Over before it began: How conflicting actor perceptions hinder performance-based contract initiation in service triads

Type: Work-in-progress

INTRODUCTION

Performance-based contracting (PBC) has received increased attention in the academic and business literature as a strategic approach to foster long-term value co-creation and innovation in supplier-buyer relationships in B2B markets (Selviaridis & Wynstra, 2015; Essig, et al., 2016). In general, PBC refers to long-term contractual approaches that aim to deliver specific outcomes instead of individual products and services, and, where payment schedules are tied to realized milestone outcomes (Mouzas, 2016). While PBC should provide a strategically aligned and mutually beneficial arrangement for both suppliers and buyers, several studies indicate that in practice, such contracts are often fraught with barriers and tensions that can hinder or completely halt their implementation (e.g., Töytäri et al., 2015; Liinamaa et al., 2016).

While prior research has explored PBC in buyer-supplier relationships, there has been an overwhelming focus at the dyadic level (e.g., Lewis & Roehrich, 2009; Selviaridis & Norrman, 2014; Essig et al., 2016). Yet, in the contemporary B2B markets, PBCs are increasingly implemented in settings that include service triads (c.f., Wynstra, et al., 2015), where three actors are involved in the PBC (Tate et al., 2010; van der Valk, & Iwaarden, 2011; Howard et al., 2016). Initiating and implementing PBC in triadic relationships requires broader understanding of the dynamics between multiple actors, who may have different perceptions of the goals, benefits, and potential risks related to the PBC. Indeed, highlighting the need for more research in this area, recent studies have called for "richer depiction of relational dynamics in PBC where interactions take place among three critical players" (Howard et al., 2016, p. 65), and underlined empirical analyses of PBC in service triads as a priority research area (Wynstra et al., 2015; Essig et al., 2016; Uenk, & Telgen, 2018).

Therefore, the purpose of this study is to explore how different actors in service triads perceive PBCs, and why conflicting perceptions may emerge between different actors. We do this by integrating theoretical insights from PBC and service triad literature with empirical insights from a single and embedded case study (Yin, 2016) that involves qualitative interviews (n=25) with representatives from a service triad in the forest and paper manufacturing industry.

The findings from this study reveal several sources of conflicting actor perceptions, including exchange focus, innovation capability, value sharing logic, relationship approach, risk perception, and sourcing approach, that impede the initiation and implementation of PBC in service triads. Based on the findings, this study develops an empirically grounded conceptual framework that illustrates how and why conflicting actor perceptions emerge in service triads that utilize PBC. Overall, this study contributes to current priority areas in industrial marketing and purchasing research (Wynstra et al., 2015; Essig et al., 2016) where new theoretical insights on PBC in service triads are necessary (Uenk & Telgen, 2018). For managers in both buyer and supplier companies, this study offers important insights that can facilitate the implementation of PBC in service triads.

CONCEPTUAL BACKGROUND

Performance-based contracting: Benefits, challenges, and barriers

PBC has been discussed in several research streams and across many sectors (for reviews, see Selviaridis & Wynstra, 2015 and Essig et al., 2016). While this has resulted in many different definitions and terminologies for PBCs, they are all built around the core idea of exchanging and paying for performance outcomes instead of individual products and services (Randall et al., 2015; Visnjic et al., 2017). For suppliers, PCB offers a route to higher margins, steadier revenues, more intimate customer relationships, bigger share of customer´s business, and potential for locking out competitors (Kleemann, & Essig, 2013; Visnjc et al., 2017). For buyers, PBC offers a way to transfer risk, reduce tied capital, access supplier´s expertise, and increase reliability, efficiency, and easy-of-use (Hypko et al., 2010b; Sumo et al., 2016). In addition, collaborative PBCs are often implied to deliver additional benefits to value chains, networks, and broader social systems, such as decreased life-cycle costs, improved resource usage, and optimized system performance (Randall et al., 2015). Yet, despite the wide-ranging benefits that PBCs can deliver, many firms find them highly challenging and problematic to implement (Hypko et al., 2010b; Töytäri et al., 2015; Liinamaa et al. 2016).

