuable”, or “the beneficiary of the firm’s value proposition”. Such customer contacts and contracts can be direct or indirect, arm’s length or trust based, simple or complex. In all cases, firms have relationships with customers. In our understanding, the term “relationship” does not imply a specific quality, such as “friendship” or even “good” or “bad”. Rather, it indicates that the parties somehow relate to one another. “Customer-supplier relationship” describes the fact that companies interact with each other in order to enable value creation on both ends of the relationship.

The establishment of relationships is therefore not a choice for a company, but a necessity. However, ensuring that the firm is involved in suitable customer-supplier relationships that support its competitiveness is a challenging task and a daily challenge. This book provides a 360-degree view of customer-supplier relationships, and offers tools useful for describing and understanding relationships in order to develop them into valuable assets for the firm. Notably, the book is not a complete collection of all of the models and tools ever suggested. Rather, it offers our selection of tools that have been proven to work over time.

This book is based on more than 15 years of experience in researching customer-supplier relationships, and in teaching executives and graduate students about the various aspects of these relationships. Our perspective has mostly been that of a supplier trying to optimize customer relationships. However, as every customer-supplier relationship encompasses two parties, this book is equally relevant for customers seeking to understand and manage their supplier relationships. While most of our background relates to business-to-business relationships, i.e., firms and organizations relating to other firms and organizations, the logic and the tools found in this book are also applicable to consumer relationships. In fact, we believe that the application of our tools to

consumer relationships can add structure and elements that are otherwise not commonly employed in consumer-goods firms.

Thomas Ritter & Jens Geersbro

Copenhagen, September 2015

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CHAPTER 1

CHALLENGING AND BEING CHALLENGED - AN INTRODUCTION TO THE CUSTOMER CHALLENGE

Customers are an important part of any business. In fact, without customers, there can be no business. Therefore, any business faces several challenges: finding customers and convincing them to use the business, retaining and developing existing customers, and ending relationships with unprofitable customers. These challenges can be difficult to address. Levitt's portrayal of customers seems relevant in this regard: "consumers are unpredictable, varied, fickle, stupid, shortsighted, stubborn, and generally bothersome"¹.

Despite the fact that customers might be challenging on a wide variety of levels, business success is impossible without them. Therefore, managers need to tackle the customer challenge. This book offers a set of tools that can enable them to master this key challenge.

Customers are the source of value creation for a business. However, customers are only willing to contribute to a business's value creation when that business contributes to their own value creation. Thus, value needs to be understood as the fundamental basis of the business, and it needs to be optimized if the business is to be developed. We therefore address value analysis in Chapter 2, where we offer useful tools for understanding value in customer relationships.

While value is the reason for developing a relationship with a customer, the structure of the relationship is the mechanism that enables interactions between a supplier and a customer. This, in turn, allows for value creation. Relationships can differ significantly – from arm's length to close integration, from friendly to antagonistic, or from close to distant. We discuss the elements of relationship structure in Chapter 3.

The basis for the long-term development of a business relationship lies in suppliers' and customers' judgments of satisfaction with the relationship, the level of trust between the partners, and their commitment to the

¹ Levitt, Theodore (1960): "Marketing myopia", *Harvard Business Review*, Vol. 38 (4): 45-56.

relationship's continuation. These elements capture the perceived quality of a given relationship and, together, they can be understood as the overall assessment of the relationship. We deal with these elements of a business relationship in Chapter 4.

In combination, value, structure, and quality provide a picture of the state of a relationship. The understanding of this current state can serve as the basis for describing a desired future state of the relationship. This, in turn, allows for the development of relationship strategies dependent on where the firm wants the relationship to be. We develop our six-strategy framework in Chapter 5. This framework captures the six strategic options managers have for any relationship. The analysis of the relationship state, combined with the firm's strategic plans and the competitive market situation, serves as the basis for making an informed decision about which relationship strategy to use.

As with any other strategy, the realization of relationship strategies depends on their implementation. Six relationship-management processes, which correspond to the six strategies, determine the success or failure of a firm's approach to securing successful management of customer relationships. Combined with six interaction processes, the relationship management matrix is outlined in Chapter 6.

Figure 1.1 shows a graphical illustration of our framework. The state of the relationship is a snapshot of how the relationship appears "right now". The current state is defined by three elements: the relationship value, the relationship structure, and the resulting perceived relationship quality. The state of the relationship is illustrated as the outcome, consequence, or result of relationship management, i.e. the managerial actions and activities of the firm. Relationship processes are guided and shaped by the relationship strategy.

Graphically, we have placed relationship strategy on the top because managerial decisions and actions will make an impact on the relationship – regardless managers' knowledge of the relationship. But we highlight the feedback loop. In other words, the framework is actually a circle. The current state of a relationship may give rise to changes in strategy, which in turn leads to changes in managerial action and activities. Those changes result in an altered relationship state, and the cycle continues. The interpretation and meaning of strategy will change depending on where we start in the loop. If we start with strategy, we have a rational view of strategy as a plan or goal for the relationship. On the other hand, if we start with the relationship state, we view strategy as an emergent

phenomenon or pattern. Companies will typically view strategy in different ways, and this framework caters equally well to those different views.

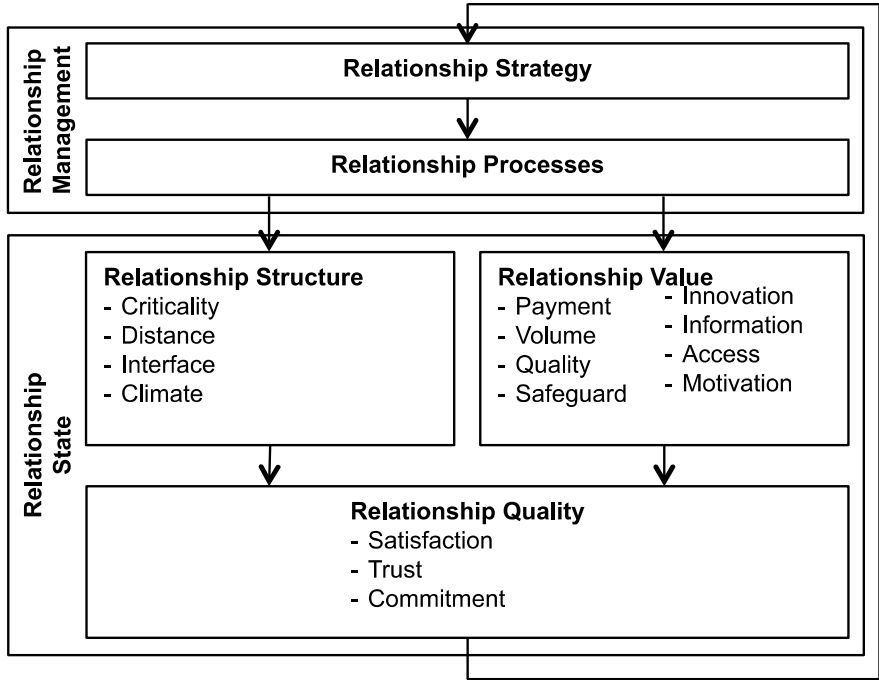


Figure 1.1: The Relationship Challenge Framework

Given our framework, we expand our view by taking a look at the surroundings: the organization and the market. We explore specific issues of customer-relationship management: the challenge of inputs for customer-relationship management (Chapter 7), the role of top management in driving the customer challenge (Chapter 8), and the market in which the firm operates (Chapter 9).

Why Customers Challenge

Why are customers challenging? Because they can be! In a world of many suppliers, customers have bargaining power. As markets become more mature, more alternatives become available, and customers can afford to be choosier and make higher demands of their suppliers. Many industries

have experienced customers' moves toward single supplier or multi-tiered supplier networks, which also increases customers' bargaining power.

Customers have also become more knowledgeable about their needs and the process to fulfill them – and pressure supplier to better contributions towards their value creation. This, in turn, translates into the customers knowing more and, therefore, become more demanding. When the strategic focus shifts from “what one sells” towards “what the other buys”, suppliers' market orientation, their focus on value creation and their customer knowledge becomes increasingly important to get on par with customers.

Customers are also becoming better educated and more professional in their purchasing processes. Over the past two decades, companies have recognized that a larger portion of their costs goes to purchased goods and services than to in-house production. As lowering costs has a very visible and direct effect on the bottom line, many companies have invested significant amounts in recruiting and training highly professional purchasing people. On the supplier side, how marketing and sales influence firm profitability is less evident. Companies have therefore only recently begun considering professionalizing and updating these functions, but there is still a long way to go to catch up with the purchasing side. Therefore, the advantage lies with the customers!

Customer complaints are an excellent source of information and they point to potential areas for improvement. When customers take time to complain, they are also implicitly saying: “I want you to improve because I want to stay with you rather than find an alternative supplier”. In this light, a complaint becomes something positive – it creates an opportunity to show the customer what you can do. In many cases, customer satisfaction rises above the initial level after a successful response. Yet, given the reach and speed of social media, sharing bad experiences has never been easier and potential “shit storms” constitute a major threat to firms.

Why Challenge Customers?

We claim that customers increasingly wish to be challenged by their suppliers. Why is this the case? More importantly, what do they view as positive challenges? Clearly, no one wants to be challenged in a negative way.

Customers want their suppliers to actively help them innovate and develop their businesses. They seek out suppliers that are able to provide this assistance. In fact, they may even accept a supplier with an inferior product or solution if that supplier places the innovation dimension at center stage. As a supplier, you want to challenge these customers rather than leave the customers' business to one of your competitors.

A proactive supplier can influence the customer in a way that the customer had not already expected. Such suppliers may have an important edge compared to their competition. In other words, a proactive focus can improve competitiveness.

The customer may be "king", but kings may want to be challenged by new or different products, or by changes in the way of doing business. In many ways, it is more rewarding and interesting to sell ideas to customers than to push products. Of course, it all comes down to understanding what the customers value.

The Challenge Matrix and Duality

Given that both sides can choose to challenge a relationship, there are always two sides to a relationship – the customer and the supplier. Both have their own views, opinions, perceptions, and strategies. This is not only true for challenges but it generally implies that every concept used to explain a customer-supplier relationship can be applied from two sides – the customer and the supplier. This also means that each actor will have a perception of both their own situation and the other side's situation. This results in four perspectives in every relationship, which implies that everyone working with a relationship must take on a great challenge: to always understand which perspective is being taken (Figure 1.2). Failure to specify the perspective can lead to inefficient meetings with misunderstandings and poor decisions been made.

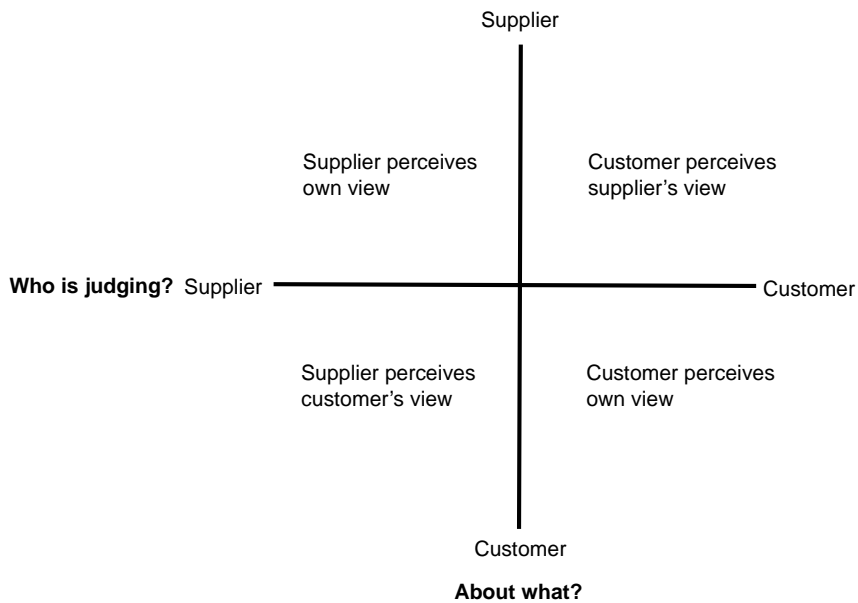


Figure 1.2: Four perspectives in customer-supplier relationship

And now, let us move on to face the Customer Challenge.

PART I

RELATIONSHIP STATE

CHAPTER 2

THE CHALLENGE OF RELATIONSHIP VALUE

The creation of value for both the customer and the supplier is the key goal of any customer-supplier relationship. Relationships between suppliers and their customers have always been about value creation – companies do not establish and maintain relationships for the sake of having a relationship. They do so solely to take advantage of what the relationship can offer.

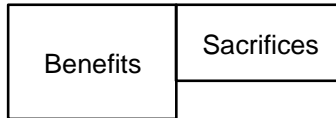
This fundamental premise of a customer-supplier relationship is not new and, as such, does not challenge common thinking or daily practice. The challenge associated with relationship value lies in understanding and analyzing it – to capture the essence of a given relationship and to imagine its potential to create value in the future.

In this chapter, we present a comprehensive analysis of relationship value based on three tools:

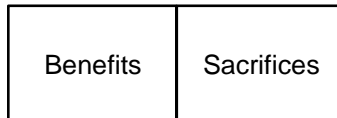
- 1 Value calculation,
- 2 Value radar chart, and
- 3 Value gaps.

Value Calculation

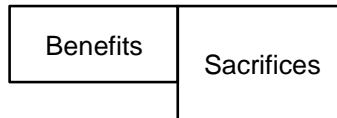
Value is defined as “benefits minus sacrifices”. In other words, suppliers or customers create value for themselves when what they get exceeds what they have to give up. As the phrase “there is no free lunch” suggests, some sort of sacrifice is always linked to any benefit. As Figure 2.1 illustrates, we can envision three different situations for a supplier or a customer in a given relationship.



Value Surplus
(more benefits than sacrifices)



No Value
(benefits equal to sacrifices)



Value Drain
(more sacrifices than benefits)

Figure 2.1: Three value situations

This understanding creates the basis for calculating value in business relationships. We can do so by listing all benefits and sacrifices, and then attaching a monetary value to each item, such that:

- 1: Value = Benefits - Sacrifices, or
- 2: Value = Benefit 1 + Benefit 2 + Benefit 3 + ...
- Sacrifice 1 - Sacrifice 2 - Sacrifice 3 - ...

This is a challenging yet rewarding exercise. The challenge arises from the fact that the list of benefits and sacrifices needs to be as complete as possible. Moreover, the monetary evaluation of each element can be challenging. In addition, based on the principle of mutuality, a customer-supplier relationship demands two calculations: a supplier-side calculation

and a customer-side calculation. The following case illustrates a value calculation.

CASE: Launching ProZyme (A)

Ingredient Inc., a leading biotech firm in food ingredients, is preparing for the introduction of a new, revolutionary product, ProZyme, which is a natural food-conservation enzyme. As it is very attractive for the bakery industry, Ingredient's scientists and product managers performed several application tests together with industrial baking firms. Ingredient's scientists learned that the average customer will need 100 kilograms of ProZyme per week and that the ProZyme dispenser, which introduces the enzyme during the production process, will perform for 10 weeks without maintenance. At the 10-week point, maintenance costs total \$3,000, which covers wages and spare parts. As industrial bakeries generally shut down production over the weekend, maintenance occurs on Saturdays. As ProZyme is an advanced enzyme and the dispenser is modern, operating costs per week are only \$1,000. The application of one kilogram of enzyme leads to lower production costs (\$200 per week), longer shelf-life (\$40 per week), and a better environmental image for the company (\$60 per week).

ProZyme's production costs are \$70 per kilogram, and its sales and distribution costs are \$10 per kilogram. At what price can Ingredient sell its new enzyme given that the firm is currently operating with a profit margin of 20%?

The value calculations are presented in Box 2.1.

Both sides achieve a value surplus in the price range of \$80 to \$287. As long as the agreed price per kilogram of ProZyme is between \$81 and \$286, both parties would enjoy a value surplus of at least \$1 and should, therefore, be interested in a relationship. Given Ingredient's targeted profit margin of 20%, its acceptable minimum price is \$100, but this price will leave a lot of the value to the customer who, in theory, is willing to accept a much higher price (up to \$287). The value calculation allows Ingredient a basis for its price setting that is based on customer perceived value rather than production cost.

Value for the customer (ProZyme)

<i>Benefits</i> (10 weeks at 100 kg per week)	
Reduced production cost (\$20,000 per week)	\$ 200,000
Longer shelf life (\$4,000 per week)	\$ 40,000
Greener image (\$6,000 per week)	\$ 60,000
<i>Sacrifices</i> (10 weeks)	
Purchasing price	\$?
Operating costs (\$1,000 per week)	\$ 10,000
Maintenance	\$ 3,000
<i>Value</i> (10 weeks at price zero)	\$ 287,000
<i>Maximum price (equal to no value for customer)</i>	
Value (10 weeks at price zero)/10 weeks at 100 kg	\$ 287

Value for Ingredient Inc.

<i>Benefits</i> (10 weeks)	
Sales price	\$?
<i>Sacrifices</i> (10 weeks)	
Production costs (\$70 per kg)	\$ 70,000
Sales and marketing costs (\$10 per kg)	\$ 10,000
<i>Minimum price (no value to Ingredient Inc.)</i>	\$ 80
<i>Minimum price (20% profit margin on \$80 costs per kg)</i>	\$ 100

Box 2.1: Calculations for ProZyme (A)

In addition to absolute value (i.e., how much value is created within a given relationship), a value calculation must also consider relative value (i.e., how much value is created relative to alternative relationships). Customers and suppliers will assess and compare alternatives. Moreover, they will choose the alternative that offers them the highest value. Notably, it is the surplus, rather than the absolute benefit, that determines these decisions. Thus, the relevant formula compares the values of alternatives A and B:

3: ValueA <?> ValueB

We can now extend our case to include a competitive offering.

