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COMPETITIVE PAPER

Strategy As The Management Of Adaptation

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Abstract

Adaptation of company activities is a phenomenon which pervades businesses at multiple levels and is central to organisational success. Although it is important to a company's performance and it has featured heavily in academic literature, a clear and integrative understanding is lacking. This paper draws from existing corporate, marketing and relationship strategy literature and data drawn from primary research in order to develop a more integrative understanding of the characteristics and significance of adaptation. In doing so we consider strategy and adaptation both in terms of content and process. Of particular interest to us is the connection between adaptation at the supplier-customer relationship, marketing and business strategy levels.

Strategy as the Management of Adaptation

Introduction

“Strategy is the matching of the activities of an organisation to the environment in which it operates and to its own resource capabilities” (Johnson and Scholes, 1988). Such matching inevitably entails adaptation of those activities, something which can be formally planned or might emerge as firms learn about specific features of the environmental conditions under which they operate. Adaptation of firm activities or behaviour is a phenomenon which pervades organisations at multiple levels, at the corporate, functional and relationship level and as a concept it features in corporate, marketing and relationship strategy literature. In spite of its apparent importance to organisational success and its prominence in academic literature, a clear and integrated understanding of adaptation has yet to be developed. This article addresses this omission and develops a more integrative understanding of adaptation by

- drawing from existing literature on adaptation
- using data from case study- based research conducted on adaptation in supplier-customer relationships in the IT and telecommunications industries, in order to
- make clearer the connection between the adaptation process at the supplier-customer relationship, marketing and business strategy levels.

THE NATURE OF ADAPTATION

Strategy and adaptation *content*

Strategy can be viewed from two perspectives, namely *process* i.e. the *manner* in which the strategy is arrived at and *content* i.e. the *output* of the process (de Wit and Meyer, 1994). A central issue shaping strategy content is the extent to which a firm should adapt elements of its strategy “as a result of aligning organisational capabilities with environmental contingencies” (Hrebiniak and Joyce, 1984). Associated with strategy content is the debate on whether it should be derived as a result of a firm primarily adapting to conditions of the external environment (competitive positioning) or proactively seeking out markets which suit its own internal resources (resource-based approach). This dichotomy is an over-simplification since some adjustment to the way

that a firm's resources are used in order to realise long term objectives is inevitable. Indeed it could be argued that what is more important as far as an organisation's strategy is concerned is its degree of coherence with external market conditions and compatibility with internal resources and capabilities (Turnbull and Valla 1986). As figure 1 shows, strategy content at the business level is guided by, and informs, the actions and decisions at the functional level (including marketing), and in many business markets, at the level of individual key customer accounts. The distinction between marketing strategy designed to target groups of customers and relationship strategies to deal with individual customers is a key factor for companies in business markets. Whilst organisations operating in consumer markets might successfully implement marketing strategies to cater for groups of consumers with similar characteristics, the grouping and targeting of customers based on a limited number of macro-segmentation variables can be inadequate in business markets. The role and importance of some customers means that a supplier would typically formulate strategies specifically to deal with key exchange relationships, with key "micro-segments" (Turnbull and Valla 1986).

In business markets, companies typically deal with a limited number of suppliers, competitors and customers. Repeated exchanges with these parties result in the development of relationships and the linking of activities and resources between partners (Håkansson and Snehota, 1995). The linking of activities and resources between partners means that the ability of a company to realise organizational goals is as much determined by these connections and the behaviour of those other parties as it is by the action of the company itself. So relationships with key stakeholders are central to company performance, requiring that a firm develop business and marketing strategies that guide company behaviour and decisions in dealing with those stakeholders. Decisions that will inform such strategies include

- whether a collaborative or competitive approach might be adopted in dealing with stakeholders
- which relationships should be developed and which others might be terminated

- what benefits might be provided, as well as what investment and adaptation might be performed for individual customers
- how benefits might be delivered.

