UNIVERSITY OF STIRLING

DEPARTMENT OF MANAGEMENT

# AN EXPLORATORY STUDY INTO BUYER AND SUPPLIER RELATIONSHIP PROBLEMS, CAUSES, CONTROL STRATEGIES AND EFFECTS IN SAUDI ARABIAN COMPANIES

BY

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## ABSTRACT

Around the world, companies are rapidly moving towards outsourcing to enhance their competitive position in the market through reduction in product development cycle times (costs), demands for better quality, improvement in supply chain management and higher expectations from more discriminating and demanding customers (Lyons and Krachenberg, 1990). An outsourcing mechanism consists of two parties, buyer and supplier. Hence, the success of the buyer and supplier relationship is the main factor to achieve successful outsourcing operations.

This research studies the buyer and supplier relationship in each relationship type in the Saudi Arabian market; market exchange, captive buyer, strategic partnership and captive supplier. The main objective of this research was to study in depth buyer and supplier relationships (outsourcing) by discovering which problems exist in each type of relationship, how they can be controlled and what are their effects. It examines and tests certain factors associated with the relationships, such as incentives for their creation, relationship problems, cause of problems, problem control mechanisms and finally the effects of these problems on the buyer, the relationship and the market.

The methodology used in this study was as follows: an interpretative research philosophy, an inductive research approach and an exploratory research strategy. Semi-structured interviews were found to be the most appropriate method of data collection because they enabled the researcher to gather valid and reliable data. The research model involved all the components affecting the buyer and supplier relationship. These components were categorized and classified in a meaningful way, describing the flow of the relationship from the research perspective in terms of testing the effect of each

component in the relationship between buyer and supplier in general and its effect on the category to which it belongs.

The data was collected from purchasing employees on the buyers' side and sales employees on the suppliers' side. The total number of participating buyer and supplier firms was 57, distributed across manufacturing and service industries.

The first data collection phase involved all the buyer data and the second following up, reviewing and completing the data that the researcher thought had been missed during the first phase of interviews, and which needed to be explained more fully by the interviewees. This phase also involved collecting all the supplier data. 40 interviews were conducted to collect buyer data within three months. The 40 interviews involved 88 recorded hours, and each buyer discussed 4 relationships (not necessarily 4 different types of relationship), resulting in a total of 64 market exchange, 30 captive buyer, 22 strategic relationship and 44 captive supplier relationships, accounting for the total of 160 different types of relationships across the 40 different buyers. Supplier data was collected by conducting 17 interviews within 27 days. The 17 interviews involved 34 recorded hours.

While the researcher was analyzing the data collected, a special case in market exchange relationship was found. In this case, buyers preferred to deal with suppliers under a captive buyer relationship though the relationship characteristics were market exchange relationship because of their interests. The researcher also found that Saudi firms are the same as other firms in the rest of the world. They are trying to maximize their competitiveness in the market by improving product or service quality and speed of delivery, reducing product or service costs and enhancing decision making efficiency.

Additionally, it was found that relationship incentives, arising from buyer wishes or compulsory reasons, create any one of the buyer and supplier relationship types, which were other than what has been mentioned in the outsourcing reasons in the literature. In addition, the researcher also found that relationship incentives might cause problems, so the buyer should be more careful with them. Additionally, there are also other causes that might create agency problems than those mentioned in previous studies. At the same time, it was observed that there are new control mechanisms, not previously discussed in the literature. The study found that the outsourcing relationship is affected negatively, and there are other effects than those mentioned in the literature by Tezuka (1997). In addition, the researcher found that because of the 'agency' system in Saudi Arabia its economy is affected negatively. Finally, the original research conceptual model was found applicable to all types of relationship.

**CONTENTS**

# CHAPTER ONE

# CHAPTER ONE

# INTRODUCTION

## 1.1 Introduction

When firms contract, sub-contract, or externalize non-core activities to free up cash, personnel, time, and facilities for activities, where the firm holds competitive advantage, this is called outsourcing. Firms concentrate on what they do best, and they contract out to others. Thus, by outsourcing firms provide more flexible, faster, cheaper and effective services. Outsourcing is often an integral part of downsizing or reengineering.

Business outsourcing is a delegation some of firm/ company in-house operations/processes to a third party while maintaining ownership and ultimate responsibility for the processes. The company then informs its provider what it wants and how it wants the work performed. So the company can authorize the provider to operate as well as redesign basic processes in order to ensure even greater cost and efficiency benefits.

Today, for services and products outsourcing has become commonplace. Most companies are looking for outsourcing to enhance their competitiveness in the market. Outsourcing constitutes an alliance between two parties who work together to achieve their goals and interests. Both parties need to make special efforts for outsourcing to be successful, but, as with any relationship, this alliance may be affected negatively because of problems which occur between the parties. Hence, it is important for buyers and suppliers to understand each other clearly and in depth to avoid these problems to achieve successful outsourcing.

Although there are several reasons that encourage firms to use outsourcing, there are disadvantages in using it. There are risks should be considered and analyzed whenever a company embarks on outsourcing, such as job losses, loss of managerial control, threat to security and confidentiality.

In this chapter the researcher gives overview and explains the research objectives and questions, the research significance and the research methodology. Finally, the thesis chapters and their contents are outlined..

## 1.2 Research objectives and questions

The researcher found that behavior in the relationship between buyer and supplier is the most important factor for outsourcing to be successful. It is from this point that the research began. This study aims to explore the relationship between buyers and suppliers in depth and detail in the Saudi Arabian market by studying how agency affect buyer and supplier in four types of outsourcing relationships (Market exchange, captive buyer, strategic partnership and captive supplier)

More specifically, the research questions are as follows:

- What are the incentives that create each type of relationship?
- Which problems exist in each type of relationship?
- How can these problems be controlled and what are their effects in terms of understanding the reality of the outsourcing relationship flow, and how it can be improved?
- What are the effects of the problems on each relationship in the market?

Plus, and finally what the effects on the research model in each relationships?

## 1.3 Research significance

This study therefore represents an important contribution to the business field in Saudi Arabia. This importance comes from the following reasons:

- This study has been applied in Saudi Arabia, a country which has never been studied from such a perspective. The research therefore provides a valuable resource for those interested to know more about the Saudi market or those wishing to invest in it.
- Unlike previous studies (automobile manufacturers), this one has been conducted in different manufacturing and service organizations in the Saudi market (glass, food, petrochemical, transportation, stationery and communication industries), thereby providing rich and varied information from different perspectives, which can be generalized to represent the business climate in the Saudi market as a whole.
- The study has been applied to each type of relationship (market exchange, captive buyer, strategic partnership and captive supplier), and represents the problem causes and their effects, which enables a deeper, clearer understanding of the differences of each outsourcing relationship.
- The study improves and develops a better understanding of how each relationship between buyer and supplier can be strengthened by avoiding the identified causes of problems and by understanding both buyer and supplier needs.
- This study also provides useful information for researchers interested in the same

subject area because it is a rich source of buyer and supplier relationship information which could be applied in other countries around the world. In other words, the study could be generalized to other countries.

### 1.4 Research methodology

The topic of this research was extremely sensitive for most companies in the Saudi Arabian market, especially since the Kingdom of Saudi Arabia joined the World Trade Organization (WTO) in December 2005 as the 149th member. The competition between them has strengthened, thereby forcing them to be more conservative; the answers from the researcher interview questions must therefore be considered as confidential data. To achieve the research objectives, the researcher decided to choose and use interpretive-ism as the research philosophy in order to explore and discover the details of each relationship between buyers and suppliers and an inductive research approach to help organize observations between buyers and suppliers and assist the understanding of what was happening in each type of relationship by conducting interviews with both buyers and suppliers. An exploratory research strategy was adopted to explore each relationship type by asking in depth questions and using semi-structured interviews, so as to give the researcher the ability to change interview direction, and to open up new aspects of the subject during discussions.

The data collection was divided into two phases because the researcher anticipated that some obstacles would be faced during data collection. The first phase involved collecting all the buyer data and the second involved follow up, review and completion of the data that the researcher thought had been missed during the first phase of the interviews and which needed to be explained more fully by the interviewees. The second phase also involved collecting all the supplier data.

The data was analyzed personally using a number of steps. The first step was to transcribe the data collected and the second step to translate this data from Arabic into English as the interviews had been conducted in Arabic. Subsequently, the researcher classified all the data into categories and units in accordance with the research model. The findings of the buyer and supplier interviews and associated diagrams were finally produced.

## 1.5 Organization of the Thesis

The study is divided into seven chapters, which are:

- Chapter one introduces the study, including research objectives and questions, research significance, research methodology and organization of the thesis.

- Chapter two provides an overview of Saudi Arabia, its business environment, policies and regulations.

- Chapter three overviews the relevant literature, including agency theory, outsourcing, agency effects on outsourcing, types of buyer and supplier partnership and introduces the conceptual research model to be used.

- Chapter four introduces the research methodology. It includes the research philosophy, approach and strategy, interviewee selection and issues around the data collection.

- Chapter five contains the research findings. It includes:

    - The market exchange relationship
    - The special case of market exchange relationship
    - The captive buyer relationship
    - The strategic partnership
    - The captive supplier relationship
    - The causes which prevent suppliers acting opportunistically
    - The causes which encourage suppliers to act opportunistically

- Chapter six discusses the research findings. It includes the answers of the research questions.
- Chapter seven concludes the study. It highlights the research significance and research contributions as well as suggestions for future work.

### 1.6 Summary

This chapter has provided a general overview of the thesis and discussed the research objectives and questions, the research significance and the chosen research methodology. Finally, it has introduced the thesis chapters and their contents. The next chapter explains the research context, the Saudi Arabian business environment.

# CHAPTER TWO

# CHAPTER TWO

# THE KINGDOM OF SAUDI ARABIA

## 2.1 Introduction

This chapter provides a general overview of the Kingdom of Saudi Arabia. The first part explains the foundation of the Kingdom of Saudi Arabia, some basic facts and information, the geography of Saudi Arabia, its Government and its economy. The other part explains the business environment in Saudi Arabia, some forms of business in Saudi Arabia, some business policies and regulations in Saudi Arabia.

## 2.2 General overview of the Kingdom of Saudi Arabia

### 2.2.1 Foundation

The modern state of Saudi Arabia was established in 1932 by Abdul Aziz bin Abdul Rahman AL SAUD after a 30-year campaign to unify most of the Arabian Peninsula (CIA, 2007).

### 2.2.2 Facts and information

There are some relevant facts and information to be considered about the Kingdom of Saudi Arabia (SBM, 2006), which are:

- Head of State: King Abdullah bin Abdul Aziz Al-Saud
- Crown Prince: Sultan bin Abdul Aziz Al-Saud
- Population: 22.67 Million (72.9% Saudi citizens; 27.1% foreigners)
- Population Growth: 3.39% (approx. 3% per year) (55% are under the age of 20)

- Capital: Riyadh
- Major Cities: Riyadh, Jeddah, Dammam, Jubail, Buraydah
- Holy Cities: Makkah, Madinah
- Language: Arabic
- Business Language: English
- Ethnic Groups: Arab (90%), Afro-Asian (10%)
- Religion: Islam
- National Day: September 23rd commemorating the foundation of the modern Kingdom of Saudi Arabia in 1932.
- Currency: Saudi Riyal (SR) pegged to U.S. dollar ($1 = SR3.745); bank notes, in Arabic and English, in denominations of 1, 5, 10, 20, 50, 100, 200 and 500 riyals; coins in denominations of 5,10, 25, 50 and 100 halalas (100 halalas = 1Riyal).
- Electricity: 110v and 220v (60 cycles, 2 pin)
- Weights and Measures: Metric
- Measure of Time: Hejira Lunar Calendar (moves forward by 11 days each year in the Gregorian calendar).
- Time: Greenwich Mean Time plus three (GMT+3)
- Important Dates:
    - Ramadan (The Holy Month of Fasting)
    - Eid Al-Fitr (End of Ramadan)
    - Eid Al-Adha (The Feast of Sacrifice)

### 2.2.3 The geography of Saudi Arabia

The Kingdom of Saudi Arabia is the largest country on the Arabian Peninsula. It is located in the Arabian Peninsula in South West Asia, which is known as the Middle East. It covers an area of approximately 2.2 million square kilometers. In the eastern part of Saudi Arabia is a plateau that starts in the North at the Nafud Desert and ends in the South in the RUB AL-KHALI (Empty Quarter), which is the largest sand desert in the world. To the West of this plateau is the Najd area, which is the heart of the country. In the West, a chain of mountains, called AL-Sarawat Range, runs parallel to the Red Sea and is separated from it by the Tehama coastline. In the South, there is Asir Province, which is located at the southern part of the AL-Sarawat Range. Its boundaries are as follows: Kuwait to the northeast, Iraq and Jordan to the north and the north-west; to the east, the Arabian Gulf, Bahrain, Qatar and the United Arab Emirates; to the south the Sultanate of Oman and the Republic of Yemen; and to the west, the Red Sea and the Gulf of Aqaba (SBM, 2006).

