What relationships are truly worth: Initial Steps in developing a new metric for firms based on their relationship quality.

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Abstract

A firm's performance, competitive position and future potential are all determined by a wide range of tangible and intangible elements. Much attention has been paid to the tangible and physical assets of firms, whilst far less attention has been paid to some of the intangible elements. This paper proposes the need for a new marketing metric based on relationships; this paper extends the recent work of Lages et al (2007) and integrates this with the IMP work and the network perspective. Existing literature is reviewed and a framework proposed suggesting the component variables of such a metric.

Keywords

Value, relationships, metric, network, alliances

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Introduction

A firm's performance, competitive position and future potential are all determined by a wide range of tangible and intangible elements. Much attention has been paid to the tangible and physical assets of firms, whilst far less attention has been paid to some of the intangible elements. Nevertheless, nearly half the value of a firm lies in intangible aspects (Srivisata and Reibstein, 2004) such as "goodwill" and "brand equity". Recent estimates of intangible assets are up to 69% of a firm's total market value, as compared to only 17% in 1978 (Sawhney and Zabin, 2002) As early as 1992, Kaplan and Norton suggested that accounting measures derived from an industrial age are no longer sufficient to measure performance in a post industrial age. Conventional measures tend to be historical and do not provide information that can be used to assess the future potential of a firm (Ittner and Larcker, 1998) thus there is a need for metrics to be forward looking (Seggie et al., 2007).

An alternative view suggests that the actions of the competition should be included to develop a range of relative metrics, based on the assumptions of game theory that the value of a firm is partially determined by its own actions and those of its rivals (Brandenburger and Nalebuff 1995). This idea that a company is valued partially on the relationships or networks that it builds up around it is also supported by Kothandaraman and Wilson (2001) as creating customer value can be driven from a set of capabilities not just within the firm, but from the firm's access to other firm's capabilities through its network.

A more likely direct influence on the value of the firm is that value derived from its collaborative relationships, which can offer significant opportunities for firms, so managing the outcome of these can result in better performance (Ulaga, 2003), yet most metrics are focused on the value of customer relationships. The obvious potential outcomes of a collaborative relationship include new product development, market entry, access to markets and suppliers etc, yet many alliances fail to fulfil their initial potential with more than half failing (Brouthers et al, 1998). The obvious outcomes of the alliance process can overshadow some of the more process oriented outcomes which in themselves may result in additional skills being learnt, additional future opportunities and as a result added value to the firms entering the relationship.

Many firms rely extensively on collaborative relationships with a range of firms outside their supply chain and often including competitors through strategic alliances and joint ventures which can directly enhance the firm's prospects. Other firms rely heavily on highly integrated relationships within the supply chain and both of these types of relationships could increase the performance of both firms by accelerating new product development, or establishing a new industry standard, or through ingredient branding.

In the longer term these activities will affect the market value of a firm, but in the short term these relationships also directly affect the value and potential of firms. This paper proposes a conceptual framework for future research to evaluate the value of a relationship based on a review of current literature and develops a metric to capture the value of B2B relationships based on previous research. This metric would allow firms to include intangible value derived from a firm's relationships or its position within a network to be assessed. For small firms, this metric would allow better valuation of their potential, especially for high-tech or start up firms which have not yet commercialized products and services, and for firms trying to raise venture capital or other funding. For all firms the potential of such a metric has immediate managerial implications in terms of assessing competencies and identifying opportunities for improvement.

A firm's relationships can have obvious consequences on the valuation of publicly listed firms and also impact significantly on the potential of smaller firms to raise venture capital. The value of relationships can be easily illustrated in a fictional scenario: Two small biotechnology firms are in the final stages of developing a new blood based genetic testing kit for bowel cancer or some other important disease. Neither of these firms have the resources or skills required to successfully commercialise this product on a global scale, and both have some limited work to do before the product is ready to launch. One of the firms has successfully developed another products – it has a track history of joint development programs for innovative products and a long history of successful relationships with a range of firms. It has experience in not only forming collaborative relationships is of importance but also in sustaining and getting successful outcomes. The other firm has recently signed an agreement to a joint R & D project to complete development of this product with a large multinational pharmaceutical company which has global access but this company has a poorer technology and nearly all of the other previous alliances it has formed with other companies have failed. In this scenario, the tangible assets of product development, the ability to perform within a collaborative relationship and the power and assets of the partner firm are all variables in assessing the position of the two companies.

