The Relationships Between The Companies and Their Suppliers

José Luis Durán Valenzuela
Fernando Sánchez Villacorta

ABSTRACT. Our research has found that companies which have diverged from traditional management in order to adopt strategies which include ethics, cooperation and a joint vision of management obtain a greater added value. The new challenges of competitiveness require a position of active cooperation between firms and their suppliers, which should be considered as collaborators rather than adversaries. An active cooperation management may well allow the company to improve the quality of its products and its image, speed up delivery to its clients and make its production and trading more agile, thus enhancing the perception the client has of the product. An improved ethical quality in our dealings, generating trust, improving communication and establishing long-term relationships with joint added value, results in higher competitiveness and greater creation of wealth.

KEY WORDS: business ethics, consequences, co-operation, suppliers, trust

José L. Durán is an associate professor of marketing at the University of Cádiz. His research interests include marketing and consumer ethics, the ethical decision making processes of marketers and consumers and ethics in advertising. He authored different papers published in scientific journals and presented at international conferences on marketing and business ethics.

Fernando Sánchez is an assistant professor of management and organisation at the University of Carlos III. He authored different papers published in scientific reviews and presented at international conferences. His research interests include change and co-operation strategies. He is also Corporate Development manager at Telefónica Móviles, a major Spanish telecommunications company.

Introduction

The aim of this paper is to analyse the cooperation relationships which are established between the company and its suppliers, the factors which influence the long-term maintenance of these relationships and the increase in economic results together with its ethical implications. Our research has found that companies which have diverged from traditional management in order to adopt strategies which include ethics, cooperation and a joint vision of management obtain a greater added value. The greater returns yielded by this joint approach must also be shared ethically in order to favour long-term cooperation.

Traditional business management is oriented towards generating the maximum possible profit with little or no consideration for the consequences to other firms, persons or the environment. The traditional strategy focuses on obtaining the highest possible results in a competitive struggle with all the other agents with which it has dealings. This "dog-eat-dog" philosophy inevitably leads to a wide range of unethical procedures which, in turn, has led to the necessity of elaborating a list of forbidden, illicit practices. "The implicit assumption has been that organizations live much more in zero-sum or negative-sum games than they do in positive-sum games. An uncommon type of question is "what type of strategies can transform zero-sum games into positive-sum games?" (Nielsen, 1988, p. 478).

Real ethical responsibility, however, goes beyond the simple adherence to this list of forbidden practices. It requires frank and open communication, sincere dedication to our commitments and concern and attention to the needs

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of others. The company's obligation to society and the achievement of the common good consists of obtaining optimum results for society as a whole, not just that part which is represented by the firm.

The concept of the company as a community of persons must transcend the core and encompass all its stakeholders, including, of course, its suppliers. If the company really cares about the common good (and also very importantly, to be seen to care, thus setting an example) this concern must include the supplier firms.

We are now confronted with the need to devise a new business philosophy which applies ethics to management and which confronts decision making from the perspective of the optimum result for the complete set of firms and social groups. The transition from an outlook which considers only the individual firm to a more general perspective will open up a wide range of possibilities of increasing profits jointly. The new challenges of competitiveness require a position of active cooperation between firms and their suppliers, which should be considered as collaborators rather than adversaries. This new outlook must be based upon ethical practices which generate a high level of comprehension and cooperation, leading to increased efficiency in the productive system in general.

The implementation of such a system must be based upon deep-rooted ethical values and a global vision. In the long term, this continued ethical management will give rise to mutual trust, constant collaboration and a joint approach to problem solving. The reciprocal goodwill generated by these practices and the ensuing intensive cooperation will permit us to reduce costs so that both parties can benefit from greater profits.

In subsequent paragraphs of this paper, we will go on to analyse how ethical behaviour generates trust, which is the key to achieving greater profits. These profits, in turn, must be shared equitably in order to strengthen long-term ties of cooperation and the underlying ethical principles.

The second part of our paper will centre on the strategic factors which contribute to successful cooperation. The third part of the paper concentrates in more detail on the new marketing with the supplier, which would include the features required to put this new business philosophy into practice. Our paper will then approach the specific problems of Spanish distribution channels with the manufacturers. We will show, by analysing the opportunity cost incurred by these large distribution channels through postponed payment for goods, that the producer-distributor relationships present numerous ethical problems which could be solved to a great extent by a more global vision and long-term cooperation between firms.

