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**CAPTIVE IN BUSINESS NETWORKS**

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## **Abstract**

Researchers often fail to take seriously the relevance of network constraints and tend to conceptualize companies' choices as business actions that work and produce outcomes. This implies companies are free to choose their programmes of actions. The efficacy of companies' choices can however be severely restricted by pre-existing embedded networks of business relationships. Companies may find themselves captive to business networks and, hence, being forced to act in a certain direction in order to establish or continue business. Consider for example, cost and price restrictions, specifications regarding retailer brands or manufacturer brands, limited number of irreplaceable raw material suppliers as well as the limited number of major customers. Extant research acknowledges the general need to take into account the contextual conditioning of companies. Nonetheless, there is a lack of empirical investigations that shed light on the impact of network constraints on today's companies. This paper addresses this research gap. Based on an empirical investigation of manufacturer-retailer networks, this study attempts to map the multiplicity of network constraints and analyses how companies cope with these over time. The findings illustrate that although companies are captive in business networks they can find ways to deal with this captivity and pursue their own interests.

## **Introduction**

Consider two hypothetical retailers, Alpha and Beta, who are negotiating deals with the manufacturers Delta, Manufact and Zeppelin to supply their retailer brands. Alpha and Beta inform the manufacturers that if they sign a contract with either of them, they will not be able to supply the other one due to exclusivity clauses that will be placed in the negotiated contracts. Retailers often expect exclusive supply when negotiating retailer brand contracts because they do not want manufacturers to supply key competitors at the same time.

In this paper we use the example of the European paint market which is characterized by strong consolidation leading to few major retailers and market domination. In specific, we research the category of retailer brand supply. Paints as products, are heavy weight, low value per litre and bulky in size. These products are ideally distributed by retailers as manufacturers can supply large quantities. Due to the fact that each retailer has its own retailer brand which is owned by the retailer, they try to exert their market power in order to prevent manufacturers from supplying to key competitors simultaneously. In such situations the manufacturer is given no choice but to accept certain terms and such conditions. The inability to act freely leads to a captive business situation. This dependency is seen as a network constraint which plays a major role in business relationships.

In order to understand the phenomenon, we need to look at existing research to identify factors that cause captivity. First of, there is a paucity of research in connection with the relevance of network constraints. Previous studies have tended to conceptualise companies' choices as business actions that work and produce outcomes. This implies that companies are free to choose their programmes of actions and there are superior business actions behind every successful company (Ford & Mouzas, 2008). The efficacy of companies' choices, however, can be restricted by pre-existing embeddedness in complex networks of business relationships (Uzzi, 1997; Håkansson & Snehota, 1998; Halinen, & Törnroos, J-Å. 1998).

Therefore, it is not the single action but the combined interaction happening within the network that determines the outcome.

In this context, Halinen & Törnroos (2005) recognize that “networks of connected firms are rapidly replacing traditional markets and vertically integrated companies” (p. 1285). Even though this trend can be observed, little research about networks, their functioning and management has been conducted (Achrol & Kotler, 1999; Möller & Halinen, 1999).

This research therefore examines the interaction between companies that are captive in business networks in order to understand the phenomenon from a network perspective. The unit of analysis is a defined network of retailers and manufacturers in a Central European DIY (do-it-yourself) market in the category of paints (retailer brand supply). Within this industry, the two largest retailers give out tenders for their retailer brand at similar times and force manufacturers to agree on supplying either one of them but not both. The research objective of this paper explores the phenomenon of captivity and analyses how companies cope with such situations. We seek to address the lack of empirical investigations that shed light on the impact of captivity in the context of business relationships. The following research questions are addressed in this paper: 1) Why are companies captive in business networks? 2) In what forms is captivity demonstrated? 3) How do companies cope with captivity in business networks? 4) What are implications for further research and what are managerial implications?

In the following section we build upon a framework for analysing captivity in business networks. We then discuss literature on the anatomy and impact of network constraints, the role of negotiation and the concept of embeddedness in business networks. Following this, the research method and the context in the form of overall market structure, players and size is outlined. The Bestland and Neverland case then illustrates an example of a paint manufacturer being captive in a business network and other influential challenges to manufacturers and

retailers (such as cost and price restrictions and the role of brands) are highlighted. The analysis follows the case illustration and the final section of the paper deals with implications for further research and managerial implications.

### **A framework for analysing captivity in business networks**

Captivity infers that companies are unable to act freely due to network constraints. In this case, two large DIY retailers give out tenders for the supply of their retailer brands in the category of paints and insist that the participating paint manufacturers are to accept exclusive supply clauses which prevent them from supplying both retailers simultaneously. The reason manufacturers face such network constraints is due to the high degree of consolidation in this market and the ownership of the brands. Retailer brands are owned by the retailer. The retailer needs a competent partner to supply and manage their brand because the supply is complex and requires large investments of the manufacturer at the beginning of supply contract. Manufacturers are specifically interested in the supply and management of the brand due to the long term gains and large supply quantities. Due to the ownership of the brand, the manufacturer nevertheless has limited chance of demanding terms and conditions. Supplying a well known industrial brand would engender a different scenario because the retailer would be facing end consumer demand for the brand, which is, for example, promoted by the media.

In the context of retailer brand supply, manufacturers therefore face the difficulty of winning as many retailers as possible in order to stay independent on the one hand and retaining existing customers on the other hand. Finding a balance between the two is difficult to impossible in some cases due to retailers' market power and brand ownership preventing a shift from the status quo to potentially new business situations. In order to understand the nature of this captivity we present a framework for analysing business captivity.

There are multiple companies in the network and each company's overall business action is embedded in a process of questioning the status quo and raising new challenges or possibilities (Ford & Mouzas 2008) which results in network constraints that each company has to face because there only is limited demand in the market. As given business networks do not have identifiable boundaries (Araujo, Dubois, & Gadde, 2003) or defined centres that cannot be owned or controlled by one actor (Ford & Mouzas, 2008), it is not possible to plan all future outcomes. Therefore, the multi-lateral, conscious and unconscious interaction (Hakansson et al., 1982; Hakansson & Ford, 2002) that takes place between the individually significant actors in given business networks determines the outcome in a given business situation and requires constant questioning and monitoring of the status quo.

