A Practical Discussion of Buyer Supplier Relationship Development

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Every organization engages in buyer-supplier transactions to obtain materials and services to operate its business. Each pair of buyers and suppliers involved in such transactions develops a relationship between the two parties. This paper provides a framework for understanding how these relationships develop and for developing relationship strategies. Key variables are defined and a temporal relationship process model is provided. The findings of theoretical papers are translated into a form that practitioners will find useful. Using practical scenarios, the model framework is put into a practical perspective that can be applied at any stage of the buyer-supplier relationship process.

INTRODUCTION

Because buyers and suppliers are constantly developing, maintaining, or concluding relationships between them, it is important and advantageous for both parties to have a thorough understanding of how buyer-supplier relationships develop, mature, and evolve (or not!). In many cases, quantifiable variables such as prices (because of a more direct relationship with operating and financial results) are the main, if not the sole basis of evaluation for buyer-supplier relationships. However, non-quantifiable variables often play a role of equal or greater importance in buyer-supplier relationships, particularly in how relationships develop over time. The purpose of this paper is to provide supply chain management professionals with a practical discussion of how business relationships develop and, in particular, the role of non-quantifiable variables in the development process. To accomplish this objective, the relationship development process is explained by first defining the key variables in the process and then with a model of the overall development process. Using this model as a basis, a list of practical scenarios are identified that can be used by practitioners to assess the current state of a particular relationship, predict the future potential of a particular relationship, and diagnose problems in an underperforming relationship.

In many relationships, one party may possess a greater position of power than the other party. Therefore, how the impact of power imbalance between the parties can affect the several stages of relationships is also discussed and included in the model. The research behind the model and variables discussed in this paper began with the proposal of a theoretical "Temporal Model" of how buyer-supplier

relationships initially begin and, if successful, develop into long-term arrangements. The model was initially developed from extensive analysis and synthesis of existing research and later extended to include the impact of power imbalance. Subsequently, the model was empirically tested and validated, (Khoja, Adams, and Kauffman 2010, 2011).

The model depicts the interaction of variables that are of key importance in the formation and development of buyer-supplier relationships. These variables include: Buyer and supplier power and power imbalance, Commitment of both parties to each other, Trust of both parties in the other party, and Relational embeddedness (how closely the parties work with each other and exchange information and know-how). Also considered are the impacts on each party's accumulation of knowledge and know-how (intellectual capital) and general performance of their firms. The variables and interactions are discussed in more detail in the following sections.

KEY RELATIONSHIP VARIABLES AND CONSTRUCTS

A search of the literature on buyer-supplier relationships revealed several primary variables most commonly analyzed in buyer-supplier relationship research. These are identified below along with brief explanations and example references.

Buyer and Supplier Power and Power Imbalance

Buyer and supplier power was examined in detail by Casciaro and Piskorski in 2005 using resource dependency theory as their model framework. They defined buyer power and supplier power in the following manner:

- *Buyer power* may exist when there is an increased number of suppliers and substitutes, and a small number of buyers, that limit suppliers' marketing alternatives. It may also exist when the buyer's purchases constitute a relatively large portion of the supplier's sales.
- *Supplier power* evolves when there is a small number of suppliers, a limited number of substitutes available that limit competition, and a large number of buyers in the industry. It may also result from the possession by a supplier of critical and rare resources such as patented technology.

Using these definitions as a basis for describing the impact of power on relationships, *power imbalance* or power asymmetry can be defined as "the difference between two actors' dependencies or the ratio of the power of the more powerful actor to that of the less powerful actor." (Khoja, F., Adams, J., & Kauffman, R., 2011, p. 77)

Commitment

Commitment "refers to an implicit or explicit pledge of relational continuity between exchange partners." (Dwyer, Schurr, and Oh, 1987) We identify three types of commitment:

1. *Input commitment:* Actions up to and including an initial deal between partners.
2. *Attitudinal commitment*: A sense of unity between the partners from goal achievement and/or operational linkages.
3. *Temporal commitment*: Indicates an enduring relationship, e.g. specific asset investments related to the deal.

