

## Total value in business relationships

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Total value in business relationships: Exploring the link between power and value appropriation

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## Total value in business relationships:

### Exploring the link between power and value appropriation

#### Abstract

**Purpose:** The purpose of this paper is to consider how value can be better defined and to understand the drivers of value appropriation in business relationships. In doing so, we explore the role that power plays in determining the sharing of value in those relationships.

**Design/methodology/approach:** A conceptual discussion about value and the appropriation of value in business relationships, which leads to the development of a methodology for assessing the sharing of value.

**Findings:** In this paper we have developed our view of total value in supply chain relationships. We argue that the value of the relationship is the sum of the customer and supplier value, including both tangible and intangible benefits and sacrifices. In addition, we maintain that the appropriation of value in a business relationship is reliant upon: 1) the power both parties possess; 2) the direct and tangible value each party has to offer; and, 3) the indirect and intangible value that each has to offer. We also provide a methodology, which can be used to determine the sharing of value between two actors within a business exchange.

**Research limitations/implications:** In arriving at our conceptualisation of total value and in our discussion of value appropriation in business relationships, we drew upon extant literature. However, a limitation is that we were unable to fully consider all the academic discourse centred on value and value appropriation.

**Originality/value:** The discussion brings together the issues of customer value and supplier value to the concept of 'total value'. Thereafter, it links the contentious issue of buyer and supplier power, so as to better understand the appropriation of value in business relationships.

**Keywords:** business relationships, value, value appropriation, customer value, supplier value, power

**Paper type:** Conceptual

## 1. Introduction

Concepts such as value and power are at the heart of business relationships. Value has always been important for sales organisation and it has long been argued that the aim of any enterprise is to offer products and / or services that are of value to customers (Brandenburger and Stuart, 1996). Conversely, the professionalization of the buying function within organisations is aimed at unpacking supplier offers to ensure value for money (Ramsay, 2005). Value is therefore critical for the success of a firm. Additionally, the relative power between two parties within a business relationship has a significant influence on the initial formation of the relationship and the subsequent sharing of value within the business exchange (Cox, 1999). Although both power and value are critical elements in business relationships, they are more often than not implicitly present, rather than explicitly defined. This lack of a clear understanding of what value means for the buyer and supplier, as well as who has power, can cause significant relationship difficulties and may well be one of the reasons that many relationships fail. Therefore, it is important to develop a conceptual model that can provide us with a more comprehensive understanding of what constitutes value and power within business exchanges.

Value is important in various streams of literature, including marketing (Vargo and Lusch, 2006; 2012) finance (Copeland, 1994), and supply-chain management (Womack and Jones, 1994; Ellram and Cooper, 1990). In this article, the focus is on business relationships, where there has been considerable academic discourse concerning the concept of value, value creation and the question of value appropriation (Lindgreen and Wynstra 2005; Ulaga and Eggert 2005). However, definitions of value are multifarious and often vague with a ‘bewildering variety of disparate meanings’ (Ramsay, 2005, p. 563). Moreover, value in this

literature is typically associated with customer value whereas the idea of supplier value remains largely undeveloped (Ibid).

In addition, even if it is possible to define value and agree on the most appropriate way to create value, it is also difficult to tackle the contentious issue of how value is appropriated. Few writers explicitly discuss the factors that influence the appropriation of value for actors in business relationships. According to Reitzig and Purnham (2009) *'[W]ith a few exceptions (e.g., Teece, 1986), scholarly discourse on the topic of organizational capabilities has focused largely on the differences between firms in their ability to create value, rather than their differential ability to capture and protect the returns to value creation from the forces of competition' (p. 765).*

We argue, that in order to understand how value is shared between actors in a business relationship, the nature of the power dynamics at play between those actors needs to be investigated. This is because it is likely that the more powerful party in the relationship will appropriate a greater proportion of the available value (see Chicksand, 2013; 2015, Rehme et al. 2016).

This paper explores the sharing of value in business relationships. Although there is an increased treatment of the term value in marketing, as well as in purchasing, the definition of value is still vague. Therefore, the purpose of this paper is to consider how value can be better defined and to understand the drivers of value appropriation in business relationships.

