Taxonomy of Supplier Firms in the Hungarian Automotive Industry – Aligning Customer Value and the Capability Based Approach

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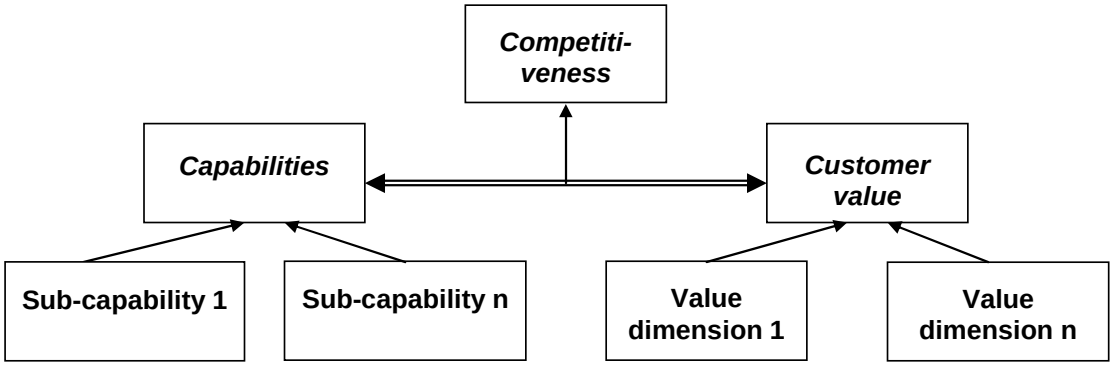
1. Research problem

The paper aims at identifying different types of supplier firms in the automotive supply chain. While identifying these supplier types the approach of the resource-based theory will be adapted. Working with such Hungarian suppliers for several years now has convinced me of the fact that possessing and developing different resources and capabilities is a sound base of their competitiveness. This statement is a well known proposition of the resource-based theory, but there is only a limited literature on the exact portfolios of these resources and capabilities in different industries (Hamel – Prahalad, 1990; Grant, 2002) and especially in the automotive supply chain (Clark – Fujimoto, 1991; Haffmans - van Weele, 2003).

Furthermore these descriptions leave the customer value aspect out of consideration. Resources and capabilities are directly not coupled with specific customer expectations. The paper therefore connects the resource-based theory and the customer value approach by saying that in order to maintain firm competitiveness it is indispensable to understand and deliver *customer value*. Suppliers have to be able to identify those *value dimensions* that are most important for their customers, the factors considered as critical in evaluating the performance of a supplier company. The identification of customer value dimensions is necessary but not sufficient for competitiveness. It is also important to determine what *capabilities* have to be developed in order to ensure different value dimensions. In the long run, company competitiveness can be maintained only through a continual alignment of customer value dimensions and the associated capabilities. This context of company competitiveness is demonstrated in Figure1.

Figure 1 – Capability based company competitiveness discussed in the paper: components and their relation



Based on this framework and theoretical approach the basic research problem of the paper (identifying supplier types in the automotive supply chains) can be broken down into the following specific research questions:

Research question 1 – What customer value dimensions can be identified for supplier companies involved in supply chains of the car industry?

Research question 2 – What capabilities and sub-capabilities do suppliers have to possess in order to be able to create the different customer value dimensions?

Research question 3 – Is it possible to identify complex packages of customer value dimensions and the associated capabilities of suppliers on the basis of which one could draw up taxonomy of car industry suppliers?

2. Literature review

The paper builds on two theories, the customer value approach and the resource-based theory. In the following literature review a short summary concerning the current body of knowledge in both fields is given. First the customer value approach is introduced. Than the terms and concepts of the resource based theory will be discussed. Finally an attempt is made to connect the two approaches using the concept of aligned competence.

