

Lehrstuhl für Logistikmanagement



Universität St.Gallen



Copenhagen
Business School
HANDELSHØJSKOLEN

Supplier integration and the challenge of relationship-exit strategies

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Agenda

1. The concept of supplier integration: Benefits and challenges

2. The concept of supplier switching management: Theoretical foundation of exit strategies

The emerge of supplier integration in contemporary supplier-buyer relationships

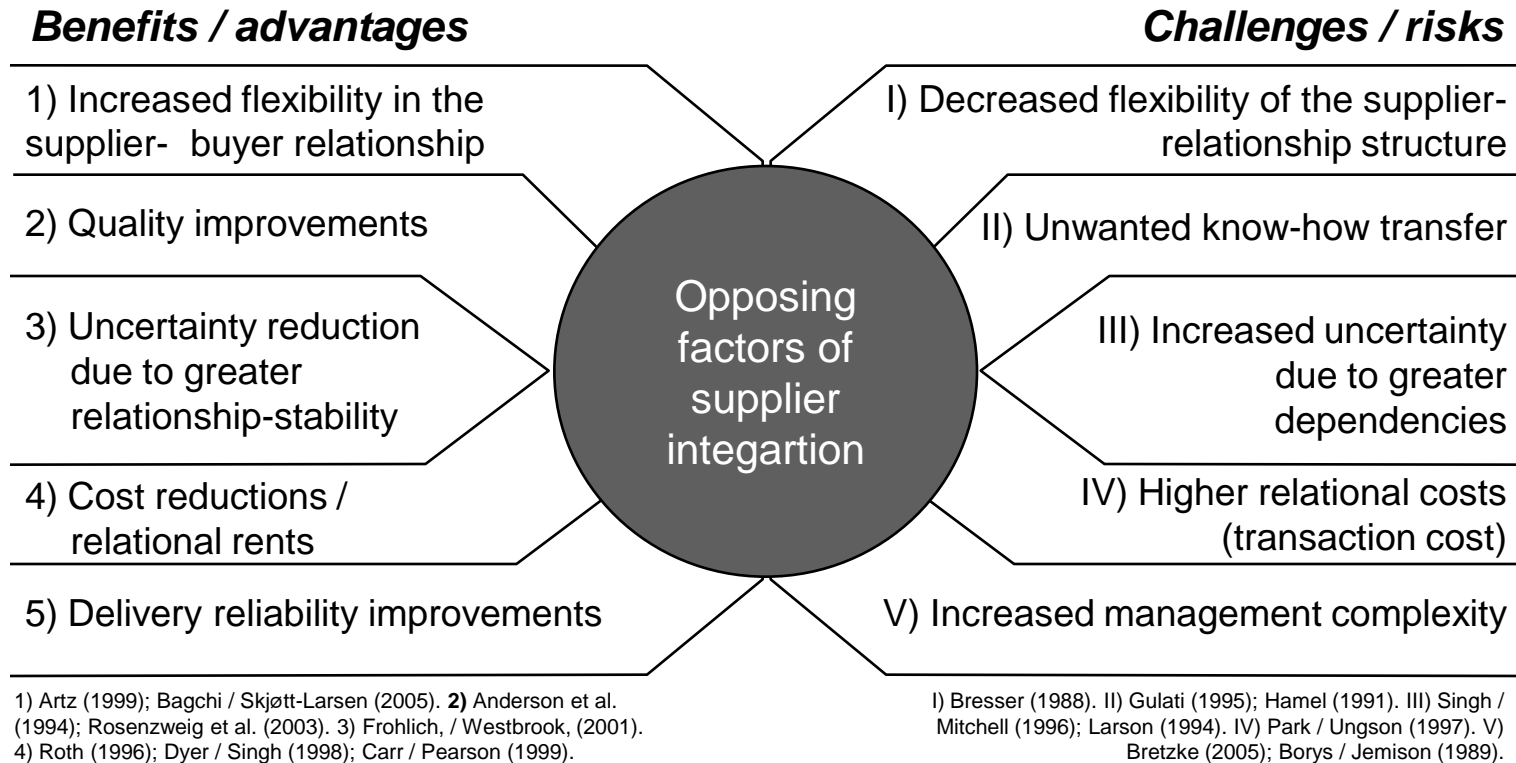
- ➔ Market trends like globalization, fast changing customer preferences, and short product lifecycles, have lead to an extremely **dynamic** and highly competitive market **environment**
- ➔ Dynamism has **increased uncertainties** and challenges companies to achieve sustainable **competitive advantages**
- ➔ Companies seek competitive advantages by **concentrating** on **core-competencies**
- ➔ **Outsourcing** has led to a decreased net added value ratio in several industries
- ➔ Accordingly, companies have to make sure that they always have reliable and efficient **access to superior resources** from outside the firm boundaries
- ➔ To improve the supplier-base performance, companies accept a slightly loose of bargaining power by **concentrating on fewer, yet integrated suppliers**
- ➔ Through integration, the buyer expects a greater willingness by the vendor to build relationship specific investments and ends up “...being better off by keeping a **smaller piece of a bigger pie.**” Bakos / Brynjolfsson (1993), pp. 43.



