ECR and category management – supplier's and distributor's joint effort to understand the empowered customer

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Abstract (working paper)

In this paper the main focus is on understanding the importance of supplier – retailer partnerships as an enabling factor for the continued implementation of ECR ("Efficient Consumer Response") and category management. Based on this approach category management is seen as an opportunity to manage the relationship between customers, retailers and suppliers where all three parties interact and a win-win-win situation is obtained. The paper focuses also at analysing the impact of ECR and category management in the changed business environment in order to better understand the customer, who nowadays is accepted as an equally important actor in the distribution process. The customer is sometimes even seen as an empowered actor compared with the traditional players' suppliers and retailers.

One of the main goals of category management has been to call off the war between suppliers and retailers. However, the collaboration has become a clear obstacle for many companies. Organisational changes and collaborative partnerships are closely related to the phenomenon. By changing the organisational structure it has become possible to change unproductive historical boundaries. The change gives an opportunity and a challenge to create more open and trusting relationships. This study will therefore, emphasise that there is a correlation between companies' abilities to co-operate in the supply chain and in their success of implementing category management, and that category management is a phenomenon that has come to stay in business.

These assumptions have been analysed and measured on the basis of a qualitative study made in the Finnish grocery industry. Based on the study a model has been created, where co-operation structure development is linked to the category management structure development process. Another empirical study for analysing the co-operation development and category management potential within the pharmaceutical industry is made during the spring 2002.

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Introduction

The industrial market has been changing in many ways during the recent years. Effectiveness of business marketing has been largely determined by long term relationships between buyers and sellers (Dion et.al 1995). During the latest years there has been a consensus of that the nature of buyer –seller interactions has changed from adversarial to relationship building. (Kalafatis 2000:215) These changes in supply side are commonly referred to as a shift from purchasing to supply management (Gadde and Snehota 2000; Davis 1993). According to this perspective, competitive advantage no longer resides with a company's own capabilities, but rather with the relationships and linkages the firm can forge with external organisations (Gadde and Snehota 2000; Lewis 1995). The industrial market has been changing in ways that make distributor commitment both more important to suppliers and in some ways more difficult to achieve (Goodman and Dion 2001:288). According to Goodman and Dion (2001:288) the most relevant reason for changes have been that distributors have become stronger and bigger in size as mergers and acquisitions increase. Distributors have become more independent. Thus, manufacturers in the industrial marketplace must strive to enhance their understanding of the process by which distributor commitment is created and maintained (Morgan and Hunt 1994).

According to researchers (Kalafatis 2000:216, Metcalf et.al 1992, Sheth and Sharma 1997) forces behind the recent development have been e.g. pressures to meet the demands of global competition, reliance on single-source suppliers, the development and adoption of just-in-time systems, outsourcing and development of "partnerships". The acknowledged importance of channel intermediaries (i.e. wholesalers), and consequently, of supply chain management can be identified as two of the main drivers behind the formation of relationship based channel structures (Kalafatis 2000:216). Reflecting the relationship based channel structure an increased strategic attention has been given to benefits that can be gained from co-operation with suppliers (Gadde and Snehota 2000:305). In particular, partnering has been suggested to be the superior solution for making the most of supplier relationships (Gadde and Snehota 2000:305). In ECR and category management 'partnership' is one of the key issues that has nevertheless become a quite difficult matter to handle for companies. The meaning of the word is not clear in the context and therefore in many cases companies concentrate on other tasks that are more easily implemented.

In this paper the main focus is on understanding the importance of supplier – retailer partnerships as an enabling factor for the implementation of ECR and category management. Developing partnerships with suppliers is however resource-intensive and can be justified only when the costs of extended involvement are exceeded by relationship benefits (Gadde and Snehota 2000: 305). Category management is an opportunity to manage the relationship between suppliers and retailers, and also customers, where all three parties can interact and a win-win-win situation is obtained. Earlier research reflects though that a company can be highly involved with only a limited number of suppliers and that a company needs to have a variety of relationships – each providing different benefits (Gadde and Snehota 2000: 305). In other words, partnership in ECR and category management perspective should be analysed from a broader perspective. Business relationships will develop in different pace and they have different characters. The core is to understand that the capacity to cope with a variety of relationships in a differentiated way has a profound impact on performance (Gadde and Snehota 2000:305). The focus in this study is, thus, to look at ECR and category management from a relationship development perspective. It is an asset for a company to have a variety of relationships. ECR and category management are part of the strategic change in the business environment nowadays (see Araujo and Mouzas 1997). If ECR in the beginning of its development was in conflict with many existing practices (Araujo and Mouzas 1997:23-24) the situation a few of years later is somewhat different. The difficulties in the late 90's, e.g. technological and political, seem to be over and ECR and category management have established their place in business networks. These concepts enable better understanding of the customer, who nowadays is an equally important actor in the distribution process. The customer is sometimes even seen as an empowered actor compared with the traditional players suppliers and retailers. ECR and category management can hence be seen as supplier's and distributor's joint effort to understand the empowered customer.