2.1 The customer value approach

Customer value is created when the overall profit of the customer from a given transaction exceeds the total costs of the given product and service package (Chikán – Demeter, ed.; 2003). The definition of ***customer value*** is given by Parasuraman et al. (1985). According to this definition customer value is the subjective opinion of the customer as to what extent the provided product and service package meets his/her expectations. This definition of customer value is very comprehensive but does not say anything about the internal structure of these expectations, the building blocks of customer value and as a consequence it is hard to interpret in company practice. The term ***customer value dimension*** helps to catch this internal structure. Customer value dimensions show the most important elements of an expected product-service package, those building blocks of the customer expectations through which customer value can significantly be increased (Walters, 2002).

Mandják and Durrieu (2000) reviewed the literature of value dimensions and concluded that the value components provided by one party to another during the cooperation can appear at three different levels. These are transaction, relationship and network level:

- The value dimensions appearing at *transaction level* are those resulting from a concrete transaction.
- The value dimensions at *relationship level* include those created in the course of specific transactions, usually necessitating longer term cooperation.
- N*etwork level* value dimensions include those that are created in a given cooperating relationship, but the realisation of which also depends on additional network partners of the specific cooperating parties.

Walter et al. (2001) classify value dimensions created through cooperation between business partners in a similar, still to some extent different way: they introduce the categories of *direct and indirect value dimensions*. Direct value dimensions include the components of a direct relationship with a given partner. Following the same logic, indirect value dimensions include value components the realisation of which requires the involvement of third parties.

Möller and Törrönen (2003) based on Walter et al. work (2001) specified different concrete value dimensions. According to their opinion the following customer value dimensions can be distinguished: profit, volume, safeguard, innovation, market, scout and resource access dimensions.

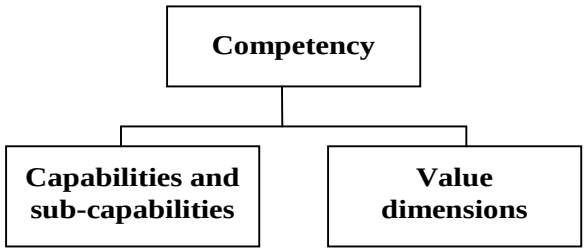
The literature of operations management also uses, interchangeably with the above definition of customer value dimensions, the concept of *sources of competitive advantage* (Chase et al., 2001). This concept also describes the most important factors through which customer value can be increased. Usually the following sources of competitive advantage (that is customer value dimensions) are listed: price, specification-conform quality, flexibility, reliability and logistics service level.

2.2. The resource-based theory

According to the resource-based view (Penrose, 1959; Rumelt, 1984) competitiveness depends not only on special product-market positions, but also on company-specific elements. The resource based theory applies a consistent approach while exploring these elements and has already developed well defined and widely expected terms for describing them. Such basic concepts are resource and capability. *Resources* have been interpreted as production or in a broader sense, operational factors (inputs) possessed by or available for a company (Grant, 2002). *Capability* according to the resource-based approach is the capacity of a firm to carry out specific tasks and operations (Teece et al. (1997). Theory also stresses that organizational capabilities are manifested in *routines* or a group of interactive routines (Fahy, 2000; Miller et al., 2003). *Competence* is a third

often used but not as clearly defined concept. Specific competences - such as *distinctive competency* (Selznick (1957), or *core competence* (Prahalad - Hamel, 1990) - are precisely defined, but in generally competence lacks clear-cut definition. Several authors (Grant, 2002; Hamel – Prahalad, 1990; Miller et. al., 2002) stress that competences are compound and systemic, being made up of several resources or capabilities which themselves are often compound as well.
I also worked through operational management literature (mainly articles from the field of production and logistics management) using the resource-based theory as their theoretical background. I found that these studies and articles often approached the concept of capabilities applying an *output orientation* and interpreted capabilities as performance indicators. Leong et al. (1990) lists for example four production capabilities, namely quality, delivery performance, costs and flexibility. Hayes and Wheelwright (1984) as well as Noble (1995) add reliability to the above four.
The output orientation of some authors highlights the need for aligning capabilities (as internal building blocks of company operation) with the performance that can be achieved by using them. Company capabilities and the performance created by them are two side of the same coin, but are not the same. The model developed in this paper (see Figure 1) tries to distinguish but at the same time to align these two sides. Based on literature review the term competence seemed to be useful to create the necessary connection between customer value dimensions and the necessary capabilities. I interpret ***competencies*** as complex groups of customer value dimensions and aligned capabilities (and sub-capabilities), which create product and service packages that can be seen by the customer as coherent, assessable and acceptable. The notion of this alignment between customer value dimensions and capabilities is made by the CLM Research Group in 1995, when they define competence as managed result. CLM Research Group on the other hand does not give a precise interpretation of this concept and do not develop it in details.

