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8. Securing and managing external relationships

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Learning objectives

- understand the fundamental elements of external relationships
- know the type of common relationships and the phases of developing relationships
- use the characteristics of the business situation to choose the right type of relationship
- understand the relationship between types of external relationship and business strategies
- understand the risks associated with various business strategies

Introduction to external relationships

In today's business world, organizations increasingly depend upon developing external relationships to remain competitive. This trend occurs for two reasons. First, organizations have come to realize that they cannot be first-rate in every phase of their business (e.g. marketing, production, information systems, etc). Instead, they recognize that a better strategy is one in which they focus on core competencies, or the things they do best, and establish relationships with other companies to perform those functions where they do not have outstanding capabilities. For example, Amazon.com offers a wide variety of products and even recommends personalized suggestions to its customers. It realizes, however, that other companies such as FedEx and UPS have world-class competence in delivering goods. That is why Amazon.com customers have their purchases delivered by FedEx, UPS or a country's postal service. You do not see Amazon delivery trucks and likely never will. Secondly, information and communication technologies make it much easier to operationally create seamless relationships. Instant communications between two separate companies enable them to manage a business process as if the two companies were a single company. Both companies and the customers benefit from relationships that work. The entire business process of ordering and delivering is world class for Amazon.com. Additionally, FedEx or UPS receives more business, and customers benefit from receiving superior service.

External relationships provide access to additional information and financial resources, which ideally results in increased profitability and success. Yet, forming relationships involves associated risks, and debate continues about how to best realize benefits and minimize costs (Street and Cameron, 2007). Nevertheless, many managers now agree that strategies for establishing and managing external relationships are necessary for all organizations in the current and future global business environment.

8. Securing and managing external relationships

This chapter describes the components of external relationships to provide the background needed to understand and form the right relationships for organizations of all sizes. These include the types of common relationships, the phases of relationship development, critical factors for successful relationships and the skills needed to perform these essential tasks. Leveraging external relationships requires a strategic perspective that ranges from obtaining reliable supplies of raw materials for internal production processes to outsourcing entire business processes. Exhibit 32 shows that developing the right relationships depends on implementing explicit strategies that are built upon an understanding of relationship fundamentals.

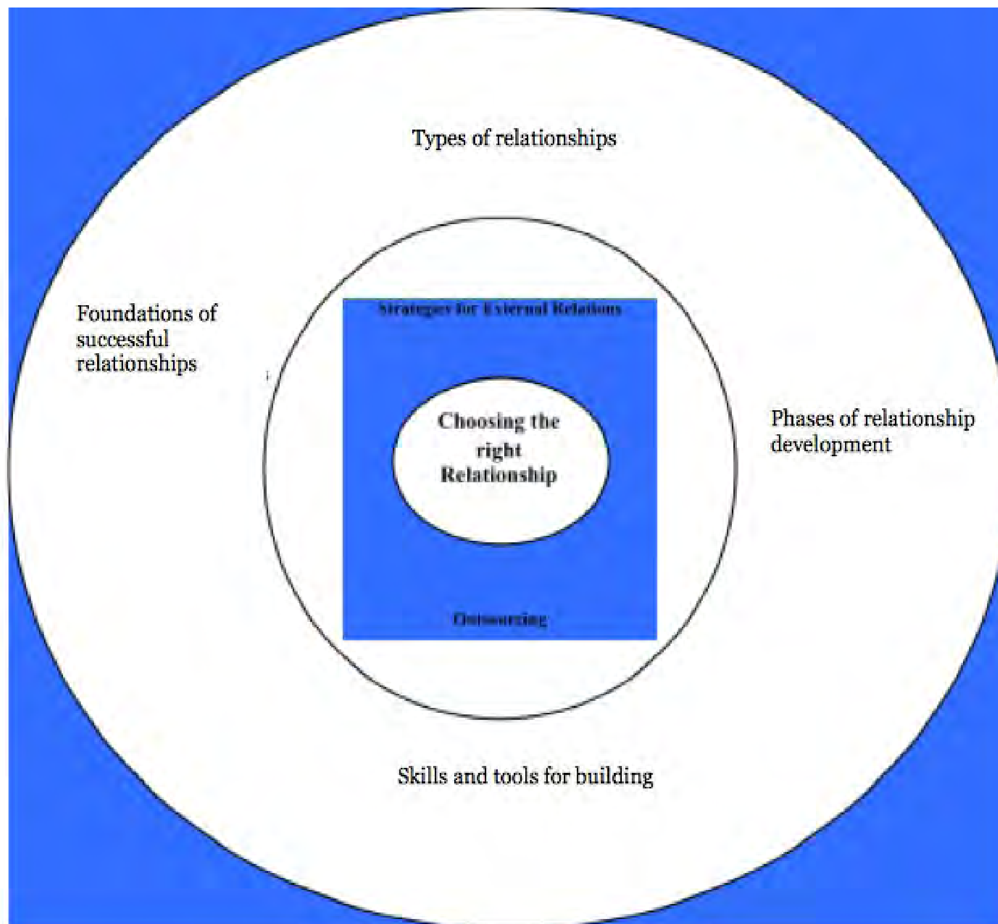

Exhibit 32: Developing relationships

An external relationship is defined as a commercially oriented link between two business institutions with the intent of increasing tangible and/or intangible benefits for one or both of the organizations involved (Street and Cameron, 2007). Two common types of external relationships are market exchanges and partnerships, which we will discuss later in this chapter.

