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# Theoretical Perspectives of Business Relationships: Explanation and Configuration

# 2

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## 2.1 Theoretical Approaches to Explaining Business Relationships: Classification

The first chapter of this book presents the business relationship as a form of exchange and sharing amongst companies. Without expressly mentioning it, this already includes various theoretical perspectives regarding the phenomenon “business relationship” as well as potential constellations. It is obvious that, depending on the theoretic perspective chosen, a business relationship can be explained in different ways and the subsequent recommended actions can also vary.

As this chapter will show, research approaches to marketing in business relationships are very heterogeneous (El-Ansary 2005). This chapter intends to create awareness for the significance of different theoretical perspectives in regard to the topic business relationship.

Initial approaches to business relationship management first occurred and were first mentioned in publications in the 1950s, in the course of the development of earlier forms of key account management. The essential element remains the strategic and organizational focus of a supplier on individual, important customers (e.g. on large corporations specializing in consumer goods retail; refer to Sect. 7.1).

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But the true beginnings of business relationship research can be found in the late 1970s and the 1980s (refer to various assessments of the development: Backhaus 1997; Christopher et al. 2002; Bruhn 2003). Initial studies examining this phenomenon were conducted in both industrial marketing (part of what is now referred to as business-to-business marketing) and in services marketing. These studies naturally focused on the considerations that tended to deal descriptively with the meaning of business relationships and with their definition (Levitt 1985; Diller and Kusterer 1988; Plinke 1989) as well as certain characteristics, e.g. phases of a business relationship (Jackson 1985a, b; Dwyer et al. 1987; Sethuraman et al. 1988).

Other studies were devoted to special aspects or features of industrial business relationships, such as the constellation of sales processes in this context (Spekman and Johnston 1986), just-in-time supply relationships (Frazier et al. 1988; O'Neal 1989) or issues concerning customer evaluation (Turnbull and Wilson 1989).

The work of the IMP group (*Industrial Marketing and Purchasing*) assumed great significance during this time (Ford 1978, 1980; Hallén and Wiedersheim-Paul 1979; Hakansson and Wootz 1979; Håkansson 1982). Their work is distinguished by the fact that they assume a network perspective, meaning that not only the dyadic relationships between supplier and customer are examined; instead, their analyses attempt to include the entirety of all direct and indirect delivery and supply relationships in which a supplier is involved.

While the studies mentioned above concentrated on the relationships existing between companies, the work performed in the field of service marketing focused more on the relationships of consumers who purchase and use services. Particular attention was paid to the interaction between customers and employees of a supplier company that takes place when a service is provided as well as to the effects of such interaction, e.g. in regard to customer satisfaction, repurchase behavior, etc. (Berry 1983; Gummesson 1987).

The field of business relationship management became firmly established during the 1990s, with the publication of multiple theoretical-conceptual studies (e.g. (Heide and John 1992; Möllner and Wilson 1992; Morgan and Hunt 1994; Söllner 1999) and of the first text books on the subject (e.g. Kleinaltenkamp and Plinke 1997; Gordon 1999; Peck et al. 1999).

Finally, research on business relationship management received an additional boost in the first decade of this century, with the development and propagation of customer relationship management (CRM) (e.g. Payne and Frow 2005; Hippner et al. 2011; refer to Chap. 8). This was due mainly to information technology systems, which allowed virtually all processes of business relationship management to be supported and to be more effectively and efficiently structured.

These approaches to business relationship management as well as those mentioned later in this chapter focused on two central issues:

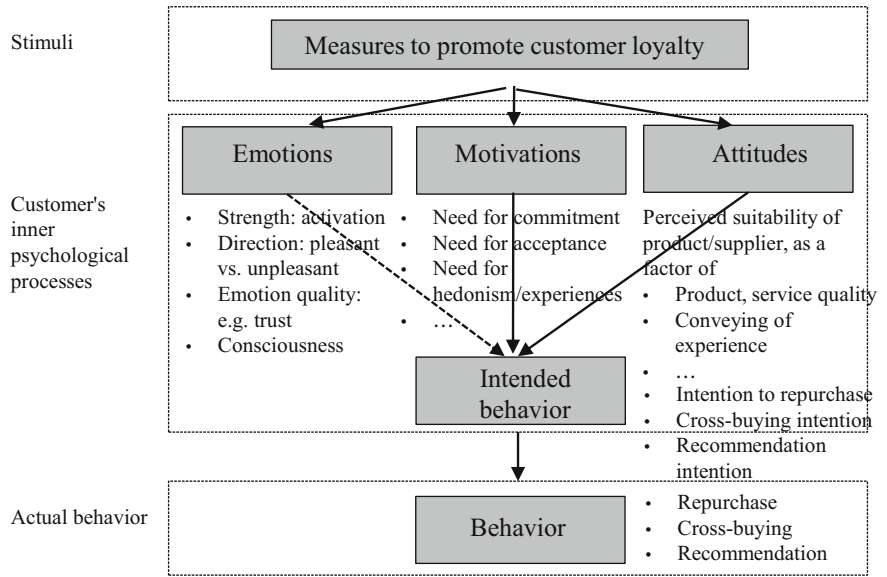
1. Which factors cause business relationship partners to commit to each other?
2. Which behavioral effects and intentions emanate from the commitment to a business relationship?

The answers to these questions and the conclusions drawn from them—particularly in regard to the constellation of business relationship management—can be very different, depending on the theoretical focus chosen.

## 2.2 Behavioral Approaches

Articles related to the behavior science of business relationship research focus particularly on the effects that occur at the level of single individuals. They deal with the occurrence of commitments as well as with the resulting effects on repurchase behavior and certain behavioral intentions of individuals. The fundamental pattern of behavioral explanatory approaches is shown in Fig. 2.1. The illustration indicates that single measures to promote customer loyalty to a supplier stimulate emotion, motivation and even the attitude of the individual and influence the person’s inner psychological processes. The commitment that results is either strengthened or weakened, depending on whether positive or negative effects are triggered in these areas. This, in turn, affects the behavioral intentions as well as the actual behavior of a person in regard to repurchase (intention), cross-buying (intention) or recommendation (intention).

Concepts that explain individual aspects of the emergence of commitments and loyalty in this regard are the learning theories, the theory of perceived risk or the dissonance theory (Homburg and Bruhn 2008):



**Fig. 2.1** Conceptualization of customer loyalty from a behavioral perspective. Source: Based on Weinberg and Terlutter (2003, p. 49)

- If, for example, the theory of learning by reinforcement is applied, beneficial past behavior is retained, while behavior that was not beneficial is relinquished or modified (Wilkie 1994; Engel et al. 1995). A customer's loyalty to a supplier always increases when the customer perceives a benefit from the business relationship or is satisfied with the relationship.
- The theory of perceived risk states that people attempt to minimize the risks that they perceive. Customer loyalty can occur in this sense, too, when customers adhere to their trusted and familiar purchase decisions and/or suppliers to minimize the risk of dissatisfaction (Hentschel 1991).
- The dissonance theory is based on the assumption that individuals strive for long-term equilibrium of their cognitive system (Festinger 1957). Revaluation, additions or suppression are applied to attempt to abolish dissonance and to once again achieve inner equilibrium. If this is successful—in this case regarding purchase decisions made—it can lead to commitment to a supplier. If it is not successful, the intention to switch becomes stronger, resulting in a business relationship being terminated or not even entered into in the first place.

