Managing Relationships in Showery Weather: The Role of Umbrella Agreements

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Abstract
Network approaches have expanded our view of markets as interconnected networks of exchange relationships, in which companies interact. This paper deals with an increasingly important aspect of interaction. This is the role of umbrella agreements in business relationships. These umbrella agreements can be understood as attempts to mirror the reality of business interaction by providing a framework of principles within which exchanges may happen. This paper builds on ideas on interaction to examine a number of real-world cases of umbrella agreements. It draws conclusions on the role of these agreements for managers and more widely on the nature of interaction itself.
INTRODUCTION: SHOWERY WEATHER AND THE PROBLEM FOR COMPANIES

The resources that are necessary to solve business problems in single companies are not available in a concentrated form. Increasingly they are dispersed in many different companies within business networks. At the same time, technological changes, shifting economic conditions and global competition for customers and market shares are creating formidable uncertainties and a high degree of unpredictability (Duncan, 1972; Downey, Hellriegel and Slogum, 1975; Huff, 1978; Jauch and Kraft, 1986; Miliken, 1987; Hargadon, and Fanelli, 2002). In a continuously changing business network, companies are confronted with the challenge of assessing business opportunities which are only open through the existence of relationships with idiosyncratically positioned actors. In other words, relationships enable companies to access the resources of other firms and through interaction, transform these resources into capabilities for their own benefit and that of their counterparts (Barney, 1986; Denrell et al., 2003).

The problem with developing relationships with other firms is that it always carries the risk that these relationships may become dysfunctional if conditions change. The relationship may hit “showery weather”, perhaps because of the developing requirements of the company or the actions of the counterpart, or because of changes in the contextual circumstances of the network. A well known example is the case of Baird and Marks and Spencer1. Baird, a textile supplier, had an exclusive, 30-year collaboration with the retailer Marks and Spencer although there was no business contract between the two companies (Harrisson, 2004; Blois, 2003). Due to intensified competition in the retail market, Marks and Spencer’ financial performance deteriorated. Prompted by a rapid decline of earnings, Marks and Spencer was forced to restructure and consolidate its existing pool of suppliers. As a consequence, Marks and Spencer informed its textile supplier Baird that its current orders due for delivery will be the last and the business relationship will terminate at that point. Baird, however, held expectations of continuity of the business relationship and decided to sue Marks and Spencer to claim damages for the cost of closing several production sites and providing redundancy payments. After a lengthy and cost-intensive process, the courts rejected Baird’s claim that a 30-year business relationship constituted an implied contract.

Showery weather may also arise in a relationship because new, more productive options may emerge elsewhere. Some companies are better prepared to embrace new and emerging opportunities while other companies are trapped within existing business arrangements. Consider the cooperation between Morningstar, a consumer goods manufacturer and Econ, a discount retailer (Mouzas and Ford, 2003). Up to the year 2000, Econ represented over 30% of the annual sales of Morningstar, and Econ was its most important key customer. Morningstar’s relentless focus on Econ may be traced back to the fact that retailer Econ is the leading retailer in Europe. In a similar way, Econ’s interest in manufacturer Morningstar was mainly attributed to Morningstar’s excellent brand management capabilities worldwide. Despite the excellent collaboration between the two companies, discount retailer Econ could not ensure that its branded products were offered at the lowest possible price in the market. The entry of new aggressive discount retailers increased price competition. Following a crucial business review, Econ decided to de-list all Morningstar’s brands from its outlets and replace them by Econ’s own labels. Morningstar’s managers were badly surprised. They had expected a continuing long-term relationship, and were disappointed that their preferred customer did not respect what they show as implied norms, such as a reasonable period of notice. Furthermore, dealing with a major customer over long period of time, they had neglected other exchange relationships, without embracing new business opportunities.

