

CAPABILITY AND POWER IN VALUE NET

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Abstract

The strategic meaning of business relationships has increased because of the constantly changing business environment. Companies are forced to develop relationships through which the use of complementary capabilities is enabled. Today, these relationships are developed and established in value nets. Value net is a dynamic network where several actors are creating value through collaboration. The capabilities and resources of the value net actors affect their roles and power positions in a net. A firm with control over unique resources through which it is able to create unique value has a strong power position in a value net. By developing appropriate capabilities internally firms can change their power position in a value net and achieve greater value for the whole network. The approaches of value net and capabilities and power in business relationships are examined in the context of supplier networks and analyzed in the case study from the Finnish food industry.

Keywords: value net, power, capabilities, supplier relationships

Introduction

The global economy has created new challenges for firms. Efficiency demands force companies concentrate on their core business and cut down those functions that are unprofitable or can be outsourced. At the same time, firms are growing through global consolidation and grouping. From the perspective of supplier management this will increase the complexity of supplier networks, and hinder control and management of supplier relationships. To streamline the material flow and minimize lead times, costs and risks firms have started to integrate their supply chains and form supplier networks which aim to satisfy effectively end-customers' needs.

In this continually changing situation the power positions between suppliers and buyers can change quickly in terms of volume and demand. The more the buyer is dependent on the supplier the more important the relationship is from the buyer's point of view. The power position of a buyer relative to supplier influences strongly to the purchasing risk management of a firm. However, from the perspective of the value creation, management's ability to see the profit impact from the integration of the whole supply network and benefiting internal capabilities of the purchasing function is essential. In this study we explore how the firm's power position in a value creating network may change by developing appropriate capabilities internally.

Traditionally power and capabilities between buyers and suppliers have been studied in the context of dyadic relationships and rather in the supply chain level than in the network level. The principles of the chain perspective have been widely utilized in the studies concerning value creation as well. Since 1985, when Porter developed value creation model called value chain, value creation has been studied from the value chain perspective. However, because the business environment is constantly changing, also the strategic approaches and models need to change. Several authors (e.g. Hines, 1993; Hines and Rich, 1997; Parolini, 1999; Amit and Zott, 2001; Kothandaraman and Wilson, 2001) have criticized the inadequacy of the value chain model from several perspectives. Because the value chain as a value creation model is too rigid, sequential and unable to respond to changes, more flexible and agile value creation model has been created. This new model is called a value net and it has been examined for example by Bovet and Martha (2000), Jarillo (1998), Möller, Rajala and Svahn (2005), and Parolini (1999). Instead of conceiving economic activity in terms of a set of economic players who internally perform a set of activities, value net approach considers it in terms of the set of activities that create value for final customers (Parolini, 1999). Value net is a dynamic network where several actors are creating value through collaboration. It generates value through complex exchanges between the actors and it is composed of specialized actors who collaborate to achieve shared goals. (Bovet and Martha, 2000)

The industrial network approach which studies networks through activities, resources, and actors (Håkansson, 1986; Harland, 1996; Anderson and Narus, 1998; offers tools for the study of network structures. The strategic value net approach, on the other hand, focuses on the study of value-creating systems and value nets (Parolini, 1999). Both of these approaches consider networks from similar basis because actors, resources, and activities, and their interrelationships are in focal roles in both approaches. The approaches are complementary to each other, and by combining approaches, the theoretical basis for the study of value nets can be created.

The focus of this study is in the capabilities and power in relationships between suppliers and buyers in a value net. To study this complex phenomenon we present a case study from the Finnish food industry. The main objective of the case study is to describe how a firm can change their power position by developing or acquiring capabilities. We study organizational capabilities of network actors in a firm level in a value net context. The next section of this paper provides the theoretical background. We review the past literature of organizational capabilities and power aspects and apply value net approach. Then, these aspects are examined empirically in the context of supplier networks and analyzed through the case study from the Finnish food industry. The conclusions section presents a summary, practical implications, and suggestions for future work.