So the behavioral approaches offer insight that is relevant particularly to explaining individual behavior of customers in consumer goods markets. These approaches apply fundamentally to the behavior of persons dealing with (re)purchasing in companies as well. However, taken alone they are surely not significant, because they ignore some essential aspects of organizational purchasing processes. This particularly includes the effects of the cooperation of multiple persons in a (re) buying center as well as the fact that procurement decisions are made in an organizational environment geared towards making a profit (refer to Chap. 3). This last aspect has been especially relevant, as will be explained in the following section, to the significance that economic approaches based on cost-benefit as well as value aspects of business relationships have gained.

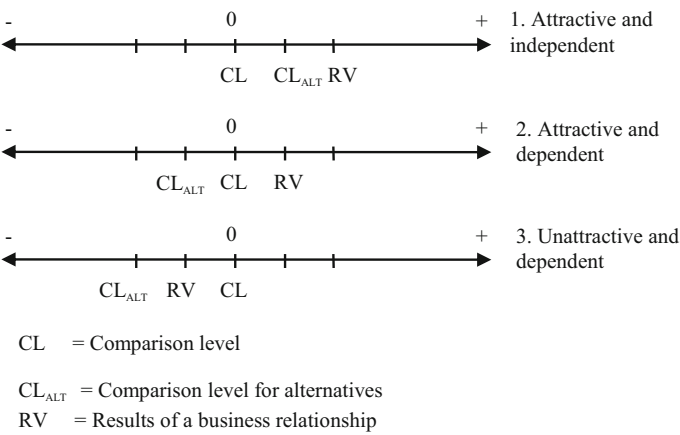
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### **2.3 Social Psychological Scheme of Explanation: The Approach of Thibaut and Kelley**

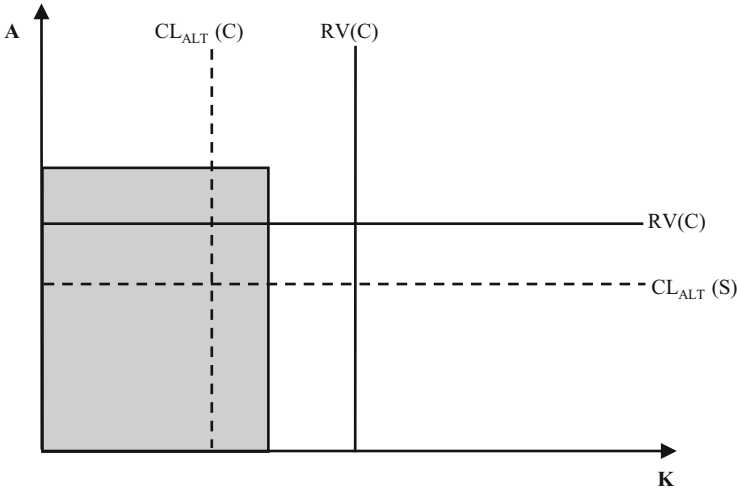
The social psychological theory by Thibaut and Kelley is another approach that was originally developed to explain individual behaviors but was then applied to organizational business relationships. It was designed to explain the occurrence of commitments amongst people in social groups. It is based on the theory that all human relationships are formed by comparing the costs and benefits of a relationship as well as the costs and benefits of other relationships in which they are involved (Thibaut and Kelley 1959). Although the concept was initially developed to explain individual human behavior from a non-economical perspective, the fact that it is based on cost-benefit considerations means that it can easily be applied to business relationships of companies. When this is done, a partner evaluates the results of a business relationship (RV) on the basis of two criteria. The first is the comparison level (CL) and is a measure of previous experiences. The experience

can have been gained from this business relationship or from a different one. Positive experiences increase the CL, while negative experiences decrease it. More recent experiences have a stronger effect on the CL than do older experiences. Situational influences also carry weight. So the CL is a measure of the **expectations** of the customer. The business relationship is perceived as “attractive” when the difference of costs and benefits of the relationship is greater than the CL. However, when the attractiveness of a relationship is determined in this way, it is not sufficient to be able to evaluate whether a partner will remain in a business relationship or not. This can be accomplished in the theory of Thibaut and Kelley by applying a second criterion, the Comparison Level for Alternatives ( $CL_{ALT}$ ). This measure describes the ratio of benefits and costs in the best alternative business relationship that can possibly be achieved. By applying both CL and  $CL_{ALT}$ , a conclusion can be reached on the attractiveness of and dependency in the relationship. There are three different cases (refer to Fig. 2.2):

1. The current relationship is perceived as more attractive than the CL, meaning that the value RV also exceeds the attractive alternative relationship  $CL_{ALT}$ . Because of this alternative, the partner in the business relationship is not dependent (s/he can switch and is then still above the expectation benchmark).
2. The current relationship value RV is higher than the CL, making the relationship attractive. However,  $CL_{ALT}$  is below CL, so the business relationship partner has no attractive alternative in this case. S/he is dependent.
3. The current value RV of the business relationship is lower than the CL, making the relationship unattractive. Since  $CL_{ALT}$  is below the current value, switching would be detrimental to the business relationship partner, who is already in an unattractive situation. S/he is dependent in an unattractive relationship.



**Fig. 2.2** Attractiveness of or and dependency in relationships. Source: Based on Herkner (1991, p. 398)



Legend: Refer to Figure 2.2

**Fig. 2.3** Structure of dependency in a business relationship (example)

In the model of Thibaut and Kelley, attractiveness and dependency are the result of the difference between costs and benefits of an existing relationship, evaluated on the basis of the expectation benchmark for costs and benefits not specific to the relationship as well as on the specific benchmark of the cost-benefit ratio of a specific alternative. This means that, when defining costs and benefits, all of the cost components of the current business relationship as well as those related to switching the business relationship partner are considered.

(Un)attractiveness and (in)dependence can now also be used to describe the position of the two partners to one another, particularly in regard to business relationship management from the supplier's point of view (refer to Fig. 2.3).

In this example, the supplier S is in an unattractive business relationship [ $RV(S)$  is less than  $CL(S)$ ] and dependent as well [ $CL_{ALT}(S)$  is even less than  $RV(S)$ ]. Customer C, on the other hand, is in a relationship that is attractive for him [ $RV(C)$  is greater than  $CL(C)$ ], but is dependent, just like S [ $CL_{ALT}(C)$  is less than  $CL(C)$ ]: One sees a case of mutual dependency with asymmetrical distribution of attractiveness. These could offer starting points for business relationship management.

So this model offers fundamental insight into the reasons that persons or organizations enter into (business) relationships, remain in the relationships or strive to sever them. Essentially, this model states as the primary driver the costs and benefits of a relationship and as the fundamental behavior that participants can choose in this regard the options of switching and remaining in a relationship. The concepts explained in the following Sect. 2.4 are thus fine-tuning of this basic model. They concentrate sometimes more on costs, sometimes more on benefits or

the value of a relationship, or on the behavior or behavioral intentions resulting from a commitment.

