

# Unveiling The Importance Of Being A Preferred Customer In Order To Develop Innovations With Suppliers

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## **Abstract**

*Purpose of the paper and literature addressed:* The purpose of this research is to understand why early supplier integration in new product development repeatedly fails and how to select the right suppliers to avoid supplier obstructionism. We review the literature on early supplier integration.

*Research method:* We conducted a consortial benchmarking study, involving seven firms as part of the research consortium and benchmarking visits to six best-practice firms.

*Research findings:* Literature was distinguishing between operational and relational criteria explaining success (or failure) in buyer-supplier collaboration in innovation processes. Our research suggests that the direct relationship may be moderated by a strategic dimension. Missing buyer attractiveness for suppliers may be one additional explanation for the high rate of supplier obstructionism in such collaborations. As a consequence, a buying firm may want to become a preferred customer of its key suppliers. This can be achieved through concentration of the purchasing volume or selection of smaller suppliers.

*Main contribution:* The notion of the buyer becoming a preferred customer of its suppliers effectively inverts the classical marketing approach. This change of perspective opens the avenue for a whole series of future inquiries, in particular answering the question on how to become a preferred customer.

*Keywords:* buyer-supplier relations; new product development; early supplier integration; consortial benchmarking

## **INTRODUCTION: IDENTIFYING THE CHARACTERISTICS OF INNOVATIVE SUPPLIERS**

If one thing has changed in the process of innovation over the last decade, it is the growing reliance on external partners. For instance, a survey involving the largest R&D investors revealed that the proportion of firms that rely heavily on external support for innovation increased from 20% a decade ago to 85% at the beginning of the new millennium (Roberts 2001). This change reflects not only the establishment of horizontal alliances, whose number has stagnated since the mid-1980s (Hagedoorn 2002), but also the increasing role of suppliers.

In principle, the solution for firms wanting to profit from this trend towards “open innovation” (Chesbrough 2003) is to promote early supplier inclusion in their development processes. However, there are abundant reports of supplier incompetence and even of project obstruction when unsuitable suppliers are selected (Flynn, Flynn, Amundson and Schroeder 2000; Hartley, Zirger and Kamath 1997; Primo and Amundson 2002; Rutten 2003; Wognum, Fisser and Weenink 2002; Zsidisin and Smith 2005). The research question that arises is, why do so many suppliers fail to collaborate in joint innovation projects? And how to select the right suppliers to integrate into collaborative development processes? Or, framed differently, what are the typical characteristics of suppliers effectively collaborating with

buyers in new product development? For many firms, this is a new and unconventional situation, since what is purchased is the supplier's competence to come up with a solution, not a finished product, as in the past (Golfetto and Gibbert 2006).

There is abundant literature on new product development that focuses on project-management issues, but the problem of supplier selection arises prior to the start of a project or in its very early phases. Only few and indirect references can be found in the literature. For instance, Handfield et al. have surveyed the practice of supplier selection criteria for supplier integration (Handfield, Ragatz, Petersen and Monczka 1999), while Croom reports on sourcing criteria observed in several case studies (Croom 2001). Rese proposed a process model for selection, but does not examine the criteria for recognizing (potentially) innovative suppliers (Rese 2006). Schiele put forward propositions for such criteria (Schiele 2006), which however were derived from theory and not subject to any empirical verification.

Faced with this underdeveloped state of research, we decided to explore the question using a qualitative research methodology. In detail, we organized a "consortial benchmarking" project. In such a research setting an academic-practitioner research consortium is formed which jointly visits best practice firms and benchmarks their experiences with the research question at hand. In this case, next to the academic organizers, our research consortium consisted of delegates from seven firms interested in the question. Jointly we visited six best practice firms questioning them on how they identify innovative suppliers and which are their particular characteristics.

Findings indicate that in addition to operational criteria, such as the technical competence of a supplier and relational criteria, such as cultural fit, a strategic dimension plays a role. If the buyer is not sufficiently attractive for the supplier the latter may be hesitant in collaborating in innovation. In case of a scarcity of suppliers such as in many segments of industrial markets it may become a strategic necessity of firms to become a "preferred customer" of their key suppliers in order to benefit from their power of innovation. This surprising finding effectively inverts the classical marketing approach, which was directed at increasing the seller's attractiveness. This paper's contribution is to highlight the importance of the buyer becoming interesting for the seller. Further, our case studies provide some first hints on how to become a preferred customer.