How can companies achieve a competitive advantage through supplier integration without being caught in a relationship, whose advantageousness can change fast due to the dynamic environment?

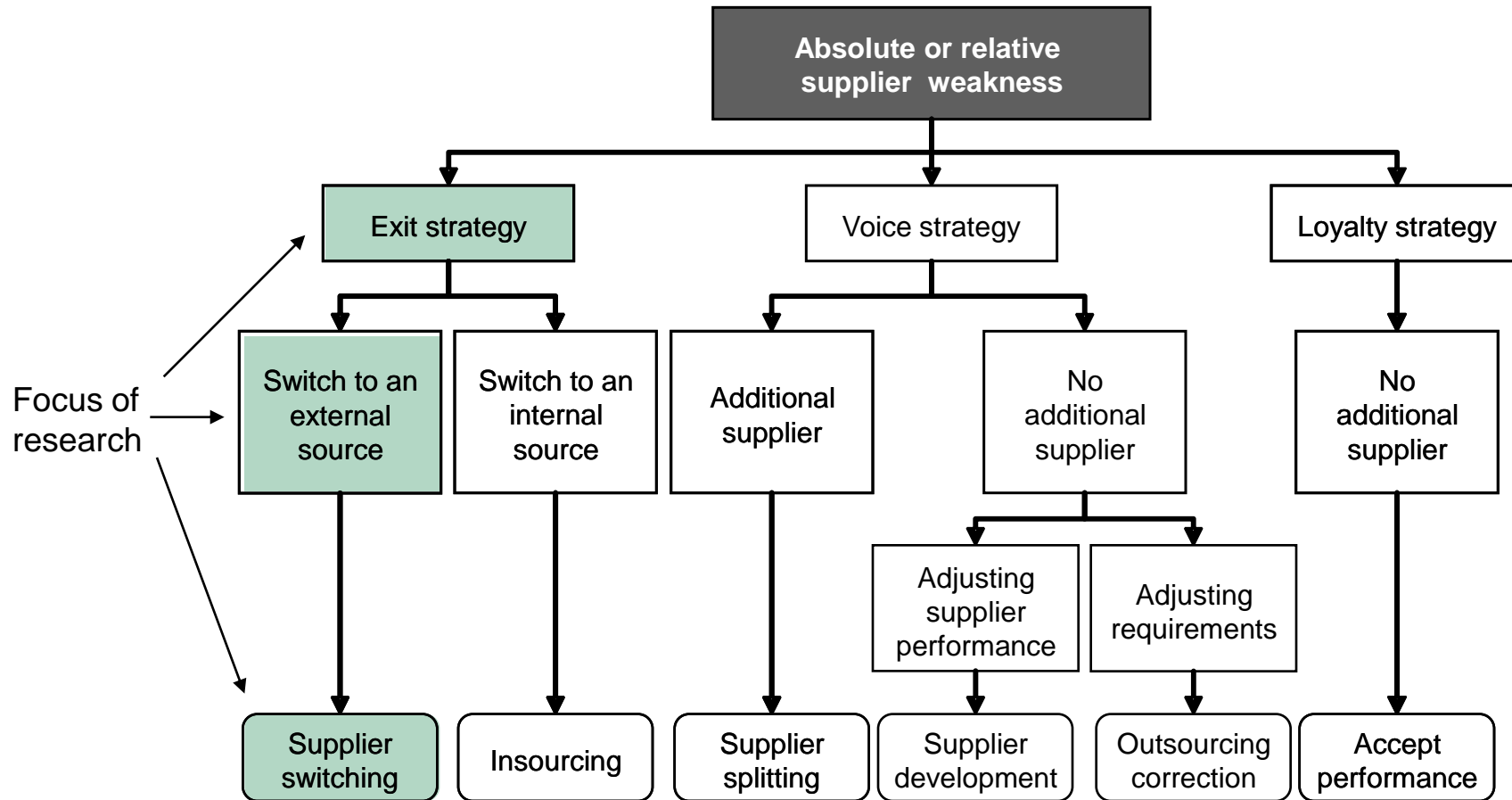
Supplier integration can be achieved through the meshing of inter-company business processes Wagner (2003), p. 4.