CASE: Launching ProZyme (B)

Currently, bakeries use the artificial enzyme ArtiZyme to optimize their production. There would be no difference in application volume: one kilogram ProZyme would replace one kilogram ArtiZyme. ArtiZyme is priced at \$130 per kilogram. The ArtiZyme dispensing system has an application cycle of 10 weeks, after which it must undergo maintenance and recalibration. The process usually costs \$5,000 in wages and spare parts. Operating costs for the ArtiZyme installation are \$1,000 per week. As ArtiZyme is an artificial enzyme, bakery products that include it need to carry a special label, which costs \$500 per week for the printer-and-label machine and the labeling itself. ArtiZyme offers the same production-cost reduction and shelf-life effects as ProZyme, but it does not serve to enhance the company's environmental image.

The relevant calculations are displayed in Box 2.2.

Value for the customer (ArtiZyme)	
<i>Benefits</i> (10 weeks at 100 kg per week)	
Reduced production cost (\$20,000 per week)	\$ 200,000
Longer shelf life (\$4,000 per week)	\$ 40,000
Greener image (\$0 per week)	\$ 0
<i>Sacrifices</i> (10 weeks)	
Purchasing price (\$130 per kg)	\$ 130,000
Operating costs (\$1,000 per week)	\$ 10,000
Labelling costs (\$500 per week)	\$ 5,000
Maintenance	\$ 5,000
<i>Value</i> (10 weeks)	\$ 90,000
Comparing ProZyme with ArtiZyme	
Value (ProZyme) > Value (ArtiZyme)	
\$287,000 – Price (1,000 kg) > \$90,000	
Price (1,000 kg) < \$197,000	
Price (1 kg) < \$197	

Box 2.2: Calculations for ProZyme (B) and ArtiZyme

The focal customers are accustomed to creating value for themselves through the use of enzymes. In this case, the customers have an alternative, and they will only switch to the new enzyme when the value created is superior to the value created in the current situation. The availability of ArtiZyme results in a lower maximum price for ProZyme – if ProZyme is offered at more than \$197, customers would be better off to continue using ArtiZyme.

While this drop in the maximum price is significant – compared to the calculated maximum price without competition of \$287, it does not constitute a problem. The new maximum price is still much higher than the required minimum of \$100.

Value calculations have become very popular and very powerful, and they are increasingly applied in value selling and solution selling across industries. Many firms use Excel sheets or iPad applications that quickly calculate the value potential of their offerings for their customers. The challenges are:

- Developing a complete list of benefits and sacrifices,
- Pricing all elements, and
- Developing calculations for alternatives.

Value Radar

Value calculations offer great insights when the relationship is based on a concrete offering. However, as soon as a relationship involves a wider perspective, managers need to capture additional value-creating dimensions of that relationship. They therefore need a different tool. In complex relationship-value settings, the value radar can help capture the value of a relationship.

There are eight different value-creating functions in business relationships: payment, volume, quality, safeguard, innovation, information, access, and motivation.

Payment function

The payment function captures the financial transactions in the relationship in terms of how much is paid and how. The most dominant

element of the absolute payment is the price, which reflects the financial exchange. This is the price a buyer needs to pay and the revenue that a seller receives. While some firms only focus on the direct financial exchange (i.e., the price), others employ a full value calculation, as illustrated in the ProZyme case above.

The payment method captures the way in which the financial means are exchanged and the timing of that exchange. The issue is the perceived optimal cash flow – some firms prefer payment according to usage, while others have to maintain certain deadlines for budgeting reasons. Recent years have brought an increasing awareness and dislike of fixed costs. Thus, many firms are shifting away from fixed upfront investments to continuous payments for such items as production equipment, IT equipment and company cars. This allows them to limit their own financial risks.

For assessing the payment function, managers can establish their own benchmarks by using the best and the worst customer as “extreme” cases (boxes on each side in Figure 2.2). Once the scale is calibrated to the firm, a given relationship can be analyzed by drawing a line indicating how close, or far away, the relationship form other businesses.

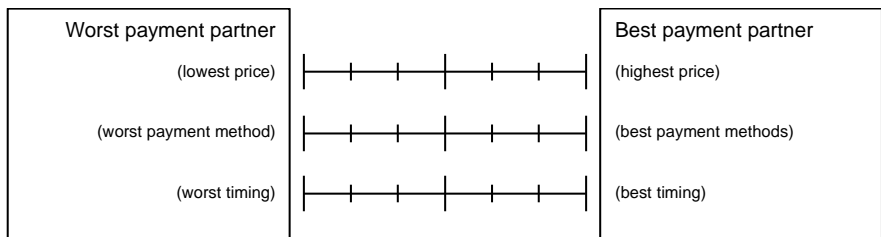


Figure 2.2: Analyzing the payment function

Volume function

The volume function is related to the depth, breadth, reach, and length of the exchange within a relationship. Exchange depth relates to “share of pocket”, which refers to the extent to which an actor relies on one source for a given item. In recent years, we have seen a trend towards single (or limited) sourcing. This, in turn, offers opportunities for more exchange volume per relationship.

Exchange breadth relates to “share of portfolio” – the number of different items in one category that are exchanged. Consider, for example, a corporate travel agent or a consumer travel site. The agent or site may offer flight tickets, train tickets, rental cars, and hotel reservations. Likewise, many telecommunication providers offer fixed-line services, mobile-phone services, voice-over-IP solutions, and Internet access. Increasingly, they also offer access to certain content, such as TV shows, movies, and music.

Exchange reach relates to the globalization of markets in terms of how many regions the exchange covers. Global firms often demand global partners. Many local and regional firms have seen their businesses vanish when customers begin to demand global contracts. Previously local issues, such as office cleaning, may be negotiated as part of worldwide solutions and contracts.

Exchange length captures the timespan of the contract or, in other words, the period of time to which the partners commit to the agreement. Firms are willing to trade long-term volume (i.e., contracts covering several years) for short-term earnings. Moreover, suppliers offer and customers demand lower prices with longer contracts.

The various elements of the volume function are illustrated in Figure 2.3. Again, we suggest identifying the best and the worst partners as reference points, and then rating a given relationship.

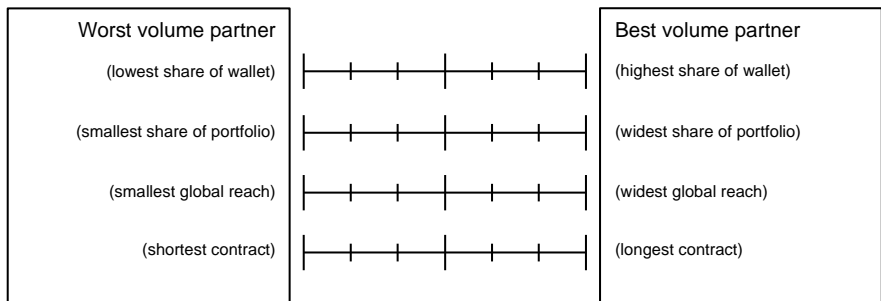


Figure 2.3: Analyzing the volume function

Quality function

Quality is a measure of how well the exchanged inputs fulfill a firm’s needs. The quality function is specific to the relationship, and its analysis

depends on identifying the relevant items or features to be included. Customers may look at performance features, failure rates, or delivery compliance, while suppliers may look at the quality of the contract. For the latter, the extent to which the supplier’s capabilities match the customer’s demands is key. If the customer is either too demanding or not demanding enough, there is a mismatch that could drain value creation.

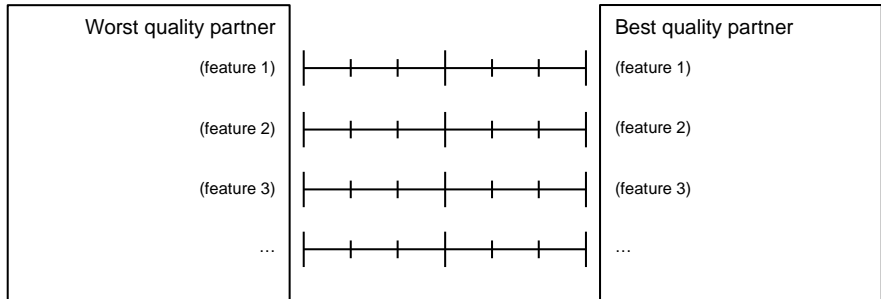


Figure 2.4: Analyzing the quality function

Safeguard function

Safeguarding offers an actor help in challenging situations. For example, customers may unexpectedly stop making their purchases, forcing the supplier to find another customer to fill the gap. Likewise, suppliers may have delivery problems, which could leave customers in need of alternative suppliers. Therefore, companies may establish relationships that can function as backups or safeguards in unforeseen circumstances. Second sourcing – the use of a second, smaller supplier – is a typical example of safeguarding.

Firms may also offer alternative supply systems to handle fluctuations. Some firms have extended opening hours to provide customers with access to supplies around the clock. Others invest in on-site dispenser systems. Moreover, customers may have projects with high degrees of flexibility regarding delivery times, which can be used to offset capacity fluctuations.

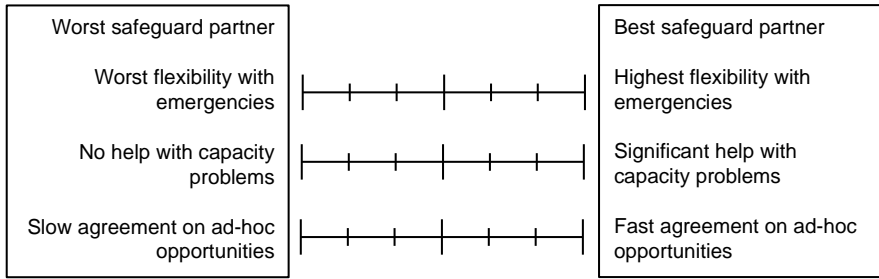


Figure 2.5: Analyzing the safeguard function

Innovation function

Innovation is increasingly a collaborative, distributed activity rather than a situation in which one lone innovator invents a revolutionary new offering. Thus, active involvement in an actor's innovation process serves as an important value driver that is enabled by relationships. Empirical studies highlight the fact that customers are viewed as the most important partner for innovations, followed by suppliers. Universities, consultants, governments, and distributors have also been shown to make significant contributions as innovation partners.

Suppliers typically receive a large portion of their total input for innovation from their customers and vice versa. Therefore, they enter into relationships with lead users or other types of advanced customers in order to co-create insights about new applications or to be challenged about their innovative ideas, even if that relationship does not provide significant value in terms of payment or volume.

However, customers can also limit a supplier's innovation if they simply demand faster and cheaper products and solutions rather than true innovations. As such, the agenda is not to seek innovation-related contributions from all partners. Successful firms carefully select their innovation partners. Innovations can be smaller modifications or they can be more radical, and they can be related to products and services or to business models.

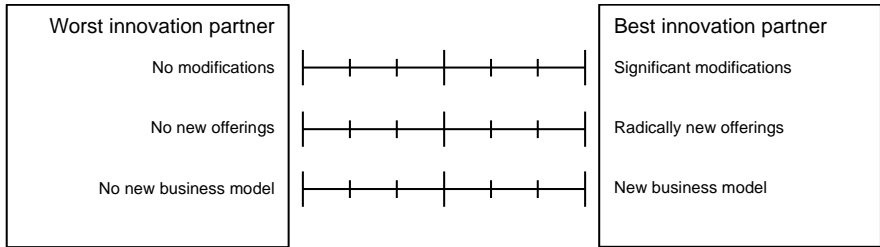


Figure 2.6: Analyzing the innovation function

Information function

The information function emphasizes the importance of access to information about the market, competitors, regulations, and new technological trends for both suppliers and customers. In fact, as customers are often in different markets or situations than their suppliers, they are likely to be sensitive to and have access to different information. Therewith, customers and suppliers can enlighten and enrich each other. The different dimensions of the information function are illustrated in Figure 2.7.

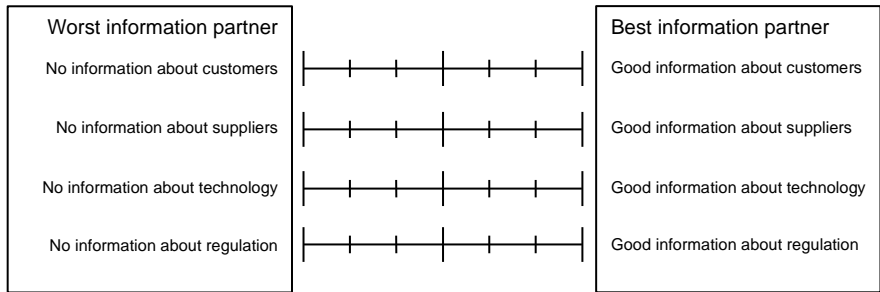


Figure 2.7: Assessing the information function

Access function

One of the key benefits of business relationships is that business partners can facilitate access to other players. Classic access value drivers are referrals to a partner or featuring a partner as a case. Likewise, introductions to each other's networks provide access to new

opportunities. A customer that recommends a supplier to other potential customers or helps a supplier establish a position in a new market is valuable. In a mature market, a customer that is particularly prestigious, large, or known for its high-quality standards may be valuable to a supplier. Likewise, customers may use a supplier to showcase their own quality and standards.

Partners may also serve as a route to other institutions and organizations, such as governmental bodies, politicians, financial institutions, key opinion leaders, or the press. Many of these organizations and institutions can be difficult to approach and handling them may require a lot of experience. Therefore, partners with the right contacts and experiences in dealing with relevant actors are highly valuable.

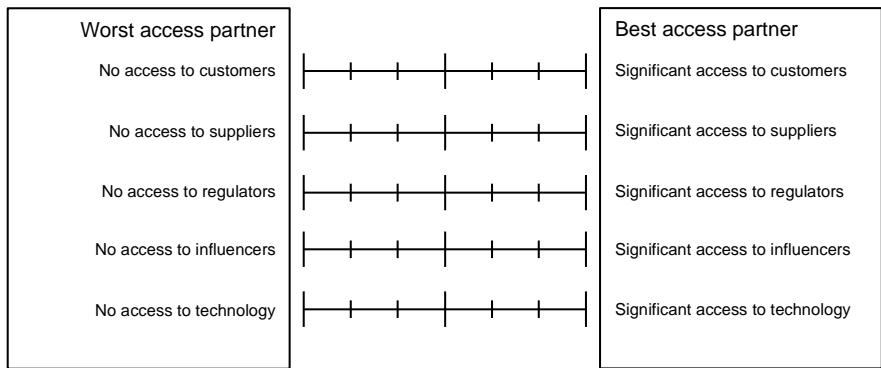


Figure 2.8: Assessing the access function

Motivation function

Finally, partners can be a motivational force for a firm. Working with renowned organizations, such as Greenpeace, NASA, or the UN, may provide employees with extra motivation. The additional motivation enhances the firm's productivity and, thus, creates value.

Unfortunately, the motivation factor can also be negative. Certain customers might be considered difficult and bothersome even if they provide a great deal of revenue to the supplier. Similarly, employees that find changes disturbing or seek comfort in business-as-usual and routines are unlikely to be motivated by the prospect of working with new or challenging customers.

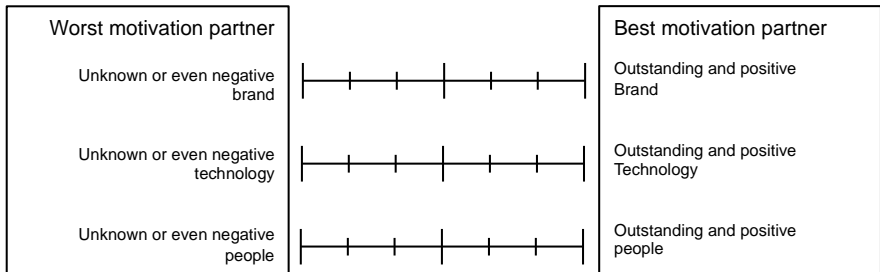


Figure 2.9: Assessing the access function

Combining the value functions

The combination of the eight value functions gives rise to a value radar, as illustrated in Figure 2.10. This figure provides an overview of the value-creation situation in a relationship (analyzing today's value creation) and offers a tool for discussing goals for the future (planning for tomorrow's value creation).