Capabilities as significant elements in value nets

The concept of organizational capabilities is derived strongly from the resource-based view (RBV) (Penrose, 1959; Wernerfelt, 1984; Barney, 1991, Teece et al., 1997). RBV assumes that by focusing on the internal organization and its resources competitive advantage can be achieved. RBV explains resources to be specific physical, human, and organizational assets that can be used to implement value-creating strategies and are difficult to imitate. These organizational assets are considered to be firms' dynamic capabilities (Teece et al., 1997). As Teece et al. (1997) have stated capabilities are seen as firms' ability to integrate, build, and reconfigure internal and external skills and knowledge in rapidly changing environment. According to Dosi et al. (2000), capabilities fill the gap between intention and outcome. Makadok (2001) has defined capabilities to be a firm's capacity to deploy resources by using organizational processes to achieve the firm's goals. Eisenhardt and Martin (2002) explain that organizational capability grows from the experience, knowledge and skills of individuals. Helfat and Peteraf (2003) state that organizational capability is a firm's ability to perform coordinated tasks by utilizing organizational resources to achieve desired results. Snow et al. (2006) explain that the core configurational elements in a firm are strategy, capabilities, structure and process. If strategy is the firm's intent and plan, then capability is the main enabling factor that allows strategy to be pursued. Thus, capability is a focal element in a strategic value net structure.

In purchasing and supply management literature, the terms *competence* and *capability* are used interchangeably. In most cases, competencies are seen as personal supply management skills (e.g. Carr and Smeltzer, 1997, 2000; Giunipero and Percy, 2000; Faes et al., 2001). However, Narasimhan and Das (2000) have separated competence and purchasing practices. They argue that purchasing practices are internal observable activities that can be measured, and purchasing competence is a latent capability to structure, develop, and manage the supply base in alignment with the business priorities of a firm. Further, in the studies of Narasimhan et al. (2001) and Knight et al. (2005), are pointed that the key content elements of supply management competence, in addition of individual skills, are e.g. buyer-seller relationship management, network understanding, developing the network position, and strategy formulation and implementation. In that case, a firm level competence can be said to be firm's capability to fulfill its assignments (Axelsson et al., 2005), and thus, it is the firm's ability to combine and deploy its resources and competencies (Teece et al., 1997).

The capabilities of the network actors affect the roles and power positions of the actors. According to Harland (1996), an actor's identity and role is comprised of a unique combination of its resources and activities. Furthermore, the resources the value net actor owns are one of the main sources of power for the actor. The actor that owns or can control unique resources through which it is able to create unique value has a strong power position in a value net. The resources that are valuable, rare, imperfectly imitable and non-substitutable (so called VRIN-resources) are highly valued among the actors and improve the negotiation position of an actor (Barney, 1991; Svahn and Westerlund, 2007). Value can be created by uniquely combining a set of complementary and specialized resources and capabilities (Amit and Zott, 2001). Thus, effective and successful value net needs diverse core capabilities which are complementary to each other. According to Harrison and Håkansson (2006), value is located in the combination of resources, and no one resource has

value in itself. Instead, value comes from productive use when combined with other resources (Penrose, 1959).

Power in value nets

The resource dependency perspective (RDP) (Pfeffer and Salancik, 1978) of relationship formation states that to acquire resources, organizations must interact with others who control these resources. The survival of the organization can be partially explained by its ability to ensure the continuity of the needed resources. Power is determined by the definition of social reality created by the actors and their control over the resources. Organizations seek to avoid dependencies and external control and try retain their autonomy for independent action (Pfeffer and Salancik, 1978). Krapfel, Salmond and Spekman (1991) refer to RDP and argue that the value of a relationship differs according to the willingness and ability of current exchange partners to provide sufficient demand for current and expected outputs, in light of the availability and cost of locating, qualifying and establishing relationships with an alternative exchange partner. Cox (2005) states that relational power determines the sharing of added value.

According to Håkansson (1986), the role of the value net actor depends on the activities the actor performs or controls, the resources the actor controls and the knowledge the actor has about the activities, resources and other actors in the network and all of these define the actor's position in the network. Value net actor's power position in a network is a part of a firm's resource base that both enables and constrains its actions and strategic vision (Wilkinson and Young, 2002). A significant part of a company's total resource base is located beyond its ownership boundary and is controlled bilaterally with other firms. Therefore, the resources of a company are tied to resources in other firms. (Gadde et al., 2003)

The power of buyers and supplier can stem from various sources. According to Cendon and Jarvenpaa (2001), resources, interconnections among the actors in the organizational structures, and organizational position are considered as significant sources of power. Furthermore, actors' unique and highly valued resources and competencies (capabilities) are the basis for influence and power (Doz and Hamel, 1998; Ford et al., 1998; Cendon and Jarvenpaa, 2001). In this study we share this approach and define actors' capabilities to be important sources of power for the value net actors. Therefore, the actors are able to change and develop their power positions by changing and developing their capabilities.