(Donaldson and O'Toole, 2002)

For important customers with whom a firm chooses to develop or maintain collaborative relationships, adaptation can be a key component of a firm's relationship strategy. In the context of exchange relationships, adaptation is understood to be

“modifications at the individual, group or corporate level which are carried out by one or both parties in an exchange relationship in order to suit new needs or conditions, and which are designed initially for that specific relationship” (Canning, 1999).

Relationship specific modifications can occur in the early stages of a relationship in order to bring about “fit” between organisations but will also continue for the duration of a relationship as understanding and expectations change and companies seek to respond to the dynamic business environment in which they operate. These adjustments take a variety of forms, including those listed in Table 1.

(Take in Table 1 about here)

Adaptations can vary in terms of the resources involved as well as the effect on company behaviour and the relationship itself. They can be relatively minor and might simply involve a sales person changing his/her style of communication in dealing with counterparts in a customer company. At the other extreme a company might invest in manufacturing facilities specifically for a particular customer. Such investment clearly impacts a firm's overall business strategy and the resources available to it to support other relationships.

Choices made at the product market, macro-segment and relationship (micro-segment), levels with regards strategy content and the nature of adaptation are related. As figure 1

shows, these choices cannot be neatly separated, rather their integration is key to ensuring *consistent* programmes of action and the deployment of resources throughout a company. In organisational markets, business policy decisions will be shaped quite markedly by market and relationship strategies. By the same token, relationship strategy is guided by market and business policy decisions. For example, a customer may require a technical adaptation, such as the development of a new product to meet their specific requirements. Whether a supplier chooses to satisfy this requirement will depend on strategic decisions at the

- *relationship level* : is this customer important enough; will the development be profitable,
- *market level*: will customers in the same sector require this product; does the investment support company strategy for this sector,
- *business level*: is the strategy for this business unit based on differentiation or otherwise

(Canning, 1999; Turnbull and Valla, 1989)

The vignette that follows deals with a supplier's decision to perform adaptations for one particular customer. The decision is placed in the context of the supplier's business, marketing and relationship strategies, illustrating the connections between these strategies and their effect on the adaptation decision.

VIGNETTE 1: PLASTCO

Business and Marketing Strategy

Plastco is involved in the supply of thermoplastics worldwide, using its material engineering capabilities to compete and to meet customer requirements in terms of the forming, physical and aesthetic characteristics of plastics.

Plastco-IT Customer: Relationship Strategy

The primary activity of the IT customer's "production" sites is to assemble finished products and systems. It sources components and finished hardware items from

subcontractors and original equipment manufacturers, nominating approved suppliers and target prices for materials used. Plastco's objective is to maximise its share of plastic used in IT hardware, although from a materials perspective, there is little difference between competing plastics products, with the IT company specifying and subcontractors choosing from 2-3 approved materials suppliers. To figure as an approved supplier and stand a chance of being chosen by a subcontractor, Plastco must use its materials engineering expertise to

- advise the IT customer on how design, performance and cost targets for plastic components might be realised
- co-operate with OEMs and injection moulding companies to establish how a plastic might be manipulated and to determine the tools needed for the most cost effective production processes.

Plastco-IT Customer: Relationship Specific Adaptation

The quantities of plastic sold to this IT customer are relatively small. However, the customer is viewed as being strategically important by its association with its parent company (which overall represents a key client for the supplier) and because in some sectors in Europe it has outperformed major international competitors. This importance informs adaptation decisions made by managers in relation to this customer. For example, Plastco's corporate strategy includes priority given to efforts to minimise the negative environmental consequences of plastics and, as part of this policy, the company operates a business unit tasked with improving the recyclability of its engineering plastics. This unit was approached by the IT customer for help in improving the environmental performance of its IT hardware. Plastco's support resulted in the company becoming a user in its own operations, of plastics recycle prepared and sold by the IT customer itself. Clearly Plastco's environmental policy affected the supplier's interest. However the decision by the supplier's recycling unit to become involved in this customer's efforts was principally as a result of consultation with account managers and the belief that such support could

- contribute to building business with this part of the customer organisation

- act as a lever in the supplier's dealings elsewhere in the parent company
- be used to enhance the supplier's position with other customers in the same market who were faced with similar problems.