Typically, the key issues related to implementing PBCs relate to matching and aligning partners´ expectation and goals (Selviaridis & Norrman, 2015), specifying performance elements and contract details (Glas & Kleemann 2017), evaluating realized outcomes and appropriate pricing mechanism (Vitasek, Ledyard & Manrodt, 2010) and sharing the perceived risk and realized benefits (Liinamaa et al., 2017). While the barriers and challenges related to implementing PBC have been examined in different contexts, most of the extant studies have focused on dyadic relationships, with an emphasis on the supplier perspective (Essig et al., 2016). Whilst insightful, these studies provide relatively narrow, if not restricted picture of the actor perceptions and relational dynamics that may impede the implementation of PBC in relationships that involve more than two actors (Howard et al., 2016).

Performance-based contracting in service triads

Commercial exchanges in B2B markets are increasingly taking place in service triads, where a professional buying organization contracts a supplier to deliver a service to an end user, which can be internal or external to the buyer (Wynstra et al., 2015; Vedel et al., 2016). In such settings, the relational dynamics are likely to be more complex than in supplier-customer dyads, as they are perceived and negotiated between multiple actors with different agendas (Uenk & Telgen, 2018). This is especially critical issue in strategic and high-value relationships, such as PBCs, where misaligned perceptions between either the internal members of the buying organization (Pinnington et al., 2016) or members of the buying and supplying organizations (Töytäri et al., 2015) can be a key reason to relational failures.

Service triads can have many structures, but they are usually considered in terms of open vs. closed and supplier- or buyer-initiated triads (Wynstra et al., 2015; Vedel et al., 2016). Furthermore, buyer-initiated triads can be either external, where the end customer resides outside the buyer´s organization, or internal, where the end customer resides inside the buyer´s organization (Tate et al., 2010; van der Valk, & Iwaarden, 2011). The few studies that examine PBC in service triads tend to focus on external triads in public procurement context (van der Valk, & Iwaarden, 2011; Caldwell & Howard, 2014; Howard et al., 2016; Uenk & Telgen, 2018). However, public procurement has different characteristics and contractual obligation

than commercial B2B procurement (Caldwell et al., 2009; Josephson et al., 2018), and external triads no not reveal in detail what and how specific tensions and dynamics inside buyer organizations can handicap PBC negotiations with supplier organizations (c.f., Pinnington et al., 2016). As a notable exception, the study by Tate et al. (2010) explores goal conflicts between actors in an internal service triad, but their focus is on purchasing marketing services and relatively general relationship management conflicts instead of conflicts and subsequent barriers related to PBC specifically.

RESEARCH DESIGN

Given that research on PBC in service triads is an emerging but underexplored phenomenon (Essig et al., 2016), we adopted a qualitative research strategy, and an abductive and embedded single case research design (Dubois & Gadde, 2002; Yin, 2016). The qualitative strategy is suitable for eliciting insights on actor perceptions in complex inter-organizational settings, while the embedded case design allows us to understand how individual and subjective perceptions are formed, negotiated, and accumulated in multi-actor settings (Järvensivu & Törnroos, 2010). The use of abductive approach allows us to build on the emerging insights in the current literature, and extend earlier theories based on empirical field observations (Dubois & Gadde, 2014).

We used theoretical and purposive sampling logic (Eisenhardt & Graebner, 2007; Patton, 2015) to identify a focal buyer organization who operated in a capital-intensive forest and paper manufacturing industry, and was in the early stages of making a strategic and organization-wide transition towards PBC. The embedded single case design in this study is centered on a *closed and internal service triad* (Vedel et al., 2016), which is focused on paper machine clothing (PMC) purchasing category, and involves the central purchasing department from the buyer, their internal client (eight mills), and three alternative suppliers. The unit of analysis in this study is an individual actor in the service triad.

Data collection and analysis

We conducted altogether 25 individual interviews, including seven interviews with the purchasing department, eleven interviews with eight different mills, and seven interviews with three different suppliers. All the interviews were semi-structured and utilized open-ended questions, which gave the informants freedom to raise emerging issues, and researchers the possibility to probe naturally occurring data (Creswell, 2013). The thematic interview guide focused on how and why (i.e., motivations, criteria) actors adopted or offered PBCs, and what kinds of benefits and costs they expected and perceived related to the purchase, implementation, and management of PBCs. The interviews lasted on between 57 and 115 minutes, and were recorded and subsequently transcribed in verbatim.