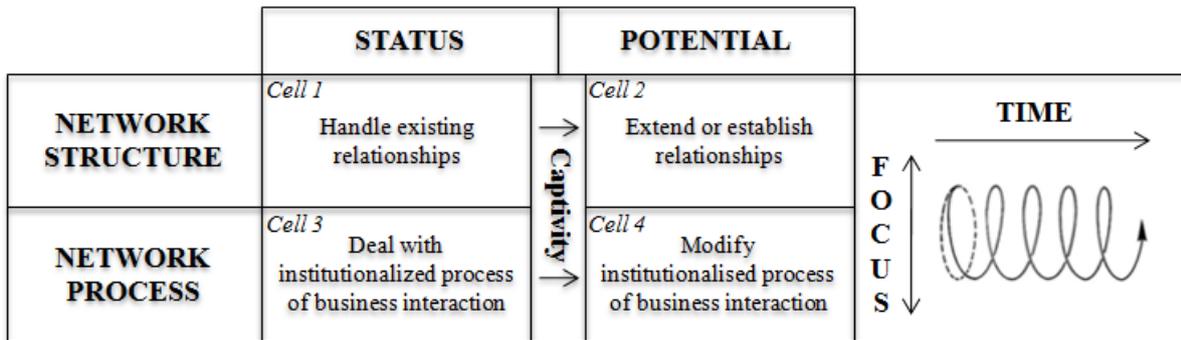
The challenge becomes to handle business relationships accordingly because the level of interdependency increases with higher retailer concentration. Becoming interdependent, for example on the resources of the other party in this context can happen consciously or unconsciously (Ford & Mouzas 2008). A way to manage such a situation is to appreciate that *“business relationships provide the arena for both parties to attempt to manage and exploit the benefits of those interdependencies.”* (p.67). However, concentrated market settings with many interdependencies can lead to captivity regardless of the above. The chosen case in this paper underlines this argument as the paint manufacturer in question had no choice but to accept exclusive supply.

Companies captive in business networks have a limited ability to act and need ways to understand why this is the case and how they can manoeuvre in such situations. This is why a theoretical approach is needed to shed further light on the specific aspects of captivity. Companies are constantly looking at their existing structures and processes to try to adjust or act in some form to use future potentials. Captivity influences the transition from the status quo to future potential situations in a way that several potential options are simply not

available because one or more actors in the network have the ability to prevent certain outcomes. In the following theoretical framework we modify Ford and Mouzas' (2008) matrix (see Figure 1) linking the status quo with the potential by looking at existing structure (cell 1: handling existing relationships), potential structure (cell 2: extend or establish relationships), existing process (cell 3: deal with institutionalised process of business interaction) and potential process (cell 4: modify institutionalised process of business interaction). Captivity in the model is represented by the constraints of transition from status to potential. We argue that companies establishing new business relationships with a particular retailer might have to face the consequences of not being able to establish other business relationships. The case study in this paper showcases this phenomenon as establishing a business relationship with Megastore (cell 2) dismisses the opportunity to build a business relationship with Inhouse.

Companies might face a dismissal of certain business opportunities. This nevertheless does not mean that companies stop questioning potential business opportunities. Rather the opposite takes place. Companies act in all four cells simultaneously all the time. They have to handle existing relationships (cell 1) and need to question them in order to extend them (cell 2). They need to look out for new business opportunities (cell 2) and need to understand what institutionalised processes of business interaction are (cell 3). Furthermore, the side effects of establishing new business relationships need to be regarded as well because a modification of the institutionalised process of business interaction is required.

Figure 1: A model of analysing captivity in business networks



Source: In accordance to Ford & Mouzas (2008)

When trying to address captivity, companies in business networks cannot ignore the phenomenon as it is present at all times in certain market settings. Therefore companies need to accept its existence and find ways to manoeuvre it in order to achieve best possible outcomes. One way of doing so is to question the status quo regularly and try to find out which potentials could be utilized. This requires a varying focus on certain cells at certain points in time. We argue that companies sometimes need to place more emphasis on establishing new relationships while not forgetting to handle existing ones in order to address captivity. This argument is illustrated in the model by the spiral indicating companies' varying focus on one cell at one specific point in time without disregarding the other four cells. The advancement in time is presented by the arrow.

The case study in this paper shows that while dealing with various business relationships simultaneously, the establishment of one business relationship makes it impossible to establish another relationship. Disregarding the phenomenon can lead to companies facing ending contracts with no opportunity to continue business.

In order to explain underlying factors of captivity, we have chosen three major aspects that play a vital role. First, we have identified companies' pre-existing embeddedness in complex networks of business relationships (Uzzi, 1997; Håkansson & Snehota, 1998; Halinen, &

Törnroos, J-Å. 1998). Second, companies have to face network constraints which is catalysed by the embeddedness in business networks. And third, in order to address ways of dealing with captivity, we look at the role of negotiation.

### **The impact of network constraints and embeddedness on captivity**

Network constraints are ubiquitous and are inextricably linked with the structure of networks (defined by business relationships) and the process in networks (institutionalised process of business interaction). Consider cost and price restrictions that exist within networks, specifications regarding retailer brands or manufacturer brands, limited number of irreplaceable raw material suppliers as well as the limited number of major customers. Extant research acknowledges the general need to take into account the contextual conditioning of companies and there are calls for a relentless focus on the spatiotemporal context (Pettigrew *et al.*, 2001). Nonetheless, there is a lack of theoretical and empirical investigations that shed light on the anatomy and impact of network constraints on today's companies. One major aspect of network constraints is the existence of companies' embeddedness in complex business relationships. Embeddedness in complex networks plays a major role in leading to captive business situations. The more embedded a company is, the more challenging it can be to act freely in a certain direction. Depending on the interconnectedness and webs of ties, companies are able to act in either more or less autonomous ways within given networks (Uzzi 1996). In this context, it is important to differentiate between arm's length ties and relational ties. This is because the level of embeddedness is determined by the form of tie. Embeddedness is low within arm's-length ties and high within relational ties (Uzzi 1996). The relationships that exist between manufacturers and retailers in the context of retailer brand supply are relational ties due to a high level of embeddedness, frequent exchange and interaction.

