Relationship management from the Key Account buyer’s point of view: the role of frameworks contracts

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Abstract

Relationship marketing seem to have become the new paradigm in marketing (Grönroos, 1994)\(^1\), and although it has been defined from the supplier’s point of view, it could apply to buyers as well, especially if it is related to the definition of a Key Account customer, which is seen as a customer that “desires a long-term, cooperative working relationship as a means to innovation and financial success.” (McDonald & al.,1997)\(^2\).

Key Accounts often want to set up cooperation strategies with “preferred” suppliers, which are defined by contractual agreements, called “framework contracts”. These are not supply contracts, but are “umbrella agreements” that define how companies want to interact (Mouzas & Ford, 2006\(^3\)).

We have carried out an exploratory study among ten major French Key Accounts to study manufacturer-to-manufacturer relationships from the point of view of the customer.

Our research provides empirical evidence of some paradoxical findings: framework contracts are managed as an asymmetric relationship tool by powerful Key Account buyers, and whilst they appear to be contractual to suppliers, they are relational to the Key Accounts, nevertheless,

1. Framework contracts define mutual commitment and hence, interdependence, between Key Account buyer and seller;
2. Framework contracts reflect the mutual benefits of value creation and sharing;

Our study discusses those findings.
INTRODUCTION: KEY ACCOUNTS’ MAIN ISSUE IN SUPPLIER RELATIONSHIP MANAGEMENT

Two major features help defining a key account (Stevenson, 1980): centralisation of purchasing and a high level of purchase in value. Along the years, this centralisation of purchasing has, more and more, moved from a national perspective to a global one and as a consequence, supplier relationship management has become highly strategic. This move has been following the development of Relationship Marketing as a new marketing paradigm (Grönroos, 1994; Day, 2001).

Supply decisions are no longer based mainly on price (Fram, 1995), but on value creation derived from the relational benefits (Anderson & Narus, 1999, 2004; Ulaga, 2003).

The focus today is to develop close and partnership-like relationships (Cardozo et al., 1992; Ehret & Ploetner, 2006; Kanter, 1994; Rese; 2006), which implies reducing the number of suppliers by selecting a small number of “preferred” suppliers (Spekman, 1988; Kalwani & Narayandas, 1995). For example, EADS in their «Smartbuying» program want to reduce their supplier base by 80% (from 3000 to 500 by 2010), reduce their logistic platforms from 80 to 8 and set up a network of first-tier suppliers.

The choice of those “first-tier” or “preferred” suppliers thus becomes critical.

Key Accounts must choose suppliers who will be willing to share risks and not only reduce costs, but more important, increase their customer’s revenues and get involved in innovation and product/service improvement.

Of greater difficulty is the selection of suppliers who can sustain their collaborative efforts in a long-term relationship.

For Key Accounts, defining their expectations and getting suppliers to commit to and fulfill those expectations has become the most important phase of their supplier relationship management.

To do so, they more and more often use framework contracts (Mouzas & Ford, 2006).

1. THE ROLE OF FRAMEWORK CONTRACT TO INITIATE SUPPLIERS RELATIONSHIP

Macneil (1980, 1987) defined contracts as relations among parties who have previous experience of exchanging or expect to be exchanging in the future. According to Macneil’s view, contracts and exchange are two interrelated concepts and he described exchange on a continuum that goes from discrete exchanges to relational exchanges, laying the foundations for Relationship Marketing opposed to transactional marketing (Day, 2001).

He then developed nine (1980) and subsequently ten (1983) norms of behaviour within an exchange that he called common contractual norms and linked them either to discrete transactions or to relational exchanges.

Blois (2002) has visualised those norms and their links as follows (figure 1):
If we focus on the relational norms, we can see that some of those norms are a combination of common contractual norms: flexibility and the harmonization with the social matrix are to be found, combined with other contractual norms, in two different relational norms.

The norms of flexibility and harmonization with the social matrix stress that a contract drafted within a relational exchange cannot be "perfect" in the sense of a neo-classical contract and that flexibility is required because of a lack of perfect information and rational decision-making.

Thus, when early in the relationship the contract drafting takes place to define exchanges to come, the relational norm of flexibility is enhanced as a lot of information and decision-processes are still unknown.

The contract, in such cases, becomes symbolic of both parties’ willingness to cooperate (Brousseau, 1996). As customers and suppliers are aware that it is impossible to sign a contract which creates a perfect incentive at such an early stage of the relationship and that any mistrust which evolves in the future could freeze attempts at cooperation, they instead sign contracts that will “symbolize” their will to cooperate. The contract becomes the starting point of mutual reliance between the parties. The contract stands for a commitment that will increase the cost of opportunism. Although there may not be a penalty system, any breach of contract will involve moving from a secure contractual environment into uncertainty. As parties are usually averse to uncertainty, the risk of opportunism will thus be limited and the contract will deter them from not cooperating.