In this paper we make the following contributions. First, we suggest a definition of value, which encompasses direct and indirect benefits and sacrifices for both customers and

suppliers. Second, we introduce the concept of total value, which is the sum of customer and supplier sacrifices and benefits. This provides a more realistic depiction of value in a business exchange. Third, we provide a conceptualisation of the sharing of value in business exchanges, linking value appropriation with power. Lastly, a methodology is developed which provides guidance for determining and better understanding how value is shared between collaborating parties.

The rest of the paper is structured as follows. Definitions of customer and supplier value are discussed. This is followed by introducing the concept of total value. Thereafter, power and its connection to value appropriation is explored. Finally, we develop a methodology for the analysis of value sharing in a collaborative business relationship.

## **2. Arriving at a definition of value**

### **2.1 Defining customer value**

There has been considerable debate about value in business relationships (for a fuller review of that topic see Lindgreen et al., 2012; Ramsay, 2005; Lindgreen and Wynstra 2005; Ulaga and Eggert 2005; etc.). According to Lindgreen et al. (2012) there are various research fields that improve our understanding of value in a business setting. The majority of research attempts to explain how certain product characteristics or attributes can be translated into value from the perspective of individual consumers (Lindgreen et al., 2012). Therefore, many definitions of value are concerned with customer value, where terms such as customer perceived value (Ulaga and Chacour, 2001; Woodruff, 1997) are treated as synonyms of the word 'value'. Customer value is often regarded as something perceived by customers rather than objectively determined by a seller (Ulaga, 2001), where value is the balance between

customers' benefits and sacrifices (Holbrook, 1994; Walters and Lancaster, 2000, Christopher, 2005). Customer value is therefore derived from the trade-off of those benefits and sacrifices for a specific purchase of a good or service (Holbrook, 1994).

According to Simpson et al. (2001) the definition of customer value focuses on the total worth of the benefits received for the price paid. Customer value in business markets is therefore derived from supplier activities that can be expressed in a monetary sense (Anderson and Narus, 1998; Brandenburger and Stuart, 1996) and include benefits that improve revenue for the buyer, including access to new markets, the possibilities to increase prices and ability to differentiate product's or services. There are operational benefits that reduce costs for the buyer, such as creating more efficient processes, providing lower maintenance costs, and less stock (Cox et al., 2002; Walters, 1999). Finally, when a supplier is able to reduce commercial, operational and / or technical risk there are significant and quantifiable benefits for the buyer (Das and Teng, 2001).

From this perspective, in addition to the customer benefits derived from an exchange there will also be sacrifices. These sacrifices include, the price paid for a good or service and the cost of financing, which are by far the most significant, as well as other direct sacrifices or, what some authors call transaction costs (TCs) (see Williamson, 1975; Nordigården et al 2014). These include: the initial search costs for the product or service (as well as the additional costs of negotiation and contracting); the learning costs, which can include adapting technology, processes and procedures; and, the switching costs, the costs incurred by the buyer in moving from one supplier to another. Many of these sacrifices lead to increased risks for the customer (Akerlof, 1970) and are sources of power for the supplier, as



they are isolating mechanisms (see Rumelt, 1987) that create imperfect markets (Cox, 2007).

The direct benefits and sacrifices for the customer are depicted in Figure 1.