Figure 2 – Interpretation of competence in the paper



The concept of competency thus incorporates the corresponding groups of customer value dimensions and the capabilities, sub-capabilities needed for their creation. This interpretation includes further major concepts. It includes the already discussed interpretation of customer value dimension, according to which customer value dimensions brake down customer value into its elements, and show the different dimensions of the expected product and service package that are significant in terms of the creation and increase of customer value. Competency in this interpretation also includes the capabilities and sub-capabilities of the company relating to its internal operation. Based on literature I interpret ***capabilities*** and ***sub-capabilities*** in the paper as group of activities the execution of which is needed in the case of a given competency, in order to create the expected value dimension. The difference between capability and sub-capability is that while the former refers to a particular – broad, though seen as integrated – area of activities, the later relates to the building blocks or activity-groups of a particular capability.

3. Research Methodology

The research conducted was ***qualitative***. Results were drawn based on interviews made with supplier companies being active in the Hungarian part of the global automotive supply chain. I used the method of ***unstructured interview*** (see interview outline in Appendix).
Basic research units were ***supplier companies*** belonging to any of the global car making supply chains in Hungary. In the ***selection*** of the supplier companies I applied ***quota sampling.*** I tried to

find firms representing different types of companies. Aspects of company selection were: size (defined by number of employees), owner structure, operational level, position within the supplier pyramid and complexity of the product.

Table 1 – Relevant characteristics of the companies involved in the research

Company name	***Company size (according to the number of employees)***	***Major owner***	***Operational level***	***Position in the supply pyramid***	***Product complexity***
ABF Bowden-technika Kft.	Medium	Hungarian, privately (family)-owned	Local	Tier 1	Fairly complex
Denso	Large	Japanese, privately-owned	Global	Tier 1	Complex
Holz-Plast Műanyag- és Faipari Kft.	Small	Hungarian, privately (family)-owned	Local	Tier 3	Fairly complex
Linamar Hungary Rt.	Large	Canadian, privately-owned	Global	Tier 2	Complex
InterPlus Kft.	Medium	Hungarian, privately-owned	Local	Tier 2	Complex
Rába Járműipari Alkatrész-gyártó Kft.	Large	Hungarian, privately-owned	Local	Tier 1 and 2	Fairly complex
Sokoró Ipari és Kereskedel-mi Kft.	Large	Hungarian, privately-owned	Local	Tier 2	Fairly complex
Schefenacker Automotive Parts Hungary	Large	German, privately-owned	Global	Tier 1	Complex
Szemes Tömítéstech-nika	Small	Hungarian, privately-owned	Local	Tier 2	Fairly complex
Working Magyaror-szág Kft.	Small	Hungarian, privately-owned	Local	Tier 2	Fairly complex

Besides making interviews, other sources of information were also collected and analysed. Useful ***background material***s were provided by the companies and the Pannon Autóipari Klaszter (Pannon Automotive Cluster).

In the interviews, due to the nature of the study, I inquired about both customer value and capabilities in general, without explaining the exact meaning of the concepts or the differences in its various interpretations. I did so because I wanted to avoid influencing the interviewees with the explanation of the research model and the underlying concepts. Consequently, the informants used these terms variously and I had to interpret them. In order to reduce the problem of intersubjectivity I put down my initial findings sent them out to companies ***asking for feedback***. I also organized a ***round table*** for the company managers and car industry associations involved in the research and presented first findings asking for comments and opinions. First draft of the results sent out and my presentation made at the round table has already given specific definition of the

connected terms used in the research. Feedback was also asked concerning both these theoretical terms and the industry- or company specific findings.