The buyer has power over the supplier if the buyer offers the supplier resources that are relatively scarce and that the supplier regards as relatively important, and if the supplier's resources are relatively commonplace and of relatively low importance for the buyer (Cox et al., 2001). Buyer's power stems from a combination of the attractiveness of their own resources and the supplier's freedom to obtain resources from other organisations. Supplier's power, on the other hand, is derived from the attractiveness of their own resources and the buyer's freedom to obtain resources from other organisations. (Ramsay, 1996) The more important the resources controlled by the actor, the more other actors will be dependent upon it, and the greater will be its power over those other actor (Medcof, 2001). Caniëls and Gelderman (2005), who have studied power between a buyer and a supplier from purchasing portfolio perspective, stated that power and mutual dependence are closely related concepts. The supplier's dependence on the buyer is a source of power for the buyer, and vice versa.

When drawing together the aspects of value net, capability and power we raise a question of how capabilities influence to the power positions of firms in a value net. Figure 1 presents a basic model how capabilities influence to the interaction inside a value net. Generally, it can be assumed that new capabilities increase power of an actor and reduce its dependency from other actors. However, the effect of power increase on value creation is twofold. Increasing power of one actor may influence negatively to the relationships inside the net. In that case the balance of sharing value within the net may falter. On the other hand, increasing dependency on more powerful actor may force less powerful actor to create closer collaboration, which in turn may benefit positively the whole value net.

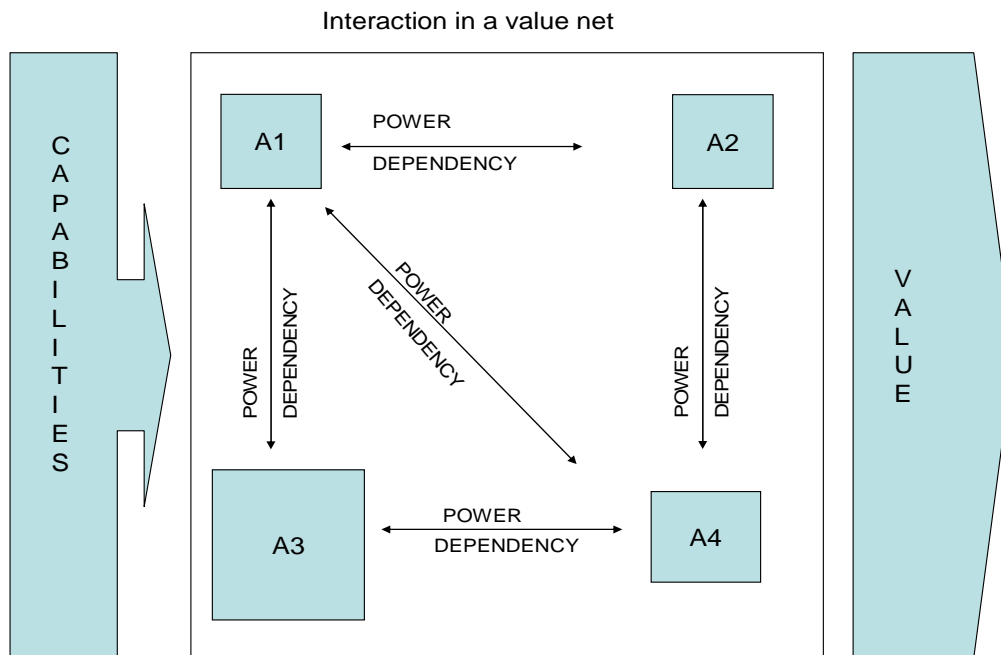


Figure 1. The influence of capabilities to the interaction in a value net.

This indicates that increase of capabilities or new capabilities have both positive and negative influences to the relationships between the actors in the value net. However, as an outcome there is a greater value derived from the whole value net. In the next section we present a case study to illustrate the power positions and dependency links within a value net.

Capability and power in the Finnish food industry value net

This paper applies qualitative research methods by presenting a case study. The case study method is chosen because a case study is an empirical inquiry that studies phenomenon within in its real-life context (Yin, 2003). The main argument for the case study research method here is that the research problem is complex in its nature because it includes many variables and concepts which are not easy to grasp with a quantitative study. Furthermore, because the empirical research context is a contemporary event, it leads to multiple sources of evidence, like interviews, introductory and informative sessions in the case companies, and the use of company-specific documentation. On the other hand, the theory and the method should be aligned with each other (Dubois and Araujo, 2007). In case research, the different aspects of a case are understood in relation to one another in a coherent whole or configuration, rather than modular assemblages of variables (Dubois and Araujo, 2007).