This can be summed up in the following metric which takes account of these items. The value of the relationship, and therefore the added value of the firm is partially determined by:

$$\sum F_1 R_n F_2$$

Where F_1 is composed of the relevant characteristics of the firm being measured and F_2 represents the relevant characteristics of the relationship partner. R_n is the measure of relationship quality which is itself composed of multiple items. The composition of R_n will include measures such as the number of alliances (past / present); the ability of the firm to work well in relationships (past performance); the relative strength of the firm within the alliance, the relationship strength (trust / commitment etc); the type of alliance etc. As each individual firm may have many relationships, its value will be derived by the sum of all the relationships and interactions with other firms. This figure can then be mapped directly onto a firm's position within a network to give a snapshot view of the strength of the relationship and the firm relative to its competitors and other firms in the industry. Data could be generated to map firms in a network diagram and also be used for improving firm valuations to venture capitalists and money markets.

The remainder of the paper discusses extant work on suggested component factors of F_n and R_n..This is preceded by a discussion on existing performance metrics and the value of such metrics in venture capital situations. The paper concludes with the theoretical and managerial implications of such a metric and ideas for future research.

Metrics and use of metrics

Much attention has been paid to developing measures to capture some of the intangible elements driven by marketing, including the development of measures for brand equity. The balanced scorecard developed in the early 1990s was a discontinous change from statis marketing metrics (Kaplan and Norton, 1992). Instead of working on financial measures, or even intangible marketing metrics, the balanced scorecard took a set of between 16 and 28 different measures, coordinated into four categories; financial performance; customer relations; internal business processes and the organizations learning and growth activities. Customer measures initially focused on the value propositions delilvered to target customers; internal bueinss process measures relate to operational processes of the business unit; learning and growth measures refer to employee capabilities, information systems, and employee capabilities. Finally financial measures include both the traditional measures of return on investement etc, but perhaps measures specific to the business being measured in addition. Whilst this was a major move forward in performance metrics and has been widely accepted, a number of more complex additions and variations have been made since the 1990s.

Marketing metrics in particular have come under recent focus with the need for better marketing metrics being seen as a top research priority in recent years (Seggie et al., 2007). Customer equity in particular has received some attention, as has customer lifetime value but a firm has other important relationships which can also add value to its activities, including value derived from associations with other firms, and value derived from the relationship the firm is in. Srivastava, Shervani and Fahey (1999) suggest marketing value can be captured in three processes; product development, supply chain management and customer relationship management. They recognize the need for customer relationships to be managed and to add value, and they suggest that future research should extend this into developing best practice and developing ways of measuring performance in other network relationships (Srivastava et al.,1999). The ability to add value though relationships, rather than through transactions, resources or product development has been largely accepted (Ulaga 2001). Kothandaraman and Wilson (2001) propose three fundamental building blocks for relationship value including core competencies, customer value and relationships.

A Venture Capitalists View

Placing a value on a firm can be particularly difficult for young firms, or early stage high technology firms with a heavy reliance on R & D (Gompers and Lerner, 2001) Not only might the potential profitability of a firm be many years ahead, but the aspirations of the firms' Directors may be different from the venture capitalist; the firm might be a "hobby" or bring personal recognition rather than financial success (Gompers and Lerner,2001). In order to deal with these eventualities and to allow relationships to develop over time, Venture capitalists use staged infusions of money to mitigate their potential losses. However there is some evidence to suggest that even early on in this staging process, many venture capitalists are more likely to fund firms which other venture capitalists have funded. This idea that a firm is worth more because someone else has already backed it, could be seen in two ways. The first is it is simply replicative behaviour on the part of the venture capitalist and seen as reducing risk.

An alternative way of examining this is to see that the relative value of the start-up firm has been affected by the relationships it already has, and the firms with which it has established the relationships. Thus, from a network perspective the start-up firm has its own intrinsic value in terms of its own capabilities but acquires a greater value than this from its relationship with another specific firm.

