

The Folly of Financial Myopia

Robert J. Trent
Lehigh University

Few executives would argue against the notion that their firms are under intense pressure to manage costs. Unfortunately, in an effort to enhance their financial position industrial customers have pursued financial strategies that can affect supplier-buyer relationships quickly and sometimes irreparably. This article focuses on the negative outcomes that can result when industrial customers take actions that affect adversely the financial standing of their suppliers. Research findings presented here will show that strategies that are financially myopic not only reduce the probability of receiving preferential treatment from suppliers, they can also affect other important dimensions of the supplier-buyer relationship.

INTRODUCTION

Few executives would dispute that their firms are under intense pressure to reduce costs and improve profitability. Unfortunately, in an effort to enhance their financial position industrial customers have at times taken actions that affect supplier-buyer relationships quickly and sometimes irreparably. Consider the potential outcomes from the following scenario.

A consulting team comprised of finance experts recommended that a retailer switch from its current 60-day period to a 220-day payable period with suppliers. The team's analysis included an abundance of charts, graphs, and data showing the financial benefits that would accrue to the retailer. What the analysis failed to consider was the impact this change would have on the financial condition of suppliers. It also failed to consider any retaliatory action by suppliers in response to this change. When these omissions were pointed out the consulting team responded by saying "that is outside the scope of this analysis." Unfortunately, what is "outside the scope" should be of concern to managers. Companies often spend an inordinate amount of time and resources developing trust-based relationships with their trading partners only to take actions that can cause those relationships to deteriorate quickly.

As a rebuttal to what is rapidly becoming an accepted business trend, this article focuses on the negative outcomes that can result when industrial customers take actions that affect the financial integrity of their suppliers. These actions can also circle back in ways that are not beneficial to the customer, making the customer's actions financially myopic. Research findings will reveal that financial myopia reduces the likelihood of receiving preferential treatment from suppliers, something that affects a customer's ability to gain an advantage over competitors.

WHAT IS FINANCIAL MYOPIA?

This discussion introduces a concept called financial myopia. Financial myopia is defined here as the inability to comprehend, anticipate, or be concerned about the longer-term consequences that result from shorter-term actions that affect adversely one or more parties within a value chain. While the term myopia is often thought of in terms of a visual defect, such as nearsightedness, it has a broader meaning. It also refers to a lack of imagination, foresight, or intellectual insight.

It does not take much imagination, foresight, or insight, for example, to unilaterally reduce a purchase price or lengthen payment terms to suppliers, which essentially results in a transfer of operating margin from a supplier to a buyer. All that is required is the coercive use of power by one party over another, something that is effective primarily in the short term. The longer-term effects from exercising coercive power, however, are often quite different. The sidebar “Financial Myopia at its Best” provides examples that, while anecdotal, illustrate this concept quite well.

Procurement and finance groups are primary contributors to financial myopia, although any corporate group can play a role. Consider the unintended consequences when a procurement group reduces its suppliers’ invoices by a certain percentage to lower its purchase costs; applies reverse Internet auctions in a way that forces suppliers to compete solely on price instead of critical non-price variables; fails to share savings from supplier-provided improvements; forces suppliers to hold inventory so they can deliver on a so-called just-in-time basis; and mandates annual price reductions, even in periods when material costs are increasing. Each of these has the ability to affect a supplier’s financial health.

Perhaps the most visible and financially myopic step taken by finance groups involves extending payment terms with suppliers. Typically, customers want to accelerate their collection of receivables while lengthening the time they take for payables. But, suppliers know that when a customer extends payment terms from the standard 30 days to 60 or even 90 days and beyond it affects their cash flow and profitability. The supplier, instead of a financial institution, is financing its customer’s payables, often with nothing in return but higher costs.

The evidence is clear that companies, particularly larger ones, are extending the length of time they take to pay suppliers. And, the evidence is clear these same companies are working hard to accelerate the collection of their receivables. The 2017 U.S. Working Capital Survey conducted by the Hackett Group reports the best performers in working capital management collect their receivables over two weeks faster, pay suppliers nearly three weeks slower, and maintain less than half the inventory compared with typical companies in their industry.

Extended payment periods often result in suppliers borrowing funds, at a fee, from a financial institution or other third-party providers (sometimes called fintechs) in order to receive payment in a reasonable time. This process, called supply chain finance, is often portrayed in publications as a win-win solution (McCrea, 2018). These portrayals conveniently ignore the fee that suppliers must pay to receive their payment. One financial provider, for example, charges 3.5% of the total amount of a 90-day receivable when providing payment to the supplier. This rate can change rapidly if interest rates increase, which many experts believe is a likely scenario. As the data presented here will show, receiving payment within a reasonable time is one of the most important outcomes that suppliers seek from their customers. Therefore, it is easy to conclude that extending payments to suppliers is one of the most myopic actions that a customer can take.