Having considered and illustrated the nature of strategy in terms of its content and the connections multiple levels of strategy, the discussion now switches to review the *process* by which a firm manages its *adaptation* to external conditions.

Strategy and Adaptation Process

Intrafirm Process

The "rational" planning model assumes a process in which there is clear distinction and progression between analysis, strategy formulation and selection and the implementation of a chosen strategy. The evolutionary approach argues that strategy and adaptation at the business, functional and relationship level emerges via the problems and decisions that managers deal with on a daily basis. Companies may formally derive and clearly articulate strategies on a periodic basis, deciding how to exploit a firm's resources for long-term survival. However, the success of a company frequently lies in its ability to learn from the dynamics of its external and internal environments and to adapt programmes of action in response to those dynamics.

The debate over formally planned versus emergent strategy formulation extends to the marketing function also. The process for developing a firm's marketing strategy is guided by (but will also inform) a company's business strategy. Decisions regarding target markets, positioning platforms and the design of marketing mix programmes are formulated via a business's analytical and decision making process where company performance, resources and capabilities, as well as external market conditions, are reviewed (Jain, 2000; McDonald, 1996). Yet Turnbull and Valla (1989) argue that the complexities associated with operating in business markets and the importance to company performance of relationships with key stakeholders mean that the realisation of a formally derived and comprehensive marketing strategy is difficult and frequently unrealistic. Rather, a "company's marketing strategy is more often the result of a disjointed, incremental approach", (p. 273, Turnbull and Valla, 1989).

Distinctions between the ways in which firms arrive at programmes of action are developed by Brennan and Turnbull (1999) at the dyadic relationship level, who view the internal process of one company adapting to another as a series of incidents, activities, and stages (Van de Ven, 1992). As can be seen from figure 2, the authors distinguish between different internal processes enacted by a firm to adapt to the needs of a specific exchange partner, depending on the scale of the adaptation being sought and the degree of formality associated with realising the change. Strategic adaptations might typically involve some significant resource commitment and so result from formal decision making processes, whilst ad-hoc adaptations are small-scale, normally associated with companies learning to do business with each other and as such require little formal planning. Tactical adaptations might be relatively minor, but the decision to perform them is part of an overt “political” process i.e. the expectation that the favour will be returned by the other party. Tacit adaptations come about where a number of relatively minor, unplanned adaptations result in the “adapting” party becoming aligned to its exchange partner in a significant way.

Take in figure 2 about here

The vignette that follows provides an illustration of a *formal decision making process* (strategic adaptation according to Brennan and Turnbull’s matrix) enacted *internally* by a materials supplier in developing a new product for a customer. The description shows the connections between the account specific adaptation process and the supplier’s marketing and business strategies regarding efforts to ensure *consistency* at these various levels, as well as the effect of this adaptation on scope for adjustments to the supplier’s marketing strategy aimed at macro-level segments.

VIGNETTE 2: CHEMCO-IT CUSTOMER RELATIONSHIP

Chemco is an international diversified chemicals processing and materials company. The Identification and Converter Systems Unit forms part of the company’s Industrial Markets Business Centre in Europe, supplying customers in

the metal, automotive, electrical, electronic, machine tool and instrumentation industries with label technologies used for identification, instructional or safety purposes. The IT company represents an important customer for Chemco in terms of volume requirements and as part of a much larger electrical engineering conglomerate.

Relationship-Specific Adaptation: Intrafirm Process

Exchanges between the two companies are initiated on a periodic basis either by

- Chemco's technical sales managers to identify new applications and product requirements, or
- the IT company's designers as and when technical advice is needed on material usage and labeling systems for new hardware designs or to resolve problems with those used for existing hardware.