Exemplary benefits and challenges of supplier integration:



The challenges and risks remain under the surface as long as the supplier-buyer relationship works well. However, if a supplier weakness occurs the risks can become a concrete threat

If a company identifies a supplier weakness, three different management options can be followed



See: Hirschman, A. (1970); Helper, S. (1990); Hofmann, E. (2007)

▶ *In integrated supplier-buyer relationships, exit strategies are combined with several challenges and barriers. One important challenge can be described as a flexibility dilemma...*

Dilemma between flexibility **in** and **of** supplier-buyer relationships

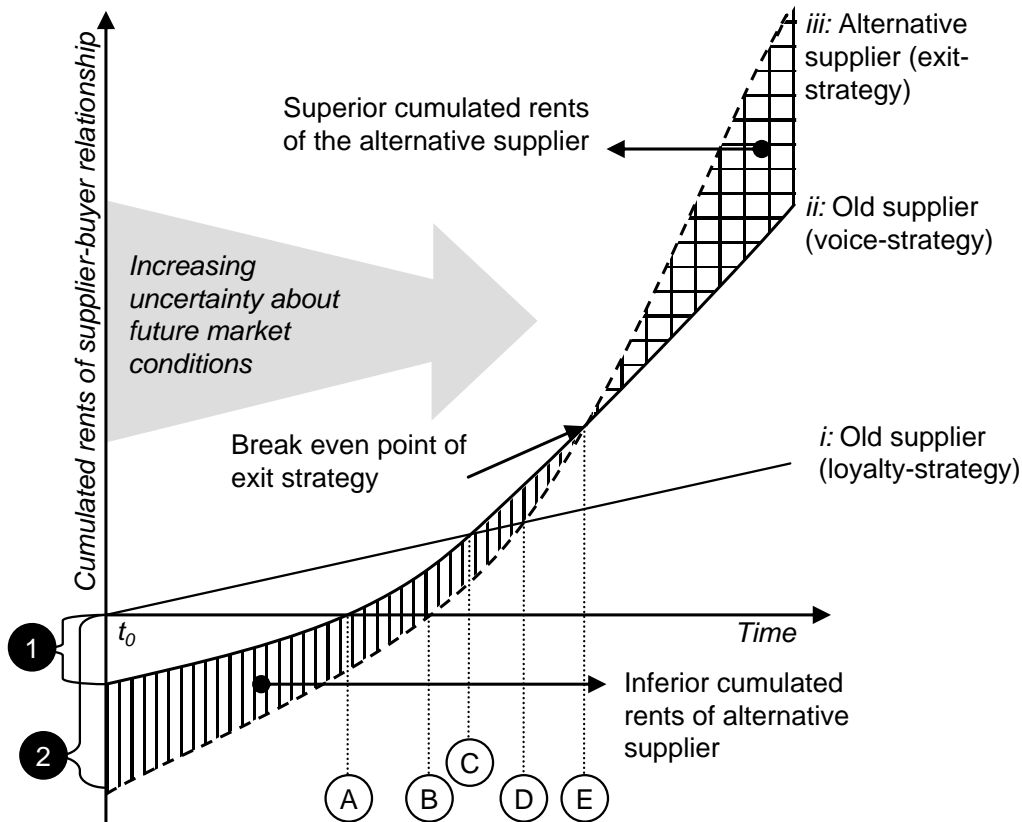
- Companies seek competitive advantages and rents, which can be achieved through **integrated supplier-buyer relationships**
- **Relational rents** are **supernormal profits** that are jointly generated in an exchange relationship and cannot be generated by either firm in isolation Dyer and Singh (1998), p. 662.
- Relational rents can only be achieved through **relationship-specific investments**, intensive knowledge exchange, the combination of complementary resources, and effective governance mechanisms Dyer and Singh (1998), pp. 662; Lavie (2006), pp. 644.
- Specific investments make supplier-buyer relationship exit strategies more difficult, since they **increase the dependency** on the supplier and turn into sunk costs if the exchange relationship will be terminated
- This causes a **goal conflict** between the achievement of relational rents and flexibility **in** supplier-buyer relationships and the realization of independence and flexibility **of** supplier-buyer relationships:

Flexibility in supplier-buyer relationships can often only be achieved through relationship-specific investments. These in turn, decrease the flexibility of the supplier-structure.



This dilemma can be explained by illustrating the basis of decision for the choice of the exit-, voice-, or loyalty-strategy after a supplier weakness

The schematically advantageousness of supplier-buyer relationship exit-strategies in comparison to a voice- and loyalty-approach



- Ⓐ Time to absolute supplier development investment amortization
- Ⓑ Time to absolute switching cost amortization
- Ⓒ Time to relative supplier development investment amortization
- Ⓓ Time to relative supplier switching cost amortization
- Ⓔ Time to alternative suppliers superiority
- ① Supplier switching cost
- ② Cost of old supplier development

In order to make supplier switching more realistic and increase the flexibility of supplier-buyer relationships, two levers can be used:

1) Decrease of supplier switching cost and 2) Shorten the time to alternative supplier's superiority

However, these levers should be utilized without sacrificing the advantages of integrated supplier buyer relationships. Thus the question is: How to increase relationship flexibility without sacrificing relational rents.