The R factor- Measures of Relationship Quality

Given the importance of inter-firm relationships to B2B markets and the increasing role of collaborative relationships in addition to traditional B2B relationships, it is surprising that there is relatively little attention paid to the ability of firms to form successful alliances or other successful business relationships. Parasuraman, Zeithaml and Malhotra (2002) pointed out the importance of the development of B2B metrics but despite much research into relationship quality within the supply chain literature, there has been little progress made on developing a measure for relationship quality (Lages et al., 2007; Grewal, Comer, and Mehta, 2001; Klein and Quelch, 1997).

Walter, Ritter and Gemunden (2001) examined the buyer-supplier relationship and suggest a move from value for customers to value created concurrently for both suppliers and buyers. In an empirical study they show that customers can perform value added activities for suppliers through a series of indirect actions including working together on product innovation, providing market information, and having a reference effect as well as allowing access to external bodies such as trade associations. As well as showing these effects, some other smaller effects were also seen though could be indicative of the size of the companies being studies (SMEs) which include "soft" value creation including social functions, fairness, trust, or "good feelings" (Walter et al., 2001).

Very recently, Lages et al., (2007) developed a new measure entitled B2B-RELPERF designed to capture the value of a relationship between a firm and its customer in a B2B setting. Their B2BRELPERF scale consists of five components:

- Relationship policies and practices
  Relationship policies and practices are an essential dimension of the relationship process (Jap and Ganesan, 2000). This variable also includes elements of ethical behaviour, strategic considerations (i.e. what is most important to our company) and common beliefs). This variable also echoes the strategic alliance literature which clearly shows that for alliances to work, firms must hold common beliefs (Kauser and Shaw, 2002). This appears

to be similar to the decisions and actions variables considered by Ford and McDowell (1999) but is apparently overlapping with the elements of mutual cooperation which also refers to actions.

- Trust
  The willingness to rely on another party to take actions has long been acknowledged as important in the supply chain literature, although can be sometimes seen as a result of the reliability and integrity of the firm (Morgan and Hunt, 1994). In addition, Kauser and Shaw (2004) demonstrate a positive relationship between trust and performance of the alliance. These studies all suggest that the choice of partner firm in terms of similarity of shared attitudes and beliefs is an important factor in determining the outcome of the alliance.

- Relationship Commitment
  Is referred to as the desire to develop a stable relationship (Lages et al, 2007).

- Mutual cooperation
  Lages et al., 2007 refer to mutual cooperation as a series of coordinated behaviours which grow with the relationship process. The alliance literature has tended

- Relationship satisfaction.
  Lages et al., (2007) propose relationship satisfaction to be an element of the B2BRELPERF scale; that is they see satisfaction as a component of the relationship, although they clearly refer to other work which sees relationship satisfaction as a *result* of the relationship quality (Geyskens, Steenkamp and Kumar, 1999). Within the alliance literature, satisfaction is sometimes measured as an outcome of the relationship rather than a component of it (e.g. Cravens et al, 1993; Harrigan, 1996).

There are other definitions of relationship quality, largely derived from the supply chain literature which also defines these elements in different ways. For example, Wilson and Jantrania (1995) base relationship value on 3 dimensional categorization including economic, strategic and behavioural values. Whilst Moller and Torronen (2003) suggest valuing the supplier-customer relationship along three dimensions of supplier's efficiency, effectiveness, and network function. Lapierre (2000) summarises 13 drivers of relationship value into 3 components; product, service and relationship qualities. Walter et al.,(2001) separate out two forms of relationship qualities; Direct (to include profit / volume and safeguard) and indirect (including functions of innovation, market, scout and access). In general, the supply chain literature is concerned with issues of trust, commitment and satisfaction with the ongoing relationship and much focus has been placed on these variables.

The strategic alliance literature has largely looked at dyadic time bounded single relationships but still has much to add on relationship quality. With the focus of this stream of literature focuses on motivations for forming alliances and factors which allow alliances to succeed; the literature is clearly positioned to identify those factors which enable a relationship to work well.