4. Customer Value Dimensions in the Hungarian Automotive Industry

According to the results important value dimensions in the Hungarian part of the global automotive industry certainly include the low **prices** of the given product- and service package and the customer's expectations for a continual **decrease in prices**.

A supplier may also contribute to its customer's profitability and consequently increase customer value by delivering the products in **appropriate (**specification-conform) **quality**, thus reducing the customer's costs in relation to quality control, repair and scrap. Another way in which a supplier can positively affect customer is the quality and the reliability of its **logistics services**, because as long as supplier tasks are performed on time, it helps the customer to keep its schedule, while delays may cause downtimes and re-scheduling for the customer, which can protect itself only by accumulating stocks. Downtimes, re-scheduling and safety stocks all reduce the customer's profitability, i.e. its ability to provide profit.

Associated services were often considered very important by the supplier companies involved in the study. They listed, among other things, line sequence and Just in Time delivery as valuable sources of customer value creation. Suppliers' **flexibility** has also proved an important value dimension. In the contracts made with their suppliers purchasing companies often define the acceptable limit for the sometimes significant deviations from the agreed production quantities. In case the supplier is not willing or unable to accept this condition, it may suffer competitive disadvantage.

Another significant value dimension in the automotive industry supply chains is **volume dimension**. Manufacturing and purchasing activities in global operation are based on facilities which are designed to be able to produce large volumes of products. Suppliers unable to offer large capacity fall behind in the competition.

A further important value dimension in the auto industry is **stability dimension.** Operational stability of the partner (both in terms of finance and market position) is a fundamental condition for the customer's operational stability as well. Interestingly, in the interviews the emphasis was mainly put on market stability and diversified operation of suppliers.

Innovation dimension seems to be significant in the automotive industry. Walter et al. (2001) define innovation as an indirect value dimension, the creation and realisation of which is also influenced by actors other than the two business partners. Though this is certainly the case with strategic innovation, the realisation of the value of incremental innovation typically depends on activities taking place within the concrete relationship, and its creation is independent of other actors in the network. The split of innovation activities into incremental and strategic innovations was clear during the interviews. ***Incremental innovation dimension*** describes small-scale innovations, which come as appropriate responses to small-scale changes in customer expectations (induced usually by model changes) and is necessary for all suppliers who seek long-term competitiveness. Besides incremental innovation dimension in some cases strategic innovation dimension was also named. The ***strategic innovation value dimension*** included the customer's expectation from supplier firms to come up with new products and/or technologies. A new product means the development of a supplier-specific specification of a so-called catalogue product (product included already in the product catalogue and consequently available on the market), or the development of a new product (not available previously at all).

Out of the indirect value dimensions discussed by the literature **scout dimension** is relevant in the automotive industry. Companies may have the expectation from its suppliers that they should be able to manage the complete supply of their own product. This can increase customer value in two ways: On one hand all efforts and costs associated with managing supplier's suppliers can be eliminated. On the other hand business relationship with such supplier can increase customer value because through this integrator supplier the customer may obtain new business information and gain access to new contacts.

In the interviews I could also identify the **resource access dimension**. This dimension is in strong relation with the above mentioned scout dimension, but is not identical with it. In this case the