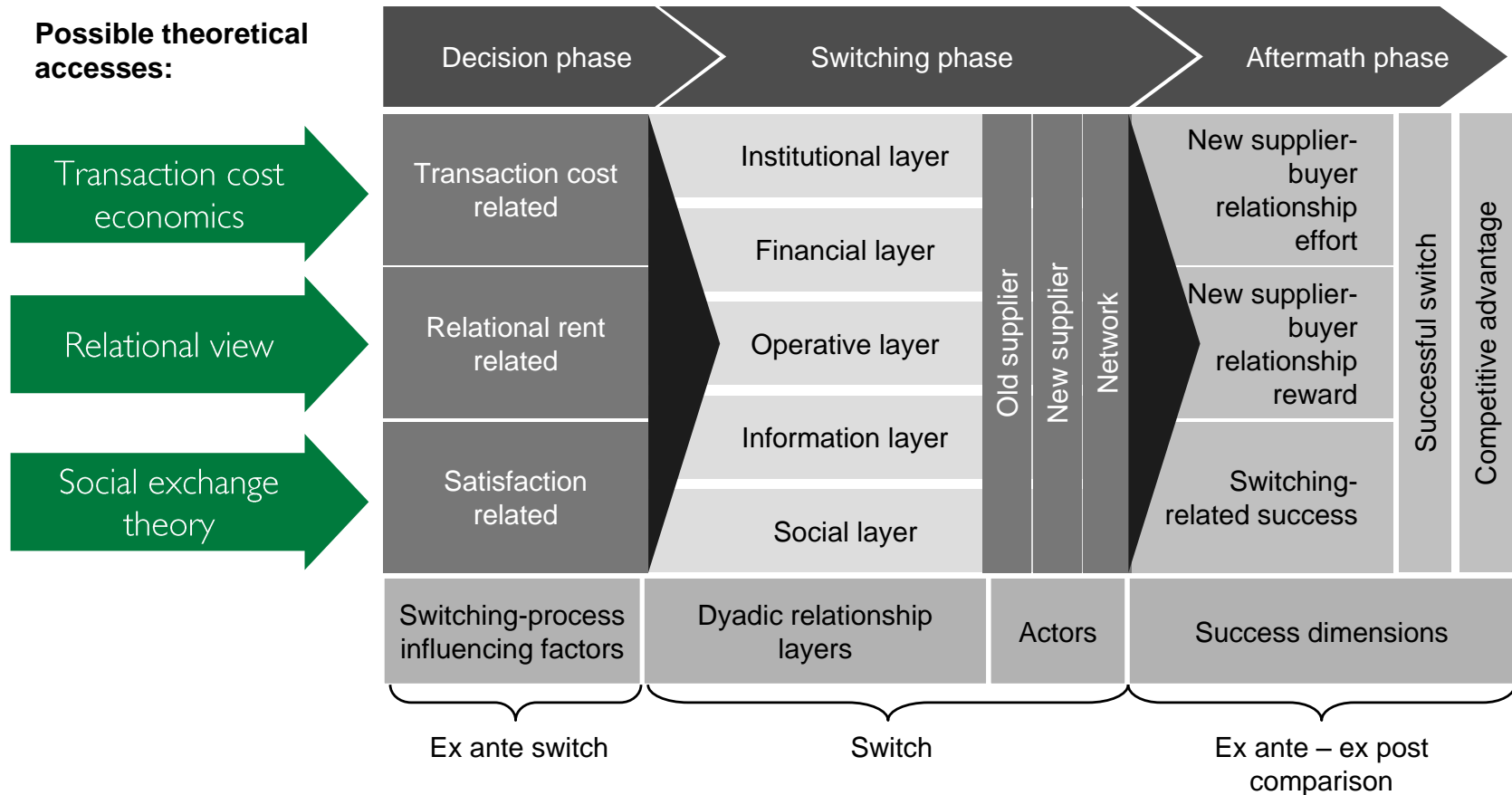
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Introducing the concept of Supplier Switching Management (SSM)