Causes of Financial Myopia

What causes customers to take actions that affect adversely the financial integrity of their trading partners? While no definitive answer applies to all situations, the pressure to improve financial performance is relentless across most industries, and taking actions that offer a rapid infusion of cash is almost too tempting to ignore. In an economic downturn, or in their quest to show financial improvement quickly, companies often extend payment cycles to improve their own cash flow.

Financial analysts maintain that larger companies in particular use this strategy since they are not worried about being cut off by suppliers. Not surprisingly, suppliers usually perceive this as a coercive

use of power. The practice of extending payment terms started with retailers that traditionally hold inventory for longer periods. This has since spread to industrial firms and further upstream to progressively smaller suppliers, many of which are ill-equipped to become the financing arm of larger companies. Customers are essentially going to their suppliers rather than a financial institution for credit (Storm, 2015).

A driver behind some of the actions taken by customers is a mandate to better manage their working capital and improve cash flow. The technical definition of working capital views it as the difference between current assets and current liabilities. Another perspective views operational working capital as the money committed to raw materials, work-in-process inventory, and finished goods plus accounts receivables less accounts payables. From a value chain perspective, and certainly from a supplier's perspective, there are desirable and less desirable ways to manage working capital. Finance and supply chain professionals often take very different approaches when addressing this topic.

Research findings reveal that supplier-provided non-price benefits, particularly preferential treatment, almost always outweigh, sometimes dramatically, the dollar value received from mandated supplier piece-price concessions and other financial mandates such as lengthened payment terms (Henke, Stallkamp, and Yenyurt, 2014). The challenge is to create an environment where suppliers willingly share innovation and other preferential treatment that is not necessarily available to other companies, some of whom may be the customer's direct competitors. Better firms know that working capital management techniques are not all equal in their effectiveness, not equal in how they affect supplier-buyer relationships, and not equal in terms of how a supplier will respond.

The Cash Conversion Cycle

An important metric that promotes financially myopic behavior is the cash conversion cycle (CCC). The conversion cycle calculates the number of days it takes a company to convert its resource inputs into cash. It measures the time each net input dollar is tied up in the production and sales process before it is converted into cash through sales to customers. The conversion cycle considers the time needed to sell inventory, the time needed to collect receivables, and the time a company is afforded to pay its bills without incurring penalties. This metric, also known as the cash cycle, is calculated as:

$$\text{Cash Conversion Cycle (CCC)} = \text{Days Inventory Outstanding (DIO)} + \text{Days Sales (receivables) Outstanding (DSO)} - \text{Days Payable Outstanding (DPO)}$$

Top industry performers are nearly three times faster at converting working capital into cash, with a cash conversion cycle (CCC) of only 17 days, nearly 30 days faster than typical companies. The conversion cycle improved by four percent in 2016 compared with 2015, largely because companies paid suppliers nearly four days slower. In 2016, days payable outstanding increased from 49.5 days to 53.2 days across all industries compared to the prior year (Ryan, 2017).

The cash conversion cycle is especially important for retailers and other businesses that have significant inventory, receivables, and payables. The shorter the cash conversion cycle, the less time capital is committed to working capital, and thus the better off a company is from a cash flow and profitability perspective. The conversion cycle is also widely studied by analysts, who then pressure financial managers to identify the fastest ways possible to shorten the cycle. Wall Street has accelerated the trend toward extending supplier payables as investment analysts compare one manufacturer to another and ask why a company is not managing its working capital like other companies (Storm, 2015).

One analysis views improvements in the cash conversion cycle with skepticism. One reason for this skepticism is that the collection of receivables (days sales outstanding) and days inventory outstanding both deteriorated during a recent period, even though the overall cash conversion cycle showed a net improvement compared with a previous period (Ryan, 2017). This analysis noted that any net improvement was due solely to lengthening the payable period with suppliers.

Understanding Cost Adders

A common response when a customer takes financially myopic actions is for suppliers to add additional fees (i.e., cost adders) wherever possible, usually in the form of a higher unit price, to mitigate the financial harm that is being inflicted upon them. Cost adders, which few suppliers admit to including in their price, are a type of surcharge. These fees are a rational response to financial myopia as predicted by reciprocity theory, which is discussed shortly.