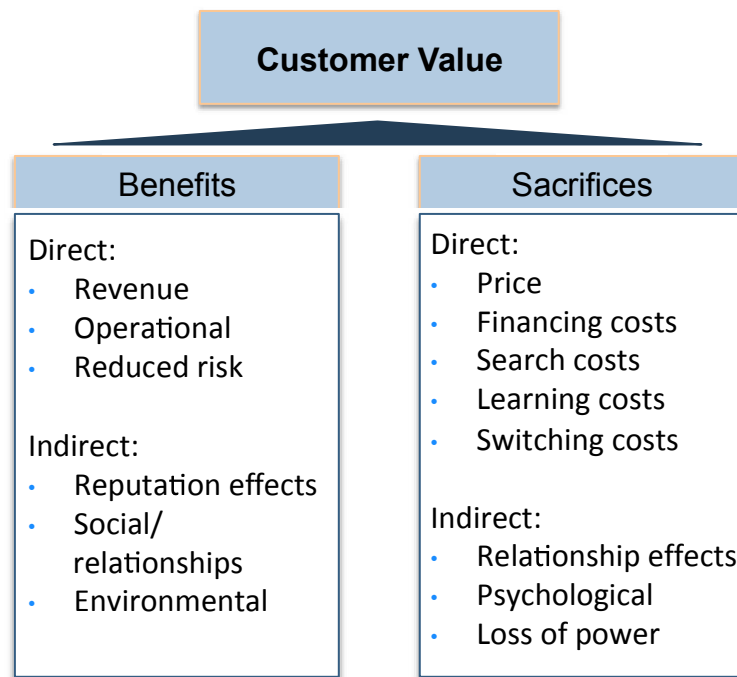


Figure 1: Customer value represented by the balance between benefits and sacrifices

The benefits and sacrifices are however, not only direct and easily measured but also indirect and difficult to quantify (e.g. Anderson and Narus 1998; Vandenbosch and Dawar, 2002; compare also the debate on intrinsic and extrinsic value e.g., Kumar and Grisaffe, 2004; Sánchez-Fernández, Iniesta-Bonillo and Holbrook, 2009). The indirect value comes from less tangible aspects of the relationship, such as, for example, a positive association with using a particular brand (Simpson et al., 2001) and broader social / relational and environmental benefits. Indirect sacrifices include relationship effects, psychological lock-in and loss of power (Ramsay, 2005; Cox, 2007; Chicksand, 2015). Although often difficult to quantify, in some circumstances a buyer can find it difficult in practice to switch suppliers, even though it is theoretically possible to do so. This is because strong relationships have been formed and

the buyer is psychologically dependent upon a supplier, resulting in a loss of power for the buyer.

## 2.2 Defining supplier value

Most of the extant literature on value focuses on the nature of the concept from the customer's perspective. However, this does not fully represent a business relationship, as a relationship is made up of two parties, a buyer and a supplier. Miles (1961) made a distinction between buyer and supplier value, when he argued that value means something different for a buyer than for a seller. Therefore, value must be understood from both actors' perspectives (Ramsay, 2005). Supplier value can be seen as the net benefits that a supplier receives in exchange for the product or service it produces and supplies to the market (Ramsay 2005). Ramsay and Wagners' (2009) research highlighted that there are many sources of benefits - other than money - for suppliers in supply chain relationships (see Ramsay and Wagner, 2009). In line with customer value, it is thus possible to illustrate the supplier benefits that a buyer can provide the supplier with, as illustrated in Figure 2 below.

Here, similarly to customer benefits, there are direct revenue improving, operational and risk reduction benefits for suppliers. Revenue improving benefits for the supplier include, increased sales volume, cross-selling opportunities, stable revenues, customer-led innovation and support for diversification. Operational benefits for the supplier, in turn, include accurate and timely information, demand stability and support for operational development (Ramsay and Wagner, 2009). Finally, there is also significant commercial, operational and technical risk reducing benefits offered by the customer to the supplier. The most significant direct sacrifice for the supplier is to the delivery of the product or service to the customer. Other direct sacrifices will include the cost of learning and adapting processes (developing

customer specific processes or technology) and keeping dedicated inventory for a specific customer (cf Williamson's, 1979; 1985).

As with customer value there will be indirect sacrifices and benefits, which although often difficult to quantify, can still have a significant impact on perceived value. Indirect sacrifices for the supplier can include costs associated with investing in developing and managing the relationship with the customer, as well as becoming dependent on the customer for fear of losing revenue and prestige associated with servicing a specific customer. In turn, there will also be indirect benefits associated with servicing a specific customer. Selling to a blue-chip company, for example, can bring about access to new markets and raise the profile of the supplier in a particular market. In some circumstances the indirect benefits of having a relationship with a specific buyer could outweigh the direct economic value.