### 2.2.4 Government

Saudi Arabia is a monarchy in which the King heads the executive system and is also the commander in chief of the military. The King appoints a Crown Prince to help him with his duties. Islamic law (Shari'ah) is the source of all laws and regulations in the country and is the pillar of the basic system of government. The Saudi Arabian government consists of three main branches, which are the Council of Ministers, the Consultative Council (Majlis Al-Shura) and the Provincial System. The Council of Ministers consists of 22 government ministries that are part of the Cabinet. Each ministry specializes in a different part of the government, such as foreign affairs, education and finance. The Consultative Council (Majlis Al-Shura) proposes new laws and amends existing ones. It consists of 150 members, who are appointed by the

King for four-year terms that can be renewed. Saudi Arabia is divided into 13 provinces, with a governor and deputy governor in each one. Each province has its own council that advises the governor and deals with the development of the province (Royal Embassy, 2007).

### 2.2.5 Economy

Saudi Arabia is considered as the largest free-market economy in the Middle East and North Africa. It accounts for 25% of total Arab gross domestic product. Because of its location, which provides easy access to export markets in Europe, Asia and Africa, it has a continuously expanding domestic market (annual population growth of 3.5%), which is adding to a young and consuming population with strong buying power. The Saudi government has strong political and economic ties with the USA and UK, but these ties are now moving further east (Giunipero and Flint, 2001).

Political and economic stability and investment law encourage foreign ownership of projects and real estate investment in Saudi Arabia. The investment environment is characterized by traditions of liberal and open market private enterprise policies. There are no restrictions in repatriation of capital and profits. The government allows companies to carry forward losses indefinitely – effectively relieving businesses of their tax burden until they become profitable.

It is important to mention that Saudi Arabia has the world's largest oil reserves (25%) and has other natural resources, including bauxite, limestone, gypsum, phosphate and iron. Petroleum is an integral part of the Saudi economy; Saudi Arabia is the world's largest producer and exporter of oil. In recent decades the Kingdom has increasingly diversified its economy, and today produces and exports a variety of industrial goods all over the globe (FDI, 2005).

Saudi Arabia joined the World Trade Organization (WTO) in December 2005 as its 149th member. Saudi Arabia gains benefits from joining the World Trade Organization (WTO). This gives Saudi products greater access to compete in the domestic, regional and global markets. It encourages foreign investors to invest and new businesses to be started inside the Kingdom because of the lowering of tariffs, along with the liberal investment atmosphere, which allows the transfer of new technologies and brings skills to the area through the training of the Saudi labor force. Saudi Arabia has reformed and restructured many of its systems, regulations and policies to be in line with WTO agreements. To do this the commission of experts and delegates from the ministries of justice, finance, national economy, trade and the office of the ombudsman studied the subject of Saudi `Arabia joining the WTO and gave their recommendations (Ministry of Commerce, 2006), some of which were:

1. The review of the draft court system, labor and business traffic, and the study of attribution when considering trade disputes in the tribunal, as well as for other commercial activities.

2. Preparation of appropriate arrangements for the issuance and distribution of periodic publications with one or more provisions issued by the final judicial authorities.

3. The Ministry of Commerce in coordination with the Ministry of Finance and National Economy draft organization comprehensive insurance services Preparation of a draft regulation on the creation of a specialized translation from the official interpretation of functional regulations being reviewed by the experts.

4. Study of the actions taken by the publication and distribution of regulations.

From the above, it can be inferred that Saudi Arabia is moving towards establishing a free market economy. The government is making efforts to bring its trade regime in line with the standards required for accession to the WTO. Saudi Arabia's Council of Ministers approved a new foreign investment law on April 10, 2000, which is designed to make it easier for foreign companies to establish themselves in Saudi Arabia. The law establishes a framework for future legislative and regulatory activities to improve the foreign investment climate in the country and has established minimum levels of investment in agricultural products ($US 6.6 million), industrial products ($US 1.3 million), and non-industrial products ($US 533,000). The Saudi Arabian General Investment Authority (SAGIA) has been established to manage investments under the new code and has approved more than 200 new licenses for projects valued at more than $US 8.5 billion. SAGIA developed a negative list of 22 areas in the industrial and service sectors off limits to foreign investment (Bureau of Economic and Business Affairs, 2002).

Saudi Arabia always offers numerous business opportunities to international firms for the following reasons (Culpan, 1985; Rossides, 1994).

- Its high purchasing power (quarter of the world's proven oil reserves).
- The heavy reliance of its economy on imported products because of an infant indigenous manufacturing sector.
- Its massive consumer demand (sizeable and fast-growing population).

## 2.3 Business environment in Saudi Arabia

Saudi Arabia presents a wide variety of business opportunities for foreign and local companies. It is important for companies, especially for foreign companies, to have a basic knowledge of the business community in Saudi Arabia and the Saudi legal system to be effective and successful. Most businesses require some form of licence from the Government, and some require investments or the employment of Saudi citizens. The optimal form depends on the type of business, the duration of the involvement, and the nature of the transactions. Saudi Arabia is a very attractive market for most companies around the world because it has large and virtual projects. For example, Saudi Aramco is investing $2.5 billion for a development project in the Shayba oil field, leading to expenditures on goods and services of all kinds (e.g., oil and non-oil industries, such as building and telecommunications, infrastructure improvements) forecasted to exceed $3 billion (Middle East Executive Reports, 1995a). There are successes and large contracts, such as Saudi Arabian Airlines, which consumes a $6 billion fleet renewal order with Boeing and McDonnell Douglas, opening up hundreds of supply relationships with both US firms as well as related firms in Saudi Arabia (Lenorovitz, 1994) (dated sources most recent available). Additionally, the Water & Electricity Ministry of Saudi Arabia has offered a number of projects for outsourcing its water operations by inviting local and foreign company tenders. These projects include managing underground water production, water distribution and wastewater collection, customer services and billing, and improving water quality (MEED, 2007).

The focus of the Saudi Arabian government's industrial policy is on reducing the dependency on the crude oil sector by diversifying manufacturing industries. To achieve this goal and maximize the economic and social benefits from industrial development for Saudi nationals, the government announced the main principles of its industrial development policy in 1974:

1. The government aims to encourage and expand manufacturing industries, including agricultural industries, which can contribute to an increase in national income and raise standards of living and employment.

2. Businessmen who are prepared to take the risks of success and failure, motivated by prospects of profits, will enjoy the full support of the government in the preparation, establishment and operation of industrial projects beneficial to the Kingdom. The government is also ready to supplement the efforts of businessmen in the private sector by establishing, financing and participating in the management of large industrial projects requiring wide technical experience that the private sector cannot undertake on its own.

3. The government considers that competition is the most effective means for selecting investment schemes that meet market requirements, as it encourages low-cost production and fair prices for both consumer and producer. However, the government will not permit harmful foreign competition.

4. To ensure that businessmen who want to participate in the industrial development of the Kingdom have all the information they need to identify, implement and operate feasible projects, the government will, from time to time, familiarize them with industrial and feasibility studies, together with other useful information as may become available. The government will also provide existing industrial establishments with available management and technical services.

5. To encourage businessmen to invest in projects of prospective benefit to the national economy, the government is prepared to offer encouragement and financial incentives to all industrial sectors, such as:

a) provision of loans and participation in equity capital under favorable conditions;

b) assistance to businessmen in the formation and organization of new industrial companies;

c) provision of assistance in the selection of industrial projects, the preparation of economic feasibility studies and evaluation;

d) operational assistance (technical, managerial and financial);

e) exemption from customs duties on imported machines, equipment and raw materials;

f) exemption from taxes on the profit share to foreign partners of the company, as provided in the Foreign Capital Investment Act;

g) granting of preference to local producers in government purchases;

h) imposition of protective customs tariffs on competing imports;

i) granting of plots of land for establishing factories in industrial cities;

j) granting of subsidies for training Saudi employees;

k) assistance in exporting products.

6. When the government establishes large and important industrial projects on its own initiative, it will encourage as much participation as possible from the private sector. In such cases, and in cases where the government contributes capital for private projects to supplement investment from the private sector--in respect of industries other than projects related to national security – it is the policy of the government to sell its shares to the public in due course, if this serves the public interest. In cases where the government finds it necessary to assume responsibility for the management of an enterprise owing to the inability of businessmen to manage it successfully, it will eventually hand these back to the displaced partner and not to a competitor in the private sector.

7. The government welcomes foreign capital as well as foreign expertise for participation in industrial development projects in cooperation with Saudi

businessmen.

8. The government shall provide public utilities and make any such basic arrangements as are necessary for the setting up of economically feasible industries. Appreciating the dependence of industry on the general development of the Kingdom, the government will promote the growth of all economic sectors to make local resources available to producers in sufficient quantities and to increase consumer purchasing power within an ever growing national economy (Ministry of Commerce, 2006).

In Saudi Arabia there are 26,658 firms, which are divided among small, medium, large and very large firms. 25,506 firms operate in the private sector and 1,152 in the government sector (Al-feriyan, 2000) (see table 2.1 (Ministry of Commerce, 2006) and Table 2.2 (Saudi Stock Exchange, 2008)). Saudi Arabia is also committed to increasing private sector participation in economic growth and encourages new sectors being opened to the private sector, such as telecommunications, electricity, airlines, postal services, railways, port services and water utilities, all potential areas for investment. The private sector now accounts for 48 percent of the gross domestic product (GDP). The sector is expected to continue growing, especially as Saudi Arabia opens its doors further to foreign investment (FDI, 2005). There are many forms of business in Saudi Arabia, as discussed in the following sections.

Table 2.1 Important Saudi Arabian Government Companies

| Important Saudi Arabian Government Companies |
| --- |
| **Saudi Arabian Airlines** |
| **National Shipping Company of Saudi Arabia (NSCSA)** |
| **Saudi Arabian Oil Company (Saudi ARAMCO)** |
| **Saudi Basic Industries Corporation (SABIC)** |
| **Saudi Electricity Company (SEC)** |
| **Saudi Arabian Mining Company (MA'ADEN)** |
| **Saudi Arabian Public Transport Company (SAPTCO)** |
| **Saudi Telecom Company (STC)** |
| **Saline Water Conversion Corporation (SWCC)** |

Table 2.2 Government owned percentage in Saudi stock market companies

| Company name | Government owned percentage |
| --- | --- |
| **Saudi Electricity Company (SEC)** | **74.2%** |
| **Saudi Real Estate Company** | **72.9%** |
| **SABIC** | **70.8%** |
| **Saudi Telecommunications Company** | **70.0%** |
| **Riyadh Bank** | **42.7%** |
| **Saudi Hotel and Resort Company** | **40.3%** |
| **Saudi Fisheries** | **40.0%** |
| **Southern Cement** | **39.9%** |

| | |
|---|---|
| **Al-QASSIM Cement** | **37.5%** |
| **National Shipping Company** | **31.6%** |
| **Eastern Cement** | **30.0%** |
| **Saudi Public Transport Company** | **30.0%** |
| **Saudi Investment Bank** | **28.6%** |
| **YANBU Cement** | **21.1%** |
| **Ceramic** | **20.5%** |
| **NADEC** | **20.0%** |
| **Samba Financial Group** | **15.6%** |
| **National Gas & Industrialization Co.** | **15.5%** |
| **TAIBAH Investment and Real Estate Development** | **11.5%** |
| **Company** | **8.4%** |
| **Banque Saudi-Faransi** | **7.4%** |
| **Al Rajhi Bank** | **7.0%** |
| **Al-Ihsa for Development Co.** | **6.2%** |
| **SABB** | **6.2%** |
| **SAFCO** | **6.2%** |
| **Savola Group** | **6.2%** |
| **Makkah Construction** | **4.0%** |
| **Bank Al Jazira** | **3.7%** |
| **Arab National Bank** | **2.5%** |
| **Tabuk Agriculture** | **1.9%** |
| **Saudi Cement** | **1.9%** |
| **Industrialization** | **1.1%** |
| **Yamamah Cement** | **0.2%** |

### 2.3.1 Direct exports or local manufacture

The simplest form of business in Saudi Arabia is direct export into the country. Generally, companies may sell their goods or services directly to Saudi Arabian customers. These companies should be owned by Saudi citizens, or foreign companies must have a local presence to sell their goods effectively, and some types of transactions require a local presence. Another form of business in Saudi Arabia is to produce goods locally and then sell them into the local market or export them to other markets in the world.

### 2.3.2 Commercial agents (Brokers)

A commercial agent is important element of starting business in Saudi Arabia for foreign companies. This is because the commercial agent is familiar with the local market and may be able to facilitate certain transactions. Hence, companies should choose their agents carefully. Commercial agents may sell goods or services. Some commercial agents buy goods directly from the manufacturer and resell them; others sell goods for the manufacturer and receive a commission. All are covered by commercial agency laws in Saudi Arabia. The commercial agent may be an individual or a company and must have the appropriate licence. Saudi law only allows citizens of Saudi Arabia to operate as commercial agents. All foreign companies should join with commercial agents through an agreement to enter the Saudi market. This agreement must be approved by the Saudi Ministry of Commerce. Companies can negotiate their own agreement, but the Ministry must approve any changes.