We employed abductive and thematic coding protocol to analyze the data findings (Dubois & Gadde, 2002). Our goal was to capture the actor-specific expectations and perceptions of PBCs in the triadic relationships. We followed the principles of abductive analysis and systematic combining (Dubois & Gadde, 2014), and compared the insights from prior literature to emerging themes in the field data iteratively throughout the study. This allowed us to identify, match, and revise the differences between existing literature and field observations.

In the first stage of analysis, we relied on data-driven coding and actor-specific analysis, and focused on capturing a wide range of different perceptions (broadly in terms of expectations, goals, benefits, challenges, and risks) that each actor had of PBC. In the second stage, we grouped the identified perceptions into emerging categories, and compared these between actors and against the extant literature. In the third stage, we used selective coding, and focused on uncovering why and how actors' perceptions of specific categories diverged.

WORK-IN-PROGRESS FINDINGS

In this section, we report the findings of the study. Based on the empirical fieldwork and preliminary data analysis, we identified six categories (exchange focus, innovation capability, value sharing logic, relationship approach, risk perception, and sourcing approach) of actor perceptions related to PBC that seemed to conflict between at least two members of the service triad, thus hindering the PBC initiation. Given the space limitations and the work-in-progress state of this study, we provide a summary of our findings with illustrative quotations in the Table 2, and subsequently discuss the preliminary implications to theory and practice.

Table 1. Summary of the key actor perceptions related to PBC in the service triad.

Categories	Central purchasing department	Mill(s)	Supplier(s)
Exchange focus	• **Price reduction** • **Cost minimization** "We want to change to pricing model more favorable to us… that we would pay less, or maybe nothing up-front" (CP1) "We do this [PBC] to get better prices on the table in the future." (CP1) We are doing PBC to have our cost under control. "(CP3)	• **Improved production efficiency** • **Better price-quality ratio** "From user´s perspective, the pricing is not that important; the technical functionality is the number one thing." (M7) "If the price would be based on euros per ton, the suppliers would think more of our production efficiency and production capability, and we would get more tons out of it." (M8)	• **Improved pricing power** • **Increased customer share** "We want to be better than the competitors and PBC is a s way to get better prices on our products" (S6) "For us, PBC offers a change to obtain a larger contractual package, and we might get allocated larger volumes as a single supplier." (S3)
Innovation capability	• **Wants to rethink strategic sourcing** • **Seeks radical innovations** "We want to the change this concept so that we would not purchase individual items anymore, but we want to purchase production with that item. And to get there, we need to change the whole logic in this arrangement" (CP1) "Suppliers think that they are innovative…but it is not necessarily as radical as we want … they have more like small jumps, whereas we need to turn the whole market upside-down" (CP7)	• **Low/no tolerance for major changes** • **Limited resources to pilot new solutions** "We have been a bit allergic to the suppliers proposals to move towards PBC … There has been no pressing reason for us to do it, and it would require more work and resources from us." (M8) "Suppliers are usually very eager to discuss new [PBC]models … but we just don´t have the time or resources to test new products or technologies." (M11)	• **Willing to innovate with customers** • **Sees mills as barriers for innovation** "Our goal is to develop innovations and break traditions. If we know that we have the experience and skills to do something what the customer can´t do, we try to actively bring that up and improve their performance". (S7) "I think cost-per-ton pricing is a good thing, and we have nothing against pilot runs or innovating new approaches with our customers **…** But the mills don´t want to do it … for them this is difficult and extra work to monitor." (S1)
Value sharing logic	• **Unwilling to share benefits** • **Dominant partner approach** "Our principle is that if something is modified and cost savings occur, all the money will be ours. Nothing is given to the suppliers!" (CP1) "We try to get rid of the idea that we should give the supplier something. Our principle is that if we tune something and make savings, then everything stays in our own pocket. Nothing is given to the supplier". (CP1) "Our organization wants to benefit more from PBC: I strongly believe that central purchasing´s goal is that they get the benefits, not necessarily the suppliers." (M7)	• **Willing to share benefits** • **Equal partners approach** "If the supplier is ready to invest more to develop the functionality of the line, or improving other areas that might not be even related to the performance of their fabric, then we are open to increase their carrot in the that contract." (M2) "The pricing for BPC should be done so that there would be incentives for both …to improve the current situation we should calculate what benefits there potentially could be available for both parties." (M3).	• **Willing to accept risks to share benefits** • **Fair and balanced approach** "I don´t know if there is any risk in PBC for them. If the machine does not run, or production is lower, they pay less … and if the tonnage is higher, the supplier would get their share, but only after the customer has received something better. (S3) "In general, both would benefit from PBC if the contract is not only squeezing out the supplier … and if this is a fair discussion, they would allow some benefits for the supplier as well, who is giving a lot of knowledge and resources away which could be used in other accounts too." (S5)