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## 2.4 Economic Indicators: Switching Costs and Relationship Value

### 2.4.1 Bonding Effects of Switching Costs

#### 2.4.1.1 Investments Related to Business Relationships

In the definition of a business relationship, the internal link between transactions and investments that customers make to establish and maintain a business relationship played a decisive role. This does not necessarily have to be high one-time expenses at the beginning of a business relationship. Overcoming entry barriers to a business relationship (offensive as an out-supplier) and defending the position by a single customer (defense as in-supplier, refer to Chap. 5) are a strain on the supplier that show up as current expenses in his internal accounting. Irrespective of how they are treated for accounting purposes, these costs are considered to be an investment. The supplier takes a **long-term** view. He sees not only the initial transaction but also subsequent business that will amortize the expenses invested in the initial acquisition. Entry costs and costs relating to defending business relationships can thus be considered **investments**, their reference object being the relationship to a specific customer (Bursk 1979; Kleinaltenkamp and Ehret 2006; Ungruhe 2011).

An investment is the acceptance of a certain disadvantage in the present in anticipation of an uncertain benefit in the future (Schmidt 1983). This definition reveals a perspective adequate to solving the problem. All expenses that a supplier incurs that are not geared towards order acquisition of a specific market transaction but towards securing subsequent transactions to later cover the expenses should be considered investments. These expenses include accepting unplanned and unsecured **additional costs** (e.g. goodwill services, generous interpretation of contract ambiguities, favors, seminars for customer's employees, referrals, etc.) as well as the continued cost of directly maintaining the relationship (e.g. regular meetings of top management, trade fair contacts). A particularly important aspect of the investment is forgoing the complete utilization of pricing policy latitude for every single transaction, e.g. when a competitor experiences a supply shortage, when a customer causes his own scheduling bottleneck, etc. In such a situation a customer would have no choice but to accept the "skimming" of the price leeway, but it is very likely that the customer would develop a good memory and would attempt to decrease dependency in the future. So the total marketing effort invested by suppliers to establish and maintain individual business relationships can be interpreted as an investment in this sense. Thus marketing in business relationships is linked to a long-term perspective in which single transactions should always be seen as a means of generating new transactions with the same customer. The investing perspective is thus a key feature in differentiating transaction marketing from relationship marketing (refer to Sect. 5.1.2).

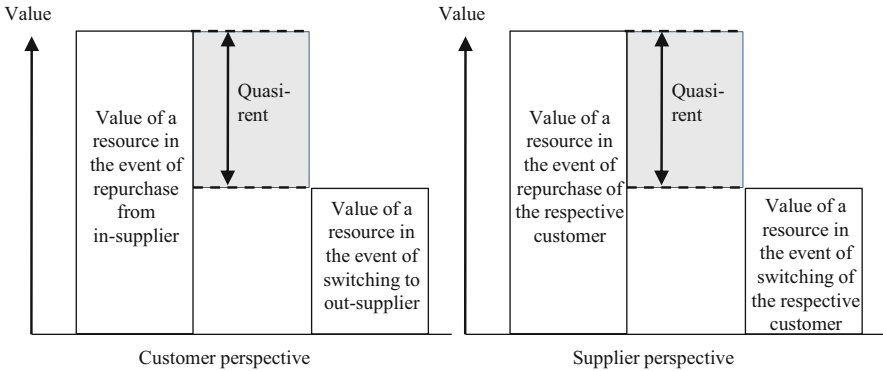
The fact that both the customer and the supplier can benefit from substantial investments in a business relationship brings up the issue of the **symmetry** of the commitments between supplier and customer. It is definitely possible that one of the two sides feels a greater sense of loyalty (meaning greater dependency) than the other, and there is a risk that the other side could exploit this (Söllner 1996; Kleinaltenkamp and Ehret 2006; refer to Sect. 2.2).

Dependency based on investments plays a decisive role in the approaches of New Institutional Economics. This field of research has been met with great interest since the 1970s, which can be attributed particularly to the early publications of Oliver E. Williamson (1975, 1985). Williamson, the most prominent proponent of the transaction costs theory, received the Nobel Prize in Economic Sciences in 2009 for his work in the coordination of transactions. The starting point of his research is the conviction that the core problem of economics, the organization of the activity of the economic entity, cannot be sensibly dealt with without examining the organizational costs (transaction costs). As Williamson sees it, the existence of business relationships is evidence that this type of coordination reduces transaction costs.

The question of why economic activities are actually realized by applying a wide range of coordination forms—besides market transaction and coordination within the company (hierarchy), there are many combined forms applied—can be explained with the transaction costs theory, pointing out differences between the transactions to be coordinated. For Williamson, the most important element of a transaction is the specificity of the related investments. Transactions can then be differentiated by whether or not they require long-term and specific commitment of resources. Williamson argues that it is the specific investments that can lead an economic entity to be caught up in a dependency (“lock-in” situation) and that, when combined with other factors (uncertainty, restricted rationality and opportunism), can cause coordination problems (Williamson 1975).

So dependency in transaction costs theory means remaining dependent on the **inputs** required for a transaction. It does not express dependency of an economic entity on specific services of a different economic entity. The specificity of an investment can be determined rather by looking at the value of the resource in a capacity other than the intended use, particularly in the best alternative use—in this case, a business relationship with a different partner. If the value of a resource in its original capacity is higher than in the best alternative use, the difference in value is referred to as quasi-rent. It results in a return that the specific resource can provide only in its originally intended capacity—in this case, the business relationship with the respective partner (Fig. 2.4). This applies equally to buyers and suppliers. So when a purchaser changes suppliers, he should ask himself how the value of a resource (e.g. a machine, an IT system, employee know-how) would change were he no longer to buy from the current supplier—the in-supplier. If this difference (the quasi-rent) is significant, he would be forced to accept great economic disadvantages were he to switch the supplier, which tends to result in remaining with the “old” supplier (left side of Fig. 2.4). The cost of switching, gauged as loss of value of the respective resources, would be too high.





**Fig. 2.4** Specificity-related losses when the intended utilization of a resource ceases

The same concept can be applied to a supplier with a customer considering or threatening to terminate the business relationship or with a customer he no longer wishes to do business with—for whatever reason. Here, too, the supplier must compare the value of his resources when the customer repurchases to the value in a situation in which the customer would have switched or would no longer be supplied (right side of Fig. 2.4). The greater the potential loss of the respective resources (machines and equipment, business processes, employee know-how, etc.) would be, the more likely the supplier is to make concessions for the customer in question—theoretically, until the quasi rent is exhausted—and the less economic sense it would make to cease supplying the customer. The cost of switching, caused by the loss of the customer and the associated loss of value of the company's own resources, would be too high.

So the existence of high and specific investments justifies a commitment in two ways. On the one hand, the resource specificity forces the investor to realize the planned transaction(s) so that the investment can be amortized. On the other hand, the specificity substantiates a dependency based on the “good will” of the transaction partner: The partner could be tempted to dispute the quasi rent with the committed business partner by insisting on new negotiations (Butler and Baysinger 1983). It is precisely this good will on the part of an actual or potential business partner that Williamson rules out by assuming that humans are by nature opportunistic (using their own cunning and wits).