Relational ties also result in exchange leading to a network structure where arm's length ties are characterized more by market-like structures (Powell, 1990). The relational ties can also lead to beneficial situations for companies as a high level of embeddedness "increases economic effectiveness along a number of dimensions (...)" such as "organizational learning, risk-sharing, and speed-to-market" (Uzzi 1996, p. 694).

A high level of embeddedness therefore can be positive and enrich a business relationship but relational ties are beneficial only up to a certain threshold (Uzzi 1996). If companies in the network do not favor relational ties, the outcomes could be negative for business relationships and thereby have an effect on network constraints. As no single company is able to control the network and dictate the way companies chose their ties (Uzzi 1996), it is possible that network constraints lead to captive business situations. Retailers for example, see the value of a business relationship and try to prevent value created for other retailers by the manufacturer. The question remains of how companies can deal with embeddedness, retain retailers and win new retailers in order to break free of captivity or use network constraints to the advantage of the company being captive in a business network. In order to address this issue, literature on negotiation is reviewed to see whether companies can address captivity by negotiating better deals.

### **Negotiation as a mechanism to address captivity**

Companies who look to break free of captivity require tools that would enable them to act more freely. Negotiation is one of these tools that can be helpful in the context of captive business situations. Looking at research on negotiation, contrary to the traditional contributions on game theory and decision analysis (Luce & Raiffa, 1957; Nash, 1950; Roth, 1985), Lax and Sebenius (Lax & Sebenius, 1986) represent the newer generation of negotiation researchers. They base their contribution on the work of Raiffa (1982) who introduced the term "*negotiation analysis*". In the later work of Lax and Sebenius (2002), they

apply a three-dimensional approach to negotiation contrary to the classical one-dimensional approach. The two dimensions they add are: “*deal-crafting*”, focussing on creating joint value, and the “*role and outcome of entrepreneurial action*” within negotiations (Lax & Sebenius, 2002). Instead of searching for the equilibrium and “the” big solution (game theory), Lax and Sebenius (1991) argue that actors’ alternatives change during negotiation. This might be the reason because new information is available or time advances and the willingness to settle is higher than in the beginning phases of negotiation. “*Resources such as effort, time or money should go toward affecting alternatives or generating new ones until the expected improvement in the value of the negotiated outcome from expending additional resources just equals the cost of doing so*” (p.98) (Lax & Sebenius, 1991). In this context, differences in perceptions and interests influence the creation of joint value (Lax & Sebenius, 2002; Sebenius, 1992).

When markets are consolidated and the interest of the retailer to create joint value is limited however, negotiation can play its part to help the manufacturer to create value accordingly. Mouzas & Ford (2003) in this context argue that “*organisations conduct simultaneous dyadic negotiations in a web of business relationships and their dyadic negotiations have an impact on other relationships in the network*” (p.358). In this case simultaneous negotiations are shown to have a significant impact on the overall outcome (see case analysis). The matrix of network negotiations (Mouzas & Ford, 2003) shows that it is vital for organisations to use the negotiation space given to them. While initiating options (phase 1), companies see what opportunities arise for them by negotiating with multiple parties. Furthermore, they have to provide “*the rationales and the resources that enable other organisations to initiate change*” (p.61). Furthermore, it is vital to infuse options (phase 2) which requires one party to ensure that the other party wants to act based on the options presented to them. In order to achieve wise trades at the end of the negotiation “*value that is placed on a real option by another*

*organisation*” has to be “*greater than the organisation’s own cost of providing it*” (p.63) (phase 3). If companies pay attention to these points, they are not able to break free of captivity, but they are able to work towards better outcomes for themselves (Mouzas & Ford, 2003, p. 61).

We have now discussed the underlying factors of captivity in the form of network constraints and embeddedness as well as negotiation as a tool to address captivity. In the next section, we discuss the research process, provide contextual information and discuss the Bestland and Neverland case.

### **The research process**

We employ the case study method to investigate the present phenomenon of captivity in business networks (Eisenhardt, 1989; Tsoukas, 1989; Pettigrew, 1990; Orlikowski, 1992; Easton, 1995; Halinen & Törnroos, 2005; Yin, 2008). With the case study method being suitably fitted to the ontological choice of the network approach, data collection for the study took place between October 2010 and March 2011. The research was mainly conducted in a paint company called Paintco. Several meetings took place during that period of time to understand the philosophy of the company and get inside information about the structure and unique selling propositions. Semi-structured interviews with senior staff of the company took place from November 2010 until February 2011.

In the context of the Bestland and Neverland case, we conducted interviews with the head of research and development, the managing director of international sales, the managing director of national sales as well as the assistant sales person and the product manager in order to achieve a holistic picture of the phenomenon from multiple company departments. We paid attention to base the research on multiple sources and triangulate the data in order to achieve a

chain of evidence which increases the validity and reliability of research findings. In particular, we conducted a critical review of existing literature alongside data collection and constantly revisited the literature during this period. We also analysed archival records and press releases of the paint manufacturer to improve triangulation. Data analysis was based on critical examination, evaluation, categorization, and recombination of the data collected to address the research phenomenon (Glaser & Strauss, 1967).

### **Contextual information**

The investigated case examines a tender in the category of paints between retailers Megastore and Inhouse and paint manufacturer Paintco. Megastore and Inhouse operate in two Central European countries: Bestland and Neverland and are the number one and two when combining both markets in terms of market share. Paintco is an international paint manufacturer and sells its products to DIY retailers in nine European countries.