Trends in management

The global business environment requires managers to integrate outside sources and business partners to increase efficiency. Technology has been proven to be a key factor in improving good relationships, while also providing capabilities to evaluate and eliminate poor relationships (Scannell and Sullivan, 2000). Companies are partnering together to form virtual organizational units, which work to the benefit of core businesses as we

illustrated with the Amazon.com example in the introduction to this chapter. Managers must have business management skills, technical skills, and a thorough knowledge of external relationship management in order to take optimal advantage of opportunities and leverage the skills and knowledge of other organizations to maximize returns on investment.

Trust: the foundation for a successful relationship

One of the most important elements in developing a successful, long-term relationship is trust. Trust affects the quality of every relationship, every communication, and every project. **Trust** can be defined as the belief that one party will fulfill its obligations. According to Jim Burke, former chairman and CEO of Johnson & Johnson, "You can't have success without trust. The word trust embodies almost everything you can strive for that will help you to succeed" (Covey, 2006). This key factor must be mutual between all organizations involved, whether they are suppliers of materials or providers of outsourcing capabilities. If mutual trust is established early on, all organizations will benefit through a greater willingness to share ideas, goals, and work together to solve problems Exhibit 33 reveals trust is a function of five different dimensions.

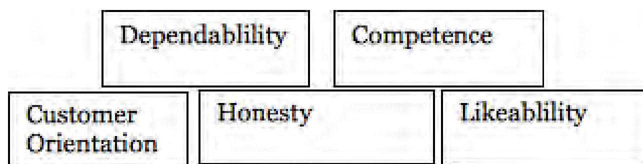

Exhibit 33: Dimensions of trust

- **Dependability:** Is one party making and fulfilling promises to another (Covey, 2006). Dependability can also be exemplified via third party confirmations. For example, a credible source can vouch for a firm when dependability has been proven through past experiences. Product demonstrations and plant tours are other ways companies can illustrate the capability to be dependable.
- **Competence:** Is when an organization appears knowledgeable. Demonstrating competence can be the fastest way to increase trust (Covey, 2006). A thorough understanding of suppliers, customers, products, competitors, and the industry demonstrates competence. If a manager understands the relationships they develop, the organization will be perceived as competent.
- **Relationship orientation:** Is the degree to which the company puts the partner first (Weitz, Castleberry, and Tanner, 2005). A company cannot be successful if managers are only concerned about their own profits within a transaction. The company has to make their partner feel valued and can accomplish this by tailoring a product or service specifically for its partner. Creating a feeling of individuality usually results in a loyal, reliable partner.
- **Honesty:** Incorporates truthfulness, sincerity, and dependability. For example, if a seller has established a dependable reputation, the company is usually perceived to be honest. However, illustrating honesty has many other facets as well. A good partner organization should provide all aspects of the truth, whether it is positive or negative information. Creating a relationship based on a foundation of lies is one of the biggest mistakes an organization can make. Partners typically discover the lies, which may result in the loss of critical supplies and/or highly profitable opportunities. One way to combat this is to create a culture that

values and encourages honesty. Studies have, in fact, shown that telling the truth strengthens team-building efforts and increases morale and productivity (Smith, 2007).

- **Likeability:** Is finding a common, friendly ground between the partners. The relationships you select should be ones where you would like to increase trust, and where, by improving trust, you would get far better results professionally (Covey, 2006). This is likely the least important of the five dimensions of trust; however it is still noteworthy in the formation of an external relationship.

Marketing exchanges and partnerships

In 2005, Barton A Weitz, Stephen B Castleberry, and John F Tanner published their book "Selling: Building Relationships" in which they discuss many of the aspects of modern business relationships, including market exchanges and partnerships. According to their book, a market exchange is defined as a relationship where each party is only concerned with their own welfare. A partnership, conversely, is based on creating a mutually beneficial affiliation for both of the organizations. Market exchanges and partnerships both generate commercially oriented connections, which classifies the two relationships as external (Weitz, Castleberry, and Tanner, 2005).Market exchange:

A **market exchange** is a type of relationship between a buyer and seller in which each party is only concerned about that particular party's benefit (Weitz, Castleberry, and Tanner, 2005).