2. A special type of stakeholders: the suppliers

There are two types of theories in the relationship between buyers and suppliers known as 'adversarial' and 'obligational' contracting, respectively (Morris and Imrie, 1993, p. 53). The first would be equivalent to the traditional perspective: short-term vision;, adversarial attitude towards suppliers, short-term relationship with them, and considering them as a "commodity" (goods with a high degree of substitution), high number of suppliers, management based on administration and order control, and emphasis on purely contractual terms: price, instalments, means of payment, etc., without considering the possible consequences on the other side.

The following text about negotiation with suppliers is an illustrative example of this traditional perspective: ". . . To have suppliers waiting for more than two hours; to make them sit in a lower seat making them feel smaller and inferior; to place them facing the light in a dazzling way; to tell them they have come the wrong day as they were expected the following day; to tell them we are listening to them while looking at the watch, reading the correspondence or yawning; to leave some chosen papers – mainly competitors' offers – partially covered on the table, etc." (Cía and Fernández, 1990, p. 18).

The second type of contract, the "obligational", already shows the new demands required in the above mentioned environment. In fact, its definition is completely different from the basic ideas of the traditional or adversarial model: "The obligational contracting model involves a series of close ties between buyer-supplier . . . its features are a long-term trust partnership . . . The obligational relationship interacts along several dimensions with the objective of producing high quality, low cost parts or services . . ." (Morris and Imrie, 1993, p. 54).

The new challenges of competitiveness require a position of active cooperation between firms and their suppliers. Let us take a closer look at this contracting model:

A) Viewing suppliers as collaborators. According to this perspective, we move from the traditional idea of business value chain to another where the product is the principal axis in the value chain. There will be more possibilities of producing added value, which will require the participation of different organisations, principally those located in previous stages of the product value chain.

In this new philosophy, the organisation is considered to be part of a more complex system that includes all the organisations implied in the production. The successful implementation of this business philosophy would then demand a total change of the organisation's culture into an ethical one, thus improving the relationship with external agents. This change in culture may cause an increase in the company's profits, as well as an increase in the welfare of society in general.

The cooperation strategy does not look for the appropriation of added value but for added value generation, which presupposes a continuity in the supplies management and coordination in the information systems. At the same time, this strategy allows the investment in the specific assets required to achieve the company's goals. This blurs the companies' limits as suppliers perform tasks not long ago done by customers. This is achieved through the exchange of resources – assets, human resources, information – between companies.

B) Long-term relationship with suppliers to ensure the company's needs are met. Thanks to this, we get a high quality product that differentiates itself from its competitors. Difference and quality are becoming the new competitive tools for companies in the present, more competitive and demanding markets.The suppliers then become a reduced group with whom there will be a long-term relationship. It is essential to take a "long-term proactive strategic perspective". An ethical relationship based on a positive mutual trust to reduce the level of opportunism, which does not benefit the company. Opportunism leads to continuous reprisals on both sides. Hence, an increase in uncertainty, control costs and interchange supervision which make it impossible to achieve their goals. Therefore, the necessary steps must be taken to establish mutual trust and openness in these relationships.

C) Bidirectionality and richness in the information flow. A closer relationship with the different suppliers enlarges the company's system considerably, in contrast with the lack of information shown in traditional systems of relationships. The higher the level of quantity and quality in information, the higher the efficiency. This improvement makes it possible to react faster to external changes to improve the coordination of the processes throughout the product value chain and improve the product quality.

D) Active management of supplies. The customer takes an active attitude with regard to supplies through different ways, e.g. reverse marketing that helps to achieve the established goals instead of dealing just with the administration and order control. This makes the management of supplies more important in the company, not only at an ahierarchical level, but also at a strategic one.

It is obvious that the implementation of this new philosophy will face some problems, such as: (1) The inherent individualism of the western culture which, in many cases, prevents collaboration in a world where working in cohesive groups is a key aspect for economic performance (Franke et al., 1991); (2) Lack of trust by suppliers – especially in cases where customers outnumber suppliers – because they think that the customer's aims are to reduce their profit margins by manipulating the information flow. In these cases, mutual trust is the only way to success.

