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From relationships to partnerships—new forms of cooperation between buyer and seller

Olaf Ploetner [a,1], Michael Ehret [b,*]

[a] esmt European School of Management and Technology, Schlossplatz, 110178 Berlin, Germany
[b] Department of Marketing, Freie Universitaet Berlin, Otto-von-Simson-Str. 19, 14195 Berlin, Germany

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Abstract

An increased focus on operational performance and the reliance on fewer suppliers by industrial customers call for a higher quality of buyer–seller relationships.

This article elaborates on economic explanations for value generated partnerships and describes the distinctive qualities of partnerships as something more than ordinary customer relationships. Particular attention is paid to the managerial implications and pitfalls awaiting companies when pursuing a partnership approach and a definition of vertical partnerships is provided.

Keywords: Vertical partnerships; Collaborative advantage; Trust; Non-zero sum games; Specific investments

1. Introduction: what are partnerships and why do they matter now?

Business-to-business-partnerships are gaining rising attention in management and in academic research. Increasingly companies are advised to pursue their collaborative advantage (Moss Kanter, 1994; Dyer, 2000; Teng, 2003) in order to co-create world-class products, attract the most valuable customers and reach extraordinary profits. Accordingly researchers link the current leading edge of Toyota in the automotive industry to its superior collaboration competencies (Dyer & Singh, 1998; Dyer & Hatch, 2004; Economist, 2005a), and we may well believe that Chrysler survived near closedown by investing in the establishment of a network of supplier partnerships (Dyer, 1996).

By restraining from the arms length relationship approach so common in US business, Toyota attracts the collaboration of world-class suppliers, who share path-breaking technologies and help to leverage value chain efficiency. In our consulting and research experience we were able to observe partnerships pursuing a scope of collaboration not easily found in ordinary customer relationships. In our special issue, Siemens board member Klaus Wucherer describes an example on how extremely positive experiences in the Automation and Drives division helped to transform the strategic approach of the whole multi-division company operating on a global scale. Now, at Siemens, business units are required to provide open interfaces, pursue common standards and to identify and realize system-wide value propositions.

What makes vertical partnerships so special compared with ordinary buyer–seller-relationships? We define a vertical partnership to be a specific type of relationship between a customer and his supplier, based on mutual dependency and trust, where both parties are committed to collaboration beyond a sequence of buying–selling transactions. As an example the European car manufacturer Fiat and the technology driven automotive supplier, Bosch, in addition to their standard supply collaboration on brake systems research, hold joint training-courses for employees and even engage in common communication campaigns. This is a special type of working partnership, as perceived by Anderson and Narus (1990), where the collaboration is based on the "…mutual recognition and understanding that the success of each firm depends in part on the other firm".

This definition excludes mergers and acquisitions, where collaboration is coordinated by a hierarchical governance

* Corresponding author. Tel.: +49 30 838 56 014, +49 30 838 54 557.
E-mail addresses: ploetner@esmt.org (O. Ploetner), michael@michael-ehret.com (M. Ehret).
[1] Tel.: +49 30 212 31 8000; fax: +49 30 212 31 8001.

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structure, and spontaneous market transactions on the opposite extremes of the spectrum (see Heide, 2003; Wathne & Heide, 2004). Also types of long-term buyer–seller relationships, confined to intense collaboration on a series of transactions, as for example the implementation of a just-in-time delivery system, are excluded from this definition.

Therefore we would like to pay particular attention to the increasing visible phenomenon of new forms of collaboration, where vertical partners interact with the aim of shaping future markets and creating business opportunities in a turbulent environment under constant flux. Partnerships enable companies to cultivate core competencies on a specific set of offerings, technologies or processes and bundle them to competitive customer solutions while staying independent. This makes a flexible specialization of independent companies possible. Compared to vertical integration, partnerships render a higher responsiveness to external conditions as changing customer preferences or new emerging technologies. In contrast to strict market based coordination, it enables specific investments leading to offerings, technologies or services not available on present markets yet. In comparison to ordinary buyer–seller relationships mutual commitment is not confined on a clear defined series of transactions but on the development and cultivation of future business opportunities and emerging markets.

Several forces are driving customers and their suppliers to intensified levels of collaboration, which eventually lead to a vertical partnership. In general, the high level of coordination implied by modern intense competitive markets has induced industrial customers to reduce their supplier base. As a consequence, collaboration between buyers and sellers becomes more intensive and contains new elements and processes that are subject to cooperation such as joint research and development projects or business development.