If the contract was to be terminated because of non-cooperation, parties find themselves in a greater situation of uncertainty and do not fully know how the other party is going to react.

Framework contracts, in a business to business environment, typically reflect the wish to cooperate for a certain length of time and do not involve immediate and detailed contractual decisions.

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*fig. 1 based on Blois (2002)*
They define the relationship to be built and what will happen if the relationship deteriorates. They “provide an explicit framework of norms within which contractual decisions can be made” (Mouzas & Ford, 2006) – hence, framework contracts can be defined as a relationship management tool.

In the case of Key Accounts, if framework contracts depend on some of the norms defined by Macneil for relational exchanges, such as flexibility and harmonization of the social matrix (which can be understood here as the harmonization between Key Accounts teams within the supplier’s firm and Supply Management relationship teams in the Key Account’s firm), some other norms such as reciprocity are less likely to be found.

Framework contracts between suppliers and Key Accounts are often defined and signed within an asymmetric relationship (Mouzas & Ford, 2007), when suppliers are dependent on Key Accounts.

2. **KEY ACCOUNTS AND SUPPLIERS: INTERDEPENDENCE IN ASYMMETRIC RELATIONSHIPS**

Key Accounts create a relationship in which they attract suppliers because of the potential high level of purchase value and thus very often draw them to enter into an asymmetric relationship.

Cox (2001) and Caniels et Gelderman (2005) have studied under which contingencies the power of customers (here Key Accounts) allowed them to be in a situation of dominance versus their suppliers.

Cox (2001) has focused on how buyers try to reposition themselves to achieve some economic dominance over their suppliers. (see figure 2).

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**Buyer – supplier power matrix**

![Diagram](Fig. 2 based on Cox (2001))

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The main attributes that apply to Key Accounts are as follows:

- Buyers will keep on centralising their purchases and make the total volume or value extremely attractive to suppliers (route 1).
- By reducing the number of suppliers, buyers will increase suppliers’ business share, making them more dependent on them (route 2).
- By creating close partnership like relationships, Key Accounts will learn new competencies from their suppliers and diminish the interdependence (route 3).

Thus, Key Account buyers often find themselves in a powerful asymmetric situation. In such a situation, as stressed by MacCaulay (2003, p 82): “a party with greater power wants a relationship based on trust and co-operation but also wants to reserve power to hold over the other to the letter of a written document when it is to its advantage.”

Hence, the initiative for the creation of framework contracts is typically theirs. They can impose a framework contract on their selected suppliers, requiring them to commit to a large number of issues related to the Key Account’s expectations of their relationships, whereas the Key Account has no obligation to purchase from them.

Nevertheless many suppliers freely choose to enter such a relationship and such a contract as they expect that the benefits they anticipate gaining from the relationship will justify the risks associated with being in an asymmetric power position (Mouzas & Ford, 2007).

Suppliers, even in an asymmetric power position, believe there is some mutual (but not necessarily equal) benefits to be derived from the relationship. Kalwani & Narayandas (1995) stress that suppliers with a collaborative approach may achieve greater profitability by reducing their general costs than suppliers with a transactional approach.

Napolitano (1997) emphasizes the possibility for the supplier to,

- Realize Incremental Volume
- Increase Market Penetration
- Gain Operational Efficiencies
- Product Development Ideas
- Get Greater Customer Loyalty

Walter et al. (2001) also define some functions that allow suppliers to perceive value creation for themselves (fig. 3):

![Diagram](fig. 3 based on Walter et al. (2001))
Those relational value drivers are shared between suppliers and customers.

Ulaga (2003)\textsuperscript{27} has listed 8 constructs with 3 dimensions as the customer relational value drivers: most are common to the functions described by Walter et al. (2001). (see fig. 4 based on Ulaga (2003) and Walter et al. (2001)).