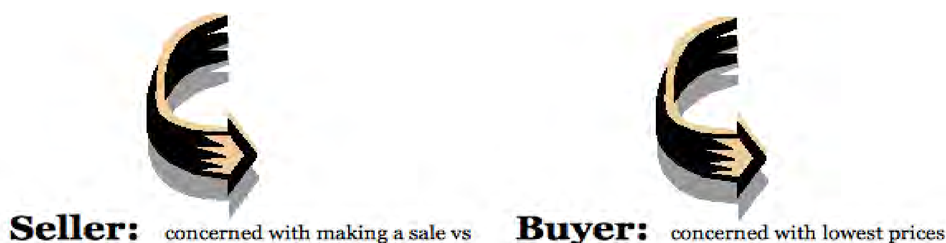

Exhibit 34: Market exchange

A **solo exchange** is a transaction that occurs between the buyer and seller where each pursues' their own individual self-interest (Weitz, Castleberry, and Tanner, 2005). Suppose you are traveling to visit relatives in a nearby town on a warm and sunny Saturday morning. As you pass a small store that is having a sale you see a wooden bench, much like one your grandmother had, with a USD 25 selling price. At this point you might pay the USD 25 for the bench, haggle for a lower price, or walk away from the transaction. You decide to make the seller an offer of USD 10 for the bench. After minimal negotiations the bargain price of USD 15 is agreed upon.

This transaction is an example of a solo exchange. The two parties are not interested in or concerned about the well-being of the other party. Neither you, nor the seller, expect to engage in future transactions, and both parties are successful in pursuing their individual goals. The consumer receives the bench for the lowest possible price, while the seller charges the highest acceptable price. A solo exchange should not be considered an ethical decision, merely an uncomplicated, one-time choice.

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Two basic relationship types

The two basic relationship types of market exchange and partnerships are divided further based on eight factors shown in column 1 of Table 5. Varying values of these factors represent situations where the organizations reach greater levels of integration and provide greater returns to both sides of the relationship.

Table 5: Types of relationships

	(1) Market exchanges		**(2) Partnerships**	
Factors involved in the relationship	Solo exchange	Functional relationship	Relational partnership	Strategic partnership
Time horizon	short term	long term	long term	long term
Concern for the party	low	low	medium	high
Trust	low	low	high	high
Investment in relationship	low	low	low	high
Nature of relationship	conflict, bargaining	cooperation	accommodation	coordination
Risk in relationship	low	medium	high	high
Potential benefits	low	medium	high	high

Functional relationship

A **functional relationship** is a long-term market exchange characterized by loyalty (Weitz, Castleberry, and Tanner, 2005). This type of relationship portrays the buyer purchasing a product out of routine or pattern. In a functional relationship, previous purchases will often influence later purchases. Typically, the buyer will continue to purchase from their selected seller as long as the price and the product stay relatively consistent to the original transaction. Buyers often illustrate this loyalty for several reasons. One reason a buyer remains loyal is simply convenience. It is easier for the buyer to avoid the arduous task of searching and negotiating for a product every time a recurring purchase needs to be made, especially when they are likely to come to the same conclusion and buy again from the previous supplier.

For example: A buyer for a school is in charge of purchasing all items that will be necessary for the cafeteria to function. Assume the school in question is a small elementary school with only about one hundred students. The buyer must purchase snacks, candy, meat, and drinks, just to name a few. This particular buyer uses a wholesaler to purchase all necessary items. This wholesaler has no desire to establish a partnership with the school; it merely

wishes to sell as many items as possible. Similarly, the success of this relationship will not make or break the school's success as an educational institution. This affiliation is established out of convenience. However, if the vendor begins to have poor service or inflated prices, the purchaser will simply choose a comparable wholesaler with little anxiety.

With a functional relationship, both parties are interested in their own profits, therefore, price is usually the most important factor in the decision making process. The relationship established between the buyer and seller is not permanent. Buyers will often change suppliers to try and get the best possible deal; however, when deciding on a supplier other factors are often weighed into the equation such as quality, reliability, trust, and commitment.

Partnerships

A **partnership** is two parties concerned about the welfare of each other in developing a win-win relationship (Mohr, 1994). There are two types of partnerships: a relational and strategic partnership.

Relational partnership

A **relational partnership** is a partnership that develops on the premise of a close, personal relationship built on trust (Mohr, 1994). With this type of partnership there is an open line of communication, and the parties work together in order to overcome any potential problems. Both sides of the partnership are trying to make money, but the more important factor is developing a long-term, working relationship that will continue to generate money over time. When relational partnerships are successful, it is often not necessary to have more than minimal negotiations about price. In addition, minor details will not be allowed to derail or end the relationships because the goal is to establish an ongoing mutually beneficial exchange.

Relational partnerships may develop because of personal ties, but more often they occur due to professional necessity. For example, every year large US businesses recruit new employees using booths at career fairs across the country. Such a career fair program is not significant enough for the company to enter into a strategic partnership with an employment service to perform hiring at career fairs, but finding employees with the necessary skills is still very important. Regional managers will likely be responsible for this job and they may form a relational partnership with the organizations that host the job fairs in their area to ensure that when the job fairs are planned the representative company will be included. A relational partnership is more similar to a friendship than to a market exchange. Rather than showing concern only for their own self interests, partners will offer their time and resources to continue the relationship, because of the expected future benefits of continuing interactions. James Cash Penney, the founder of the US department store chain JCPenney, believed that "all great businesses are built on friendship". If this ideal is applied, a strong foundation can be formed through relational partnerships.