ECR, category management and business relationships

ECR (Efficient Consumer Response) is a combination of co-ordinated logistics, electronic databases and systems, and marketing decisions, all based on the supply chain management. ECR strategies' overall aim is to reduce the overall costs, which is an important issue in the supply chain management. (Qureshi and Baker 1996) Of the many different areas the ECR concept covers, category management is focused on creating product categories and through new insights of customer thinking, adopting the customer's perspective into the business. (See e.g. Dussart 1998, Nielsen 1992) One could say that category management is the starting point for the strategic business thinking of ECR, because it brings together many parts of ECR to ensure that customer's perspective and needs are in focus.

One of the main goals of category management has been to call off the war between suppliers and retailers. The definition of category management states that retailers and suppliers work together for mutual benefit. Earlier recommendations of arm's length relationships to suppliers have been replaced by an emphasis on the benefits that can be reaped from close relationships (Gadde and Snehota 2000; Carlisle and Parker 1989). Co-operative arrangements between companies range along a continuum from weak and distant to strong and close (Kanter 1994:98). Value-chain partnerships are according to Kanter (1994:98) the strongest and closest collaborations of relationships. Different parts in a supply chain start to co-operate in order to offer more value for the end-users. Commitment or involvement (Gadde and Snehota 2000) in those relationships tend to be high, the partners tend to develop joint activities in many functions, operations often overlap, and the relationships thus creates substantial change within each partner's organisation (Kanter 1994:98).

There are also business relationships that involve only a low level of interaction but no doubt, they are also important in their own way. Relationships also vary as they evolve over time. Relationships (Ford et.al. 1998:8) always exist between all suppliers and their customers in business markets, whether or not those relationships are close, complex, productive, troublesome, calm or stormy. A relationship is always built of choices that we make. Relationship management can in many cases be compared to portfolio management (see e.g. Bensaou 1999, 1997, Ford et.al.1998:12-13). Companies need both high- and low-involvement relationships, in part because differing degrees of involvement lead to different costs and benefits, in part because the resources that can be dedicated to management of supplier relationships are limited (Gadde and Snehota 2000:310). Different customers have different needs and the strategic decisions will affect them all.

A review of the current literature reveals a general consensus on the importance and merits of "partnership posture" in supplier relationships (Gadde and Snehota 200:309). However, partnership seems to be a problem for many companies. At the same time as it has been emphasised as a main source for future competitive advantage, feelings and confusion has been voiced about what exactly a partnership is (Gadde and Snehota 2000; Sheth and Sharma 1997). Partnership is an important strategic element in the ECR and category management literature but the content of it is however somewhat unclear in the context. Very often partnership is defined as a "close" relationship where parties want to co-operate and work together not only for the profit but also for getting something more, that they could not get otherwise. Gadde and Snehota (2000) argue that also the word ‘close’ is too vague in explaining the meaning of partnership. If partnership is defined as ‘closeness’, which according to Ford et.al (1998) is the degree of interaction between buying and selling company, we may come closer to a clarifying explanation. According to Bensaou (1999) the extent of integration between customer and supplier, expressed in terms of the specific investments made by either partner, has a clear impact on the performance of the relationship. (See also Gadde and Snehota 2000) By focusing on integration Gadde and Snehota (2000:309) have distinguished three dimensions of involvement in that affect outcomes in supplier relationships: Co-ordination of activities; adaptations of resources; and interaction among individuals.