<table>
<thead>
<tr>
<th>Customer relational benefits</th>
<th>Supplier relational benefits</th>
</tr>
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<tbody>
<tr>
<td><strong>Product quality:</strong></td>
<td></td>
</tr>
<tr>
<td>✗ Product performance</td>
<td>✗ High level of operational performance =&gt; <em>market function</em></td>
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<tr>
<td>✗ Product reliability</td>
<td>✗ (supplier captures critical information to access new markets)</td>
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<td>✗ Product consistency</td>
<td></td>
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<tr>
<td><strong>delivery:</strong></td>
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<tr>
<td>✗ On-time delivery</td>
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<td>✗ Delivery flexibility</td>
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<td>✗ Accuracy of delivery</td>
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<td><strong>Process costs:</strong></td>
<td></td>
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<tr>
<td>✗ Inventory management</td>
<td></td>
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<tr>
<td>✗ Order handling</td>
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<td>✗ Incoming inspections</td>
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<td>✗ Manufacturing</td>
<td></td>
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<td><strong>Time to market:</strong></td>
<td></td>
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<tr>
<td>✗ Design tasks</td>
<td></td>
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<tr>
<td>✗ Prototype development</td>
<td></td>
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<tr>
<td>✗ Product testing and validation</td>
<td></td>
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<tr>
<td><strong>Supplier know-how:</strong></td>
<td></td>
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<tr>
<td>✗ Knowledge of supply market</td>
<td>✗ <em>Innovation function</em> technological know-how and creative ideas are obtained from the customer.</td>
</tr>
<tr>
<td>✗ Improvement of existing products</td>
<td></td>
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<tr>
<td>✗ Development of new products</td>
<td></td>
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<tr>
<td><strong>Service support:</strong></td>
<td></td>
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<tr>
<td>✗ Product related services</td>
<td></td>
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<tr>
<td>✗ Customer information</td>
<td></td>
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<tr>
<td>✗ Outsourcing of activities</td>
<td></td>
</tr>
<tr>
<td><strong>Direct product costs (price):</strong></td>
<td></td>
</tr>
<tr>
<td>✗ Price above, below, at competition</td>
<td>✗ <em>volume function</em> contributes to the success of the supplier by securing the necessary “break-even” volume and, thus, allows the company to operate on a profit-making basis</td>
</tr>
<tr>
<td>✗ Annual price decreases</td>
<td></td>
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<tr>
<td>✗ Cost reduction programmes</td>
<td></td>
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<tr>
<td><strong>Personal interaction:</strong></td>
<td></td>
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<tr>
<td>✗ Communication</td>
<td></td>
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<tr>
<td>✗ Problem solving</td>
<td></td>
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<tr>
<td>✗ Mutual goals</td>
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</table>

*fig. 4 based on Ulaga (2003) and Walter et al. (2001)*

In their search for common relational benefits that help them to create value, customers and suppliers become interdependent. For instance, both customers and suppliers base innovation on mutual know-how and sharing of creative ideas.
Within an asymmetric relationship dominated by a Key Account’s buying power, an inter-dependence is nevertheless created by the common efforts and knowledge sharing to capture value by both the supplier and the Key Account. This is not reflected, as such, within the framework contract that only defines the obligations of the supplier, but our empirical study revealed some interesting features resulting from that interdependence.

3. Analysis of Empirical Study

The empirical stage of our research on framework contracts was an exploratory study carried out within a wider research for a doctoral dissertation. This exploratory study dealt with the supply relationships from the point of view of a Key Account buyer towards his suppliers within leading and non-competitive companies in different industries* (not including the automotive industry).

We conducted in-depth interviews with Purchasing Managers or Directors who were contacted through the alumni network of a Business School and were senior buyers with a substantial purchasing experience. Our sample consisted of ten interviews within ten companies. This was consistent with sample sizes recommended by scholars for exploratory studies (McCracken, 1988\textsuperscript{28}). On average, the interviews last one hour to one hour and half. Each interview was audio-recorded and transcribed within 72 hours. We used thematic coding and a mapping of concept relationships (Miles & Hubermann, 1994, 2003\textsuperscript{29}).

We focus in this paper on the role of framework contract to initiate a “preferred” supplier relationship in an asymmetric relationship where the buyer is dominant.

The need for framework contracts is mostly determined by the project mode of working of the companies involved who have realised that, if they only start selecting suppliers, when a project arises they may not meet delivery deadlines. Hence, the need to work with pre-selected suppliers who have previously signed a framework contract.

Quote 1 (Buyer N) "(Before I entered the job and defined that framework contract approach), my company used to list projects at the start of the year and negotiate with suppliers: the result was that between the project definition and the signature of the final contract 6 months could elapse and the site strategy may have changed in the meantime. It happened that we signed contracts for equipments we never purchased …”

Quote 2 (Buyer D)”(we define framework contracts) because we are purchasing per project: we win a project after a competitive bid and the lead-time is very short between the project allocation and the implementation. We cannot then start looking for a supplier”

Framework contracts can be divided into three conceptual dimensions as per figure 5:

\* This is a major difference with Mouzas and Ford (2006, 2007) study, who have investigated manufacturer-retailer relationships whereas we have studied manufacturer to manufacturer relationships.
3.1. Relationship consensus

The time dimension is here of primary importance: in manufacturer to manufacturer contracts, framework contracts are discussed when the buyer wishes to initiate a long term relationship – which does not mean there was no relation before, but the relationship was previously more of a transactional type.