Strategic partnership

A s**trategic partnership** is a long-term business relationship in which the partner organizations make significant investments to improve the profitability of both parties (Mohr, 1994). Strategic partnerships are created to uncover and exploit joint opportunities while minimizing joint weaknesses. Both parties will contribute financially, and consequently take significant risks in order to provide the partnership with a strategic advantage. This type of partnership is founded on the basis that both members are dependent on each other. The partners will have the same goals, as well as agree on the best course of action to achieve those goals. In order to achieve the

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target objective, partnerships must be based on an open-door policy; the partnership cannot be successful if information is kept confidential or there is a lack of willingness to accept risk equally.

An example of a strategic partnership was evident in 2007 when Time Warner's AOL strengthened their strategic partnership with Google. Google invested one billion dollars for a five per cent stake in AOL. The agreement created a global online advertising partnership, which has made more of AOL's industry leading content available to Google users. These strategic partnerships tend to be very successful because products and services are created that are not offered by competitors.

Before entering into any particular type of partnership, each company should consider all of the potential benefits and consequences. The next section of this chapter will help weigh the various costs and benefits related to choosing a relationship.

Choosing the right relationship

Managers are responsible for establishing the type of relationship that is appropriate for each situation. Every situation should be considered inherently different. The dynamics of every relationship are unique and managers must customize their agreements to the situation. Therefore, before deciding what type of relationship to develop several factors need to be considered (Weitz, Castleberry, and Tanner, 2005). These factors include market issues (e.g. maturity, size, and barriers), the potential returns of the relationship, and the capabilities provided by the partners (e.g. experience with technology or access to innovations). In addition, managers must assess the likelihood of success and other risks. These items include both quantitative and qualitative measures that require a manager's complete attention when designing relationships.

In the previous example, the strategic partnership formed between Time Warner's AOL and Google was justified, because the company expects a return great enough to justify the investment. Time Warner's AOL was a suitable partner for Google because the company was large enough to meet Google's product demands. Conversely, Google would not have entered into a strategic partnership with a small, local Internet provider, because a smaller company would not have enough production capability to meet Google's demand. The idea is that as partnerships are successful, the companies will make more money, i.e. Google believes benefits will exceed costs as does Time Warner's AOL.

Strategic partnerships may be established in order to gain access into a specific niche or market. The relationship between Google and AOL may be an example of this type of relationship. Other partnerships may be formed in an effort to improve a company's image. For example, large oil companies receive a significant amount of bad press due to pollution and environmental concerns. Therefore, it may be in their best interest to partner with companies attempting to develop alternative energy sources, e.g. solar or wind power, to gain goodwill among consumers.

A partnership may be developed in order to gain access to technological innovation. A company may find a relationship with a lead user beneficial. A **lead user** is someone who has invented or resolved a customer issue months or even years ahead of competitors in the marketplace. They provide information and give companies the ability to co-develop novel products, which provide a competitive edge over other market participants.

The key to every successful partnership is communication and, as a result, technology should be used as a means of increasing communication lines. This may mean using e-mail to interact with customers, or in a much more complex manner, using ongoing data exchange enabled by information technologies designed to increase efficiency. Wal-Mart is a perfect example of a company using technology in a highly sophisticated manner. Wal-Mart has created a competitive advantage through managing their inventory system. Their inventory is systematically programmed to replenish common items as they reach a minimum level. This inventory control system has been central to Wal-Mart maintaining low operating costs and providing competitive advantage through product availability.

Foundations of successful relationships

Earlier we discussed the importance of trust in a relationship. Trust, however, is only one building block of several involved in the creation of strategic partnerships. This section will briefly introduce five foundational elements and present how they form long-term, successful relationships.

These elements include:

- mutual trust
- open and truthful communication
- measurable mutual goals
- organizational support
- commitment to mutual gain

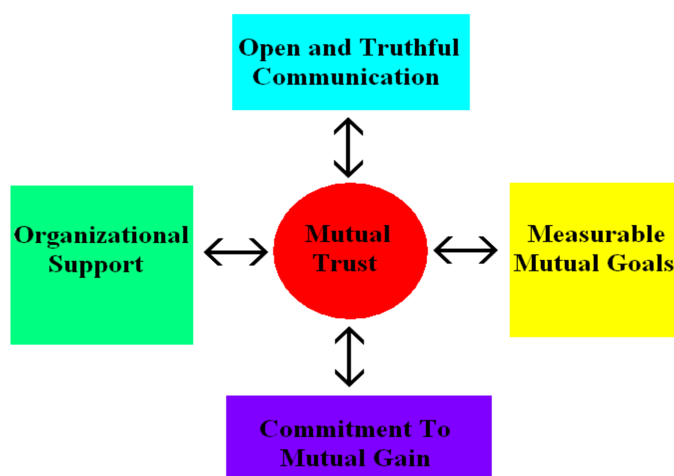

Exhibit 35: Elements of successful relationship

Mutual trust: Not all building blocks are created equally; the most important of the five foundational elements is mutual trust. As previously mentioned, **trust** is the confidence one party has in another to perform an action as agreed. In order for a partnership to be successful, trust must be mutual. As mutual trust grows between partners, parties will not limit themselves to contractual requirements but actually go to great lengths in order to satisfy the other partner, as well as strengthen the relationship.