This case study is a result of interviews, and thus the data is qualitative. The interview data was validated by using company information data gathered from a database. Also the data concerning the amount of sales and purchases of the case companies was used. The data concerning the amount of sales and purchases and company information were used as a secondary data while the data collected with the interviews was the primary data. The primary empirical data was collected with 22 semi-structured interviews conducted with the case companies' personnel. Totally 10 interviews were conducted in the manufacturer company, 5 interviews in the retailer company, 5 interviews in the supplier company A and 2 interviews in the supplier company B. Research informants were selected and interviewed on the basis of their active involvement in the buyer-supplier relationships and supply management, and for example supply managers, CEOs and buyers were interviewed. The questions concerned the relationships, the power positions, the sources of power, the capabilities and the roles of the actors and the structure of the Finnish food industry. During the interviews the notes were taken and the interviews were taped. The interviews were transcribed and the resulting qualitative data was coded. The data was analyzed with content analysis and classification. Coding and analysis were done manually by one researcher. After the data was analyzed, it was compared to the theoretical framework and interfaces were searched.

This case study discusses the power relationships and capabilities in a Finnish food industry value net. The case value net is composed of several actors, and the four main actors, representing different nodes of the value net, are the case companies of this study. The case companies are a manufacturer company, two supplier companies, and a retailer in the role of a customer company, and they are all significant actors in the Finnish food industry. In the Finnish food industry there are several value nets, and the case value net of this study represents a value net that is remarkable in the context of the whole industry. The relationships between the value net actors and the structure of the case value net are illustrated in Figure 2.

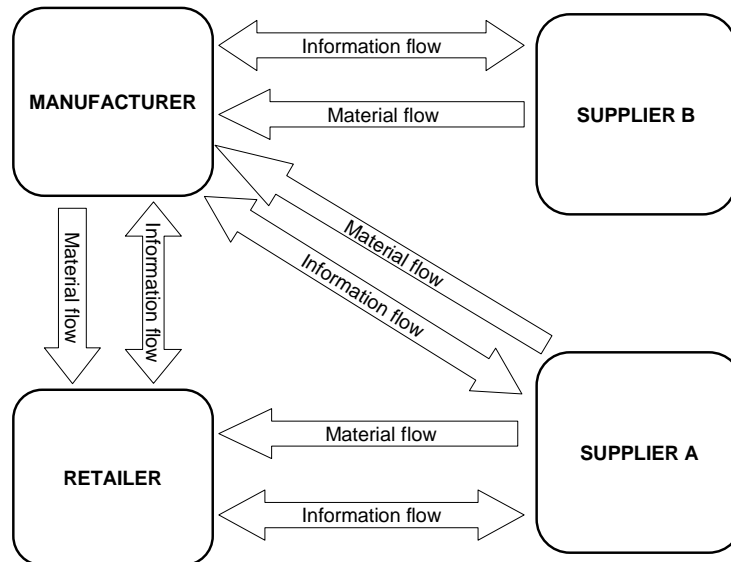


Figure 2. Relationships in the Finnish food industry value net.

In the Finnish food industry value net the case companies have different competencies and capabilities which are complementary to each other. The case companies offer their core capabilities which are relevant to this certain value net and utilize the capabilities of other actors. Through these complementary capabilities, unique value is created for the value net actors when the competencies are combined in order to form the output of the network. The aim of this value net is to increase efficiency, rapidity and customer orientation.

The Finnish food industry is characterized by the centralization of the market, and there are only few retail specialists that are dominating the market with their buying volumes. The retailer of this case study is one of those and thereby its power position in the case value net is significant. Even though the power of the retailer stems mainly from its market power, its power stems also from the size of the company, from the amount of purchases, and from its resources. The retailer has many resources and capabilities which are significant to the case value net. It has, for example, extensive knowledge about the selection and customer preferences and knowledge about purchase prices and market prices. The most important resource of the retailer is, however, the control it has over the distribution channel. The retailer has the control of and knowledge about the distribution channel, and therefore the other value net actors are dependent on the retailer. However, even though the power position of the retailer is remarkable, the strong net of suppliers, the suppliers' specific core capabilities and the suppliers' well-known brands have a diminishing effect on its power.

The manufacturer company, which is a supplier to the suppliers A and B and a buyer to the retailer, has many capabilities and resources that are essential to the case value net. The manufacturer has indispensable knowledge about fresh ready prepared food and it has a very strong and well-known brand. Moreover, the manufacturer's brand is so popular and well-known that is the most significant power source for the manufacturer. It is worth noting that if the retailer wants to offer the products of the manufacturer's brand for its end customers, it is forced to purchase these end products from the manufacturer. This increases the negotiation power of the manufacturer. However, the manufacturer is still dependent on the retailer because of its predominant power position in this value net. In addition to strong brand, the manufacturer has marketing and manufacturing capabilities and active product development which are essential capabilities for this value net. All these resources, capabilities and competencies are remarkable sources of power for the manufacturer, and through these, its power position in the value net is strengthened.

