Supplier Relationships and Recession

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Abstract

This paper aims to explain the origins of different approaches to customer-supplier relationships in turbulent economic times. Over the last two years, the Finnish boatbuilding industry has been under great pressure, and many firms have halted their production and recalled some of the functions which had previously been outsourced. This has affected the customer-supplier relationships in the industry. The level of cooperation appears to depend on the type and level of supply strategy and the depth of customer-supplier relationships. Furthermore, comprehensive and planned supplier relationship management in such times has been suggested as a key strategic dimension during the coming recovery.

Keywords: customer-supplier relationships, supply strategy, recession, case study

Introduction

Over the last two years the Finnish boatbuilding industry has been under great pressure even in comparison with other industries. Most firms produce boats that sell very poorly in an economic downturn, and revenues have diminished greatly. Some firms have reduced their production and purchases by as much as 80 per cent of previous figures while retailers have been trying to sell the accumulated products manufactured during the economic boom. The revenues of Finnboat (Finnish Marine Industries Federation) members in 2009 have diminished 50 per cent on average from 2008. The sales have declined especially in more mass-produced boat segments (small and medium-sized motorboats) in which customers often borrow to finance their purchases. Some firms that produce more expensive and customized boats (big motorboats and sailing boats) have had smaller declines in sales as their order books were full before the recession and they have been able to maintain production during the recession. However, there is need for more orders shortly in order to keep production active in coming years.

When sales were at a good level and the revenues of many firms increased in some cases by more than 10 per cent annually, supply strategies in the boating industry increased in variety. Previously, most firms were quite small in terms of production and revenues and supply strategies were more passive. At that time there were very few firms where supply management was an important part of strategy; more advanced approaches to supply management, such as proactive or value-driven, were mostly absent (see Keough, 1993; Nollet, Ponce and Campbell, 2005; Reck and Long, 1988). The increase in firm sizes and revenues facilitated by the economic boom and the great demand for marine products enabled and encouraged some firms to focus on the purchasing function in the development of their strategic planning. The manufacture of marine products has been traditionally dominated by hand-built approaches, and firms have not used many suppliers. Furthermore, those components and functions which have been purchased have been quite simple in nature.

During the economic boom some firms maintained this supply strategy, and in some cases, when the firm has focused on highly-customized products in small niche markets, it has proved to be a successful approach to supply management. However, in many segments more advanced supply strategies have emerged, and industry leaders have excelled not least due to their improved management of supply. Some firms have increasingly begun to analyze their production and have used different tools for make-or-buy decisions. While most production has not been outsourced, they have nonetheless chosen certain major components and systems to be purchased from suppliers.

Due to the increased demand and perceived possibilities in mass production some firms have outsourced manufacturing of some or all the products in their catalogue. This has enabled the emergence of professional contract manufacturers in the boatbuilding industry, and their size and revenues increased drastically in the years leading up to the economic downturn. Within the segments that have seen the most growth in the boatbuilding industry, market leaders have increasingly been using this approach to supply management.

Theoretical background

Different approaches to supply management have also had a varying impact on customer-supplier relationships in the boatbuilding industry. One major impact has been the emphasis on strategic purchasing (see e.g. Cox, 1996; Cox and Lamming, 1997). The type and level of strategic purchasing (see e.g. Paulraj, Chen and Flynn, 2006) appears to affect the approach applied by the customer to supplier relationship management.

According to the studies (Carr and Pearson, 1999; Narasimhan, Jayaram and Carter, 2001) the purchasing function has a vital role in integrating supply activities between organizations' internal activities and suppliers. Paulraj, Chen and Flynn (2006) have developed a comprehensive model for linking strategic purchasing and supply integration. The model consists of relational integration (limited number of suppliers, long-term relationships), process integration (logistics integration), information integration (two-way communication, inter-organizational systems), and cross-organizational teams (general and product development supplier involvement). The model focuses on customer-supplier dyadic integration and on the supply-side of the value chain. This link is argued to be vital to the effective management and integration of supply chain activities (Anderson, Håkansson and Johanson, 1994).

Relational integration has become more important as organizations have limited their number of suppliers (Helper, 1991; Guimaraes, Cook and Natarajan, 2002), and the relationships between buyers and suppliers have become deeper and long term. Additionally, they include more interaction and information exchange (Helper and Sako, 1995). This has increased the acceptance of shared risk, as well as benefits, between buyers and suppliers (Cooper and Ellram, 1993). Along with closer relationships the pace of technological and business changes has increased greatly the importance of process integration. In addition to internal activities, this extends the focus of development work to external parts of the supply chain (Langley and Holcomb, 1992). In process integration the model (Paulraj et al., 2006) focuses on logistical integration but there can be also found other areas of process integration where it is beneficial to integrate functions such as ordering and product development (Vesalainen, 2002).