Especially in technology intense markets, outsourcing strategies have reached a new level. In a growing range of industries, innovation activities, once considered as pure core activities of a company, are outsourced (Engardio & Einhorn, 2005; Quinn, 2000). Especially time-to-market and performance considerations have led companies to reside on collaboration with partners, in contrast to in-house development or vertical integration.

Another backdrop stems from the disillusion about the performance of the past wave of Mergers and Acquisitions (M&A's). Especially in the US economy, providing a comparably good environment with its flexible capital and labor markets (Nooteboom, 2000), value creation by M&A's has become tougher (Dyer, Kale, & Singh, 2004). Therefore, also US companies have been leaning toward alternatives as partnership based approaches cultivated in Asian and European economies, where traditionally relationships and partnerships have played a larger role in economic organization.

The backdrop for this development stems from intensified competition, resulting in demanding customers and the increasing differentiation efforts of companies based on new offerings and technologies. Demanding customers and the instantaneous influx of new technologies have weakened the performance of economic organization under one roof. When the winning formula to market success is not evident or continuously challenged, more flexible forms of organization are needed, which combine the virtues of both hierarchy and the market.

In the following sections we present the economic fundamentals, which provide the case for collaboration and we discuss the decisive characteristics of partnerships, subject to managerial action, which serves as the background for the potential pitfalls associated with partnering.

2. The economics of partnerships

Are there economic reasons for the apparent trend toward collaboration? Or is this just one of the buzz-words which are so often invented by academia and popularized with the help of consulting companies and the business press? The idea that the evolution of markets increases the need for collaboration is at the heart of Adam Smith's market theory (Smith, 1776). His basic theorem states that the division of labor is limited by the extent of the market. Recent and significant developments to this theory stem from the fall of the Berlin Wall, which opened Central and Eastern Europe markets as well as the integration of emerging markets in China, India and Brazil (Economist, 2005b; Micklethait & Woolridge, 2000; Wolf, 2004). As a consequence, we perceive a growing need for the division of labor as inducing more intense collaboration in the course of the expansion of market economies. However, the collaboration can be organized within companies. For instance, in the US economy, with its flexible labor markets and its affluent capital–markets, collaboration is more easily organized within a company than in more rigid or underdeveloped economies (Nooteboom, 2000). As a consequence, US companies have tended to favor mergers and acquisitions, as compared to partnerships and alliances. However, the performance of M&A's has increasingly been questioned, turning attention to the option of partnerships and alliances (Dyer, Kale, & Singh, 2003).

Approaches like transaction cost economics or property rights theories have stressed that there is a boundary for the firm (Coase, 1937; Milgrom & Roberts, 1990; Williamson, 1975). Uncertainty and potential opportunism can render transaction costs prohibitive and therefore delimit the growth of the company (Williamson, 1975). Transaction cost theory has paid particular attention to hybrid governance structures trying to combine the virtues of both companies and markets (Williamson, 1985). This branch of economic theory focuses on the drawbacks of specific investments in the form of transaction costs (Heide, 2003; Wathne & Heide, 2004). As soon as specific investments are translated into value, they are exposed to the risk of being lost once the relationship is terminated. Hold-back of an opportunistically acting partner therefore can endanger and redistribute the profits generated in the collaboration. Approaches in the field of transaction cost theory and New Institutional Economics focus on governance structures limiting potential fraud and thereby enable an inclination to collaborate and strengthen the performance of

the partnership (e.g. Heide, 1994). In this regard, trust becomes a common issue (Morgan & Hunt, 1994; Plötner, 1995). As potential opportunism is never totally absent when taking into account economic agents, collaboration is impossible without a minimum level of trust. Therefore trust building is an essential antecedent to the development of partnerships. It must be complemented with a governance structure, providing incentives to support partnership performance. One basic economic effect of trust built in relationships is the reduction of transaction costs (Plötner, 1995).

One aspect ignored by transaction cost theory is that specific investments are not only a drawback, but are basically made in order to differentiate the company's offerings. The value of partnerships resides in the differentiation effect of specific investments placed by partners, which eventually pay-off in superior customer value and surplus profits (Nooteboom, 1992, 1993) (See Fig. 1); this aspect of partnership has been stressed by competency-based theories. Companies specialized in specific competencies are able to out-compete vertically integrated companies, by means of collaboration (Dyer, 2000; Morgan & Hunt, 1994). These specific investments are placed in order to differentiate the joint output and thereby increase the value pie. Achrol and Kotler (1999) maintain that partnering enables the integration of core competencies of specialized knowledge, with collaboration and integration competencies, cultivated by front-end companies acting as customers' agents.

