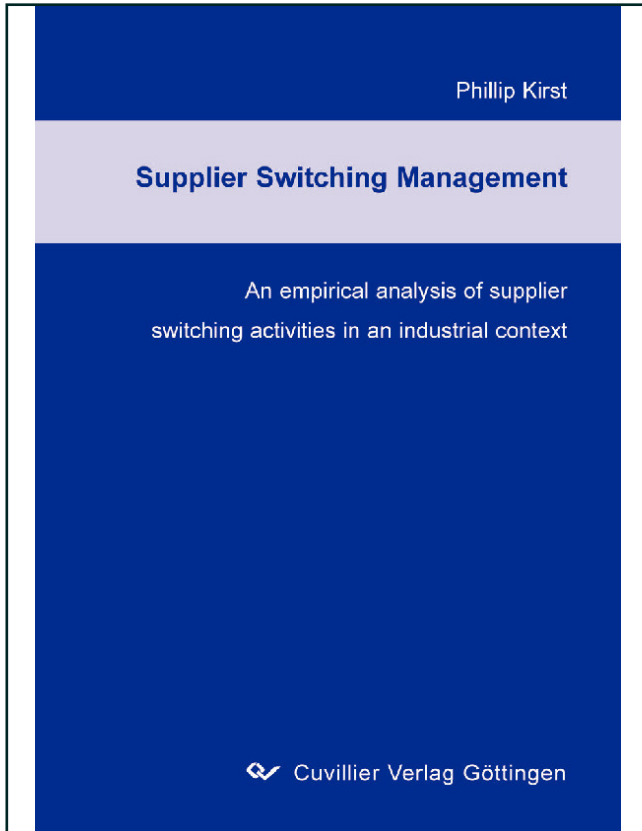




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Supplier Switching Management

An empirical analysis of supplier switching activities in an industrial context



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1 Introduction and relevance of this research on supplier switching

Companies in the current business environment are affected by increasingly complex market dynamics that are caused by, among other things, global competition, new information and communication technologies, fastidious customers, and capital market pressures.¹ In order to compete in this challenging environment, companies have pursued strategies that either help to adapt more quickly to changes, or strategies that support stability and the reduction of complexity. For the latter, and specifically with reference to the supply side of a company, the concept of supplier integration has been strongly promoted recently. Supplier integration first requires the reduction of the number of suppliers, in order to intensify the relationship with some of the remaining ones. If the intensification of supplier-buyer relationships comprises mutual adjustments or specific investments, the supplier becomes integrated. The specificity of an investment refers to the degree to which a company can redeploy it to alternative uses without a sacrifice of productive value.² Thus, the more specific a certain investment becomes, the lower its value is when put to another use. Integrated supplier-buyer relationships promise benefits and increased competitiveness for both parties. On the other hand, they cause dependencies and hence an inflexibility to switch, which can be a threat for the purchasing organization if the performance of the incumbent supplier weakens unexpectedly. The practical relevance of research on supplier switching relates to the dilemma of the simultaneous need for stability through supplier integration and the flexibility of the supplier structure.³ This work discusses the possibilities of increasing the flexibility of supplier-buyer relationships without sacrificing the benefits of supplier integration. In the perspective of the research on hand, this can be accomplished through a systematic approach to supplier switches.

As far as the scientific relevance of the research on supplier switches is concerned, it can be stated that approaches that combine supplier integration with increased flexibility of the supplier-buyer relationship structure are new. Furthermore, a gap in the scientific literature has been identified, since the research of the supplier-switching phenomenon in the context of integrated supplier-buyer relationships has been neglected in comparison to alternative reaction options – like supplier development – to supplier weakness. The following sections of this chapter explain the relevance of systematic supplier-switching approaches in further detail. Furthermore, the objective of this research with regard to supplier-switching activities will be set forth, along with the questions posed by the work. Additionally, the research will be positioned in relation to scientific theory and an outline of the work is presented at the end.

¹ Hofmann (2004), p. 1.

² Williamson (1991), p. 281.

³ A dilemma is a contest between conflicting imperatives, whereas an imperative is a pragmatic rule, which expresses the objective necessity for an action in such a way that the action would inevitably take place if the will were to be entirely determined by reason. van Gigch (1997), p. 383.