The paper is organised as follows: In the next section a framework for analysis will be elaborated. This framework served as basis for the benchmarking study, which will be explained subsequently. Then, the results, namely the unveiling of the preferred customer concept will be laid out. Finally, we can discuss implications.

#### **FRAMEWORK FOR ANALYSIS: IDENTIFICATION OF INNOVATIVE SUPPLIERS AS A TASK IN NEW PRODUCT DEVELOPMENT**

As a point of departure, a framework for analysis can be derived that distinguishes between operational and relational sourcing criteria (Croom 2001; Schiele 2006).

For the operational sourcing criteria, that is, the character of the supplying firm, the importance of the supplier's technical competence has been identified in the research on new product development (Birou and Fawcett 1994; Handfield, Ragatz, Peterson and Monczka 1999; Hartley, Zirger and Kamath 1997; Primo and Amundson 2002; Wasti and Liker 1999). Another suggestion is that the suppliers' quality performance, assessed in terms of certificates obtained, for example, could serve as an indicator (Di Benedetto, Calantone, Van Allen and Montoya-Weiss 2003; Ellram 1990; Handfield, Ragatz, Peterson and Monczka 1999). The suppliers' innovativeness in terms of launching new products by their own is also mentioned (Di Benedetto, Calantone, Van Allen and Montoya-Weiss 2003; Handfield, Ragatz, Peterson and Monczka 1999).

As far as relational sourcing aspects are concerned, that is, the character of the buyer-supplier relationship, there is a clear focus on the importance of trust, in addition to an emphasis on the relevance of a cultural fit between the collaborating firms, as integration has first and foremost been regarded as a social process (Handfield, Ragatz, Petersen and Monczka 1999; Petersen, Handfield and Ragatz 2003; Ragatz, Handfield and Scannell 1997).

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Although it is possible to derive a framework for analysis, a comprehensive theory is missing, as are clear indications for management on how to fully exploit the contribution of supply bases to new product development. This situation is a typical environment for “mode 2-type” research (Gibbons, Limoges, Nowotny, Schartzmann, Scott and Trow 1994), which involves a comparatively new and practically relevant problem coinciding with limited research maturity. A consortial benchmarking case study project fits particularly well in such a context.

#### **METHOD: ACADEMIC-PRACTITIONER COLLABORATIVE RESEARCH USING A CONSORTIAL BENCHMARKING APPROACH**

Consortial benchmarking is multi-phase collaborative benchmarking and can be characterized as a form of collective multi-case study work. Thus, in contrast to traditional individual forms of benchmarking (Camp 1989), several firms conduct the benchmarking exercise simultaneously, resulting in a cross-industry benchmarking study (Fahrni, Völker and Bodmer 2002). To date, consortial benchmarking has received attention almost exclusively in German-speaking countries (Fahrni, Völker and Bodmer 2002; Felde 2004; Puschmann and Alt 2005; Schweikert 2000).

Consortial benchmarking brings together a group of investigators (the consortium) who are interested in finding an answer to a specific research question. The consortium is composed of practitioners from several firms who finance the project and send delegates on benchmarking visits, ensuring relevance by co-defining the research questions and academics who add theoretical knowledge and ensure methodological rigor. The team visits and benchmarks several best-practices firms and collects data on a research topic. This way, a large research team including practitioners as well as academics visits each best-practices firm. They listen to presentations, conduct topical discussions, talk to managers, visit the firm’s installations and review internal documents.

The consortial benchmark method follows four distinct phases, which will be explained below:

- I. *Preparation:* In the first phase a reference framework is generated and the members of the research consortium are selected. In this case, the consortium consisted of the following firms: BMW, Dräger Medical, Siemens Automation & Drives, Siemens Global Procurement and Logistics (central function), Siemens Logistics & Assembly Systems and Unilever. The consortium was put together by the organizers in co-operation with the German purchasers’ association, BME.
- II. *Kick-off workshop:* In the second phase of a consortial benchmarking project an interview guide for the visits is developed and best-practice firms which could be an

interesting object of analysis are identified. In our case, during a two day workshop with delegates from the firms participating in the research consortium a detailed questionnaire was developed based on the initial research framework explained above. The topics were the characteristics of innovative suppliers and how to identify them, as well as internal organizational issues within innovative firms. For the sake of brevity, here we focus only on the first part, that is, the characteristics of innovative suppliers and their identification. The consortium also agreed on a list of firms to be visited. The selection of the best-practice firms was based on 42 outside-in studies plus suggestions from the consortium firms' delegates. For example, prizes commending the innovativeness of these firms, as well as citations in the literature, were used as points of departure for inclusion. A voting scheme was used to rank the proposed firms.