- Megastore currently has a total of 360 stores in 2010/11 in Bestland and Neverland and has generated 1384 million Euros in net turnover in 2009 (Dähne, 2010).
- Inhouse operates a total of 365 stores with a net turnover of 1874 million Euros in Bestland and Neverland in 2009 (Dähne, 2010).

Bestland has a population of 10 million inhabitants and a GDP of 265 billion Euros (Dähne, 2010). Ten retailers operate in the country of which Megastore is number one in terms of net turnover and number of stores; Inhouse is number three. Neverland has a population of 16.5 million and a GDP of 572.1 billion Euros with nineteen retailers in operation (Dähne, 2010). Megastore is number two in the market in terms of number of stores and net turnover; Inhouse is the market leader.

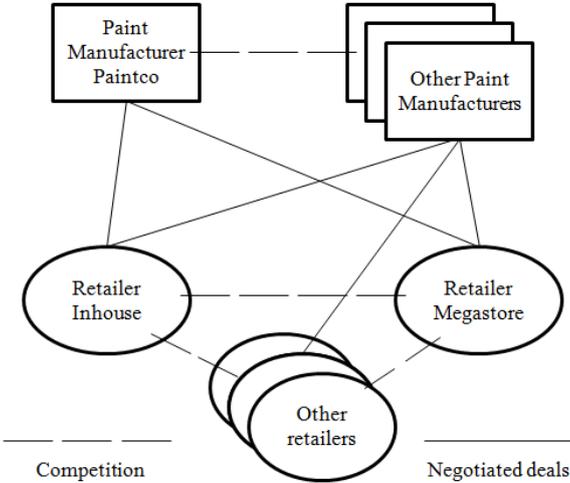
Both markets are characterized by market concentration. Inhouse and Megastore dominate the market and therefore are attractive to paint manufacturers who see the potential of supplying a

significant number of products in the category of retailer brands. Nevertheless, due to the market situation, the retailers have the opportunity to demand best price and dictate certain terms and conditions such as exclusive supply which poses various risks to the manufacturers.

### The Bestland and Neverland case

The case that is presented shall be a starting point for further research in the area of business networks and captivity. The following figure shows the manufacturer-retailer network in this context:

Figure 2: Manufacturer-retailer network



Source: Own development

Paintco is an international paint manufacturer specialized in the production and management of retailer brands and is particularly interested in developing a) long term relationships with their retail partners and b) offering a large share of the paint category in order to secure competitive prices to the retailer.

In early 2010 (February-March), retailers Inhouse and Megastore gave out tenders for their product categories of retailer paints to several paint manufacturers. Paintco and other paint manufacturers had the chance to participate in the tender with the possibility of winning

Inhouse and Megastore as retail partners. Paintco was not doing any business with Inhouse and Megastore so far.

Paintco decided to enter both tender processes and negotiate with Inhouse and Megastore simultaneously. The case describes how the negotiated agreement between Paintco and Inhouse affected the negotiation with Megastore and illustrates the process in which Paintco agreed to an exclusivity clause to supply Megastore.

Inhouse and Megastore handled the tender process in **four phases**:

<b>Phase 1</b>	<b>Phase 2</b>	<b>Phase 3</b>	<b>Phase 4</b>
January – February 2010	February – March 2010	March – November 2010	November – December 2010
<b>Introduction of tender</b>	<b>Decision on participation</b>	<b>Negotiation of supply relationship</b>	<b>Final contract negotiation &amp; contract signature</b>

In **phase one**, Inhouse and Megastore distributed various tender documents to Paintco and the other manufacturers. These documents included contract information, the description of the overall process in order for the manufacturers to know how to proceed and what to do in case they wanted to participate in the tender. The retailers gave out detailed instructions so that each manufacturer knew what product groups were part of the tender and what was expected in terms of paint quality and further procedure.

On February 4, Inhouse contacted Paintco to see whether they would be interested in further information related to the tender. Paintco was interested and received the request for quotation and the tender documents on February 8<sup>th</sup>. Paintco received Megastore’s tender documents on March 2, 2010 resulting in the tender process started at similar times for both retailers.

In **phase two**, the retailers and Paintco used the opportunity to get to know each other as no business relationship between Paintco and Megastore or Inhouse had been established prior to this point in time. Furthermore, the companies exchanged various documents and samples.

Two days after receiving the documents from Inhouse (February 10), the managing director of international sales and the managing director of R&D from Paintco availed the opportunity to meet with the central buyer of Inhouse. Paintco made an offer to Inhouse on February 28. Inhouse gave out a detailed agenda for the tender process. It is important to mention that Inhouse did not give out a tender for the whole category of paints and glosses but only for glosses.

**The deadlines were the following:**

- Deadline for submitting questions: 14 February 2010 12:00 PM
- Date by which questions will be answered by Inhouse: 19 February 2010
- Deadline for submitting RFP (request for proposal): 25 February 2010 12:00 PM
- Evaluation and selection of the tendering firms: 25 February –14 March 2010
- Contract negotiations: 16 - 25 March 2010
- Definitive award of RFP and signing of contracts: 28 March 2010
- Starting date of contracts: 1 April 2010

Concerning the tender with Megastore, Paintco sent out the required documents and samples on March 17. On March 15, Inhouse changed the tender to include the whole category of paints and informed Paintco and the other manufacturers accordingly. The reason for the decision was that Inhouse wanted to achieve better prices due to a greater offer. Inhouse sent the documents for the updated tender process to Paintco and the other manufacturers on April 28 with the same deadline structure as before only extending the process by a few months. Starting on May 13 and ending on August 14, the whole process was postponed for four months. The interesting side effect of this action was that now both tender processes were comparable in terms of overall timeframe. Both tender processes lasted for approximately 10 months from February 2010 until December 2010.