### 2.3.3 Franchises

Franchise law began in 1992. It is more flexible than commercial agency agreements because the parties may negotiate their own franchise agreement and it is not necessary to follow the model provided by government.

### 2.3.4 Branch offices

A branch office is a direct presence of a company only. It is not allowed to act as a commercial agent. It is restricted to an administrative role and is not engaged in trading activities. A branch office is useful as a liaison presence.

### 2.3.5 Government contracting in Saudi Arabia

A great deal of business in Saudi Arabia involves government contracting for both local and foreign companies. Generally, contracts with the Saudi Government are controlled by the Saudi Tender Regulations. To be successful, both local and foreign companies must closely observe the rules for bidding on and fulfilling government contracts.

### 2.3.6 The Saudi Society and Business Corruption

Society in Saudi Arabia has always been highly personalized. Friendship, kinship, regionalism, and communal relationships have had a significant influence on individual actions and behavior. Relationships evolve around the personal tribal network. Despite the erosion of tribal organizations, individuals take great pride in keeping up their tribal traditions, divisions, and Bedouin heritage (Abbas, 2009).
In Saudi Arabia the Muslim faith plays a large role in the people’s lives. "Large power distance and uncertainty avoidance are the predominant characteristics for this

region. This indicates that it is expected and accepted that leaders separate themselves from the group and issue complete and specific directives." (*Butler, 2007)*

Furthermore, the study indicates that Saudi Arabia's society and is expressed in a close long-term commitment to the 'group'. Group could be Family, extended family or extended relationships and strong friendships. And hence, loyalty in such a culture is dominant, and over-rides most other societal rules. (*Butler, 2007)*

The above mentioned type of society influenced the way business is conducted in the Kingdom. Some business etiquette appears in the following points:

- Decisions are made slowly.
- The society is extremely bureaucratic. Most decisions require several layers of approval. It takes several visits to accomplish simple tasks.
- Saudis are tough negotiators.
- Business is hierarchical. Decisions are made by the highest-ranking person.
- Decisions are easily overturned.
- When discussing price, Saudis will often make an initial offer that is extremely low when they are buying. Conversely, when they are selling, their initial offer will be extremely high.
- Compromises are sometimes made if someone's dignity is at stake.
- There is a tendency to avoid giving bad news and to give effusive acceptances, which may only mean 'perhaps'. (Kwintessentials, 2010)

Corruption is well known as the misuse of an office for private gain. Bribery, extortion, graft, and embezzlement are just some of the form of corruption. In some countries, "corruption is so common that it is as expected as a handshake when ordinary people or businesses deal with government officials" (Rigoglioso, 2007)

Saudi Arabia business climate shows a variety of corruption indications. Based on the fact that Saudi Arabia's culture is based on the loyalty to the 'group', these 'group' or tribe members always act in business according to the group or tribe interests first.

Furthermore, the society of Saudi Arabia embraces a large number of non-Saudis. Data issued by the Central Department of Statistics and Information indicate that the Kingdom's total current population stands at 25.4 million, of which 18.5 million are Saudis, constituting 73.1 percent of total population, and 6.8 million are non-Saudis, representing 26.9 percent of the total population, (Fakeeh, 2009). This large percentage of non-Saudis is employed in different levels of jobs in the market. Some expatriates are employed in high positions and are influencing the decision-making process in big firms and organizations. This is due to the fact that they are trying to protect their positions from being handed over to Saudis because of the Saudization policy being implemented by the government.

On the other hand, many private companies have voiced concerns that the Saudi labor is an inexperienced workforce and difficult to be controlled, whereas the foreign workforce is easier to be controlled (Al-Dosary, 2005). The reason that they are easier to be controlled is explained by Mellahi (2009) in that foreign workers work for Saudi employers under a sponsorship system “kafala”. Expatriate workers hold work permits for a specific time period and are prohibited from shifting jobs without the consent of their employer or sponsor.  Hence, shifting jobs among foreigners does not exist. Also, foreigners normally do not qualify for permanent residency or naturalization.Tthis  makes it easier for the employer to control the expatriate workers, and if necessary, to deport him/her back to his/her country if he wishes. A commonly known practice in Saudi Arabia called “tarheel”. Saudis on the other hand are very unstable when it comes to work and they move and change jobs frequently. These facts about Saudis make firms in the private sector favor non-Saudis to fill managerial positions.

### 2.3.7 A quick overview of SABIC and ARAMCO

**SABIC**: The Saudi Basic Industries Corporation (SABIC) is a Saudi Arabia based public shareholding company, representing 22% of the Saudi stock market, and one of the five largest petrochemicals manufacturers in the world. SABIC maintains long-term relationships with quality suppliers. Many of their suppliers from Europe and North America have been working with the company for decades and are supplying major shares of their production to SABIC. All suppliers are being managed by the Department of Supply Management which is part of the Shared Services Organization. (Study of SABIC Value Chain, 2010)

**ARAMCO:** The Saudi Arabian Oil Company (Saudi Aramco) is a government-owned entity (since 1988 fully government-owned) and the world's largest oil company in terms of output and managed natural crude oil resources. The company specializes in the exploration, production and distribution of crude oil, petrochemicals and natural gas. Saudi Aramco maintains transparent and long-term relationships with quality suppliers. Many of their suppliers from Europe and North America have been working with the company for decades and provide up to 75 % of their production to Saudi Aramco. (Study of ARAMCO Value Chain. 2010).

## 2.4 Some business policies and regulations in Saudi Arabia

### 2.4.1 Saudization

Under its policy of "Saudization," the government strongly favors companies with extensive Saudi participation or investment. Some contracts will require a minimum amount of subcontracting with Saudi companies. The government will give preferential treatment to companies in which a majority is Saudi-owned and companies which use Saudi-manufactured goods and services. Accordingly, a foreign company may improve its position by allying itself closely with Saudi interests when bidding for a government contract (Madhi, and Barrientos, 2003).

### 2.4.2 Labor law

Labor relations in Saudi Arabia are controlled by Saudi labor law. A company should be cautioned before terminating or restricting the rights of an employee because when employers enter into employment contracts, the terms of the contract must adhere to Saudi Labor Law. Employment contracts receive special scrutiny in Saudi Arabia, which heavily protects against employees being terminated or restricted; even if an employment contract states that an employee may be terminated at will, the company may not terminate an employee unfairly (The Saudi Net Work, 2007).

### 2.4.3 Resolution of disputes in Saudi Arabia

There are three ways to resolve disputes which may occur between parties. They are; Saudi Tribunals which are like arbitration Courts elsewhere, The Saudi Judicial System and Arbitration. It is important for a company to understand, before entering into any transaction, how a dispute will be resolved in order to perceive the necessary time required for resolving the problem.

### 2.4.4 Customs and duties

The following customs duties' rates have been in effect since January 2, 1988 (Ministry of Commerce, 2006).

- Most of the basic consumer products are duty free, e.g., sugar, rice, tea, unroasted coffee, cardamom, barley, corn, livestock and meat (fresh or frozen).
- Customs duties of 20% are imposed on some imported commodities for the purpose of protecting the national infant industries.
- Import duty on other items is 12% on the c.i.f. (cost, insurance, and freight) value.
- A limited number of items are subject to customs duties calculated on the basis of metric weight or capacity.
- Members of the Arab League who are signatories to the Agreement to Facilitate Trade and Exchange and to Organize Transit between the Arab League States are granted special concessions.
- Imports from the Arab states with which Saudi Arabia has bilateral trade agreements are entitled to further reductions of duty.

### 2.4.5 Relationship between Foreign Contractors and Saudi Agents

The Saudi Government arranged the relationship between foreign contractors and Saudi Agents in January 1978; some of these arrangements are (The Saudi Net Work, 2007):

- A foreign contractor, who does not have a Saudi partner, should have a Saudi services agent.
- The agent should be a Saudi national residing in the Kingdom of Saudi Arabia

and should be registered in the Commercial Register of the Ministry of Commerce authorizing him to act as an agent.

- The relations between a Saudi agent and a foreign contractor should be governed by an Agency Agreement defining the obligations of both parties.
- A foreign contractor is required to pay the Saudi agent fees in return for the services he renders to the contractor. Such fees, as determined by an agreement between both parties, should not exceed 5 percent of the cost of the contract executed by the foreign contractor.
- A foreign contractor performing different types of work may have more than one Saudi agent so as to match each type of work.

## 2.5 Summary

Saudi Arabia has the largest free-market economy in the Middle East and North Africa and, because of the stability of political, economic and investment law, local and foreign companies are encouraged to invest in Saudi Arabia. The government has issued a number of policies and regulations to control and arrange the market and its relationship with other parties, taking care of the benefits for all parties. This chapter has set the scene for the research study, emphasizing the importance of developing better buyer/supplier relationships in Saudi Arabia for a variety of reasons and from a variety of perspectives. The following chapter explores the theoretical underpinning for the research.

# CHAPTER THREE

# CHAPTER THREE

# LITERATURE

## 3.1 Introduction

The research studies how agency problems affect buyer and supplier relationships. The main core themes involved are outsourcing (buyer and supplier relationship types), agency theory, causes, control and effects, as illustrated in figure 3.1. Outsourcing section gives an overview about outsourcing, discusses why firms using outsourcing, display some tips for both parties who, working with outsourcing and talk about outsourcing disadvantages. Agency theory section presents the agency definition and its classifications, agency problems, problem causes and how problems are controlled. Then, the researcher discusses the relationship between agency and outsourcing, and finally, presents the types of buyer and supplier relationship.

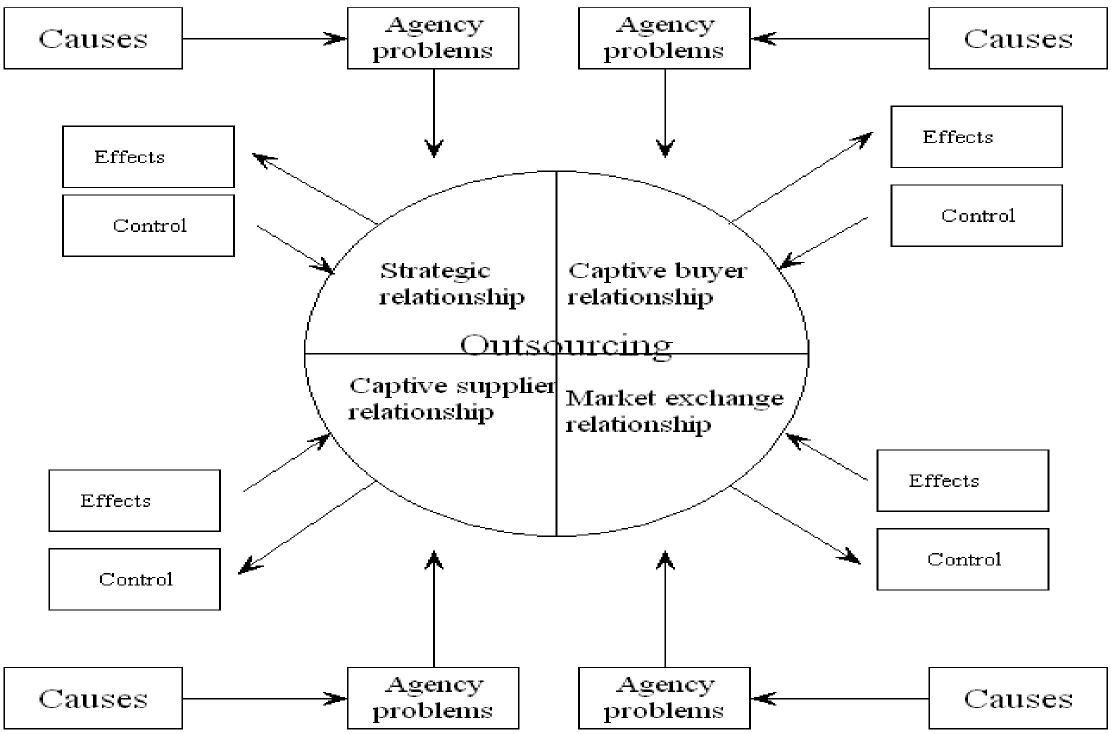


Figure 3.1 The main themes involved in the research

From figure 3.1 it is shown that buyer and supplier relationship (outsourcing) is divided to four types (Bensaou ,1999). These types are market exchange, captive buyer, strategic relationship and captive supplier. Each relationship is affected by some causes which create agency problems. These agency problems affect the relationships negatively. At the same time, controlling tools are used to minimize the negative effects.

In this chapter, the researcher discusses the concepts of outsourcing and its reasons, trends, tips for working with outsourcing and disadvantages. The researcher also presents the agency theory definition, classification, problems, causes of problems and controlling. Finally, the researcher talks about types of buyer and supplier relationship from different study perspectives

## 3.2 Outsourcing

Business success depends on an ability to find strong partners. Outsourcing is considered to be a marriage, so the relationship must benefit both sides substantially. Yet this relationship involves inevitable frictions and conflicts, so each side should keep in mind the interests and desires of the other, try to please each other, and resolve conflicts in a civilized way. Outsourcing relationships should work smoothly and with maximum benefits for the client, as well as for the service vendor, even if there are difficulties, conflicts, obstacles, misunderstandings and changed circumstances.