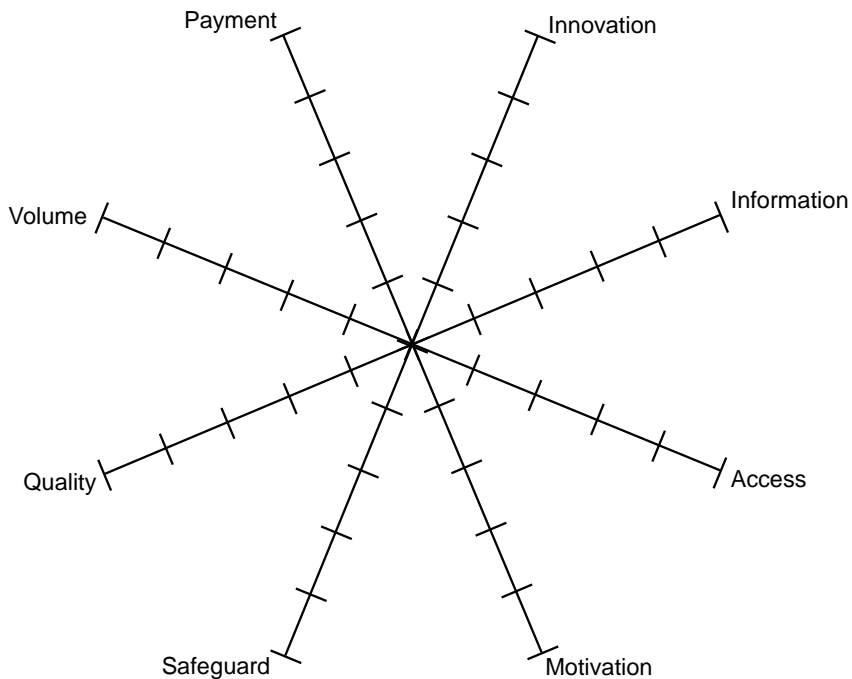


Figure 2.10: Assessing the relationship value

Value Gaps

Thus far, we have treated value as an objective measure, as we have not considered different views and perspectives of the two parties within the relationship. The perception of value is actor specific. In other words, all actors in a relationship have their own views on the value created – as discussed in Chapter 1. This means that firms must not only consider and analyze their own value perceptions but also account for their partners' perceptions of value.

This leads to four perspectives of value in each relationship. In Figure 2.11, we have deliberately drawn the boxes with different sizes to illustrate the potential for different perspectives.

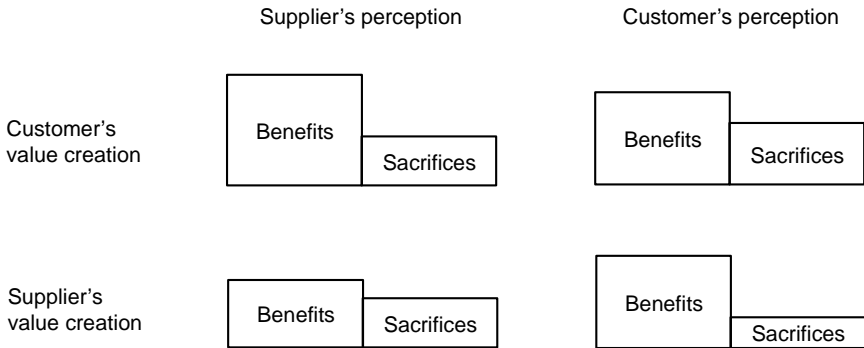


Figure 2.11: Illustration of four value perspectives in a relationship

Let us extend the ProZyme case to include customer perceptions.

CASE: Launching ProZyme (C)

The marketing analysis performed by Ingredient suggests that few bakeries are aware of the advantages and disadvantages of natural food conservation. Therefore, customers are likely to be hesitant to adopt the new product. In particular, customers may question the possibility of benefiting from a more environmentally friendly image. Likewise, potential customers may be wary of the promised low maintenance costs until they have been proven in “real production”.

A re-calculation of the value given these new insights produces the results in Box 2.3. As the calculation shows, the maximum price is still well above the minimum price. As such, customers do not have to “believe” in the new (and “unproven”) claims to make the product a success. If Ingredient Inc. offers ProZyme at \$120 per kilogram, there is an additional incentive of \$15 for the customers to buy into the concept compared to the competitor's offering ArtiZyme. This incentive is in addition to the potential for extra gains arising from reduced maintenance costs and an enhanced image. Moreover, at a price of \$120, Ingredient can double its profitability. Ingredient would also be well advised to secure extra value if its calculations regarding image benefits and maintenance costs are proven.

Value for the customer (ProZyme as perceived by customers)

<i>Benefits</i> (10 weeks at 100 kg per week)	
Reduced production cost (\$20,000 per week)	\$ 200,000
Longer shelf life (\$4,000 per week)	\$ 40,000
Greener image (\$0 per week)	\$ 0
<i>Sacrifices</i> (10 weeks)	
Purchasing price	\$?
Operating costs (\$1,000 per week)	\$ 10,000
Maintenance	\$ 5,000
<i>Value</i> (10 weeks at price zero)	\$ 225,000
<i>Maximum price</i> (equal to no value for customer)	
Value (10 weeks at price zero)/10 weeks á 100 kg	\$ 225

Comparing ProZyme with ArtiZyme

Value (ProZyme) > Value (ArtiZyme)
\$225,000 – Price (1,000 kg) > \$90,000
Price (1,000 kg) < \$135,000
Price (1 kg) < \$135

Box 2.3: Calculation for ProZyme (C)

At a price of \$120, Ingredient realizes a value of \$40, while the customer gains \$167 (\$287 - \$120) based on the value originally calculated in CASE A. However what the customer perceives is only a value of \$105 (\$225 - \$120) as we can see in CASE C.

This is typically the case; customers and suppliers rarely perceive value in the same way. Often we find significant differences. Thus, the customer's perception of value is either lower or higher than the supplier's perception of value, giving rise to four different scenarios of value-perception gaps.

With four different perspectives on value, gaps between them can, and do occur. The first two gaps are what we term *perception* gaps. A seller may perceive that the customer receives a lot of value, while the customer perceives very little value. Such a gap in value perceptions can lead to problems in the relationship. In this situation, the customer is likely to look for alternative suppliers that can provide the desired value. The supplier will probably be unaware of this search until the customer actually defects.

Conversely, the supplier may believe that the customer receives little value, while the customer feels that it is getting very good value. This can lead to a situation in which the supplier over-delivers or charges a price that is much lower than the customer would be willing to pay.

The first gap occurs between what the supplier sees as value to the customer and the customer's views of the value received. Ideally, the parties are well informed about the other side. Unfortunately, in many cases, such insight is missing. The second gap is similar, but the "guessing" regards the value created by the supplier.

The other two gaps are *fairness* gaps. As each side has perceptions of its own value creation and the other party's value creation, there is some notion of fairness of value distribution between the two parties. If the gap in these perceptions is too big (i.e., one side is perceived as appropriating much more value than the other), the relationship may suffer. The different types of value gaps are shown in Figure 2.15.

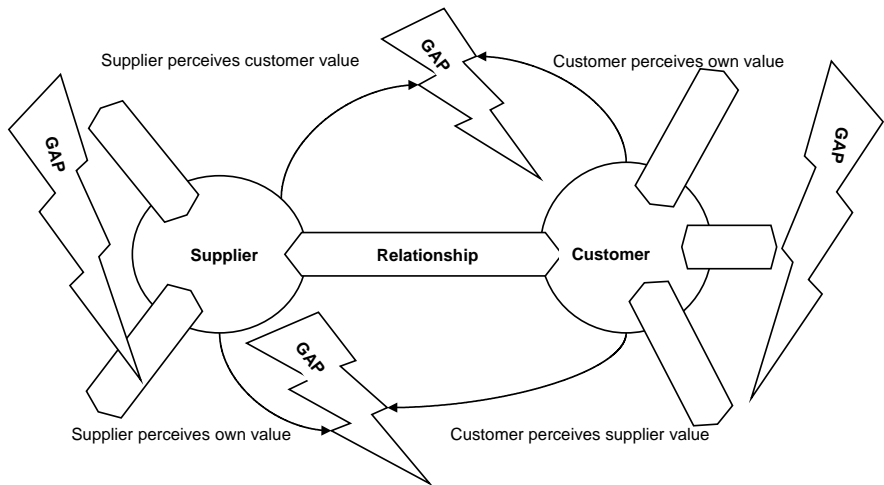


Figure 2.12: Gaps in value perceptions

Managers can gain a comprehensive – yet very actionable – understanding of relationship value using value calculations, value radar, and the value gap pointer. As value creation is the one and only reason to build customer-supplier relationships, understanding value is a key challenge for firms.

THE CHALLENGE OF RELATIONSHIP STRUCTURE

While relationship value is the fundamental driver of the development of customer relationships, value is not the only key element in a customer relationship. The relationships themselves differ in ways beyond the value they create. The structure of a relationship describes how a supplier is connected with a customer, and it captures the ways in which the two parties interact.

The structural elements of customer-supplier relationships can be divided into four dimensions: criticality, distance, interface, and climate. If we view a relationship as a bridge between two islands, relationship criticality captures the importance of the resources on the other island and the possibility for building bridges to alternative islands. Relationship distance captures, for example, how far away the two islands are, while relationship interface can be symbolized as the breadth of the bridge and the traffic on the bridge. Finally, relationship climate describes the weather conditions around the bridge. In this chapter, we describe these structural elements of customer relationships. In other words, we look at the relationship itself.

Relationship Criticality

Relationship criticality captures the necessity of maintaining a relationship from two dimensions: the extent to which the value from the relationship is critical for an actor (value criticality) and the extent to which the customer is critical for providing that value to the supplier (i.e., the supplier's dependence on the customer; partner criticality). As such, value criticality captures the dependence of a supplier on the value contribution from a customer, while partner criticality captures the supplier's dependence on a given partner. Again, the principle of mutuality applies, as a customer makes its own assessments of relationship criticality with regards to a given supplier (see also Figure 3.1).

Value criticality can be analyzed by answering the following questions:

1. How important is the value offered by this relationship for the business?

- How will not having that value contribution affect the company's operations and profitability?

Partner criticality can be analyzed and understood using the following questions:

- How difficult would it be to replace the customer (the supplier)?
- Are there other potential or existing customers (suppliers) that could contribute in similar ways and, if so, are they available?

For example, if there is only a one highly specialized supplier, replacing a supplier would be difficult, if not impossible. Similarly, if a customer who uses a highly customized solution represents a large portion of a supplier's turnover, that customer relationship is critical. For a bank, IT is highly critical – most banks would be out of business in a matter of hours and days without functioning computer systems.

Coping with relationship criticality is primarily a matter of being aware of the importance of specific value contributions and specific partner. Firms can try to decrease criticality by developing alternative sources of value. At the same time, an understanding of the partner's perception of their relationship criticality is key for understanding how criticality is balanced in the relationship.

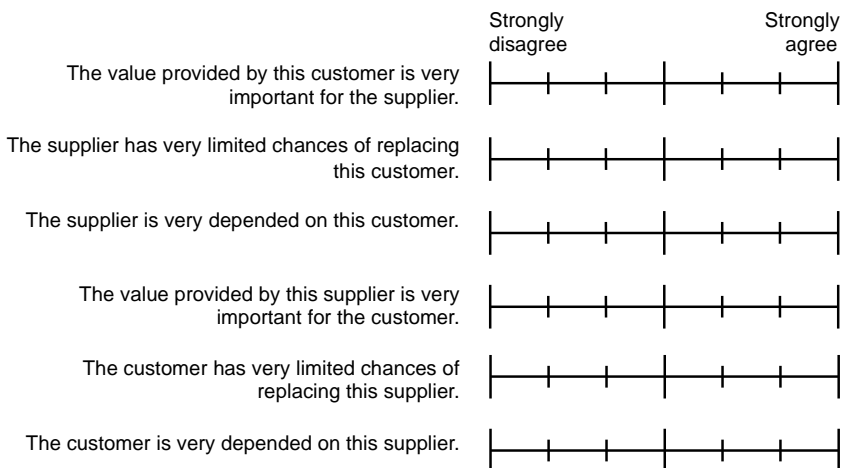


Figure 3.1: Assessing the relationship criticality

Relationship Distance

In a relationship between a supplier and a customer, “distance” describes the gap that the relationship needs to bridge. We can distinguish among four types of distance (Figure 3.2).

First, geographical distance captures the physical gap between the two firms in terms of how many kilometers separate them. Geographical distance has implications for how quickly physical goods can be exchanged and how practical it is to meet in person. For relationships that require frequent personal interactions, such as innovation projects, physical distance can be a hurdle.

Second, cultural distance challenges a relationship regardless of the geographical distance. For example, the way business is conducted in Asia differs from how it is conducted in Europe. Likewise, there are differences between engineers and accountants. Therefore, cultural distance is not limited to international relationships – it can also be found between production-oriented and market-oriented companies, between small companies and large companies, or between entrepreneurial firms and established firms. The challenge with cultural distance is that although firms are often aware of the major cultural differences, the smaller differences tend to go unnoticed, even though they have the potential to create misunderstandings and friction between the parties. And even large differences can go unnoticed with potentially disastrous consequences once their surface.

Third, firms typically employ different types of technology that are more or less compatible with the technologies used by their business partners. This creates technological distance. The greater the technological distance, the more difficult and costly collaboration tends to be. As a result, some firms want to dictate their partners' choice of technology in order to align a value chain and enable smooth interactions. Some industry players may even attempt to determine a choice for the entire industry.

Finally, firms operate at different speed in terms of their cycles for planning and renewal. This results in timing distance. In the textile industry, for example, some companies develop 12 different clothing collections each year. In contrast, cotton farmers (who grow cotton for the textile industry) usually harvest only once each year. Just like the wheels rotating at different speeds need a gearbox to get synchronized, timing differences must be synchronized if companies are to cooperate

successfully. Typically, timing differences can be overcome through, for example, the introduction of buffers or a reliance on warehouses. Moreover, both parties can work to foster a mutual understanding of the timing differences.

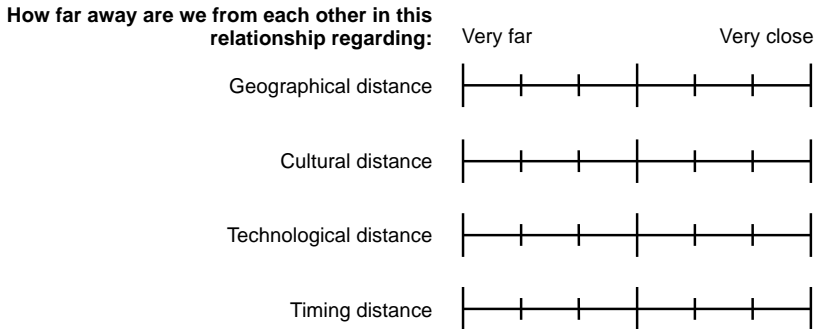


Figure 3.2: Analyzing the relationship distance

Relationship Interface

The relationship interface captures people involved in the relationship and their interactions. As such, it describes how the relationship is anchored in the two organizations. A key issue is the number of people involved in the relationship on both sides as well as their roles in terms of organizational position and influence. People may be promoters who actively support the relationship or they may be opponents who, for some reason, obstruct the relationship. Opponents are often difficult to identify from the outside because they keep their opposition hidden. A mapping of the relationship interface (Figure 3.3) offers interesting insights into the strength of the relationship and its vulnerability to certain individuals. For instance, when financial advisors move to new employers, a significant proportion of clients move with them. Likewise, new purchasing contacts may challenge an established supply relationship.

Business relationships almost always involve more than one person on each side. The involvement of numerous and different people on both sides adds to the complexity and makes managing relationships a challenge. Different people are bound to have different backgrounds as well as views that are based on their social and cultural backgrounds or

on the roles they play in the relationship. From the supplier's perspective, there might be different "customers" within a single customer's organization, each of whom might have a different agenda. The purchaser is typically concerned with the formal contract and price, the users will be interested in how the solution affects their work, and the CEO might be concerned with more strategic questions, such as how the solution can support the firm in its pursuit of future opportunities.

Other aspects of the relationship interface include the mode of interaction and interaction frequency. For example, do those involved meet face to face or do they speak on the telephone? To what extent do the parties use e-mail, online chats, or other digital channels? The different aspects of relationship structure can be assessed as illustrated in Figure 3.3.

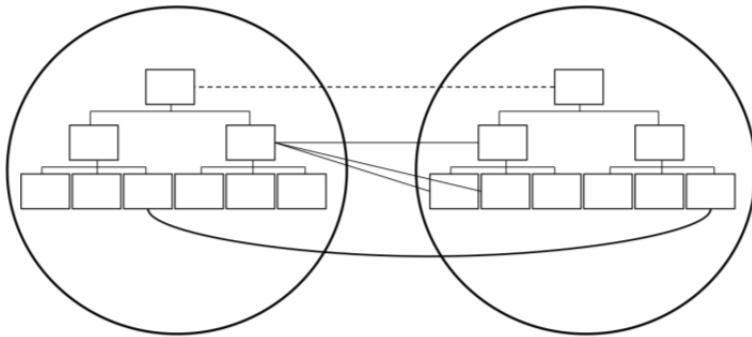


Figure 3.3: Analyzing the relationship interface

Relationship Climate

Relationship climate, which is sometimes referred to as chemistry or atmosphere, captures the collaborative attitude (or lack thereof) in a relationship. Key aspects associated with this dimension include willingness to collaborate, attitudes regarding competition, the level of ambiguity, the prevalence of conflict, and the existence of uncertainty (Figure 3.4).

As in team sports, competition and collaboration can exist at the same time – they are not mutually exclusive or found at opposite ends of a continuum. Players compete for fame and glory with each other, but they

can simultaneously agree to cooperate as a team. Clearly, the competitive aspect must be balanced with the cooperative, or the team cannot function effectively. However, too much cooperation without competition will probably lead to suboptimal results, as no one is striving to improve performance.