Why is taking actions that result in cost adders financially myopic? Supplier cost adders often have subtle yet clear financial consequence for customers, many of which are unlikely to be considered. Inflating the purchase price of a good through cost adders increases the value of a customer's inventory, a result that affects the current asset account on the customer's balance sheet. Because current assets comprise an important part of total assets, inflated inventory values affect adversely some key corporate indicators such as return on assets and return on invested capital. Higher inventory values also result in higher inventory carrying costs. Interestingly, many firms do not track inventory carrying charges, an omission that itself is financially myopic.

Extending payment terms affects a supplier as operating margin is transferred from the supplier to the customer. What does it mean numerically to say that operating margins are transferred from the supplier to the customer? Suppose a supplier sells an item to a customer for \$5,000 on 30-day credit terms. The supplier has an 8% operating profit margin on this sale, which assumes the customer pays in 30 days, with a cost of capital of 10%. Assume the supplier actually pays the invoice in 60 days. What is the cost to the supplier and what is the effect on the supplier's operating margin when the customer takes an additional 30 days to pay?

The supplier's expected operating profit from this sale is $\$5,000 \times .08$, or \$400. The financial cost to the supplier of the extended 30-day payment term is the $\$5,000$ selling price $\times 10\%$ cost of capital $\times 30/365$, or \$41.09. The supplier's new operating profit is $\$400 - \41.09 , or \$358.91. The effect of the extended payment term reduces the operating profit margin on this sale from 8% ($\$400/\$5,000$) to 7.2% ($\$358.91/\$5,000$) with the customer improving its financial position. A smart supplier will build this finance charge into its unit price whenever possible.

While the effect of cost adders is important, it often pales in comparison with the opportunity cost from suppliers that are unwilling to share innovation, make direct investments in the supplier-buyer relationship, or provide favorable treatment to customers that treat them poorly. The importance of supplier-provided innovation is currently the focus of a research project by the *Center for Advanced Purchasing Studies* (Yan, Dooley, and Choi, 2018). The consequences of financial myopia to a customer can be much greater than what a basic cost adder conveys. Financial myopia can create a strategic disadvantage as others prosper from supplier-provided preferential treatment.

Linking Theory to Practice

Expecting suppliers to respond in kind when a customer takes actions that affect their financial health is predictable according to reciprocity theory. This theory states that reciprocity is an expected response to perceived kindness and unkindness, where kindness is a function of distributional fairness as well as fairness intentions (Falk and Fischbacher, 2006). According to this theory people evaluate the kindness of an action not only by its consequences but also by the intention underlying the action. As a social construct, reciprocity theory maintains that in response to friendly actions, individuals are frequently much nicer and cooperative than predicted by a self-interest model; conversely, in response to hostile actions they are frequently more punitive and even brutal (Fehr and Simon Gächter, 2000). Reciprocity theory is well suited for predicting that suppliers will take steps to counteract financial harm whenever possible.

Raising prices, adding fees to customer invoices, and sharing preferential treatment with other customers are just several ways that suppliers will counter financially myopic customers. Some suppliers will also forego business or seek new customers that are less likely to inflict financial pain, even when suppliers can absorb the changes to payment terms. Others will share their improvement ideas with other customers or forego altogether a customer's business. The CEO of a major supplier to the automotive

industry commented that he was willing to concede business if his company could not operate on the margins or terms that are reasonable for his organization (Ng, 2013). Even if a payable cycle, for example, returns to a normal period, suppliers will likely maintain their higher price. As reciprocity theory suggests, responses to hostile actions are often punitive.

Getting paid in a reasonable time and achieving a fair financial return are the most important outcomes that suppliers seek from their relationship with customers. Far too many finance professionals disregard this important point as they take actions that affect a supplier's financial standing. The evidence presented here will show this to be myopic.

LINKING CUSTOMER ACTIONS AND FINANCIAL MYOPIA

This discussion so far has been largely conceptual and anecdotal. The findings presented in this section are supported by primary data collected using an instrument called the *Supplier Satisfaction Survey*. This survey is a reverse scorecard where suppliers evaluate an industrial customer rather than a customer evaluating a supplier, which is traditionally the case in supplier-buyer relationships. Parts of the survey address how well the customer considers the financial interests and success of its suppliers.

Researchers worked with executives at two major companies (i.e., customers) to identify the suppliers they considered the most important to their success. Customer A is a wholly-owned subsidiary of a European company based in the U.S. The company's primary business is the production of transportation equipment. Of the 131 suppliers invited to be part of the study, 113 participated, yielding a response rate of over 86%. The second customer, also headquartered in the U.S., has operations and suppliers located throughout the world. Customer B's products involve industrial gases that are required by almost all industries. Of the 180 suppliers invited to participate, 131 participated, yielding a response rate of 73%. All data presented here come from the supplier satisfaction research project.