Strategic alliances differ from supply chain relationships due to the intransient nature; some are formed for specific time bounded objectives as opposed to ongoing transactions. The goals of partners may change, and this may happen during the lifetime of the alliance (Doz, 1996). This may result in alliances which have very positive yet unexpected outcomes, yet this issue has received little attention and has been identified as an area of future research (Todeva and Knoke, 2005). However many strategic alliances are vaguer in their objectives and evolve through the lifetime of the alliance (Das et al from evolution paper), reducing the importance of the initial stated objectives of the firms and increasing the importance of relationship policies and practices.

There are also characteristics of the relationship itself; alliances can vary between joint venture and very loosely defined working agreements. Likewise, a supplier relationship can vary between a rigidly defined legal agreement to a much looser ongoing and evolving relationship. The difference in formality, or legality is also a characteristic of Rn and can be a result of the planning process. The alliance planning process has also been identified as influential (Cravens et al., 1993). The length of time spent negotiating is important in determining success; the longer firms spend in the pre contractual period, the clearer the objectives of each partner are, and the mechanisms for achieving these objectives are better understood. The time spent negotiating the alliance should be reflected in the choice of partner simply by the fact that firms that take longer to negotiate an alliance are more likely to have picked a partner that will work well. Other characteristics of the alliance that are important are: the type of alliance, the formalisation of the alliance agreement. Canon and Perrault (1999) refer to this as “legal bonds” which provide a form of contractual arrangement.

Drawing from the strategic alliance literature, much emphasis has been placed on capturing the outcome of alliances, or relationships, though little agreement exists as to how best to do so. For example Joint venture outcome can be measured in a number of ways including: profitability, growth and cost position, survival, duration, instability of ownership, and re-negotiation of contract (Geringer and Hebert, 1990; Anderson, 1990). However, due to the diversity of alliances, objective measures are inapplicable to some agreements because traditional measures such as sales or profits do not capture the success of many forms of collaboration (Kogut, 1988) and are only relevant for strategic alliances which have specific financial objectives (Arino, 2003). Other measures have included overall managerial satisfaction with an alliance meeting its initial objectives (Cravens et al, 1993). Many strategic alliances are finite in length thereby precluding the use of duration as a measure. Other alliances may only involve R & D agreements and therefore the use of profitability, and growth as suitable measures would not be appropriate. More complex measures of strategic alliance performance include multiple outcome measures. Anderson (1990) examined joint venture performance against three continuums: stability vs. flexibility, well being of individuals vs. profitability and process vs. outcome (Anderson, 1990). Other measures include the parent firms’ level of satisfaction with the alliance (Cravens et al., 1993), or a composite of meeting strategic objectives *and* recovering their financial costs (Bleeke and Ernst, 1991). Harrigan (1996) used a combination of duration, survival and managerial perceptions to capture the success of a group of Joint Ventures. This paper therefore suggests that managerial satisfaction should be seen as capturing the outcome of a relationship rather than being a component of its quality as suggested by Lages et al., (2007).

The alliance factors contributing to the metric are therefore four of the five factors from Lages et al (2007) (Policies and Practices, Trust, Commitment and cooperation, and Goals) but also include the following items: Legal bonds / Formality, some measure of the balance of power, and the scope or depth of the particular relationship.

The F factor

Drawing from the strategic alliance literature, there are a number of factors which contribute to the successful outcome of an alliance. These factors therefore facilitate the preferred outcomes of the relationship and in this respect, are an indicator of relationship quality. There is a large body of literature that examines factors thought to influence the outcome.

The first is “Environmental” (external to both the alliance and the partner firms). These are characteristics of the macro environment that affect Firms, and may independently directly or indirectly affect the relationship in question. Environmental factors can include a reliance on other alliances through being part of a network (Burgers and Hwang, 1996). Gomes-Casseres (1997) also suggests that position in the network may be important. Industry life cycle and infrastructure, or changes in the technology life cycle, including discontinuous technological change, may also play a role in determining outcome (Lambe and Spekman, 1997; Burgers and Hwang, 1996;). Finally, factors relating to demand or levels of profitability in the industry (Burgers and Hwang, 1996) may also influence the outcome of the alliance.