Differential analysis of specific investments is made easier with Williamson's differentiation between four types of specificity (Williamson 1985). The list is not necessary complete and has been amended by Williamson himself (Williamson 1986). It also offers an initial analysis matrix to compile appropriated specific investments, which are a particularly influential factor in the economic approach to explaining loyalty.

- **Site specificity** means that the customer and the supplier made agreements tied to specific places and later relocation would be very costly or impossible. This

type of specificity can occur when e.g. a steel manufacturer builds a plant near the ore supplier or when a supplier to the automotive industry relocates to a new facility of the customer in a foreign country. Dependency results from the customer having no other transaction partners in this location.

- **Physical asset specificity** means that a customer adapts interfaces to the supplier, e.g. by acquiring certain equipment or implementing certain processes. Specific material goods can include communication equipment to link the supplier and purchaser, transport and storage facilities used by both parties, etc.
- **Dedicated assets** are the result of a company structuring its capacity exclusively for the cooperation with a certain market partner. Capacities are created in anticipation of a certain transaction volume. Were the transaction volume do not occur, there would be no other suitable use, even if the technical properties are unspecific.
- **Human asset specificity** means that knowledge related to the business relationship exists or is acquired. Human capital that is lost outside of the business relationship can be acquired e.g. through targeted training. It can just as well have resulted from earlier transaction and experiences with the partner—more or less as a by-product.

The phenomenon of specificity in combination with the problem of opportunism is thus essentially responsible for the safeguarding of resources having become such an important management task for many transactions. Since protecting from the risk of specificity on the market would lead to such high transaction costs, the transaction costs theory's standard solution to this problem is vertical integration. Integration of specific transactions is intended to utilize the controlling benefits of the "hierarchy" and thus to minimize transaction costs.

However, from the customer's and supplier's perspective, the vertical integration suggested by Williamson is generally not a viable option. It was particularly Picot (1991) who pointed out that barriers to integration can result primarily from financial restrictions and from a lack of know-how. The desire to stick to one's own core competencies can also be arguments against integration. And finally, such a step would mean that, in the case of downstream integration of a supplier, a company would become a competitor to its own customers; and were upstream integration of a customer to occur, the company would become a competitor to its own suppliers. In both cases this can generally lead to significant disadvantages. In light of this, close cooperation amongst business partners is a realistic alternative for cooperation as compared to the hierarchy option, especially—as Stinchcombe (1985) pointed out—taking into consideration the fact that many of the benefits of a hierarchy can also be achieved in close business relationships. However, it should be kept in mind that entering into a business relationship with the intention of protecting the required specific investments usually leads to additional specific investments being needed to establish the business relationship. The role that investments play in business relationships has already been emphasized in earlier publications on this topic (Johanson and Mattsson 1985; Plinke 1989). Specific investments have been cited as a central aspect of business relationships in many

other articles as well (Hallén et al. 1991; Heide 1994; Plinke 1997; Plinke and Söllner 1997; Söllner 1999). In this respect one can agree with Sheth and Parvatiyar (1994) when they emphasize that specificity is definitely not only a condition for entering into business relationships but is also the result of the decision to choose a close business relationship. Specific investments have far-reaching consequences for the relationship between suppliers and purchasers by sustainably affecting their negotiating situation.

Economists from the most varied schools of thought all acknowledge the significance of negotiating situations in which transactions are brokered. The number of potential suppliers and purchasers plays a decisive role in this aspect. If a customer has several potential suppliers to choose from, we refer to this as a situation of supplier competition. If there is only one supplier, a monopoly exists. The negotiations between the monopolist and the purchaser will differ vastly from the negotiations in the case of supplier competition.

By taking the specificity into consideration, Williamson succeeds in demonstrating that a situation of supplier competition does not necessarily have to remain in place. From the customer's perspective, the competitive situation upon conclusion of the contract can by all means change from a situation of complete supplier competition to a unilateral or bilateral monopoly. Whether or not the competitive situation changes in this way depends completely on the scope and specificity of the resource allocation resulting from conditions of the contract. If neither of the two parties makes investments, the next round of negotiations also takes place under the same conditions of supplier competition. If, on the other hand, specific investments are made, the competitive situation is "*fundamentally transformed*" (Williamson 1985, p. 61). As soon as the customer has made specific investments, competitors that were not included in the first round of negotiations are at a disadvantage in the second round compared to suppliers who were successful in the previous round. When the customer makes such specific investments that bind him to a certain supplier, barriers are erected for potential competitors, protecting the established business relationship.

Supplier investments can also effect a fundamental transformation. In many cases, the supplier in a business relationship will be forced to make investments that are sunk costs for him. Investments made by the supplier can also transform the market situation to a bilateral monopoly. On the one hand, supplier investments made under the assumption of an imperfect market are relevant, because new investment projects cannot always simply be financed. On the other hand, the calculation basis for the in-supplier's pricing is completely changed by the specific investments. While the resources to be expended are still completely disposable to the out-supplier and thus represent relevant costs to be covered, the resources already disposed of are sunk costs for the in-supplier because the investments are irreversible. The in-supplier company may possibly consider this in its pricing and remain below his full costs in the competitive situation. This situation alone can discourage potential out-suppliers from an offer and stabilize the monopoly situation.

When a customer invests in a business relationship, the investments—if they are specific—are irreversible. They substantiate switching costs and bind the customer to the successful supplier. While the supplier frequently achieves the essential marketing objective of customer loyalty (Diller 1996), the customer may experience stability and security and thus the transaction cost efficiency essential to performance of certain transactions. However, the price of this is forfeiting the corrective influence of competition and the acceptance of problems common to monopolies or bilateral monopolies. The loss of resources in the event of termination of a business relationship shifts the relationship of the customer to potential suppliers, and it changes the bilateral negotiating position towards the current business partner. This is due to the lack of replaceability of the successful supplier.

#### 2.4.1.2 Direct Switching Costs

In addition to the costs that a business relationship partner incurs for loss in value of the invested resources, a supplier or a buyer switch can be prevented or hindered by the fact that its initiation and execution are difficult and costly. These direct switching costs include all “*anticipated, directly attributable costs to terminate the old and begin the new business relationship*” (Saab 2007, p. 122); based on (Adler 2003, p. 115). This includes not only monetary values but all other expenditures—such as time and effort—incurred from (potentially) switching as well. These cost components include expenditures (Saab 2007) for

- The termination of the existing relationship (*take down costs*), contract penalties or the time required for termination,
- the search for an alternative relationship (*search costs*), e.g. to collect and prepare information on suitable contract partners and
- establishing such an alternative relationship (*setup costs*), e.g. negotiations, coordination of organizational processes, introduction of new procedures, investments in equipment, training employees.