As part of this research respondents were asked to rate how important 25 items are to them and then rate their customer's performance for each item. These items were identified through focus groups and interviews where participants were asked to identify what is important when they interact with an industrial customer.

An important finding from the supplier satisfaction research is that satisfaction with a customer correlates directly with factors that relate to that customer's behavior (i.e., pay in a reasonable time, treat suppliers ethically, etc.) rather than demographic or other factors such as supplier size or the length of a relationship. No statistical relationship exists, for example, between the size of a supplier in terms of its sales and satisfaction with the buying customer. Furthermore, no relationship exists between the size of the contract relative to the supplier's total sales and satisfaction with the buying customer. Satisfaction also shows no relationship with the duration of the supplier-buyer relationship. In both studies satisfaction relates primarily to customer behavior and performance. This is a welcome finding because it suggests that as customers improve their performance they can affect supplier satisfaction. And, as will be explained, satisfied suppliers are more willing to provide preferential treatment to their best customers.

Table 1 identifies the four highest-rated items in terms of their importance to suppliers, something that suppliers across the two studies largely agree on. This table reveals clearly the importance that suppliers place on financially-related items. This is the first of a series of data results that tell a compelling story.

TABLE 1
IMPORTANCE TO SUPPLIERS OF CUSTOMER-PROVIDED PERFORMANCE ITEMS

Importance of the industrial gas customer to...	Avg. Rating	Importance of the transportation equipment customer to...	Avg. Rating
Demonstrate ethical and respectful behavior	5.63	Provide a fair financial return on our investment	5.73
Provide payment in a reasonable time	5.62	Provide payment in a reasonable time	5.68
Offer opportunities for a longer-term business relationship	5.55	Offer opportunities for a longer-term business relationship	5.63
Provide a fair financial return on our investment	5.49	Demonstrate ethical and respectful behavior	5.62
Average across all 25 performance items	5.12	Average across all 25 performance items	5.29
N = 131 suppliers		N = 113 suppliers	

Scale: 0 = not important; 3 = somewhat important; 6 = very important

The results in Table 1 suggest that taking actions that affect negatively the financial standing of suppliers might not be a smart option. Even though the suppliers participating in these two studies support very different customers and industries they share a commonality regarding what is most important to them. Three of the four most important items to suppliers in Table 1 affect financial well-being.

While the two studies are in agreement regarding the most important items, minimal agreement exists in the rating and rank order of the other 21 items that suppliers evaluated. A key conclusion is a belief that financial integrity is of paramount importance to suppliers regardless of industry. Industrial customers should consider this carefully before taking actions that impact those items that are the most important to their suppliers. Extending this analysis further, Table 2 presents the ratings of customer performance compared to an ideal customer for the items presented in Table 1.

TABLE 2
SUPPLIER RATING OF CUSTOMER PERFORMANCE COMPARED TO AN IDEAL CUSTOMER

Ability of the industrial gas customer to...	Avg. Rating	Ability of the transportation equipment customer to...	Avg. Rating
Demonstrate ethical and respectful behavior	5.42	Provide a fair financial return on our investment	2.92
Provide payment in a reasonable time	4.79	Provide payment in a reasonable time	3.18
Offer opportunities for a longer-term business relationship	4.71	Offer opportunities for a longer-term business relationship	3.53
Provide a fair financial return on our investment	3.98	Demonstrate ethical and respectful behavior	4.32
Average performance rating across all 25 items	5.02	Average performance rating across all 25 items	3.77
N = 131 suppliers		N = 113 suppliers	

Scale: 0 = much worse than the ideal; 3 = somewhat less than the ideal; 6 = equal to the ideal

While both studies provide valuable insights, the variance in supplier responses for the transportation equipment company is especially interesting. Although variability is the enemy of quality, in a data set it

allows for a more meaningful analysis. The remaining analysis presented here focuses largely on the transportation equipment customer, a customer that has a reputation for taking a much more aggressive financial stance with its suppliers compared with the industrial gas customer.

The data presented in Tables 1 and 2 reveal a troubling disconnect between performance and importance. Table 3 presents the five largest gaps between the transportation equipment customer's performance and the importance of that item to suppliers. While not shown in Table 3, a large break in the size of the gap occurs after these first five items. The magnitude of the gaps presented in Table 3 stand apart statistically from the gaps for the other 20 items evaluated by suppliers.