For example, the customer approached Chemco for the supply of labeling systems that would be compatible with plastic components, would not require removal prior to recycling end-of-life equipment and thus would improve the environmental performance of the customer's products. Such a product fell outside the supplier's existing technology range and if developed, would be new to this customer and to the electronic and electrical equipment markets worldwide. The strategic importance of the product request and the necessary investment meant that the development was handled within the supplier's "European Business Centre" and subsequently worldwide to determine its compatibility with the company's strategic direction for competing in the electronic and electrical markets. Activities conducted by the supplier included

- seeking internal approval to initiate exploratory research
- determining the nature and potential scope of the opportunity via consultation with plastics and equipment manufacturers and reconditioners
- commissioning work from a plastics research institute to materials performance requirements and to identify plastic and labeling system compatibility,
- escalating the exploratory research to a formally approved product development project within the European Business Centre,

- gaining approval from the US corporate headquarter for inclusion of the new product in the company's portfolio, because it complemented the company's global strategy for the product group and the new technology would help the company deal with similar problems faced by key accounts in the US and Japan.

The customer's contribution to this formal intra-firm decision making process was limited to initial explanations of nature of the problem faced, the value to the customer in being able to resolve it, as well as the testing, approval and commercial negotiation for the supply of the materials eventually developed.

Interfirm Process

As vignette 2 shows, firms enact processes internally to determine whether and how to adapt the use of company resources to better suit the requirements of a specific exchange partner, just as processes are enacted (whether purposively or tacitly) to adjust to the conditions of the external environment in general or of a particular market (or "macro-segment). We have already noted that companies in business markets develop relationships with a limited number of suppliers, competitors and customers. A firm can access and benefit from the resources of exchange partners with whom it has developed relationships. This is particularly important given the tendency for firms to focus internally on those activities in which it excels and to outsource those where it is unable to develop a strategic advantage (Quinn and Paquette 1990). This means that in order to realise long-term organisational goals a firm must determine not only how best to exploit its own resources, but how it might draw from those of exchange partners. As part of its strategy a company might consider how to align activities with a partner in order to deal with external market conditions, meet its own needs and/or to suit the requirements of that partner. Such alignment requires cooperation between firms, whereby firms will use information exchange episodes to determine how each party might coordinate activities (if at all) to better align an exchange relationship or to resolve a particular problem faced by one or both parties (Bureth, Wolff and Zanfei 1997; Sobrero and Roberts, 2002). In many instances only one party in an exchange relationship actually performs the adaptation and in some cases this might be because of power asymmetry (Hallen et al.,

1991). The involvement and contribution of both parties to the process can also vary (Brennan and Canning, 2002). Some changes might be made without an exchange partner knowing (Pardo et al., 1995) whilst others, might be straightforward requiring little more than a brief exchange before the change is made. However, where adaptations are more complex, involve a more protracted process and require the involvement of both parties, then managers from each company are involved in exchange episodes in order to decide how to realise the sought after change.

So strategy is not necessarily about managing the adaptation of an individual firm's resources and activities in relation to some featureless external environment. Rather it concerns the process of influencing and responding to the behaviour of specific exchange partners and determining how parties can combine resources for mutual benefit. This does not make the intra-firm process invalid, but instead, acknowledges that this can not be neatly separated from the external environment, nor can a firm act independently of it (Håkansson and Snehota, 1995). In fact, in a business market, adaptation involves combined inter and intra-firm processes that take place in parallel. Figure 3 shows how these processes consist of "inter-firm and intra-firm activities involving information exchange, negotiation, commitment to and the performance of particular tasks.

Insert figure 3 about here

The following vignette illustrates the *interfirm processes* enacted between a telecoms equipment supplier and its UK distributor in their combined development and adjustment of strategies for the UK market.

VIGNETTE 3: TELCO-DISTRIBUTOR RELATIONSHIP

Telco supplies multi-media communication systems worldwide, using only one distributor in the UK for these systems. By the same token, the UK distributor carries only those multi-media communication systems provided by Telco. This means that both parties are heavily dependent on each other's capabilities in order to achieve their respective objectives in the UK market.

i. Strategy Development

Formal processes exist between the firms to clarify decisions regarding strategy content that enable the two firms to compete in the UK market. These processes include