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Open and truthful communication: An additional element in building long-term, successful, relationships is establishing open and truthful communication lines. Parties that communicate openly and truthfully have a better understanding of each others' visions, missions and goals in the relationship. One way this can be accomplished is by always creating environments where each party feels comfortable speaking up. Once both partners gain a strong understanding of what motivates the other partner, dealing with changing business conditions becomes significantly easier. Communications often include the exchange of measures of the efficiency of shared business processes.

Measurable, mutual goals: A key element necessary for relationships to be successful is having both parties share measurable, mutual goals. Mutual goals allow parties to pool together company resources and strengths. In order to ensure goals are being met, they must be measurable and quantifiable. Some examples of measurable mutual goals include sales revenue, return on assets, or some performance indicator of customer satisfaction. Measures may also include production levels, error-rates, or other items that enable integration of the businesses processes of the partners. Agreeing on the items to be measured and establishing a continuous measurement program is necessary to provide optimal cooperation among partners and a substantive contributor to establishing mutual trust.

Organizational support: The support of employees throughout the organization is another key element in creating successful relationships. The organization as a whole, from front line members to local and corporate offices, must support the idea of a partnership. Structure and culture are the underlying roots that create organizational support. Although it is expected that employees support management decisions, it is necessary for managers to objectively understand and evaluate the structure and culture of the organization when designing partnership relationships. Proposed partnerships perceived as contrary to the existing structure or cultures are candidates for enhanced scrutiny. Once a partnership is entered into it is necessary to develop programs such as training and rewards to establish the desired partnership behaviors. Establishing these types of programs will increase the frequency of and improve the dynamics within the interactions of both partners. Training teaches behaviors which are needed to achieve partnership goals and rewards encourage the support of the previously taught behaviors.

Commitment to mutual gain: The final building block in the foundation of successful relationships relates to the level of commitment each partner has in creating mutual gain. Simply put, partners look out for one another and do not take advantage of each other. If one party has more resources or more efficient operating procedures than the other, this should not impact the relationship. If problems arise within the partnership, both parties need to consider the mutual investment each has contributed to the relationship. **Mutual investments**, or **relationship-specific assets**, are the tangible investments and resources that are specific to the relationship in nature. Although mutual investments strengthen mutual gain, they cannot be easily transferred if a partner wishes to leave the relationship. Thus, it is important to evaluate the level of intrinsic gain that has been established through the partnership. Ideally, such an analysis is performed before entering the partnership, although it requires the manager to make a substantial number of assumptions.

These foundations of relationships comprise the broad range of factors managers must consider when developing and implementing durable relationships. In addition, developing relationships consist of a series of

phases that explains how they are identified through how the partners become committed to continuous improvement of the relationship. The next section presents these phases of relationship development.

Phases of relationship development

Strategic partnerships experience four major developmental phases and Exhibit 36 represents the life cycle of such a relationship. The length of phases and transitions between phases will vary due to cultural and/or social differences. Managers should be aware of the current phase of the relationship and evaluate decisions based upon how they impact the development of the relationship. Dissolution can occur at any time when incompatibilities exist between partners as the relationship develops.

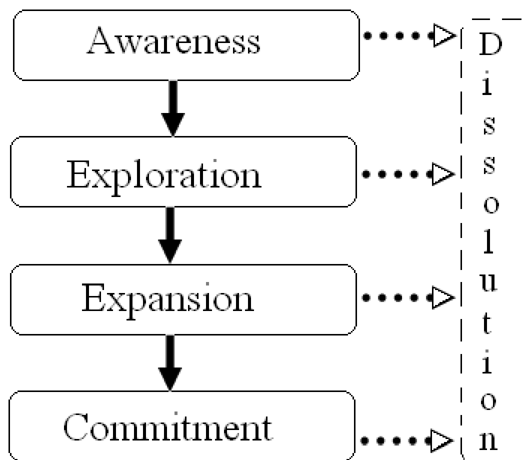

Exhibit 36: The relationship development process

The awareness phase begins before any transactions actually occur. During this phase, partners are locating, identifying and qualifying various prospects. Since no transactions take place, company image and reputation are weighed heavily during this phase. Awareness means assessing the business relationships needed to advance organizational goals, evaluating potential areas that would benefit from a partnership, and identifying potential partners. Partnerships can have various types of relationships; some areas may only need to be functional, whereas others may seek to be strategic. Consequently, identifying which type of relationship would most benefit the firms is imperative and a primary responsibility of managers

The exploration phase is considered the test for both parties. During this phase, parties engage in exchanges to explore potential partnership costs and benefits. Although neither side has committed to a relationship at this point, each transaction between the two parties tests each of their capabilities. Managers evaluate the transactions in terms of the foundations of relationships discussed above, e.g. identifying potential measures that indicate successful transactions or estimating the impact on organizational culture should the relationship become established. After both parties prove that they are capable of performing as needed, the partnership will move to the expansion phase. In this phase, additional business interactions focused on a long-term relationship are investigated. The expansion phase may be time consuming because it requires extensive research to be conducted both internally and externally. The primary activity of this phase is comparing the results of a series of financial analyses of various possible interactions and relationship types.