TABLE 3
LARGEST GAPS BETWEEN CUSTOMER PERFORMANCE AND ITEM IMPORTANCE

Performance Item	Average Rating of Customer Performance	Average Importance to Suppliers	Gap
Provide a fair financial return on investment	2.92	5.73	-2.81
Payment in a reasonable time	3.18	5.68	-2.50
Opportunities for early involvement during customer new product development	3.24	5.52	-2.28
Adequate lead times for planning	3.37	5.59	-2.22
Opportunities for a longer-term business relationship	3.53	5.63	-2.10

Performance scale: 0 = much worse than the ideal; 3 = somewhat less than the ideal; 6 = equal to the ideal

Importance scale: 0 = not important; 3 = somewhat important; 6 = very important

Gap = (Performance - Importance)

Table 3 again reveals the importance of financially-related items. The two most important items to suppliers are also the two items *where the customer is rated the lowest in terms of performance*, resulting in the largest gaps between importance and performance. The data become even more interesting when segmenting the suppliers for the transportation equipment customer by how they rate this customer in terms of paying in a reasonable time and providing a fair financial return.

Payment in a Reasonable Time

The number of responses for the transportation equipment provider divides almost evenly between two segments in terms of rating their customer's ability to pay in a reasonable time. The lower-rated segment includes suppliers that provided a customer rating of 0, 1, 2, or 3 in terms of paying in a reasonable time on a scale where 0 is much worse than the ideal customer; 3 is somewhat less than the ideal customer; and 6 is equal to the ideal customer. The higher-rated segment includes suppliers that provided a customer rating of 4, 5, or 6. Table 4 reveals definite contrasts between the two segments.

TABLE 4
CUSTOMER'S ABILITY TO PAY IN A REASONABLE TIME

Ability to Pay in a Reasonable Time: Lower-Rated Segment	Avg. Rating	Ability to Pay in a Reasonable Time: Higher-Rated Segment	Avg. Rating
Overall satisfaction with this customer (1= very dissatisfied; 7 = very satisfied)	4.02	Overall satisfaction with this customer (1= very dissatisfied; 7 = very satisfied)	5.10
How the supplier views this customer (1= a least preferred customer; 7 = a most preferred customer)	4.69	How the supplier views this customer (1= a least preferred customer; 7 = a most preferred customer)	5.80
Level of trust that characterizes the business relationship with this customer (1=very low, 7 = very high)	3.83	Level of trust that characterizes the business relationship with this customer (1=Very low, 7 = Very high)	6.23
Perception of the type of relationship the supplier has with the customer (1 = counter-productive; 7 = collaborative)	3.72	Perception of the type of relationship the supplier has with the customer (1 = counter-productive; 7 = collaborative)	5.15

The difference between the two segments regarding the trust that characterizes the supplier-buyer relationship is especially noteworthy. Compelling evidence exists that companies with the most trusting supplier relations also have the most financially rewarding relationships (Henke, Stalkamp, and Yenyurt, 2014). This supports two important conclusions. The first is that building trusting relationships with suppliers is a financially responsible activity that every company should undertake. The second conclusion is that by working to create trust-based relationships with suppliers, the opportunity to achieve meaningful supplier-provided benefits that are not necessarily available to other companies is maximized (Keith, Vitasek, Manrodt, and Kling, 2016).

It is difficult to overstate the importance of relationship trust. One noted expert maintains that trust is hard, real, and quantifiable and affects both the speed and cost of a relationship. When trust is present the cost to manage a relationship decreases while the speed or rate at which things are accomplished through the relationship accelerates. Perhaps most importantly, a lack of trust carries a tax, which is an economic burden that must be borne by parties as they discount and often must verify what they receive from another party. Opposite of a trust tax is the notion of a trust dividend. This dividend leads to improved communication and collaboration; better and faster execution of decisions; enhanced innovation and strategy development; and stronger engagement with the other party(s) (Covey, 2006). Preferential treatment from suppliers is an important part of the trust dividend. Table 4 reveals that an absence of trust, among other things, is clearly an issue for suppliers that believe their customer does not pay in a reasonable time.

Provide a Fair Financial Return to the Supplier

Similar to the analysis in Table 4, respondents divide almost evenly between the two segments regarding the ratings for the customer's ability to provide a fair financial return. Using the same scale and segmentation that was applied in Table 4, Table 5 also reveals important differences.