Relationship dynamics/ approach	• **Leverages purchasing power to enforce favorable contract conditions** • **Unwilling to negotiate contract terms** "We have discussed PBC with suppliers, and we have told them that whether you want this or not, we will do it. And we are using out purchasing power ruthlessly to our advantage …. We don´t ask whether you like it or not. We say how it goes." (CP1) "From their point of view, it's not an open discussion … There was never a common approach to say, let's sit together, where do you see from your side potential to improve". (S6) "They are inflexible when it comes to negotiations … When they ask us to participate in PBC discussions, it is a rather one-way thing where they are trying to maximize their own benefits without giving the supplier a chance to make an OK deal also" (S5)	• **Flexible approach to negotiating** • **Open dialog & mutual discussion** "PBC is not that kind of purchasing where you just order the bearing, vent, or a pump from somewhere without seeing anybody and saying that this is what we want … this is a different, our process, products, or problems can change, and it is continuous dialog on how the fabric operates and behaves." (M8) " They fine-tune the fabrics to our machines and make sure the deliveries fit to our timetables … and we give them all the small but important information that are crucial for them to optimize the production … We have gentleman´s rules, otherwise this [PBC] would not work." (M6)	• **Feels "squeezed" by the buyer** • **Ready to downgrade/terminate the relationship if necessary** "They are using quite brutally their purchasing power … we feel that they dictate the terms, and this is where we are stuck because we believe that a fairer approach on their side would open up much more opportunities." (S5) "We have been told if we stay with these very small price increases, we will not be invited for negotiation. … in terms of lab reports or measurements, we could do much more, but if we are compared to suppliers who could do less, then we adapt our services to that level." (S6) "The prices are already at the level we can barely survive, and if they push them lower …then our company tells us that no way, this stops now, and we don´t sell to them anymore." (S2)
Risk perception	• **Fears that exclusive PBC alienates other suppliers** • **Relatively low perceived risk** "When you are doing these [PBC] contracts you are losing the contacts to other suppliers. They are not interested anymore to visit your mill, to do any service because they know there is a five-year deal in place." (CP2) "The monetary risk in this model [PBC] for us can be negative, but that is not worst case if we go in with trials. As long as we don´t start sacrificing supplier relationships … I don´t see that it would be very risky approach for us" (CP7)	• **Disruptions in production a key risk** • **Relatively high perceived risk** "What if we give the responsibility of one line´s performance to a single supplier, and then something happens and it does not work. We would lose a lot of production before we can change to another supplier. So production losses would be the key risk in that kind [PBC] arrangement." (M8) "Worst case scenario would be if the PBC would lead to higher prices or more costs to a production line, then we would end that quite fast." (M4)	• **Lack of clear and objective performance criteria a key risk** • **Relatively low perceived risk** "The biggest risk is that we have not fixed all the parameters which have a negative influence on the performance of our goods. And then you are penalized for something that you have no influence in. We are not worried if everything is fairly negotiated, but if we are judged on a performance that we have no influence on, then it is getting tricky." (S6)
Sourcing approach	• **Prefers multi-sourcing to maintain competition and pricing power** • **Fears that single-sourcing reduces access to innovations** "The supplier of would like to have the whole deliveries for this section. But we wouldn't like to go that way because we need some ideas from other suppliers too, and, also to choose over the best, pieces for each position, and then to, look if the other is better or not." (CP3) "We made them a cost-per-ton offer for a whole production line, but their purchasing did not accept it because they wanted more competition. They want to use several suppliers and not to rely only on one, to keep the competition on." (S1) "We wanted to try single-sourcing, but it got forbidden … it had too big influence on the sourcing´s ability to negotiate prices." (M9)	• **Mixed perceptions** • **Some mills prefer single sourcing for higher efficiency and less workload** • **Others prefer multi-sourcing to maintain competition** "When we had that TCO-contract with only one supplier, it was easier, and time management was more efficient, when we did not need to talk to several suppliers … they key problem with many suppliers is that they can always say that it was not my fault, it was the other suppliers." (M2) "Reducing the amount of suppliers could make sense … we could optimize the breaks and the pace of changing the machine clothing…But I am not very excited about a single supplier, because I see a lot of benefits having suppliers to compete against each other… But for the suppliers, to have PBC for a whole line would make it more efficient and easier to develop" (M8).	• **Prefers single-sourcing to be able to optimize customer´s performance** • **Fears that multi-sourcing makes managing and monitoring performance difficult** "There is a big risk for us, and hence there need to be very clear boundaries. And the only way PBC can really work, is that there is a single supplier who is responsible for everything. If there are several suppliers, then it turns very quickly into a blame game of whose fault it is when the machine is not running as well as it should." (S3) "You need one single supplier who is responsible for the whole line, and who manages it and the development work with the customers. If there are many partners doing the development, how do you ensure that the ideas are aligned? Or if something goes broke and the line is down, who gets penalized? (S3)