Finally, most relationships contain a certain degree of conflict. There will be areas of disagreement and contention. Nevertheless, some level of conflict can serve to energize a relationship and provide inspiration for new solutions. One way to cope with conflict is to use ambiguity and uncertainty. By being deliberately vague, the parties can maintain some room for maneuvering and negotiation, rather than making the conflict highly visible and, thereby, potentially creating an insurmountable problem. Again, it is important to find the right balance rather than to minimize or maximize ambiguity and uncertainty. Figure 3.5 illustrates the dimensions of relationship climate.

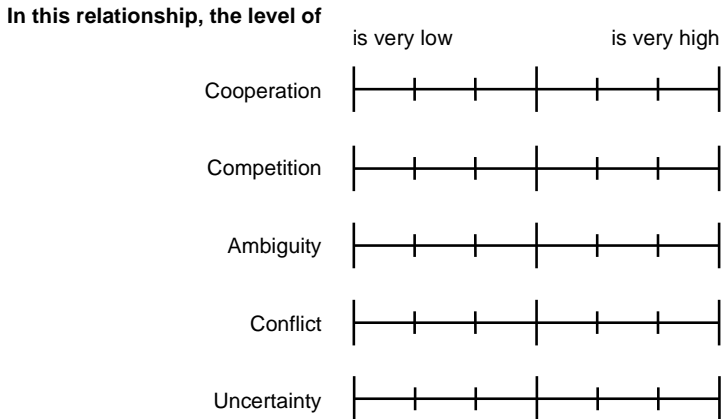


Figure 3.4: Analyzing the relationship climate

Challenging Relationship Structure

Managerial attention and action are necessary if a firm is to cope with these different dimensions of relationship structure because they may entail huge costs and because the necessary decisions may be strategic in nature. Much of the popular literature on business relationships

suggests that suppliers must “get close to their customers”. However, companies must realize that such efforts require resources and they are associated with diminishing returns on the investments. Therefore, relationship structures need to be adapted to the value-creation potential of the relationship and to the external forces surrounding the relationship, such as legislation requiring certain forms of interaction (e.g., bidding processes) or powerful actors’ demands (e.g., third parties forbidding or enforcing a relationship).

In terms of climate, there are no indications that “staying friends at all costs” always works for a customer-supplier relationship. In fact, relationships characterized by conflict and competition often perform better than more collaborative relationships. Moreover, there are differences across industries as to the acceptable levels of conflict and competition, i.e. what is accepted in one industry may be totally unacceptable in another.

Business relationships also typically vary over time in terms of the number of people involved and the frequency of interactions. The introduction of new products or solutions may require the involvement of more people. However, the inclusion of more people and an increase in the number of interactions require more resources and add to the complexity of the relationship.

Criticality is an important dimension from a managerial perspective for a number of reasons. First, it is often not explicitly considered – companies tend to believe that they will remain in a relationship forever, and they are surprised if a relationship is terminated. Second, an understanding of the relationship’s criticality from the perspective of the partner offers a holistic understanding of the power/dependence balance in the relationship.

Relationship structure offers a wide playing field for managerial action. Significant advances can be made but also significant and costly mistakes. The challenge is to balance one’s own view and the other’s view, as well as the link between relationship structure and relationship value.

Figure 3.5 summarizes our discussion on relationship structure. The figure can be used for analyzing “as-is” and desired “to-be”. It can also include the supplier’s and the customer’s perception of the relationship.

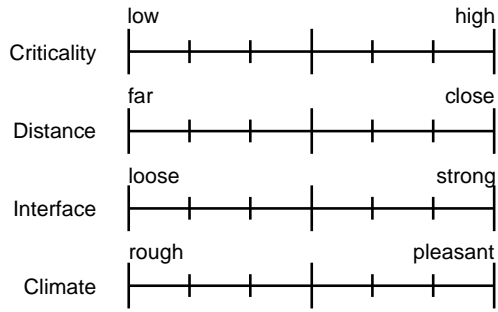


Figure 3.5: Analyzing the relationship structure

THE CHALLENGE OF RELATIONSHIP QUALITY

The previous two chapters captured the value created in the relationship (Chapter 2) and the structure of the relationship (Chapter 3). Even though there may be different perspectives on the various elements of relationship value and structure, any analysis of these elements merely provides a snapshot of today's situation rather than a satisfaction measure or some qualitative judgment that typically involves a longer time perspective. The quality of a relationship is this final outcome in the assessment of a relationship's state. "Relationship quality" captures a qualitative assessment of the relationship that focuses on satisfaction, trust, and commitment.

Satisfaction

Based on their assessments of relationship value and relationship structure, suppliers and customers have a certain level of satisfaction with the relationship. In other words, the supplier and the customer both know how satisfied they are with the value created and with the way the relationship is functioning (Figure 4.1). Regardless of whether this satisfaction is formally or informally discussed in the firm, and regardless of whether a customer has explicitly made up his or her mind about the quality of a supplier, everyone has some standards of evaluation.

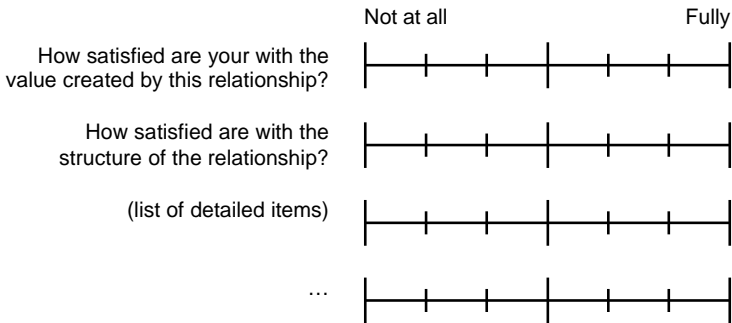


Figure 4.1: Assessing satisfaction

Both partners in a customer-supplier relationship are interested in knowing the other's level of satisfaction as accurate as possible – and most firms explicitly ask for feedback. It is hard to buy or sell something these days without being asked “How satisfied are you with this supplier?” after the transaction. Customer satisfaction has become a key organizational objective, with many firms reporting customer satisfaction scores on their websites and in their annual reports. Similarly, supplier satisfaction surveys are very popular. But despite the increasing formalization and professionalization through consultancy companies of satisfaction measures, everyone has their own satisfaction level – and most people have at least an idea about the satisfaction perceived by their counterparts.

Trust

Trust is often viewed as an important element for explaining long-term business relationships. Trust is defined as a business partner's belief in the other firm's willingness to act in the best interest of the relationship. Trust is based on perceived capabilities (i.e., trust in the partner's ability to perform to expectations), honesty (i.e., trust in the partner being open and reliable), and goodwill (trust in the other's willingness to perform and general attitude towards the relationship) (Figure 4.2).

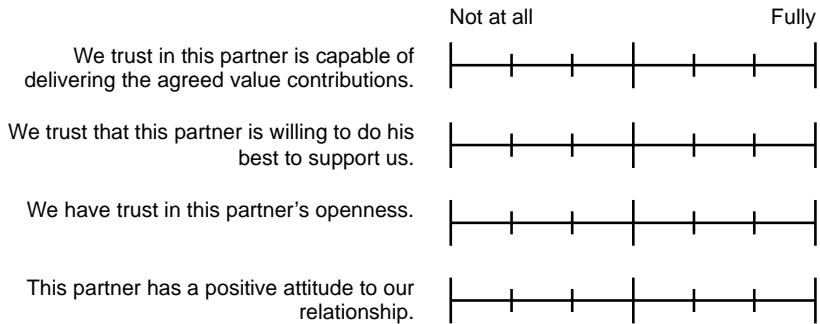


Figure 4.2: Assessing trust

It is often difficult to assess whether or not the customer trusts a supplier and vice versa. A small trick here is to look for distrust instead of trust. Distrust is typically much more apparent and detectable than trust: If e.g. the customer asks for extra guarantees or if the supplier asks for prepayment trust is limited. In fact, such behavior exposes an element of distrust: can the supplier deliver; can the supplier pay?

Commitment and Loyalty

One can find a multitude of suggested measures and interpretations of commitment and loyalty. In a nutshell, commitment and loyalty capture the desire of a supplier or a customer to continue a relationship, even if that continuation entails short-term sacrifices. In other words, commitment and loyalty indicate that despite a firm's need to make short-term sacrifices to enjoy long-term benefits, the firm prefers long-term development. As such, the expected advantages of the long-term relationship are viewed to justify the short-term sacrifices. The difference between commitment and loyalty merely rests in the fact that they originate from different fields. Commitment has been mainly used in business-to-business settings, while loyalty is preferred in business-to-consumer studies. However, the underlying logic of a preference for a long-term relationship is the same. Figure 4.3 illustrates a commitment measure that captures a supplier's perspective on the customer's commitment.

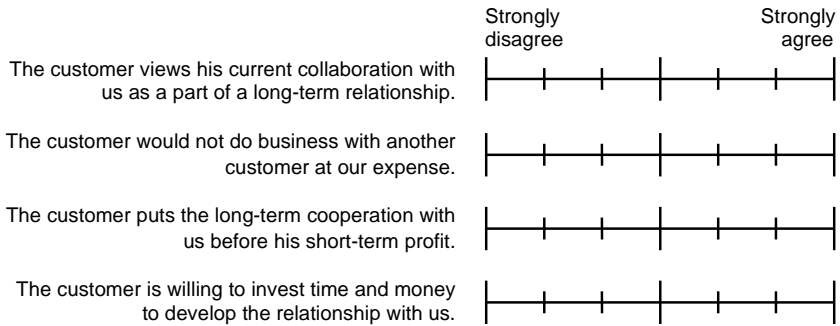


Figure 4.3: Assessing commitment and loyalty

When assessing commitment and loyalty it is important to keep in mind the difference between satisfaction and loyalty. The general assumption that satisfied customer are also loyal and committed customer may not be true. Customers are often satisfied (when asked) with the current supplier's offerings etc. and, thus, they are supposed to be loyal as well. However if they get a more favorable offer from a competing supplier satisfied customers may change instantly; thus having no real loyalty or commitment.

Challenging Relationship Quality

While relationship value and relationship structure offer a picture of the relationship in terms of substantive elements, the assessment of relationship quality is an evaluation of how the perceptions of those measures live up to the partners' expectations of the relationship in terms of satisfaction, trust, and commitment (Figure 4.4).

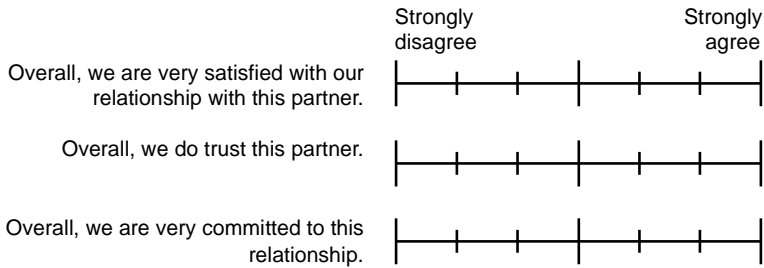


Figure 4.4: Assessing relationship quality

It is worth noting that the evaluation of relationship quality is based on two very different perspectives or references: one is what a supplier and a customer have come to expect from this relationship. The other is what the firm thinks its best alternative is. If a firm gets what it expect managers tend to be satisfied and dissatisfied if not. But if perceived quality is regarded to be less than with the best alternative managers will start evaluating these alternatives.

Challenging the Relationship State

In Part I of this book, we outlined the elements of a relationship's state: relationship value (Chapter 2), relationship structure (Chapter 3), and relationship quality (Chapter 4). By combining these three parts, we can now create the business relationship dashboard that is illustrated in Figure 4.5. The relationship dashboard offers a 360-degree overview of the relationship at a given point in time.

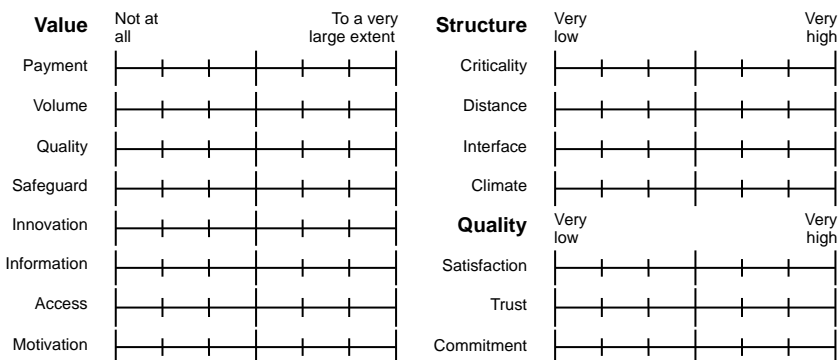


Figure 5.1: The relationship dashboard

Based on this assessment, executives can develop their vision of the desired state – a picture of where they want the relationship to be in the future. This vision is typically based on such questions as:

- Do we want to sell or buy more (volume), or have a different price point (payment)?
- Do we want to increase or decrease the innovation output?
- Do we want to get closer by establishing facilities nearby or even co-locating with our partner (geographical distance), or by hiring employees with backgrounds similar to those of our partner’s employees (cultural distance)?
- Do we want to involve more or less people (interface)?
- Do we want to develop a less personal climate by introducing new contacts through job rotations?

On the basis of information about the current state of a relationship, the dashboard is useful in developing a definition of the desired state and thus a clear goal. The comparison between the current and desired states then leads to identifying gaps and the development of a relationship strategy.

PART II

RELATIONSHIP MANAGEMENT

THE CHALLENGE OF RELATIONSHIP STRATEGY

After analyzing the state of a relationship in terms of value (Chapter 2), structure (Chapter 3), and quality (Chapter 4), a supplier needs to focus on the desired future state of the relationship. In this regard, the supplier may wish to ask: What do we want to do with this relationship? How do we want the relationship to develop? What objectives are realistic?

One of six strategies will be chosen depending on the current state of the relationship and the view for the future (Table 5.1 and Figure 5.1): acquisition, blockage, maintenance, development, reduction, or termination.

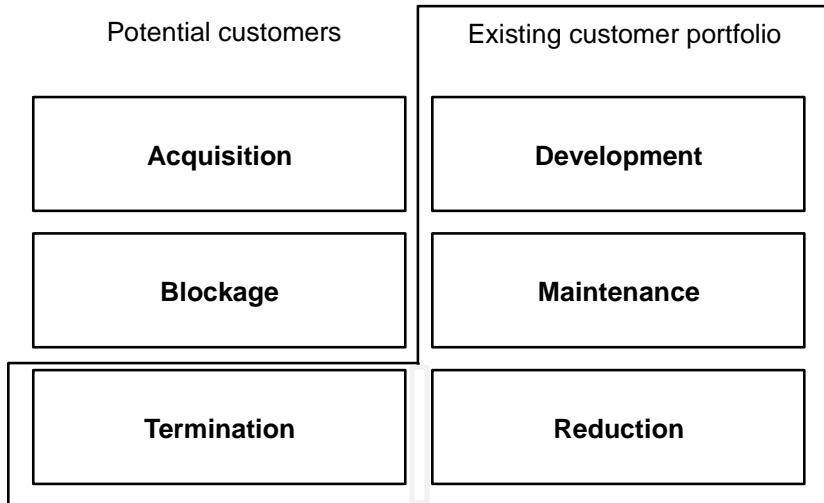


Figure 5.1: Six relationship strategies

Current status	Future status	Strategy	Relevant context
Potential customer, not currently active in our customer base	Potential customer should become a customer	Acquisition	A situation in which a firm wants to initiate business transactions with a potential customer.
	Customer is not active and should remain a non-customer	Blockage	A situation in which a firm wants to avoid entering into business transactions with a potential customer.
Customer active in our customer base	Relationship should be maintained	Maintenance	A situation in which a firm wants to continue a given customer relationship (i.e., no changes to value, structure and quality intended).
	Relationship should be enhanced	Development	A situation in which a firm wants to change a customer relationship in a way that either makes the relationship stronger and/or enhances the value created.
	Relationship should decrease	Reduction	A situation in which a firm wants to change a given relationship in a way that makes the relationship weaker and/or lessens the value created.
	Relationship should end	Termination	A situation in which a firm wants to actively end business transactions with a given customer.

Table 5.1: Current and future state of relationship strategies

While this set of strategies reflects the proactive, forward-looking perspective that many executives prefer (we choose a strategy), the six strategies can also be used to classify developments ex-post. In other words, they can be used to answer such questions as: What has happened? What kind of strategy was implemented? Again, the principle of mutuality applies: both the supplier and the customer choose a strategy. The strategy's realization depends on the joint negotiated outcome.

There are six options for each and every relationship a supplier can choose from. Yet, the choice is not optional. In fact, a supplier has to make a choice; suppliers have to have an idea of the desired future state of any given relationship and about the corresponding strategy. Not having a strategy makes managing customer-supplier relationships dysfunctional – in particular when a group of people is involved in the relationship. While much of the popular literature focuses on developing relationships (i.e., on doing more with one customer), our experience suggests that the other five relationship strategies have similar potential to contribute positively to a business. In fact, most of a business' relationships are often found to have a maintenance strategy.

In order to determine the strategy that is most suitable for a relationship, two sets of questions are helpful. First, is the relationship profitable? In other words, does the relationship contribute to value creation? In this regard, it is important to recall the value radar presented in Chapter 2, which details the eight ways a customer can contribute to a supplier's profitability and the eight contributions a supplier can make to a customer. Similarly, firms should question the strategic fit of a customer. Should the firm deal with this customer? Should the customer belong to the "non-customer" group? For customers offering no profitability or lacking strategic fit, the strategic options are blockage (for non-active potential customers) and termination (for existing customers).