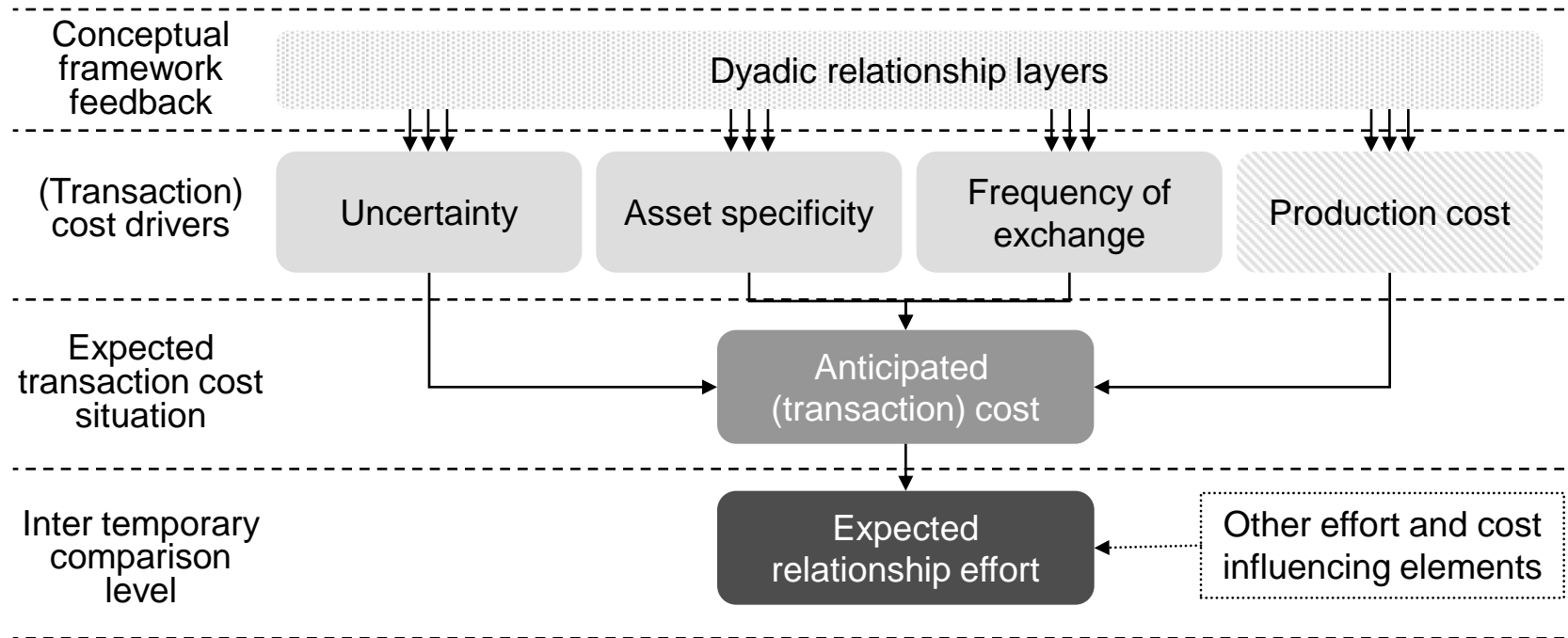
Supplier switching management deals with unintended and unplanned changes of the long-term supplier structure. The concept encompasses the planning, organization, and control of a supplier switch, which is the change of an integrated supplier to an alternative supplier that has to be integrated.



▶ *The three theories offer different avenues to an explanation and description of the phenomenon of supplier switches*

Transaction cost economics and supplier switching management

A buying company has certain perceptions about the maximum acceptable amount of (transaction) cost and will evaluate four cost drivers before integrating suppliers ...