Category management as part of the wider frame of ECR is a supplier’s and distributor’s joint effort to understand the empowered customer. In order to succeed in the task, a strong commitment and involvement of parties in the relationships is needed. Category management is built on the company’s relationships and therefore dependent on the development of the relationships. The three dimensions of involvement are very describing when analysing companies in the category management processes. First, the activities carried out by both supplier and retailer are co-ordinated, where after the resources are measured and adapted into each others systems. High involvement will lead to close interaction among individuals in the organisations. The choices, that are made, are interdependent and affect both commitment and trust in the relationship, which in turn impacts on co-ordination and adaptations (Gadde and Snehota 200:309). The problem of category management theory and implementation is what Gadde and Snehota (2000) have argued to be the practice: supplier relationships are often oversimplified. Oversimplifying the issues involved and overlooking the variety of relationships, and in the worst case following them blindly, may be bad for practice. (Gadde and Snehota 2000) Category management offers an oversimplified model of a business process and in many cases the results of following it blindly have been bad. The process model emphasises heavily the technological solutions and integration whereas relationship development is bypassed. Category management literature emphasises also that "partnering" with only one manufacturer is the most effective way to manage a category. (Nielsen, 1992)

Based on the recent studies within the field of supplier relationships, I argue that these earlier recommendations for successful category management partnering can be forgotten. I argue that the variety of different relationships on different involvement levels is positive also for companies implementing ECR and category management. After all, ECR and category management are not new phenomena within the industrial markets, in contrary they have gained a stable position in the strategic planning. Following the line of Gadde and Snehota (2000:311-312) there is an increasing awareness of the need to differentiate the approach to supplier relationships, which is in contrast with generalised recommendations to pursue the partnership posture. I believe that the differentiation perspective and relationship development in general would the best angle for supplier's and distributor's to succeed in implementing the category management and ECR.

The model for the development of business relationships

The assumptions presented have been analysed and measured on the basis of a qualitative study made in the Finnish grocery industry. In order to investigate the impact of relationship development and management to success in category management implementation, a qualitative study was conducted within the Finnish grocery industry. In all, three major suppliers and three major retailers were interviewed. Based on the results of the study a model has been created, where buyer-seller development model by Ford et.al 1998 is linked to the category management development process. Another empirical study for analysing the relationship development perspective in relation to Category Management potential has been conducted within the pharmaceutical industry during spring 2002.

The model of development of buyer –seller relationships in business markets (see Ford et.al. 1998:29) is a general illustration of how the evolving of business relationships usually occurs. The model presents four different stages that companies in developing their relationships go through: the pre-relationship stage with high inertia, the exploratory stage, the development stage and the stable stage. It reflects the variety of relationships that are partially due to the different requirements, uncertainties and abilities of the companies in a relationship. (Ford et.al 1998) Each process is though an individual development process and therefore, an ideal state is not realistic to presume to exist. By combining this four-stage development model with category management process model, the purpose was to emphasise the correlation between companies' abilities to co-operate in the supply chain and in their success of implementing category management.

Results

The concepts of learning, investments, adaptations, trust, commitment, and distance are emphasised in the developing process developed by Ford et.al (1998). Many other researchers' have discussed these concepts as well and their evident existence in relationships has been acknowledged. However, if some of the concepts are lacking it is also evident. On the basis of the results from the first study within the grocery industry, a clear correlation between companies' abilities to co-operate in the supply chain and in their success of implementing category management could be found. Basically, the companies could be divided into three categories, those who had succeeded well, those who were working to get better results and those who were disappointed with category management and their business partners. Companies who had traditionally been investing in their relationships and generated a relationship management concept, had also had less negative experiences of the category management. These companies had varying portfolios of relationships from very high to low involvement. They seemed to know their business partners well, and knew were to invest in the relationships. They also had strong commitment to their joint goals in the relationships. Companies that were still working for results showed signs of power use in the relationships. They liked to refer to the size of their company and that they therefore were to be the leaders also in category management. They also showed less interest to their partners and were not willing to develop and invest in relationships in the same scale as the companies in the first category. Companies in the last category were in general disappointed with the category management process. They had not succeeded in implementing it either because of the scarse resources or because of clear lack of trust to partner companies.

The preliminary results from the first study support the assumption of relationship investment and management being a supportive factor for category management implementation. In general, it also proved that category management is a phenomenon that has come to stay in the grocery industry. For those who had succeeded in implementing category management it had given more insight to both partners' business and to the end-consumer's needs.

The second study was intentionally conducted within the pharmaceutical industry in Finland, which has traditionally been a very conservative industry. Although it is too early to give any certain answers, I believe that there are also clear differences in relationship development between different industries. The grocery industry in Finland has had to develop its structure and strategy in the hard international competition, whereas pharmaceutical side has been living a quiet and sheltered life within a state regulated market without the same pressures.

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