The relevance of these factors in this particular model is in the way the firms, or the relationship might change as a result of these. For example, if one firm operates in technologies requiring animal experimentation, and public opinion forces new legislation or increases pressure to stop these experiments, then one firm will be under more pressure, both financially and strategically than the other within the relationship- the two firms may behave in different ways, which also impacts upon the relationship. This is both a factor of the event occurring at all, and the manner in which each firm reacts to this. The culture and strategy of the firm has therefore been included as a Firm level factor.

The strategic alliance literature has a long list of "firm characteristics" which affect alliance outcome, and "Partner characteristics" is the most commonly cited reason for strategic alliance failure. However certain of these characteristics need to be complementary and others need to be similar in order for the alliance to succeed; these broadly divide into two groups:

- Characteristics that should be complementary
- Characteristics that should be similar

Complementary factors. These are characteristics where a match of factors is important but each partner does not need exactly the same characteristics. For example, one firm may be skilled in marketing, whilst the other may be skilled in production. Gordon (1995) uses a similar notion of complementarity and refers to the balance of value chain processes as "strategic fit". Complementary factors are usually functional, or resource based, but can include managerial expertise such as prior experience of strategic alliances (Brouthers et al., 1995; Woiceshyn and Hartel, 1996).

Other factors that have been identified are: goals (Brouthers et al., 1995), common perceptions of the risk involved (Brouthers et al., 1995), similar or complementary cultures (Brouthers et al., 1995), commitment (Cravens et al., 1993), complexity of operations (Pekar and Allio, 1994), equivalence of contribution (Bleeke and Ernst, 1991), contribution based on core competencies (Cravens et al., 1993), size and bargaining power of each firm (Forrest, 1992), and ownership (Bleeke and Ernst, 1991).

Similar characteristics refer to those that have been identified in previous research as necessary in *both* partners. They include: managerial ability to learn (Bertodo, 1990; Woiceshyn and Hartel, 1996; Forrest 1990), a determination to exploit acquired skills (Bertodo 1990); and the ability to control information transfer (Bertodo, 1990). In addition, other factors include that both partners clearly see the short and long term advantages of the alliance (Bertodo, 1990), the attitude of the firms (Yuan and Wang, 1995), management style (Cravens et al., 1994) and clarity of objectives. (Slowinski et al.,1996; Doz, 1996). Conflicting with the notion of firms requiring complementary cultures is research suggesting that culture is required to be similar (Brouthers et al., 1995; Cravens et al., 1993; Slowinski et al., 1996; Doz, 1996). Related research indicates the importance of shared attitudes and behaviours as these factors enable the companies to work well together (Yuan and Wang, 1995; Forrest and Martin, 1992).
Leisen et al., (2002) provided empirical evidence of the relationship between the firm's level of market orientation and the outcome (effectiveness) of the strategic alliance.

In 1992, Forrest and Martin identified the most important factor as being predictability of partners' behaviour, and expanded this concept in another paper in the same year, where empirical evidence showed that the three characteristics of alliance success an be summarized as continuing, compatibility and commitment – having agreement on the expected outcomes of the alliance; working well together and a willingness to make a sustained commitment (Forrest and Martin 1992). In this study "cultural compatibility" was not rated highly as a factor influencing success. They suggest that it may not be the overall cultural compatibility of the organizations but rather the ability of individuals to bridge the gap in cultures between organizations. Forrest and Martin (1992) also found that joint ventures between similar partners were more successful, although this finding was from a study of joint ventures set up in developing countries, and may not be so applicable to firms in developed countries. Another important effect is the balance of power and dependence and there is evidence to suggest that most alliances that are one-sided appear to fail (Cravens et al., 1993; Harrigan, 1996). The components discussed above are summarized in Figure 2.