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A contract, or at least a verbal commitment, for a certain period of time must take place for the commitment phase to begin. This stage is usually the final and most complex stage of a strategic relationship. During this phase, the details of the transactions are decided, including initial investments that will be made into the partnership and specification of how returns will be divided among the partners. The dissolution phase is the decision to end the partnership. This may occur during any of the various phases of the relationship development process. Dissolution may arise for a number of reasons, including rising costs, poor performance, or changes in corporate goals. The decision to end the partnership should not be taken lightly, but when all other options have been exercised it may be the correct choice. While relationships will follow this development life cycle, a manager's skills will substantially impact how the relationship develops and the success of the agreements for the organization. Training and development programs for managers should explicitly include skills for developing relationships.

Skills for building positive relationships

Two key skills that promote positive relationships are negotiation and facilitation. **Negotiation skills** can assist with problem solving and conflict resolution with partner organizations. **Facilitation skills** deal with the understanding of group processes and feedback.

Negotiation skills are necessary for managers to ensure they understand the goals and tactics of others. Negotiation involves understanding goals and the impacts of the range of possible outcomes on an organization. Adept negotiators must be able to identify compromises such that both partners are supportive of the resulting agreements.

Facilitation involves listening to the views of all parties and ensuring that critical issues are heard, regardless of their origin. Active facilitation brings objectivity to group processes and results in shared understandings of potential opportunities and the costs of pursuing those opportunities. Technology can aid managers in facilitating group discussions and recording group interactions. In some situations, professional facilitation may be appropriate if either side has reached a point where reaching a mutual understanding is difficult.

Strategies for external relationships

The rapid change in technology and the development of the Internet has changed the traditional definitions of manufacturers, suppliers, and customers. **Supply Chain Management** (SCM) is the integration of key business processes that add value for customers and other stakeholders. This added value is created through the integration of networks of suppliers that provide products, services, and information. Supply chain management allows this network of cooperating agents to perform one or more supply chain functions, potentially reducing costs and resulting in a competitive advantage for the organization.

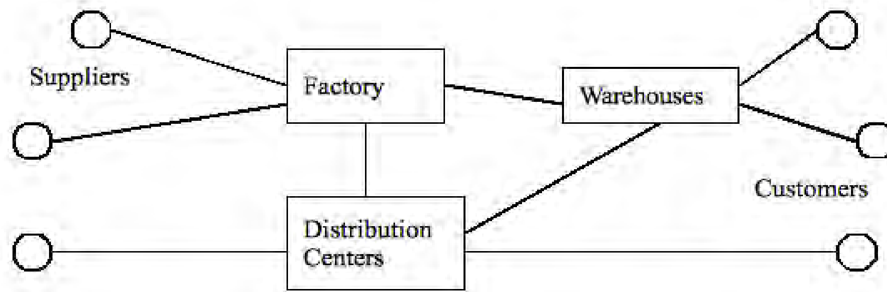

Exhibit 37: Movement through a supply chain

The above figure illustrates the movement of products through a supply chain network. The supply chain begins when suppliers send raw materials to a factory. The factory may use the materials in a number of ways. They can either manufacture subcomponents or assemble the materials into finished products to be sent to the warehouse or distribution center where customers can get the products.

In order for the supply chain to be successful, organizations must recognize that they are but one player in the long chain that starts with suppliers and also includes transporters, distributors, and customers. The organizations must interact cooperatively with their channel partners (Gandhi, 2003). An important issue relating to the development of a collaborative supply chain is following specified ordering and replenishment policies. An example of Collaborative Supply Chain Planning (CSCP) is Vendor Managed Inventory (VMI).

Vendor Managed Inventory allows the supplier to receive electronic data to maintain constant information about the manufacturer's sales and stock levels. The supplier is then responsible for creating and managing the inventory replenishment schedule. VMI is defined as a process where the supplier generates orders for customers based on demand information sent by the customer (Gandhi, 2003). VMI leads to changes in both the buyers' and suppliers' inventory management activities. VMI has not become a standard way of managing the replenishment process in the supply chain due to some practical issues that have slowed down its implementation in many organizations. One problem may exist because the supplier and manufacturer are unwilling to share information because of a lack of trust. In order for VMI to be effective, it has to produce observable benefits, especially in the reduction of inventory costs.

Some of the benefits of VMI include:

- lower customer inventories
- better forecasts
- reduced costs
- improved services
- strengthening competitive advantage

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- strengthening buyer-supplier relationships

Similar to SCM and VMI, Collaborative Planning, Forecasting, and Replenishment (CPFR) was developed to allow better communication of control information, which enables coordination and optimization of shared business processes. CPFR is defined as an initiative among all participants in the supply chain intended to improve the relationship among them through jointly managed planning processes and shared information (Seifert, 2003). When successful, it also improves relationships between producers and retailers.