TABLE 5
CUSTOMER'S ABILITY TO PROVIDE A FAIR FINANCIAL RETURN

Ability to Provide a Fair Return: Lower-Rated Segment	Avg. Rating	Ability to Provide a Fair Return: Higher-Rated Segment	Avg. Rating
Overall satisfaction with this customer (1= very dissatisfied; 7 = very satisfied)	4.13	Overall satisfaction with this customer (1= very dissatisfied; 7 = very satisfied)	5.32
How the supplier views this customer (1= a least preferred customer; 7 = a most preferred customer)	4.78	How the supplier views this customer (1= a least preferred customer; 7 = a most preferred customer)	6.08
Level of trust that characterizes the business relationship with this customer (1=very low, 7 = very high)	5.06	Level of trust that characterizes the business relationship with this customer (1=very low, 7 = very high)	6.38
Perception of the type of relationship the supplier has with the customer (1 = counter-productive; 3 = competitive; 5 = cooperative; 7 = collaborative)	4.02	Perception of the type of relationship the supplier has with the customer (1 = counter-productive; 3 = competitive; 5 = cooperative; 7 = collaborative)	5.21

Why are the findings in Tables 4 and 5 noteworthy? While not presented here, an unusually strong correlation exists between satisfaction with the customer and how a supplier views that customer (a correlation of .73 exists between satisfaction with a customer and viewing that customer as preferred). Suppliers that believe their customer performs poorly on financially-related items are much less satisfied with their customer compared to suppliers that perceive their customer performs well. This suggests that when a supplier is dissatisfied with a customer, becoming a preferred customer is likely not to become a reality.

Why should being viewed as a preferred customer by suppliers be a concern? A clear relationship exists between satisfaction with a customer, how the supplier views that customer (i.e., preferred or not), and a supplier's willingness to provide that customer with preferential treatment (data supporting this appears shortly). Gaining insight into what is most important to suppliers increases the likelihood that a customer can direct behavior in ways that satisfy the most important needs of suppliers. And, in all likelihood, those needs are financially related.

A primary objective of commercial relationships should be the receipt of preferential treatment from suppliers that is not readily available to other customers, including those that may be direct competitors. Tables 4 and 5 reveal that suppliers that rate their customer lower in terms of paying in a reasonable time as well as their ability to provide a fair financial return are less likely to be satisfied with that customer. This, in turn, reduces the likelihood that the customer will receive preferential treatment. Table 6 identifies the kinds of preferential treatment that suppliers evaluated in terms of their willingness to provide to their customer.

TABLE 6
TYPES OF SUPPLIER-PROVIDED PREFERENTIAL TREATMENT

Supplier-Provided Direct Investment

- Capacity dedicated to the customer
- Personnel to work directly at the customer's facilities
- Engineers to support the customer's product design needs
- Investment in new equipment that benefits only the customer
- Exclusive use of new technology developed by the supplier
- Hold inventory to support the customer's needs
- Provide direct financial support if needed
- Create information technology systems unique to business with that customer

Supplier-Provided Innovation

- Product innovation
- Production process innovation
- Process innovation other than production processes

Supplier-Provided Favorable Treatment

- Shorter quoted order lead times
- Preferential scheduling of orders
- Early insight into the supplier's future product technology plans
- More favorable payment terms
- Performance improvement ideas
- More frequent deliveries
- Access to the supplier's executive level personnel
- Access to supply market information the supplier may possess
- Better pricing
- First allocation of output if supplier capacity is constrained
- Early warning to potential supply problems

Tables 7-9 reveal directly the detrimental effects of financial myopia. Table 7 identifies the three lowest-rated kinds of preferential treatment that suppliers are willing to provide to their industrial customer. It also shows the willingness to provide these items for the lower-satisfied segment (suppliers that provide a satisfaction score with the customer of 1, 2, 3 or 4) and the higher-satisfied segments (suppliers that provide a satisfaction score with the customer of 5, 6, or 7). The differences across the segments are not trivial.

The averages presented in Table 7 stand apart numerically from the next lowest-rated item, which has an average rating of 4.35 across the total sample. This table reveals that suppliers are least likely to provide preferential treatment that is financially related. The willingness to provide this type of preferential treatment is substantially less for suppliers that are the most dissatisfied. Since this customer demonstrates a willingness to enhance its financial standing at the expense of its suppliers, it should come as no surprise that suppliers are not too willing to extend financially-related preferential treatment in return. This is predictable according to reciprocity theory.

TABLE 7
LOWEST-RATED PREFERENTIAL TREATMENT ITEMS IN TERMS OF SUPPLIER WILLINGNESS TO PROVIDE

Lowest-Rated Preferential Treatment Items	Willingness to Provide: Total Sample	Willingness to Provide: Lower Satisfied Segment	Willingness to Provide: Higher Satisfied Segment
Provide more favorable payment terms to the customer	3.14	2.53	3.53
Provide direct financial support to the customer if needed	3.39	2.75	3.80
Provide better pricing to the customer	3.73	3.00	4.20
Average rating across 26 preferential treatment items	4.81	4.55	4.97

Scale: 1 = not willing to provide to this customer; 4 = somewhat willing to provide; 7 = very willing to provide to this customer

As a comparison, supplier willingness to provide the industrial gas customer with more favorable payment terms (4.22); direct financial support if needed (3.83); and better pricing (5.01) are appreciably higher than the figures in Table 7. It is important to note that suppliers to the industrial gas company also have a much higher level of overall satisfaction with their customer (6.22/7) compared with suppliers to the transportation equipment company (4.58/7).