Second, is the customer buying all possible items? Is there additional sales potential? Given profits and fit, customers with no additional sales potential qualify for maintenance, while customers with additional potential should be developed.

Although the firm should have a strategy for each customer relationship, Figure 5.1 can be used to gain an overview of the entire customer portfolio and the implied business implications of the chosen relationship strategies.

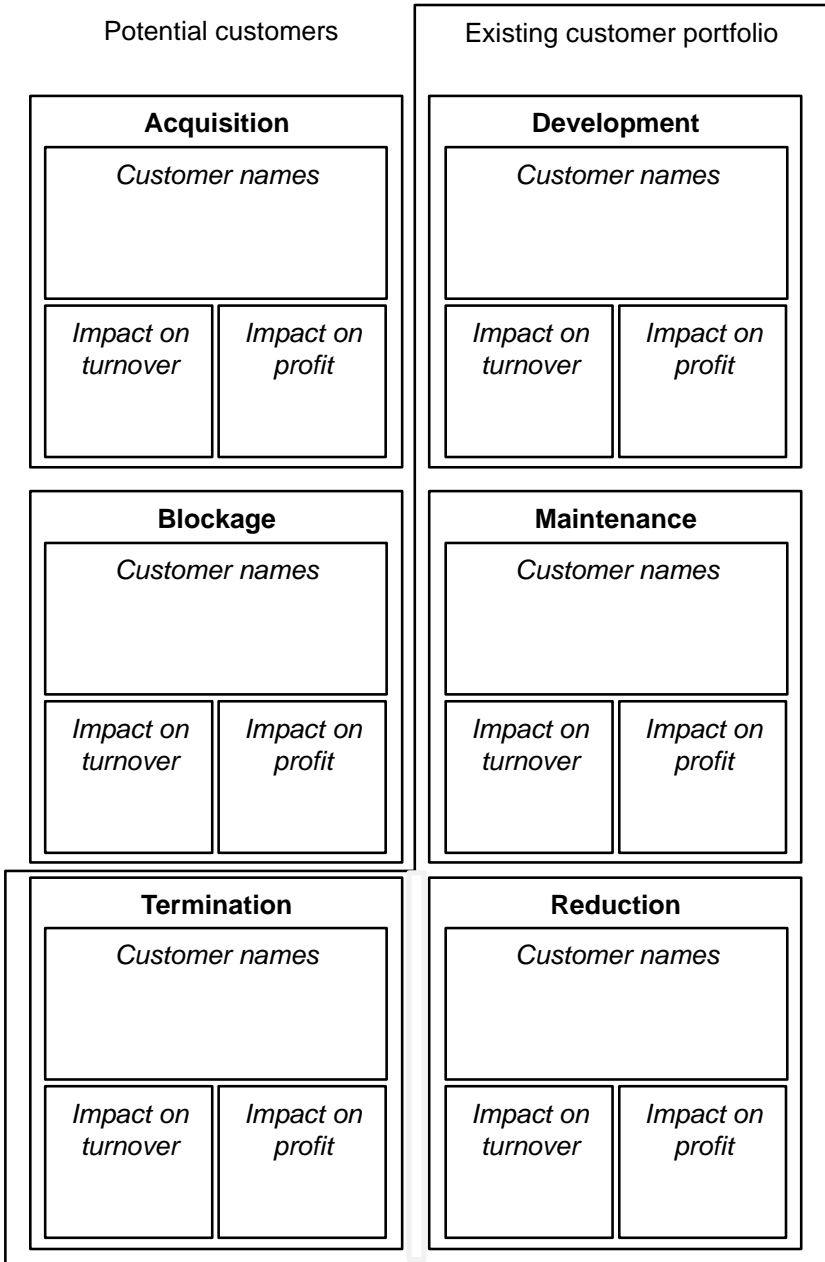


Figure 5.2: Distribution of relationships across the six strategies

A typical result of the above exercise is that the majority of customers are found in the maintenance box. This suggests that the firm has developed its customer relationships to a satisfactory level, and that its limited resources demand selectivity in determining which customers to develop. Moreover, termination tends to hold only a few relationships – firms may continually clean up their customer base or they may believe in the potential to change bad relationships to good. In addition, it is typically more difficult for companies to accept the fact that some customer relationships should be reduced rather than maintained or developed.

When asked directly about bad customers, most managers typically deny having any or they only admit to having a few. However, when managers are asked the same question anonymously, more than 80% admit to having customers that do not provide any form of value. The legitimacy and relevance of reduction and termination are, therefore, very important. Not all companies should be engaged in relationships with each other, and management must recognize that situations change over time. A once-profitable relationship may become unattractive over time for various reasons.

The acquisition of new customers is an important task for most companies. However, many companies forget the other side of that coin, especially in times of crisis. Which customers do we not want to acquire? Without a well-functioning filtering or blockage strategy, there is a risk of wasting resources on attracting unprofitable customers.

Overall, the six strategies are all legitimate options, and all firms will be able to find candidates for each strategy. In order to optimize a customer portfolio, a firm needs to use all six strategies. Otherwise, the firm will not be able to reach the optimum. The exact same logic applies to customers optimizing their supplier relationships. Interestingly, it is more legitimate to reduce and terminate a supplier relationship in business than it is to apply the same strategies to customers.

CHAPTER 6

THE CHALLENGE OF RELATIONSHIP PROCESSES

Relationship management is a topic that has attracted much attention from scholars and practitioners alike. Although there is some attention to the command and control thinking often associated with managing and strategizing; relationship processes are more about coping with relationships. For this understanding of relationship management it is useful to focus on how the firm implements its relationship strategies and how the firm is interacting with customers.

The Implementation Processes

After a firm has decided on a strategy for a given relationship, implementing the necessary relationship management processes begins. Relationship processes can be divided into six implementation processes corresponding to the six relationship strategies.

- **Acquiring:** This process aims to transform a non-customer into an active customer, i.e., to establish new customer relationships.
- **Maintaining:** This process aims to continue an existing relationship without major changes, i.e., to keep the relationship in its current state.
- **Developing:** This process aims to change a customer relationship in a way that strengthens the relationship and/or enhances the value created in the relationship.
- **Reducing:** This process aims to change a given relationship in a way that weakens the relationship and/or lessens the created value, i.e., to scale down certain elements of the current relationship.
- **Terminating:** This process aims to actively end business involvement with a given customer.

- **Blocking:** This process aims to avoid the initiation of business involvement with a given customer and/or to hinder a potential customer from becoming a customer.

Accordingly, different performance indicators must be used to monitor the success of the implementation process (Table 6.1). A key challenge for implementation success is the fact that it is dependent on the customer's reaction to the adopted approach. For example, a relationship-termination process may not result in a termination if the customer does not agree to the suggested termination and renegotiates the relationship into continuation. In such cases, the firm must adopt and implement a new strategy (e.g., reducing instead of terminating).

Implementation process	Measure / performance indicator
Acquiring	Number of new customers
Maintaining	Customer satisfaction
Developing	Increase in turnover and profit
Reducing	Meeting of optimization targets
Terminating	End of business transactions
Blocking	No business transaction

Table 6.1: Overview of key performance indicators for strategy-implementation processes

Most firms, if not all, have customers in each relationship-strategy category (see Chapter 5). Therefore, all firms need to have all six processes in place and they must develop their abilities to execute all six implementation processes. Only a full set of capabilities will enable a firm to optimize its customer portfolio. Nevertheless, our studies show that firms are generally much better qualified to execute the acquiring, maintaining, and developing processes, which one might refer to as the “positive” processes. On the opposite side, we find that reducing, terminating, and blocking score lower in capability studies. This is not surprising given – firms are typically focused on positive developments, as there are benefits and awards for obtaining new customers, keeping

existing customers, and enhancing the value of current accounts. However, the negative processes have equal optimization power and they must be rewarded to the same extent as the positive processes. For example, a firm might implement a reward for dropping an unprofitable customer or for hindering a troublesome customer from contracting with the firm.

In order to analyze a firm's relationship-management capabilities, one can search for answers to the following questions (see Figure 6.1):

- How well do our implementation processes function compared to our competitors?
- What is the best practice for this implementation process and how can we adopt it?
- Which employees and units in our firm are best able to handle a given process? How can we disseminate their practices throughout the organization?

The Interaction Processes

If we adopt a different lens, we can see that customer relationships are best understood as ongoing, interlinked, action-reaction patterns in which each interaction forms an episode of the business relationship that drives change in a relationship. We have therefore developed a list of generic interaction activities that are applicable to all six implementation processes.

Convincing

The overall aim of convincing is to reach an agreement between the customer and the supplier. It involves negotiation between the parties in which each side tries to achieve the other's acceptance of their wishes and ideas. The search for contact with potential customers is often driven by convincing processes. However, convincing is also a central element in ongoing business relationships. It might include attempts to extend the time-frame of the initial contract, or activities related to increasing sales (i.e., selling higher volumes and, thereby, increasing the firm's share of the customer's wallet), up-selling (i.e., selling higher-end offerings), or cross-selling (i.e., selling other offerings from the supplier's portfolio). Firms negotiate with and convince each other on a continual basis as the relationship changes and develops over time. Even termination of an

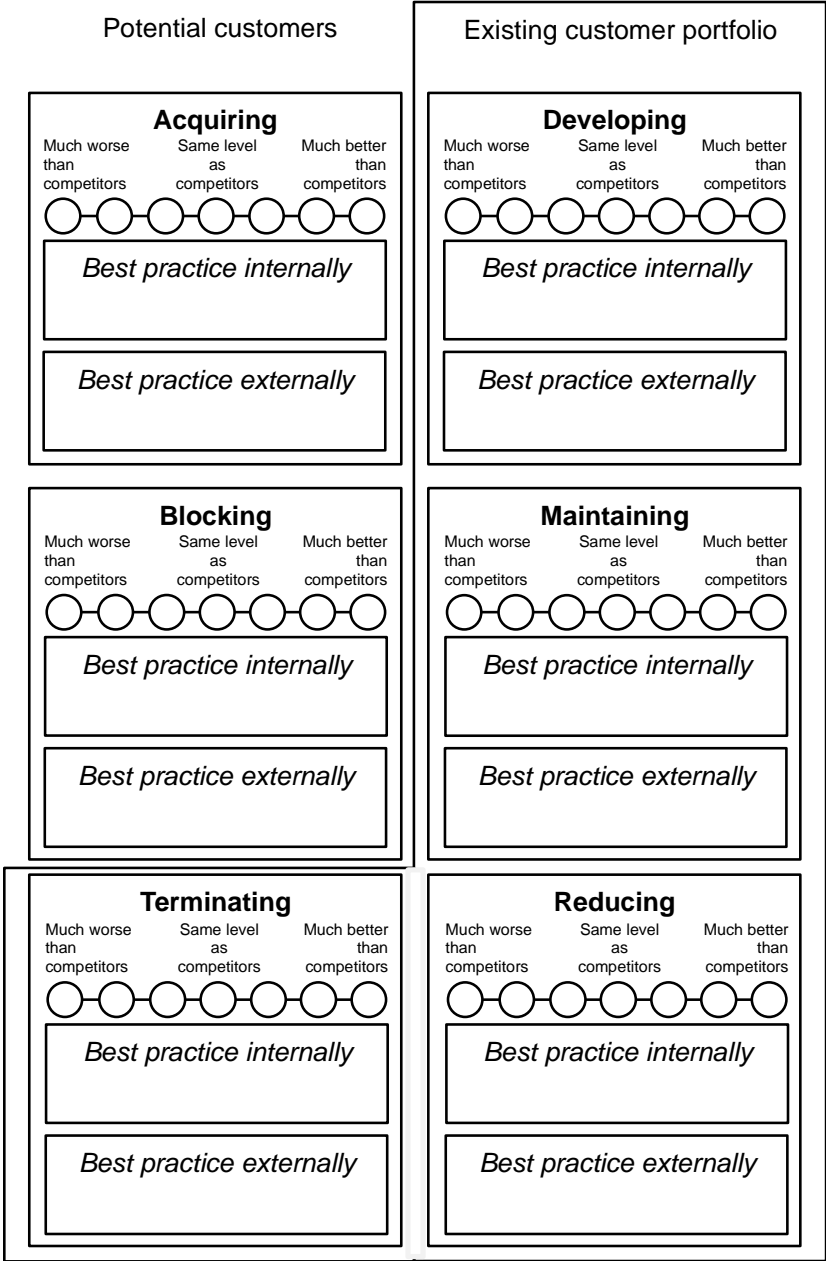


Figure 6.1: Analyzing the implementation processes

existing business relationship typically entails convincing (e.g., “you should accept the termination of our relationship”). As such, the convincing process cuts across all strategy-implementation processes.

Socializing

Some practitioners and academics suggest that the selling process has shifted from traditional transactional selling towards a more relational approach, as firms have adopted a more long-term perspective on their customer-supplier relationships. Unfortunately, this has also broadened the concept of selling, such that it is sometimes viewed as including almost everything needed to develop and maintain a customer-supplier relationship. While we agree that the roles of the sales department and the individual sales people have changed, we wish to explicitly distinguish the process of convincing from the process of socializing.

Socializing may occur not only in the normal business setting but also during events (e.g., football and golf arrangements) aimed at decreasing social and cultural distance. It can also occur through the establishment of “in-customer offices”, which serve to decrease geographical distance, and through increases in the number of people directly involved in the relationship, which helps develop the interface between the firms.

Of course, convincing can occur at social events and socializing can take place at business meetings. Business-to-business relationships are inherently social in that they are manifested in people. Firms do not relate to firms. Rather, the people representing firms relate to other people representing other firms.

Changes in relationship structure are inherent in most strategy-implementation processes. For example, developing (reducing) relationships may entail holding more (fewer) meetings, involving more (less) people, or increasing (decreasing) the importance of a relationship. As such, socializing also cuts across strategy-implementation processes.

Delivering

While the convincing and socializing processes allow for the development of a mutually agreed understanding of exchange and a platform for that exchange, suppliers and customers need to establish processes that will enable them to fulfill their value propositions. Most business relationships are valuable because they entail the exchange of goods and services, although business relationships may provide value in other ways (see Chapter 2).

Normally, delivering is not part of the marketing domain in firms, as it is typically handled by the operations and production departments. As such, delivering is an essential process in a business relationship that is not controlled by a sales or marketing department. This creates some fundamental challenges for the organization of commercial activities in firms.

Linking

Given the rising importance of open business models, suppliers often use third-party providers as complementors in order to fulfill a value proposition. These third-party providers might include direct sub-suppliers, installation firms, or sources of financing. These firms typically have direct contact with the customer, and the establishment of these contacts can be an important deliverable in a relationship. As such, the main supplier needs to link additional suppliers to their customers in order to enable these suppliers' delivery processes. In some situations, the supplier takes on the role of orchestrating a wider network of supply firms. Alternatively, suppliers can link their customers to other actors, such as other customers, potential customers for the customer (customer's customers), or technology partners. In order to enable direct third-party delivery, firms need to engage in linking processes.

Linking processes are relevant across all relationship strategies. Moreover, linking processes also include "delinking". This is key when, for example, terminating a customer relationship, as all third-party relationships will be affected.

Learning

As firms interact with each other throughout a customer-supplier relationship, they learn about each other. Business partners share information about successful and unsuccessful experiences with products, changes in needs, changes in market structures, new technologies, unexpected problems, and changes in the strategies and policies of the respective firms. Joint sense making takes place when business partners assign joint teams to solve operational problems or to analyze strategic issues.

Firms continuously adjust their relationship-specific memory (information) about end-user needs, preferences, and behaviors, as well as their understanding of technologies and their order-delivery routines. Formal contracts are evaluated and updated when needed, personal networks are refreshed through face-to-face meetings, and relationship information stored in electronic databases is updated.

Monitoring

Beyond the more explorative learning, firms engage in monitoring activities in order to control their deliveries and to document the potential to deliver value. Such activities may include meetings with customers and suppliers to follow up on service-level agreements (SLA), key performance indicators (KPI), and the costs of supplying the customer.

In order to analyze a firm's relationship management capability from an interaction perspective, firms can answer the following questions (see Figure 6.2):

- How well is our interaction process compared to our competitor?
- What is the best practice for this interaction process in our industry and beyond?
- How can we implement it?
- Which employee and which unit in our firm is the best in a given process?
- How can we disseminate this practice throughout the organization?

Challenging Relationship Processes

As pointed out above, there are two sets of processes interweaving with each other as illustrated in Figure 6.3. Each intersection describes a micro process that contains the blue print for how the interaction process is (to be) applied in support of the implementation process; therewith supporting the chosen relationship strategy. For example: a strategic decision to develop a given relationship may be executed by different interaction processes such as persuading the customer to buy additional products (convincing) by including a third party complementor (linking) and shipping these products to the customer (delivering) while constantly ensuring the agreed quality levels (monitoring). The matrix offers a framework for detailed planning and analyzing of relationship processes. Change and stability in customer-supplier relationships are not just happening, they need to be managed. Looking at the specific interaction processes and the implementation process provides a deeper understanding of what relationship management means in a specific relationship and what a business can do to advance its relationship practice.