Note: CP1-7 = central purchasing informants, M1-11 = mill informants, S1-7 supplier informants

PRELIMINARY IMPLICATIONS AND CONCLUSIONS

Theoretical contributions

At a work-in-progress stage, this study makes three preliminary contributions to contemporary industrial marketing and purchasing literature, which has called for more empirical research on PBC in service triads (Wynstra et al., 2015; Essig et al., 2016). First, this study explores how different actors in service triads perceive PBCs, and why conflicting perceptions may emerge between different actors. While prior studies have examined potential barriers and conflicts for PBC, they have focused mostly on supplier-buyer dyads (Töytäri et al., 2015; Essig et al., 2016). This study complements this literature by examining PBC service triad, and illustrating

six different sources for conflicting actor perceptions, including exchange focus, innovation capability, value sharing logic, relationship approach, risk perception, and sourcing approach.

Second, while there is an emerging stream of research that examines service outsourcing in service triads (e.g., Howard et al., 2016; Uenk & Telgen, 2018), most of these studies are conducted in the public procurement context, where legislation and standardized service deliveries regulate many aspects of the potential exchange conditions. Furthermore, most of these studies focus on contract management and monitoring after contract implementation (Tate et a., 2010; van der Walk & Iwaarden, 2011). In contrast, this study is conducted in the private sector context and pre-contracting stage (Essig et al., 2016), and illustrates how non-regulated and commercial factors, such as exchange focus and value sharing logic, may emerge as major hindrances to PBC initiation and implementation, even in cases where all the triadic actors see value potential in the PBC.

Third, while most of the extant PBC studies have adopted a supplier-perspective (e.g., Liinamaa et al., 2016), this study adopts a buyer-perspective, thus balancing the view on PBC in the current literature. More specifically, this study shows how misalignments both within the buyer´s organization, as well as between different units of the buyer´s organization and the supplier organization can hinder the initiation of PBC. These findings complement earlier insights on internal misalignments in service outsourcing between marketing and supply management (Tate et a., 2010), and how misalignments and goal conflict in complex procurement situations can also occur between purchasing and operations.

Managerial implications

For managers in buyer and supplier organizations, this study offers important insights on how to facilitate PBC in service triads. Buyers can use these insights to identify key areas where they need to have internal alignment, or be willing to make adaptations to external exchange practices with suppliers to facilitate PBC. Sellers can use these insights to identify key areas that are likely to hinder PBC negotiations with customers, proactively mitigate them to garner support from different (customer) stakeholders, and/or segment potential PBC customers based on their willingness and/or ability to adapt current purchasing practices.

Limitations and avenues for future research

While our study offers important insights, it also has also limitations. First, it is at a work-in-progress state, and needs further theoretical and empirical elaboration. Second, it is focused on an internal service triad in the forest and paper manufacturing industry. Examining and contrasting both internal and external service triads in other industries might reveal additional based for conflicting actor perceptions. Third, this study is focused on conflicting actor perceptions that manifest in the pre-contracting stage, but future research could contrast already implemented and successful PBCs to rejected PBCs, and compare how specific conflicts were mitigated, or what are the potential thresholds in terms of specific perceptions after which PBCs become unattractive to different stakeholders.

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