Trust

Trust is one party's belief that the other party will behave predictably and in a manner acceptable to both parties. (Morgan and Hunt, 1994; Sabel, 1993; Miyamoto and Rexha, 2004). We identify four dimensions of trust:

1. *Contractual trust*: Partners' belief that the terms of an agreement will be executed as negotiated.

2. *Competence trust*: Expectation that partners have the capability to successfully complete their work.
3. *Goodwill trust*: Partners' belief that the individual parties to the agreement will provide the necessary support to maintain the relationship long-term.
4. *Intended trust*: One's faith in the other party's objectives, which encourages them to perform as expected.

Relational Embeddedness

Relational embeddedness is how intertwined the buying and selling organizations are. The definition of relational embeddedness is "the role of direct cohesive ties as a mechanism for gaining fine-grained information" (Gulati, 1998). It consists of two inter-related dimensions: tie strength and type of knowledge shared. Tie strength indicates the degree of exchange of fine-grained, private knowledge between the parties (Brass, Galaskiewicz, and Tsai, 2004; McEvily and Zaheer, 1999; Rowley, Behrens, and Krackhardt, 2000). Type of knowledge shared can be either explicit knowledge or information or tacit knowledge or know-how. The type and extent of what is shared can be summarized into high or low degree of embeddedness.

High degree of relational embeddedness exists in a relationship where there are strong ties and tacit knowledge and know-how are exchanged between parties. An example of a relationship with high relational embeddedness would be a long-term partnership with considerable information sharing between parties.

Low degree of relational embeddedness exists in a relationship where there are weak ties and mostly explicit information and knowledge are exchanged between parties. An example of low relational embeddedness is an arm's length short-term relationship where little information is exchanged between the parties.

Intellectual Capital and Performance

Intellectual capital is "knowledge and knowing capability of a social collectivity, such as an organization, intellectual community or professional practice" (Nahapiet and Ghoshal, 1997. P. 245). Long-term relationships accrue a number of benefits for both parties. They increase organizational knowledge and learning capabilities, and as the parties become more interdependent, they are more likely to exchange process knowledge and technologies thereby increasing the level of synergy. (Crook and Combs, 2007). This synergy can then contribute to increased performance.

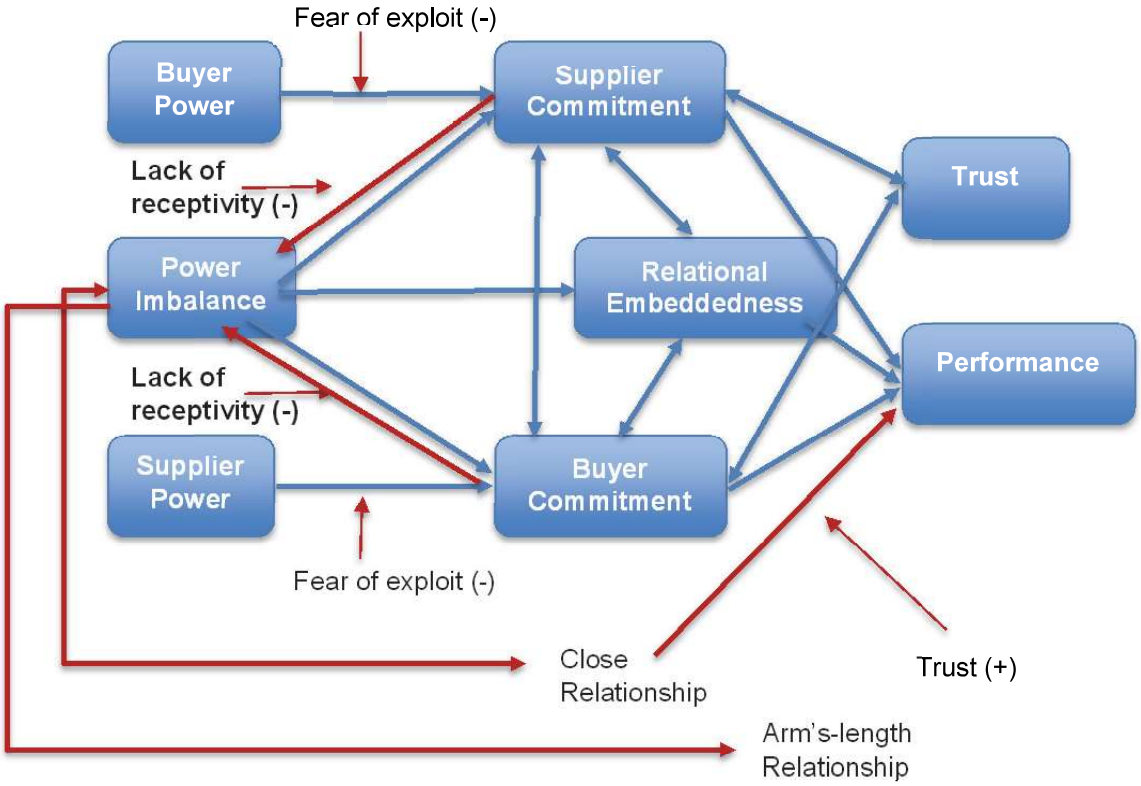
Performance: Studies have shown that commitment enhances performance in terms of productivity and rewards (e.g. Skarmeas et al (2002).