Eastman Kodak is considered a pioneer in the outsourcing movement. They contracted with the Integrated Systems Solutions Corporation (ISSC) in 1989, IBM’s services branch, to do the computer work that the Kodak Company had been performing for its products. Then Xerox signed with Electronic Data Systems Corp.

(EDS) a 10- year outsourcing contract for $4.1 billion in 1994 to do a major portion of its computer work (Tinnirello, 2002).

The outsourcing trend has been growing quickly over the last decades. Linda Musthaler says that most IT jobs are particularly vulnerable, so analysts predict that upwards of 2 million IT-related jobs will move offshore within the next decade (Musthaler, 2004).

### 3.2.1 Overview

The word “outsourcing” usually conjures up an image of multimillion-dollar contracts, 10-year relationships and huge projects. But in some cases, outsourcing is just out-tasking in a very simple way. Outsourcing is a strategic decision which requires proactive and professional decision making. It is similar to the subcontracting, joint venturing and strategic partnership concept. Greaver demonstrated in a 1996 survey by a division of the American Management Association that 94% of 619 respondent firms outsourced at least one from thirty seven listed activities. The survey also found that outsourcing is growing rapidly in accounting, finance, information-systems and marketing (Greaver, 1999). Bierce and Kenerson, an international law firm providing legal advisory and transactional support to clients in business, technology and finance, have said that by using outsourcing the customer receives a service that supplies a distinct business function and which fits into the customer's overall business operations. The benefit of outsourced services lies in the service provider’s capacity to deliver predictable service. Thus, if the customer’s service requirements are highly volatile, so as to control the scope or risk structure, the function should be retained “in-house” (Bierce and Kenerson, 2007).

### 3.2.2 Outsourcing reasons

Denise Dubie mentioned in her article that Glore, chief of implementation and standards for the Department of the Air Force at Patrick Air Force Base in Florida, stated “Outsourcing gives us the higher calibre technical people we need and a better sense of continuity in the long term” (Dubie, 2003, p.4). Many companies are using outsourcing to improve themselves; each one behoves to ask itself whether to initiate the outsourcing step to stay ahead in its field. A lot of companies have found they can provide many functions more cheaply and more reliably than has been done at their client companies. A company needs to know what its reasons are for considering outsourcing and the benefits a company seeks specifically.

There are many common reasons for outsourcing, each giving somewhat different results, as mentioned by Greaver (Greaver, 1999). Greaver says that outsourcing reasons are:

Organizationally driven reasons such as to enhance effectiveness by focusing on what you do best, to increase flexibility to meet changing business conditions, demand for products, services and technologies, to transform the organization and to increase product and service value, customer satisfaction and shareholder value.

Improvement-driven reasons which are more likely to improve operating performance, obtain expertise, skills and technologies that would not otherwise be available, improve management and control, improve risk management, acquire innovative ideas and improve credibility and image by associating with superior providers.

Financially driven reasons such as to reduce investments in assets and free up these resources for other purposes and to generate cash by transferring assets to the provider.

Revenue-driven reasons, such as to gain market access and business opportunities through the provider's network, to accelerate expansion by tapping into the provider's developed capacity, processes and systems, to expand sales and production capacity during periods when such expansion could not be financed and commercially exploit existing skills.

Cost-driven reasons such as turn fixed costs into variable costs and reduce costs through superior provider performance and the provider's lower cost structure.

Employee-driven reasons, such as to give employees a stronger career path and to increase commitment and energy in non-core areas.

Further, according to the Outsourcing Institute, reasons for outsourcing from its annual survey (Outsourcing Institute, 1998) are as follows,

*Accelerate reengineering benefits*; reengineering aims for dramatic improvements in critical measures of performance such as cost, quality, service and speed. But the need to increase efficiency can come into direct conflict with the need to invest in the core business. As non-core internal functions are continually put on the back burner, systems become less efficient and less productive. By outsourcing a non-core function to a world-class provider, the organization can begin to see the benefits of reengineering.

*Access to world class capabilities*; world class providers make extensive investments in technology, methodologies and people. They gain expertise by working with many clients facing similar challenges. This combination of specialization and expertise gives customers a competitive advantage and helps them avoid the cost of chasing technology and training.

*Cash infusion*; outsourcing often involves the transfer of assets from the customer to the provider. Equipment, facilities, vehicles and licenses used in the current operations have value and are sold to the vendor. The vendor then uses these assets to provide services back to the client. Depending on the value of the assets involved, this sale may result in a significant cash payment to the customer.

*Free resources for other purposes;* outsourcing permits an organization to redirect its resources, most often people resources, from non core activities toward activities which serve the customer. The organization can redirect these people or at least the staff slots they represent onto greater value adding activities.

*Function difficult to manage or out of control;* when a function is viewed as difficult to manage or out of control, the organization needs to examine the underlying causes. If the requirements expectations or resources needed are not clearly understood, then outsourcing won't improve the situation; it may in fact exacerbate it. If the organization doesn't understand its own requirements, it won't be able to communicate them to an outside provider. Suzanne Thornberry stated in her article “if the problems are from bad management, outsourcing won’t help” (Thornberry, 2002, p.2).

*Improve company focus;* outsourcing lets a company focus on its core business by having operational functions assumed by an outside expert. Freed from devoting energy to areas that are not within its expertise, the company can focus its resources on meeting its customers' needs.

*Make capital funds available;* outsourcing can reduce the need to invest capital funds in non-core business functions. Instead of acquiring the resources through capital expenditures, they are contracted for on an "as used" operational expense basis in non core areas.

*Reduce operational costs;* companies that try to do everything themselves may incur vastly higher research, development, marketing and deployment expenses, all of which are passed on to the customer. An outside provider's lower cost structure, which may be the result of a greater economy of scale or other advantage based on specialization, reduces a company's operating costs and increases its competitive advantage.

*Reduce risk;* outsourcing providers always make investments on behalf of many clients, not just one, so shared investment spreads risk, and significantly reduces the risk borne by a single company.

*Resources not available internally;* companies outsource because they do not have access to the required resources within the company.

Furthermore, Klepper and Wendell stated “The number and quality of outsourcing vendors offering price competitive and high-quality services has increased. As new vendors enter the marketplace, competition increases which in its turn further reduces prices and increases the quality of service” (Klepper and Wendell, 1998, p.2).

### 3.2.3 Trends in outsourcing

Outsourcing has given rise to new trends in business structure and relationships with vendors, has made some companies more effective and enabled significant cost reductions. “One trend is for management to focus more heavily on the core businesses, contracting out less essential functions. Another is to establish more friendly relationships with other organizations, considering vendors and contractors as 'partners' in alliances pursuing common goals. In seeking better ways, sometimes as part of reengineering processes, management questions traditional approaches, keeping an open mind in seeking alternatives that might improve their operations." (Ayers, 2002, p. 36).

Furthermore, outsourcing helps companies with documentation for outsourced tasks. Shelly McIntyre, second vice president of business-technology services at Guardian, stated, "Offshore outsourcing has helped us be more rigorous about documenting everything," And she adds that it "has brought rigour and process to the table." (Leung, 2003, p.1).

By outsourcing non-strategic activities, an organization can reduce its size and make it less hierarchical, allowing it to focus on obtaining, developing and motivating the people who create value, and helping to allow management to shift their attention toward strategic activities, coordination and the skills that promote competitive success (Klepper et al, 1998). Thus, it can be inferred that the outsourcing market is expected to grow within the coming few years in parallel with increasing the numbers of companies in the market and their belief in the advantages of outsourcing.  This is especially an area that is still growing in importance, particularly in countries such as Saudi Arabia.

### 3.2.4 Tips for working with outsourcing

There are many tips for both parties that should be studied very well so that the relationship between them is clear and they can work together constructively and cooperatively; clear responsibilities for liaison are essential, regular meetings are helpful and avoid misunderstandings, yet having a mechanism for dispute resolution is essential as they are discussed in the following sections by Tinnirello (Tinnirello, 200).

### 3.2.4.1 Spirit of partnership

Outsourcing arrangements work best when there is a basic feeling of trust and cooperation between the client and vendor. Truly, both should be working to accomplish common goals wherein each benefits in its own way. Both sides should gain substantially from the relationship. However, if conflicts dominate the relationship, lawyers probably get involved to protect what they see as their individual side's rights, and the original goal of mutual gain and benefit is not achieved

### 3.2.4.2 Liaison staff

One person should be appointed as chief liaison representative for the client in dealing with the outsourcing vendor on a continuous basis. Liaison individuals should have the authority to act for their employers and should be the normal channel of communications between client and vendor, particularly for complaints. Therefore, the liaison person must be knowledgeable about the technology involved, be a diplomat, and yet be able to be firm in monitoring and demanding proper performance from the vendor. The outsourcing contractor should be asked to set up a liaison counterpart, and both client and vendor should clearly define their liaison representatives' responsibilities. Liaison staff should preferably be fixed and stable and should not change frequently to be more effective.

### 3.2.4.3 Meetings

The spirit of working together can be strengthened by frequent meetings between representatives of the client and vendor on topics of interest to either party or to both. Having such meetings regularly, under the guidance of the liaison representatives, can get problems under control before they get out of hand, and foster an understanding among people on both sides of the interests and activities of the other parties, thereby encouraging a friendly and cooperative relationship and a feeling of participation, which are important factors leading to the success of the relationship.

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**3.2.4.4 Avoiding misunderstandings**

The best way to avoid misunderstandings is to have a contract clearly describing the work to be done and the standards of performance expected, and covering all the possible contingencies that might arise. But even with a well drawn up contract, there will be events that have not been anticipated, or one party may construe a part of the contract to mean something different from the other party's interpretation.

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**3.2.4.5 Resolving conflicts**

There are three general approaches to conflict resolution other than legal action, which it is recommended be avoided at all costs. They are:

-A conflict resolution committee

-Referring the matter to higher executive levels

-Arbitration or mediation

The conflict resolution committee should probably be co-chaired by the two liaison representatives, with additional specialists involved based on the nature of the issue, such as whether it is an accounting or technical matter.

If the committee cannot bring the matter to a compromise or other solution, it can be referred up the executive ladder - say to the vice president level, then to the

CEOs - to resolve. This process can sometimes settle the matter quickly. However, it often takes valuable executives' time away from their main functions, the time they would take in researching and negotiating the issue.

Taking the conflict to arbitration or mediation is far superior to court action. Using such ways can resolve issues faster, more cheaply and easily than suing, engenders less hostility, and can even be done without lawyers.

### 3.2.5 Factors for successful outsourcing

According to the Outsourcing Institute, the top 10 factors that can assist companies to engage in successful outsourcing, from a survey of current and potential outsourcing end-users (Outsourcing Institute, 1998), are: understanding company goals and objectives, a strategic vision and plan, selecting the right vendor, ongoing management of the relationships, a properly structured contract, open communication with affected individuals/groups, senior executive support and involvement, careful attention to personnel issues, near term financial justification and use of outside expertise.

### 3.2.6 Outsourcing disadvantages

In the above, the advantages and the positive side of outsourcing have been discussed, but, on the other hand, outsourcing does not always be entirely beneficial. For example, specific types of jobs can certainly be lost, such as in telephone call centers or in routine tax preparation sector. In another word, outsourcing job to foreign country means reduction in local low wage workforce, which leads to displacement of workers from certain type of job to another. Also, the economy may be affected negatively by outsourcing. Outsourcing jobs to foreign labor in places like India and China lets many manufacturing plants to close because they cannot compete with the cheap labor overseas. Many small manufacturing plants feel helpless because their supporting factory has shutdown (Bhagwati, Panagariya, and Srinivasan, n.a). In addition, outsourcing may cause risk of exposing confidential data when an organization outsources some work such as HR, Payroll and recruitment services. It involves a risk of exposing confidential company information to a third-party. For instance, outsourcing the IT function and having outsourced employees may use their access to confidential customer data for their own gain. Moreover, in case firms do not choose a right partner for outsourcing, some of the common problem areas like stretched delivery timeframes, sub-standard quality output and inappropriate categorization of responsibilities will be faced, because of inflexibility to changes in business environment, but at the same time, company employees may have a better understanding of the industry, when they have vested interests to make decisions in accordance with the company's goal. Another disadvantage, although outsourcing most of the times is cost-effective at times, there are hidden costs involved while signing a contract across international boundaries such as exchange rate differences, fuel cost in transportation, and paying of taxes. Hidden costs are also involved like vendor employees training because they may require training to sharpen their skills and make them more competitive. Furthermore, an outsourced vendor may work with multiple organizations at the same time, which makes vendors lack complete focus on firm's tasks (Flat world solutions, 2006). Another disadvantage, the supplier is a separately managed entity (independent), which means there **is** Loss of managerial controls**.** It may be much easier for the buyers to get the job done by their own employees rather than someone else over whom he has no control. In addition, there is greater risk to buyer from politics. The supplier may be affected by the political instability in the region. Thus, smooth functioning could be hindered. Finally

Cultural differences are also greater risks in case of outsourcing, because of misunderstandings, which may occur due to differences in language (Rose India, n.a).