- meetings at director level to evaluate business development activities, relationship performance and the distribution agreement
- the operation of a joint business development group, involving sales, marketing and product managers from each company to discuss and agree the future product requirements for the UK market, the direction of Telco's research and development investment and timescales for future product availability
- the review and, where necessary, renegotiation of the distribution agreement to support new business development and new product introduction decisions.

ii. Strategy Implementation

These deliberate strategy development processes feed in to operational activities for the day-to-day handling of the supplier-distributor relationship. Managers from both companies are in daily contact with counterparts as part of combined efforts to

- *secure customer business.* The distributor's channel marketing team establishes customer specification needs from the existing product range and negotiates prices with end customers. Telco's account team managers support the distributor's efforts by giving the distributor technical support as well as making technical presentations to, and meeting with end customers.
- *administer the supply and distribution agreement.* Processes enacted between Telco's commercial and operations managers in conjunction with the distributor's supply team include
 - calculating and negotiating prices for new products,
 - administering orders won by the distributor and monitoring product supply needs
 - conducting commercial negotiations for variations in the distribution agreement

Clearly, some of these are part of a planned process for operationalising the parties' strategies for realising objectives and winning business whilst others emerge in response to opportunities or problems that cannot be foreseen and indeed might even fall outside of the basis of the relationship between the parties.

The outcome of repeated phases of information exchange, negotiation and commitment between the parties feeds into the internal processes that eventually bring about change within the adapting organisation (Brennan and Canning 2002). The uncertainty or complexity associated with the adaptation will determine the nature and extent of repeated cycles of these inter- and intra-firm processes.

Having considered the nature of adaptation in terms of content and process, the discussion now turns to review its significance.

Why is Adaptation Important?

An organisation's performance is inextricably linked to its external environment, as it is this external connection that activates and gives value to the resources within a company and that can facilitate or inhibit the realisation of organisational objectives. Adaptation is important because it is intended to ensure fit between a firm and the environment in which it operates, with the alignment of activities prevailing at the macro environment, market and relationship levels. The effect on firm resources, of performing adaptations, is two-fold. The principal aim of aligning a firm to the external environment, via adaptation, is to make better use of those resources that a company has at its disposal. By combining its resources more successfully than competitors, a company is able to offer superior value to exchange partners and so enjoy a strong position in its market (Porter, 1985; Rhenman, 1973). A firm's capabilities certainly provide the basis for its ability to compete in a chosen marketplace. Changes to the way in which resources are employed to reflect changing market conditions can impact wealth accumulation for a firm. For example, in recent decades legislative and market pressure has increased on electrical and electronics equipment companies to reduce the environmental impact of their products.

The IT company featured in this paper has driven environmental product design for IT equipment in Europe for a number of years, has led product changes with materials suppliers and as a result of its environmental product design activities has succeeded in winning contracts in competition with larger IT companies.

Adaptation also manifests itself in direct relationships with exchange partners.

Companies draw from their physical, human and financial resources for the internal operations and exchange activities that enable a relationship with a supplier or customer. Adaptations to those operations and activities will be made in order to make better use of the resources that are spent and the costs incurred in facilitating the relationship. In the IT industry, for example, components suppliers have established manufacturing facilities near to customer plants to increase supply flexibility available to the customer and reduce logistical and administrative costs incurred (Canning, 1999). Chemco, the materials supplier featured in this paper, developed a new product to help reduce the internal costs of the IT customer's product recycling operation (Canning 1999). In much the same vein companies might develop EDI systems in order to reduce administrative costs or JIT delivery systems to rationalise material flow costs between firms (Frazier et al., 1988; Gadde and Håkansson, 1994).

