Business Relationships as Value Drivers?*

Work-in-Progress paper

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Abstract

The aim of our paper is to understand better the relation between business relationships and business performance. This paper is one of the first steps in a research program intended to examine the value-creating role of business relationships.

Organisations are acting, developing in their environments. Business means the exchange with this environment. These organisations are embedded in the business network. In the business network, actors are mutually dependent on each other. The other actors increasingly influence business performance, through the network. Efficiency and efficacy are no longer the internal questions of a company. Business relationships are the forms and the tools of the actors' interdependency. How could business relationships influence (help?) business performance? In the case of Hungarian industries, we would like to investigate these kinds of problems.

We will start by describing the main concepts of value creation. After summarising the characteristics of business relationships, we will examine Hungarian practice. Using a database of a Hungarian research program “In global competition” – micro-economic factors of the competitiveness of the Hungarian economy (a sample of 300 companies) we have analysed some business relationship issues. After evaluating the performance measurement practice of Hungarian companies from the point of view of business relationships, we analysed the reasons behind long term contracts with customers and suppliers, and the factors influencing purchasing success. Our aim is to compare the approach and the practice of successful and lagging companies, and discover the connection between business relationships and business performance. Based on our very first research findings we will conclude with a new conceptual framework of the role of business relationships in business performance.

In our paper we will try to match financial, operational, and marketing approaches.

Subject areas: business performance, business relationships, value creation, Hungary
The aim of our paper is to better understand the relation between the business relationships and business performance. Our main question is how business relationship could influence the business performance. This paper is one of the first steps of a research program intended to examine the value-creating role of business relationships. We start with describing the main concepts of value creation. After resuming the characteristics of business relationships, we examine the Hungarian practice. Using a database of the Hungarian research program “In global competition” we have analysed some business relationship issue. After evaluating the performance measurement practice of Hungarian companies from the point of view the business relationships, we analysed the reasons behind long term contracts with customers and suppliers, and the factors influencing purchasing success. Our aim is to compare the approach, the practice of the successful, and the lagging companies, and discover the connection between business relationships and business performance. Based on our very first research findings we conclude with a new conceptual framework of the business relationship’s role in the business performance.

1. Main concepts of the value creation
The concepts of value and value creation are increasingly popular, although they frequently cover different approaches. Here we discuss briefly the concepts of shareholder value, customer value and stakeholder value. We argue that business relationships could support the process of value creation, and became value drivers.

1.1. Shareholder value, customer value and stakeholder value
Many authors define the fundamental goal of business as the maximisation of shareholder value (e.g. Rappaport 1998, Copeland et al. 1999). Rappaport highlights that in the early nineties shareholder value was used mainly for evaluating investments and for defining the price of companies when buying them, whereas today this approach is an important tool for planning and evaluating the overall performance of the business. According him even the most enthusiastic followers of the shareholder value approach acknowledge that shareholder value cannot exist without customer value: the long-term positive cash flow requires satisfied customers. (At the same time, this is not automatically true the other way around: satisfied customers and the value served to customers does not necessarily mean the increase of shareholder value.)

The creation of shareholder value in effect means the creation of value-added: shareholders providing resources for the companies expect a profit that exceeds the cost of capital (expected profit from alternative investments), for them, this is the added value. The increase of shareholder value is achieved through value-added given to the customer. In the customer's point of view, it is created if the perceived usefulness of a bought product (service) exceeds the expenditure related to its purchasing.

Customer value is a widespread concept in the marketing literature. According to Kotler’s definition (1998) customer value is the difference between total customer value and the cost of total customer value. In other words, customer value is "the customers’ subjective opinion about the extent to which a product or service meets their expectations" (Chikán and Demeter, eds., 1999, p.6.). This customer opinion also determines the price what the customer is willing to pay for the product, so indirectly it influences the sales revenue of the company.

Based on a comprehensive field study in business marketing Anderson, Jain and Chintaguta (1993) define customer value as "the perceived worth in monetary units of the set of economic, functional/technical, and psychological benefits received by customer in exchange for the price paid for a product offering taking into consideration the available competitive offerings and prices" (Anderson, Jain and Chintaguta 1993, p.5.). This definition means that customer value is perceptual, multidimensional and contextual in nature. When choosing a new product, customers compare it to available alternatives along the three dimensions (economic, functional, and psychological benefits) and than makes a final choice (Jain 2001).