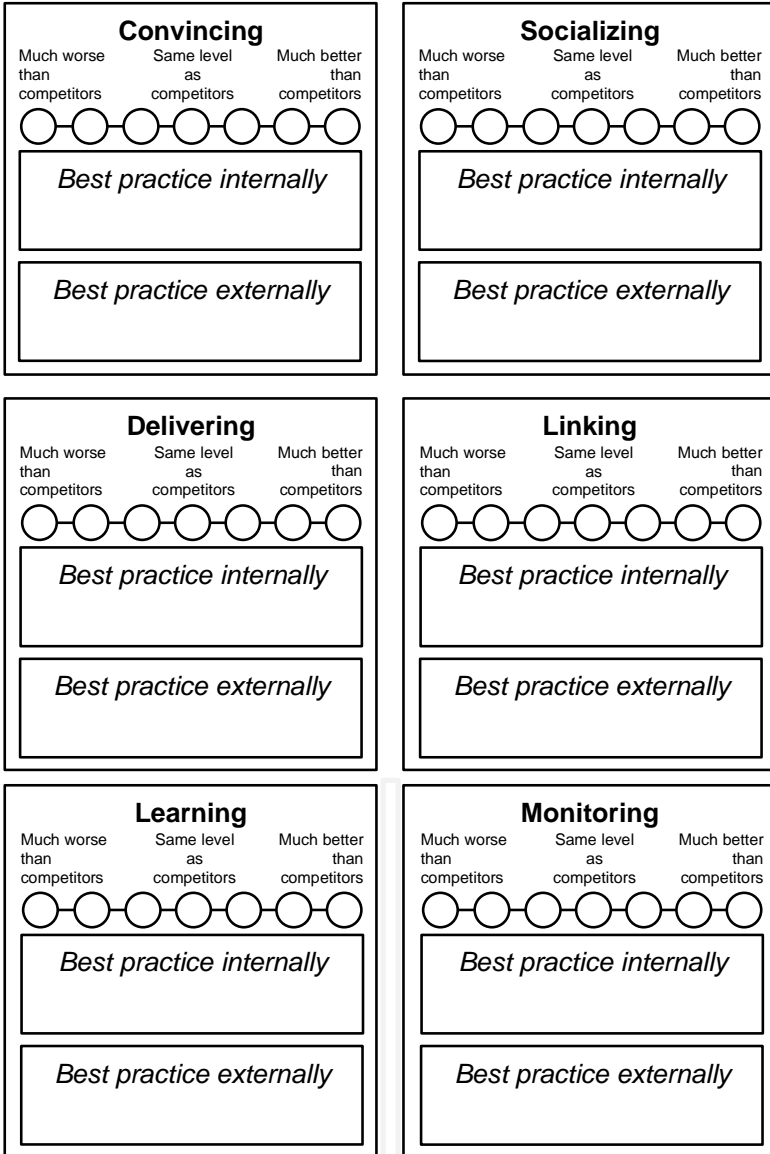


Figure 6.2: Analyzing the implementation processes

	Convincing	Socializing	Delivering	Linking	Learning	Monitoring
Acquiring						
Blocking						
Developing						
Maintaining						
Reducing						
Terminating						

Figure 6.3: The relationship processes matrix

One advantage of the process perspective is the possibility to analyze and to plan timing and interplay of different processes. For example, the timing of convincing versus socializing can be quite different in different cultures. Where in Western countries business relationships often start with business transactions and later include socializing processes, the reverse timing is associated with Asian and Latin American countries: a personal relationship has to be established (i.e. socializing) before the convincing process can start. Figure 6.4 illustrates the change of intensity of interaction processes and therewith also shows the gradual change of

resource allocation to the different processes over time. The process challenge is to be able to perform all processes and to find the right mix of processes and the right timing.

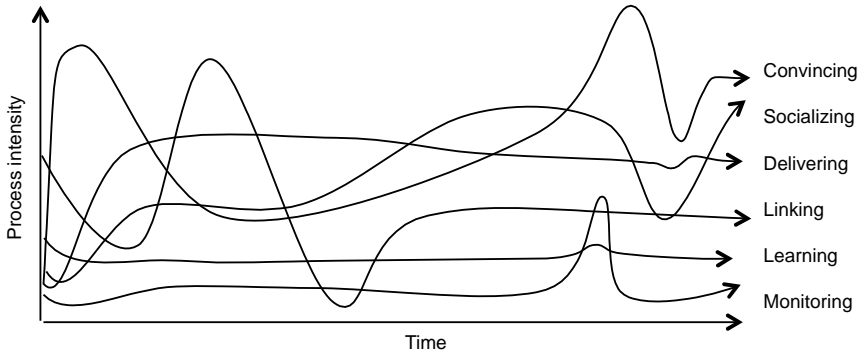


Figure 6.4: Process intensity over time

The process perspective allows a detailed insight into how a customer-supplier relationship develops over time. Because the processes all need resources, managing a relationship is a matter of ensuring availability of the correct resources at the right time in the right amount for the given process taking other relationships' requirements and potential outputs into consideration and at the same time monitor the results obtained by these processes in order to make adjustments where and if necessary.

PART III

FACING THE CHALLENGES

INPUTS FOR MEETING THE CUSTOMER CHALLENGE

The customer challenge does not resolve itself on its own. Facing it successfully requires a number of important inputs in terms of the firm's resources and capabilities. The major success factors in addressing the customer challenge are: access to human resources, access to financial resources, efficient internal communication, and openness of culture.

Human Resources

The analysis of the state of the customer-supplier relationship, decisions on relationship strategy, and the relationship-management processes require human resources. Therefore, to ensure that the jobs get done, firms must allocate human resources to these tasks via explicit job descriptions, explicit encouragement, and control. Still too often, relationship management responsibilities are not explicitly outlined, in particular for those employees not working in sales and marketing departments. Equally important is the fact that the right kinds of employees must be found for the relevant positions. Again, this becomes an important issue for non-sales employees who are facing customers. For example, a head of production may show visitors the production facilities of a firm on a regular basis. For such position, it is helpful to mention this task in the job description and to find a suitable candidate for the job also assessing the customer-facing abilities. Moreover, employees must be regularly trained to ensure that they maintain state-of-the-art qualifications.

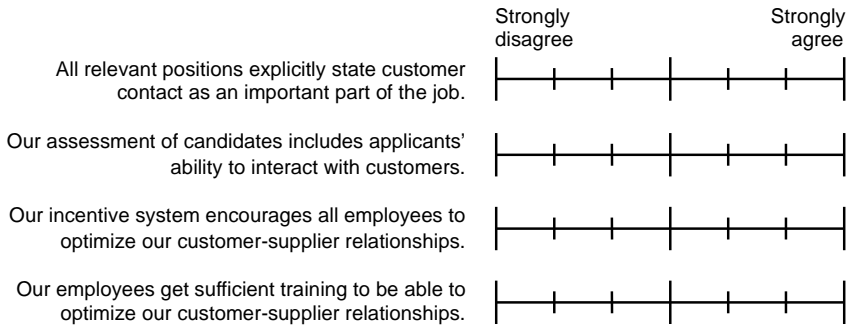


Figure 7.1: Analyzing human resources

Financial Resources

Customer relationships require investments in, for example, travel, sample and brochure production, representation, meeting facilities, factory visits, customer databases, and smart phones and tablets. A lack of access to such resources hinders the optimization of customer relationships, as necessary visits are not made, meetings are held under suboptimal circumstances, and trust-building activities are missing. In addition to discussing what businesses want from their relationships (see Chapter 2), firms need to assess the available resources (Figure 7.2) and develop explicit investment plans.

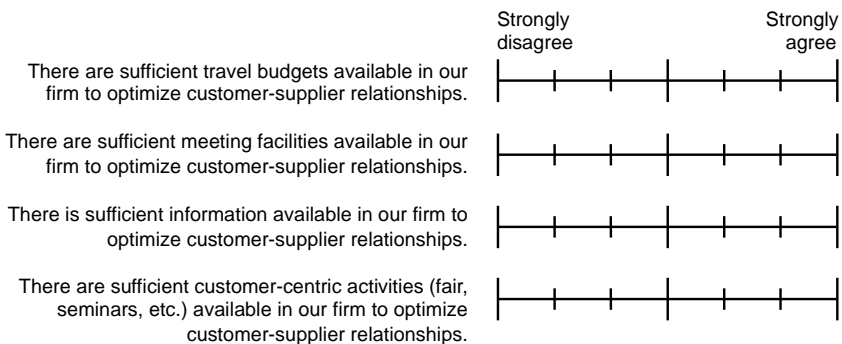


Figure 7.2: Analyzing financial resources

Internal Communication

In order to optimize customer-supplier relationships, a supplier needs to “get its act together”. The different elements of a relationship, such as convincing and delivering, depend on different people from different departments in the supplier organization. Moreover, suppliers and complementors need to be coordinated in order to satisfy a given customer, which adds to the complexity. Therefore, there is a strong need for wide-reaching and efficient internal communication.

This can be achieved in two ways. First, communication channels can be formalized. In other words, the organization can develop rules about who should communicate with whom, what is to be communicated, and how the communication should take place. Typical formats include regular meetings, automated message systems, and contact flow charts.

Second, organizations develop informal communication patterns based on who knows who and who happens to meet whom. While the formal communication systems can handle “business as usual”, the informal communication system helps developing specific solutions outside normal procedures. Informal communication is a very powerful tool for achieving flexibility and responsiveness. The managerial challenge is that these informal communications are often not known, hard to manage because they occur randomly, and easy to destroy. Firms can support the development of informal communication by holding cross-departmental events (e.g., training seminars and celebrations), by offering meeting opportunities (e.g., centrally located coffee machines and water coolers), and by allowing for job rotations.

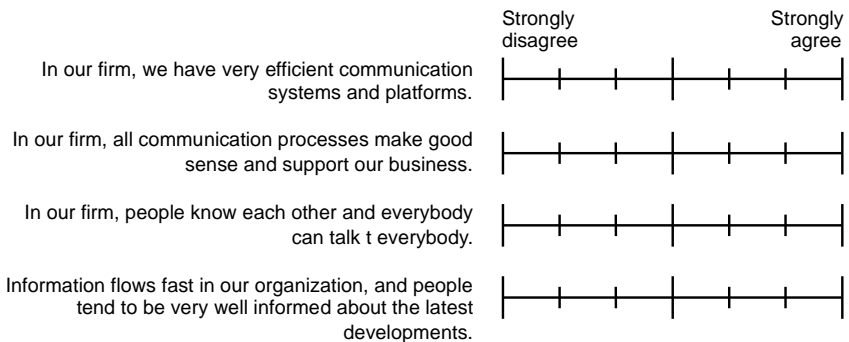


Figure 7.3: Analyzing internal communication

Corporate Culture

In order to work with customers, suppliers and other partners, a firm must be open to the outside world. This openness enables a positive view of the firm's ecosystem. The networking firm needs to see partners rather than enemies. This requires a corporate culture of openness and collaboration.

Networking also involves various people at different levels and from different units of the organization. When facing a customer, each and every employee represents the firm, and every employee in that situation must make decisions on behalf of the firm. As such, a networking firm needs to allow employees to assume responsibility. It should also accept mistakes as learning opportunities. This does not imply that a firm should support an "anything goes" mentality, but rather a view that "everyone is rightfully involved".

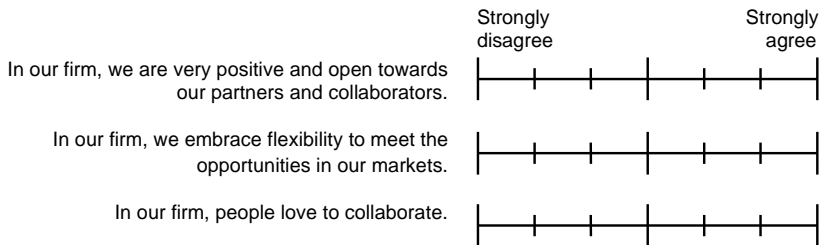


Figure 7.4: Assessing corporate culture

Challenging the Inputs

Given our process view of relationship management (see Chapter 6), relationship-management innovation occurs whenever there is a change in the way the firm executes the relationship-management processes found in the 36 processes. Such changes do not just occur – they are the result of changes in inputs, such as financial resources, employees, tools (e.g., sales-promotion material), or systems (e.g., CRM software). In order to qualify as an innovation, a changed process must somehow be new to the firm but not necessarily to other firms or to the world. Despite the general notion that more inputs and innovate inputs are positive for performance, our analysis shows that better performance only can be

achieved when more inputs or new inputs are implemented in a way that changes a firm's relationship-management processes. It is therefore paramount for managers to investigate and understand how innovation can and will affect the firm's relationship management capabilities. They cannot sit back and hope that innovation will somehow magically enhance performance. Likewise, the simple addition of more resources will not enhance performance unless that addition improves relationship-management capabilities. There is unfortunately no easy, well-functioning quick-fix. We have therefore developed an exercise that explicitly links innovation to management to ensure heightened performance (Figure 7.5).

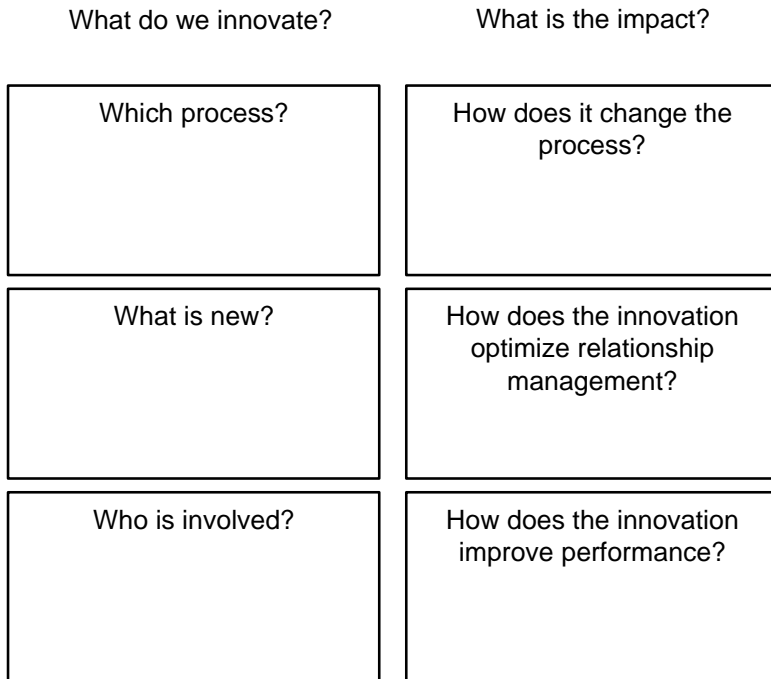


Figure 7.5: Analyzing relationship-management innovation

Innovation is often viewed as a general firm capability. As such, a high level of innovativeness should translate into high degrees of innovation in relationship management. Product innovations may even demand new

ways of relating to customers and new ways of managing those relationships.

Therefore, the likelihood of innovation in relationship management increases as the product innovation focus rises. This innovation focus can be expressed in two ways: in terms of the level of innovativeness relative to competitors or in terms of improvements in a firm's innovativeness (in general, in terms of its products and services). However, our studies show that general innovativeness is not related to innovation in relationship management. Relationship innovations must be made direct and explicit – they do not just emerge because other parts of the firm are innovative.

Figure 7.6 illustrates the inputs in the relationship challenge.

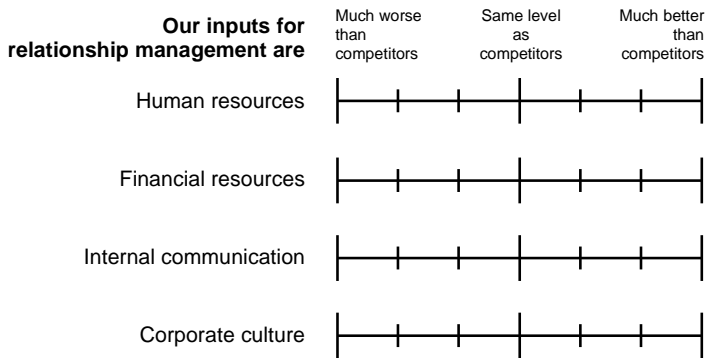


Figure 7.6: Analyzing the relationship resources

The challenge of inputs lies in understanding what resources are required for implementation of the chosen relationship strategies and in understanding what resources the firm currently possesses, which can be developed and which resources can be accessed through the firm's network of connected relationships.

CHAPTER 8

THE CHALLENGE OF TOP MANAGEMENT

The top management team of a firm has a significant impact on many, if not all, aspects of that firm. In particular, top management is often regarded as essential for a firm's market orientation. The top management is the group of people at the upper echelons of the organization who are accountable for the company's overall direction and results. In addition to the chief executive officer (CEO), the top management team often includes a chief financial officer (CFO), a chief operations officer (COO), and a chief marketing officer (CMO). Depending on the firm's terminology, these team members may also be called presidents, vice presidents, directors, vice directors, chairmen of the board, or members of the board.

With regard to customer-supplier relationships, top management's activities (i.e., the tasks performed or roles played by the top management team) can be divided into four categories: visioning, designing, energizing, and monitoring (Figure 8.1).