This kind of collaboration is built on the economic rationale of non-zero-sum games (Neumann & Morgenstern, 1947). Whereas in zero-sum games, the gain of one party means loss for the competing party, in non-zero-sum games the gain of one party increases the gain of the collaborating party. Anthropologic research identifies the human proficiency for win–win-partnerships as the driving force of human evolution and economic growth (Wright, 2000).

The vision of win–win-partnerships engaging in non-zero-sum games may sound attractive and promising. At least in the beginning, it is no self-enforcing process and remains extremely complex. While partnerships rely on some form of mutual agreement they are built on enlightened self-interest and the aim of superior performance of both parties (Anderson & Narus, 2004). Although described by business press and academia as harmonious endeavors, partnerships are founded on the economic ambition for performance and profit. As a consequence, partnerships have both a competitive and a collaborative element, often referred to as "co-opetition". Even if they are successful in expanding the value-pie (Jap, 1999), there may remain a conflict in portioning the pie. While today we do not have a comprehensive theory of collaboration, important aspects are highlighted by the different approaches. Partnerships matter, as soon as markets grow and coordination within companies becomes complex, which is one way to reduce transaction costs caused by uncertainty and potential opportunism. But most importantly, they are a vehicle for mobilizing specific investments to generate superior value for customers and thereby enabling the partners to enjoy extraordinary profits. This economic benefit can only be obtained in the course of a non-zero-sum game, by cooperation on the basis of mutual trust and commitment. What does this mean for management? We will explore the decisive characteristics of successful partnerships in the following section.

3. Characteristics of successful partnerships

Research on business relationships suggests that the evolution of partnerships is a time consuming process (Dwyer, Schurr, & Oh, 1987; Johnson & Selnes, 2004). Content, quality and intensity of collaboration change, as a result of common experiences and outcomes of the collaboration.

Results of the study Eggert, Ulaga and Schultz presented in this issue confirm this aspect. In addition they show that the core offering of a supplier is increasingly perceived as a mere entry ticket for a relationship. Value, as perceived by industrial customers, resides increasingly in customer specific services and collaboration. The general implication of their empirical study is that customer specific investments are the decisive trigger for the creation of customer value.

Jacob highlights the competencies a supplier needs in order to collaborate successfully with its customer. He draws on the notion that typically 80% of the total sales of industrial suppliers reside in customized offerings. As a consequence, he presents a measurement model for the evaluation of the competency of a supplier successfully interacting with customers. He identifies communication, configuration and control

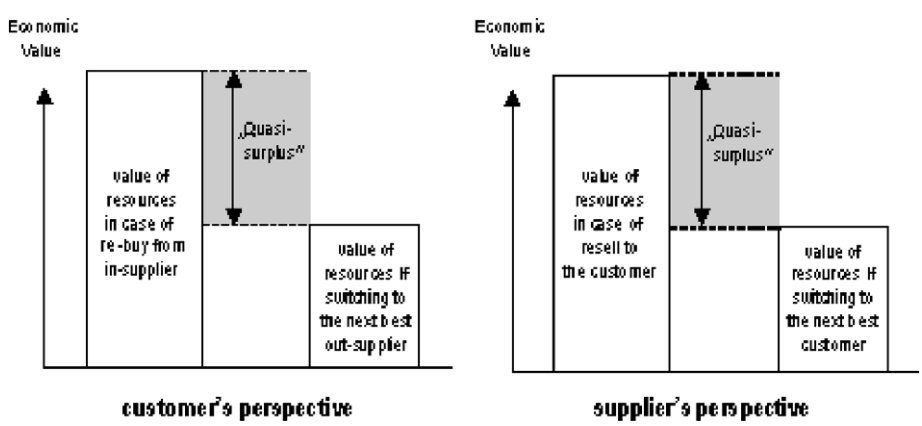

Fig. 1. The quasi-rent of partner-specific investments.

as the decisive management dimensions for the integration of customers in the value creation process.

Ideally, this would be rooted in a state of non-collaboration, turning into an initial collaboration between acquaintances, evolving into a more intense cooperation within a relationship, leading to a strong partnership based on a common vision, mutual agreement and a high level of specific investments (Dwyer, Schurr, & Oh, 1987; Johnson & Selnes, 2004). Lindgren et al. (2005—this issue) present a framework, which enables a company to evaluate its relationships. They build on the in-depth study of the relationship portfolio of an automotive supplier.