FRAMEWORK DEVELOPMENT

The Temporal Model of Buyer-Supplier Relationships

The Temporal Model depicted in Figure 1 from Khoja, Adams, Coy, and Kauffman (2015) summarizes how the relationship variables interact during development and maturation of buyer-supplier relationships.

FIGURE 1
TEMPORAL MODEL INCLUDING IMPACT OF POWER IMBALANCE



Integral to the model is the concept that there are three stages of relationship development. The first or pre-deal stage (denoted as t-1) consists of all interaction up to agreement on a first transaction between the parties. The second stage (denoted as t) is the deal enactment stage when the first transaction takes place (i.e. the first purchase order or contract). The third stage (denoted as t+1) is the deal continuation stage that consists of all interaction and transactions following the deal enactment stage. The temporal model encompasses all three stages of a buyer-supplier relationship. This is a dynamic process. Most businesses are engaged in all three stages with different buyers and/or sellers at any given time. Development and empirical testing of the model is described in more detail in Khoja, Adams, and Kauffman (2010, 2015) and Khoja, et al. (2015).

The Temporal Model considers where power imbalance exists between buyer and seller and includes the effects of power imbalance on the relationship. Specifically, the model indicates that buyer and supplier power may increase or limit the level of commitment of the other party. However, this may be negatively mitigated by fear of exploitation. If the level of commitment is increased, it may or may not reduce power imbalance depending on switching costs, dependencies, and opportunism (Keep, et al., 1998; Cannon and Perreault, 1999). These potential effects on power imbalance may be negatively mitigated by lack of receptivity. Buyers and suppliers that are able to reduce power imbalance in their respective relationships, due to increased commitment (e.g., mutual investment of time and/or capital, technology sharing, etc.), are likely to develop close relationships that may result in long-term partnerships. Increased trust between the partners normally results from such relationships. Also, increased trust positively mitigates performance of the firms of both parties. Contrarily, buyers and suppliers that are unable to alter *power imbalance*, due to limited or no commitment or their inability to create switching costs and dependencies, are likely to foster arms-length relationships. Additionally, long-term relationships help reduce power imbalance, as the latter is not of much consequence when partners

begin to trust each other. Development of the extended model is described in more detail in Khoja, Adams, and Kauffman (2011). *Power imbalance* does not necessarily result in arms-length relationships between buyers and suppliers. In fact, *power imbalance* can foster *high relational embeddedness*. Also, the relationship between *power imbalance* and *high relational embeddedness* is mediated by *buyer and supplier commitment and trust*. This result may be, at first a bit counter-intuitive. But it is possible that when the weaker party has become dependent on the stronger party, it will engage in defensive activities to mitigate the power imbalance, which can reinforce the relationship.