Contracts

In order to safeguard their reliance on business relationships, companies may use contracts as manifestations of agreements, which could be legally enforced (Fuller and Perdue, 1936, 1937; Treitel, 1988; Steyn, 1997). Contracts, however, may limit a company’s ability to innovate or change its policy. For example, prior contractual decisions made by a company

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1Baird v Marks & Spencer plc,[2001] EWCA Civ 274, [2002] 1 All ER (Comm) 737.
may limit its ability to embrace new or emerging business opportunities, to differentiate, or to change its arrangements in the future (Argyres and Liebeskind, 1999:49). This might explain why in many business relationships, companies prefer not to use contracts at all (Macaulay, 1963, 2004; Campbell and Harris, 1993; Collins 1999; Campbell et al. 2003; Roxenhall and Ghauri, 2004). Today’s companies face a problem: How can they deal with pressing issues that require collaboration with counterparts today, without closing the door on more productive options tomorrow?

RESEARCH METHOD

This study is part of a wider research project into the ways in which companies negotiate and make deals in complex business networks. One of the most intriguing empirical findings of that research is the importance of re-negotiation of agreements between companies in long-term relationships. We found that each single round of negotiation can only be understood as part of a complex and continuous interaction between the companies, and that relationships are neither fixed nor an unchanging asset that companies “own”. This encouraged us to examine closer how companies deal with the complexity of interaction. By using case study research (Eisenhardt, 1989; Tsoukas, 1989; Orlikowski, 1992; Ragin, 1992; Yin 1994; Easton, 1995; Halinen and Törnroos, 2005), the present research looks at umbrella agreements a way of dealing with this complexity of interaction. The method of data collection places an emphasis on obtaining contemporary manifestations of agreements, such as written contracts and informal gentleman’s agreements, as well as participant observation and personal interviews. Over the field study period, 54 interviews and 12 research workshops with senior managers conducted between 2001 and 2004. The pool of interviewees was identified in trade and manufacturing and trade congresses, and was enriched and expanded by continually asking “who works where and who knows whom”. It included decision-makers such as Marketing Directors, Trade Marketing Managers, Sales Directors, Purchasing and Supply Directors, Key Account Managers and Financial Controllers representing a variety of industries as well as some of the best known blue chip consumer goods manufacturers, pharmaceutical companies, grocery retailers as well as service providers.

THE ROLE OF UMBRELLA AGREEMENTS

Many companies attempt to solve the inherent conflict between capitalizing on business opportunities and maintaining corporate flexibility through so-called umbrella agreements. Umbrella agreements mirror the reality of business relationships today. They are not concerned with contractual decisions (Crone, 1993). Instead, they provide an explicit framework within which interaction between companies can take place. Umbrella agreements spell out a framework of norms in accordance with which future contractual decisions can be made. Many contemporary business practices have evolved over time due to implicit norms in common usage or developed in specific relationships. Umbrella agreements between parties make these implicit norms explicit. They provide a framework of “reasonable expectations” for the involved parties, they regulate continuing interaction between actors and translate the consequences of fulfilling or breaching exchange promises. An umbrella agreement represents a coping strategy for dealing with the complexity of business interaction, which may protect or at least reassure managers. In this way, umbrella agreements provide an array of explicit options for the choices of a company and those of its suppliers and customers.

We will now examine the variations in the content of these agreements, the motivations of the parties involved and their experiences within the agreements. This will demonstrate that in many cases, umbrella agreements nowadays spell out the framework for managing relationships between companies. We will explore the advantages of umbrella agreements and highlight the situations in which managers find them particularly useful, such as those involving regular transactions. We will also show that the reasonable expectations enshrined in umbrella agreements mean that managers can, time and again, use them as a way-station to test their understanding of what they have agreed. If circumstances for either interacting party change, then re-negotiation of the umbrella agreement can occur. Thus managers
Consider umbrella agreements as a strategic tool that sets the ground rules for continuing interaction between business actors.

**WHAT DO UMBRELLA AGREEMENTS INCLUDE?**

In order to examine the variations in the content of umbrella agreements, we now present four agreements between companies (see Table 1). The first agreement is between ChemCo, a leading chemical and pharmaceutical company and Service Provider SP in the area of business technology. The second agreement involves the relationship between an insurance company and an investment company in the provision of financial services. The third agreement is between a retailer, Metro and a manufacturer of Fast Moving Consumer Goods. The fourth agreement is between Bavaria, a chemical and pharmaceutical company and Biochemical Laboratories and deals with microbiological testing of consumer products.