A comparison of selection criteria for innovative suppliers from the literature with criteria commonly used for supplier evaluation (Weber, Current and Benton 1991) yielded a negligible difference from a content point of view. With the exception of innovativeness, the proposed operational and relational criteria are the same as those used for "normal" supplier selection. Indeed, firms have been found not to differentiate here (Hartley, Zirger and Kamath 1997). Questions arose in the research consortium as to whether there were more proprietary models for selecting innovation-suppliers and how the predictive power of selection criteria could be increased.

- III. *Benchmarking visits:* The third phase is the core of a consortial benchmarking project, because the actual benchmarking visits take place. Here, the new knowledge has to be generated. The firms visited in our study have a strong background in the production industry (in chronological order, including the location visited): Deckel Maho Gildemeister (machine tool manufacturing, Bielefeld, Germany); BMW (motor vehicles manufacturing, Munich, Germany, which decided to join the consortium after being visited as a best-practice example); Leica Geosystems (manufacturer of precision measuring instruments, Heerbrugg, Switzerland); Magna Steyr (automotive contract manufacturing and contract development, Graz, Austria); BSH – Bosch Siemens Haushaltsgeräte, Electronics, Drives & Systems Unit (producer of components for household appliances, Regensburg, Germany); and Cherry (production of computer input devices, switches and controls, and automotive supply, Auerbach, Germany).

Each visit took one and a half days. The first day usually included briefing consortium team members and possibly a visit to the production facilities or a first informal dinner meeting with members of the best-practice firm. The second day was taken up with presentations by the best-practice firms and a discussion of the research questions. From the consortium firms, the head of purchasing and the head of research and development or their delegates usually participated in the visits. From the best-practice firms, the functions mentioned above were typically represented during the visit, in addition to the chief executive officer and colleagues in a pertinent area, such as the head of the innovation division or advanced sourcing or supplier development. Immediately after the visit to the best-practice firm, still on site, the members of the research consortium, i.e. the visitors, met in a separate room and compiled the findings.

- IV. *Final meeting:* The last phase of a consortial benchmarking project targets at harvesting, discussing and summarizing the findings. After more than a year of study, the lessons learned from the individual benchmarking visits were collated and a final

report produced. A final one-day meeting was organized to discuss the results and conclude discussions on issues that had remained open during the visits.

The next section elaborates on the most interesting finding from the project: unveiling the “preferred customer” concept.

### **RESULTS: THE COMMONLY OVERLOOKED IMPORTANCE OF BEING A PREFERRED CUSTOMER**

During the benchmarking visits, several features were found that explain how best-practice firms identify innovative suppliers and the characteristics they consider important. Five out of six best-practice firms had introduced capability and performance-based supplier classification schemes that led to the identification of a small group of distinguished “core” suppliers. With one best practice firm, for instance, for a supplier to be put into the highest category and become a “preferred supplier,” it needed an innovation advantage over its competitors of more than six months.

While “preferred supplier” is a well-known concept, during the visits to the best-practice firms, the importance of a reverse perspective on the buyer-seller relationship became apparent: the need to be the “preferred customer” of key suppliers to ensure that the suppliers make a maximum contribution to innovation.

Unfortunately, it was not possible at this stage to identify a consistent and shared system of identifying collaboration-skilled suppliers, even in the best-practice firms. What was reported, however, is the idea of ensuring full support from suppliers by becoming one of their preferred customers. Some best-practice firms have developed specific sourcing strategies aimed at securing collaboration with prime suppliers. With one of the visited firms, for example, the objective was to purchase between 10% and 30% of turnover from a core supplier. This ensured treatment as a preferred customer from this supplier’s point of view, without creating too much dependency. This practice is reminiscent of Japanese sourcing structures, where individual buyers are often even more important to their core suppliers in terms of supplier turnover (Birou and Fawcett 1994; Wasti and Liker 1999).