The research also reveals some interesting aspects of the trust between parties. Buyers may not be as confident of how suppliers perceive their depiction of trust; but according to Khoja et al. (2011) and Khoja et al. (2015), buyers trust their suppliers in most cases. Furthermore, in these relationships, how one party perceives the level of trust of the other party is as much or more important than how much the parties actually trust one another. Thus, the level of intended trust depicted by sellers can have a positive impact on the development of a long-term relationship.

Finally, the level of relational embeddedness between buyers and suppliers appears to have a positive impact on organizational performance (Khoja et al., 2015). As the relationship becomes closer, the benefits from knowledge sharing and overall synergy increase.

Model Stages

Figure 2 depicts how the major variables interact through the three stages of relationship development.

Stage 1: Pre-deal Stage

In the pre-deal stage, buyer and supplier explore the possibility of developing a new relationship. Typically, the parties have little or no experience dealing with each other, or they have been transactionally engaged in the past, but they are exploring the possibility of engaging in a new type of business. Although most buyer-supplier relationships have progressed beyond this initial exploration, all buyer-supplier relationships begin at some point with this stage. At this stage, both partners display *input commitment* to signal interest in proceeding to deal enactment. *Relative power* also impacts at this stage. In particular, high relative *buyer power* may result in increased *supplier commitment* to proceed to deal enactment.

Stage 2: Deal Enactment Stage

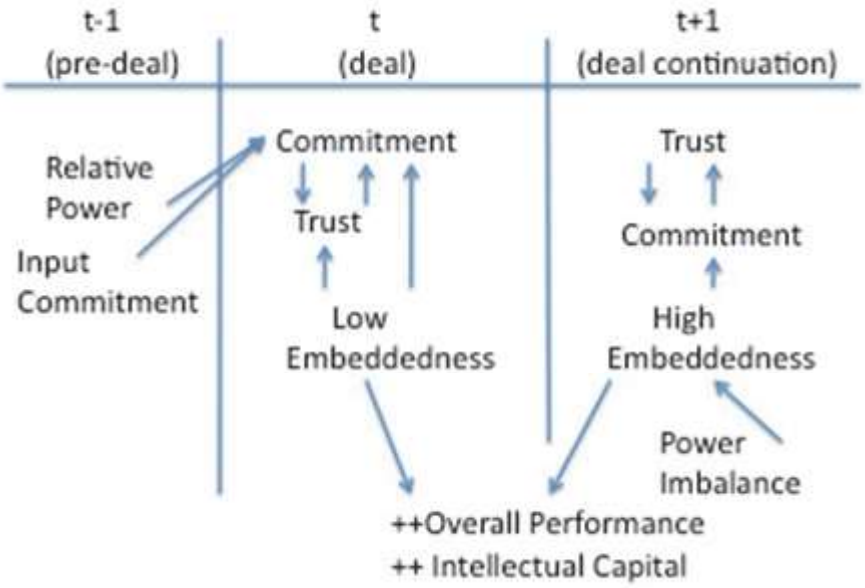
In the deal enactment stage, a first purchase order is made or a contract is agreed upon. At this stage, the buyer and supplier have a tenuous relationship that may or may not advance to a long-term relationship. Arms-length purchases, for example, typically end at this stage. At deal enactment, both parties can be expected to display *attitudinal commitment* signifying a joint sense of unity to proceed. This can be expected to result in a *low degree of relational embeddedness* as the parties work more closely together. The *relational embeddedness*, in turn, will contribute to *buyer commitment and supplier trust* and also positively impact *overall performance and intellectual capital* of both parties. Also, at this stage, *supplier commitment* increases *buyer trust*, which can evolve into *contractual and competence trust*, indicating that the partners expect that contracts will be fulfilled by the other partner. The resultant increased *trust* by both parties increases the *commitment* of both.