Value creation is now a central purpose of marketing (Jantania and Wilson 1999) and particularly to understand the dynamics of the business relationships (Anderson and Narus 1999). It is because delivering superior value to customer enhanced his satisfaction, his competitive position and his loyalty for sustaining long-term business relationships. Characteristics of relationships could have an important role in creating customer value by ensuring stability, predictability, easier communication, greater flexibility, or smaller costs.

It is worth to highlight that apart from shareholder value and customer value the interests of the rest of the stakeholders are also frequently mentioned. The business ethics uses a wider concept extended to cover a wider range of stakeholders (see for example Enderle and Tavis 1998; Pruzan 1998; Atkinson et al. 1997). More and more experts say that providing added value on the long run to stakeholders (customers, employees, suppliers, or others.) can attain the increase of shareholder value.
1.2. Process of value creation, value drivers and performance
The understanding of the process of value creation, seeing through the causal relationships is the precondition of effective and efficient decisions. Rummelr and Branche (1990) emphasise that the lack of success of companies is frequently caused by their inability to understand the factors influencing organisational and individual performance. The shareholder value added components (cash flow from operation, discount rate used for evaluation, the debt used for financing, according to Rappaport 1998) are influenced by various value drivers. The value creating elements listed by Rappaport (1998) are factors expressed in money, but their development can be influenced by the management’s decisions regarding operations, investments and financial issues. Each company must find the factors through which the value creating process can be influenced.

Lebas’s model of the performance tree (1993) shows the multidimensional character of performance. The operations and the firms’ processes influence the value created for the customer and through their market consequences (sales revenue) and related costs influence the financial result. Every company must find the key factors (“the roots of the tree”, value drivers, performance drivers or action variable, with different terms in the different approaches) adjusted to its own objectives and processes. Through these key factors the company can influence the achievement of its goals and its effectiveness and efficiency, through which it can achieve a competitive advantage.

In this work, we argue that business relationships could be important elements, influencing factors of value creation by decreasing costs and increasing value provided for business partners, customers as well as suppliers. The importance of process orientation is emphasised and the process-oriented thinking prevails in many concepts and methods. The concept of supply- and value chain or the idea of process-oriented management (suggested by Rummelr and Branche, 1990) attempt for effectiveness, efficiency and success are exceeding the frontiers of the company. Companies are starting to recognise that enhancing their own efficiency is not enough, they have to become the part of the most effective supply chain (Cooper 1996). Therefore, besides internal processes the relationships with business partners are increasingly important for firms’ performance. Business relationships could become factors supporting the process of value creation.

2. Business relationships
Our starting point about business relationships is the interaction model (Hakansson 1982) developed by the researchers of the IMP group at the beginning of eighties. We emphasise that the business relationship is a process of bounded interactive exchange episodes (products/services, information, finance, and social exchanges) between the groups of actors involved in it. Business relationships are realised between the buyer and seller and demand different level of efforts in investments (money, time, skill), organisational learning, adaptation, co-ordination, commitment and trust building from both parties (Ford 1990, Ford et al. 1998).

Anderson argues that "value creation and value sharing can be regarded as the raison d'être of collaborative customer-supplier relationships" (Anderson 1995 p.348.). Value created and shared in and by a business relationship is a quite complex phenomenon. The value could be considered as a benefit. The benefit is the result of the difference between the advantages and sacrifices realised in the business relationship.

Ravald and Grönroos (1996) based on the benefit concept argues that "safety, credibility and security contribute to a reduction of the sacrifice the customer and this is something we believe that customer finds essential and very valuable." (Ravald and Grönroos 1996 pp.24-25) They emphasise the importance of continuity in a customer relationship. Considering value as a means of bonding customers "the discussion should not be limited to value-adding features in the offering. The customer perceived value needs to get a deeper understanding, a deeper meaning – a meaning which does not relate only to episodes, but to the expectations of the customer and the responsibility of the company to meet these expectations in a long-term relationship. Then the customer perceived value can be increased on an episode level as well as on relationship level" (Ravald and Grönroos 1996 p.25). The episode value is increasing the benefits or reducing the sacrifice, thus stimulates repurchasing activity and so builds the relationship. Relationship value means safety, credibility, and security, which build trust. Trust increases the loyalty and as results, a mutually profitable relationship for supplier and customer is created (Ravald and Grönroos 1996).