A firm is involved in a number of relationships with supplier and customer companies and will typically be part of a vertical supply chain. Adaptations at the dyadic level can also manifest themselves at the network level. Numerous companies that are part of the same network will perform adaptations, the intention being to make the network itself, or those connected relationships more efficient (Anderson et al., 1994). For example, the efforts by the IT company featured in this paper, to improve the environmental performance of its equipment resulted in

- adaptations performed by its plastics (Plastco) and labeling (Chemco) suppliers,
- co-operation between these suppliers for one project in particular,
- the introduction of materials sorting and processing companies to the IT customer's supply chain to identify, sort and process materials extracted from used IT equipment

(Canning 1999)

So adaptation is important because in dealings at the market, relationship and network level, its purpose is to align the firm to the external environment and to enable the better use of resources that a firm has its disposal. But adaptation can be costly. Increased competitive pressures in IT industry has led companies to concentrate on core IT equipment and system design and rely more heavily on a network of equipment and component suppliers. This has required greater coordination of design activities between the firms and changes in the way that IT companies manage relationships with critical suppliers (Canning 1999). Establishing manufacturing facilities to improve supply capability and costs for customer obviously represents a significant investment for a components supplier (Canning 1999). The development of JIT delivery systems to rationalize material flow costs entails the training of personnel, restructuring of production processes and the development of quality assurance systems (Buvik and Halskau, 2001). Clearly when making such investments, firms seek to determine and monitor the return on the investments made. Such returns might be in terms of improved financial performance, increases in overall market share, growth in the amount of business with a particular exchange partner or improvements in the costs of doing business with that partner.

Adaptations may entail sunk costs. Companies have to take time and effort to in order to develop a shared understanding of how progression towards adaptation might be made and what form the adjustment might eventually take. This understanding is a result of information exchange, enabled by the reallocation of firm resources, such as time and personnel (Bureth et al., 1997; Weiss and Kurland, 1997). Whilst the investment in time and effort to facilitate the process might be lost, a firm might expect a return on this investment not only as a result of the adaptation itself begin realised, but also via generic knowledge and expertise acquired via the adaptation process which can be transferred to other relationships (Bureth et al., 1997; Canning and Hanmer-Lloyd, 2002).

Adaptation not only affects a firm's resources but also influences its behaviour. By adapting, a firm is committing its resources to supporting a particular strategy, market, segment or relationship. The dedication of the firm's assets (whether in physical, human or financial form) has been a central interest in understanding inter-firm relationships and networks. This is in part because modifications performed solely for the benefit of a particular exchange partner, represent relationship specific investments i.e. assets (whether in physical, human or some other form) that are dedicated to a single business relationship. These assets can be difficult to transfer to other relationships, or have less value when this is done and as such represent sunk costs. It has been argued that adaptation in inter-firm relationships contribute to both commitment and trust (Ford, 1980; Hallen et al., 1991; Dion et al., 1995) because the costs that are sunk into the adaptation process and outcome cannot be readily transferred elsewhere, so the likelihood of a firm behaving opportunistically is reduced.

Conclusions and Suggestions for Further Research

The primary assertion with regards adaptation is that it has a positive impact on company performance. This paper has shown that adaptation of the way in which a firm deploys resources in order to achieve its goals is a central feature of strategy content and process at the business, market and relationship level. One area worthy of further investigation lies in the development of measures that might be used to determine the effect on firm performance of adaptation at these different levels.

Research at the relationship level has placed emphasis on the impact of adaptation on relationship performance (e.g. better use of resources via the alignment of activities) and firm behaviour (e.g. reduced opportunism, increased trust and commitment) as a consequence of companies performing adaptations for the benefit of a particular exchange relationship or partner. Much of the research ignores the resources sunk (*cost*) into the process (*events, activities and stages*) of adapting and expertise (*benefit*) that can be acquired as a result of learning during the process of adaptation and which can be transferred elsewhere (Canning and Hanmer-Lloyd 2002). What has yet to be determined

is the means by which process investment and learning (and the transfer of accumulated learning to other relationships) might be factored into company

- decisions to perform/contribute to adaptations
- evaluation of returns on investment once the adaptation process is completed.