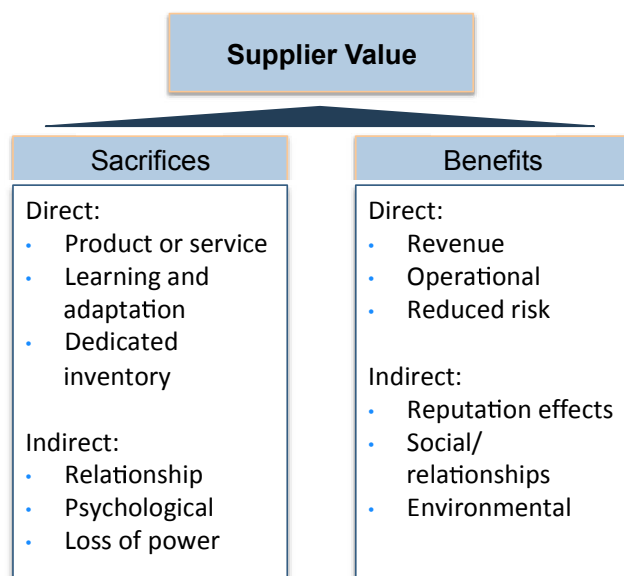


Figure 2: Supplier value represented as the balance between benefits and sacrifices

### 2.3 Defining total value in a business relationship

Hence, we posit that in order to arrive at a more comprehensive definition of value in a business relationship, it is necessary to include: 1) both buyer and supplier perspectives; and 2) tangible and direct, as well as intangible and indirect benefits and sacrifices. Hereafter, the term ‘total value’ will be used to refer to the sum of the customer and supplier value including both tangible and intangible benefits and sacrifices, in a relationship. This is represented in Figure 3.

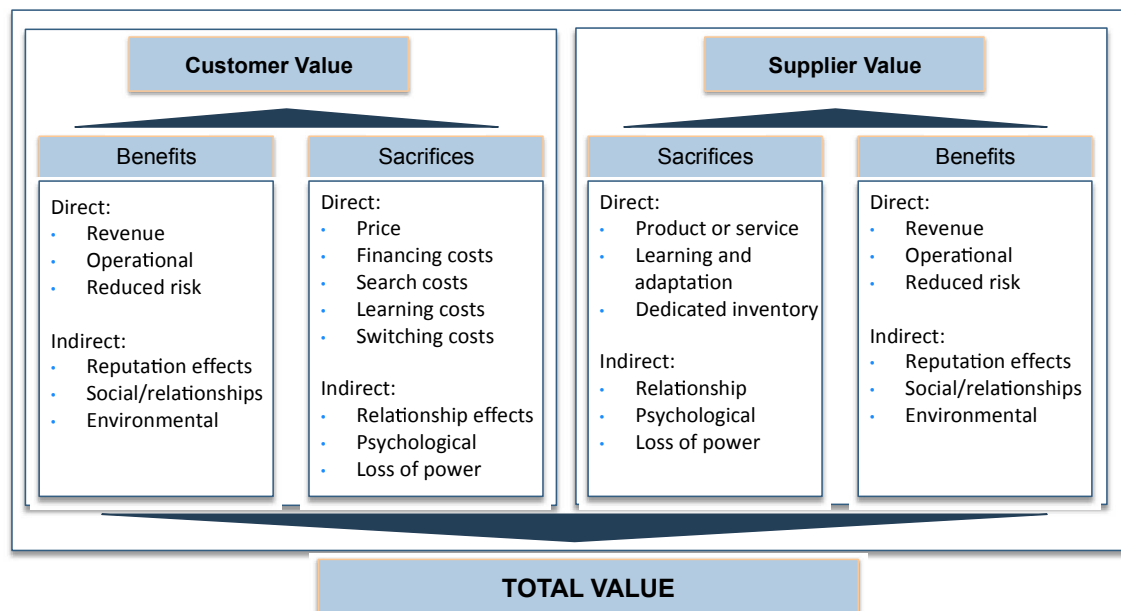


Figure 3: Total value in a business relationship

In Figure 3, the concept of total value is explored. However, there could be other benefits and sacrifices, which are not presented. Yet, this view of value is a significant departure from prevailing thinking, whereby the literature is dominated by a customer-focused view of value. Even in the area of value co-creation (see Normann and Ramirez, 1993; Galvagno and Dalli, 2014), the starting point is that value co-creation is a joint effort by buyer and seller to improve the benefits of the *seller* offer. However, this still negates the value provided to the

seller by the buyer, as already discussed. From our perspective it is the sharing of *total value* within the business relationship, which must then be determined.