Also the supplier companies have resources and capabilities that are relevant to the network. Supplier company A is a supplier to the manufacturer and to the retailer. The manufacturer company purchases raw materials and the retailer end products from supplier A. Supplier A has manufacturing resources and capabilities and product development capabilities. It has also a very strong and well-known brand. Supplier A's raw materials are mostly basic raw materials and supplier A has some competitors who have substitutive raw materials for the manufacturer. Therefore, the manufacturer is not dependent on the supplier A. However, supplier A has other buyers to whom it can sell its raw materials as well and thereby, supplier A is not dependent on the manufacturer. In the case value net supplier A is dependent only on the retailer because of the retailer's dominant power position.

Supplier company B, on the other hand, is not directly dependent on the retailer. It does not supply anything directly to the retailer, it only supplies to the manufacturer who supplies to the retailer. Supplier B supplies packaging materials to the manufacturer and it has some joint projects with the manufacturer. Furthermore, supplier B has a balanced power position with the manufacturer and it is not dependent on the manufacturer. It has to be noted that supplier B does not have an exchange relationship with supplier A at the moment and they are not competitors. The most important capability that supplier B has is its extensive knowledge about packaging and packaging materials. The company is also very innovative in product development and it offers high quality products.

All these value net actors develop constantly their capabilities and competencies and try to achieve sustainable competitive advantage, effectiveness and more dominant power position through their capabilities and resources. In the case value net especially suppliers A and B could gain more dominant power positions by developing their capabilities further. Supplier A has possibilities to develop its raw material further and to customize raw materials especially for the manufacturer. By developing its resources and capabilities and by customizing its products supplier A could create indispensable products for the manufacturer and achieve new power sources in relation to the manufacturer. Also supplier company B has possibilities to develop its power position when compared to the manufacturer. Supplier B has some joint projects with the manufacturer and through these, supplier B is able to get information concerning the manufacturer's needs and products. By utilizing this information supplier B is able to develop packaging solutions especially to the manufacturer's needs and make the manufacturer become more dependent on its products. The manufacturer, on the other hand, does not have existing capabilities which it could develop further to achieve more dominant power position compared to its suppliers. The manufacturer can only try to achieve more power through its buying volumes. Furthermore, the manufacturer and suppliers A and B do not have significant possibilities to enhance their power positions in relation to the retailer. The retailer has so significant power sources in this value net, that the other actors are dependent on it in any case.

Conclusions

The focus of this study has been in the relationships between suppliers and buyers in a value net. The study emphasizes the importance of capabilities in managing relationships in a network context. We have presented a literature review on value net approach, capability, and power aspects. Capabilities and power in a value net are examined through case study from the Finnish food industry. Previously, the research of value nets has concentrated mostly on the ICT-sector, and there is a limited amount of research in the field of food industry. Taken account that food industry is a very traditional industry in constantly changing business environment it has several features which make special demands for it to develop new business models and create value nets.

The aim of the study was to clarify how a power position of a network actor may change when developing or acquiring new capabilities. The findings from the case study show that the capabilities the value net actor has obtained and developed can be the main sources of power, and power decreases dependency. However, in a value net context, increased power of one actor may disturb the balance between power and dependency in relationships if the need for complementary capabilities decreases. In that case, the value creation role of other network actors is diminishing. On the other hand, in case that the developed and acquired new capabilities are not influencing to the complementary capabilities of the value net the increase of power benefits the whole value net. Despite the fact that in this case study the retailer seemed to have dominant power over the other network actors, the actors with less power compensated their power influence with the capabilities the retailer is dependent on. The more capabilities the actors have the greater is their power position in a value net. However, to be able to create and increase outcome value to the whole net and end-customers the acquired

capabilities should be complementary. Otherwise, the opportunistic behavior between the actors increase and the balance of sharing value is disturbed.

Further research could be directed towards the role of capabilities in value nets. Especially the value creation enabled by collaboration between the value net actors' should be studied more closely. In collaboration the value net actors combine their complementary capabilities and the value is created by collaborating and by combining the capabilities. Hence, it would be interesting to study the value creation enabled by collaboration between the value net actors and the role of capabilities in value creation.

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