Table One provides details of these four agreements. The table is divided into a number of sections corresponding to the important clauses in each of the agreements that were identified by examining the agreements and in interviews with the managers who were involved. The clauses start with a description of the scope of business between the two companies by defining types of products or range of services and then articulate the basic principles that regulate the business interaction. The clauses deal with important issues of exclusivity, information flow, confidentiality, subcontracting, warranties, property rights as well as termination. The clauses also emphasize the importance of re-negotiation and the inclusion of extreme contextual contingencies in the form of force-majeure, such as political unrest, strikes, lock-outs and governmental interventions.
<table>
<thead>
<tr>
<th>Clauses</th>
<th>Umbrella Agreement 1</th>
<th>Umbrella Agreement 2</th>
<th>Umbrella Agreement 3</th>
<th>Umbrella Agreement 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ChemCo &amp; Service Provider SP</td>
<td>Insurance &amp; Danison</td>
<td>Metro &amp; FMCG Manufacturer</td>
<td>Bavaria &amp; Biochemical</td>
</tr>
<tr>
<td>Product range/Services</td>
<td>Business technology Management Consulting</td>
<td>Financial services</td>
<td>Consumer Products</td>
<td>Microbiological test of consumer products</td>
</tr>
<tr>
<td>Exclusivity</td>
<td>ChemCo has the right obtain competitive offers at any time</td>
<td>Danison has the right to obtain competitive offers at any time</td>
<td>No Exclusivity. Unless otherwise agreed, terms and conditions are valid for all future contracts</td>
<td>No Exclusivity Unless otherwise agreed, terms and conditions apply for all future transactions</td>
</tr>
<tr>
<td>Information/Notification</td>
<td>Mutual notification regarding all investment/development projects involving BBS</td>
<td>A 12 month timing plan Key dates throughout the year Division of responsibilities</td>
<td>Notification regarding product damages need to be made within 2 weeks. Perishable products can be destroyed at the supplier’s cost.</td>
<td>Immediate notification of test results (within 24 hours). Bavaria receives the complete set of raw data.</td>
</tr>
<tr>
<td>Subcontracting</td>
<td>Possible only upon consent</td>
<td>Possible</td>
<td>Possible upon consent</td>
<td>Not Possible</td>
</tr>
<tr>
<td>Assignment</td>
<td>All requests in writing Verbal requests will be confirmed in writing</td>
<td>Communication plan seeking to inform current and new employees about the existence of plan and boost membership</td>
<td>All requests in writing Verbal requests will be confirmed in writing.</td>
<td>All requests in writing</td>
</tr>
<tr>
<td>Volume/Price</td>
<td>To be agreed</td>
<td>To be agreed</td>
<td>To be agreed</td>
<td>To be agreed</td>
</tr>
<tr>
<td>Invoicing</td>
<td>Unless otherwise agreed, on a monthly basis. If there is no objection in writing within 6 months, invoices will be considered approved.</td>
<td>To be agreed</td>
<td>Payment in 60 days Delivery cost is paid by the supplier (Delivered Duty Paid). Electronic data Interchange (SEDAS/EANCOM)</td>
<td>Delivery cost is paid by Bavaria.</td>
</tr>
<tr>
<td>Re-negotiation</td>
<td>Unless negotiation is requested in writing by one of the parties 3 months before, prices are valid until 31.12.</td>
<td>Based on shared experiences and learning</td>
<td>Annual re-negotiation</td>
<td>Re-negotiation possible at any time</td>
</tr>
<tr>
<td>Force Majeure</td>
<td>Parties bear no liability for damages occurred as a result of war, political unrest, strikes, lock-outs and governmental interventions. Parties will contact each other immediately in case of obstacles and will negotiate the steps to be taken</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Guarantee/ Liability</td>
<td>Performance will follow according to agreement, statutory regulation, generally accepted</td>
<td>Informal agreement No legal enforcement</td>
<td>Does not apply</td>
<td>Does not apply</td>
</tr>
<tr>
<td>Standards and agreed deadlines</td>
<td>24 months guaranty after performance of service</td>
<td>The obligation to remedy deficiencies apply also to services obtained from subcontractors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-----------------------------------------------</td>
<td>-------------------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secrecy</td>
<td>All information is confidential and not to be available to third parties without written consent of the other party. This obligation continues for further 5 years after expire of the agreement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property rights</td>
<td>All material, charts, models and e-files will become property of ChemCo. BBS inventions are a property of BBS. An offer will immediately be made for their transfer to ChemCo. Acceptance no later than 3 months</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transfer of property rights has not been agreed</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transfer of property rights on goods delivered is concluded with the payment. Supplier ensures that no third person has obtained property rights</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>No transfer of property rights</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does not apply</td>
<td>All information is confidential and not to be available to third parties without written consent of the other party.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All information is confidential and not to be available to third parties. This obligation continues after expire of the agreement.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saving Clause</td>
<td>Unless it is of major importance, invalidity of one or more clauses will not have any effect on the agreement as a whole</td>
<td>No</td>
<td>Unless otherwise agreed, terms and conditions apply.</td>
<td>In case that single clauses are invalid both parties will replace them accordingly</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Legal venue</td>
<td>Germany</td>
<td>England</td>
<td>Germany</td>
<td>Germany</td>
</tr>
<tr>
<td>Amendments/Addition/In writing</td>
<td>In writing</td>
<td>In writing</td>
<td>In writing</td>
<td>In writing</td>
</tr>
<tr>
<td>Duration/Termination</td>
<td>Unless otherwise agreed at the termination at the end of a calendar year, giving one year prior notice. Each party has the right to terminate the agreement immediately with regard to a particular type of services if the other party contravenes important provisions</td>
<td>Beginning of a long-term servicing arrangement.</td>
<td>Indefinite agreement. The supplier has the obligation to revoke any orders in writing which she wishes not to accept. Otherwise, the contract is concluded with the retailer’s order.</td>
<td>Indefinite agreement. It is agreed a 6 months period of notice.</td>
</tr>
</tbody>
</table>
ANALYSIS OF THE AGREEMENTS