It follows that the costs mentioned here depend strongly on the level of knowledge of the participants on the existing and any potential alternative business relationships. The trust in an existing business partner as well as the satisfaction in regard to the partner are significant factors (Kühne 2008). If, for example, the trust in a current partner is high, the transaction costs for the initiation and execution of subsequent transactions are—sometimes drastically—reduced (Plötner 1995). One feels that the in-supplier can be trusted and that less activity is required to find information and to safeguard against later disadvantages. When little or nothing is known about an out-supplier, the exact opposite is the case, with the consequence that high direct switching costs are (or can be) incurred for a potential switch. It would be necessary to compile information on the quality of the goods and services supplied by the company in question, to check the creditworthiness and reliability of the potential partner, etc. And one would probably also have to expend considerable effort in drawing up contracts that protect against any opportunistic behavior on the part of the new partner. This last case clearly indicates that, by remaining in

the “old” business relationship with the in-supplier—sometimes substantial—direct switching costs can be avoided.

The same concept applies to the satisfaction felt in regard to a business partner. Satisfaction means “knowing what you have.” To find out whether the satisfaction would be comparable with a potential new partner, effort would have to be invested in seeking information such as references. Such efforts are also a source of direct switching costs and can make switching less likely or even prevent it.

The amount of the direct switching costs in a specific case is to a great extent a factor of the number and strength of other relationships in which the supplier and purchaser are participants. As previously mentioned (refer to Sect. 1.1), companies in business-to-business markets are generally involved in a greater number of parallel business relationships. Switching to a customer or supplier within such a group generally incurs fewer direct switching costs than establishing contact to a completely new business partner. In such a case switching in its own sense is not even necessary: One’s own situation can be improved by restructuring the procurement and/or customer portfolio. For example, a customer can put pressure on a supplier by reducing the delivery rate (*share of wallet*) or by temporarily not considering the supplier for deliveries (Janker 2004), because he will incur only minimal termination, search and/or setup costs, if at all (Saab 2007). This does not, however, affect the significance of direct switching costs as a loyalty factor. The amount of the costs is also a significant factor in the cases described above. The more alternatives a company has in its customer and supplier base, the lower are the switching costs, the less it is committed to a single partner with which it is in a business relationship and the greater is the probability that it could switch (Saab 2007).

#### 2.4.2 Loyalty Effects of the Value of a Business Relationship

Concentrating transaction cost economics on transaction cost efficiency while strictly applying the concept of opportunism is, however, restrictive when attempting to analyze actual management situations. This was first explicitly expressed by Zajac and Olsen in 1993, when as part of their “Transactional Value Analysis” they argued that interorganizational business relationships are entered into primarily to achieve mutual benefits. Their findings indicate that business partners come to agreements that do not necessarily minimize transaction costs when the resulting cost disadvantages are at least balanced by the additional values created by the relationship (Zajac and Olsen 1993; Madhok 2000).

The significance of the business relationship value is also apparent in a series of studies that confirm that the value that the business relationship partners place on the relationship (*relationship value*) has become an essential if not the decisive factor for the initiation and success of business relationships as well as for the behavior of the partners in the business relationships (Krapfel et al. 1991; Anderson 1995; Wilson 1995; Wilson and Jantrania 1994; Tunder 2000; Cannon and Homburg 2001; Hogan and Armstrong 2001; Adler 2003; Walter et al. 2003). Wilson

**Table 2.1** Dimensions of the business relationship value. Source: Based on Ulaga and Eggert (2006)

		Value dimensions	
		Relationship benefits	Relationship costs
Sources of value creation	Core offering	Product quality Delivery performance	Direct costs
	Sourcing process	Service support Personal interaction	Acquisition costs
	Customer operations	Supplier know-how Time-to-market	Operation costs

(2003, p. 176) expressed this clearly: “*Product value is not enough to win in the marketplace. Relationship value creation is critical to winning in the marketplace*”.

In this realm the relationship value model created by Ulaga and Eggert (2006) has attracted considerable attention. On the basis of theoretical preliminary considerations and a series of in-depth interviews, they identified six values perceived by customers in business relationships. Three of these values include cost aspects and three benefit aspects. They are each based on the actual core offering, the sourcing (procurement) process and the customer operations in which the products and services purchased from the supplier are used (refer to Table 2.1 and to Sect. 5.3.1).

Empirical examination of the model revealed that, in regard to assessing the value of a business relationship, the perceived benefits play a greater role than the perceived cost reductions. In regard to the significance of the individual dimensions, the study showed that the greatest value was placed on gains in benefits in the operations and sourcing areas as well as on production cost reductions (Ulaga and Eggert 2006).

The significance of the business relationship value is also apparent in the results of a more recent study geared towards the international marketplace. The analysis of a large number of cases in Argentina, Germany, New Zealand and South Korea indicated that, on both the supplier and purchaser sides, the business relationship value sometimes had a much stronger influence on the intended behavior of the partners involved than did the switching costs (Geiger et al. 2012).

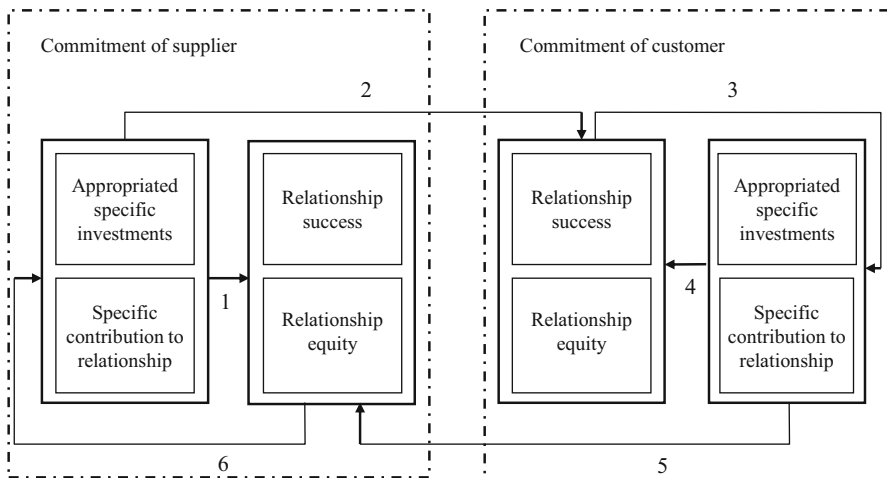
### 2.4.3 Commitment in Business Relationships: Interaction of Business Relationship Value and Switching Costs

The previous section clearly indicates that cost as well as benefit or value aspects are the foundation of the loyalty of a business relationship partner. So it seemed and seems reasonable—as the Thibaut and Kelly model did—to combine the two approaches to be able to fully comprehend how commitments in business relationships come about.

These considerations can be plausibly phrased by saying that ultimately there are—“only”—two reasons why people remain in relationships: either because they want to or because they have to (Johnson 1982); quoted according to (Söllner 1993). The aspect of having to stay in the relationship stands for the switching costs, while wanting to represents the benefits gained from the relationship. This concept has been revived again and again for business relationship research and to explain commitments in this context (Söllner 1993; Plinke 1997; Bendapudi and Berry 1997; Gilliland and Bello 2002; Gounaris 2005; Liu 2006; De Ruyter et al. 2001; Saab 2007).