On the same day Paintco received the information about the changing tender (April 28), they had a meeting with Megastore to show them their production plant. The marketing and buying director of decoration, the marketing manager paint, the analyst of the marketing decoration department, the DIY market and concept manager as well as the buying director, the head buyer paint, decoration, lightening and the senior buyer paint from Megastore attended the meeting. The purpose was to get to know each other better and show the production technology and marketing centre of Paintco to the Megastore personnel. A meeting with Inhouse did not take place during the same period of time. Paintco sent the updated documents and samples according to the new timeframe of the tender to Inhouse on June 11.

In **phase 3**, frequent interaction took place between retailers and Paintco, discussing various topics concerning supply relationships. Between June and September, Megastore and Paintco met several times. On June 6, the team from Paintco (sales team and R&D) discussed the overall strategy of Megastore, the retailer brand positioning and the tender as well as the cost structure and exclusivity. The discussion about exclusivity at this point in time was interesting to note as this would mean that Paintco could not sign another supply contract with another key retailer operating in the same countries. Inhouse stated exclusivity from the beginning of the tender process forcing the participating paint manufacturers to make a decision at the end of the process of whom to supply.

On June 27<sup>th</sup>, Paintco's sales team and Megastore's buying team discussed topics such as price indices, commercial support and upcoming legal regulations concerning the ingredients of paint. On July 7, the DIY market and concept manager and buyer of Megastore and the sales team and product manager of Paintco discussed the aforementioned topics further and exchanged their viewpoints on production quality, contract duration, proceedings in case of image damage, delivery quota and packaging prices. On August 23, an additional meeting to discuss a letter of intent (LOI) and schedule workshops to define the overall strategy and

assortments took place between the head buyer of Megastore and managing director sales of Paintco. The scheduled workshops between the buying team and marketing team of Megastore and the marketing team, product management team and R&D team of Paintco took place on September 1 & 2, 8 & 9 and 28 and October 7 and 8.

In the first workshop, the parties discussed possible market positioning of emulsion paints. In the second workshop, the companies discussed and specified the category of glosses and in the third workshop, they specified the category of wood care. In the final workshop, the companies selected specific color shades. During the workshops, Paintco presented country specific market data with detailed product positioning of paints and glosses in Bestland and Neverland to Megastore to show its understanding of the market and suggest possible market positioning in terms of quality and color selection of the retailer brand.

During the period of August and November, several meetings between Paintco and Inhouse took place. On August 8, the central buyer paints from Inhouse met with the managing director of international sales and his assistant to discuss product qualities, delivery quota, prices and rebates, logistics and a country specific hotline. On August 25, another meeting took place between the central buyer paints from Inhouse, a consulting agent and the sales manager international and his assistant from Paintco to discuss the same topics as on August 8 as well as a renegotiation of prices, contract duration and proceedings with old stock. On August 31, the central buyer paints and the consulting agent met again with the Paintco team to discuss a possible acceptance of the tender, discuss exclusivity again and point out that a possible LOI could be ready to sign by mid-September. On September 21, the purchasing director and the central buyer paints met with the sales team and the law representative of Paintco to negotiate further about the supply relationship and sign a LOI. One month later on October 21, Paintco arranged a final discussion about the strategic planning and a meeting to visit the production plant.

After several meetings between Paintco and Inhouse and Paintco and Megastore, the overall details about the possible supply relationships were defined so that Paintco was able to negotiate final agreements with both retailers.

**Phase 4** represented the final stage of negotiation for the final agreements. Two key meetings about the contract and the overall supply relationship took place between Paintco and Megastore on September 19 at the Megastore headquarter and October 6 at Paintco's headquarter to finalise all details of a possible supply relationship.

During the various meetings between Paintco and Inhouse, contract details were already discussed and a final meeting on November 10 at Paintco's headquarters between the managing director, the purchase director, the central buyer paints from Inhouse, the CEO, managing director of international sales including his assistant and the managing director of R&D from Paintco took place. The meeting's purpose was to renegotiate the final terms and find an agreement to which both sides could agree upon. Inhouse was not interested in giving the whole retailer brand category to one paint manufacturer. Paintco offered to wait until existing contracts with other paint manufacturers would determine whether or not they could take over the whole category and manage it holistically from that point on. Inhouse remained firm on their grounds for exclusivity however, but were interested in signing a supply relationship with Paintco.

After the meeting, Paintco needed to reflect on how to manage these circumstances / constraints and had a final meeting with Megastore on December 2 to negotiate final contract details. During the meeting the chief commercial officer and the head buyer from Megastore had another chance to see the production plant. Paintco's CEO and managing director sales negotiated the supply relationship further and argued that they had the opportunity to sign a supply relationship with Inhouse. This being said, Paintco was able to renegotiate contract

terms in order to achieve a longer contract duration and exclusive supply of the category of paints and glosses with Megastore.

On December 8, Paintco informed Inhouse that they could not accept the contract terms and conditions. On December 12, they signed a multi-year supply contract with Megastore.

## **Case analysis**

This case study has shown how companies find themselves being captive in business networks. Paintco under no circumstances would have been able to break free of the retailers' demand for exclusivity. Nevertheless, Paintco found a way to cope with the situation. In order to understand the phenomenon of captivity, the following paragraphs discuss the case in the context of the theoretical framework presented earlier, analyses the intention of retailers to force manufacturers to exclusivity and show how manufacturers cope with such situations.

### **Network constraints and captivity**

Based on the theoretical framework presented earlier, we argue that companies, if they want to attempt to break free of captivity, need to act from all four cells of existing and potential process and structure simultaneously and that by doing so that could enable companies with a way to handle captivity but not to break free of it entirely. The Bestland and Neverland case has shown that captive business situations result because markets are very concentrated and retailers have high market share. Paintco was not able to break free of captivity but could handle it by acquiring a new customer by negotiating with both parties simultaneously. The difficulty in the case was that Paintco had to deal with its existing supply relationships at the same which verifies the framework in the sense that acquiring new customers is very important but paying attention to not loose existing customers is also vital. We observed that Paintco had to focus to a great extent on the establishment of relationships when two simultaneous negotiations were taking place. Paintco dealt with the two tender processes for

almost 10 months and the frequent interaction required significant amounts of manpower and resources. Furthermore, we were able to show that a particular negotiation process with one retailer to establish a business relationship can lead to another business relationship not being established. As this case was an example of cell 2, it would be interesting to discuss a case that relates to the argument we made earlier concerning the establishing of a new business relationship and its side effects on the way existing relationships need to be handled (cell 4).