In this paper, when discussing customer value, supplier value, total value and value appropriation, the focus is on a specific exchange relationship or transaction (cf. Cox et al., 2003) However, we maintain that a specific exchange, although often short-term in nature, can often be part of a broader relationship (Håkansson, 1982). Here, the broader relationship can be complex, long-term and dynamic. In our model of total value (Figure 3), there are elements of benefits and sacrifices that are heavily influenced by, or originating from, the broader relationship. For example, in a relationship between a subcomponent manufacturer and OEM, they could be supplying a number of different components. Although a negotiation may be taking place over component A, the fact that the organisation also supplies component B and C and / or services D and E, will influence the total value. For this reason, when building up an understanding of total value it is often necessary to look beyond the individual transaction or exchange. In addition, there is a longer-term perspective, which will also influence total value in an exchange. For example, when negotiating the sharing of total value for delivering a specific product or service, future potential revenue generating opportunities or access to new markets will be factored into buyer and supplier benefits and sacrifices.

### **3. Sharing total value in business relationships- value appropriation**

It is evident from the discussion thus far, that both customer and supplier value are created from, inter alia, buyer-supplier relationships. However, this tells us little about the way in which the total value created in these relationships is shared. There are some authors who

would argue that although collaborative relationship or partnerships, in some circumstances may result in creating more money and resources (i.e. growing the pie), than an arms-length relationship, this does not mean that the results will necessarily be shared equitably (Cox et al., 2004; Cox and Chicksand, 2005). Research suggests that individual firms within an industry will try to extract or appropriate as much money and/or resources as possible for themselves (Mizik and Jacobson, 2003). Indeed, this is the logical outcome of many business relationships. Although we acknowledge that there are other perspectives, we contend that understanding the power dynamics between buyers and suppliers is key to explaining how total value is shared in the supply chain. The reason for this, we contend, is that there is a link between the relative power of buyers and suppliers and who appropriates more of the total value.

There is a considerable body of literature that focuses on power. However, power is a contentious construct, in that many disagree as to its scope and how power should be understood (Gallie, 1955). Contu and Willmott (2003) considered the role of power within organisations and explored the embeddedness of learning practice in power relations. They argued that learning practices are shaped, enabled and embedded within relations of power. Here, the control of resources and social organisation of those resources gives power (Lave and Wenger, 1991). Within this theoretical area the view is that power can enable or deny access to learning practices. Fleming and Spicer (2006), also wrote on the topic of power within organisations, and argue that there are four distinct ‘faces’ to power. The first face of power is direct coercive power. As originally illustrated by Robert Dahl (1957), coercive power is the ability of one actor to force someone else to do something that they would not otherwise do. From a business relationship perspective, power is often defined as one firm’s ability to influence another firm (Asare et al, 2016; Rehme et al, 2016). In addition, it has

been noted that power is relative, that it is not like money, for example, as it cannot be accumulated and no single firm has power in all situations (Pfeffer, 1981; Ireland, 2005).

Power can also be described as a function of dependence (Emerson, 1962). Often firms do not have the resources to do everything themselves and will, therefore, be dependent on external providers for products or services. Although there may be a degree of mutual interest, each firm in a buyer-supplier business relationship will normally attempt to influence the terms of the exchange to give them maximum benefits (Rumelt, 1987). It can be argued, that to be able to influence another firm's behaviour requires one actor to have control of resources, as well as a degree of dependency on them by the other actor (Cox, 2007). Therefore, from this perspective we can view the power of one player over another, as a function of resource dependency. Power exists in supply chain relationships if one party needs the other party more than they need them (Emerson, 1962; Blau, 1964; Thompson, 1967; Cook and Emerson, 1978). In resource dependence theory, power has been defined by Emerson as "the power of actor A over actor B is the amount of resistance on the part of B which can be potentially overcome by A" (Emerson, 1962, p.32). Therefore, power between two actors is essentially about the relationship between the utility and scarcity of resources each actor brings to an exchange (Emerson, 1962; El-Ansary and Stern, 1972; Jacobs, 1974; Pfeffer and Salancik, 1978; Campbell and Cunningham, 1983; Frazier and Antia, 1995; Caniels and Gelderman, 2007).