The four agreements are further analysed in Table Two. Here, the agreements have been examined within a framework relating to some commonly accepted characteristics of interaction in business relationships (Ford, Hakansson and Johanson, 1986, Hakansson and Ford, 2002). This analysis demonstrates how umbrella agreements can be seen as attempts to cope with the reality of these relationships and to provide a framework for future exchanges (Crone, 1993).

Time

Business is not a collection of isolated, non-related transactions. Instead, business takes place within continuing relationships where current interaction is affected by the respective perceptions of the participants of their previous interactions and by their expectations of the future. Relationships between companies are frequently long term (Ford 1978). But even in this case, “relationship time” does not appear as a linear process but as recursive practice. Habits and institutionalized forms of interaction, such as periodic business or task reviews, annual negotiations and conventional contracts are manifestations of recursive time. However, companies’ time perspectives are often not aligned, even though interaction schedules may indicate that they are (Mannix, Tinsley, and Bazerman, 1995). The companies in a relationship may have different views on the length of their relationship, or on the speed in which it should develop, or indeed on how far it should develop. The umbrella agreements that we examined attempted to mirror this reality by providing the flexibility to accommodate differences in the attitudes of the participants towards the long-term future of a relationship. One way in which this was achieved by allowing important terms of exchanges, such as prices and volumes to be deferred for future agreement. By this time, the developing commitment of the two parties, demonstrated by the adaptations that they have made to accommodate each other, may facilitate agreement (See below).