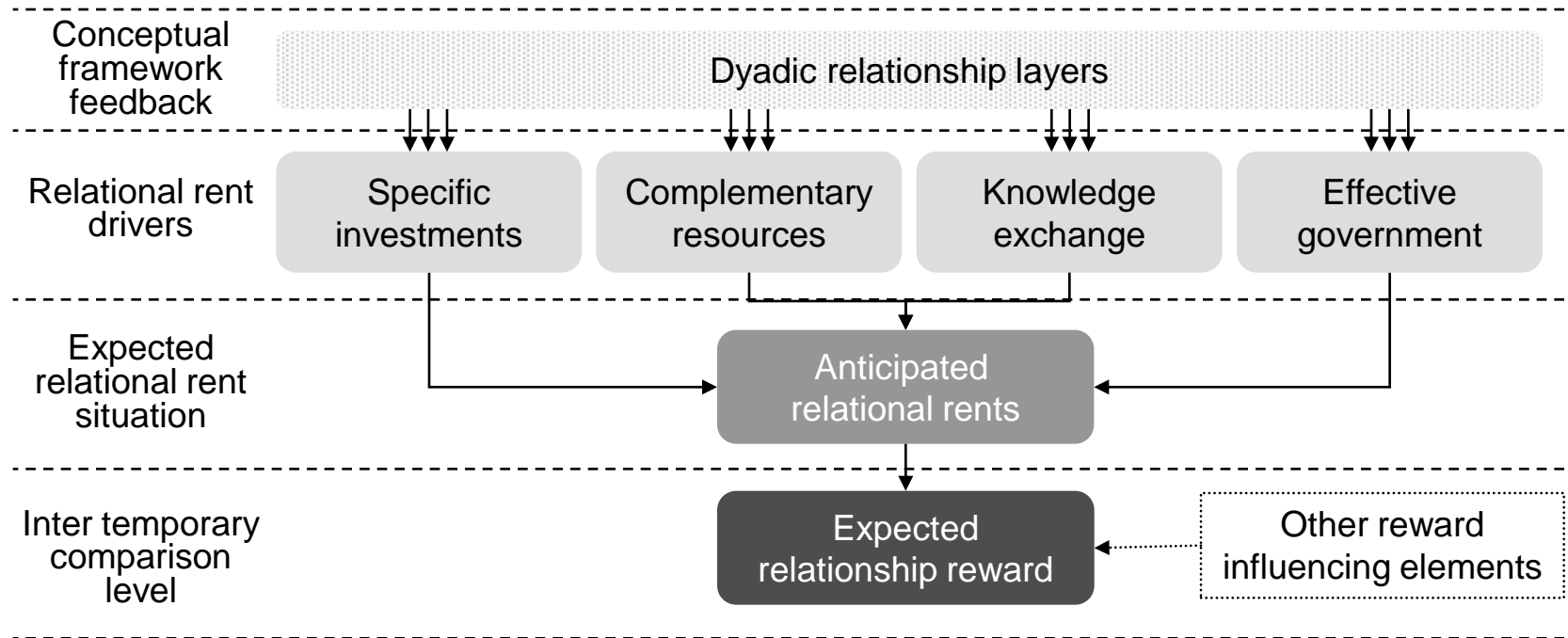


Switching need influencing tendencies (c.p.)	<p>If: Uncertainty ↑, Asset specificity ↑(↓), Production cost ↑</p> <p>Than: Real transaction cost > Anticipated transaction cost</p> <p>Than: Real relationship effort > Expected relationship effort</p>
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▶ *The buyer decides about the level of supplier integration in consideration of the anticipated transaction costs. As soon as the real transaction costs are higher than expected, disintegration and switching tendencies will arise*

The relational view and supplier switching management

A buyer evaluates the rewards of relationships as well. The rewards above comparable supplier-buyer relationships are called “relational rents” that are driven by four elements:



Switching need influencing tendencies (c.p.)	<p>If: Specific investments ↓, Complementary assets ↓, Knowledge exchange ↓, Effective governance ↓</p> <p>Than: Anticipated relational rents > real relational rents</p> <p>Than: Expected relationship reward > real relationship reward</p>
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An increase of one of the relational-rent drivers goes along with an intensification of supplier-buyer integration. If one of these elements becomes weaker, disintegration and switching tendencies will arise

Transaction cost economics and the relational view can be integrated into the social exchange theory

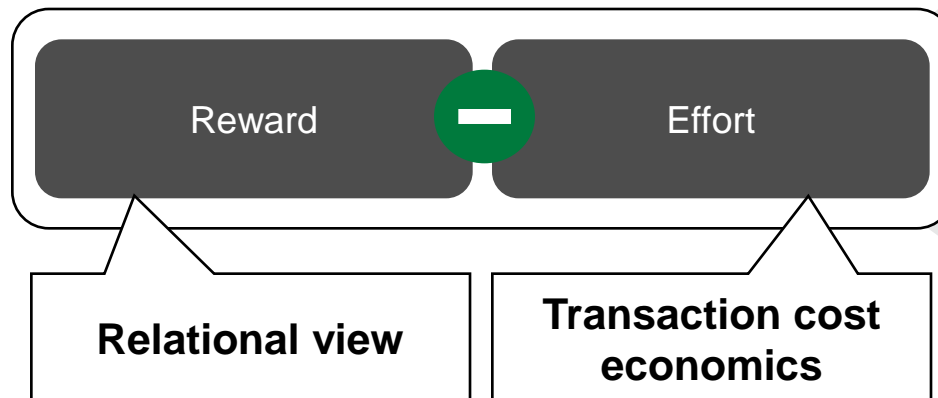
Social exchange theory relationship evaluation criteria

Outcome = *Describes the real result of the relationship (real reward – real effort)*

Comparison level (CL) = *The threshold above which an outcome seems to be attractive*

Comparison level alternative (CL_{new}) = *Reflects the best payoff available outside the current relationship*

Integrating transaction cost economics and the relational view:



Expected reward – expected effort = **Comparison level**

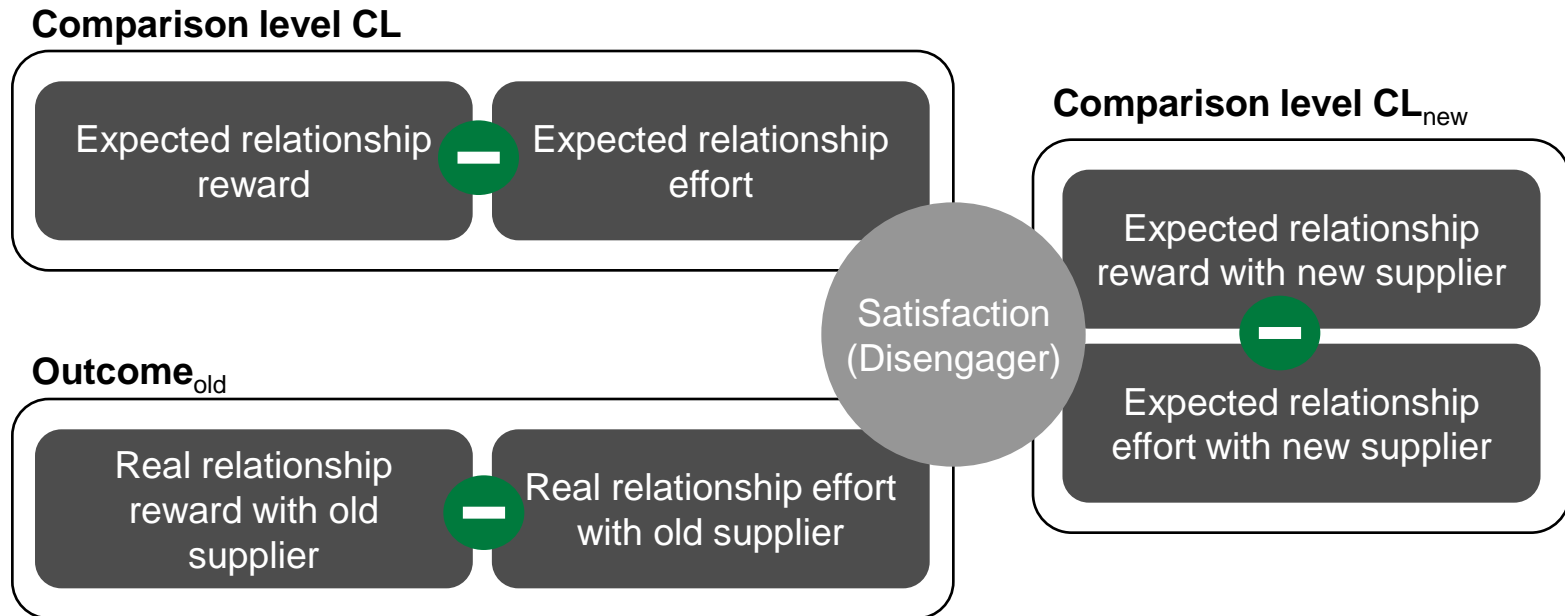
Expected reward_{new} – expected effort_{new} = **Comparison level alternative**

Real reward – Real effort = **Outcome**

▶ *The integration of transaction cost economics and the relational view into the social exchange theory helps to make the concept of satisfaction more tangible...*

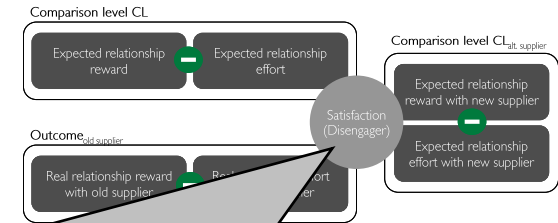
The social exchange theory and supplier switching management

The process of comparing expected relationship efforts and rewards with the real efforts and rewards in the particular supplier-buyer relationship, leads to a certain degree of satisfaction. This degree of satisfaction can be increased or decreased by comparing the current supplier-buyer relationship with an alternative one



► *Satisfaction in the context of a supplier-buyer relationship is influenced by the general expectations about the outcome of a certain transaction, the real outcome, and possible alternative outcomes. If one of these elements changes, disintegration and switching tendencies may arise*

The social exchange theory and supplier switching management (1 / 2)



Relative value of Outcome; CL, CL_{alt} (qualitative comparison)

Outcome > CL > CL_{new} → satisfying, stable, dependent

Outcome > CL_{new} > CL → satisfying, stable, nondependent

CL_{new} > CL > Outcome → not satisfying, break relationship, happy elsewhere

CL_{new} > Outcome > CL → satisfying, unstable, happier elsewhere

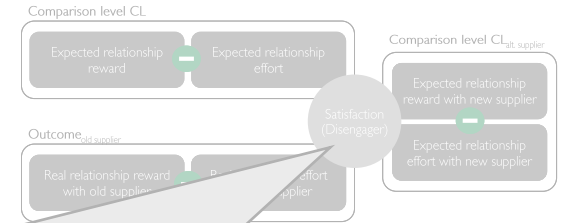
CL > CL_{new} > Outcome → not satisfying, break relationship, continue unhappy

CL > Outcome > CL_{new} → highly unsatisfying, can't break away, dependent and unhappy

Roloff (1987)

▶ *The elements of transaction cost economics and the relational view can be integrated in the social exchange theory. Together they offer a comprehensive picture about disintegration and supplier switching tendencies*

The social exchange theory and supplier switching management (2 / 2)



- Relative value of Outcome**
- Outcome > CL > CL_{new} →
 - Outcome > CL_{new} > CL →**
 - CL_{new} > CL > Outcome → not satisfying, break relationship, happy elsewhere
 - CL_{new} > Outcome > CL →**
 - CL > CL_{new} > Outcome → not satisf
 - CL > Outcome > CL_{new} → highly un
unhappy

Example (1):
 Price, quality, and transaction cost are better than presupposed, other alternative suppliers could perform to a level which is still satisfying, thus the buyer is happy in the transaction relationship but could go away and would still be happy elsewhere.

Example (2):
 Price, quality, and transaction cost are better than presupposed. However, another alternative supplier could perform even better and thus, the buyer will switch and be happier elsewhere.