Value created and shared in and by a business relationship could be considered as a utility. This utility exists for both parties. The meaning and the perception of the utility created by the business relationship could be different by partners. Wilson and Jantrania (1996) conceptualise the utility of a business relationship along three dimensions as economic, strategic and behavioural (psychological) ones. The economic dimension consists of cost reduction, value engineering, investment quality and concurrent engineering effects of the relationship for both parties. Relationships
should be driven by different strategic goals. Through the relationships partners can gain competitive advantage, force their core competencies or create market position. Behavioural dimension contains social bonding, trust and the culture of and developed by the relationship. Behavioural elements are interrelating and dynamics. With time a mutual culture develops that will help bond the relationship. "The culture is likely to carry values from both organisations and may develop values not present in either organisation" (Wilson and Jantrania 1996 pp.66). The combination of the economic and social values of two firms in the relationship through behavioural patterns creates the outcomes (exit, maintain, and tolerate with safeguards) of the relationships (Gassenheimer at al. 1998). Their research makes idea to regard the value of different stages of relationship's development. In his integrated model of buyer-seller relationship Wilson considers the value creation as a stage of relationship development (Wilson 1995). Based on a list of relationship variables Wilson describes the creating relationship value stage as mutual goals, nonretrievable investments, adaptations, structural bonds, co-operation and commitment by partners in the relationship (Wilson 1995).

Value created and shared in and by a business relationship could be considered at different relationship level. Mandják and Durrieu (2000) have analysed the value literature at episode, relationship, and network level. At episode level, the value is the result (static) of the exchange that receives the customer. They noticed that different types of offering (customer perspective) define the episode value. At the relationship level, the value seems to be a process of creation (dynamic). This approach concerns both parties. They noticed that two types define the relationship value: value and creation value. The result of this process (or the outcome of it) is not only the relationship value but also the relationship itself. The creation value is realised inside a focal relationship but this creation has also impact on connected relationships. That is why it seems to be logic to regard the value at network level, where the value seems to be a process of sharing (spatial). As consequence of connectedness, the different elements of this value seem to be non-economic (Mandják and Durrieu 2000). In this research, we focus on the elements of business relationships, and their role in value creation.

3. Research methodology

In this research, we examine the practice and approach of Hungarian firms. Our paper is a first step of a research project starting this year. In this exploratory stage we have made a secondary analysis of an empirical database “In global competition – the micro-economical factors of the competitiveness of the Hungarian economy” "Competitiveness research"). We have re-evaluated some of our former research results in the point of view of business relationships. The first data registration of this research program was in 1996, while the second took place in 1999. The research was co-ordinated by the Competitiveness Research Centre, operating next to the Department of Business Economics, BUESPA. In our research, we used only the 1999 survey's results as the basis of a secondary analysis. In this survey, 319 companies filled in questionnaires.

The questionnaire of almost 100 pages consisted of four parts: executives, marketing, production and financial managers filled in questionnaires, relevant to their special field.

The majority of the questions were based on the self-evaluation of the respondents. Items were measured on 5-point scales. The scoring system, depending on the type of the item, looked as follows: “1” and “2” generally referred either to the category of “poor”, or “no importance”, “3” indicated the category of “average” or “indifference”, while “4” and “5” showed positive evaluation, great importance or significant improvement.

In order to characterise companies’ approaches and practice related to business relationships we have examined three aspects, as the performance measurement practice, the reasons behind long-term contract with customers and suppliers, and the supplier evaluation factors

4. Hungarian practice, some first research results

The evaluation of performance compared to the industrial average served as a basis for the separation of clusters, which have different performance characteristics. Because of missing data, only 259 companies could be classified. Based on K-mean cluster analysis with increasing cluster numbers finally three well interpretable groups could be shown. The dendogram of the hierarchical cluster analysis also supported the separation of these groups. The first results of cluster analysis and the description of the company groups created were included in the report on Competitiveness research (Wimmer 2000a)

These three groups are:

Successful companies

Companies that were classified in the successful group (69 companies) are leading companies, all of their performance characteristics are above industrial average. Companies with average performance
The largest group (126 companies) is characterised by about average performance in almost all of the aspects. The respondents consider their product quality to be better than average, but it seems, that this is not supported by an appropriately modern technology (in this respect the rating is a little weaker than average). The market performance and financial performance can be considered to be average.

Companies lagging behind
The third group (64 companies) consists of companies that are lagging behind: quality and operation characteristics are considered to be around average, but they are also characterised by weak market performance and financial performance. The product/service quality is the only case where this group performance is a little better than the industrial average.