An initial approach that applies and pursues these thoughts is Söllner’s **commitment model** (1993). This model sees commitment as the perceived loyalty to one economic entity as opposed to another. An extension to this line of reasoning on the transaction costs theory is that the commitment is no longer attributed solely to the scope of specific investments. The extension includes the addition of the **specific contribution to the relationship** as an input category and—as previously mentioned (refer to Sect. 2.4)—the **success of the relationship** and the **relationship equity** as two output dimensions that also influence the customer’s perceived loyalty (refer to Fig. 2.5). Direct switching costs, on the other hand, are not considered.

Specific contributions include e.g. loyalty to the business partner and motivation to achieve the same objectives (Allen and Meyer 1990; Gundlach et al. 1995). It can evolve over the course of a business relationship with no planning whatsoever. And it can also be consciously created, e.g. by supporting interorganizational relationships with planned interpersonal relationships. The commitment dimension is a significant modification in relation to transaction cost economics. All conceivable components of the commitment dimension are fundamentally suitable for reducing the tendency of the involved parties to be opportunistic. However, when



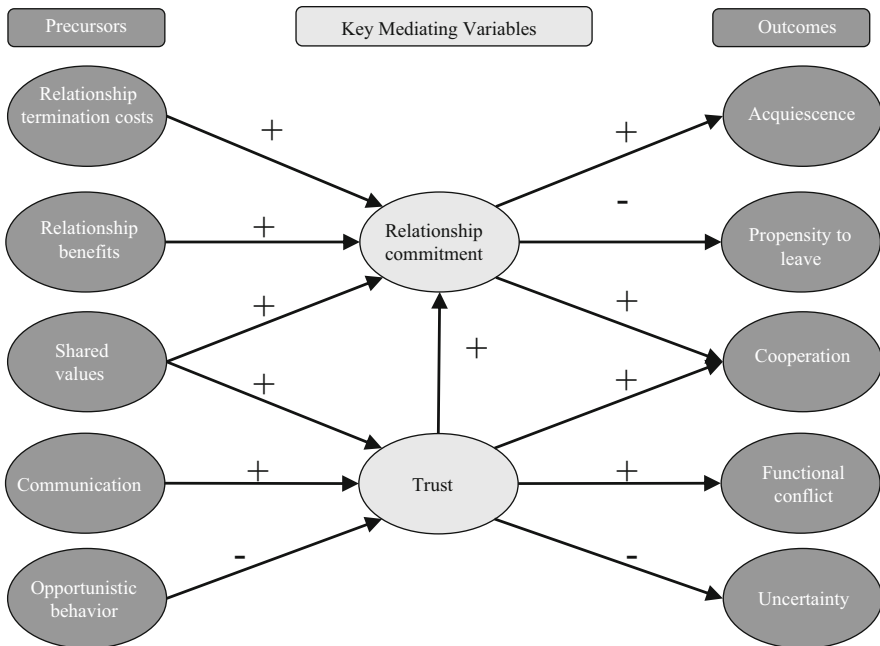
**Fig. 2.5** Commitment in a business relationship (dyadic view). Source: Based on Söllner (1999)

this is acknowledged, opportunism is no longer about a given property; it is a variable that, depending on the specific application in the relationship, can manifest itself to varying degrees in the relationship.

The **relationship equity** reflects the question of how the success of the relationship is divided between the partners. A measure for the relationship equity can be the perceived comparability of the respective input-output ratio of the two partners. Particularly when it is examined dynamically, the perceived equity in a business relationship will have a strong impact on the further course of the relationship. Some authors now expand the contemplation to include the generally perceived quality of the relationship (Mysen and Svensson 2010).

While Söllner's model focuses primarily on the economic factors leading to a commitment, Morgan and Hunt examine certain intended behaviors that can result from varying degrees of commitment in their commitment-trust model (refer to Fig. 2.6).

These factors include the willingness of a business relationship partner to meet the wishes or requirements of the other side (*acquiescence*), to terminate the relationship (*propensity to leave*) or to show a willingness to cooperate (*cooperation*). When determining the degree of commitment, not only the benefits of the business relationship (*relationship benefits*) are examined, but also the anticipated



Legend:  
A "+" stands for a positive correlation, a "-" for a negative correlation between the respective variables. Sample reading: The higher the "relationship benefits," the higher is the "relationship commitment."

**Fig. 2.6** Commitment-trust model. Source: Based on Morgan and Hunt (1994, p. 22)



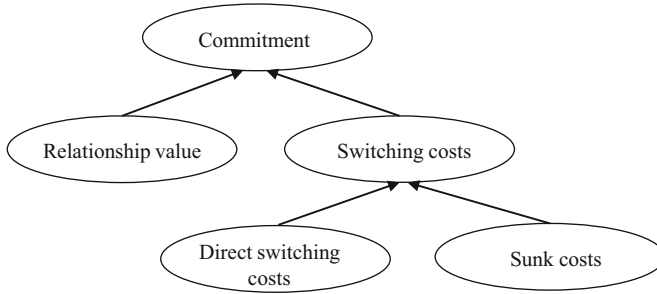
cost of ending the relationship (*relationship termination costs* which also represent a portion of the direct switching costs. Values from which both partners in a business relationship benefit (*shared values*) are also seen as factors that impact commitment. In the model the commitment is seen as a value that provides a mediating influence between the initial and influencing factors (*precursors*) and the results of the business relationship (*outcomes*). The commitment itself is a dependent—in this case on stated influencing factors—variable that intervenes in the effect of the ultimately dependent variable—in this case the intended behavior.

*Trust* is also seen as a mediator effect in this model. It is also influenced by the shared values as well as by the way in which the partners have communicated with one another in the past (*communication*) and by the *opportunistic behavior* of the other side—or by the lack thereof. The degree of trust has an effect on the tendency to cooperate as well as on the extent to which conflicts can productively be used to successfully continue the business relationship (*functional conflict*). As the only factor that does not represent intended behavior, the authors see trust as influencing the *uncertainty* that a business relationship partner feels in regard to the integrity of his counterpart. And trust also has an impact on the commitment itself.

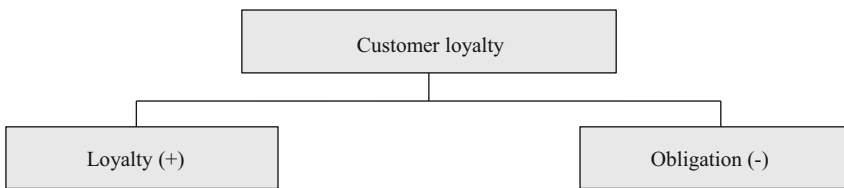
The model has attracted a wealth of attention in relevant literature and has become one of the most frequently quoted approaches. A point that warrants criticism is that the termination costs only factor in some of the switching costs. Neither the expenses incurred as direct costs for searching for an alternative relationship (*search costs*) and for establishing the relationship (*setup costs*) are not considered explicitly, nor are the sunk costs attributable to specific investments (refer to Sect. 2.4.1). They flow into the approach only indirectly and in different ways as mediating values through trust:

- Deep trust in an existing business relationship partner increases the “search costs” as well as the “setup costs” related to an alternative business relationship. This indicates that trust is a factor that impacts the amount of the direct switching costs.
- Opportunistic behavior poses a risk particularly with high specific investments. In this sense, non-opportunistic behavior that does not threaten the quasi-rent leads to low sunk costs and it increases trust in the business relationship partner. So trust is a value that is determined by the type of switching costs, the sunk costs.