### 3.3 Agency theory

Numerous reviews of agency theory exist in the literature, in the subject areas of accounting (e.g, Demiski and Feltham,1978), economics (e.g, Spence and Zeckhauser, 1971), finance(e.g, Fama,1980), marketing (e.g., Basu, Lal, Srinivasan & Staelin, 1985), political science (e.g., Mitnick, 1986), organizational behaviour (e.g., Eisenhardt,1985,1988;Kosnic, 1987) and sociology (e.g., Eccles 1985; White 1985). From the agency perspective, "most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals" (Jensen and Meckling, 1976, p.8). The main idea of the theory is that there is a good reason to believe that the agent will not always act in the best interests of the principal if both of them (principal and agent) are Utility-Maximisers in the relationship (Jensen and Meckling 1976). In general, the theory focuses on the contract between the principal and the agent and how the contract can be concluded from the point of view of the principal (Williamson, 1975). It also discusses incentive and information problems inside and outside the firm. In agency theory, one person, the principal, wants to induce another person, the agent, to do something that the agent does not want to do. The agent's information or actions may be hidden because it is hard or expensive for the principal to monitor the agent. Often in agency theory, principals and agents have different attitudes toward risk (Karake-Shalhoub, 2002).

Agency theory is very important part in such research because it takes into account the behaviour of both sides of the relationship (buyer and supplier). At the same time, it helps to understand problems, which are created between buyer and supplier, and what the problem causes are, which allows the building up of a successful outsourcing relationship by avoiding such problems and support for an environment of trust.

### 3.3.1 Definition

Agency theory is a very academic term. Agency relationships occur when one party (the principal e.g. the owner or shareholder or buyer), hires another party (the agent e.g. a manager or director or employee or supplier), to perform a service or tasks because of the agent's specific talents, knowledge and capabilities to increase the value of an asset on behalf of the principal. In general, an agency relationship is created when one party (the principal) delegates decisions and/or tasks to another (the agent). Before the development of agency theory, it was typically assumed that agents acted in a professional manner in performing their services, without regard for the economic consequences of their actions, but now, more attention is being paid to possible conflicts of interest that could be occur between parties, known as agency problems, and to the means of resolving such conflicts. This involves the costs of resolving conflicts between principals and agents and the aligning of interests of the two groups, known as agency costs (Fletcher and Diskin, 1994). Essentially, all contractual arrangements, as between employer and employee or the state and the governed, contain important elements of agency theory (Ross, 1973). The agency relationship is defined as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent" (Jensen and Meckling, 1976, p.5). Agency theory is concerned with the 'agency problem' that exists because of the agent's different goals from those of the principal, when there is an agency relationship.

### 3.3.2 Agency theory classifications

Agency theory research is divided into two types: positivist research and principal-agent research.

#### 3.3.2.1 Positive agency

Positive agency research focuses "on identifying situations in which the principal and agent are likely to have conflicting goals and then describing the governance mechanisms that limit the agent's self-serving behavior"(Eisenhardt, 1989, p.59). This type of research is concerned with the special case of the principal-agent relationship between owners (shareholders) and managers of large public corporations (Eisenhardt, 1989). In terms of positivist research, explanations have been provided by the following authors: Jensen and Meckling (1976) discussed the ownership structure of the corporation and how equity ownership by management helps align the goals of managers with those of owners; Fama (1980) discussed the role of capital and labor markets in controlling the behavior of managers; Fama and Jensen (1983) discussed the role of the board of directors as a monitoring device (Ekanayake, 2004). Generally, positivist agency research concentrates on controlling mechanisms and solving agency problems (Jensen, 1983; Eisenhardt, 1989). As shown in previous studies, positivist research is limited because it focuses on controlling mechanisms and solving agency problems which arise between owners and managers only. Positivist research does not assist the researcher to achieve the aim of this research, which is to study the relationship between principal and agent from the buyer and supplier perspectives with varying levels of outcome. Agency theory has grown beyond its original positivist domain and has been used by (principal-agent) researchers in a number of disciplines to study issues that arise from agency-like relationships (Ekanayake, 2004).

#### 3.3.2.2 Principal-agent research

Principal-agent research focuses on a general theory of the principal-agent relationship applicable to employer-employee, lawyer-client and buyer-supplier relationships (Ekanayake, 2004). This type of agency research takes a wider view and generates greater interest than the positivist agency research which focuses on special cases of the owner / CEO relationship of the organization. Principal-agent research is concerned with determining the optimal contract, and on behavior versus outcome between principal and agent (Eisenhardt, 1989). Principal-agent research is applicable to this study because it helps the researcher to take a general view, which assists in going further and into greater detail among relationships. This is the objective of this study, rather than being confined by the limited positivist research between owners and managers.

### 3.3.3 Agency problems

The general agency problem arises when the agent does not act in the best interest of the principal. Opportunistic behavior on the part of the agent tends to increase with a consequent decline in control mechanisms (Goldberg and Idson, 1995). “The premise of agency theory is that agents are self-interested, risk-averse, rational actors, who always attempt to exert less effort (moral hazard) and project higher capabilities and skills than they actually have (adverse selection)” (Ekanayake, 2004, p.2). So, under conditions of incomplete information and uncertainty, which characterize most business settings, two main agency problems arise: adverse selection or the misrepresentation of ability by the agent and moral hazard or the lack of effort on the part of the agent (Ekanayake, 2004). Taking a look and understanding agency problems are important for the study to classify the problems arising between buyers and suppliers, as found in the collected data.

#### 3.3.3.1 Adverse selection

Adverse selection arises when the principal cannot ascertain if the agent accurately represents his or her ability to do the work for which he or she is being paid. The adverse selection problem is associated with the information which is possessed by the agent, which the principal does not know. Therefore, the principal cannot know if the decisions, which have been made, are for his benefit or not because he does not know about the information which forms the basis of the decisions. In this case the principal faces an asymmetric information problem (Padilla, 2003).

#### 3.3.3.2 Moral hazard

Moral hazard arises when the principal cannot be sure if the agent has put forth maximal effort to work in the principal’s interests. With the moral hazard problem the principal is not able to evaluate the effectiveness of the agent’s actions by observation because the agent’s actions do not determine clearly the outcome of these actions (Padilla, 2003). Because of agents’ self-interests, they may not make the effort to work towards the goals of the principal (Baiman, 1982) and they may shirk their responsibilities (Mahaney and Lederer, 2003), preferring different actions from those of the principal (Eisenhardt, 1989).

### 3.3.4 Causes of agency problems

Agency theory discusses contractual problems arising from the assumption that agents will behave opportunistically if their interests conflict with those of principal's (Sharma, 1997). The domain of agency theory involves relationships that mirror the basic agency structure of a principal and an agent who is engaged in cooperative behavior, but have differing goals and differing attitudes toward risk (Eisenhardt, 1989). Agents act opportunistically for a variety of reasons. These reasons are important and need to be studied in greater depth and detail so as to understand the incentives and causes that push suppliers to act opportunistically and the ways in which this opportunism can be controlled.

#### 3.3.4.1 One-shot or short term nature of relationship

Agents may act opportunistically because of the one-shot or short-lived nature of the exchange with the principal. In a long-term relationship, agents tend to minimize opportunism behavior to encourage principal's repeat businesses with them. By this way, the principals can build a history which gives greater opportunity to observe and assess agent behaviour (Sharma, 1997).

#### 3.3.4.2 Cultural differences

Cultural differences may cause agency problems. Since work related norms and values of agents differ between cultures, it can be argued that the basic nature of agents is different between cultures. The agency theory presented in the Western group does not hold for the Chinese group. For example, a study found that the effects of agency conditions (the presence of an incentive to shirk an asymmetric information) on project escalation decisions are smaller in Asia than in North America (Ekanayake 2004). Saudi Arabian culture is one of the many cultures in Asia, but one that has not been previously researched from this perspective, so it is desirable to investigate it further to discover what differences might or might not exist.

### 3.3.4.3 Unsatisfactory compensation

Compensation is the most important factor that may cause agency problems. It plays a major role in modern perspectives on organizational control. In economic theories, compensation is a primary mechanism for aligning the often divergent interests of agents. Depending on the economic model, the organization should design compensation systems so that agents and principals exist in a "win-win" situation. Principal pay should be positively related to corporate performance (Conlon and Parks, 1990). A number of organizations now are attempting to increase the relationship between performance and pay and make them interdependent (Kanter 1987). Therefore, compensation and reward should satisfy the agent and act as an incentive to work in the principal's best interests.

### 3.3.4.4 Improper agent selection

Agent selection should be carried out carefully by principals depending on qualifications and reputation. Principals should evaluate an agent's motivation to perform. There are two types of evidence that can be used by principals to assess an agent's motivation: firstly, principals may evaluate an agent's generalising, on the basis of the agent's general previous practices and business philosophy. Principals make such assessments on the basis of a supplier's behavior in other relationships. Secondly, an agent's motivation may be assessed on the basis of his or her incentives to perform, as is evidenced by the willingness to make investments of various kinds in the relationship.

In general, the agent's qualifications serve the two purposes of (1) eliminating suppliers lacking the required skills and motivation and (2) providing an opportunity for appropriate suppliers to self-select by showing a willingness to undergo qualification (Stump and Heide, 1996).

The Outsourcing Institute has indicated the top 10 factors on which companies can depend to select agents (Outsourcing Institute, 1998), which are: commitment to quality, price, references/reputation, flexible contract terms, scope of resources, additional value-added capability, cultural match, existing relationship & location. It is important to understand the factors that encourage buyers to select suppliers because this explains how a lack of awareness in choosing a supplier for meaningful reasons may be one of the causes that lead to opportunism against buyers.

#### 3.3.4.5 Outsider owners

Outsider owners of the firm can cause agency problems because they will be limited in their ability to evaluate and control managers due to environmental dynamism, so those managers have a chance to work for their own self-interest. In contrast, there are positive relationships between insider ownerships and firm performance because they have effective monitoring and control of top managers and they understand the environmental conditions and firm operations (Li and Srly, 1998).

### 3.3.5 Controlling agency

As a management function, control is the process of taking the necessary corrective action to ensure that the organization's mission and objectives are accomplished as effectively and efficiently as possible, in keeping with the principal's goals as the number one priority (Karake-Shalhoub, 2002). There are many ways that can be used to control agents. In any organization, principals are concerned that the agent is working for their interests, and resources are productively deployed, job responsibilities properly stated and various assignments adequately coordinated. A company's control systems are used for several purposes. They inform the principal as to which resources are available and in use by the firm and agent. They also assist in coordinating diverse segments of the organization. Finally, they allow management to gather information from agents and all layers of the organization for devising strategic alternatives and operating decisions. A control system attempts to ensure that people or agents do what the company (principal) requires them to do, in meaningful ways. Such systems coordinate the planning of future activities and later measure performance against those plans (Karake-Shalhoub, 2002).

#### 3.3.5.1 Contract types

From the above, it is therefore most important for the principal to design an incentive contract that induces the agent to act on the principal's behalf. "Agency theory seeks to define the nature of contracts that will minimize agency costs; that is the costs of monitoring, motivating and ensuring the commitment of the agent. Nilakant & Rao, 1994, p.6). The contract is a core concept in agency theory. There are two types of contract: outcome based contract and behavior based contract. In either case, the agent is compensated.

##### 3.3.5.1.1 Outcome-based contract

An outcome-based contract compensates agents for achieving certain of the principal's goals or outcomes. Compensation with this type of contract typically is given as a commission, such as stock options or bonuses. Thus, the tying of performance evaluations and merit bonus payments to meeting goal deadlines and staying within budget and requirements illustrates an outcome-based contract (Lederer and Prasad, 2000). “Such a contract is commonly used with both in-house employees and with outside contractors” (Mahaney and Lederer, 2003, p.3). The advantage in the outcome-based contract is that both the principal and agent can observe outcomes, but all efforts exerted by an agent are not observed by the principal, and are known only to the agent (Ekanayake 2004).

#### 3.3.5.1.2 Behaviour-based contract

On the other hand, a behaviour-based contract compensates agents for performing certain tasks or behaving in a certain way. The agent is paid a salary or hourly rate for performing the tasks, regardless of the outcome. This type of contract is more common with in-house employees than it is with outside contractors (Mahaney and Lederer, 2003).

From the perspective of the principal’s best interests, agency theory suggests that the more outcome-based (and thus less behavior-based) the contract, the greater the project success. This is because outcome-based contracts ensure the agent works in the best interest of the principal (Mahaney and Lederer, 2003).

In contrast, from the agent’s perspective, a behaviour-based contract protects the agent from unexpected uncertainties and hazards, especially those which are out of his control (Logan, 2000).