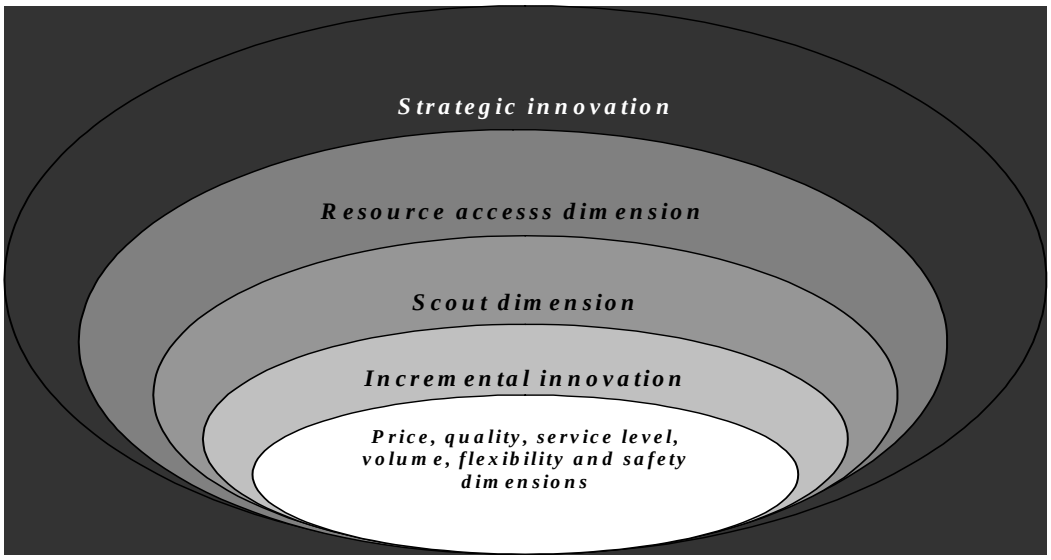
customer expects the supplier not only to manage its supplier base on the basis of the supplier's own expectations, but to actively develop its network according to the customer's expectations. This increases customer value by ensuring the customer a quick and cheap access to the capabilities of the supplier's supplier base.

Table 2 – The classification of value dimensions observed i8n the Hungarian car industry suppliers based on the interviews

Level of realisation of value dimensions (Mandják – Durrieu, 2000)	Nature of value dimensions (Walter et al., 2001)	Value dimensions in the Hungarian automotive industry – research findings
Transaction level	Direct	**Price**
		Appropriate quality
		Reliability of the service
		Volume dimension
		Safeguard (stability) dimension
		Associated services
		Flexibility
Partnership level		**Incremental innovation**
Network level	Indirect	**Strategic innovation dimension**
		Scout value dimension
		Access value dimension

Quality conformance, appropriate quantity, appropriate price, on-time delivery, reliable service level, the volume dimension, stability and flexibility were named by all companies as significant customer value dimensions. According to the interviews this basic package of customer expectations may be expanded with additional customer value dimensions, such as incremental innovation dimension, scout dimension, resource access dimension and strategic innovation dimension. Figure 3 illustrates a typical, but not an exclusive way, how customer value dimensions, that is customer expectations may expand in a specific customer – supplier relation.

Figure 3 – Typical way, how customer value dimensions may expand in a specific customer – supplier relation in the Hungarian automotive industry



5. Competency Based Taxonomy of Suppliers in the Hungarian Automotive Industry

During the research I also looked for those capabilities and sub-capabilities, which are needed in fulfilling customer expectations, create the different identified customer value dimensions. While aligning customer value dimensions and capabilities I could identified five specific competences, ***capacity, product, adaptation, network and innovation competency***. This taxonomy was developed based on the specific interpretation of competence given in the paper earlier. According to this competences are complex groups of customer value dimensions and aligned capabilities (and sub-capabilities), which create product and service packages that can be seen by the customer as coherent, assessable and acceptable. According to research findings *production, technological, supply and product development capabilities* are crucial in creating the different customer value dimensions. Interestingly sub-capabilities of these capabilities proved to be also important differentiating elements. Table 3 summarizes the internal built up of different competences.

Table 3 – The internal structure of the different competencies

Competencies	**Customer value dimensions**	**Capabilities necessary**	**Sub-capabilities necessary**	**Number of companies owned the specific competence (from 10)**
Capacity	Price, Conformance quality, Volume, Expected service level, Stability, Reliability	Production	Process management; Production planning; Production management; Maintenance; Quality management	10
		Technological	Application of the technology;	
Adaptation	Incremental innovation	Technological	Manufacturing process development; Technology development;	10
		Product development	Break down customer specification for supplier's own product specification;	
Product	Scout dimension	Supply	Selection of Suppliers; Supplier management;	8
Network	Resource access	Supply	Development of suppliers;	4
		Product development	Product development with partners;	
Innovation	Strategic innovation	Technological	Technological innovation;	0 (but 2 of the companies made already efforts to develop it)
		Product development	Own specification 1: Development of products listed in the supplier catalogue; Own specification 2: Development of new catalogue product	