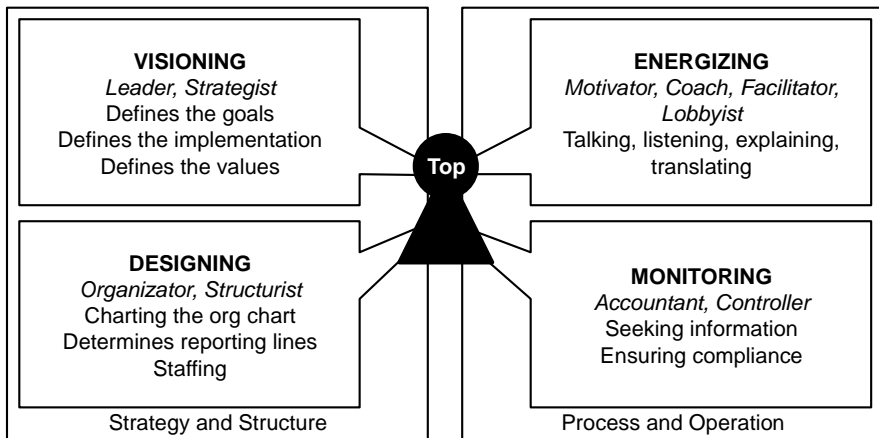


Figure 8.1: Top management activity categories

Visioning

One of top management's primary activities is to give direction and focus to the business, as well as to define the general rules of engagement. "Visioning" covers the domains of mission (the firm's reason for existence), vision (a view of the firm's position in the future), values (the firm's intended work behavior), business model (the firm's logic for creating value), and strategies (the firm's plans to fulfill its mission and achieve its vision, and the implementation of those plans). All of these items have clear connections to a firm's customer-supplier relationships and their management (Figure 8.2).

Visioning can, for example, be a decision by the firm to actively identify and terminate highly unprofitable customers. Visioning also defines the role of customers, suppliers and partners in the firm's strategy. By that, top management announces a specific focus that serves as a guiding star for the organization. When a top management team only is concerned about shareholders and financial target and spent little time with customers, they may serve as a limiting factor for the development of customer-supplier relationships.

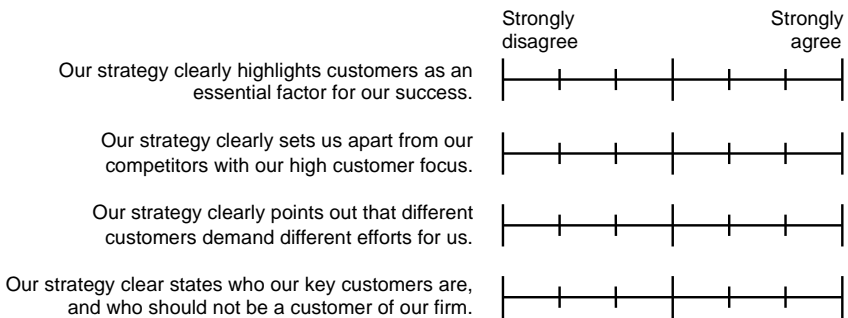


Figure 8.2: Analyzing a firm's visioning

Currently, many top management teams decide to move closer to customers to gain more business – i.e. they increase the customer focus in their visioning. Visioning is about seeing where the firm could (and should) be in the future based on insights into the market and an understanding of the firm's competencies and resources

Designing

Top management also decides on the overall structure and organization of the firm. It defines the need for certain activities, designs organizational units, allocates responsibilities, and defines reporting lines.

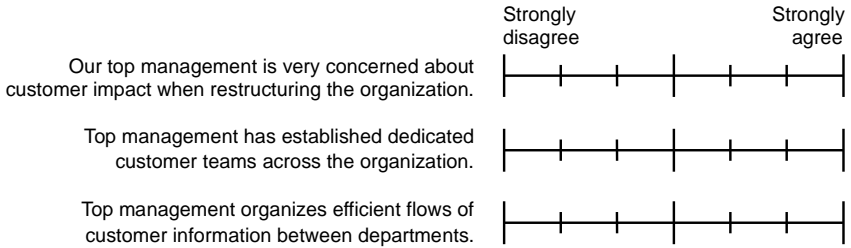


Figure 8.3: Analyzing a firm's designing

Design is crucial for implementing the vision of top management. If suitable structures are not in place, performance will suffer because the organization is too slow, too costly and too inefficient. Firms are uniquely designed to achieve exactly those results that they are currently achieving. If change is needed, organizational design most likely will have to be changed as well.

Energizing

Organizations need energy. For example, employees need motivation to be effective, and they need stimulation to be creative and to make a useful contribution. Top management's job is to create motivation throughout the organization, to commit people to the firm's strategy, and to help employees understand and appreciate the decisions made and the chosen design. Leaders need to create excitement, so that all employees are alert and ready to contribute to the firm.

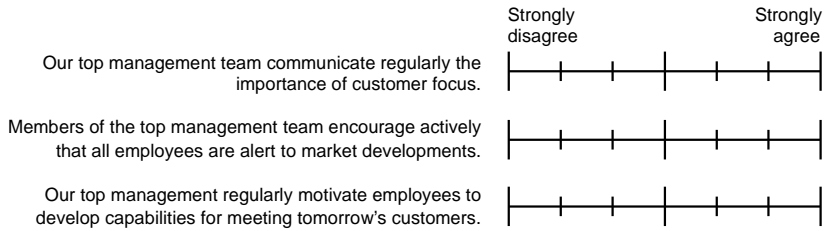


Figure 8.4: Analyzing a firm's energizing

Some times energy may be found in returning to core values and core competencies; doing what the firm is good at and have achieved success with in the past. Such “back to basics” moves can increase motivation and increase support and buy-in from the employees.

Monitoring

“Monitoring” encompasses all of the elements that contribute to top management’s knowledge about the firm’s status both internally (e.g., employee feedback and production numbers) and externally (e.g., data on customers, market share, and industry trends). Internal monitoring is about the organization’s compliance with internal standards and guidelines, and is aimed at ensuring that organizational processes are performed as envisioned, expected, and instructed. Moreover, the organization’s status in relation to the external environment is monitored to determine the organizational fit.

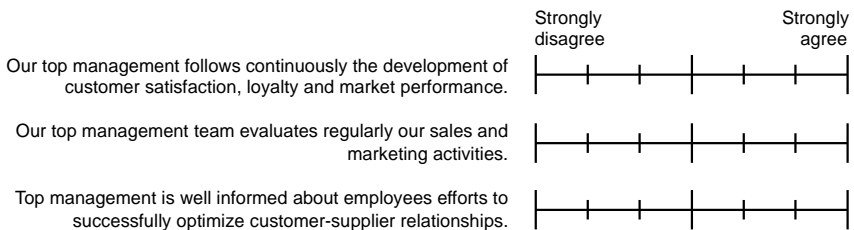


Figure 8.5: Analyzing a firm's monitoring

Monitoring is both hard and soft. Parts of the monitoring function are based on obtaining and reading reports containing numbers. Yet, monitoring also has a soft side: top management needs to have a deep understanding of the firm and its market, knowing what is going on, who is doing what and what trends and new technology is or will become interesting. Top management that only stays in their offices and read reports will very likely lack the softer side of monitoring and the “feel for the business”.

Challenging Top Management

Of course, all four top-management tasks are important and none can be ignored. However, our experience suggests that there are significant differences in time and resource allocation among firms, as well as differences in the abilities of their top management teams. We have found very few firms and very few top managers that excel in all four disciplines. It is therefore important to view top management as a team of individuals with different strengths and interests. Figure 8.6 offers a tool to visualize the overall focus of the top management team and the distribution of tasks across the team.

How much of their attention does top management spend on the different tasks (in percent)?

	CEO	CFO	CMO	COO
Visioning	Visioning	Visioning	Visioning	Visioning
Designing	Designing	Designing	Designing	Designing
Energizing	Energizing	Energizing	Energizing	Energizing
Monitoring	Monitoring	Monitoring	Monitoring	Monitoring

Figure 8.6: Division of attention for top management tasks

Meeting this challenge is about finding the right balance between who is doing what and identifying what kind of attention and support is required from which top manager in what areas. Some firms will allocate a top management sponsor for initiatives such as new product development or the entry into new market to ensure the right level of attention and resources are directed to the initiative.

CHALLENGING ENVIRONMENT

Thus far, the tools we have presented have been aimed at a given relationship and various aspects of that relationship. While this is a suitable perspective, an analysis of the impact of the relationship's surroundings, such as the market in which it is embedded and the competitive actions of other market participants, should be addressed as a final step in optimizing customer-supplier relationships.

Interconnected Relationships

Relationships do not exist in isolation – they can influence and be influenced by other relationships. As such, what happens in one relationship will very likely have an impact on the other relationship. In its simplest form, a relationship can have a positive impact, a neutral impact, or a negative impact on another relationship.

Positive connections may be found between a supplier relationship and a customer relationship because, through the provision of resources, the supplier relationship enables the firm to have a customer relationship. Likewise, firms with complementary offerings have positive connections and, thus, reinforce each other. For example, a customer buying a car must also buy fuel.

Despite the valid argument that all relationships are somehow connected, firms will be able to identify “disconnected” relationships – relationships that do not influence each other. These relationships have a neutral impact on each other.

Negative connections occur in situations where competition for resources exists. For instance, a customer buying from one supplier has the consequence of no or, at least, less business for other suppliers.

As a first step in the analysis of a relationship's environment, Table 9.1 can be used to make a list of all of the connections to which a relationship is subjected and to explicitly examine the reasons for each connection.

Such discussions often reveal unexpected or hidden connections, and unanticipated impacts (i.e., negative instead of positive or vice versa).

Relationship with:		
Connected to: (e.g., customer or supplier)	Kind of connection Positive Neutral Negative	Explanation (i.e., the reason and basis for the connection)

Table 9.1: Assessing connected relationships

Time and Timing in Relationships

Another interesting view on the customer-supplier relationship can be derived from the two partners' positions on their innovation curves in their respective industries. Industries do not develop at the same pace.

Moreover, the firms within an industry grow and change at varying rates. Consider a customer and a supplier along the innovation adoption curves in their respective markets (Figure 9.1). Both firms can be innovators and the basis for their relationship can be creating innovations together. As time passes, the two firms maintain their innovation leadership on each side and continue to create value for one another.

However, the supplier and the customer may also decline in their respective markets. The two firms might have used their resources to become innovators, such that they are now exploiting their efforts. In such a situation, they fall behind in the innovation race (case 2, Figure 9.2). Alternatively, they could develop a relationship with both innovative and explorative elements (case 3, Figure 9.2). This latter case is common in practice – firms collaborate on new products and services, exchange just-released innovative offerings, and base the majority of their business on established offerings.

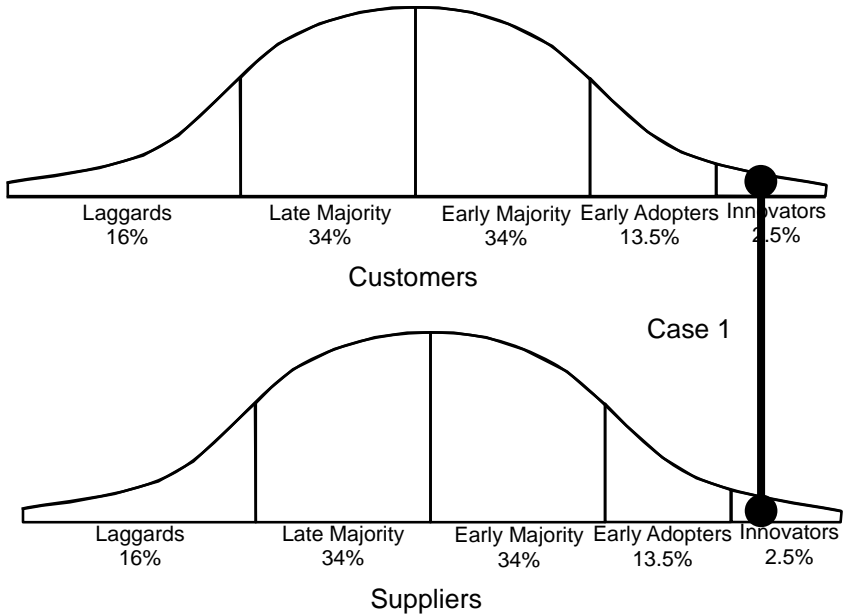


Figure 9.1: Two innovators and their relationship

The three cases described above assume that both firms move to similar positions in their innovation curves, but that is not always the case. The supplier may remain innovative, while the customer becomes exploitive (case 4, Figure 9.2) or vice versa (case 5, Figure 9.2). In these two cases, the customer-supplier relationship will eventually come to an end due to the differences between the partners and the incompatibility of their positions.

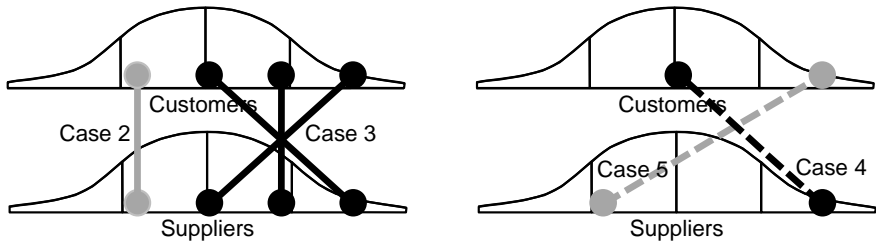


Figure 9.2: Four cases with different partner positions along the innovation curve

Finally, the speed of technological development can be different in the supplier's and customer's industries. The supplier's industry might develop faster than the customer's industry, which leaves innovative suppliers without a market opportunity (case 6, Figure 9.3). Typical remarks in such cases are that "the market was not ready" and that "customers were not prepared to understand the new offerings". While customers will enter the market over time, the innovator faces a problem – the waiting time. The innovator must find a way to finance the period between innovation expenditures and revenue intake. In addition, innovators run the risk that their competitors will succeed in developing similar offerings and, thereby, increase the competition for innovative customers. In such markets, fast-second strategies can be highly successful. Fast-second players allow the innovator to incur the cost of innovation and then overtake the innovator before customers enter the scene.

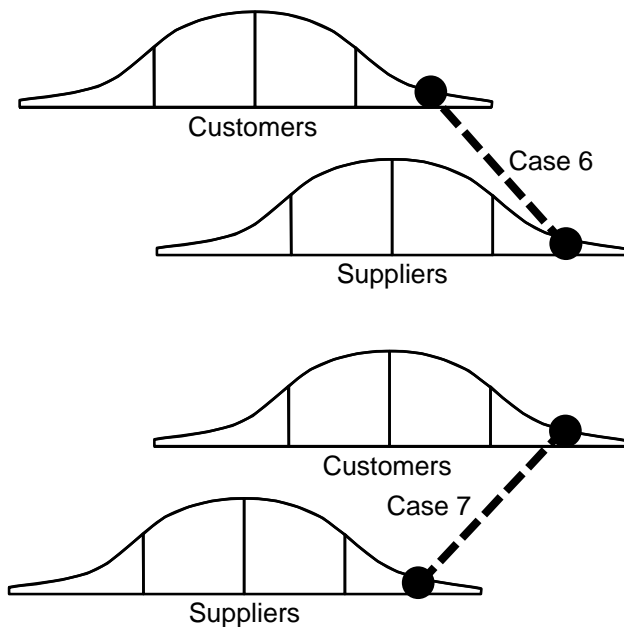


Figure 9.3: Two cases with different innovation speeds

Customers can also outpace suppliers in terms of innovation speed (case 7, Figure 9.3). Demands may move faster than suppliers can develop offerings. In such situations, the innovative supplier has an advantage in knowing that customers are awaiting supply and can, potentially, help in the development of new offerings. However, there is a risk that customers will find alternative solutions to their innovative needs, such that there will be no customers on the market when suppliers are able to deliver.

The seven cases are summarized in table 9.1.

Case	Supplier	Customer	Likely relationship outcome
1	Stays in position as innovator	Stays in position as innovator	Potential for a stable relationship based on innovative capabilities
2	Falls behind	Falls behind	Potential for a stable relationship based on joint "aging"
3	Has a broad portfolio of offerings ranging from innovative ones to commodities	Has needs in many categories	Potential for a stable relationship with exchanges across various product categories
4	Stays in position as innovator	Falls behind	Relationship likely to end due to incompatible positions
5	Falls behind	Stays in position as innovator	Relationship likely to end due to incompatible positions
6	Moves faster	Moves slower	Supplier innovates itself out of the market – relationship becomes unstable and vulnerable
7	Moves slower	Moves faster	Customer is over-demanding – relationship becomes unstable and vulnerable

Table 9.2: Seven timing cases for customer-supplier relationships

Market Conditions and Relationships

Customer-supplier relationships and relationship management are also influenced by the market in which the firms operate. Key aspects in this regard include the number of alternative suppliers, the number of customers, the distribution of market shares, whether the market is growing or shrinking, and whether technology is changing or stable. In the following, therefore, we discuss customer dynamics, competitor intensity, competitor dynamics, and technology dynamics (Figure 9.4).

Customer dynamics: Customer dynamics, or customer turbulence, are characterized as changes in existing customers' preferences over time. Alternatively, firms may experience demand for their products from new customers or firms' new customers may have product-related needs that are different from those of existing customers. When customers change their preferences or the customer base changes, managers need to follow developments closely to gain an understanding of their consequences. Managers need to understand such aspects as the impact on value creation and the consequences for the structure of the relationship. Fast-changing markets require more frequent relationship analysis in order to capture change and implications early enough. Likewise, change may result in a new strategy for a given customer and may imply changes in relationship-management processes. For example, demands from customers for online systems may lead to new relationship processes and new ways of handling customers.