Table 8 presents the correlation between supplier satisfaction with the transportation equipment provider and a supplier's willingness to provide specific types of preferential treatment. Higher correlations mean that as supplier satisfaction with the customer increases, the willingness of suppliers to provide the customer with that type of preferential treatment also increases.

**TABLE 8
HIGHEST CORRELATIONS BETWEEN SUPPLIER SATISFACTION AND
WILLINGNESS TO PROVIDE PREFERENTIAL TREATMENT**

Preferential Treatment Item	Correlation: Total Sample*
Provide direct financial support to the customer if needed	.42
Provide better pricing to the customer	.41
Hold inventory to support the customer's needs	.36
Provide more favorable payment terms to the customer	.35
Average correlation across 26 preferential treatment items	.19

* Represents the correlation between supplier satisfaction with the customer and supplier willingness to provide a preferential treatment item

While not immediately obvious, Tables 7 and 8 are the most revealing of all the data presented here. The kinds of preferential treatment that suppliers are the least willing to provide (Table 7) are the items that correlate the highest with supplier satisfaction (Table 8). In other words, as suppliers are increasingly satisfied with their customer they are increasingly willing to provide financially-related preferential treatment that suppliers from the total sample are the least likely to provide (Table 7). Holding inventory to support the customer's needs (from Table 8) is an item that also offers a direct financial benefit to the customer. Conversely, as suppliers become less satisfied with their customer they are less likely to provide financially-related preferential treatment.

Lastly, Table 9 presents the three highest correlations between the customer's ability to provide a fair financial return and a supplier's willingness to provide specific types of preferential treatment. This table reinforces the finding that customers that support the financial needs of their suppliers should expect reciprocal treatment in how suppliers treat them financially. As suppliers increasingly indicate their customer provides a fair financial return, they are increasingly willing to provide financially-related preferential treatment in return.

TABLE 9
HIGHEST CORRELATIONS BETWEEN THE CUSTOMER PROVIDING A FAIR RETURN
AND SUPPLIER WILLINGNESS TO PROVIDE PREFERENTIAL TREATMENT

Preferential Treatment Item	Correlation: Total Sample*
Provide better pricing to the customer	.53
Provide more favorable payment terms to the customer	.52
Provide direct financial support to the customer if needed	.43
Average correlation across 26 preferential treatment items	.19

* Represents the correlation between providing the supplier with a fair financial return and supplier willingness to provide a preferential treatment item

MANAGERIAL DISCUSSION

The evidence presented here suggests that financially myopic actions and performing in ways that create supplier dissatisfaction decrease the likelihood that an industrial customer will receive preferential treatment. The reality is that satisfied suppliers are more willing to provide valuable kinds of preferential treatment to their customers. Dissatisfied suppliers are less willing to provide this treatment, a conclusion that should now be more obvious.

The findings reported here are similar to an earlier study of European automotive suppliers that investigated why suppliers like or dislike their industrial customers. In that study a supplier's willingness to do business with a customer correlates closely with satisfying a supplier's expectations in four areas—the supplier's financial return, the customer's longer-term support of the supplier, the customer's willingness to reward cost-saving ideas, and the customer's ability to protect proprietary technology (Snyder, 2005). The willingness of suppliers to shift business away from less-favorable customers was also noted in that study.

Financial myopia with suppliers is not a new phenomenon. Historically, General Motors offers one of the most blatant examples of myopia. During the early 1990s, a period when the company was in severe financial distress, GM's new CEO brought with him from Europe his openly emotional and charismatic chief procurement officer, Dr. Jose Ignacio Lopez. Viewed as a brilliant cost cutter, Lopez was instrumental in GM's European turnaround. It was not long after Lopez's arrival that GM put existing contracts up for bid and expected suppliers to provide double-digit price reductions and commit to major productivity improvements if they expected to keep GM's business.

Suppliers soon realized that Lopez cared very little for long-standing relationships or contracts, including relationships with GM's wholly-owned parts subsidiaries. GM's supplier relationships continued to suffer long after Lopez exited the company. A survey of U.S. suppliers by *Planning Perspectives* ten years after Lopez's departure revealed that GM's *Supplier Working Relationship Index* score was the lowest of all automobile producers (Verespej, 2005). The actions taken by Lopez took a severe and long lasting toll on GM's relationships with suppliers.