Not being a preferred customer of a supplier was reported to cause problems, not only in terms of delivery failures, but also with regard to new product development. Such a situation happened to one of the best practice firms, which had decided to source from the world market leader in a particular component, located in Asia. The trigger had been more favorable prices. However, after some time problems in delivery occurred. The world-market leader was suffering from a lack of production capacity. The small buyer located on another continent did not get deliveries first. Instead, the supplier allocated the scarce production capacity to their traditional, large customers. The situation got even worse, when our case company planned a new product line and needed innovative solutions. The world-market leader did not offer sufficient support in research and was not willing to fully adapt their products to the customer’s wishes. Finally, the situation became strategically alarming when the competitors of our case company - headquartered in the same country as the world-leading supplier - entered the European market with fully customized components. In this moment the case company decided to act. Unfortunately, their traditional supplier had gone bankrupt in the meantime, so that switching back was no option. Instead, they decided to switch from the one large, world-market leader to two smaller 2<sup>nd</sup> tier suppliers. The new smaller suppliers were offered an intensive supplier development program to enable them to achieve a level of performance similar to that of the former supplier. With these suppliers, then, preferred customer status could be achieved and this allowed the buyers to influence the

direction of research and to achieve a product design that exactly fit the intended application and ultimately restored competitiveness (figure 2).

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A firm has preferred customer status with a supplier if the supplier ensures preferential resource allocation to satisfy the buyer. This can be achieved in several ways: the supplier can dedicate its best personnel to joint new product development, customize its products in accordance with the preferred customer's wishes, offer innovations to this firm first or even enter into an exclusivity agreement. The supplier can also ensure privileged treatment when constraints in production capacity result in bottlenecks.

Once the notion of preferred customer emerged during a visit to a best-practice firm, it was discussed in the consortium. Retrospectively, most consortium members confirmed this thesis with their own core suppliers. The concept was then discussed during the remaining visits to best-practice firms so that further evidence could be collected. Indeed, it may be worth amending the initial framework of an operative and a relational dimension (Figure 1) to include a strategic dimension. According to the preferred customer thesis, the innovative contribution of suppliers does not directly depend on operational and relational characteristics, but is mediated by a strategic dimension, the preferred customer construct (Figure 3).

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The operational characteristics of the supplying firm, for example its R&D capacity, do not automatically lead to more innovations with a particular buyer unless this capacity is applied to the benefit of this buyer and not spread among the demands of other customers. Trusted and intensive relationships do not develop with all customers, but primarily with those considered the most important or the most visible. Through introducing the notion of the preferred customer, the model gains predictive power: if a buyer has the chance to become a preferred customer of a supplier, the groundwork may be laid to develop a trusting and intensive relationship over time, which then fosters innovation.

#### **DISCUSSION: FAILURE TO BE A PREFERRED CUSTOMER AS A REASON FOR SUPPLIER OBSTRUCTIONISM**

Regarding the initial research question on why repeatedly supplier obstructionism is reported as cause of failure in collaborative innovation processes, an option not discussed so often can be proposed: the buyer may not be attractive enough for the supplier. Indeed, suppliers may even be willing to discontinue serving unattractive customers (Helm, Rolfes and Günter 2006). As a consequence, one way of improving the success of collaboration with suppliers in new product development can be to increase the buyer's attractiveness for the supplier. The idea of purposefully trying to become a preferred customer of suppliers is opposed to the classic assumption that sellers must take all the responsibility for becoming well positioned with buyers.

The preferred customer concept identifies a significant "white spot" that has received only limited attention in the literature. After a case study project on new product development, Wynstra et al. concluded that the buyer should present itself as a "kind of

supplier” to its supplier, that is, actively try to become interesting to the supplier (Wynstra, Weggeman and van\_Weele 2003). Ellegaard et al., again drawing from a case study, highlight the importance of customer attractiveness in industrial buyer-supplier relationships (Ellegaard, Johansen and Drejer 2003), while Christiansen and Maltz conducted case studies with small Danish firms that were trying to become “interesting customers” to their large international suppliers (Christiansen and Maltz 2002).

The scarcity of research on the issue may also be due to the conceptual difficulties of capturing this strategic phenomenon. From a market-based view, suppliers generally play a limited role, because their unlimited availability is assumed (Ramsay 2001). Researchers rooted in the classic, resource-based view would also have difficulties with the preferred customer concept, since their theory focuses on the internal setting of a firm and has next to nothing to say about inter-firm relationships, such as the supply environment (Foss 1999; Mathews 2002).

Unveiling the importance of being a preferred customer asks firms actively assess their status with their suppliers. Understanding if they have preferred customer status with the key innovation-suppliers can refine the selection process of partners for innovation, reduce supplier-induced project failures and ultimately increase the firm’s innovativeness.