One of the first CPFR projects was initiated by Wal-Mart and Warner-Lambert, which merged with Pfizer in 2000. This project was intended to reduce inventories across the supply chain. It provided comparisons of sales and order forecasts of each trading partner and highlighted any visible forecast differences early enough for the partners to resolve any potential issues. Warner-Lambert applied CPFR to the Listerine mouthwash products by sharing of forecasts and responding to inconsistencies between the collaboration partners' forecasts. In Warner-Lambert's case, Wal-Mart's promotions created large swings in consumer demand, which Warner-Lambert was unaware of prior to CPFR. Warner-Lambert maintained substantial inventory as a hedge in order to prevent supplies from running out of stock. Wal-Mart and Warner-Lambert independently calculated the demand they expected six months in advance. The partners shared this information, as well as the weekly forecast, and they worked together to resolve variations between their forecasts on a weekly basis. Wal-Mart began placing orders six months in advance, instead of nine days, so that Warner-Lambert was able to construct a smoother production plan. This allowed Warner-Lambert to maintain production based on consumer demand for Listerine rather than maintaining sufficient stock. Wal-Mart's in-stock position improved and sales increased, while inventories dropped. Additionally, Warner-Lambert's supply management improved substantially. Optimal applications of CPFR occur when, for example, many other retailers join Wal-Mart in sharing their projected demand with Warner-Lambert. Combining demand forecasts from many retail customers makes it possible for Warner-Lambert's production plans to be much better aligned with total market demands.

Benefits of using CPFR are:

- drastically improved reaction times to consumer demand
- higher precision of sales forecasts
- direct and lasting communication
- improved sales
- inventory reduction
- reduced costs

The CPFR process model is divided into three phases: planning, forecasting, and replenishment. The exhibit below provides an overview of the phases and activities in the CPFR model.

Exhibit 38: PFR Process Model

Source: http://www.scdigest.com/images/misc/Original-CPFR-Model.jpg. Accessed 30 December 2008

Planning consists of identifying an opportunity for collaboration, then developing an agreement to collaborate, as well as forming a collaborative business plan. Forecasting is the most important part of the model. It provides the mechanism through which needs are determined. It is improvement of this aspect of the supply chain through which all of these strategies provide advantages over more traditional methods. Replenishment involves making and delivering the product consistent with the needs schedule developed by the forecast. More accurate forecasts lead to production of only the needed products, which smooths the production schedule and results in price stability. This allows for existing capacity to be used to enable other products or to develop markets for additional production.

Many of the processes replaced by SCM, VMI, and CPFR strategies involve merely producing "the average of this month over the last 3 threes plus a small percentage". Such ad hoc strategies, although widely employed, contain substantial inefficiencies. Exploiting these inefficiencies is the incentive for pursuing these programs. Another reason such programs are popular with managers is that savings realized go directly to the bottom line as customer needs are met while using less organizational resources.

An effective supply chain management program is one that develops processes shared among all the supply chain members in order to minimize the waste of time and enable fast and reliable reactions to changes in demand. Technology has exponentially increased the transfer of information between organizations, resulting in improved supply chain performance. Two common practices, Just-In-Time (JIT) and agile inventory approaches, are used to allow suppliers to react more quickly to changes in customer demand.

Just-In-Time emphasizes minimizing inventory and smoothing the flow of materials to ensure adequate and prompt delivery of components. Products and materials are ordered and delivered "just in time" as they are needed reducing inventory costs and ensuring unneeded materials are not ordered. JIT began at Toyota Motor Company but it evolved into a system for continuous improvement of all aspects of the manufacturing operations.

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Lean production is a philosophy based upon a collection of management methods and techniques (Russell, 2006). Workers and machines are multifunctional in lean systems. Workers are required to perform various tasks and help in the improvement process. The machines are arranged in small, U-shaped work cells; this structure enables parts to be processed in a continuous flow. Workers produce parts one at a time and transport them between the cells in small lots. The only schedules prepared are for the final assembly line. This schedule "pulls" sub-components through production by making requests to stations that cascade to production lines. Nothing is done until requested by the next station.

The system is best implemented when suppliers are few in number and are reliable. The suppliers' manufacturing system must be flexible, because multiple deliveries may be requested of the same item in the same day. Lean production produces items in necessary quantities at necessary times. Consequently, quality must be extremely high, as there is little buffer inventory between workstations and production schedules include only requested products.

Lean systems can produce high quality service quickly at a low cost. Also, the system responds to changes in customer demand. Many retailers use lean systems such as Zara and Blockbuster.