Different Perspectives

A business relationship does not evolve according to the perspective, plans or preoccupations of either of the participants alone. A business relationship is beyond the control of either party and evolves according to the logic of the interaction that occurs between the participants (and others). Some of the companies in our sample were concerned with the transfer of property rights and confidentiality while others were more concerned with risk minimisation and warranties or force majeure. The umbrella agreements that we examined attempted to reflect and accommodate these varying perspectives, assessment criteria, sensitivities or priorities of the participants by drawing the “mental maps” of interacting parties. Companies in our sample generally had experience of each other before drawing up their umbrella agreements and this experience assisted in this process.

Distance

The significance of the many aspects of inter-organisational “distance” for business relationships has long been acknowledged (Johansson and Wiedersheim-Paul, 1975 and Ford 1978). This distance may show itself in differences in technology, culture, norms of business and interpersonal understanding. Umbrella agreements attempt to reduce the effects of the diversity of culture and technology and increase inter-personal understanding by making explicit the norms of conduct that are important to sustain continuing interaction (Feldman 1984). For example, in the umbrella agreements in our sample there was a variety of accepted norms regarding invoicing and terms of payment.

Network Context

No single business relationship exists in isolation from the other, direct relationships of the participants and other relationships elsewhere in the network in which they are not involved (Hakansson and Snehota 1995, Gnyawali and Madhavan, 2001). The umbrella agreements in our sample sought to regulate the multilateral connectivity of the companies by specifying the scope of business, geographical area, products or services and exchanges. This enabled
both companies to have a clear view of the place of the relationship within their separate portfolios of relationships and different network positions.

Commitment and Adaptation

The interplay between formal and informal adaptations in the building of commitment between the counterparts has long been acknowledged. It has also been pointed out that commitment in a relationship is likely to be restricted if participants operate only on the basis of a legal contract between the two companies (Sako, 1992).

Joint consent is key in maintaining a business agreement among parties. The underlying principle of joint consent is based on the experience that exchanges between companies which are not based on a jointly agreed action cannot be sustained (Raiffa, 1982; Sebenius 1992). Inevitably, the different perspectives of the two companies in an umbrella agreement limit the “jointness” of their views. However, the umbrella agreements provide for the companies to make explicit their respective positions and the extent of their commonality. They also enable the participants to “agree on what they can agree”, whilst postponing some contentious issues to a time when their growing experience of and commitment to each other will increase the probability of agreement. This reduces the problem of having to choose between the search for a “watertight” contract or blind faith!

Table 2: Umbrella Agreements as a Mirror of Business Interaction

<table>
<thead>
<tr>
<th>CONCEPTUAL DIMENSIONS OF RELATIONSHIPS</th>
<th>UMBRELLA AGREEMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time</td>
<td>Continuous assessment</td>
</tr>
<tr>
<td></td>
<td>Re-negotiation</td>
</tr>
<tr>
<td></td>
<td>Postponement and Flexibility</td>
</tr>
<tr>
<td>Different Perspectives</td>
<td>Clarify Business Assumptions,</td>
</tr>
<tr>
<td></td>
<td>Impressions, Sensitivities, Concerns and Priorities,</td>
</tr>
<tr>
<td>Distance</td>
<td>Establish Explicit Norms of Business as a Distance Reduction Mechanism</td>
</tr>
<tr>
<td>Network Context</td>
<td>Establish Scope of Business</td>
</tr>
<tr>
<td></td>
<td>Regulation Exclusivity, Formalise Information Flow, Notification Processes and Property Rights</td>
</tr>
<tr>
<td>Commitment and Adaptation</td>
<td>Provide for Relationships to Develop whilst Learning, Commitment and Trust Develop through Successive Adaptations. Avoidance of Relationship Inhibiting Explicit Contracts</td>
</tr>
</tbody>
</table>

What do Managers think about umbrella agreements?