Supplier companies with ***capacity competency*** perform wage work for their customers. Relying on their technological and production management capabilities and knowledge they are able to manufacture the ordered product in compliance with the customer's specification and on a production line audited by the customer Supplier is able to provide specification-conform quality at a reasonable price, appropriate volume, service level and on-time delivery. As with all supplier types, stability and flexibility dimensions are also very important factors. Out of primary capabilities companies with capacity competence rely on technological and production capabilities. While their technological capabilities are limited to the application of the needed technology with a particular product, all production sub-capabilities (process management, production planning, production management, maintenance, quality management) are required to meet the given customer value dimensions.

In the case of companies with ***adaptation competency*** the group of customer expectations and the relevant aligned capabilities and sub-capabilities is wider than in case of capacity competence. Due to the permanent fast changes in the industry - especially quick product changes and shorter product life cycles - the customer value dimension of incremental innovation appears among the expectations. Quick model changes result in frequent and often significant changes in the specification of the supplied parts too. The supplier has to be able to respond to these changes. This requires the ability to break down the new specification of customer's product to the specification of the supplied parts, and to adjust technology accordingly. This adaptation inevitably affects manufacturing process development but usually demands only small-scale improvement of the applied technology.

Suppliers relying on ***product competency*** have again broader range of customer expectations and value dimensions to meet than those relying solely on capacity competency. The customer not only expects this type of supplier to perform wage work, i.e. it is not only the supplier's capacity that the customer buys, but also requires the supplier to establish and manage its own network of suppliers. Beside the customer value dimensions discussed at capacity competency, this supplier type has to meet scout dimension as well. Suppliers can meet this only by developing, along with capabilities and sub-capabilities associated with capacity competency, their supply capability, in particular the selection and management of suppliers and the sub-components needed for daily operation.

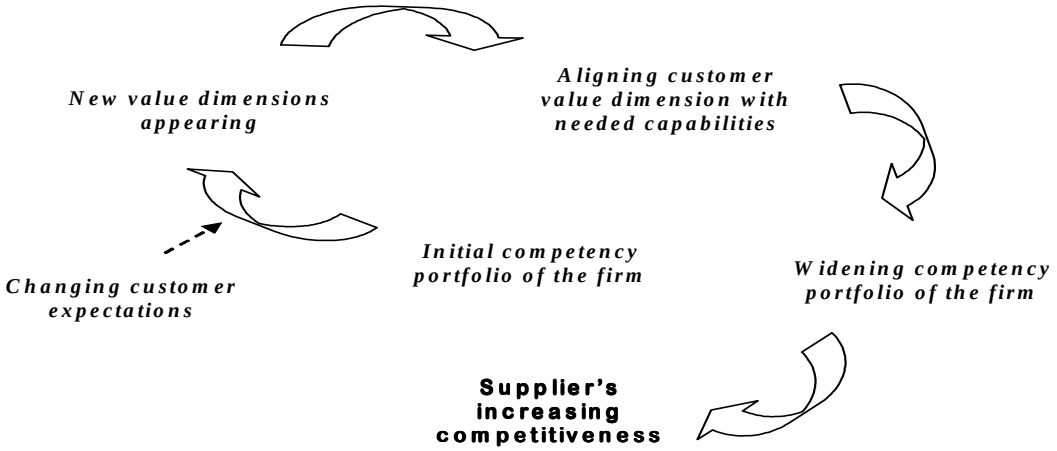
A supplier with ***network competency*** typically further expands competencies due to the appearance of resource access value dimension. Resource access dimension means that the customer expects the supplier to efficiently manage its own supply network developed for the production of a given – usually fairly complex – product, and taking over all relevant responsibilities and activities (tasks) associated with this supplier network from the customer. Suppliers can meet this customer value dimension only through further improvement of their product development capabilities, and this inevitable requires the conscious establishment of the sub-capability of supply development. A supplier willing to capitalise on network competency must have a sufficient level of knowledge of the product, technology and supplier market, which allows it to manufacture and effectively manage at the same time its own supplier base. This certainly needs further strengthening of the product development capability also. This means that apart from its already existing sub-capability (breaking down of specifications to the level of parts) the supplier will have to take an active, even pro-active, part in collaborative product (and technology) development with their own suppliers.