This paper aims to describe the changes in these relationships by using the customer-supplier integration model (Vesalainen, 2002) that involves analyzing the organizational (structural and social) and business (strategy and exchange) dimensions of a customer-supplier relationship (figure 1).

The customer-supplier relationship integration model by Vesalainen (2002) has many

similarities with Paulraj, Chen and Flynn's (2006) model. However, Vesalainen (2002) accentuates more the social aspects (e.g. trust, community and reciprocity) of business relationship integration. In his model the customer-supplier relationship consists of organizational and business bonds. Organizational integration includes structural bonds (interface structures, systems and process integration) and social bonds (reciprocity, trust and community), whereas business integration is reflected by exchange (physical exchange, R&D and logistics services) and strategic bonds (strategic dependence, common vision and commercial relationship). If a customer-supplier relationship is highly integrated at these dimensions it can be considered as a partnership type of relationship. The opposite position (low level of integration at all levels) is characteristic of market-based relationship.

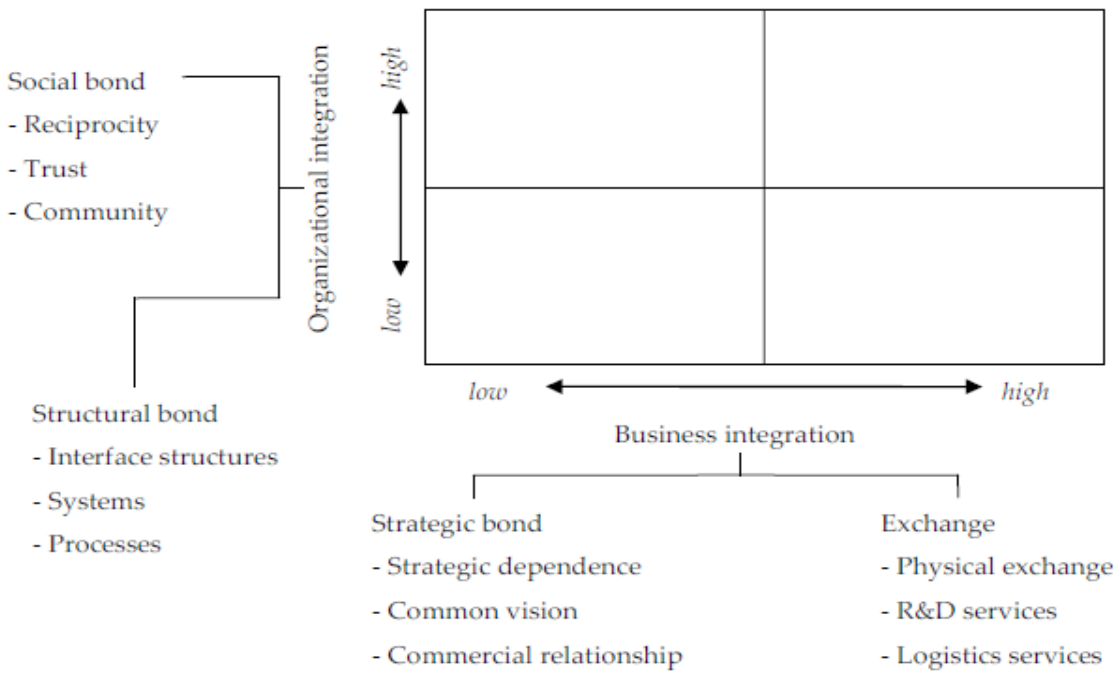

Figure 1. Customer-supplier integration model (Vesalainen, 2002)

Saccani and Perona (2007) present a comprehensive classification of buyer-supplier relationships based on previous studies. They have also created their own classification in which the relationships have been classified according to the amount of interaction by analyzing activities, processes and intensity of materials and information exchange (see e.g. Zinn and Parasuraman, 1997; De Maio and Maggiore, 1992). Other criteria for classifying relationships include the extent and degree of cooperation between buyer and supplier (Kaufman, Wood and Theyel, 2000), the level of commitment (Helper, 1991), the strategic priorities (Stuart and McCutcheon, 2000), the time perspective (Masella and Rangone, 2000), the degree of dependence (Cousins and Crone, 2003), the asset specificity (Bensaou, 1999), and the firm capabilities (Kaufman et al., 2000). Vesalainen (2002) classifies the relationships according to their organizational (structural and social bond) and business (exchange and strategic bond) integration.