#### **LIMITATIONS AND FUTURE RESEARCH**

There are limitations to our research, however, with respect to generalizability, despite this being an instrumental case study (Stake 2005). Both the best-practice firms and the consortium member firms are predominantly rooted in hi-tech industries. This renders the results applicable to similar industrial environments, only. Further, the importance of being a preferred customer may foremost be an issue in the context of innovation and in case of supplier scarcity.

None the less, from this new perspective it may be possible to revisit research on supplier obstructionism. A lack of interest on the part of the supplier may be at the heart of the problem, rather than poor project management, the usual explanation.

A prominent new task for supply management is to ensure that the firm has preferred-customer status with suppliers that need to be integrated into new product development. Unfortunately, we know too little about how to accomplish this task, other than to suggest consistent supply-base streamlining, so as to attain maximum importance in terms of volume with the remaining suppliers. Purchaser’s need to know more about the true expectations of their suppliers (Ramsay and Wagner 2009). Elaborating further on this issue will be a useful focus for future research. This is a new, strategically oriented rationale for the ongoing debate on supply-base streamlining.

Inverting the traditional perspective and focusing on the buyer’s attempt to become more attractive for its suppliers also opens up a rich field of enquiry for future research. Customer attractiveness can be analyzed as one of the antecedents of successful buyer-supplier collaboration in new product development and innovation. Another avenue for research lies in the field of resource allocation in production. This is particular relevant in a boom-phase, when there are shortages on the market and suppliers have to distribute their scare production capacity. Finally, a challenge arises on how to become a preferred customer of leading suppliers, if the buyer is a small firm or if being located in a remote location.

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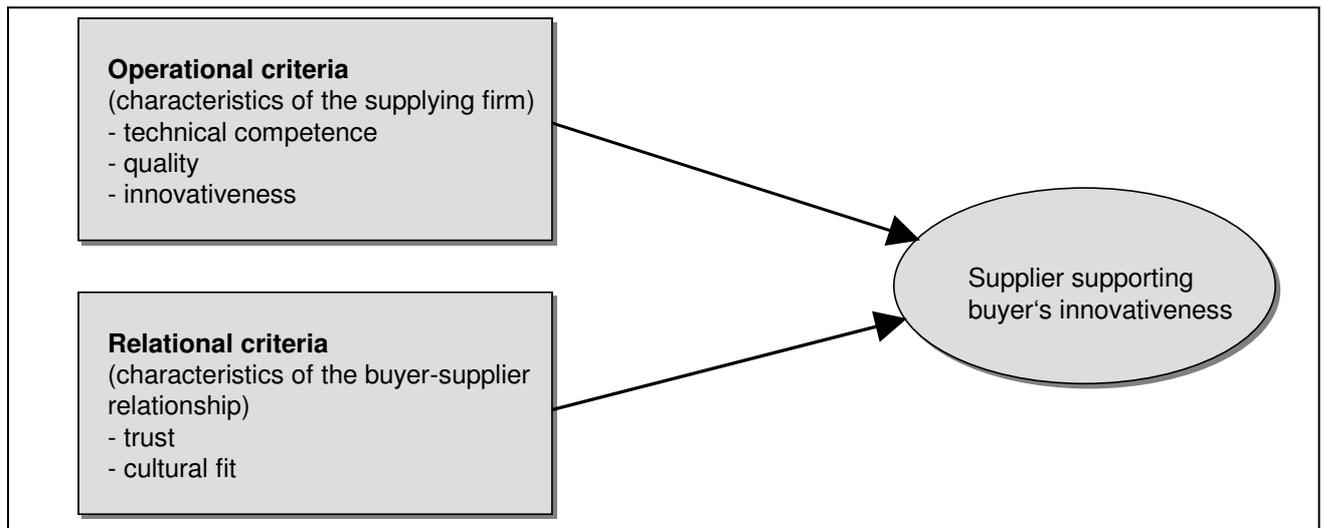