In this sense, it is worth mentioning the research carried out by Morris and Imrie (1993). According to it, in sectors where customers outnumber suppliers, such as the automobile and microcomputer sectors, suppliers working under a subcontracting system find the change from the adversarial to the obligational contracting highly positive and with considerable improvements in the interchange of technology and the transfer of quality systems.

Among the different techniques used in the strategic management of supplies, we would like to point out the role played by what could be called "reverse management".

3. Reverse management

When we talk about reverse management, we refer to a new concept of the buyer-supplier relationship where the buyer takes the initiative with an active attitude, using most of the traditional marketing operating tools. To implement reverse management, the cooperation of entire the organisation is essential as this new management philosophy, as we have seen above, is strategic but tactical. As Blenkhorn and Banting (1991) state: "Reverse marketing permits procurement to contribute effectively to the organisation's objectives and strategy . . . [it] requires cooperation from all levels and most functions in the organisation . . . [it] is future oriented and requires careful planning and research" (Blenkhorn and Banting, 1991).

Therefore, reverse management implies the setting up of goals, a process of strategic planning and the coordination of most activities, involving all parts of the organisation. The key is to try to persuade the supplier to provide exactly – and by exactly we mean the added product – what the buyer needs (Kotler, 1992, p. 5).

At a more operational level, we will analyse the different factors that take part in this new type of marketing. We will also give some examples to illustrate their efficiency.

Market research

Market research provides an invaluable qualitative and quantitative help when making decisions. In this particular case, the target population is the market of suppliers suitable for the needs of the company. Through this research we will be able to:

A) Identify the suppliers who are more likely to adapt themselves to the needs of the company. This will help us to get qualitative information about their philosophy of management, culture, etc. In a world where businesses are becoming more international, companies have a wider choice mainly due to: (1) The decreasing importance of geographical barriers and the increasing information exchange; (2) Cheaper transport costs; (3) Internationalisation of commercial trends. This widening stresses the importance of market research applied to the selection of suppliers. Moreover, the companies that have a long-term relationship with their suppliers will be more dependant on them. It is then essential to make the correct choice of supplier for the success of this policy. On the other hand, the wrong choice may lead to opportunism.

B) Study the expected development in the suppliers' sector, identifying facts such as: (1) Changes in the organisation structure, power of negotiation, agreements with suppliers, takeovers . . .; (2) Technological development and how this affects the supplier, costs, quality, flexibility and accumulation in the sector. This important factor provides information on trends that do not benefit the company, thus helping to prevent any potential damage.

C) Identify the suppliers' needs and goals. Understanding their needs and making them compatible with the company's demands helps the smooth running of both firms. The importance of this understanding is vital. As we have seen before, the current environment makes business more competitive. It is then absolutely essential to avoid conflicts and establish long-term relationships based on mutual understanding and not just on the power of negotiation of one of the parties, which will produce dangerous sub-optimal results.

Some of the companies considered as models with high profitability rates, such as Motorola, follow this market research policy: "The organisation of supplies management of Motorola's GEG periodically hands out a detailed questionnaire to suppliers in order to know what they think of Motorola as a customer. There are firms, including Motorola, that go even further and include customer and supplier representatives as members of their own internal working teams" (Ostroff and Smith, 1993).

Product

In a product policy, it is worth mentioning the importance of sharing information by both sides. An intense information exchange with suppliers provides mutual benefits such as: 1) The quick identification of new business opportunities; 2) Faster development, improvement and launching of new products; 3) Better product quality and design, which would lead to high profits as shown by the Japanese companies in the automobile and engineering sectors; 4) General reduction of costs due to the perfect adaptability between the inputs and the buyer's specific needs, possible improvements in the product design and the reduction in the quality control costs.

Long-term trust relationships involve a higher interdependence that allows the supplier's investment in specific assets of the buyer and necessary for the suppliers to take part in activities such as product design at early stages, quality control, etc.