Cox et al., (2000), developed a perspective which explored the dimensions of buyer and supplier power, using the constructs of resource utility, resource scarcity and information scarcity. They argued that a specific dyadic business relationship could be located in one of

four basic power positions: *Buyer Dominance* ( $>$ ), *Interdependence* ( $=$ ), *Independence* ( $0$ ) and *Supplier Dominance* ( $<$ ). This is depicted in a four-box matrix and is shown in Figure 4.

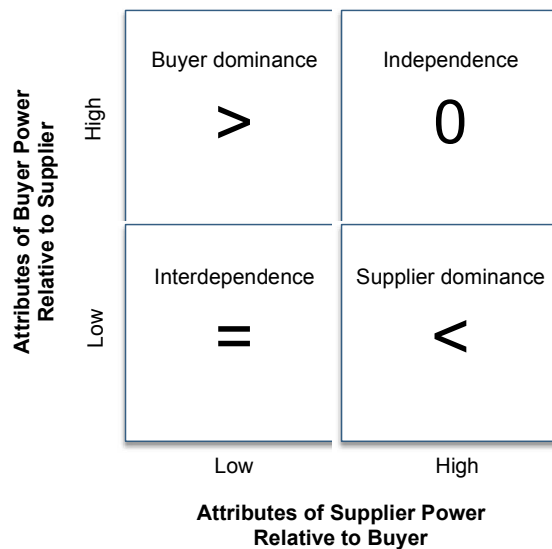


Figure 4: The power matrix (Chicksand, 2009, adapted from: Cox, et al., 2000, p. 18).

Cox et al., (2004) have argued that non-adversarial collaboration is likely when there is an interdependent power situation ( $=$ ). When there is interdependence, meaning an equal power relationship, ‘[T]he buyer and supplier share relatively equally the commercial value created’ (Cox et al., 2004, p. 354). This is represented by arrow ‘B’ in Figure 5. When the buyer possesses greater power resources relative to the supplier resulting in a buyer dominant power position ( $>$ ), then the ‘buyer adversarially appropriates most of the commercial value created and sets price and quality trade-offs’ (Ibid, p. 354). See arrow ‘A’ in Figure 5. Mirroring this, when the supplier possesses greater power resources relative to the buyer and there is a supplier dominance power position ( $<$ ), then the ‘[S]upplier adversarially appropriates most of the commercial value and sets price and quality trade-offs’ (Ibid. 354). Finally, this is represented by arrow ‘C’ in Figure 5.



This perspective is a significant departure from the mainstream view concerning *collaborative* relationships (see Chicksand, 2009), which assumes that there is a fair sharing of the benefits and risks of working together (Frazier, 1983; Cooper and Ellram, 1993). In their relationship management typology (shown on the right hand side of Figure 5), Cox et al., (2003, 2004), make an important distinction between way of working and the sharing of what they call surplus value or gains from trade (Cox et al., 2005). This is understood by determining the relative ability for either the buyer or supplier to achieve their preferred commercial goals by appropriating the greatest proportion of the surplus value possible (see Figure 5).