Saab’s model (2007) is an approach that avoids the problem mentioned above and in which the influencing factors of the commitment are attributed to solely economic considerations, and it also takes into account the essential behavioral intentions. Based on thoughts of transaction cost as well as transaction benefit theory—and in accordance with the concepts explained previously—he sees a commitment as the result of the combination of relationship value and switching costs, whereby the latter is in turn composed of direct switching costs and sunk costs (refer to Fig. 2.7). As already explained, the sunk costs can be the result of



**Fig. 2.7** Model of commitment in business relationships. Source: Based on Saab (2007)



**Fig. 2.8** Customer loyalty from the customer's perspective. Source: Based on Eggert (1999)

resources specific to the business relationship losing value from switching, meaning that the quasi-rent is at risk.

To determine the relevance of the model—previously tested successfully in the business-to-business field—to business relationship management, in his study the author also examined the intended behavior of the three commitment drivers—business relationship value, direct switching costs and sunk costs—that emanate from the supplier and the purchaser. He based his studies on findings including those by Eggert from a study in 1999—which was performed on consumer goods, however. This study also initially revealed that customer loyalty was determined ultimately by the factors “wanting to” and “having to.” A state in which for one customer the “wanting to” dominates is referred to by Eggert as—positively perceived—“loyalty,” while a state in which “having to” dominates is—negatively perceived—“lock-in” or obligation (refer to Fig. 2.8). What is interesting here is that customers feeling loyalty towards the supplier demonstrate more positive intended behavior than those that feel obligation. This is apparent in their lesser intention to switch, their greater willingness to express a recommendation and their greater willingness to intensify the business relationship, all while only minimally seeking alternative suppliers.

Saab's study reaches very similar conclusions (refer to Fig. 2.9): The higher the relationship value, direct switching costs and sunk costs are, the lower is the switching probability and the higher are the willingness to intensify the relationship and the relationship tolerance, meaning the inclination of a partner to be willing to accept a mistake made by the other side. The greater the relationship value, the less

Loyalty dimensions	Effects				
	Switching probability	Willingness to intensify	Relationship tolerance	Search for alternatives	
				Search for other alternatives	Search for additional partners
	Relationship value				
	-	+	+	-	-
Direct switching costs	-	+	+	-	n.s
Sunk costs	-	n.s	+	n.s	+

+ Positive correlation   - Negative correlation   n.s. Correlation not significant

**Fig. 2.9** Effects of commitment dimensions on intended behavior. Source: Based on Saab (2007)

frequently a partner seeks alternatives or additional partners. This also applies to direct switching costs in regard to searching for alternatives. The higher the sunk costs, the more intensively additional partners are sought to reduce the dependency created by the specific investments. The previously mentioned international study indicated a similar tendency; however, it identified differences between the respective intentions of the supplier and buyer (Geiger et al. 2012). Another interesting revelation was that buyers and suppliers have different reasons for accepting commitments. The supplier weighs the disadvantages of dependency against the potential cost of acquiring new customers. The higher the latter are, the more likely the supplier is to commit to new purchasers or to the existing customer base. Buyers, on the other hand, see the loss of procurement freedom as a necessary condition to reducing costs incurred to maintain and manage a wide supplier base.

To summarize: The commitment or loyalty that a business relationship partner feels to another party is essentially influenced by two factors: the value of the business relationship (a positive factor) and the switching costs (a negative factor). The latter can be divided into direct switching costs attributed directly to a (possible) switch and costs that could be incurred due to a (looming) loss in value of own resources were a switch to occur (sunk costs). Depending on their manifestation, the loyalty drivers can significantly influence the behavior or intended behavior of the participants involved.

This does not provide a patented explanation for the establishment and duration of business relationships. At the same time, these considerations show the approaches for successful business relationship management. They logically consist of increasing the value of the relationships for the respective partner and/or increasing the switching costs that he would incur. This can happen by the customer being “tempted” or deeming it sensible to invest specifically in the business relationship, resulting in the incurrence of sunk costs. Also, an attempt can be made to increase the direct switching costs by making it more difficult to compare alternative business partners to one another. These fundamental constellations of

business relationship management are examined extensively in Chap. 5 of this book, from the in-supplier’s as well as the out-supplier’s point of view.

In addition to the two drivers of commitment, there are additional characteristics that can be characterized by a business relationship and must thus be considered for the analysis as well as for the constellation of business relationship management. We will examine these characteristics in the following chapters.

## 2.5 Other Economic Attributes of Business Relationships

### 2.5.1 Structural Attributes of a Business Relationship

Whenever commitments make suppliers or buyers feel dependent on their business partners, their inclination to seek or turn to alternatives increases. But whether or not a partner perceives the dependency resulting from the business relationship as disruptive depends not only on the value of the relationship and the switching costs but also on the **structure** of the commitment (Gundlach et al. 1995), meaning the question of whether the commitments are balanced or asymmetrical or whether they are perceived as such. It is safe to assume that a customer considers a potential dependency on the supplier to be much less disruptive when the supplier is similarly dependent on the business relationship.

When examining business relationships, it quickly becomes apparent that the construct commitment facilitates a wealth of structures. Even when only the appropriated specific investments and their simplified characterizations as “high” and “low” are examined, four cases can easily be differentiated (Table 2.2).

Cases 1 and 4 represent symmetrical input structures. In case 1, both parties have made high and specific investments. In contrast, in case 4 both parties have made only minimal specific investments. Cases 2 and 3 represent asymmetrical input structures in which either only the customer or only the supplier has made high specific investments.

The number of cases of different business relationship structures can be greatly increased by taking into consideration the structure of the other commitment dimensions or by using a finer scale to measure the commitment dimensions. Without getting into all of the possible constellations of business relationships, a few fundamental thoughts on the relevance of the structure of dependency relationships should be mentioned here:

**Table 2.2** Structure of appropriated specific investments. Source: Based on Söllner (1999)

		Appropriated specific investments by the customer	
		High	Low
Appropriated specific investments by the supplier	High	1	2
	Low	3	4

- Besides the determinants of a company's dependency in a business relationship, the structural features of the business relationship should also be recognized when attempting to determine whether or not a customer perceives the dependency resulting from a business relationship as negative. Quite a few authors have emphasized the problems of one-sided investments in business relationships (Berry and Parasuraman 1991; Anderson and Weitz 1992; Morgan and Hunt 1994; Gundlach et al. 1995; Plinke and Söllner 1997; Kleinaltenkamp and Kühne 2002).
- Dependency that results from a certain commitment dimension—e.g. from specific investments—can be acceptable to a company when it is symmetrical dependency. Specific investments pose a lesser threat potential when both partners have made a commitment by making specific investments. Williamson (1985) refers to the necessity of exchanging hostages in this context. The same applies to output-related dependency. A customer who receives a unique service from his supplier will feel less threatened by this dependency when the supplier in the business relationship also experiences success that would not be as easily achievable in other business relationships.
- A symmetrical relationship structure will be the exception in most cases (Gummesson 1994). However, in these cases a dependency in one commitment dimension may be able to be compensated for by a partner's dependency in another commitment dimension. Heide and John (1988) talk about the opportunity to balance out specific investments in a business relationship by “offsetting investments” to establish good relationships with other members in the chain of purchasers.
- Dependency (based on investment or value) is acceptable to a company when in the business relationship standards of solidarity and justice are recognized as institutional guidelines by the independent company as well (Heide and John 1992; Kaufmann and Stern 1988; Söllner 1999). So the threat perceived by the customer is reduced by the supplier's specific stake in the relationship.