Stage 3: Deal Continuation Stage

If success is achieved at the deal enactment stage and the need for a continued relationship exists, the relationship then moves to the deal continuation stage. At this stage, *commitment* by one or both parties may become *temporal commitment* indicating an enduring relationship and may include by one or both parties specific investments related to the deal. The increased *commitment* should also increase the *trust* of both parties that results in even more *commitment*. The parties' confidence in one another at this stage may evolve into *goodwill trust* indicating mutual support and continuance of a long-term partnership. The *high degree of relational embeddedness* that can be expected at this stage will also contribute to *supplier*

commitment. Both the increased *commitment and high relational embeddedness* can be expected to contribute to increased *overall performance and intellectual capital* of both parties.

FIGURE 2
THREE-STAGES OF BUYER-SUPPLIER RELATIONSHIP DEVELOPMENT



THE TEMPORAL MODEL IN PRACTICE

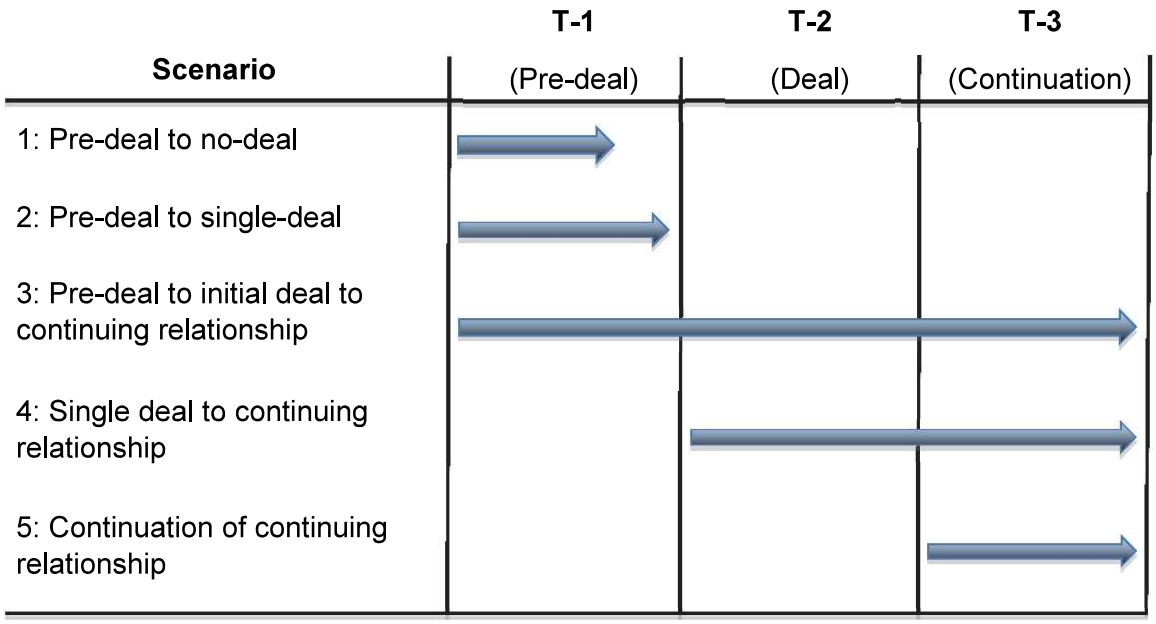
To gain a better understanding of how the temporal model and the three stages of the relationship development process operate in practice, we have identified the five scenarios that can occur in buyer-supplier relationship development. These scenarios are depicted graphically in Figure 3 and discussed in detail below.