Fig. 1: initial framework for analysis. Source: authors' elaboration

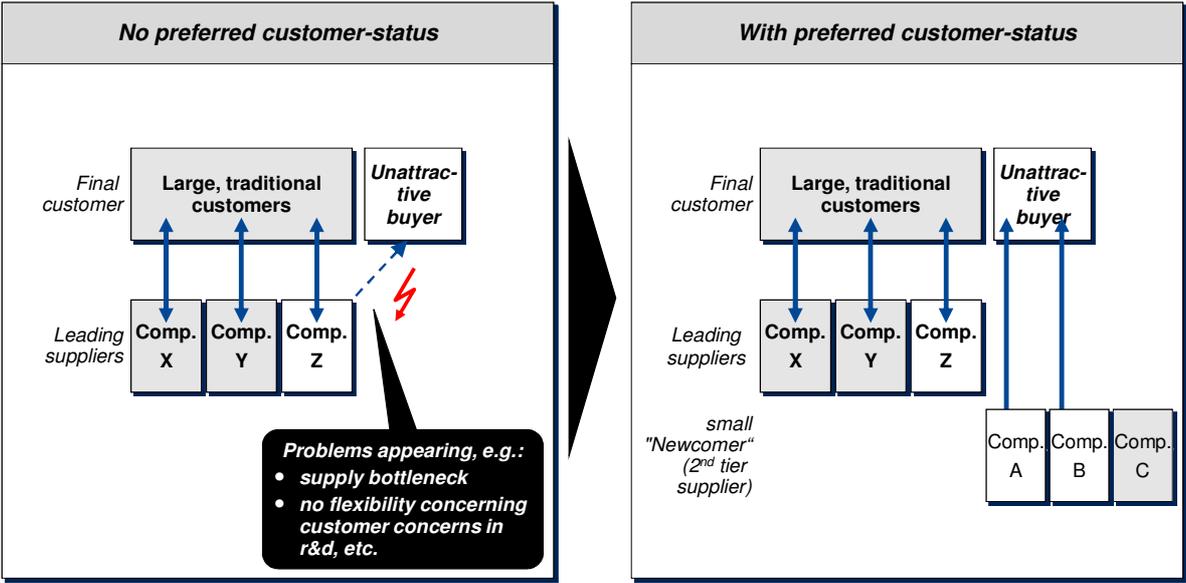


Fig. 2: becoming a preferred customer. Source: authors' elaboration

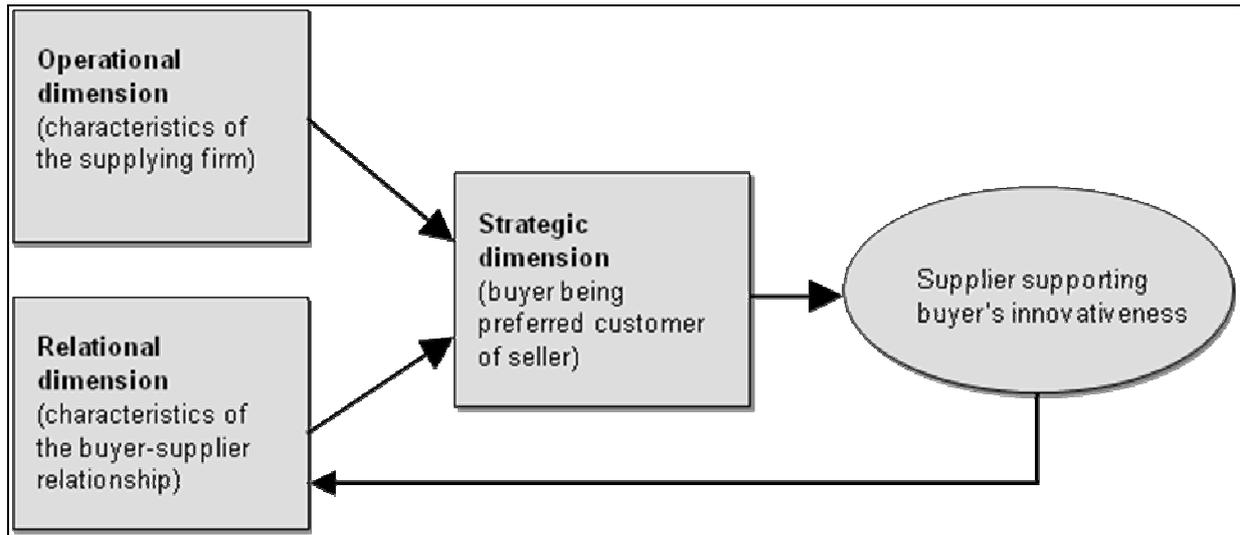


Fig. 3: the framework adopted after the benchmarking visits. Source: authors' elaboration