The framework contract is designed to build the relationship for the longer term, i. e. with no specific time limit, even when a date for the termination of the framework contract is indicated.

Quote 3 (Buyer N) “I do not find time to renew the present framework contracts. To start with I felt three years were a long time, but we are beyond those three years and I just cannot find time to renew them. In fact, they have been orally updated, but the wording has remained unchanged. It is so much work to refresh those contracts and I do not really see the need for it unless there are some major changes within our suppliers – financial situation, change of owner ... Those are specific cases we deal with, but otherwise we are the leader in our industry, none of our “preferred” suppliers want to review their framework contract !”

Quote 4 (Buyer C) “We define framework contracts for a year with a tacit agreement clause, so that we have the possibility to terminate the contract every year but may keep on working with suppliers for years !”

The first step in creating a framework contract is to define the scope of business and the products/services involved but beyond that, the nature of the relationship is the most critical element.

Quote 5 (Buyer A) “To start with the importance of the framework contract : this is not the legal aspect, but to define the relationship from the beginning. What are the objectives? Which will be the foundations of the relationship? How are we to measure the relationship?”

Quote 6 (Buyer D) “ Within our framework contracts, we define,
- our general purchase conditions
- our technical specifications
- our quality policy
- our logistics requirements
- our ethical values”

Quote 7 (Buyer N) “with a framework contract, we want to settle two issues:
- we want to make very clear what we expect from our suppliers
- what will happen if things go wrong

Concerning our supplier expectations, we have two levels:
Short- term: we define the level of quality and sales conditions we wish
Long- term: we give our vision of the future”.

The major role of framework contracts is for Key Account buyers to establish with suppliers all the relational elements that can be defined before any implementation contract takes place.
Most of those relational elements are defined in terms of standards (quality standards, technical specifications) to be reached and principles guiding the relationship (ethical values, vision) and can be related to Macneil’s linking norms.
Those norms based on restitution, reliance and expectation interests will guide any requested change within a reliable contract.
Within framework contracts, the relational elements are defined in terms which are broad enough so as to allow any required adjustment if needed.

3.2. Interdependence within asymmetric relationship

The asymmetry of the contract is a distinctive feature of these framework contracts: the supplier is “committed” to supply whereas the buyer has no commitment.

To counterbalance this commitment requirement, Key Accounts offer their framework suppliers the status of “preferred” suppliers: which means they will be given priority or exclusivity on projects (in the second case, competition is still organised but among “preferred” suppliers).
We can refer here to the “constraint of power” defined by Macneil: the framework contract reflects the power of the Key Account’s buyer, but, by also limiting the choices of the buyer (selection of “preferred suppliers), it is some kind of self-limitation of power.

Quote 8 (Buyer N) “We have an objective: when I signed those contracts, I explained to my suppliers they would be part of a “club” and the goal of that club is to develop relationships not to pressure them”.

Quote 9 (Buyer D) “if you want to have suppliers that “follow” you, it is most important that they can feel that the Key Account customer is grateful to them and can be a faithful customer.
If you want to succeed, I feel it is important to have long- term relationship with suppliers. I do not like the wording “partnership” because it is bandied out, I rather speak of long-term relationship. We have been working with some of our first tier suppliers for over twenty years.”

This may refer to the “role integrity” norm as defined by Macneil when, beyond the wording of the contract, there is an expectation (on suppliers’ side) that Key Account buyers will behave “properly or adequately in all circumstances” (Misztal, 199630).
Although this type of norm is not purely ethical but linked to some behaviour counterpart expected by Key Accounts.

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If a Key Account does not purchase from its preferred suppliers, which they are contractually entitled to do, they run the risk of de-motivating them and losing the expected relational benefits.

Although “contractual” commitment is the supplier’s responsibility, the fact of selecting, some “preferred” suppliers, creates at least some “psychological” commitment on the Key Account’s side: the preference is given in recognition of the relational benefits derived from the supplier’s commitment.
The Key Account’s commitment is interrelated with the level of motivation that it wants from its supplier to create and share value.
It is at this level that we find the interdependence in an asymmetric relationship.