#### 3.3.5.2 Monitoring

Monitoring is also one of the ways in which the principal can control his agent’s actions. Theoretically, monitoring has been defined as observation of an agent's effort or outcomes that is accomplished through supervision, accounting controls and other devices (Tosi and Katz, 1997). Agency theory suggests that monitoring increases agent control because problems are identified more quickly and corrective action can be taken, and this encourages agents to act in the interests of the principal (Mahaney and Lederer, 2003). Further, by investing in information systems such as a budgeting system or reporting procedures, the principal can monitor the agent's behavior (Eizenhardt, 1989). IT facilitates effective control systems (Karake-Shalhoub, 2002).

#### 3.3.5.3 Incentives

By establishing appropriate incentives for the agent and by incurring monitoring costs, the principal can limit the aberrant activities of the agent. In some situations, the principal pays the agent to expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal (Jensen and Meckling, 1976). Incentive alignment, as a control mechanism, which is in the agent's and the principal's best interests, can be achieved by contracts that make the agent's compensation contingent on outcomes of his performance and notions that the agent's utility is generally assumed to be a function of his/her compensation (Groff and Wright, 1989; Tosi and Katz, 1997). Engaging in a long term relationship for the same or linked products or services could be one of these incentives (Logan, 2000). "The experiment of Berg et al. (1985) provides direct evidence that agents act opportunistically but respond to their compensation plans, and that principals are aware of this and choose employment contracts that efficiently mitigate the agency problem" (Ekanayake, 2004, p.8). These incentives could and should be applied in other industries.

#### 3.3.5.4 Programmability of the task

The programmability of the task eases the control and measurement of the agent's behavior. Programmability has been defined as "the degree to which appropriate behavior by the agent can be specified in advance" (Eisenhardt, 1989, p. 62). If the task can be programmed, then agency control can be accomplished by performance evaluation of behaviors. If goals are clearly known, then outcomes can be measured and performance evaluation of outcomes is the appropriate control strategy, so if both behavior and outcome can be measured, either one can be used. But, if the task is neither programmed nor has a measurable outcome, then other control strategies can be used. For instance, the buyer can purchase information (as a surveillance mechanism) that he needs to assist him to measure the supplier behavior and make an assessment of this behavior (Eizenhardt, 1985). There is, furthermore, a need for more recent research, as this work is now somewhat dated.

#### 3.3.5.5 Principal knowledge

Principal knowledge or professional expertise is also one of the agency control strategies. Principals have to be involved in the production of services or products. The greatest distinction of principal professionalism is the assumption that principals have the power to design, enforce and monitor contracts. Additionally, because "information is a purchasable commodity" (Sharma, 1997, p.773), the principal can purchase the requisite knowledge and information to control the professional agent, especially if the principal does not have the expertise. Hence, a third party, who has good and professional knowledge, should be hired to audit the agent (Logan, 2000).

#### 3.3.5.6 Customized investment

Customized investment is a further way that allows the principal to control the agent's opportunistic behavior. The principal and agent's specific investments in each other make the two parties highly interdependent, at the same time pushing the agent to work in the principal's best interests (Dyer and Ouchi, 1993). In general, the professional agent is less likely to behave opportunistically when the principal requires the agent to make an investment in assets specific to the exchange (Sharma, 1997). Ownership- performance relationship studies indicate that to align the interests of owners, managers or agents should have a stake in the ownership (Li and Simerly, 1998).

#### 3.3.5.7 Community reputation

Community reputation is a common restraint on opportunistic behaviour. "Reputation effects are believed to extend beyond a single agent-principal exchange, and the value of human capital is presumed to be degraded if word spreads that a particular agent has not previously served principals in good faith" (Sharma, 1997, p.778). Adverse reputation makes other principals loath to engage in exchanges with that agent (Sharma, 1997).

## 3.4 Agency and outsourcing

As already discussed, outsourcing is considered as a marriage between partners, so the relationship must be substantially beneficial for both sides. Yet this relationship has inevitable frictions and conflicts; each side should keep in mind the interests and desires of the other, try to please each other, and resolve conflicts in a civilized way. Outsourcing relationships should work smoothly and with maximum benefits for the client, as well as for the service vendor, even if there are difficulties, conflicts, obstacles, misunderstandings and changed circumstances. Pushed by world –class competition, a lot of manufacturers and organizations are making strategic moves towards outsourcing. These moves are in response to increased and successful competition and innovation, reductions in product development cycle times (cost), demands for better quality, improvement in supply chain management and higher expectations from more discriminating and demanding customers (Lyons and Krachenberg, 1990).

Agency theory helps to create a success outsourcing relationship by avoiding agency problems, created between buyer and supplier (outsourcing relationship), studying parties' behavior. Usually, agency problems arise when the agent acts opportunistically, does not provide additional sources of information to the principal or retains privately held information, does not maximize his effort and commitment on behalf the principal, does not match his goals with those of the principal or works for his own self interest (does not work for the principal's interests), behaves differently towards risk from the principal, shirks his responsibilities and tries to make tasks non- programmable. As a result of these agent behaviors, outsourcing relationships would be affected negatively. Production cost or unit cost will not be reduced because of the agent's opportunism, quality will not be improved because of potential shortcutting in time or procedures, right decisions cannot be made because of information that has been hidden from the principal, competition and innovation with other agents will be curtailed because of the unethical approaches of the agent and /or orders or services will not be delivered on time. Agency problems increase monopolies that threaten the efficiency effects of the market by reducing competition and innovation, which in turn affects economic growth (Tezuka, 1997). Thus, agency is very important issue in such study, and it is linked with outsourcing to create smooth relationship.

Although, as it is mentioned in the above, agency theory is important in such study to ease and support the relationship between buyer and supplier, agency has limitations. It has been mentioned before that agency theory offers solutions to the problems of adverse selection and moral hazard. In both cases, the agent fails to achieve the goals of the principal. The principal-agent dyad assumes that adverse selection can be controlled if the principal has all available information. The moral hazard problem can be controlled using behavioural or outcome-based contracts between the buyer and the supplier. Behavioural contracts are designed to control the activities of the supplier by monitoring supplier behaviour. In the other hand, outcome-based contracts measure specific results and attempt to align the goals of the agent with those of the principal rather than monitor specific behaviours (Eisenhardt, 1989). The problem (limitation) of adverse selection and moral hazard that agency theory attempts to resolve is that costs can exceed benefits, which is one of the limitations of the agency theory (Goliath, 2009). In addition, while Agency theory explains why some suppliers do not working for buyers' interest, it is not clear how this action could be measured. Also, the theory does not make it clear what processes are involved in the shifting behavior (working for buyers' interest to not working for buyers' interest) (Walsh, 2008).

It concludes that the outsourcing relationship is a relationship between two parties who each part work for the other to let the relationship flows smoothly. The same as any kind of relationship, outsourcing relationship has characteristics and specifications, and each part should understand them clearly to create a successful relationship. Agency theory assists each party to understand these characteristics and specifications because it studies this relationship from both side principal and agent by defining the problems, which may occur between them, why it happens, how can be controlled, and how a success relationship can be created by avoiding such type of problems. So, it is important to say that agency theory is a main part of outsourcing relationship because it helps to design the types of contracts and relationships which provide and support an environment of trust.

### 3.5 Types of buyer and supplier partnership

In chapter one, outsourcing is defined as a delegation some of firm/ company in-house operations/processes to a third party to accomplish what firm/ company needs . That means, it is a relationship between two parties. First of them could be called buyer, principal, owner and employer…etc, and the second could be supplier, agent, manager and employee…etc.

Subcontracting or outsourcing for component parts in manufacturing is a vital part of most business strategies in industrial firms in any industry in the world. In general, buyers can leverage their resources through strategic outsourcing by:

- Developing a few well-selected core competencies of significance to customers and in which the company can be best-in-world;
- Focusing investment and management attention on them;
- Strategically outsourcing many other activities which cannot be or need not be best (Quinn and Hilmer, 1994, p. 12). However, a company needs to build up successful outsourcing to gain maximum benefit from it. The buyer- supplier relationship is one of the most important factors affecting the success of outsourcing.

During the past few years, many studies about buyer- supplier relationships have been conducted (Sharma, 1997; Eisenhardt, 1989), and most of them have been exhorting managers to move towards longer-term and collaborative strategic partnerships with external business partners instead of arm's-length relationships. This result is a natural reaction to studies that compare the Japanese subcontracting approach with those of the rest of the world. However, each type of relationship should be understood very well together with all their circumstances to avoid any uncertainties that could affect this partnership negatively.

Since the 1960s, Japanese producers have achieved notable growth by using strategic subcontracting, which relies on distinctive institutional arrangements, such as producing a complex historical interaction among market demand, politics, technology and producer strategy. Subcontracting consists of a series of collaborative relationships based on problem-solving principles for the manufacture of high-quality, low-cost goods and on time delivery (Nishiguchi and Brookfield, 1997).

### 3.5.1 Exit and voice partnership types

The “Exit-Voice” framework is one type of relationship that can classify the buyer and supplier relationship according to the types of problems that arise between the parties. An exit relationship occurs when a buyer has a problem with a supplier and finds a new supplier. In contrast, in a voice relationship, the buyer works with the original supplier to resolve the problem (Helper and Sako, 1995).

Helper (1991) stated that “These types of relationship have two dimensions: information exchange and commitment. Information exchange includes both the nature and mutuality of the information flow between supplier and customer. At the lowest level, the only information exchanged is the price of off-the-shelf products; this is the "market" described in economics textbooks. At the intermediate level, the parties may share information about finance, plant and equipment. At the highest level, the customer and supplier provide continuous feedback and suggestions for improvement about each other's operations. Commitment refers to the supplier's degree of certainty that the customer will continue to buy their products for some length of time" (Helper, 1991, p.15).

Helper's 1989 survey data of U.S. auto suppliers (Helper, 1991) shows that there is progress towards a voice model of supplier relations and those suppliers are more likely to provide all information to their buyer, to win long-term contracts. However, suppliers don't trust the buyers because of a lack of buyer commitment, and are compelled to improve their performance in quality and delivery, without much assistance from buyers, to reduce cost or adopt new techniques. For example, JIT delivery was not matched by JIT production, so in 1989, 48 percent of suppliers ended up stockpiling inventory to meet their customers' delivery demands, compared with 20 percent in 1984. From the above, it was indicated that the buyer had reduced prices with the reduction coming from the supplier's margin not from reduced costs.

Helper and Sako (1995) surveyed U.S. and Japanese automotive suppliers (Helper in the United States and Sako in Japan). The surveys yielded an unusually comprehensive database. In the United States, 675 responses came from Japanese transplants and vertically integrated divisions of U.S. carmakers as well as independent U.S.-owned firms, with a response rate of 55 percent. In Japan, 472 responses were received from vertically integrated divisions of Japanese carmakers and a few foreign-owned companies as well as independent Japanese-owned firms, with a response rate of 30 percent.

The Helper and Sako (1993) survey results identified three distinct supplier relationship strategies: One was a return to an exit relationship in which suppliers received only short-term contracts (which average only slightly more than a year) and had to bid against many other suppliers, largely on the basis of price, for renewal. The second was a consistently voice-based relationship that had produced significant supplier cost reductions. Companies using the third strategy had used exit in 1983 but had moved consistently toward a voice relationship, with longer contracts and steady increases in suppliers' perceptions of their fairness (Helper and Sako, 1995).

The voice relationship pushes the partnership between buyer and supplier in a positive direction. For example, Helper's survey (1991) results of U.S. car suppliers show that computer numerically controlled processes have been used to a considerable extent with long-term contracts. The rationale for the connection between technology use and contract length is that firms want to have some assurance that they will have enough work to cover their additional fixed costs before they make large investments. Performance improvements arise from direct coordination of activities by the customer and supplier visiting each other (58 percent exchange visits with their customer more frequently than every two weeks, and 95 percent exchange visits more frequently than every eight weeks), and from quality assurance systems increasing the ease of information flow between buyer and supplier (Helper,1991).

Helper and Sako's survey represents the impact of voice relationships on performance. The writers invited consideration of the performance impact of a very relaxed voice relationship in which:

- A supplier provides the customer with a detailed breakdown of its process steps,
- A supplier believes it is highly probable that it will continue to provide products to this customer for more than three years,

- If a competitor offers a lower price, the supplier expects the customer to help it match the competitor's effort.

U.S. and Japanese firms with such relationships do better for their customers and for themselves, and perform generally much better than those without. For example, according to the survey, 28 percent of U.S. suppliers received more awards from their buyers. Further, market-share growth between 1989 and 1993 was 1.5 percentage points higher, and they (suppliers) were 10 percent more likely to adopt JIT delivery without a cost increase (buyers give suppliers awards, such as Ford's Q1, for good performance in areas such as quality and on-time delivery.) However, only 29 percent of respondents had relationships that met even these minimal voice relationship criteria in 1993.

Japanese suppliers with a voice relationship receive, on average, 18 percent more awards from the buyers. Moreover, it is 50 percent more likely that JIT delivery is adopted without a cost increase. (No market-share growth advantage was evident for voice suppliers in Japan). Similarly, even in Japan, only 32 percent of respondents had relationships that met the voice criteria in 1993.