1.1 Background and the problem of the research on supplier switching

Generally, two distinct approaches to business research can be identified. Practical problems on the one hand reflect challenges of economic entities with certain phenomena. On the other hand, theoretical challenges exist when the literature does not offer descriptions and explanations that apply to the real world. Both approaches can be used to start the research process, which elucidates certain characteristics of the phenomena due to a synthesis of empirical knowledge and theoretical explanations. This procedure corresponds to the iterative research process of *Kubicek*.⁴ The following section will provide an overview of the practical and theoretical challenges that cause the relevance of the topic.

Companies in today's business environment are subject to several trends that require an organization to adapt continuously.⁵ Keeping pace with these external developments is one of the major challenges for the retention of a company's competitive position. A number of selected trends with relevance for research on supplier switches are discussed below.

First, **customer preferences** have become more volatile and diverse than ever.⁶ This trend complicates the predictability of customer demands and hence increases the demand-side uncertainty of order quantities.⁷ The wide range of customer requirements leads to a growing number of micro-segments that force companies to increase the number of product variations.⁸ This boosts the complexity of the value-creation process and adds further challenges to those already faced by companies.⁹ Organizations therefore try to reduce the diversity in certain parts and apply mass-customization strategies like modularization and postponement to limit inventory costs and obsolescence risks.¹⁰ Furthermore, customer requirements change more rapidly and unexpectedly as the media stimulate knowledge about new products. New information technologies like the Internet substantially change the customer's demand behavior, since they increase market-transparency and comparability of product characteristics and prices. This trend forces companies to adapt quickly to customer demands. Firms need to be able to reduce prices or change the product characteristics when customer orders are dropping. Especially for complex products, companies need the technological capabilities and cost-cutting creativity of their suppliers. If the incumbent supplier is unable to keep pace with the requirements of the buyer, switching tendencies can arise.

⁴ Kubicek (1977), pp. 14.

⁵ For a definition of the term "environment" see Welge (1980), p. 260.

⁶ Giesa and Kopfer (2000), p. 43.

⁷ Christopher (2000), p. 37; Lee (2002), pp. 106; Hofmann (2006a), p. 75.

⁸ Lee (2002), p. 105.

⁹ Non-transparent procedures and processes, high product variety, long value creation chains, multiple hierarchical layers, a big number of non-standardized supplies and orders as well as interorganizational interfaces, all drive high complexity. Child and Diederichs (1991), pp. 53.

¹⁰ Christopher (2000), pp. 42; Lee (2002), p. 114. For a comprehensive overview of the concept of "mass customization" see Piller (2006).

A further trend that currently challenges companies relates to the **acceleration of technological advances** and **shortened product life cycles**. Both lead to clockspeed competition. The concept of clockspeed was introduced by *Fine* and describes the relationship between time and change within different industries: in high-clockspeed industries, products and processes are replaced by completely new ones in a period ranging from six months to five years. In low-clockspeed industries, the same change will take 15 to 30 years.¹¹ Shortened product life cycles are accompanied by increased development costs and time, which makes it even harder for a single company to accomplish cost and innovation objectives at the same time. In some industries, like the automotive business, this trend has led to the necessity to split up research and development tasks between buyers and suppliers. This has multiplied inter-organizational coordination complexity and has increased the importance of the supplier-base.¹² Switching tendencies may arise as soon as the currently used supplier is incapable of delivering innovative products at the required cost and time. Additionally, a need to switch to another supplier can arise when a product or process innovation enables the purchasing company to relinquish the purchased goods of the current supplier in favor of a completely new product from an alternative vendor.

Furthermore, **globalization** has a big impact on competition intensity and describes the ongoing process of worldwide work-division.¹³ In view of the fact that international trade-barriers have been reduced, capital has become more and more mobile and employable worldwide. Since the 1990s, global sourcing in particular has gained much more attention in practice and business research.¹⁴ Currently, the proportion of globally-sourced products relative to domestically-sourced supplies is still growing.¹⁵ In general, the globalization and liberalization of trade intensifies the competition between companies all over the world. It enables production and sources of supply to shift to locations with the highest cost, quality, and technological advantages. This increases cost and price pressures, especially for companies in highly-developed and industrialized countries. Due to the vast number of possible suppliers all over the world, the supply market of a company becomes ever bigger. Thus, if the purchasing company performs effective supply market research, new potential suppliers, which can meet the buyer's requirements, can be discovered every day. This increases the probability that alternative suppliers can offer better prices, quality, or technology, which fosters the tendency to switch away from the incumbent supplier, if it cannot compete.