The basic performance characteristics of the clusters are summarised in Table 1. All the six factors played a significant role in the separation of clusters.

<table>
<thead>
<tr>
<th>Cluster: Performance:</th>
<th>Successful</th>
<th>Average</th>
<th>Lagging behind</th>
<th>All companies*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on sales</td>
<td>4,06</td>
<td>3,00</td>
<td>1,98</td>
<td>3,03</td>
</tr>
<tr>
<td>Return on capital</td>
<td>3,99</td>
<td>3,07</td>
<td>2,13</td>
<td>3,08</td>
</tr>
<tr>
<td>Market share</td>
<td>4,01</td>
<td>3,22</td>
<td>2,14</td>
<td>3,17</td>
</tr>
<tr>
<td>Technology</td>
<td>4,13</td>
<td>3,19</td>
<td>2,78</td>
<td>3,34</td>
</tr>
<tr>
<td>Management</td>
<td>3,99</td>
<td>3,48</td>
<td>2,98</td>
<td>3,49</td>
</tr>
<tr>
<td>Product/service quality</td>
<td>4,26</td>
<td>3,70</td>
<td>3,27</td>
<td>3,74</td>
</tr>
<tr>
<td>Average of evaluations</td>
<td>4,07</td>
<td>3,28</td>
<td>2,55</td>
<td>3,31</td>
</tr>
</tbody>
</table>

*Companies grouped into clusters (n=259). (Wimmer, 2000a)

4.1. Performance measurement practice in Hungary
In a previous research (Wimmer 2000b) we have evaluated the performance measurement practice of Hungarian companies by the orientation (supported goals, activities), balance (multidimensional approach), consistency (from the aspects of meeting perceived importance and strategic goals), and using these characteristics, by the extent the performance measurement practice supports the decisions on value-creating processes. Here we evaluate some result from the point of view of relations with business partners.

According to the research results companies’ performance measurement practice is characterised by controlling and reporting orientation. Evaluation of information systems shows that it works relatively efficiently for monitoring (3,91 average in a 1-5 scale), profitability (3,79) and cost reduction (3,73) calculations. The respondents find this support less adequate about business relationship issues: support of tracking customer satisfaction is evaluated 3,05 in average, suppliers evaluation 2,98, service level evaluation 2,75, distribution channels profitability (2,41). Performance measurement practice of Hungarian firms is mainly output-oriented. The quality of the input and processes is tracked less frequently. The majority of respondents concentrate primarily on the end-result, mainly on the quality issues. The result show that process oriented thinking is not widely used.

The role of subjective, opinion-based information (customers, employees, business partners) and the use of stakeholders’ opinions, are not too significant. Only few firms' use information based on opinions, although it is visible that their importance is being recognised by a growing number of companies. A small part of the companies tries to use the opinions of customers and employees as well.

Customer service and customer satisfaction are undermeasured, as companies consider them important but the do not really measure them.

4.2. Long term contracts in Hungary
According to the companies' opinion, the most important reasons for using long-term contracts are capacity utilisation, revenue stability in customer-side, and reliable supply, and cost calculation in supplier side. It means that the main reasons are related to the stability and the predictability. There is a smaller importance of the better communication, co-operation possibilities.
There are some differences between the most important reasons of a long-term contract if it is realised with a customer or with a supplier. A long-term contract with a customer (on the marketing side) is interesting because it could help a stable capacity utilisation or safe gross revenues. Other interest is a hope for future contract or a better knowing of the partner's quantity or quality requirements. In the point of view, the supplier a long-term contract means a better understanding of the customer and the using of this knowledge could increase the safety of the value creation processes.

A long-term contract with a supplier (on the purchasing side) is interesting because of the stability of the supply, the predictability of purchasing costs and the general safety of the buying process. This type of supplier relationship could help to increase the predictability of purchasing conditions to achieve a cost reduction. In the point of view, the buyer a long term purchasing contract means an increasing level of resource stability and a better cost management.

We have found that successful companies appraise the development and co-operation possibilities more important that the lagging firms (3,39 vs. 2,8 in customer side, 2,89 vs. 2,37 in supplier side). The co-operations issues are more significant with customers than with suppliers (3,01 vs. 2,77 in average, 3,39 vs. 2,89 for successful). These findings support the assumption of output-orientation. Using long-term contracts, the successful companies try to realise a joint problem solving with customers and to close out their competitors. For the lagging behind firms, the stability and the knowledge of customer requirement are relatively more important reason than in the other two groups.