Quote 10 (Buyer D) “if you want suppliers to invest (in your project), which may involve overtime, temporary staff, without taking you in hostage, they have to feel there will be some gratefulness”.

‘Gratefulness’ is here to be understood as the supplier’s expectation the customer will increase the future purchase volume or the number of allocated projects.
We can relate it to the definition of “psychological” contracts (Rousseau, 199011, 199532), which reflect the individual’s belief that certain promises have been made by the other party.
Although above definition applies to employee/employer relationship, interaction between suppliers and Key Accounts imply obligations for the supplier and none for the customer, except future expectations make its part of the contract “psychological”: there is a “psychological” commitment to increase the future purchase volume or the number of allocated projects.

3.3. Relational and economic benefits

The motivation of suppliers towards Key Accounts can be translated into relational benefits for their customer (see p 6), but also with direct economic benefits.

Quote 11 (Buyer N) “I have given some financial thresholds which are extremely interesting for us as there are some additional rebates linked to those thresholds. They come on top of the contractual rebate”.

In many cases, the more the Key Account provides their “preferred” suppliers with business, the more they benefit from advantageous economic conditions (Kalwani & Narayandas, 1995).

When commitments are balanced on both sides of the relationships, Key Account and suppliers will create and share more relational and economic benefits.

Nevertheless, some buyers are aware that, although framework contracts may diminish the risk of opportunism (see supra), the longer the relationship last, the more the risk of opportunism increase.
This aspect has been developed by Pillai and Sharma (2003)33, analysing the life cycle of relationships.
When the relationship reaches a maturity phase and suppliers realise their status of “preferred” suppliers, this is not easily to be challenged by their Key Account Customers, the risk of opportunism increases.
To avoid these risks and disadvantages of the framework contract, which may decrease both their relational and economic benefits, Key Account buyers often introduce a transactional element to the relationship.

They will either launch a competitive bid for each project or launch such a bid when the volume, for a specific equipment, becomes recurrent or reaches a threshold.

For instance, Buyer N launches a competitive bid for each project involving “preferred suppliers” and “challengers” (suppliers who have not signed a framework contract), but, if a challenger wins the bid, the second best “preferred” supplier will be giving the opportunity to match the challenger’s one and win the contract.

Buyer C will not launch a competitive bid per contract, but once some equipment or product becomes recurrent or volume is high, such a bid will be launched.

And as Buyer N concludes in a slightly cynical way,

Quote 12 (buyer N) “For the past two years we have been growing very strongly with a steep increase in our investments.
This could have led our “preferred” suppliers to review their strategy and increase their margins.
I did not notice anything like that.
May be, because I have left enough pressure from the ”challengers”....

The second risk induced by framework contract is to be focussed on a limited number of suppliers and miss emerging suppliers that may offer better economic or relational benefits.
Some buyers dismiss that risk:

Quote 13 (Buyer N) “in our field, we are not confronted to major change but anyhow we are the leader in our industry: everybody wants to work with us!”

Quote 14 (Buyer D) “ once we have a framework contract, we are not going to reconsider it. If such was the case, why would it be worth contracting? It is also a matter of ethics.
But, having said that, nothing prevents us from going onto the market and going back to our suppliers, if we notice a “gap” between the two ...”

Those risks, for the Key Account buyers, lead us back to our main point: their commitment is only ”relational” because they want to get the highest relational and economic benefits from their “preferred” suppliers, but still keeping an eye on the market ...
CONCLUSION

Leading industrial companies use framework contracts at the initial stage of entering a long term relationship with their suppliers as a means of getting them ready to cooperate and to diminish opportunistic behaviours.

Our study demonstrates that despite the asymmetry of the relationship and the one-sided contractual commitment (on suppliers’ side), framework contracts also represent a “psychological” commitment from Key Account’s side if they want to motivate their suppliers and optimize relational and economic benefits from the relationship. Framework contracts, in that sense, symbolises the interdependence between key Accounts and suppliers.

Further research should investigate how some Key Accounts with framework contracts, while maintaining the “psychological certainty”, still launch competitive bids before allocating projects and signing implementation contracts involving “preferred” suppliers and “challengers” and maintain their “preferred” suppliers’ motivation (this is part of our broader doctoral research). Our study is also focussed on the customer’s (Key Account) point of view, but to fully understand how framework contracts work the supplier’s point of view must also be investigated and subsequently the dyad ‘s interaction.

On the other hand, we are fully aware that asymmetrical relationships exist both ways and some suppliers gain power over their customers with a major technological or product advantage (e.g. recent negotiations between Apple and major mobile phone companies for the I-phone) and the implications of that type of relationship on framework contracts should also be investigated.
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