What can managers do in order to reach a partnership level? Spekman and Carraway (2005—this issue) identify two decisive drivers. Collaboration rests on a system-wide identification of benefits. The common vision for future benefits, i.e. the development of new markets, new technologies or new capabilities, serves as the prime driver for collaboration. They maintain that metrics and incentive systems constitute decisive barriers as soon as they no longer apply to system wide benefits.

Given that partnerships are economically viable, what are the decisive characteristics management should pay attention to? If we draw on our understanding of partnerships developed in the introductory section, a common vision of the future is the central motivation for starting and successfully managing a partnership. Partnerships, as we understand them, are aimed at the creation of future business, technologies or markets, where both parties are mutually dependent, share returns and losses, on equal terms, and practice open collaboration.

As previously stated, one precondition for establishing partnerships is a high level of trust. Trust is based on the expectation that a partner is not going to act dishonestly. Academic research has established that the emergence of trust is the outcome of a time consuming process (Morgan & Hunt 1994). Trust can be created out of the relationship capital built on joint experiences. It is no co-incidence that customer relationships are often the basis for the evolution of partnerships (Anderson & Narus, 2004). The common experience in managing complexity or the experience in successful conflict resolution can result in the strengthening of mutual understanding and trust. The communication of joint positive experiences plays a decisive role, particularly in the case of vertical partnerships. Also an atmosphere of open communication and collaboration nurtures the expectation that the partner is aiming to be supportive as well. As trust is based on expectations, communication can support trust, by referring to joint positive experiences.

Trust is also embedded in the development of common norms, which organize expectations of the partners, while securing independence and distinctive identities (MacNeil, 1978; Ivens, 2004). Research has addressed norms as integrity (Ganesan, 1994), long-term orientation (Kaufmann, 1987), mutuality (Dant & Schul, 1992), solidarity (Achrol, 1997), flexibility (Noordewier, John, & Nevin, 1990), information exchange (Heide & John, 1992), conflict resolution (Kaufmann, 1987), restraint in the use of power (Kaufmann & Dant, 1992) and monitoring behavior (Noordewier, John, & Nevin, 1990).

The development of common norms poses a precondition on the characteristics of the potential partners as well. Both have to show a minimum level of compatibility, which enables the development of common norms, trust and a common vision. Decisive elements reside in communication channels, access to infrastructure, accessibility of employees and openness to collaboration.

Common norms and values facilitate mutual dependency, which is a key characteristic of partnerships. By mutual dependency, we mean the absence of the execution of power to dictate the terms of collaboration. In contrast, a vast array of customer relationships are characterized by either the dominance of the buyer or the seller. Mutual dependency means a common vision for value generation, pursued in a win–win partnership, resulting in a spirit of value generation and joint profit maximization, as opposed to zero-sum-games.

Sustainable partnerships reside in a broad basis of personal interactions throughout all hierarchical levels and functional areas of the cooperating companies. This leads to an institutionalized form of collaboration, which can survive even when individual organizational members leave. Also, a broad personal basis is likely to lead to a richer form of collaboration and higher level of innovation. Flieβ and Becker (2005—this issue) emphasize this in their study of the controlling of supplier integration in the new product development process. They identified the supportive role of personal interaction, as well as clear and instant decisions as important triggers to enhance the performance of collaborative development projects. They suggest that as collaboration becomes more intensive, more informal modes of coordination gain importance, in comparison to contractual tools for coordination.

Another central characteristic is the personality of the relationship: While ordinary buyer–seller-relationships might rely to some extent on the coordination of logistics or information systems, intense collaboration and trust are built on personal interaction. Partnerships rely therefore on a web of personal relationships not exclusively defined from CEO to CEO or sales force to procurement. This may result in the exchange of employees, the building of cross-organizational and cross-functional project groups or in the founding of joint ventures. With increased personality other qualities of collaboration come into play, like the compatibility of partners and the emotions necessarily entangled in everyday collaboration. Although little research has been done covering these issues, we perceive this as a valuable future field of research.