This particular case has shown that companies do need to act upon all four cells of the matrix simultaneously to avoid becoming dependent on a particular process or structural outcome. First of all, companies need to deal with existing relationships and handle them carefully to ensure ongoing business (cell 1). Secondly, they need to attempt to extend the business relationship to show the retailer that the business relationship is valuable and worth further investment (cell 2). Thirdly, they need to establish new relationships to not become dependent on few retailers (cell 2). Fourthly, companies are constantly interacting within their business relationships and need to handle this interaction (cell 3). Finally, building new business relationships could have side effects on existing relationships which could require institutionalized interaction to be modified (cell 4). At the same time, companies may also need to place more emphasis on a particular cell at certain points in time in conjunction with paying enough attention to those existing relationships which are continually present at all times. Therefore, network constraints force companies to constantly question the status quo when attempting to manage captivity. The case has verified that the transition from status to potential was not entirely possible as only one supply relationship could be established meaning that another could not. Paintco was able to achieve an outcome and therefore did not have to face the worst case scenario of not supplying to either retailer. The transition from the status quo to potential business opportunities in the Bestland and Neverland case were certainly demonstrable of a captive situation.

### **Embeddedness in business networks**

Companies that are embedded often need to find better ways to handle relationships, know how to act assertively and know when to accept terms and conditions. The reason why Paintco was captive in the business network was because of the market positions of Megastore and Inhouse. With both parties holding such high market shares, they were constantly trying to maneuver themselves into a more advantageous position. Business relationships in the context of retailer brands are usually long term and therefore paint manufacturers need to find ways to establish as many business relationships as possible, which consequently leads to states of embeddedness. As neither manufacturers, nor retailers can control the network, both parties have to focus on their contribution and abilities (Mouzas & Ford 2008). In the context of retailer brands, the business relationships were characterised by relational ties (Uzzi 1996) as interactions were highly frequent with knowledge transfer taking place before agreement of the supply contract. The exchange to a significant part took place due to the characteristics of retailer brands. The role of these brands is vital because the ownership of the brands is one of the major reasons why captivity can exist.

### **The role of brands: Industrial brands versus retailer brands**

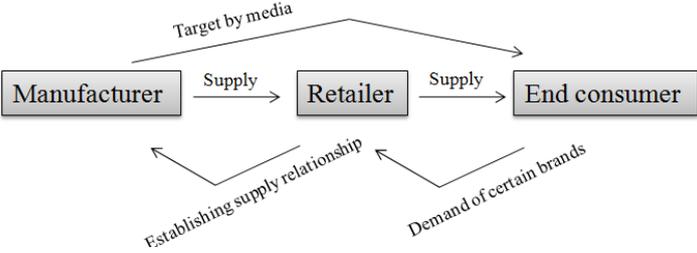
The role of brands is important in the analysis of captivity. Before going into detail about brands and the reasons why they can lead to captivity, a short explanation of the key characteristics and differences of industrial and manufacturer brands follows in the next paragraphs.

The main difference between industrial brands and retailer brands is the source of ownership. Industrial brands are owned, branded and managed by the industry, whereas retailer brands are owned by the retailer. The type of ownership has important side effects on the interaction between retailer and manufacturer. Strong industrial brands are in a way pre-sold as the Managing Director of National Sales of Paintco points out, “*Manufacturers with strong*

industrial brands can exert power and influence the retailers as the media coverage leads to end consumers asking for certain products. This brings the retailer in a situation in which they need the manufacturer’s products” (Managing Director Sales National Paintco, 2011).

Figure 3 illustrates the argument raised by the managing director:

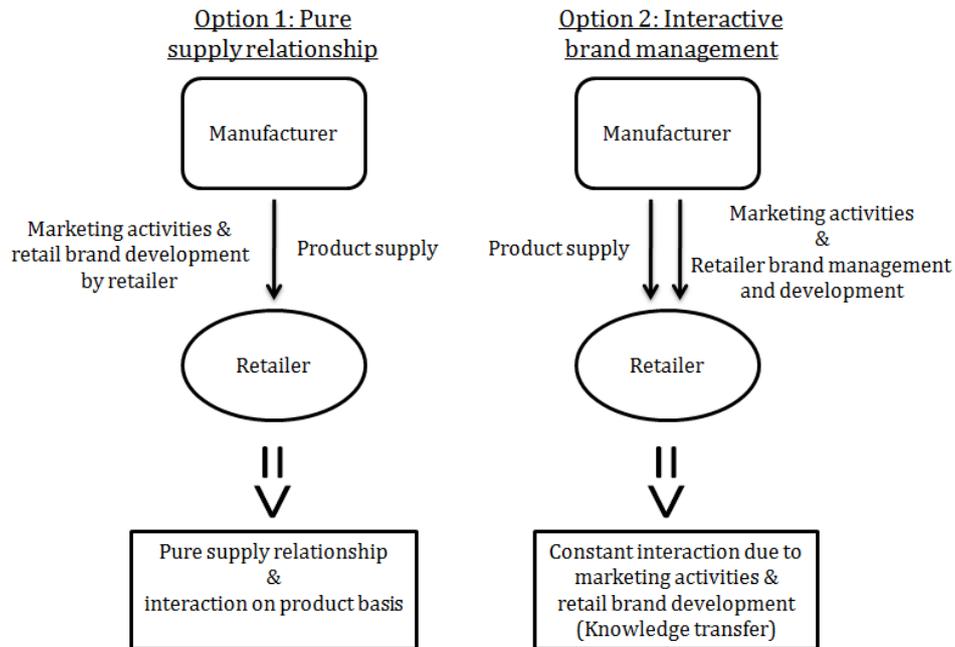
Figure 3: Pre-sold industrial brands



Source: Own development

Retailer brands on the other hand do not have high media coverage and try to win consumers in the store by their price positioning and benefits. This being said, manufacturers have no chance to force retailers to establish a supply relationship with them because the brands belong to the retailer. This is why a retail brand paint manufacturer becomes captive in the business network because they do not have a valuable brand to make demands. They need to convince the retailer by their know-how and supply possibilities. Due to the fact that there are various competent paint manufacturers in the market, captivity becomes even more present. A key question pertaining to the case is how was Paintco able to create value for Inhouse and Megastore and thereby convince them to consider establishing a supply relationship? One important aspect in this context was the option of not only supplying the products but asking for the marketing and management know-how of Paintco to develop and manage the retailer brand category for the duration of the contract. To discuss the argument, the two options of retailer brand supply are shown in figure 4:

Figure 4: Two scenarios for retailer brand supply



Source: Own development

The major difference between options one and two is the level of interaction between retailers and paint manufacturers. Option 2 enables a value creation process that option 1 cannot achieve. Furthermore, interaction is more frequent and helps the establishment of the business relationship. This argument is supported by several researchers as marketing action within networks is directed at relationships of the organization with other organizations (Gadde, Huemer, & Hakansson, 2003) and involves an on-going co-operation (Wilkinson & Young, 2002) and negotiation. (Mouzas & Ford, 2003; Mouzas, 2006, p. 1274). The importance of knowledge gain and offering added value is also pointed out by Mouzas (2006) who points out that “marketing action in networks takes the form of creating and exercising a number of options that best reflect the organisations’ strengths and their capacities derived from network membership” (p.1285). Although adding value to supply relationships cannot solve the problem of captivity it can give manufacturers a chance to make retailers more interested in their supply relationship. This is also pointed out by the sales assistant from Paintco who

confirmed that *“Megastore had the impression that Paintco was working professionally, had a competitive price offer and was convinced by the overall presentation and retailer brand concepts they had to offer”* (Assistant Sales Manager Paintco, 2011). Retailers therefore need to pay close attention to the selection of manufacturers in order to establish competitive retailer brands that are convincing to end consumers. With this in mind, the notion of motives and expectations of parties play an important role in supply chain relationships.

According to the Managing Director of National Sales from Paintco (2011), *“the smaller the market, the bigger the problem; retailers exert their market power because they can. The retailer that is in the economically better position in the market usually tries to weaken the position of the economically smaller ones”* The complexity of managing retailer brands is apparent. Knowledge that retailers can achieve best prices and minimise handling problems associated with manufacturers (by having a few main suppliers for example) certainly poses risks to both retailers and manufacturers as well. Such risks go hand in hand with the interests and motives of paint manufacturers as they strive to achieve maximum supply and dependencies. This is reflected in the following quote: *“Yes, the offer has to be competitive in terms of price but the best offer does not necessarily mean that the retailer has made the best choice. They need to find someone who can handle the complexity and create most value out of the category”* (Managing Director Sales International Paintco, 2011). To point out the complexity further, the product manager of Paintco stated that *“it is important to drive the brand together to achieve credibility and trust. This is necessary because the complexity is always present and only if everything and everybody works well, the whole process can work”* (Head of Product Management Paintco, 2011).

The arguments showcase how retailers are also dependent on manufacturers in retailer brand relationships. This does not mean that manufacturers can break free of captivity but that they can try to maximize the dependency of retailers (Ford & Mouzas 2008). To address this more

specifically, the next section discusses ways in which manufactures can cope with captive business situations.

### **Manufacturers' ways of dealing with captivity**

Manufacturers in market settings similar to the Bestland and Neverland case faced two options of either accepting exclusive supply or not supplying at all. Reason for this behaviour is often due to the fact that there are multiple paint manufacturers that are capable of offering similar packages.

*“The only way to deal with these situations is to be innovative and professional, convince the retailer that you can create added value but in order to maximize the value, it is important to get as much of the category as possible. If we accept exclusivity we need something in return. It is important that the retailer is in some ways also dependent on you as the management of retailer brands is very complex and changing suppliers takes up to one year”* (Managing Director Sales National Paintco, 2011).

The quote highlights value, innovation and also the role of entrepreneurial action within negotiations and deal-crafting (Lax & Sebenius, 2002) as being important. The team of Paintco was able to convince Megastore that they could create value but in the end, the CEO managed to use his entrepreneurial action in the form of re-negotiation to achieve better contract terms. In order to cope with captive market situations in which retailers dictate conditions, the Managing Director of National Sales from Paintco mentions various questions that manufacturers should answer in order to be prepared for negotiations:

- “If supply of either retailer A or B is possible, then which one serves the interests of the manufacturer more?
- If the manufacturer had no chance but to accept exclusivity, then what could the manufacturer ask in return? (i.e. the opportunity cost for not doing business with the other party)
- Retailers need suppliers that can handle complexity and add value. What level of complexity can the manufacturer handle and what are the ways to create value that are perceived as valuable by the retailer?
- Are there any other distribution channels in the country to go around the retailers’ visibility? (For example cooperation with other paint companies or tool manufacturers? Is there any wholesale trade?)
- How far can manufacturers negotiate supply for the whole category to have two-sided dependency?” (Managing Director Sales National Paintco, 2011)

With answers to these questions in mind, manufacturers could achieve better outcomes and maximize their interests amidst captivity in the business network. Paintco was not able to break free of captivity as their ability to act was limited but they were able to achieve a result that was valuable for them. Furthermore, by achieving the exclusive supply of the retailer brand, Paintco was able to enter a business relationship characterised by two-sided dependency as changing manufacturers in such a scenario would take up to 12 months and requires significant investments. Moreover, the chances of building a sustainable long-term business relationship were higher due to the handling of the whole category. This analyses has shown that companies can find ways to handle captivity. The next section discusses captivity further and links the literature to the phenomenon.