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Table 1: Inter-firm adaptation

Category of adaptation	Form of adaptation
technical	product and production processes
logistical	stock levels or delivery systems
administrative	planning or scheduling systems
financial	handling of payments; special credit arrangements
knowledge	(i) information exchange (ii) acting together in technical development matters
mutual orientation	changes in attitudes towards and knowledge of exchange partners

(adapted from Johanson and Mattson 1987)

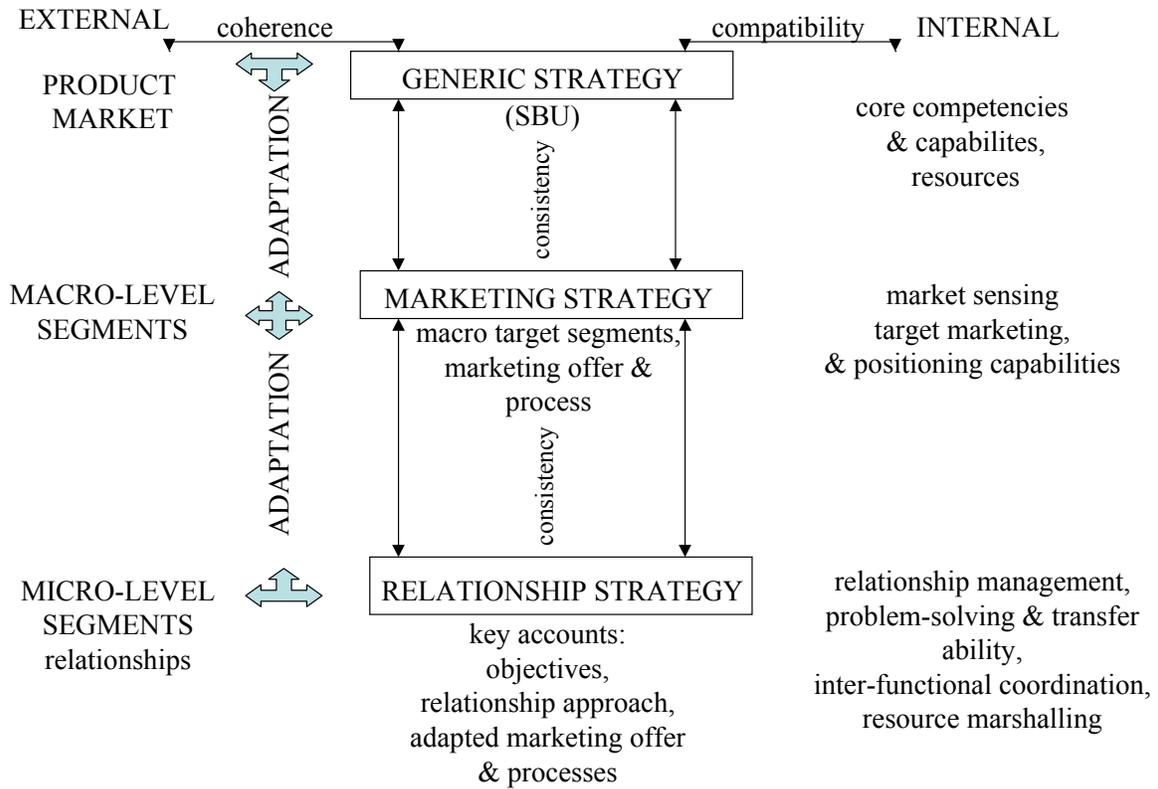
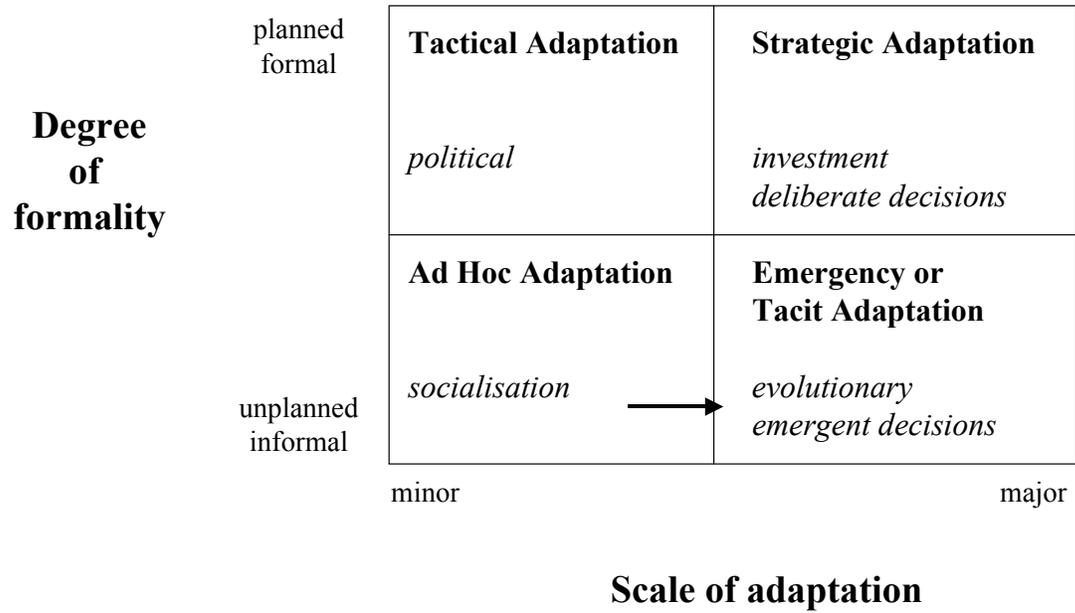