4. Potential pitfalls for partnerships and issues for further research

In partnerships decision-makers are likely to find themselves caught in a conflict between bargaining for their rightful share, as well as setting incentives for joint value maximization. This becomes apparent when it comes to pricing decisions. Traditional pricing is considered as a process for dividing profit between two bargaining parties. Voeth and

Herbst argue in their contribution to this issue that this perspective hampers another potential of price in its role of providing incentives for joint profit maximization. While collaborative pricing may provide such incentives, it also creates vast potential for withholding information. This becomes apparent as soon as open book accounting is practiced. Having information on cost structures, as well as the power to distribute substantial business, customers find a powerful tool in reaping the profits of their suppliers. Such a situation provides a substantial pitfall. One short attempt to use power against the partner instantly destroys all the trust built-up in the long-term partnership.

Even in theory this conflict is not easily resolved. The least we can say is, that this path rests on a well developed partnership. Only in a cultivated atmosphere of mutual trust, strong experience in conflict resolution and empathic understanding, can partners risk such engagements.

This leads to a second danger, namely, over-emphasizing partnerships. With all their impetus on partnering and collaborating management, consultants and the business press suggest that partnering is imperative. However, as the issue of profit distribution shows, there are only a few partners with which a company might want to engage in such kinds of relationships. Moreover partnering is a complex management task. The main implication for companies therefore is to be selective when choosing partners. Otherwise companies are in danger of being trapped in unmanageable complexity. Therefore, partnering is by no means the only viable way for a company to relate to its external environment. In his contribution to this issue, Rese maintains that intense collaboration is only recommendable under specific conditions.

Another point of concern relates to the organizational structures of companies. To a large extent these are built on the needs of internal coordination of collaboration: Organizational structures and processes are built in order to provide employees incentives for value maximization within the company, not within partnerships. Headquarters and departments might pursue their own and sometimes conflicting partnership approaches. The sales force might be compensated on the basis of sales volume rather than partner-related metrics. We have only just begun to explore how far existing organizational structures have to be re-aligned with the demands for a partner-related approach in business.

One crucial element of partnership is timing: Empirical research provides evidence that high quality relationships are built on high levels of trust, mutual dependence, common values and a joint understanding of norms. These characteristics need time and effort to be developed. On behalf of the potential partners, significant specific investments are placed, which may help to reach such a relationship level. Therefore, companies should keep a realistic perspective when envisioning a partnership.

Another danger resides in the personal touch involved in partnerships. As partnerships rely on the engagement of people, there is a danger of being professionally hurt once partnership promoters leave the organization. Companies should be aware of this and keep prerequisites such as establishing "junior partner promoters" and partnership centers which are conducive to institutionalize partnerships.

5. Conclusion

Partnerships are distinct from ordinary relationships, as they require at least the restraint of partners from abusing power, a high level of trust and a cultivation of common norms. As this is a time consuming process, buyer–seller-relationships often provide a strong basis for the development of partnerships outside a competitive environment, under conditions of uncertain consumer demands. However, some conventional predispositions of relationship research should be treated with caution. First, even though relationships are built on mutual interests, they are in essence a non-zero-sum game. As a consequence, partnerships are based on enlightened self-interest. Also, the imperative to collaborate, often called for by relationship researchers, should be treated with caution. Companies should be selective when placing investments in their partnership portfolio. Decisive characteristics are the complementarity of the joint resources and the compatibility of partner-related norms.

In this regard, there arises the need for partnership-related research, to address the specific prerequisites needed for the sound development of partnerships in more depth. While the business press is continuously praising the Toyota-approach to collaboration, only little attention has been paid to the fact that this Keiretsu model changed profoundly in the course of the years. It started on a stable tradition of long-term relationships and has evolved into a much more flexible and entrepreneurial form of collaboration. Many more types of partnerships need to be explored, a research process to which we have merely provided a starting point.

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Olaf Ploetner. In addition to his responsibilities as Managing Director of ESMT Customized Solutions, Olaf Ploetner heads the practice group Technology Based Industries and is a guest lecturer in Accounting at the Freie Universität Berlin. He brings with him experience as a consultant with The Boston Consulting Group, Director at Siemens AG and most recently the Managing Director of IMT Berlin Project. His publications focus on customer relationship management, business management, communication and marketing strategy.

Michael Ehret is Assistant Professor at Freie Universitaet Berlin/Germany and currently guest professor for technology and innovation marketing at Technical University Munich/Germany. He received his PhD. at Freie Universitaet Berlin. His research focuses on customer relationship management, business-to-business marketing and innovation marketing. He has published in the Journal of Marketing, Industrial Marketing Management and the Journal of Business and Industrial Marketing. He also has professional experience as editing manager in print and online communication and has consulted companies as Daimler–Chrysler and Deutsche Telekom.