Voice relationships improve the JIT problem by balancing production and delivery. For example, in 1984, U.S. suppliers produced in batches that would last their customers an average of nineteen days. Suppliers also delivered to their customers on average every nineteen days. By 1989, both production and delivery batch sizes had fallen significantly. However, much of the change took place in lot sizes delivered, indicating that many suppliers were stockpiling their product. In 1993, more than half of U.S. suppliers were delivering batches smaller than those they produced, indicating that they were stockpiling inventory. But the median difference between production and delivery lot sizes had shrunk for all firms since 1989 (Helper and Sako 1995). This study was applied to 500 suppliers in Japan and 600 suppliers in the United States. This sample of questionnaires constitutes a good number for giving rich information to the survey, but applying the study only in Japan and the United States is a limitation of the study because these two markets do not reflect the other markets around the world. Thus, its results may not necessarily be applied in other markets. Additionally, the study was conducted in the automotive sector alone, which constitutes another limitation of the study; the characteristics of the automotive sector may differ from other industries, albeit in the same country. Both these limitations to some extent limit generalisation of the study. Further, the classification of relationships according to the types of problems that arise between the parties without looking at other characteristics adds another limitation to this study because it does not provide market characteristics and upstream information in sufficient detail to assist the researcher to classify the relationships in Saudi Arabia.

### 3.5.2 Remote, electronic, electronic interdependence, structural, and mutual adjustment relationship types

Bensaou and Venkatraman (1995) have represented another type of buyer-supplier relationship which depends on fitting information –processing needs, which arise from environmental uncertainty, partnership uncertainty and task uncertainty, and information- processing capabilities, which are derived from structural mechanisms, process mechanisms and information technology mechanisms( Bensaou and Venkatraman, 1995).The authors classified five kinds of relationship: Remote Relationship, Electronic Relationship, Electronic Interdependence, Structural Relationship and Mutual Adjustment. The researchers collected the data that they used for their survey from interviews with 17 managers responsible for critical inter-organizational relationships in the car industry in the U.S.A and Japan.

The number of interviews (17) constitutes a significant limitation of the study; this sample does not contain enough interviews to give a detailed idea about the markets in the United States and Japan. Additionally, restricting the study, once more, to the automotive industry does not allow the reader to understand to have a wider picture of the markets as a whole, either in the United States or Japan. Furthermore, limiting the study between the same two countries as in Helper and Sako (1995) means that, once more, the results of the study may not be applied in other markets in the world. Further, Bensaou and Venkatraman classified these relationship types depending on fitting information –processing needs, which was insufficient for the researcher to classify the relationship types in a market such as the Saudi Arabian market.

- **Remote relationship**

This type of relationship is used with highly standardized components needing simple and mature technology. Suppliers with this kind of partnership need only little engineering effort and expertise. With the remote relationship, none of the partners (U.S. or Japanese) makes any significant investment in the relationship and negotiation between them is routine. The exchange of information is limited to what is operationally necessary. So, this type of relationship represents a fit between low information –processing needs and low information- processing capabilities because the authors observed that this relationship emerges in a low uncertainty environment that yields a low level of information requirements and a low level of information-processing capabilities.

- **Electronic relationship**

This is similar to the remote relationship in terms of information –processing needs. The information- processing capabilities of this type are slightly different from those of the remote relationship because there is control combined with a low frequency of information exchange which occurs during a few visits and weekly joint actions. With this type of relationship the buyer spends little time monitoring the supplier's performance, resolving urgent problems or negotiating contracts, and information technology is used to mediate control activities.

- **Electronic interdependence relationship**

This type reflects those relationships with highly customized components needing a high level of technology and engineering. The electronic interdependence relationship relates directly to the manufacturer's core competencies, so the manufacturer makes virtual investments to compete with others. Its environment consists of high growth market segment, high complexity and is highly dynamic. Information flow between buyer and supplier is rich and intense, and there are many engineering visits between them. Both parties spend a lot of their time coordinating about their future plans and continuous improvement. Information technology is also used, and it represents best practice in E.D.I (Electronic Data Interchange). The results indicate that, in this relationship, the manufacturer collaborates with the supplier from the early stage of component design, cooperates in long range planning, advanced research, product, process and tooling development, as well as technical assistance. Note that there are often disagreements between them about component pricing, cost structure, product design, quality level, and inventory and delivery policies, but they usually resolve them by a collaborative process based on negotiation rather than upon confrontation. The electronic interdependence relationship has a high level of uncertainty, which is why it needs important and rich information- processing capabilities.

- **Structural relationship**

This kind of relationship is a fusion of the remote relationships with low growth market segment, complexity and dynamism, and the electronic relationship with high growth market segment, complexity and dynamism. In contrast, this relationship has limited market growth and low dynamism (stable technology with few changes in products), but has high complexity. Communication channels between buyer and supplier represent a good structural mechanism characterised by frequent visits and good discussion environments about quality, design and manufacturing. The results show also that information technology is used only where manufacturer scopes and the climate are adversarial. With this relationship the buyer does not give a strong commitment to the supplier.

The information- processing capabilities are intense with the structural relationship. This comes from the heavy investment in the structural mechanisms. In contrast, it is characterised by poor information exchange because of deficient IT implementation, and the confrontational nature of the relationship.

- **Mutual adjustment relationship**

This type of relationship is used only with high tech, new and complex components, quickly changing in their design and performance. With this relationship a buyer is heavily dependent on the supplier because of the latter's unique skills and capabilities in the production of components. Partners, here, share sensitive information with each other because of mutual trust between them. Although the environment among partners is positive and comfortable, the information exchange is too limited because of infrequent visits between them. The results show that the information processing capabilities are limited and this is why both parties tend to have a poor response to a high uncertainty contingency.

### 3.5.3 Market exchange, captive buyer, strategic partnership and captive supplier relationship types

Bensaou (1999) has also studied the relationship between buyer and supplier. In the researcher's view, he studied partner relationships deeply, and he classified them in a simple way that can be clear to any reader. He conducted a total of 447 surveys among managers in three U.S. and eleven Japanese automobile manufacturers. This survey was more specific than the preceding ones because it discussed the outsourced components from many aspects. The writer let each informant or boundary spanner respond for only one product and one supplier for which he or she was responsible. As a result, comprehensive information about the external and internal aspects of each relationship was obtained: the data included multiple items about:

- The component and its technology;
- Competition in the upstream market;
- The supplier itself;
- The nature of the boundary spanner's job;
- The internal workings of the relationship, that is, the contractual conditions, the social climate, and the extent and type of information exchange within the relationship;
- The performance of the relationship.

The classifications of this study give it strength. Classification was simple and logical, making it easy to be understood and to follow the types of relationships inside the market. Additionally, the classifications of the study depend on a variety of characteristics, which gives the study good depth in each relationship, thereby assisting the researcher to go further to achieve the goals of his research. In contrast, conducting a total of 447 surveys among managers in three U.S. and eleven Japanese automobile manufacturers gives the study limitations because it was not enough to study and understand such large markets as those of the U.S. and Japan. Additionally, the study was once more conducted among automobile manufacturers, whereby its results do not reflect other manufacturers in both these countries. Furthermore, limiting the survey to the same two countries restricts the picture to the U.S. and Japan, without consideration of the rest of the world. However, in spite of the Bensaou study limitations, the researcher took the benefits of the study as a starting point to study buyer and supplier relationships in Saudi Arabia.

The following paragraphs discuss the four profiles that emerge from the results.

- **Market exchange profile**

This profile is usually used for highly standardized products, which are based on simple technology that requires little engineering effort and expertise from suppliers. These products, such as standard bearings or relays, require little or no customization of the final product. These products are systematically outsourced by both U.S. and Japanese buyers. The results show that there are many suppliers for such products because they require little capital investment and few innovation capabilities, thus the upstream market is highly competitive. The suppliers in this relationship profile can easily and cheaply shift their production from one buyer to another because of low switching costs, and they do not have technology brands embedded in their products or processes. The results indicate that in both countries, the U.S. and Japan, the primary goal in this relationship is to minimize cost and leverage economies of scale through a large number of suppliers, with most suppliers willing to make price concessions. Though contracts in this relationship are short term, they are usually renewed if suppliers have a good reputation without commitments from supplier to buyer to continue. But, at the same time, most suppliers have a good reputation for holding to their commitments and show a track record that satisfies the buyer.

From the above discussion it can be concluded that neither of the parties develops specialized assets to work with the other; they just work together by using general assets. In this relationship, the only information exchange between buyer and supplier is done during bidding and contract negotiations. Suppliers do not share design of the component with buyers, and the operational coordination of delivery and inventory is executed using proven organizational routines. Visits between them are rare, except when urgent and exceptional operational problems occur. Buyer staff spend a limited amount of their total time with supplier staff. The buyer's performance does not depend on the supplier staff. In spite of lack of cooperation and mutual trust in this relationship, the social climate is generally positive. Buyers treat suppliers in the Market-Exchange relationship fairly, reasonably sharing the benefits, burdens and risks in the relationship within the limits of the contract. The results show that 31 percent of all Japanese firms are engaged in this kind of relationship compared with 25 percent of all of U.S. firms (see Market-Exchange relationship characteristics table (table 3.1)).

- **Captive buyer profile**

This relationship is used for complex components that require some customization, but at the same time they are still based on a well-understood, stable technology, such as bearings, bumper fascia, beams and glass products. Few large

Table 3.1 Market-Exchange relationship characteristics table

| ***Market Exchange*** |
| --- |
| Information-sharing mechanisms |
| • "Narrow-band" and limited information exchange, heavy at Time of contract negotiation<br>• Operational coordination and monitoring along structured routines |
| Boundary spanners' task characteristics |
| • Limited time spent directly with supplier staff<br>• Highly routine and structured task with little interdependence with supplier's staff |
| Climate and process characteristics |
| • Positive social climate<br>• No systematic joint effort and cooperation<br>• No early supplier involvement in design<br>• Supplier fairly treated by the buyer<br>• Supplier has a good reputation and track record |
| Product characteristics |
| • Highly standardized products<br>• Mature technology<br>• Little innovation and rare design changes<br>• Technically simple product or well-structured<br>• Complex manufacturing process<br>• Little or no customization to buyer's final product<br>• Low engineering effort and expertise required<br>• Small capital investments required |
| Market characteristics |
| • Stable or declining demand |

- Highly competitive market
- Many capable suppliers
- Same players over time

Supplier characteristics

- Small shops
- No proprietary technology
- Low switching costs
- Low bargaining power
- Strong economic reliance on buyers' business

Suppliers are involved in this relationship, and they usually possess proprietary technology. Major improvements of product, process, or even price/performance do not happen quickly because of stable demand and limited market growth. It is difficult for buyers and costly to locate and shift to another source of supply in this kind of relationship.

The results show that both U.S. and Japanese carmakers try to keep some in-house manufacturing for such products. There is no operational coordination between buyer and supplier, despite the need for customization in this relationship, but there is exchange of detailed information, which is required for the complexity of the product and consideration of multiple functional areas, such as design, manufacturing, quality and purchasing, across the two firms. This establishes a "broadband" communication channel that contrasts with the "narrow-band" channel in market-exchange relationships, so that is why, in both countries, a high level of communication takes place in successful captive-buyer relationships. Boundary spanners spend a large amount of their time dealing with the supplier. Even in successful relationships, the social climate is tense. In the Captive-Buyer relationship, there is mutual distrust between partners, and suppliers have a poor reputation and a negative track record despite buyers' efforts to cooperate and provide suppliers with technical assistance, training and education.

From the above discussion one can conclude that the "captive buyer" relationship is an asymmetric one in which the buyer is held hostage by a supplier who is free to switch to another customer. The results show that 15 percent of all Japanese firms are engaged in this kind of relationship compared with 42 percent of all U.S. firms (see Captive-Buyer relationship characteristics table (table 3.2)).

Table 3.2 Captive-Buyer relationship characteristics table

| **Captive Buyer** |
|---|
| Information-sharing mechanisms |
| • "Broadband" and important exchange of detailed information on a continuous basis<br>• Frequent and regular mutual visits |
| Boundary spanners' task characteristics |
| • Structured task, highly predictable<br>• Large amount of time spent by buyer's purchasing agents and engineers with supplier |
| Climate and process characteristics |
| • Tense climate, lack of mutual trust<br>• No early supplier involvement in design<br>• Strong effort by buyer toward cooperation<br>• Supplier does not necessarily have a good reputation |
| Product characteristics |
| • Technically complex<br>• Based on mature, well-understood technology<br>• Little innovation and improvements to the product |
| Market characteristics |
| • Stable demand with limited market growth<br>• Concentrated market with few established players<br>• Buyers maintain an internal manufacturing capability |

Supplier characteristics

- Large supply houses
- Supplier proprietary technology
- Few strongly established suppliers
- Strong bargaining power
- Buyers heavily depend on these suppliers, their technology and skills

- **Strategic partnership profile**

The Strategic Partnership is used with highly customized components such as power steering, suspension, braking and air-conditioning systems, or integrated subsystems that require strong technology and engineering capabilities. In both countries, buyers usually keep an in-house design, development, testing and, sometimes, manufacturing capability for these technologies. In this relationship, buyers make important investments in critical internal assets of the suppliers for potential risk and damage limitation if the supplier behaves opportunistically. Partners work together from the beginning of concept design to the development of tooling and manufacturing processes to the coordination of just-in-time production and delivery between the two firms. The upstream market is high growth, extremely competitive, and there is great uncertainty about the choice of the right technology or standard. The relationship between buyer and supplier is usually a close, long-term relationship because it involves a number of investments between them.