Managers consider umbrella agreements as particularly useful if products or services are ordered regularly from a supplier, or sold regularly to a customer. The parties to such an umbrella agreement are not required to specify new terms in their future transactions nor are they required to refer to the pre-existence of a conventional contract. The advantage for buyers is that if they need a particular product or service, they only need to specify the quantity or arrange continuous stock replenishment. However, it should be noted that the
customer has no obligation to buy a specified amount of goods within an umbrella agreement. However, the customer (e.g. a grocery retail chain) has prior agreed with the supplier (e.g. a consumer goods manufacturer) that successive orders will be met, if not otherwise agreed. If circumstances for either contracting party change, then re-negotiation of the umbrella agreement will occur. The advantage for suppliers is that they invariably gain a substantial source of incremental business and that they only need to deliver according to the needs of their customers.

It was clear in the research that managers consider umbrella agreements as a strategic tool that facilitates the whole process of business interaction and reduces the costs in terms of time and effort to select, manage and oversee single transactions. Thus they think that umbrella agreements set the ground for an on-going interaction among business actors. Managers who draft umbrella agreements are not concerned with the specification of quantities or delivery terms of one particular transaction. Instead, they are concerned with normative aspects such as confidentiality or exclusivity of exchange relationships and they translate the consequences of fulfilling or breaching the exchange promises by specifying incentives and sanctions. For this reason, managers do not consider umbrella agreements to be appropriate for new or untested relationships. Instead, managers decide to draft umbrella agreements in regular and stable business relationships (Crone, 1993), such as established manufacturer-retailer relationships, manufacturer-supplier relationships, agency relationships (e.g. service providers in technology, advertising, consulting or finance) and in business-to-business co-operations or strategic alliances (Doz and Hamel, 1998), as well as long-term investments and banking.

CONCLUSION

Umbrella agreements have been embraced by companies in a variety of industries such as consumer goods, retail business, business and financial services because they simplify and facilitate the complex process of business interaction. Companies retreat from inflexible contractual arrangements and arrange umbrella agreements to achieve improved interaction with each other. The current study reveals that parties to an umbrella agreement are better able to maximise their joint gains by creating a framework for on-going negotiation and exchange.

There are three important lessons to be learned from this research. Firstly, many contemporary business practices have evolved over time due to implicit norms in common usage. Business often relied on generally accepted norms of how to do business. Norms are important because they create a structure for interaction and guide the conclusion of exchanges. The present study demonstrates that umbrella agreements between companies transform implicit norms which are embedded in customs and business practices into explicit, basic norms for interaction. The implication of this for managers is that companies need to draft their umbrella agreements in such a way that their expectations are manifested with certainty and predictability and that they include mechanisms for re-negotiation. One route for determining the appropriate content of an umbrella agreement is to apply a form of backward recursion (Schwartz, 1992). Companies need to hypothesize a re-negotiation stage and they need to ask how the initial terms will impact on renegotiation; then they need to return to their umbrella agreement and draft terms which are ‘renegotiation proof’. This is, in fact, an interaction process by which companies, with different backgrounds and different interests, seek to do better through a jointly agreed exchange. Failure to interact in this way may replicate the experience that was gained in the case Baird versus Marks and Spencer.

Second, while contracts made by companies may limit their ability to change, umbrella agreements ensure a balancing act between stability and change and solve the inherent conflict between conducting exchanges with certainty and retaining the ability to embrace business opportunities. The tension between certainty and flexibility is resolved by the operation of interaction rules, such as the inclusion of open terms regarding volume and prices.

Umbrella agreements lead to the essential question of how companies wish to interact with each other. This study indicates that related companies achieve much better co-ordination
when they are able to rely upon umbrella agreements which express a framework of mutually perceived expectations and shared appreciations.

The research reported in this article shows that umbrella agreements may serve to simplify relationships in a complex setting. This is likely to be of particular value to the stronger companies in asymmetrical relationships because they can dictate the inclusion of open terms and re-negotiation processes. Many umbrella agreements are self-enforcing because the stronger party is able to create efficient non-legal mechanisms for dealing with problems in such a way that they do not have to rely on legal enforcement. This is the case in many manufacturer-retailer agreements, manufacturer-supplier relationships or service-provider agreements. Further research in this area could increase our knowledge of the use of umbrella agreements in showery weather and would contribute to a better understanding of the complex process of business interaction.

References