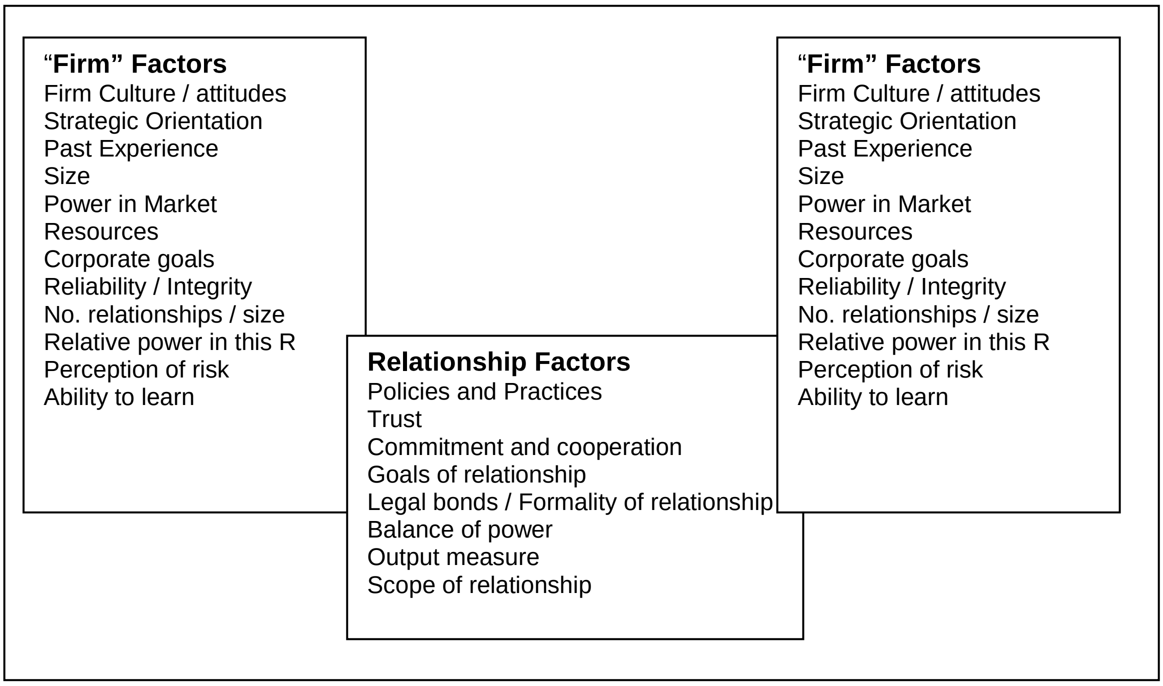

Figure 2. Suggested components of Fn and Rn

Conclusions

Consistent with the alliance literature and within the scope of this framework, there are firm level factors which exist and then activities and behaviours which occur as a result of the relationship which reflect these firm level factors. The factors affecting alliance relationship outcome therefore have some overlaps with the supply chain literature, but also some very important differences. This paper has tried to integrate the two approaches and separate out factors occurring or stemming from "inside" the firm to those factors and variables relating to the relationship in question; i.e. those "outside" the firm but dependent on the firms characteristics. In separating these variables out this framework allows firms to identify the elements which they are competent at, and which transfer across relationships as well as those internal to the firms which can affect the positions of balance and power within the relationship. There are a great deal of factors particular to each firm in the relationship which impact on the particular relationship and in addition, characteristics of the relationship which interact with the firm characteristics simultaneously. Whilst it would be ideal to quantify the relative importance of each of these factors, this may indeed change over time.

This paper extends the current work on relationships by integrating the factors drawn from a range of literature but lacks an empirical base to evaluate this framework further. Therefore future research should identify whether firm and relationship factors can be separated out in some way and if so, the underlying base for this; is this actions, beliefs or resources or some combination of all of these. Is it indeed correct to try to separate out actions from beliefs and attitudes?

The framework once evaluated and improved with empirical support will have managerial implications including providing a better identification and evaluation of core competencies, training opportunities and potentially "hidden resources". The evaluation of these skills can also be put to use in evaluating and selecting new partnerships or relationships for the firm to enter; depending on their skills profile, particular relationships could be more beneficial in terms of organizational learning, relationship outcomes, or establishing a better position for ongoing collaboration with F_2 or another firm now or in the future. It can also be used potentially as a management tool for identifying areas of business where teams or individuals are adding value through relationships with other organizations.

In terms of establishing the "value" of a firm, it is hoped that the value derived from relationships other than with supply chain / customers can be integrated into a balanced scorecard type of approach. This again has managerial implications in terms of placing a value on the firm, and may be useful in raising capital or for shareholder or other stakeholder information.

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