¹¹ Fine (1998), p. 239.

¹² Wangenheim (1998), p. 67.

¹³ Bundeszentrale für Politische Bildung (2007).

¹⁴ Arnold (1997), pp. 111; Koppelman (2003), pp. 223.

¹⁵ Trent and Monczka (2002), p. 67.

In order to preserve their competitiveness in a global environment, companies have changed their way of doing business to a far-reaching extent. The **core-competence approach** in particular was implemented intensively at the end of the last millennium, and has had a big impact on today's supply structures. Core competencies can be defined *as company-specific capabilities that help companies to achieve strategic competitive advantages in a certain market*.¹⁶ In this context, a competitive advantage can be described as follows: "A firm experiences competitive advantages when its actions in an industry or market create economic value when few competing firms are engaging in similar actions."¹⁷ However, the expression "core competence" is not defined homogeneously, but there is a common understanding of core-competence characteristics.¹⁸ In order to define a competence as core, a company needs to have capabilities and resources that support the creation of a sustainable competitive advantage by being transferable to new products and markets, and hence deliver the basis for a broad bandwidth of new products. Furthermore, core competencies must not be easily imitable and substitutable, and need to provide a recognizable benefit that is appreciated by customers.¹⁹ This pursuit of focusing on core competencies can lead to supplier-switching tendencies, if the core-competencies of the buyer and the supplier are not compatible anymore or overlap. The first case might occur when the supplier decides to focus more on other business units than the one which is involved in the particular supplier-buyer relationship. The latter case might arise when a buyer decides to insource the production of a supply good that has previously been purchased from an external supplier, due to a redefinition of its own core-competencies.

The core-competence approach relates to **outsourcing tendencies**, which have shaped the economy for many years. Outsourcing has developed out of "make-or-buy" decisions that question whether a company should produce a certain product internally or if the latter should be sourced from an external supplier.²⁰ Coming from a more cost-oriented focus for the externalization of certain operations, outsourcing has become the subject of a broader understanding, including strategic motives for using external suppliers.²¹ One result of outsourcing has been the extensive reduction of the net value added ratio due to outsourcing of areas in which companies have no distinctive capabilities. Up until now, the value of purchased

¹⁶ Prahalad and Hamel (1991), pp. 67. For a definition of competitive advantages, see Picot *et al.* (2001), pp. 523.

¹⁷ Barney (2002), p. 9.

¹⁸ Zahn (1996), pp. 885.

¹⁹ Simon (1988), p. 465; Prahalad and Hamel (1990), pp. 82; Prahalad and Hamel (1991), pp. 69; Friedrich (1995), p. 88; Bouncken (2000), p. 867; Osterloh and Frost (2000), p. 161.

²⁰ Männel (1996), p. 148. The term "outsourcing" and "make-or-buy" are often used synonymously. Engelsleben (1999), p. 81. However, in contrast to "make-or-buy" decisions, outsourcing only comprises products and services, as well as operations, which have been produced internally before and are about to be fabricated by an external supplier. Zahn *et al.* (1999), pp. 91; Barth (2003), p. 84. This is reflected by the meaning of the term as well: Outsourcing = outside resource using. Bühner and Tuschke (1997), p. 21.

²¹ Bretzke (1998), p. 393.

materials, components, and systems accounts for 50 to 80% of the total cost of goods sold in many industries.²² This situation leads to the fact that a substantial part of performance-critical activities are not under the control of buying companies anymore.²³ Thus, considering the **reduced net value added** of companies and the dynamic environment, companies have to make sure that they always have reliable and efficient access to superior resources from outside the firm boundaries.²⁴ In order to accomplish this goal, companies are advised to concentrate on fewer, yet integrated suppliers.²⁵ Some authors have emphasized that there is a chance to gain a competitive advantage through the establishment of those integrated supplier-buyer relationships.²⁶ It seems to be today's dominant logic in science and practice that integration of sequentially-linked organizations is a good thing and thus, the more integration, the higher the potential for gaining a competitive advantage.²⁷