Pre-deal (t-1) to No-deal (t-1)

In many, if not most, commercial purchasing situations, before a purchase can be made, more than one possible supplier must be considered. In some cases, such as in government contracting, law or regulation mandates consideration of multiple suppliers. In most of these situations only one supplier will receive a purchase contract. The remaining considered suppliers will either have been rejected because of cost, quality, performance or delivery capability, or other factors, or will have voluntarily withdrawn from consideration for a variety of reasons. These suppliers would be in the pre-deal to no-deal scenario.

Example: An example of this scenario would be a strong buyer and a weak seller. The strong buyer in this example is a large multinational vehicle manufacturer such as Ford or Toyota. Because of the large buying power of this manufacturer its power will be high. Numerous auto parts vendors could serve as possible sources of supply. Because of all the possible vendors, the individual selling company's power is low. A way of making up for the lack of power is to make a commitment to the buying organization. Such a commitment could take the form of designating inventory for the potential customer or developing special assets such as specialized tooling. Many companies will not make this commitment for fear of exploitation by the more powerful buying organization. They believe that the cost of the commitment of resources will be too high and provide little if any benefit. Because of the lack of commitment, the buying organization chooses another supplier and there is no deal.

FIGURE 3
BUYER-SUPPLIER RELATIONSHIP DEVELOPMENT SCENARIOS



Pre-deal (t-1) to Single Deal (t)

There are many instances in commercial procurement where a one-time purchase is required without any continuing commitment by either buyer or supplier. In such cases, the selected supplier would be in the pre-deal to single deal scenario. The single deal could be a one-time, one delivery, requirement or it could be for a single time period duration during which the supplier would deliver the contracted goods or services. However, in some situations, the buyer's intention is for the relationship to proceed from the single deal to a continuing relationship, but because of changed requirements of the buyer, poor performance by the supplier, or other factors, the relationship ends with a single deal.

Example: Consider again a strong vehicle manufacturer and numerous potential small suppliers. In this case, one supplier commits resources to the buyer in the form of inventory or specialized tooling. This commitment can result in a purchase agreement from the buying firm. However, if the supplier's performance is not sufficient or if the buyers and suppliers long term priorities are misaligned, the agreement may only last for a single purchase.

Pre-deal (t-1) to Initial-deal (t) to Continuing Relationship (t+1)

This scenario applies to development of all situations in which a continuing relationship is sought and a continuing relationship is achieved. In this situation, a supplier is selected in the pre-deal period, and the relationship proceeds to the initial deal agreement. If all goes well with the first purchase, the relationship continues into the future.

Example: Consider a large multinational vehicle manufacturer with multiple plants in the throughout the world. Since many auto parts companies are competing to become a supplier for the manufacturer and because of the existence of many alternate sources of supply, the power of the potential supplier is low. To compensate for the power disparity, the supplier commits resources to gain the manufacturer's business. Such a supplier commitment could involve devoting dedicated inventory or developing specialized assets that support the buying organization. Such a commitment can lead to increased buyer commitment such as a long-term purchase agreement. If the supplier provides good service and competitive prices, the relationship can grow stronger with the sharing of information and the development of specific assets. Over a period of time trust develops between the two parties, which

results in increased commitment and an even closer relationship. The result of these commitments and the closer buyer supplier relationship is increased performance. A good example of this scenario is the Toyota Motor production facilities in Georgetown, Kentucky where key suppliers have plants and facilities nearby.

Single Deal (t) to Continuing Relationship (t+1)

In this scenario, a single deal has been developed in the pre-deal stage and completed as a single deal with a supplier. No additional deals are originally anticipated. At some point after the initial deal has been agreed upon, a continuing need develops for the goods or services provided by the supplier. If all goes well with the delivery of the initial deal, the supplier is then contracted as a supplier on a continuing basis. Another possibility is that during the pre-deal stage the buyer perceives that the supplier does not have the capability to provide continuing supply but has the capability to provide an initial supply while a continuing supplier is sought. However, if during the initial deal the supplier increases its capacity or otherwise qualifies to be a continuing supplier, and if all goes well with the initial deal, the buyer may decide to contract with the supplier on a continuing basis.