### 2.5.2 Process Attributes of a Business Relationship

By definition, business relationships are characterized by a certain stability. This does not, however, mean that the time sequence cannot be changed. And although the commitment dimensions described here are independent of one another, they are distinguished by different interactions. And the customer's behavior affects the supplier's commitment and vice versa. So, for example, specific investments made by the customer impact not only the customer's success in the relationship but that of the supplier as well: They increase the customer's switching costs. They stabilize the relationship and reduce the insecurity of the supplier (Ungruhe 2011). Conversely, a high specific investment in the relationship by the supplier can e.g. be a sign of a slight risk of opportunism on the part of the purchaser. And finally, perceived relationship equity will impact the future investments and the future contribution to the relationship of the parties involved.

The decisive factors in this view are the dynamic aspect and the possibility of a step-by-step establishment of commitment. The prerequisite for closely binding the customer may be for the supplier to also make a commitment. Since this process can occur in steps and reciprocally, a strong commitment can be established without a company being bound asymmetrically to a high degree at a certain time.

It is not necessary and probably also not possible that both parties are equally committed. The intention is rather to signal to the partner interest in the relationship by committing oneself. This creates the conditions under which the partner is willing to commit to a relationship or the committed partner does not attempt to reduce his dependency (Söllner 1993).

Examination of the process aspects of business relationships has led to the development of different phase models of business relationships, which will be taken up in Chap. 3 to analyze repurchase decisions and in Chap. 5 to develop strategies for business relationship management.

So converting from market coordination to relational coordination leads to activities that can be far-reaching. These activities are primarily geared towards obtaining the knowledge required to coordinate a transaction through a governance structure and to creating the organizational requirements for execution of relational exchange conditions. Particularly Walter (1998) describes how the required steps can become barriers in the evolution process. It should be noted that the organizational and individual requirements for the implementation of business relationship management vary from company to company (refer to Part III of this book). So converting to relational exchange relationships poses problems of varying degrees for the people in different companies.

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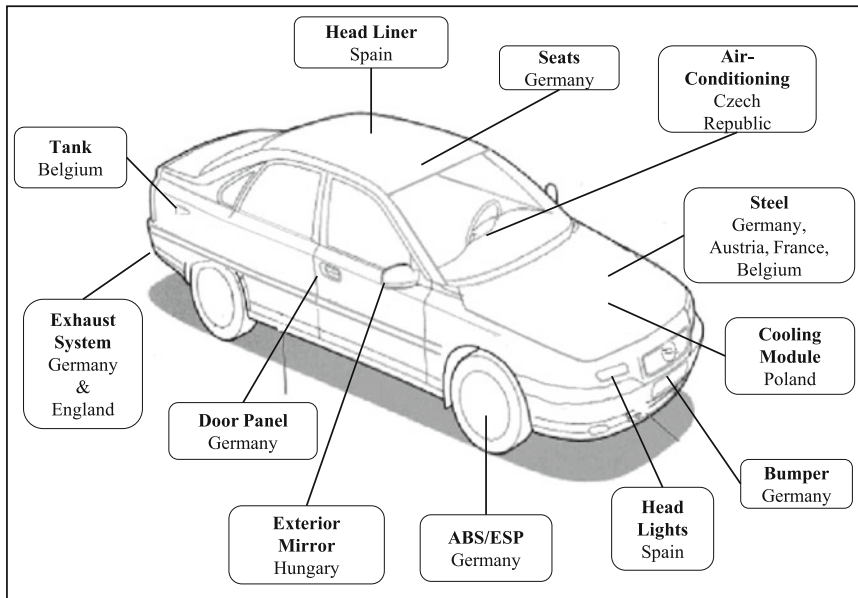
## Exercises

### Case Study

Many automobile producers have moved their manufacturing facilities to foreign countries to save costs. According to a report in the German magazine ADAC Motorwelt, the Audi TT is made in Hungary, the Opel Astra in Belgium, England and Poland, the Porsche Boxster in Finland and the VW Polo in Spain and Slovakia. And manufacturers are also increasingly purchasing parts and components in foreign countries as the vertical range of manufacture decreases. The proportion of vehicle parts produced in Germany has fallen from 35 % in 1991 to 25 % in 2001. Parts and components are often procured from suppliers all around the world.

The Opel Vectra is a good example of this development. It is produced at the Rüsselsheim plant, opened in 2002. Figure 2.10 clearly demonstrates that the Vectra is a real “European,” with components from many different places.

The establishment of international business relationships and networks has brought Opel great potential advantages (refer to Chap. 1). But a cooperative relationship between a manufacturer like Opel and a potential supplier is definitely not easy. It is plagued by uncertainties. Manufacturers and suppliers negotiate early,



**Fig. 2.10** The Opel Vectra and the origin of essential components. Source: Based on ADAC Motorwelt, 2/2007, p. 46f

meaning they discuss a service that is not yet in existence. Many issues cannot be definitely resolved: Does the supplier properly meet the expectations and what will be the actual cost-benefit ratio? Which roles do trade unions and strikes in the supplier's country play? If a bottleneck occurs, might a supplier in a foreign country give preference to customers in his home country?

The transaction is fraught with uncertainties for the supplier as well. The exclusive cooperation with the German manufacturer appears to be worthwhile at first glance. But how will the cooperation be over the long term? Will the forecast quantities be achieved, amortizing the required investments and producing profits? Will the manufacturer remain as cooperative as implied in initial discussions? Or is there a risk of an "extended workbench" occurring and having to accept prices that barely cover costs?

Discuss the risks that the potential benefits of the business relationship could endanger from the perspective of the manufacturer and his suppliers. Then consider how to manage the risk involved in business relationships.

## Additional Exercises

1. Explain the fundamental pattern of customer loyalty from a behavioral perspective. Which concepts are you familiar with within this perspective that explain the origin of customer loyalty, and are these concepts sufficient to thoroughly explain the (re)purchasing behavior of companies?
2. Explain the social psychological approach of *Thibaut* and *Kelley* in light of the origin of organizational business relationships.
3. What is the main feature that differentiates transaction marketing from relationship marketing? What are the consequences for the commitment between the customer and the in-supplier?
4. Which different types of specificity do you know about?
5. Explain the components of switching costs that a purchaser incurs when changing the in-supplier.
6. What significance does the value of a business relationship hold for the loyalty between customer and in-supplier?
7. State and explain the commitment drivers in business relationships.
8. Differentiate the essential tasks of managing a business relationship in light of the individual replacement phases from the tasks of managing a market transaction.

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