Some scientists have started to demand a more critical discussion of supplier integration, since the benefits of supplier integration used to come at the price of the inflexibility of the supplier structure and dependency.²⁸ These two aspects can cause challenges if the current supplier's performance has weakened or if the company has identified a more suitable vendor on the supply market.²⁹ Due to the close interrelation of the buyer and the integrated supplier, a buying firm cannot easily terminate an incumbent exchange relationship ahead of time in order to exploit the potentials of a better performing alternative supplier. Thus, the structure of these supplier-buyer relationships tends to be stiffer and hence less flexible than in arm's length relationships, which require no mutual adjustments or specific investments. Because of this inflexibility, buyers can face problems when adapting to fast-changing market conditions, and system- and relationship-specific investments between the supply partners can become obsolete as soon as they are created.³⁰ However, companies still need the stability and continuity of integrated supplier-buyer relationships in order to be able to focus on core competencies, decrease cost, and increase sales.³¹ Nevertheless, at the same time, they need flexibility

²² Cammish and Keough (1991), p. 23; Arnolds et al. (1998), p. 15; Arnold (1997), p. 15; Tani and Wangenheim (1998), p. 25; Sydow and Möllering (2004), p. 23; Kaufmann and Carter (2006), p. 653; Nogatchewsky (2006), p. 89.

²³ Rossetti and Choi (2005), p. 47; Stölzle and Kirst (2006), p. 240.

²⁴ Dyer and Singh (1998); Smith (2002), p. 39.

²⁵ Dwyer *et al.* (1987), pp. 11; Monczka and Morgan (1996), p. 110; Dyer and Singh (1998), p. 661; Frohlich and Westbrook (2001), p. 186; Wagner (2003), p. 4; Das *et al.* (2006), pp. 564; Paulraj *et al.* (2006), p. 107; Wagner and Hoegl (2006), p. 936.

²⁶ E.g. Dyer and Singh (1998), pp. 675; Jap (1999), pp. 466; Lavie (2006), p. 638.

²⁷ Lambert *et al.* (1998), p. 15; Bask and Juga (2001), p. 137; Bagchi and Skjøtt-Larsen (2005), p. 275.

²⁸ E.g. Bretzke (2006), p. 12; Hofmann (2006b), pp. 11.

²⁹ Performance in general is a multidimensional construct, which includes financial and non-financial metrics. It relates to the concepts of efficiency and effectiveness in combination with the way of achieving of multiple objectives. Performance has – besides a past- and present-oriented understanding – a future- and potential-orientated dimension. Karrer (2006), pp. 12.

³⁰ Bask and Juga (2001), p. 149.

³¹ Becker *et al.* (2003), p. 19.

on the supply side in order to adapt quickly to the dynamic environment.³² Thus, companies have to be able to integrate and operate close supplier relationships, but they simultaneously have to be capable of replacing suppliers if the latter do not satisfy the needs of the organization and satisfaction cannot be achieved at acceptable costs and within an acceptable time. This reflects the cornerstone of the practical relevance of research on supplier switching, which aims for the concurrent achievement of the benefits from supplier integration and supplier structure flexibility. It is assumed that the parallel achievement of both benefits can be accomplished through a structured approach towards supplier switching and the activities involved, which aims for a reduction of the time and cost needed to replace an integrated supplier. Furthermore, this approach can help buying firms to reduce the negative performance impacts of weak suppliers, since the switch to a better-performing vendor could be more easily achieved. However, a concept that supports companies in the switching decision, execution, and success evaluation does not exist, but can help companies to improve their ability to form, operate, and change supplier-buyer relationships. This is regarded as a key capability in today's turbulent business environments.³³

As far as the scientific relevance of the research on supplier switches is concerned, it can be stated that approaches that combine supplier integration with increased flexibility of the supplier-buyer relationship structure are new. Despite the contribution of various scholars to the question of how to create flexible,³⁴ agile,³⁵ or semi-coupled supplier-buyer relationships,³⁶ research has not evoked concepts that allow the simultaneous achievement of the benefits of supplier integration and flexibility of supplier-buyer relationships.³⁷ Usually, the concepts emphasize the need for either one or the other. This leads to a trade-off between the benefits of flexibility and integration: each can be improved, but only at the expense of the other. This work introduces a possible way of maintaining integration benefits and accepting the disadvantage of dependency, while reducing the negative consequences of terminating the relationship with an integrated supplier and switching demands to an alternative one. This means that the roots of the negative aspects of supplier integration (dependency and inflexibility) will not be cured – only the symptoms (loss of performance, complex switching processes) are toned down.