The typology of buyer-supplier relationships usually vary from low integration and market-based relationship type of relationships to high integration and strategic partnerships (e.g. Saccani and Perona, 2007; Vesalainen, 2002). The lowest level of integration in buyer-supplier relationships is usually referred to as traditional relationship (De Maio and Maggiore, 1992; Saccani and Perona, 2007), market-based relationship (Vesalainen, 2002), or remote

relationship (Bensaou and Venkatraman, 1995). At the highest level of integration the relationships are classified as evolved relationships (De Maio and Maggiore 1992; Saccani and Perona, 2007) or strategic partnerships (Bensaou, 1999; Vesalainen, 2002). In between these two types there are usually one to three types depending on classification dimensions or study findings. In some classifications the types are not described to be as linear as in previously mentioned studies (e.g. Stuart and McCutcheon, 2000).

Methodology

As the research questions are exploratory in nature (concerning the whys and wherefores) a case study is the most appropriate research strategy (Dubois and Araujo, 2007; Yin, 2003). Empirical data was gathered by interviewing eleven CEOs and supply managers in major Finnish boat manufacturing firms and ten suppliers between November 2009 and February 2010. The manufacturing firms (customers) involve almost all major Finnish boatbuilding industry firms, and the suppliers are among the biggest Finnish boatbuilding industry suppliers. These firms were selected according to their size and suitability to the research objectives. Furthermore, the selected customer-supplier relationships cover three different levels of relationship integration.

The data was tabled and themed in order to find general approaches and origins for changes in customer-supplier relationships and supply strategies.

In this study, the related articles were searched from several scientific databases (ProQuest, EBSCO, Elsevier and Science Direct). The following keywords were used: supply management, procurement, supplier relationship, customer-supplier relationship, buyer-supplier relationship, recession and economic downturn. These searches produced numerous articles that were evaluated thoroughly by assessing their content and relatedness to the research questions. When reviewing the related articles, there was found new sources and references which were then searched separately (snowball technique). Articles and other material were searched until all related studies and articles appeared to point to same studies and no new studies were found (realization of saturation point).

In addition to searching theory from web based databases with keywords, the following scientific journals and their annual volumes were reviewed: Journal of Purchasing and Supply Management (from year 1998 to 2009) and Supply Chain Review (from year 1998 to 2009). These journals were chosen on the basis of their relatedness and quality in the research field.

The search did not produce many studies with similar research objectives to this study. The best hit was Lamming's (2000) study on Japanese supply chain relationships in 1990s recession.

Findings

During the economic boom the development of customer-supplier relationships increased in many firms, but the recent economic downturn has had differing effects on these relationships. While some have terminated cooperation with their suppliers, some have continued to support and make orders. The level of cooperation appears to depend on the type and level of supply strategy and the depth of the customer-supplier relationship.

The relationships in the boatbuilding industry can be categorized into three types. In the first type, some customers have used contract manufacturers to build the products they have designed and marketed. These relationships (strategic partnerships) are very integrated as cooperation is quite intensive and the customer manages closely even some of the suppliers' operations such as inventory control and competitive bidding. In the second type,

customers order larger systems or parts from only a few suppliers (systems supplier relationships). This usually involves increased mutual dependence and structural integration. The third type of customer-supplier relationship (market-based relationships) is loosely integrated. A customer orders small parts or services, and it is easy to insource the function or find a new supplier.

The following paragraphs detail the changes in the studied customer-supplier relationships. The dimensions have been described above in the relationship integration model (Vesalainen, 2002).

Exchange

The delivery of actual products has declined drastically in all customer-supplier relationships. The decline has been greatest for those suppliers that deliver simple products or services that are often purchased by motorboat manufacturers (small and medium-size boats). Some customers have even called back functions that they outsourced during the economic boom in order to have some work for their own production personnel. Many customers had long production halts at the end of 2008 and in 2009, and production personnel were furloughed for several months.

The studied contract manufacturers have benefited in terms of future business from the recession as their customer has centralized boat purchases to these "exclusive contract manufacturers". On the other hand, other contract manufacturers that were used during capacity shortages have had to find new customers or increase their sales to other customers.

In order to gain higher status in customer's purchasing policies some suppliers have tried to create more extensive product groups or systems. Also, they have offered more extensive services. However, this is a quite difficult task as almost all suppliers are focused on specific products or capabilities.

In the beginning of the recession many interviewed firms saw the economic downturn as a possibility to focus on product and process development. According to the suppliers this has not been realized. They have not experienced the customers creating many additional development projects that have not been suggested before the recession. The suppliers suggest that this is due to the personnel furlough.

Strategic bond

The strategic bond between firms has not changed in many of the studied customer-supplier relationships because of the recession. Especially in market-based relationships the situation is very similar. However, the contract manufacturers suggest that the strategic bond with the customer has become even stronger as the customer has concentrated its purchases and terminated contracts with suppliers that were used during the capacity shortage. Even though they were preferred suppliers before the recession there was a risk that these capacity suppliers could replace them.