Benefits of using lean production are:

- reduced inventory
- improved quality
- lower costs
- reduced space requirements
- shorter lead time
- increased productivity
- greater flexibility
- better relations with suppliers
- simplified scheduling and control activities
- increased capacity
- better use of human resources
- greater product variety

Outsourcing

Outsourcing is a contractual relationship where an external organization takes responsibility for performing all or part of a company's functions (Vita, 2006). Outsourcing is the term used to designate a relationship in which a partner company performs business functions. Common examples of outsourced functions for companies in the developed world are software development and call centers. The principle justification for outsourcing functions like these from, for example, the US to India is that prevailing wage rates for these kinds of tasks are much lower than in the US and the Indian partner companies hire and train employees who speak English and are skilled at

their jobs. There's a difference between outsourcing and off-shoring. When a vendor in another country performs an outsourced function, off-shoring is the correct terminology for describing the relationship. The jobs being outsourced in an organization do not necessarily have to be outsourced to another country. Off-shoring can result in significant savings due to wage and currency discrepancies among countries. However, quality controls must be maintained to ensure that the products and services provided are returning the expected results. **Outsourcing** is typically done by organizations who outsource non-core processes that are inefficient, difficult to manage, or too costly. Choosing a supplier to meet an organization's outsourcing needs depends on the business process being outsourced, the scope of the project to be outsourced, as well as geographic factors. Business processes that are often considered good candidates to outsource include, but are not limited to:

- administration (audit, tax)
- asset and property management
- finance (accounting, billing, accounts payable, accounts receivable)
- human resources (benefits administration, payroll)
- information systems (development and operations)
- miscellaneous (energy services, customer service, mailroom, food processing)
- procurement/logistics

Business process outsourcing is becoming increasingly important. The management of one or more processes or functions by a third party is a means for the organization to reduce costs. The key benefits of outsourcing are realized by organizations that outsource business processes by transferring the entire function out-of-house. This enables access to specialized knowledge and expertise in the area; sharing of new methodologies, technologies and other resources; and standardizing processes across the organization.

An organization needs to outline the benefits and risks of outsourcing when deciding whether to outsource. The benefits need to outweigh the risks in order for outsourcing to be efficient and effective (Halvey, 2000). A typical benefit/risk analysis is:

Benefits:

- cost savings
- increased flexibility
- better customer or employee service
- higher productivity
- ability to concentrate on the core business
- implementation of wide initiatives
- movement of assets off books
- more resources

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- variety of skills
- access to new methodologies and technologies
- training expense reduction
- greater flexibility

Risks:

- loss of control
- difficulty in managing costs
- additional liability
- difficulty in bringing the business process back in-house
- reduced flexibility

Uncertainty in outsourcing occurs when an organization is not sure which business process function to outsource. Organizations should be overly inclusive with what needs to be outsourced. Including an unbundled requirement where the vendor provides separate pricing for certain functions can be helpful. Also, deciphering through the complexity of outsourcing can be easier once determining where the services will be provided.

The next step in assessing outsourcing is to identify potential vendors that have the desired resources, capabilities, and experience. The following will provide beneficial information to help make an informed decision:

- vendor information from industry reports/survey
- looking at industry publications
- talking to other outsourcing customers
- sharing goals and concerns with chosen vendors

Potential external relationship obstacles

Outsourcing offers a number of potential benefits for companies; however they cannot ignore the obstacles that come along with outsourcing. Some countries have not achieved the desired benefits from outsourcing, because they have not realized the expected cost reductions anticipated from outsourcing their business processes to a third party. The lack of capable suppliers and service providers is a major problem. Losing control over the outsourced process is not uncommon. Additionally, problems and issues may emerge due to the integration of services and systems provided by the vendor.

Problems within the networked organization usually arise due to the failure in identifying all stakeholders and network partners. All nodes and partners in the networked organization have to know and recognize all the stakeholders involved. Another potential problem can result from having dominant nodes, which must be eliminated in the early stages of the relationship. All nodes within a relationship must fully understand the mission and goals. Having incompatible missions and goals will destroy a relationship and no benefits will be achieved. Also, problems may arise from clashing company cultures. Therefore, when choosing a supplier or a partner in the

networked organization, having similar goals, missions, and similar ways of performing the business processes are vital for the success of the relationship.

Chapter summary

This chapter presents the basics necessary for developing relationships among organizations. These include the common types of external relationships, phases of relationship development, the building blocks of successful relationships, and the skills necessary for developing a variety of relationships. Several strategies for managing external relationships were presented that focus on the integration of the processes of multiple organizations to create “virtual suppliers” that benefit from rapid information exchange and just-in-time adjustment of sales forecasts and production capacities.

Managers must consider the many factors of each situation and design a unique relationship or set of relationships that enable the organization to accomplish its goals in the most efficient manner possible. Yet efficiency is not enough, as the needs for flexibility and quality assurance lead to ever more integrated networks of organizations, which require strategic perspectives for maximizing profitability. It is expected that every organization be involved in a variety of external relationships, where each relationship is justified according to cost and quality.

Exercises

List and describe the four dynamics that should be considered in order to choose the right relationship.

1. What are the two basic relationship types?
2. What is the difference between a functional relationship and a strategic partnership?
3. List the five foundational elements involved in the development of long-term, successful relationships.
4. Is any element more significant than another? If so, which one and why?
5. List the four major phases involved in the relationship development process.
6. When in the relationship development process does dissolution occur?
7. Define Supply Chain Management and state its goals.
8. Select a company and determine the different suppliers it has. What criteria does the company most probably use for its suppliers?
9. Describe how Wal-Mart has used VMI to improve its supply chain management?
10. On what basis does a company decide whether to outsource or not?
11. What are some potential risks to outsourcing?

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