Continuation of Continuing Relationship (t+1) to (t+1)

Continuation of existing buyer-supplier relationships depends on satisfactory performance by both buyer and supplier and on a continuing buyer need for the product or service provided by the supplier. Various methods are used to periodically assess the performance of both parties and decide whether to continue the relationship. Almost all purchase contracts have an expiration date. For situations where performance problems are not anticipated and where the buyer need is expected to continue indefinitely, contracts may be termed "evergreen" which usually means that at the expiration date, the contract is automatically renewed for an additional period of time. Commonly, contracts may be for a period of one year and renewed for a like period. In some situations, contracts may be for a multi-year period. However, longer contracts are usually not "evergreen" and undergo some sort of formal review to decide whether to renew them. A continuing relationship may also exist in situations where there is not an identified continuing need for a product or service, but there is a series of needs where each is expected to differ in some way. In such situations, because of satisfactory performance in the past, a particular supplier may be used repeatedly for such needs without a formal continuing agreement. In this scenario, a buying firm continues to use an existing supplier on a regular basis because the supplier's performance is good and the supplier's priorities are aligned with the buying organization. This leads to increased trust and commitment between both the buying and selling organizations. With this the buyer supplier relationship strengthens and develops over time. This leads to a much higher degree of relational embeddedness between the buying and selling organizations.

Example: An example of this is Toyota plants that have supplier facilities located nearby to service their operations and reduce costs through lean production. The result is an improvement in overall performance by the buying organization and a high degree of revenue certainty for the supplier firms.

DISCUSSION

Scope of Research Stream

The stream of research that led to this paper encompasses key non-traditionally-quantifiable variables impacting buyer-supplier relationships. The Temporal Model includes pre-deal, deal, and deal continuation stages of a relationship and provides an assessment tool for considering changes in type of a continuing relationship. Not merely an academic exercise, the proposed theoretical model was subjected to empirical testing using data obtained from practitioners in the field. Particular attention was paid to the balance of power between buyer and seller and several non-intuitive results regarding imbalance situations were found.

Significance of Research of Non-traditionally-quantifiable Variables

As previously mentioned, in many cases, quantifiable variables such as prices are the main, if not the sole basis of evaluation for buyer-supplier relationships (because of a more direct relationship with operating and financial results). However, as supply chains have become more extended (and individual ones more numerous due to reduced internal vertical integration of many firms), non-quantifiable variables such as commitment, trust, and relational embeddedness have become more important. For example, benefits from a supplier's low price will not be fully realized if the supplier is not willing to make the necessary commitment or achieve the necessary relational embeddedness required for operational success.

Managerial Implications

Three areas where this review provides useful insight into buyer-supplier relationships are:

1. Ascertaining why some organizations can uphold long-term relationships while others fail to do so.
2. Determining how adversarial relationships, due to supplier or buyer power, can be converted to relationships based on mutual understanding and cooperation.
3. Understanding how a three-stage progression model (Temporal Model) for buyer-supplier relationship development and progression can be used to identify and analyze the key variables involved in that progression.

The Temporal Model, including the three-stage progression concept, identification of key interrelationship variables, and how they evolve in the progression, provides insight into what is involved in making and keeping long-term buyer-supplier relationships; and as such, it provides useful insight into answering the questions posed by the first two of the three areas. The Temporal Model and its empirical validity can serve as a framework to diagnose relationship problems and devise solutions to them for managers who are responsible for buyer-supplier relationships.

Implications Concerning Buyer-supplier Interaction Variables

There are several implications concerning interactions of the key variables:

First, since the temporal model looks at relationships at different stages of development, the model allows managers to view their purchasing function more holistically, which in turn, allows them to understand how the development of buyer-supplier relationships will impact organizational performance.

Second, research on buyer-supplier relationships suggests that when the supplier is the stronger party, the buyer is unlikely to increase the level of commitment at the pre-deal stage. On the other hand, stronger suppliers may, in fact, perceive the power imbalance as a protection against negative buyer actions, which can motivate them to invest in the relationship in order to expand the relationship in the future.