The customers that have mostly market-based relationships with their suppliers have not become more dependent of their current suppliers. There are still several suppliers that deliver needed products and services as there have been only a few bankruptcies in the entire industry. Some customers can also manufacture many of these products in their own production facilities. Many suppliers have become somewhat dependent of their key customers. Before the recession many suppliers delivered products to firms that were in some cases competitors to their main customers, but this has changed. The suppliers have in many cases focused their marketing and production efforts to their main customers.

The nature of customer-supplier relationship strategy has not changed much due to the recession. The most integrated relationships (customer-contract manufacturer) are still managed in coordination, and both parties are well aware of the common goals. In other types

of relationship a problem has been the obscurity of previous agreements. As the parties had not made many written agreements or strategy statements, there has been some uncertainty of the future of the relationship.

The pricing policies have changed in some of the relationships. Before the recession many customers were willing to pay higher prices as they could sell all of their production at higher prices. Due to the recession many end-customers have become very critical of the product prices, and the boat manufacturers currently attain to produce at the lowest cost possible. The suppliers have experienced this as demands for lower prices and more flexible deliveries. In some cases, customers have aided suppliers that have had financial problems by granting them better terms on deliveries and payments.

Structural bond

The structural bond between the customer and their contract manufacturers has become stronger during the recession. There has been organized more meetings related to strategy, and product and process development. As the relationship between the customer and contract manufacturers was quite integrated even before the recession, some of the development work is improvement of old practices and systems. Both parties were already well aware of the other parties' processes and they were integrated in many parts.

In more loosely integrated relationships the level of structural integration was quite low before the recession. As production has been halted in many firms there has not been started many development projects concerning system integration (order and delivery routines, production control or technical design system integration). This may be also due to the nature of the industry: serial sizes are small and production often involves handwork.

Social bond

In the Finnish boatbuilding industry almost everybody knows each other. Many persons have common history and in some cases firms have been doing business with each other for many decades. Almost all firms are members of Finnboat in which information is shared freely and cooperation is common, sometimes even among competitors (e.g. shared departments in international exhibitions). There has also emerged local boatbuilding networks which are often loosely managed by major boat manufacturers. In these networks local firms and trust between old business partners are highly regarded, and manufacturers tend to favor local firms (suppliers) even if there was a cheaper supplier abroad.

The level of openness was high in strongly integrated relationships also during the recession. Both parties shared valuable information even if it had negative implications to the other party. There was also a strong shared feeling of common future and "succeeding together". As both parties had made vast relationship-specific investments it would have been difficult to change a partner.

Due to the recession there was some insecurity and uncertainty in more loosely integrated relationships. Previously, these suppliers were able to produce same products for many months, but the recession has decreased the size of product series and made production more difficult to predict. As there had not occurred many bankruptcies and the recession had only lasted some time, this had not yet caused many problems in the relationships.

In most relationships firms share same values and there have not been any significant changes. They have similar corporate cultures and perceptions of acceptable procedures. The interviewed firms see this as a result of entrepreneurial backgrounds that almost all parties have. In many boatbuilding regions there is also strong emphasis on favoring local firms and old inter-firm relationships. The supplier will not be changed easily if there can be found a cheaper supplier abroad. As the production series are usually quite small per boat model, the benefits of competitive bidding would be often irrelevant. In many cases trust in other party's

actions and flexibility are appreciated all the more.

Discussion

The changes in customer-supplier relationships have not been drastic due to the recession. One would have expected to see more significant changes as the production has been halted in many firms and the suppliers have not received many orders.

In strongly integrated relationships cooperation has increased due to the centralization of purchases and more focused supply strategy. This indicates that the customer of the contract manufacturers attains to ensure it has viable suppliers in the future. The increased price competition, which was sometimes absent during the economic boom, may have also driven the customer to improve its cost efficiency.

As the recession has only lasted less than two years, there cannot be observed any major changes in structural integration between firms. Some have argued that the Finnish boating industry should adopt more modern and automated production methods (Hentinen, Jolma, Furustam, Aspara, Parvinen and Silfver, 2007) but the recession has not accelerated these inclinations. This would require substantial multiplication of firm and production sizes which appears to be improbable in the near future.

Managerial relationships between local firms and trust based on long business relationships have increased their significance during the recession. Even though many firms are searching for sources of lower production cost, the suppliers have not been replaced with cheaper foreign suppliers. The pressure on the suppliers is also less apparent when compared to the 1990s Japanese recession (Lamming, 2000). As the industry is relatively small, it is rarely easy to find equivalent suppliers.

It may be that the recession has not lasted long enough to observe all possible changes in the customer-supplier relationships in the boatbuilding industry. Therefore, there should made similar study in two years to attain broader understanding of the studied relationships. If the recession lasts many years, it is possible that there can be noticed more changes in relationship trust, structural integration and supply strategies. Furthermore, there could be made comparisons with other industries in order to find industry-specific changes in customer-supplier relationships.

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