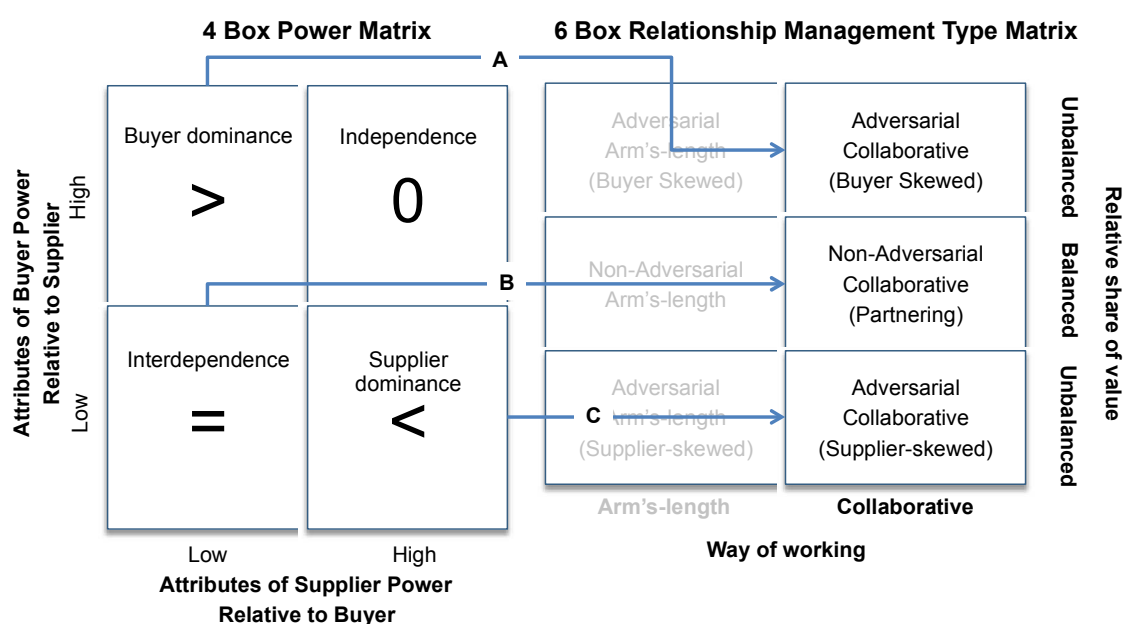


Figure 5: The link between power and appropriate relationship management type (Adapted from Chicksand, 2009)

There is considerable discussion about this typology in Cox et al. (2003), yet they do not provide explicit guidance as to how a collaborative relationship can be categorised as either balanced or unbalanced (see Figure 5). Ultimately, greater guidance here will help determine

the relative share of total value between buyers and suppliers. This is important because it informs, motivates and directs actors in relationships<sup>1</sup>.

Therefore, it is necessary to clearly define both buyer and supplier value and create measures by which balanced and unbalanced sharing of total value can be determined. This can be attained by establishing which party in the business relationship has achieved their desired outcomes and whether one party receives more of the total value than the other. In order to create indices by which the relative share of total value can be measured, a number of questions must be asked and information gathered to position the relationships accurately. The aim of the questions in Table 1 is to explore value appropriation extending beyond simple price negotiations and is in line with our definition of total value.

Question number	Question to pose
<b>Q1</b>	What are the commercial goals of entering into the business relationship i.e. the direct and indirect benefits?
<b>Q2</b>	What are the costs of entering into the business relationship i.e. direct and indirect sacrifices?
<b>Q3</b>	What evidence is there in the business relationship or contract to indicate an equal or unequal sharing of the value (payment terms, length of contract, detrimental clauses, allocation of risks, relationship commitment etc.)?
<b>Q4</b>	How close to the reservation price (willingness-to-pay) is the purchase?
<b>Q5</b>	How close to the cost of production is the delivery price?

Table 1: Assessing the appropriation of total value (adapted from Chicksand, 2009)

<sup>1</sup> Since supply chain relationships require a more collaborative approach to working together, the arm's-length relationship types as depicted in Figure 5 have been excluded from further discussion (see Chicksand, 2009).

From the answers to these questions it will be possible to ascertain whether the relationship is adversarial buyer-skewed, non-adversarial, or adversarial supplier-skewed. As this is a continuum (shown in Table 2), a judgment will need to be made as to whom, on balance, gains more of the total value from the relationship. If it favours the supplier then the relationship will be deemed as being supplier-skewed adversarial. If it is very difficult to determine any obvious beneficiary, then the relationship will be classified as non-adversarial. As is often the case, at the extremes it is relatively easy to categorise the sharing of surplus value, but in the middle it is often more problematic.

Factors	Buyer-skewed adversarial	Non adversarial	Supplier-skewed adversarial
<b>Goal attainment - benefits</b>	Buyer's perceived commercial goals fully achieved	Each party's perceived commercial goals partially realised	Supplier's perceived commercial goals fully achieved
<b>Distribution of sacrifices</b>	Buyer's perceived sacrifices are lower than expected	The perceived sacrifices are distributed equitably	Supplier's perceived sacrifices are lower than expected
<b>Contractual implications</b>	The terms of the contract favour the buyer (i.e. pricing, payment terms, exit clauses, etc.)	The terms of the contract favour neither the supplier nor the buyer (i.e. pricing, payment terms, exit clauses, etc.)	The terms of the contract favour the supplier (i.e. pricing, payment terms, exit clauses, etc.)
<b>Price bargaining for buyer</b>	The buyer is paying a price which is substantially lower than their utility function	The buyer is paying a price which is mid-way between their utility function and the supplier's mean cost of production	The buyer is paying a price which is close to their utility function
<b>Financial outcome for supplier</b>	The supplier is receiving only slight profit	The supplier is able to earn average profits for their comparable industry sector	The supplier is able to earn sustained above average profits for their comparable industry sector

Table 2- Characteristics of equal and unequal sharing of surplus value, (adapted from Chicksand, 2009).