Distribution

The coordination with the suppliers and the agreement on aspects such as stocks reduction, commodities handling, administrative controls, dispatch, packing, transport management coordination, etc., may produce important cost reductions for both sides. In the same way, the use of computers would accelerate the necessary exchange of information.

The example given by Mercadona (Villarino, 1993), a Spanish supermarket chain, is quite illustrative: this firm is carrying out a logistic cost analysis and it has found out that some of these costs, e.g. transport and discharge costs, could be reduced with benefits for both sides. This type of joint analysis can be an important way of reducing such costs.

Price

In contrast to the traditional strategy of constantly changing suppliers based on a pricing policy, the new relationship is based on the product and this does not mean that the price is not important. Instead, we turn from a narrow to a wider approach of the different elements involved in the process. In fact, we go from a concept of "product price" to a "transaction value" where there are other elements in the transaction that affect the price, e.g. trade credits, terms of payment and especially the utility of the input for the buyer.

A significant example of this is the case of the companies Wal-Mart and KMart, the most important discount retailing companies in U.S.A. (Stalk et al., 1992). While Wal-Mart – one of the highest profit retailers in the world – is building close relationships with its suppliers, KMart – previous leader in the sector and now overtaken by Wal-Mart - is constantly changing suppliers in search of price improvements.

Another feature to point out in the pricing policy is that long-term relationships with suppliers provide low and stable prices because of the reduction in the transaction costs which, at the same time, provokes important uncertainty avoidance.

Communication

Thanks to a close relationship between the staff of both companies, there is a better knowledge of the needs on either side. This cooperation also helps to bring about continuous innovations and improvements and the resolution of conflicts. An illustrative example is General Electric or Motorola's joint working teams with suppliers to solve potential problems. We can also obtain positive suggestions from these firms, which can benefit the rest of the organization (Ostroff and Smith, 1993, p. 17).

Another important feature in communication is the importance of having a solid and clear prestige, something that did not worry companies not long ago, as the target stakeholders for this prestige were mainly customers. There are many benefits in this attitude as prestige provides a reputation and a trust relationship with suppliers. This prestige could also be used by suppliers to achieve their goals. Obviously, traditional tools, such as advertising and promotion, can also be used differently to attract suppliers.

There are many more examples of the advantages of reverse management. Among the latest items of news that have had a greater media coverage is the dispute between big distribution centres and consumer goods manufacturers. We will show, by analysing the opportunity cost incurred by these large distribution channels through postponed payment for goods, that the producer-distributor relationships present numerous ethical problems, which could be solved to a great extent by a more global vision and long-term cooperation between firms.

4. A significant case: the large distribution centres in Spain

The establishment of big chain stores in Spain not long ago, and the significant process of concentration experienced by commercial distribution in Spain, has provoked an important change in the structure of power relationships in the sector, as well as in its relationship with other stakeholders involved.

The fact is that the high percentage of purchases done in big supermarkets or in supermarket chains has provided them with better negotiating conditions than the rest of their competitors. This strong position is clearly shown in the type of negotiation established with consumer goods manufacturers, especially in the food sector.

The growing power of big supermarkets chains has brought about a dramatic reduction in the number of small retailers, their numbers falling from 77,097 in 1990 to 58,654 in 1995, while the big supermarkets increased their number in the same period from 99 to 242. Out of the 50,000 million dollars made by the food sector alone in 1995, the total sales of the first ten big supermarkets represented 46%.

All these factors provoke conflicts in the relationship between big supermarkets – supermarket chains – and suppliers. This relationship is established according to a set of tough economic conditions, e.g.:

- The manufacturer must pay a fee to have access to big stores, which in turn will display the product (El País, 1991, p. 10).
- A contribution – around 1% of the goods price – towards the advertising and promotion expenses made by the stores. This factor is quite important if we consider the aggressive policy in promotions with continuous changes in the prices, adopted by these big companies over the last few years.[1]
- Advertising expenses originated by the display of the products on the shelves, gondolas, etc.
- Important discounts on the total turnover at the end of the trading year.
- Finally, a long-term payment for the products is demanded, and as a result all the financial costs from the distributor's working capital fall back on the manufacturer. These long-term payments – which are never shorter than 60 days and can last for as long as 150 days, as is usually the case with tinned goods - have been the reason of the current conflict between both sides.