## **A first approach to captivity in business networks**

Approaching captivity in business networks is multi-faceted and requires a consideration of multiple factors. The Bestland and Neverland case has shown that companies might find themselves being captive due to limited choices. These limited choices can be regarded as constraints to the transition from the status quo to potential future outcomes shown in the theoretical model. Companies have to accept certain circumstances even though they do not represent the capabilities of both parties. Both retailers made clear that if a manufacturer would sign a supply contract with them, that they were not going to have the opportunity to supply the other party. The assistant sales manager from Paintco pointed out that they tried to convince the retailers but for them, exclusivity was not negotiable: *“Even though we tried to argue to both retailers that we operate like a consulting agency, having multiple customers, sometimes even from the same market, at the same time and still ensuring discretion. Inhouse and Megastore strictly denied and expected the commitment to either one of them”* (Assistant Sales Manager Paintco, 2011).

In the literature review, the issue of knowing where to draw a line between captivity and interdependency was raised. The case has shown that captivity was a result of accepting interdependency in the first place. In the present case, Paintco was able to use ongoing negotiation with Inhouse to achieve a better deal with Megastore which shows an example of a company being able to make decisions and renegotiate terms. The importance of negotiation has been pointed out in this case, as negotiation lead to a better outcome for Paintco in the end. By confirming findings from the literature, actors’ alternatives (in this case Paintco’s alternatives) changed during negotiation (Lax & Sebenius, 1991). Furthermore, the interests and perceptions of both parties played a significant role as mentioned by Lax and Sebenius (2002) and Sebenius (1992). Paintco was interested in maximizing the creation of joint value by trying to be the sole supplier if forced to agree to exclusivity to one retailer. Inhouse had

different interests and had the impression that it would be better for them to diversify and have several paint suppliers.

The Bestland and Neverland case has also confirmed Mouzas and Ford's work (2003) arguing that "*organizations conduct simultaneous dyadic negotiations (...) and they have an impact on other relationships in the network*" (p.358). In this case, the supply relationship with Megastore could be established because simultaneous negotiation with Megastore took place. It was the only way for Paintco to maximize their stakes and make the deal more attractive for them. Applying Mouzas and Ford's (2003) matrix mentioned earlier, Paintco was able to initiate options by negotiating with Inhouse and Megastore simultaneously. They were able to infuse those options by convincing Megastore that if they would agree on Paintco as the sole retailer brand supplier and expert that they would benefit from more tailored and long term brand strategies.

In addition, the case analysis also showed that Uzzi's (1996) discussion of the difference between arm's length ties and embedded ties played a significant role in the network relationships. Paintco was interested in relational ties as they could create more value by having closer relationships and handling the category jointly. Megastore was convinced that a long-term business relationship to manage the category would be beneficial to both companies and that "*organizational learning, risk-sharing and speed-to-market*" (Uzzi 1996, p.694) could be advantageous in such close supplier retailer relationships. Nevertheless, being embedded in such a network can also lead to difficulties. In this case the outcome was positive for Paintco given the situation that they had to make a decision. But due to the fact that any one company cannot control the whole network, the outcome could also have been less favorable for Paintco.

Paintco was not able to break free of captivity but they tried to use given boundaries and maximize their interests. In this context, the theoretical framework showed that Paintco was

acting in all four cells but needed to focus on winning new customers during the presented time frame in order to address captivity. The conclusion of this argument therefore is that even though the transition from status to potential can lead to captivity, manufacturers still have to try to establish new relationships in order to reduce risk. This does not solve the initial problem of captivity but at least it gives manufacturers the chance to maneuver it in a new direction. The extent to which retailers can influence manufacturers and force them to accept exclusivity depends on the market environment. It is easier for retailers to push through exclusivity clauses in a market situation like the one in the case (i.e. oligopolistic). If the market was however less consolidated, the chances of manufacturers being able to escape captive business situations could increase significantly.

## **Conclusion**

This paper has shown that companies find themselves being captive in business networks. In a consolidated business landscape where few major retailers and various competing manufacturers can offer similar competences, it is nearly impossible to break free from being captive in a particular network. Nevertheless, the case has shown that manufacturers can find ways to deal with the circumstances and are still capable to pursue their own interests.

The case has confirmed that companies being captive in business networks need to navigate in the existing structure and processes and confront the existing with the potential to deal with captivity, stay competitive and survive. The challenge for companies is to establish a new structure of relationships and new processes of business interaction while at the same time coping with existing ones. The Bestland and Neverland case has shown that a focus on one particular cell can be necessary at certain points in time. The tender processes required frequent interaction and investments in terms of manpower to convince the retailers to start a business relationship with Paintco.

Due to investments in potential business opportunities, companies can have the chance to maximize their interests in captive business situations as Paintco was able to renegotiate contract terms and achieve better overall results in the end. Rather than focusing solely on a big solution *per se*, the paper has shown that companies' entrepreneurial action that confronts the existing status quo with the potentials inherent in existing structures of business relationships and existing process of interactions can make a real difference.

### **Limitations, managerial implications and further research**

This study acts as a starting point to understanding captivity in consolidated business networks. The Bestland and Neverland case provides an example of captivity in a business network, where Paintco was able to make the best out of the given situation. Limitations of the research lie in that the study was limited to only one product category and one specific case. More empirical work is needed to highlight the repercussions of manufacturers and retailers operating in consolidated markets. Furthermore, captivity needs more attention in the literature in terms of factors leading to captivity, levels of captivity and potential strategies to break free of the phenomenon.

From a managerial point of view, manufacturers are seen to have limited scope to break free from being captive in business networks where markets are consolidated. They can, however, try to manage situations by better understanding network constraints and by better dealing with these constraints. The more complex the paint categories are, the more important it is for retailers to source from competent partners and the more important it is to know how to manage these complexities. Similarly, manufacturers need to provide ever more competitive and innovative offerings to address existing and potential needs of their customers.

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