CHAPTER 7: Business Relationships and Networks

Key Revision Points

Introduction

The activities of just about every business organisation are likely to involve a complex network of relationships with members of its environmental set. Some links in the network will become particularly important, and characterised by long-term co-operative relationships, rather than short-term bargaining over a series of one-off transactions.

Central to an understanding of business to business relationships is the concept of a value chain. Value chains were introduced in Chapter 1, and you will recall that this describes the way in which a succession of organisations add value to a basic raw material, so that when it reaches the final consumer, it has higher value in the eyes of a consumer.

To be sustainable in a competitive business environment, a value chain must add more value relative to costs than competing value chains.

It is often not just the efficiency of individual stages of a value chain that create value, but the way in which transitions from one stage to the next are handled.

Types of Business Relationships

The complexity of networks of business relationships may impact on consumers. These relationships can be visible or invisible, but both of these are crucial to a successful service offer.

The following headings do not provide an exhaustive and mutually exclusive analysis, but provide a useful summary of the literature on crucial aspects of networks and relationships.

- **Outsourcing**

A company may undertake many different activities in the process of creating value. However, some of these activities will be less central to its process of value creation, and it may be less efficient at these activities than a specialist company. It may therefore choose to *outsource* these activities to another organisation.

Outsourcing offers many advantages to a company seeking to reduce its own inputs to the value chain, including:

- Allowing the business to focus its activities on its core activities
- Giving access to cutting edge skills that would be difficult for the company to acquire and learn on its own. The company does not have to worry about continually introducing new technologies
- Sharing risks of service provision, especially in the case of activities which are new to the company.

- **Franchising**

Franchising refers to trading relationships between companies.

The franchisor (who owns the franchise brand name) is more likely to be a public or private limited company, while the franchisee (who buys the right to use the franchise from the franchisor) is more likely to be a sole trader.

The franchisor and franchisee have legally separate identities, but the nature of the franchise agreement can make them very interdependent.

Public services are increasingly being delivered by franchised organisations.

- **Horizontal collaborative relationships**

There are many situations where two or more organisations providing an essentially similar product, at the same point in a supply chain, can create greater value for customers by working together. In some cases, these collaborative networks may span an entire industry.

Strategic alliances take a number of forms, but they are essentially agreements between two or more organisations where each partner seeks to add to its competencies by combining its resources with those of a partner.

Strategic alliances are frequently used to allow individual companies to build upon the relationship which they have developed with their clients by allowing them to sell on goods and services which they do not produce themselves, but are produced by another member of the alliance. They involve co-operation between partners rather than joint ownership of a subsidiary set up for a specific purpose, although it may include agreement for collaborators to purchase shares in the businesses of other members of the alliance.

A particular form of collaboration that has become common in many countries is the Private Public Partnership (PPP).

Against the benefits to customers and suppliers resulting from collaboration, competition authorities throughout the world are becoming increasingly concerned about business practices that directly or indirectly have the effect of restricting competition within a market.

Theories and Explanations underpinning networks and relationships

Several theories have been advanced to try to explain the bases for relationships between organisations being developed and sustained, including.

Transaction cost economics
Resource dependency theory
Choice reduction, based on buyer behaviour models
Sociological theories

‘Just-in-time’ relationships

Close business-to-business relationships are often developed in order to exploit the benefits of Just-in-Time *(JIT)* management. This is based on the view that inventory is waste and that large inventories merely hide problems such as inaccurate forecasts, unreliable suppliers, quality issues, and production bottlenecks. The JIT concept aims to eliminate the need for safety stock, with parts for manufacture (or goods for reselling) arriving just as they are needed. As a result, small shipments must be made more frequently. Order requirements can specify the exact unloading point and time of day, with suppliers having to respond accordingly. Specialist distribution companies, such as DHL and TNT often manage the logistics of supply chain management on behalf of the principal partners in the supply chain.

Power in value chains

All partners to a business relationship, or members of a network of relationships, are unlikely to possess equal power. Invariably, some will have power over others, meaning that they are able to exert greatest influence over the agenda of the relationship and how it undertakes its activities. It is quite likely that power changes over time. In recent years, power in UK distribution channels has tended to pass to a small number of dominant retailers and away from manufacturers. The growing strength of grocery retailers has put them at the focal point of a value chain. By building up their own strong brands, large retailers are increasingly able to exert pressure on manufacturers in terms of product specification, price and the level of promotional support to be given to the retailer

Chapter 11 reviews market structure and the lengths that regulatory authorities go to in order to prevent distortion of markets caused by anticompetitive business relationships, and power imbalances within relationships

Developing close relationships with personal customers

Today, firms are very keen to turn one-off, casual transactions with their customers into ongoing relationships. There is nothing new in firms seeking to do this. In simple economies where production of goods and services took place on a small scale, it was possible for the owners of businesses to know each customer personally and to come to understand their individual needs and characteristics. They could therefore adapt goods and services to the needs of individuals on the basis of knowledge gained during previous transactions, and could suggest appropriate new product offers. They would also be able to form an opinion about customers' credit worthiness.

In many markets, relationships have become a new source of product differentiation. In increasingly competitive markets, good products alone are insufficient to differentiate an organisation's products from its competitors.

It is generally more profitable to retain existing customers than continually seeking to recruit new customers to replaced lapsed ones.

Developments in information technology have had dramatic effects in firms' abilities to develop close relationships with customers. The development of powerful user-friendly databases has allowed organisations to recreate in a computer what the individual small business owner knew in his or her head. Large businesses are now able to tell very quickly the status of a particular customer, for example their previous ordering pattern, product preferences and profitability.