³² Christopher (2000), pp. 37.

³³ Fine (1998), p. 200.

³⁴ E.g. Vickery *et al.* (1999); Duclos *et al.* (2003); Martínez Sánchez and Pérez Pérez (2005).

³⁵ E.g. Christopher (2000); Mason-Jones *et al.* (2000); Prater *et al.* (2001).

³⁶ Bask (2001); Hofmann (2006a); Hofmann (2006b).

³⁷ Some of the literature examples cited deal with supply chains instead of dyadic supplier-buyer relationships. These two thematic focuses have to be distinguished from each other, since supply chains can comprise a broader perspective as single relationships. However, both research strings can contribute to interorganizational flexibility.

Furthermore, even though a scientific discussion about the causes of supplier switches³⁸ and success dimensions exists,³⁹ research that emphasizes the switching activities and their relationship to the switching objectives is particularly under-represented in a business-to-business context. Thus, this work aims to explore the structure of supplier-switching phenomena in an industrial environment, which enables future research to systemize and define further investigations according to a consistent research framework. In addition to that, research of the supplier switching phenomenon has in general been neglected in comparison to alternative reaction options towards a supplier weakness, such as supplier development.

A last argument, which further supports the relevance of research on supplier-switching, is that research explaining the impact of a successfully-executed supplier switch on the competitiveness of the purchasing organization is rudimentary. Thus, this research aims for an enhancement of the theoretical understanding of supplier-switching, supplier integration, supplier-buyer relationship flexibility, their interrelationships, and their relationship to competitive advantages.

Due to these unsolved challenges in practice and theory that describe the relevance of research on supplier switching, the work at hand attempts to gain empirical and theoretical insights into the reasons, activities, and success dimensions of supplier-switching in order to understand how a successful supplier switch can lead to a competitive advantage. The following figure summarizes the discussion of the relevance of this research (*Figure 1-1*).

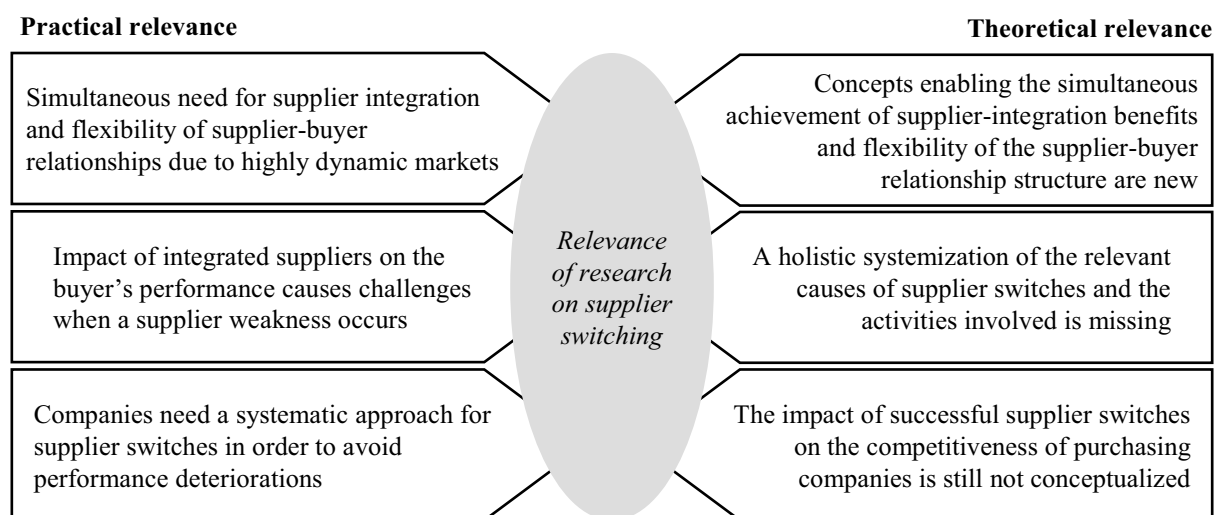


Figure 1-1: Practical and theoretical relevance of research on supplier switching

³⁸ E.g. Heide and Weiss (1995); Keaveney (1995).

³⁹ E.g. Alajoutsijärvi (2000); Arnold (2007).