While few companies pursue actions as dramatic as General Motors, the financially myopic actions being taken today are definitely on the spectrum. Customers and suppliers both can take steps to avoid or counter the effects of financial myopia. For customers it is a matter of treating suppliers fairly and ethically, including paying in a reasonable time and recognizing the supplier's need to earn a fair financial return. Also, gaining insight into what is most important to suppliers increases the likelihood that a customer can behave in ways that will initiate the chain of events that leads to preferential treatment. Those customers that put forth the effort to understand the needs of their suppliers should be better off

because of that effort. Engaging in financially myopic behavior represents a conscious decision by a customer. Not engaging in financially myopic behavior is also a conscious decision.

Customers can also take steps to mitigate the effect of actions that would normally be construed by suppliers as punitive. A customer can offer a supplier, for example, a greater portion of its purchase requirements with a longer-term contract that offsets the impact of lengthened payment terms. Or, the customer may offer the supplier opportunities to participate early in product development, something that most suppliers welcome. The customer can even offer the sharing of savings from supplier-initiated improvement ideas.

Suppliers have a range of options available to them when confronted with financially myopic customers, most of which are detrimental to the customer. They can raise prices wherever possible; build cost adders into their unit price; forego a customer's business; search for new customers to replace less desirable customers; withhold preferential treatment of all kinds, including the sharing of innovation; provide preferential treatment to competitors; refuse to share savings from internally-derived improvements; curtail the amount of credit extended to the customer; and resist special customer requests, such as holding inventory or providing product design support. The list of retaliatory actions is long, something that industrial customers are advised to remember.

CONCLUDING THOUGHTS

Preferred customer status can lead to benefits that are not available to all customers, something that can create a competitive and even strategic advantage (Porter, 1990). This is often hard for many finance and procurement professionals to grasp, likely because they are motivated by measurement systems that promote short-term behavior that counters the development of effective relationships. For whatever reason, an increasing number of industrial customers are not anticipating the longer-term consequences of their financial actions. The effects of financial myopia, however, are real, are predictable, and are easily preventable.

Sidebar: Financial Myopia at its Best (or Worst)

- A major U.S. company pays its invoices in 90 days or more even though suppliers typically quote payment terms of 30 days. This company also takes any discount offered by suppliers for early payment. Privately, some suppliers admit they try to recoup the added costs of this customer's behavior through higher prices. They also admit they have minimal desire to share new ideas with this customer.
- A European industrial producer insists that all international purchases take place in Euros. What appears to be a good deal for the producer may not actually be all that good. Suppliers understand they have assumed complete responsibility for managing currency risk and will take steps to manage that risk. They will try to recoup these currency management costs through cost adders.
- A supplier informed its customer, a Fortune 50 company, that it could reduce its invoice amount by 5% if it did not make quantity or delivery date changes within 10 days of the scheduled due date. The reality soon set in that the supplier had been including a cost adder in its price to compensate for this customer's practice of frequently changing schedules.
- A corporate trainer was surprised to find that his client that he had been working with for 12 years, decided without any notification to shift its payments to suppliers from 30 days to 90 days and longer. When it came time to re-bid a sole-source contract the trainer elected not to participate. This created a major gap since the training program was developed partly around the trainer's skill set. The trainer concluded that working with this customer had simply become too difficult.
- A supplier that manufactures specialty metal products for commercial and military uses has seen its customers taking longer to make payments. The supplier now assigns an employee to calculate the financial cost of longer payment terms, which the company builds into its quoted prices

whenever possible. This company will not admit to this practice publicly and, as its business grows, has become more selective regarding which customers it will serve.

- A supplier to the pool and spa industry has a customer that continually insisted on two-day lead times, even though the supplier quoted two-week lead times. Additionally, the customer almost always postponed payment to the supplier. In the words of the company owner, “Working with this customer became so frustrating that we fired the customer.” After the customer was unable to find an adequate replacement, it reconnected with the original supplier. But, in the words of the company owner, “Now it is business on our terms, not the customer’s.”
- An industrial provider of valves, processing instrumentation, and mechanical systems to Anheuser-Busch was not pleased when, after Anheuser-Busch was purchased by InBev, payment terms shifted from 30 days to 120 days. The company owner maintained that longer payment terms had a major effect on the company’s bottom line. The owner ultimately concluded his company could afford to lose Anheuser-Busch’s business rather than wait four months to get paid.

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