**4.3. Supplier evaluation factors in Hungary**

Concerning supplier relations, successful companies evaluate the following factors most important in purchasing success: supplier evaluation, supplier management, and improvement of co-ordination. The lagging firms deliver less important the quality improvement and the information system development. (See table 2)

| Table 2 |
|-----------------|-----------------|-----------------|-----------------|-----------------|
| Important factors in purchasing success | Average performers | Successful | Lagging behind | All |
| Cost reduction | 4.24 | 4.08 | 3.84 | 4.10 |
| Quality improvement | 4.12 | 4.12 | 3.74 | 4.02 |
| Finding suppliers | 3.99 | 3.90 | 3.56 | 3.86 |
| Partnership with suppliers | 3.85 | 3.76 | 3.67 | 3.78 |
| Supplier evaluation | 3.53 | 3.66 | 3.18 | 3.48 |
| Supplier management | 3.16 | 3.37 | 2.89 | 3.15 |
| Improvement of co-ordination | 3.12 | 3.27 | 2.24 | 3.01 |
| Environmental protection | 3.12 | 3.04 | 2.67 | 2.99 |
| Development of information system | 3.03 | 3.02 | 2.43 | 2.88 |
| Decrease of suppliers’ number | 2.99 | 2.76 | 2.68 | 2.85 |
| Development of methodology | 2.80 | 2.76 | 2.30 | 2.66 |

The most important criteria in suppliers' evaluation are prices, product quality, punctual delivery and paying conditions. The connected services, the employees training and participation in product development not considered as very important. For the lagging companies, the product quality and the flexible scheduling have relatively smaller importance than for average performers and successful companies.

The main criteria for evaluation of suppliers are the reasonable price, the high product quality and the punctual delivery. Reasonable payment conditions and low delivery costs are considered as important elements. Most of these factors are connected to the purchasing efficiency.

**5. Conclusions, a new framework**

Based on the former research results (Czakó et al. 1999, Wimmer 2000a) and our analysis and experiences we summarise that

(1) most of companies have not yet recognised the importance of business relationships in value creation. They are increasingly familiar with the concept of customer satisfaction, customer service, but the methods used do not support
adequately these concepts. That means that customer relationship considered increasingly important but not always supported by every day operations.
(2) companies' approach is mainly output-oriented. The management of business relationships is often one-sided, stronger in customer side and weaker in supplier side. Firms often do not communicate adequately their goals, preferences for their suppliers. This practice shows the lack of process-orientation, the weakness of using value chain and supply chain concepts.
(3) that successful companies' approach about business relationships are more advanced. They are more process oriented and business relationships could be more interesting for them.

The very first findings of this exploratory research could make us think a holistic framework of the business relationships as value drivers. Figure 1 shows the first edition of our holistic framework.

Shareholder value depends on the companies’ performance, the effectiveness and efficiency of the firms’ activities and business processes. Customer value means that the product or the service is valuable for the buyer. Customer is looking for values and if he evaluates the value greater than sacrifices, he buys the product or service. The existence

![Figure 1. A holistic framework of the business relationships as value drivers](image-url)

and realisation of customer value creates sales for the supplier. The value provided for the customers (among others) is one of the important elements of the firms’ performance, one of the prerequisites of the shareholder value creation. In the business environment, customer value is created in and by business relationships. Business relationships and more exactly the management of a business relationship could influence the company's performance, and the creation of shareholder value. As the business relationships influence the firms’ performance and they are manageable, it seems to be logic to consider business relationships as value drivers.

As we have seen, the business relationships are interactive exchange relationships between two companies, between the supplier and the buyer. However, a relationship is not isolated (Hakansson and Snehota 1989) by a variety of connectedness, it is influenced by different third actors. In other words, a business relationship is always embedded in a business network. This network contains, among others, a part of the stakeholders. It means that the stakeholder value is created in and by the business network.

Customer value is created directly in and by a relationship and stakeholder value is realised in the connected business network. This direct and indirect value creation contributes to the company's performance. As each business relationship has its own contribution, the company's performance is (partly) influenced by the ensemble of business relationships. In other words, the portfolio of the company's business relationships drives the performance. In this way, the management of business relationship's portfolio gets a really strategic dimension and it could be an important factor of competitive advantages.
To conclude our holistic framework, based on a from inside to outside logic, could help to suppose that business relationships and business networks are value drivers which could influence directly the company's performance and indirectly the shareholder value.
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