Goal attainment and distribution of sacrifices are based on the perceptions of buyers and suppliers related to the factors listed in Figure 3. Contractual implications, price bargaining and financial outcome for supplier are then based on an assessment on more tangible metrics that are the outcome of the specific business exchange being analysed.

#### **4. Discussion and Conclusion**

First, in this paper we have highlighted the need to define value more robustly. In presenting our view of total value in business relationships, we have argued that the value of the relationship is the sum of the customer and supplier value, including both tangible and intangible benefits and sacrifices (see Figures 3). This conceptualisation of value from both buyer and supplier perspectives has practical relevance, as collaborating parties must be clear about the potential benefit and sacrifices in order to fully understand the context of the business relationship.

However, determining total value is difficult. It is possible to make an overall assessment of the balance between the tangible and more readily quantifiable benefits and sacrifices for buyers and suppliers in the relationship. In determining total value an assessment also needs to be made about the intangible benefits and sacrifices. These are inherently difficult to quantify, yet they could conceivably be the prime source of benefits or sacrifices for buyers and suppliers. For example, when the direct and quantifiable benefits for a supplier may be outweighed by the direct sacrifices it would be justifiable to argue that the supplier should cease involvement in this business relationship. Yet, on balance, as previously argued, significant intangible and / or long-term benefits, such as access to new markets or potential future revenue for both the buyer and supplier would mean that the business relationship is worthwhile when viewed in its entirety.

Second, an attempt has been made to answer Reitzig and Purnham's (2009) call to consider how firms can capture and protect returns. To do so, we introduced Cox et al.'s, (2000, 2002)

power perspective. At the heart of this perspective was the view that collaborative relationships or 'partnerships' can be something other than relationships based solely upon equitable sharing of the benefits and sacrifices of working together. We suggested that a possible explanation for who appropriates more value in the relationship is determined by power differentials (see Figure 5).

We argue that when buyers and suppliers enter into relationships, there are three primary sources of influence on their decision-making:

- a. the power both parties possess;
- b. the direct and indirect benefits each has to offer, and;
- c. the direct and indirect sacrifices that must be made.

The relative significance of these three sources of influence is context-specific. Thus, in a buyer dominant situation for example, when a medium-sized supplier to Toyota who has no other important customers, then Toyota's buying power will predominate and the focus will be on the customer benefits. For a small or medium sized firm buying from a very large supplier with proprietary, patent protected products and few competitors (i.e. supplier dominance), again power will be the dominant influence, but this time the focus will be on supplier benefits. With power more or less equally balanced, customer and supplier benefits and sacrifices must be equally considered.

Following on from this, it is logical to argue that those who have more power in the relationship will exert this power to achieve their own commercial goals. Those dominant parties will, therefore, most likely approach their ideal commercial outcomes. However, we also highlighted that Cox et al., (2003) do not provide adequate guidance of how, in practice, one is able to distinguish between unbalanced and balanced collaboration and thereby

position business relationships in the relationship type matrix shown previously in Figure 5. The authors have gone some way towards addressing this by proposing a number of questions (see Table 1) and a framework (see Table 2), which clarifies if the buyer or the supplier appropriates more of the total value in a specific exchange relationship. Through this approach, both the buyer and seller know exactly what each party is bringing to the table and can provide an impetus for greater value creation. It is also a vehicle for having the often-difficult discussion of how value is (and maybe should be) appropriated in the relationship. We would argue that many business relationships fail because: 1) they have not a shared view of the benefits and sacrifices derived from the business exchange; and, 2) they have not determined how these benefits and sacrifices are to be shared between the parties.

We would hope that the conceptualisation of value outlined in this paper would provide a starting point for a more open discussion between buyers and suppliers in business relationships. In addition, the value appropriation methodology developed should help collaborating organisations to consider how value is shared in a specific exchange, thereby reducing potential future conflict which ultimately can lead to failed relationships.

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