This perspective may lead to a strategy of continuous conflicts based on the traditional competitive strategy described by Porter (1980), which we have called "added value appropriation".

In an attempt to remedy the problems caused by postponed payment, Spanish legislation regulating retail trading has set out the following four points: (1) Except when otherwise agreed, payment will be made upon receipt of the goods; (2) Payment postponed for a period exceeding 60 days must be set out in a document of exchange; (3) Payment postponed for more than 120 days must be guaranteed by a financial institution or insurance; (4) In the case where payment is not met by the stipulated date, interest will be paid at a rate of 50% above the legal rate.

These relationships are based only on the enormous negotiating power of one of the parties involved. Therefore, these will not be trust relationships but quite opportunistic ones. In this environment, there are great opportunities for innovative firms capable of establishing long-term relationships with their suppliers.

As an example of these opportunities we could point out strategies such as EDLP (Every Day Low Prices). In the words of the president of one of the most important Spanish supermarket chains: "This change necessarily implies a better relationship with suppliers, who play an important role in the success of new strategies. It is not a matter of reducing the manufacturers' profits or negotiating short-term prices, but a matter of long-term benefits through the optimisation of the complete product circuit." (Roig, 1993, p. 117).

This strategy requires an open relationship and long-term agreements, which take into account both customer's and suppliers' needs. Any attempt to obtain benefits as a result of a better relationship requires the understanding of the suppliers' problems. If their main problem is seemingly the financing of the long deferred payment of their sales, it is then necessary to adopt solutions leading to joint benefits.

One of these solutions might be the swapping of the distributor's and manufacturers' interests rates. In the case where the distributors' financial costs were smaller than the manufacturers', a shorter payment period would reduce the manufacturers' financial costs. Such a reduction would always outweigh the increase in financial costs due to the new terms of payment faced by the distributor. As a consequence, the difference may be applied to the price with mutual advantages. The result implies not only a minimisation in the transaction price, but also reciprocal benefits that may lead to trust relationships.

It is therefore easy to appreciate that a policy of payment which bears in mind the financial problems facing the manufacturers would permit a notable improvement in joint profits and consequently strengthen the long-term relationship between both.

In Spain, the large distribution channels follow a policy of postponed payment, obtaining a dividend of (A%) by investing in short-term financial assets. On the other hand, manufacturers must bear the financial costs (C%) arising from the delay in payment, a cost which is inevitably greater than A%. The distribution channels would logically be willing to make immediate payment if the reduction offered by the manufacturer (B%) were greater than A%. In this case, the manufacturer's liability would be reduced to B% and from a global perspective this would mean a saving of C–A%.

An ethical approach to sharing the resulting joint profit would favour the long-term maintenance of the relationship which is beneficial for both parties while at the same time strengthening the ethical culture.

5. Conclusions

Due to the fierce competition faced by companies at present, the traditional short-term adversarial contract is gradually becoming a long-term obligational one.

The inclusion of a company in a more global system, establishing intense collaboration relationships represents a profound and radical change in mentality and can well be the source of an important competitive advantage.

This new mentality leads to a substantial increase in the quality and quantity of the information flows between the organisations and their stakeholders, which is essential to establish an open and reliable relationship.

Cooperation with the suppliers is currently a basic strategy for reducing costs associated with supplies. A retailer trust in a vendor reduces the perception of risk associated with oportunistic behaviors by the vendor and the transaction cost in an exchange relationship. Any policy based solely on economic criteria will automatically derive into more irreparable opportunism.

The obligational model demands a proactive attitude from the companies, which will have to use new management strategies – i.e. reverse management – to search and analyse collaborative ways of improvement.

An active cooperation management may well allow us to improve the quality of the products and the image, speed up delivery to the clients and make the production and trading more agile, thus enhancing the perception the client has of the business.

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Note

[1] It is worth mentioning the fact that this policy of constant promotion with important differences in prices could damage the product image.

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Departamento de Economía de la Empresa,
Universidad de Cádiz (Spain),
Duque de Nájera, 8,
Cádiz 11002,
Spain.
E-mail: joseluis.duran@uca.es