Third, when the supplier makes a large enough commitment at the pre-deal stage, the buyer's level of contractual trust will likely grow at the deal enactment stage. On the other hand, if the buyer makes little or no commitment at the pre-deal stage, the level of supplier contractual trust is low. In this case, supplier contractual trust is built through experience over a number of purchase order cycles. In either case, the development of contractual trust over time increases the perception of trust, which can lead to increased relational embeddedness and a more productive long-term relationship.

Fourth, the model demonstrates potential long-term implications of short-term actions. Actions by either party in the pre-deal and deal enactment stages can signal the level of commitment and/or trust that can be expected by the other party if the relationship advances to additional stage(s).

Fifth, the temporal model depicts how buyer-supplier relationships evolve, and it provides managers with probable outcomes from specific actions. The model can, therefore, be used to test hypothetical situations in which levels of commitment (e.g., investment of resources or time) and relational embeddedness (e.g., exchange of knowledge/expertise) are manipulated.

Finally, the temporal model suggests that levels of commitment significantly impact the extent to which the relationship between buyers and suppliers will survive long-term. For situations where long-

term relationships are desirable, the model provides additional indication of positive effects of buyer and supplier commitment and relational embeddedness on development of goodwill trust and performance.

Implications Concerning Buyer-supplier Power Imbalance

The results of the study also have several implications concerning effects of buyer-supplier power imbalance.

First, it can help managers gain a better understanding of the impacts of a relationship characterized by significant power imbalance; and it shows that the existence of a power imbalance is not necessarily an impediment to the development of a long-term relationship. Furthermore, the model supports the intuitive belief that increased levels of buyer and supplier commitment and trust will likely lead to closer relationships.

Second, when a power imbalance exists, the weaker party will likely take actions to increase the closeness of the relationship and to seek agreements that will mitigate the power imbalance or to defend themselves against actions from the stronger party.

Finally, if the stronger party decides that the relationship is worth continuing, it can be expected to demonstrate commitment and trust to the other party, which will lead to a closer long-term relationship.

CONCLUSION

This paper makes two important contributions to the purchasing relationship development literature: (1) It distills the theoretical findings of a number of papers on purchasing relationship development using a model framework that can be used by practitioners to determine and plan strategies for entering and continuing particular buying and selling relationships, and (2) It introduces a practical list of relationship development scenarios that can be used by practitioners to assess and manage their supply chain relationships.

Understanding how purchasing relationships develop is extremely important for managers since purchasing decisions can have substantial impact on organizational performance. Yet assessment of the current and future state of these relationships is often done on an ad-hoc basis. There is some justification for this approach because many of the variables involved are not readily quantifiable. Furthermore, the view of buyer-supplier relationships, particularly in the popular media, appears to be that they are determined mainly by supply, demand, and price considerations. While the quantifiable aspects of a purchasing decision are important, a key implication of this research is that there also are many other, more subtle variables at work, both in getting to an initial deal and in moving past that stage to a continuing relationship.

Variables such as prices, price changes, total cost, quality levels, and delivery performance are easily quantifiable. Most businesses do this to a greater or lesser extent. However, variables such as commitment, trust, and relational embeddedness, are not readily quantifiable. These latter variables are often ignored, or subjectively evaluated through personal opinions or, perhaps, evaluation is attempted by use of opinion surveys of involved personnel. The Temporal Model is particularly valuable because it provides a conceptual framework within which to consider these intangible variables. Moreover, the model can be applied at any stage of a relationship. Results of analysis of a given buyer-supplier relationship using traditional quantifiable variables can be greatly enhanced by the addition of results from application of the Temporal Model. For example, a supply chain manager can more effectively assess relationship status, determine whether or not to proceed to an initial deal, continue a relationship, or withdraw from an existing relationship by using the Temporal Model along with more traditional quantitative analysis.

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