Finally companies belonging to the last supplier type possess ***innovation competency*** and – as a response to the appearance of the value dimension strategic innovation – further develop their technological and product development capabilities. The value dimension of strategic innovation covers the customer expectation which requires the supplier to actively work out proposals for strategic innovations regarding the product and/or the technology, based on its experience and knowledge, thus enhancing dramatically its customer's competitiveness.

On the basis of the competency portfolios of the studied companies one can conclude that no company can successfully start activities as a car industry supplier without capacity and adaptation competencies. In the cases of small and medium-sized companies product competency is also frequently developed, while large companies are characterised by network competency. An interesting finding of the research is the lack of innovation competency at suppliers involved in the study. On the other hand, as the interviews revealed, many companies have already realised its importance, and make efforts to develop it.

Company managers interviewed have confirmed that widening the possessed competence portfolio is an important source of supplier's competitiveness. This needs a permanent monitoring of changing customer expectations, detecting possible customer value dimensions and aligning them with conscious capability-development.

Figure 4 – Competency based development of supplier's competitiveness



6. Conclusion

The aim of the paper was to identify different types of supplier firms in the automotive supply chains active in Hungary. During developing this taxonomy the approach of the resource-based theory was applied. Literature review revealed that firm capabilities are not linked directly with specific customer expectations yet. Therefore the paper tried to make this link in order to be able to identify concrete packages of linked customer value dimensions and capabilities needed for creating them. The paper proposed the term of competency to capture the link between specific customer value dimensions and needed capabilities. Using this terminology the competency based taxonomy of supplier firms in the car industry could have been developed.

I hope the set of concepts appearing in the paper have practical relevance as well. Supplier types identified and their described competence portfolios give a picture of the range of capabilities required for developing relevant customer value dimensions. As one of the interviewees pointed out in the final phase of the research, the presented taxonomy provides an opportunity for the companies to implement a benchmarking and also to find new ways of increasing their competitiveness.

Several questions still need further research and also the model applied in the paper raises new ones that need further research.

Appendix: Interview outline

Basic company and product information: (size of the company, owners and ownership structure, circumstances of firm establishment, products and their main characteristics, the extent and speed of changes in their environment); ***Industry structure and characteristics:*** What drives industry?

What direction the industry is developing? Which of these directions influence the operation of the company? What speed are the changes taking place within the industry? What are the reasons of the changes? Which players induce these changes? (Who influence companies to develop and change to a certain direction? Please give specific examples of the changes taking place! ***Customer expectations:*** Who are your main customers? What are the expectations of your main customers in the automotive industry? Along what aspects is your firm evaluated by the customer? Which of these aspects are evaluated formally (written)? Are there any evaluating factors, which is not part of the formal evaluation process, but you feel is still important? Have you experienced major changes in customer expectations? What adaptation they have demanded from your company? Please give examples! Do you think such changes in customer expectations will follow in the near future? Why

do you think it will (or will not) happen? ***Capabilities:*** Have you changed the way of operation in the company due to changes in customer expectation or other changes in the environment? How this took place and why? What is the most important your company has to do well in order to stay in the automotive supply chain? In what respect and how your company has to be developed in order to be competitive in the future and keep yours customers (or even get new ones)? Please give examples of your failure! What has to be done differently not to loose a customer? Did you learn from your failure? What? What direction of further development do you see in the industry relevant for your company? To what extent the product to produce is changing? Who triggers and who is responsible for these changes? To what extent your company carries out product development activities? What other development activities do you have in your company? How many suppliers do you have? How do you deal with them? (Contact keeping, level of coordination and joint problem solving, way of supplier selection and evaluation process)

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