Competitor intensity: Competitors may be more or less aggressive in their behavior, creating different levels of pressure on the firm. Fierce competition may induce firms to strengthen their focus on retaining customers rather than attracting new ones. In the face of high competitive intensity, one might assume that firms would be likely to innovate their relationship-management processes in order to help remain competitive, and to maintain or expand a competitive advantage. However, our study shows that firms prefer to maintain their relationship processes in times of increasing competition. Interestingly, we find that a firm's relationship-management innovations are not driven by competitor intensity. In fact, the more fierce the competition, the less firms tend to innovate their approaches to relationship management. The response seems to be "more of the same" rather than "let's find a smarter way". We believe that innovating relationship management has huge potential for improving firms' competitiveness.

Competitor dynamics: Competitor dynamics deals with competition acting in ways that are different from the established status quo. “Competitor dynamics” can be defined as the level of change in the behavior of a firm’s competitors. The level of change is high when: 1) competitors constantly change their offerings, 2) competitors constantly change their sales strategies, or 3) new competitors regularly enter the focal market.

Changes in competitors’ approaches demand a response from the firm, especially when those changes undermine the firm’s market position. In addition to changes in their offerings, firms may change their approaches to relationships – both more positive (“now we need to win the customers’ hearts) and more negative strategies (“we have to cut costs”) are possible

Technological dynamics: Technological dynamics, or turbulence in an industry, are high when the technology in the industry changes rapidly. In such situations, the current technological standard is unlikely to still be dominant in five years, and technological breakthroughs regularly contribute to the development of new product ideas in the industry. In situations with technological dynamics, firms are able to base their market success on product advantages rather than on relational assets. This, in turn, leads firms’ attentions away from relationship-management issues.

We have collected some typical questions for describing and evaluating the impact of different market conditions in Figure 9.4.

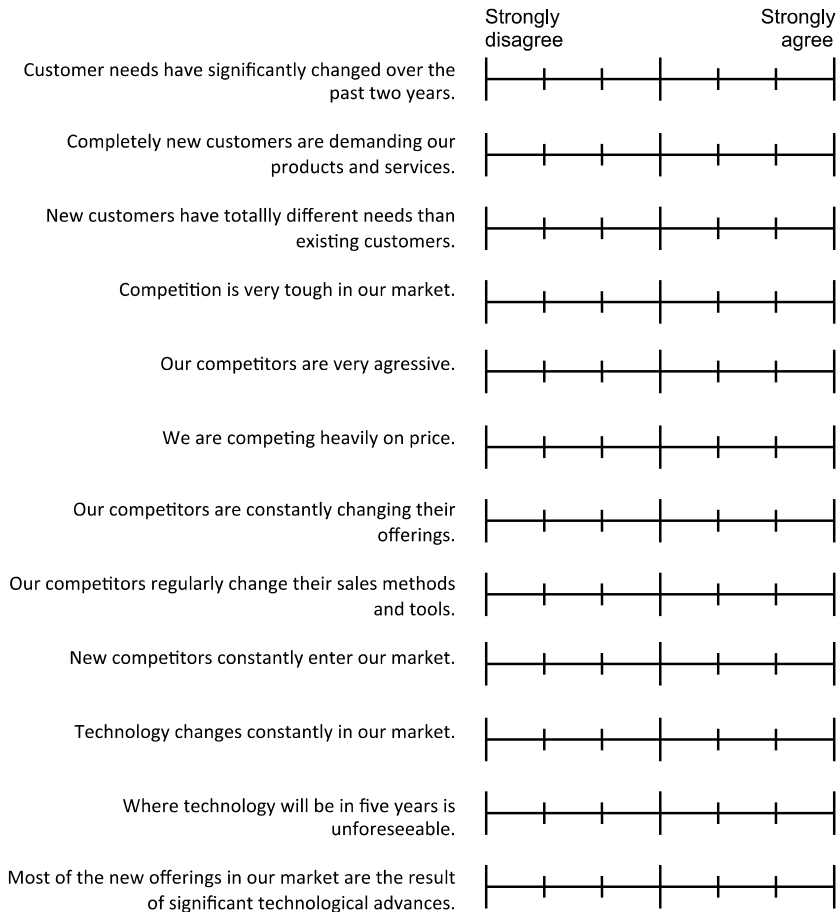


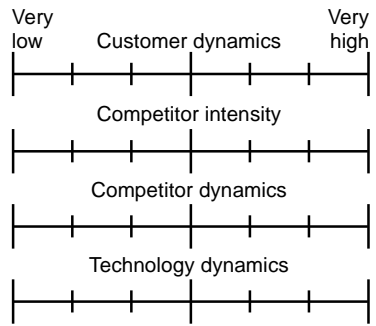
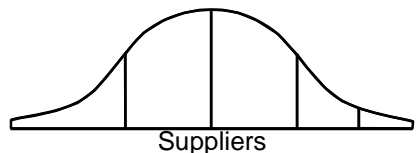
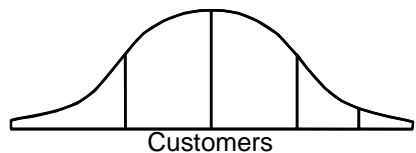
Figure 9.4: Assessing the market dynamics

Challenging Environment

The analysis of connected relationships, timing issues, and market dynamics offers interesting insights for strategizing and implementing processes in customer-supplier relationships. After identifying the environmental forces, the expected consequences and necessary actions should be discussed (Figure 9.5).

Positive connections

Negative connections



Implications for relationship value

Implications for relationship structure

Implications for relationship quality

Implications for relationship strategy

Implications for relationship processes

Figure 9.5: Assessing the environment

As we noted earlier: Business relationships do not exist in isolation. Therefore it is important that firms consider the wider environment in which their relationships are embedded because that will have an impact, positive or negative on the way the firm can face those relationships. Having a good picture like the one provided in Figure 9.5 should help firms stand up to the customer relationship challenges posed by the environment.

CHAPTER 10

FACING THE CHALLENGES

“A relationship, I think, is like a shark. You know? It has to constantly move forward or it dies.”

(Woody Allen in *Annie Hall*)

In the opening chapter, we discussed the fact that customer-supplier relationships are inherently challenging – and that there is a need to both challenge the status quo and to respond to the challenges introduced by others. We have presented our collection of favorite tools for analyzing customer-supplier relationships. We put this collection together over the years as we analyzed relationships and framed the challenges facing the customer, the supplier, or both.

We also illustrated the principle of mutuality in Chapter 1. This principle highlights the fact that there are always two sides in any given relationship, and that these two perspectives do not necessarily coincide or align. In this final chapter, we highlight the different situations that may arise from this two-sidedness. We also highlight some inherent dilemmas in customer-supplier relationships that make relationship management a challenging and complex task.

The Challenge Focus

Basically, challenges in customer-supplier relationships relate to two areas: relationship value (i.e., what is achieved in the relationship) and relationship structure (i.e., how can that be achieved) (Figure 10.1).

Challenges to relationship structure	Major	Structure challenge	Big bang
		<ul style="list-style-type: none"> • Focus on optimization of the relationship • Relationship value creates incentive to cooperate 	<ul style="list-style-type: none"> • All aspects are at stake • Critical to maintain an overview • Divide and conquer, but connect
		Small challenge	Value challenge
Minor		<ul style="list-style-type: none"> • Business as usual • Risk of complacency • Potential for lack of renewal 	<ul style="list-style-type: none"> • Foundation of relationship is questioned • Relationship structure may help to achieve suitable outcomes
		Minor	Major
		Challenges to relationship value	

Figure 10.1: The challenge focus matrix

Small challenge: The easiest challenge to address is the one that is not a “real” challenge, as it is merely an adaptation or minor change. When only minor issues arise in either relationship value or relationship structure, management’s task is to establish efficient processes and secure optimal operations in the relationship throughout those minor challenges. The managerial issue in handling minor-minor challenges is to attract sufficient attention. If left without proper attention, these challenges can lead to relationship complacency. All relationships need some level of attention to survive. Even if relationships are easy to handle, they need to be managed from an efficiency perspective. Therefore, it often makes sense to gradually adapt relationships along the way instead of waiting for major challenges to arise as a result of complacency.

Structure challenge: Structural challenges have the advantage that there is an unchallenged value-creation process in the relationship and, as such, there is good reason to address the challenge. Firms may leverage, for example, strong financial performance and value creation to push for changes in the structural interface. They may ask for more people to be involved or, in some cases, for different people to be involved. If the

structural challenges are not addressed, perhaps out of “respect” for the high value generated, then the challenge may evolve into problems that will eventually break the relationship. High value generation should not become an excuse for ignoring structural issues. An attitude of “we have to live with this” is only acceptable after having tried to challenge the partner.

Value challenge: Value challenges are more critical for a customer-supplier relationship. If the relationship creates value, value challenges question the status quo of the relationship’s core. When challenging value, the best option is to create win-win situations in which both sides gain from the challenge. However, such win-win situations are not that challenging, as there is an incentive for all to participate. More interesting are those situations in which the challenger desires an improvement that would imply lower value for the other side. For example, a supplier’s suggestion to replace a customized product with a standard product creates value for the supplier through less complex and higher volumes, but it might simultaneously lower value for the customer. In such cases, firms need to consider how to use the relationship structure in the process of challenging value, which leads to big-bang challenges in which every element of the relationship is at play.

Big-bang challenges: For firms that challenge both value and structure, or find both challenged by the other party, the customer-supplier relationship needs to be considered in its totality. Too often, many small initiatives do not add up to a suitable whole, especially when different people in the two organizations challenge different parts of the relationship in an uncoordinated manner. Thus, the primary managerial tasks are to gain an overview of the different challenges and to understand the interconnections among the issues. When such an overview has been established, the “big” challenge can be broken into smaller challenges in order to reduce complexity and to derive operationally manageable challenges. However, these task forces must be coordinated. Typically, it is more difficult to cope with both structural and value-related challenges at the same time, as the relationship is vulnerable in such situations.

The Challenger and the Challenged

Business relationships are inherently challenging – some more than others. Challenges are introduced by at least one party, as the relationship itself cannot challenge a supplier or a customer. We can

identify four different situations depending on who is challenging (Figure 10.2). In some relationships, the supplier will be the challenger, while in others it is the customer. In others, there is an even balance in which the supplier and the customer mutually challenge each other.

Supplier is challenging	High	Customer challenged	Jointly challenged
		<ul style="list-style-type: none"> • New capability or new technology • New or different interactions needed • New profit targets 	<ul style="list-style-type: none"> • Dynamic • Mutual understanding for challenge • Chaotic, as many items in play
	Low	Not challenged	Supplier challenged
		<ul style="list-style-type: none"> • Business as usual • Internal efficiency gains on both sides • Potential for lack of renewal 	<ul style="list-style-type: none"> • New or different needs and expectations demand different value • New or different interactions needed
		Low	High
		Customer is challenging	

Figure 10.2: The challenger matrix

Supplier challenged: In a customer-led relationship, the customer introduces the challenges, perhaps by asking for lower prices, higher quality, or more innovative offerings, or by demanding key account status and special treatment. Such challenges are multiplied in relationships in which the customer is bigger and more critical to the supplier than vice versa. In such relationships, the customer holds some sort of power. Alternatively, the customer may have better insight into the downstream market or a core technology, putting it in a better position to challenge the status quo. For a supplier, the two key tasks when facing customer challenges are to be flexible enough to respond, and to be brave and elegant enough to reject demands that do not create value. As in the Kenny Rogers song about the gambler: “You’ve got to know when to hold

'em. Know when to fold 'em. Know when to walk away. Know when to run.”

Customer challenged: Suppliers know about technologies as well as the supply markets, so they often want to challenge their customers with new offerings that utilize new technologies and new supplies. They can, for example, attempt to persuade customers to adopt a new technology or to accept new solutions to existing needs. They may also try to help customers recognize new and different needs that were previously unnoticed or latent. Like the supplier, a customer needs to be able to respond by either adopting the new offering or ignoring the challenge. For the customer, a critical issue to consider is the impact that a rejection may have on its competitive situation if its competitors adopt the new offering.

Jointly challenged: Suppliers and customers can challenge each other at the same time. The positive element in this regard is that both parties are prepared for a challenge. Therefore, a change or a renewal is already on the agenda on both sides of the relationship. A critical issue in this regard is that many different issues require managerial attention and action at the same time, while dealing with a lack of continuity creates a “dynamic minefield”. Therefore, firms have to find a healthy balance between stability and change – between the opportunities associated with challenges and the threats involved.

Not challenged: If neither party challenges the relationship, there will be very little change or development. The relationship works in a “business as usual” mode that offers an opportunity to develop efficient routines. If the environment is stable, challenges could be a waste of resources and, therefore, the lack of change is acceptable. The risk in this situation is that the two parties can become complacent and resistant to change even when change is necessary and vital to value creation and survival in the long run.

Challenging Trade-offs

Challenges are inherently difficult to address – if they were easy to deal with, we would call them tasks rather than challenges. As there are pros and cons, advantage and disadvantages, and benefits and sacrifices in any situation, managers have to find the “right” balance.

As customer-supplier relationships are about trade-offs, there is one final challenge we wish to highlight: the more a supplier challenges a

customer, the less the supplier may be challenged in return. If a supplier pressures a customer to accept all of its challenges, the customer finds itself busy doing what the supplier demanded. This may, in turn, lead to a situation in which the customer loses the ability and resources needed to challenge the supplier. If a supplier wins all of the challenges and gets everything its way, then the system is only as good as the supplier – the customer’s capabilities are left unexplored and underutilized, and the customer’s motivation to work with the supplier may deteriorate. As such, the more a firm succeeds in gaining acceptance of the challenges it introduces, the less creative, less responsive, and less effective the relationship may become. A customer-supplier relationship’s major advantage is that customers and suppliers challenge each other and, therewith, help each other become more competitive.

Such situations are often compared to a pendulum (Figure 10.3). The pendulum swings between its two dead points. At those turning points, there is a great deal of potential energy but no movement. In the middle of its movement, where we can assume an optimum level of challenge exists, the pendulum is moving at maximum speed. The managerial task is to keep the dead points close together to avoid too much variation and to slow the speed with which the relationship passes its optimal point, thereby making the optimum last as long as possible.

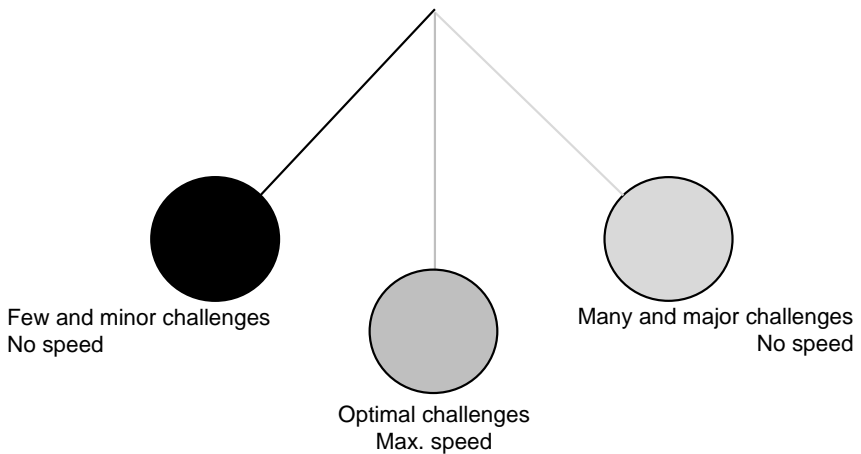


Figure 10.3: The challenge trade-off

A final thought – when managing customer-supplier relationships, the objective is not to minimize or maximize challenge. Rather, it is to find the optimum level of challenge. In other words, the goal for all concerned should be to find the optimum levels of cooperation and competition in the customer-supplier relationship depending on the situation.

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Customer-supplier relationships are the lifeblood of all businesses – without customer-supplier relationships, there can be no business! All parties in a relationship can challenge others or be challenged in order to develop and optimize their relationship. This book is about challenging customer-supplier relationships and the ways in which companies can address those challenges.

Our vantage point is that of the supplier and, as the title indicates, most of the book is focused on customer relationships. However, one company's customer relationship is another company's supplier relationship. Therefore, the book is also highly relevant for managing supplier relationships.

The book covers the central areas and dimensions of customer-supplier relationships, identifies key challenges for each of the two parties, and provides tools for analysis and managerial action. The tools can be easily and effectively included in the company's relationship strategies, portfolio management, and day-to-day relationship management. Only continuous managerial efforts in analysis, understanding, and implementation can secure optimal customer-supplier relationships and, ultimately, contribute to the competitiveness of a business.

Some of the questions addressed in the book are:

- What kind of value is created through the relationship?
- What type of relationship exists between the customer and the supplier?
- What are the strategic options for the relationship?
- How well does the business handle the six relationship-management processes?
- Why should we challenge a customer or a supplier?

Professor Thomas Ritter and Associate Professor Jens Geersbro of Copenhagen Business School have been researching customer-supplier relationships for more than 15 years. They have extensive experience in teaching graduate students and business executives about optimizing customer-supplier relationships. Moreover, they both advise international organizations active in a variety of industries, such as financial services, air travel, manufacturing, chemicals, pharmaceuticals, biotech engineering and retail. This book contains the tools and models they have developed in their work, and covers the insights they have gained from their experiences.