▶ *The elements of transaction cost economics and the relational view can be integrated in the social exchange theory. Together they offer a comprehensive picture about disintegration and supplier switching tendencies*

Conclusions

- ➔ Supplier integration is a beneficial concept and can help a company to attain relational rents
- ➔ The benefits of supplier integration will be achieved on account of a buyers independency, which causes challenges as soon as a supplier weakness occurs
- ➔ Supplier switching management accepts the required actions of supplier-integration as sources of dependencies and is not affecting or weakening them
- ➔ This allows a company to achievement competitive advantages through supplier integration and preserve flexibility of supplier-buyer relationships simultaneously
- ➔ The combination of transaction cost economics, the relational view, and the social exchange theory helps researchers to understand the reasons for supplier switches and can explain, why companies sometimes stay in unsatisfying exchange relationships

Empirical research about supplier switching management will be provided in a the dissertation project: “Managing switches of integrated supplier-buyer relationships” (Finalized February 2008)

Thank your for your attention



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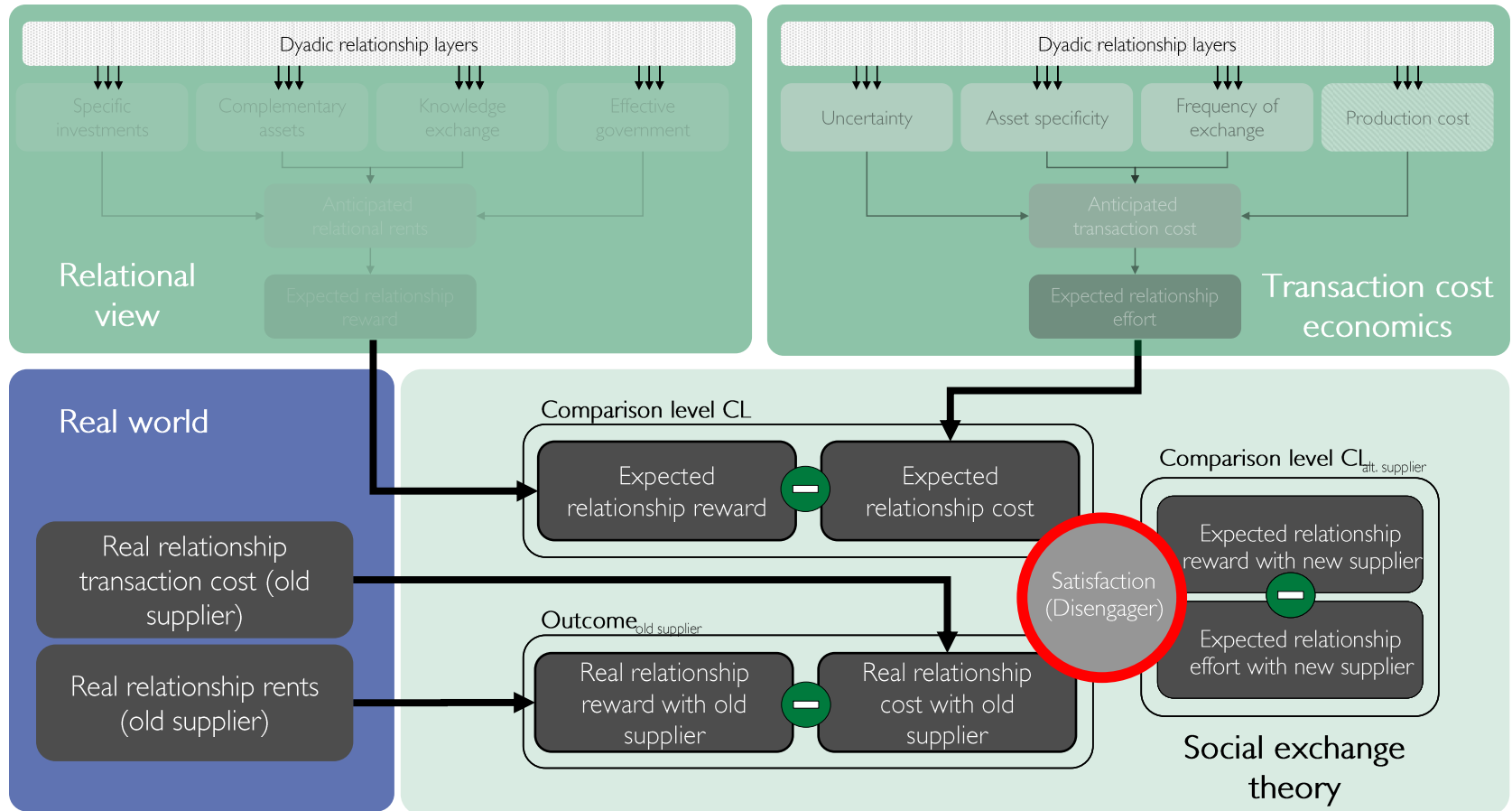
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(Backup) Interconnection of transaction cost economics, the relational view, and the social exchange theory (ex ante situation):



► At the end, supplier switching decisions are primarily driven by the buyers satisfaction

(Backup) Interconnection of transaction cost economics, the relational view, and the social exchange theory (ex post situation):