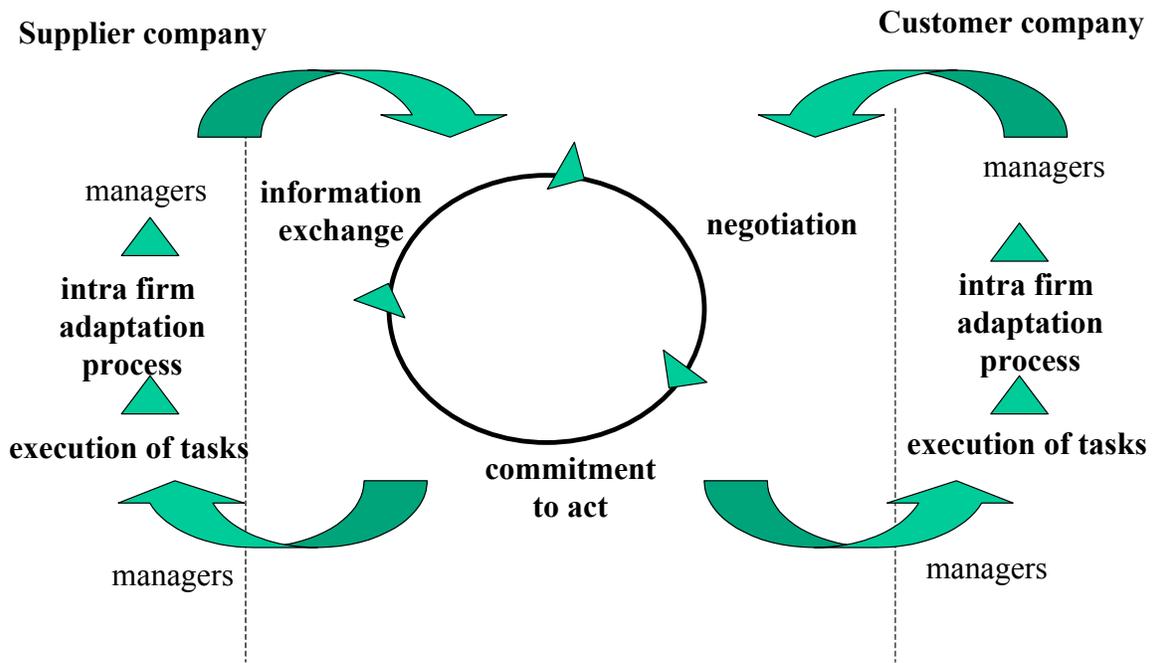
Figure 1 **Connecting Strategy and Adaptation**

(Adapted from Turnbull & Valla 1986; Hooley et al.2004)



(Brennan and Turnbull 1999)

Figure 2 **Intrafirm Adaptation Process: Scale and Formality**



(Brennan and Canning 2002)

Figure 3 **Adaptation Process**