The supplier, involved in such a relationship, develops design and production skills and capabilities for the buyer's business, invests heavily in fundamental research to keep up with the fast pace of innovation and maintains proprietary technology. For example, Toyota's strategic partners build plants or warehouses only thirty miles away on average from the final assembly plants. In such a relationship there is a high level of interaction and interdependency between buyer and supplier. Information is regularly exchanged between partners by means of reports, standardized rules and operating procedures, electronic transfer of schedules and face-to-face contact. Supplier engineers visit the assembler's engineering facilities, purchasing headquarters and assembly plants regularly. Boundary spanners have a non-routine job because of rapidly changing technology and product design, so they have to make very rapid decisions.

The buyer spends a lot of time with the supplier staff to coordinate tasks, such as exchanging ideas about future plans and improvements and controlling tasks, such as negotiating contracts and monitoring supplier performance. The social climate in Strategic Partnerships is trusting and collaborative, and there is a strong commitment between buyer and supplier to continue the relationship. However, tensions between buyer and supplier often arise over component pricing, cost structure (and the contribution to lowering costs over time), product design, quality levels, and inventory and delivery policies. These disagreements are usually resolved through collaborative processes rather than through confrontation. In these relationships, as in some market-exchange relationships, there is a strong sense of sharing the benefits, burdens and risks. The results show that 19 percent of all Japanese firms are engaged in this kind of relationship compared with 25 percent of all U.S. firms (see Strategic relationship characteristics table (table 3. 3)).

- **Captive supplier profile**

The Captive-Supplier relationship is used with highly complex products or integrated subsystems based on new proprietary technology which the supplier has embedded in their product or manufacturing process. The supplier puts heavy capital investments into these products just to stay in the market and to maintain its strong design reputation and superior engineering and manufacturing capabilities. These products and their technology are also in high demand, but the buyer may shift supplier quickly as the technology evolves and other suppliers offer improvements in technology or product performance. In contrast, although the supplier has proprietary technology, he has limited bargaining power because other suppliers could easily make the specialized investments requested by the buyer to gain a share of the business.

As results indicate, the upstream market is fiercely competitive. For example, in Japan, car manufacturers typically use up to four capable suppliers to procure the

Table 3.3 Strategic relationship characteristics table

| **Strategic Partnership** |
| --- |
| Information-sharing mechanisms |
| • Broadband," frequent and "rich media" exchange<br>• Regular mutual visits and practice of guest engineers |
| Boundary spanners' task characteristics |
| • Highly defined, structured<br>• Non routine, frequent unexpected events<br>• Large amount of time spent with supplier's staff, mostly on coordinating issues |
| Climate and process characteristics |
| • High mutual trust and commitment to relationship<br>• Strong sense of buyer fairness<br>• Early supplier involvement in design<br>• Extensive joint action and cooperation<br>• Supplier has excellent reputation |
| Product characteristics |
| • High level of customization required<br>• Close to buyer's core competency |

- Tight mutual adjustments needed in key processes
- Technically complex part or integrated subsystem
- Based on new technology
- Innovation leaps in technology, product, or process
- Frequent design changes
- Strong engineering expertise required
- Large capital investments required

Market characteristics

- Strong demand and high growth market
- Very competitive and concentrated market
- Frequent changes in competitors due to unstable or lack of dominant design
- Buyer maintains in-house design and testing capability

Partner characteristics

- Large multi-product supply houses
- Strong supplier proprietary technology
- Active in research and innovation (i.e., R&D costs)
- Strong recognized skills and capabilities in design, engineering, and manufacturing

same high-value component. One company in the sample kept three firms as its primary source for instrument panels and dashboards. Each supplier had a promise of repeat business; that is, a base contract that stipulates that unless something adverse happens, the relationship will continue, which provides the three suppliers with sufficient incentives to take a longer-term view and make investments in R&D or process technology to add value for the customer.

The buyer, on the other hand, keeps these three suppliers "on their toes", moving 4 to 5 percent of annual volume from one to another each time a deficiency in quality or delivery reliability is identified. Information exchange in this relationship is of a lower level compared with the other three relationships. Boundary spanners spend less time on tasks, such as negotiating the contract and monitoring the supplier, and most communication concentrates on coordinating tasks rather than the control activities associated with market-exchange relationships. Mutual trust is the social climate of the relationship, but still mutual trust does not mean active joint planning or development, as in strategic partnerships. The results show that 35 percent of all Japanese firms are engaged in this kind of relationship compared with 8 percent of all U.S. firms. Finally, in captive supplier relationships, the supplier enters the trap of unilaterally making idiosyncratic investments to win and keep the business with the buyer (see Captive-Supplier relationship characteristics table (table 3.4)).

### 3.5.4 Arm's-length contractual and obligatory contractual relationship types

Further, Sako (1992) provides another type of relationship between buyer and supplier. The writer indicates two types of relationship: the first one is Arm's-length Contractual Relation (ACR) and the other is Obligatory Contractual Relation (OCR). The empirical study researched 18 suppliers in both British and Japanese companies with their customer companies in Japan, Britain, and Japanese companies located in Britain. The researcher of this study did not indicate how many customers had been researched or how many there were of each type of company, a further limitation of the study. Additionally, 18 suppliers in Britain and Japan are not enough

Table 3.4 Captive-Supplier relationship characteristics table

| **Captive Supplier** |
| --- |
| Information-sharing mechanisms |
| • Little exchange of information<br>• Few mutual visits, mostly from supplier to buyer |
| Boundary spanners' task characteristics |
| • Limited time allocated by buyer's staff to the supplier |

- Mostly complex, coordinating tasks

| Climate and process characteristics |
|---|

- High mutual trust, but limited direct joint action and cooperation
- Greater burden put on the supplier

| Product characteristics |
|---|

- Technically complex products
- Based on new technology (developed by suppliers)
- Important and frequent innovations and new functionalities in the product category
- Significant engineering effort and expertise required
- Heavy capital investments required

| Market characteristics |
|---|

- High-growth market segment
- Fierce competition
- Few qualified players
- Unstable market with shifts between suppliers

| Supplier characteristics |
|---|

- Strong supplier proprietary technology
- Suppliers with strong financial capabilities and good R&D skills
- Low supplier bargaining power
- Heavy supplier dependency on the buyer and economic reliance on the same industry sector in general

to give a reasonable overview of big markets such as those in Japan and Britain (Sako, 1992). Finally, Sako depended on the Contractual Relationship type only to classify these relationships, which can be considered another limitation of this study. He defines the Arm's-length Contractual Relation (ACR) as an explicit contract that spells out before trading commences each party's tasks and duties, and the Obligatory Contractual Relation (OCR) as an economic contract covering the production and trading of goods and services. However, it is embedded in more particularistic social relations between trading partners, who entertain a sense of mutual trust. The author describes the features of both relationships as:

| ACR | OCR |
|---|---|
| **Transactional Dependence**<br>• Buyer seeks to maintain low dependence by trading with a large number of competing suppliers within the limits permitted by need to keep down transaction costs.<br>• Supplier seeks to maintain low dependence by trading with a large number of customers | • For buyer, avoidance of dependence is not a high priority, it prefers to give security to few suppliers, though may still deal with more than one source for flexibility.<br>• For supplier, avoidance of dependence is not a high priority, but it may well have several OCR customers. |
| **Ordering procedure**<br>• Bidding takes place. Buyer does not know which supplier will win the contract before bidding. Price negotiated and agreed before an order is commissioned | • Bidding may or may not take place. With bidding, buyer has a good idea of which supplier gets which contract before bidding. Without bidding there is a straight commission to supplier. Prices are |

| | |
|---|---|
| | settled after discussion about who gets the contract |
| **Projected duration of trading**<br><br>• Short-term commitment by both buyer and supplier. | • Continued beyond the duration of the current contract. Mutual long term commitment. |
| **Documents for exchange**<br><br>• Term and conditions of contract are written, detailed and substantive. | • Contracts contain procedural rules, but substantive issues are decided case by case. Contract may be oral rather than written |
| **Contractual**<br><br>• Contingencies are written out and followed strictly. | • Case by case resolution with much appeal to the diffuse obligation of long term relationships. |
| **Contract trust**<br><br>• Supplier never starts production until written orders are received. | • Supplier often starts production on the basis of oral communication, before written orders are received. |
| **Competence trust** | |

| | |
|---|---|
| • Thorough inspection on delivery, the principle of caveat emptor predominates. | • Little or no inspection on delivery for most part because buyer may be involved in establishing supplier's quality control system. |
| **Communication channels and intensity**<br><br>• A narrow channel between the buyer's purchasing department and the supplier's sales department, with frequency kept to the minimum necessary to conduct business. | <br><br>• Extensive multiple channels between engineers, quality assurance personnel, top managers, as well as between purchasing and sales managers. |
| **Risk sharing**<br><br>• Little sharing of risk | <br><br>• Much sharing of risk |

### 3.6 Summary

There are a number of factors that challenge the success of the relationship between partners, such as how can an entire organization be invited and encouraged to shift from competition to cooperation? How can control procedures be established that are compatible with cooperation? How can the buyers avoid the temptation of returning to the practice of fierce competition? (Frey and Schlosser 1993) What is more, agency theory problems can damage all the efforts put into improving buyer and supplier relationships and affect negatively the whole organization's processes.

There are always some inherent risks in outsourcing, but there are also risks and costs of in-sourcing.

From discussions so far it can be concluded that each relationship has specifications and features depending on market circumstances and product characteristics, and it is not clear-cut whether one type is better than the others, but it is clear that an appropriate relationship should be built up between buyer and supplier depending on their market circumstances and product characteristics so as to be beneficial for both.

The researcher found that to study buyer and supplier relationship types in the Saudi Arabian market, there was a need to understand agency theory, its types (positive agency research and principal-agent research) and its problems (moral hazard and adverse selection) to assist the researcher to understand buyer and supplier behaviour in depth and classify the problems which arise between them, what their causes are and how they can be controlled. Additionally, studying the outsourcing concept eased the researcher's understanding of the incentives to create each type of relationship and the important factors that assist outsourcing to be successful( avoiding agency problems). Finally, it was important to understand the classifications of relationship types to assist the researcher to classify the relationship types in the Saudi market. From previous studies, the researcher found some limitations in them. Some researchers have concentrated on only one industry, such as Helper and Sako (1995), Bensaou and Venkatraman (1995) and Bensaou (1999). Additionally, research tends to have concentrated on the same two countries only, such as Helper and Sako, (1995), Bensaou and Venkatraman (1995), Bensaou (1999) and Sako (1992). Some studies were conducted with limited sample sizes, such as Bensaou and Venkatraman's (1995) study in which the data was collected by interviews with 17 managers and Sako's (1992) study, in which the data was collected by researching 18 suppliers in both British and Japanese companies with their customer companies in Japan, Britain, and Japanese companies located in Britain. Some studies classify the relationship between buyer and supplier depending on specific factors only, such as Helper and Sako's (1995) study which classified the relationships only on the basis of the types of problems that arise between the parties, whilst Bensaou and Venkatraman's (1995) study classifies the relationships according to a fit with information –processing needs and Sako's (1992) study classifies the relationships depending on the Contractual Relationship type alone. In spite of these limitations, especially those in Bensaou's (1999) study, the researcher took this study further by using it as a starting point to classify the relationship types in the Saudi market. The researcher found that Bensaou's (1999) study is an appropriate study to be applied in such research because of two reasons. First reason, Saudi Arabian market is ambiguous market, so the researcher needs simple and logic relationship classifications to understand and follow the types of relationships inside such ambiguous market. Secondly, the classifications of the Bensaou's (1999) study depend on a variety of characteristics, it is more specific than the other studies, and it discussed the outsourced components from many aspects and multiple items. This gives the study good depth in each relationship, which assists the researcher to be more accurate in relationship classifications of Saudi Arabia market, especially while the researcher used different types of services and industries market for data collection.

From the studies which were represented in the literature, the researcher found that data collection would not be easy, so an appropriate methodology was chosen, using a conceptual framework based on the literature.

# CHAPTER FOUR

# CHAPTER FOUR

# RESEARCH METHODOLOGY

## 4.1 Introduction

The purpose of this research was to study and investigate behavior in the different types of relationship between buyers and suppliers in Saudi companies. It aims to discover which problems exist in each type of relationship and how they can be controlled. More specifically, the research tries to answer the following questions:

- What are the incentives that create each type of relationship?
- Which problems exist in each type of relationship?
- How can these problems be controlled and what are their effects in terms of understanding the reality of the outsourcing relationship flow, and how it can be improved?
- What are the effects of the problems on each relationship in the market? Plus, and finally, what the effects on the research model in each relationships?

This chapter outlines the methodology used to collect data to answer the research questions see (Fig. 4.1).

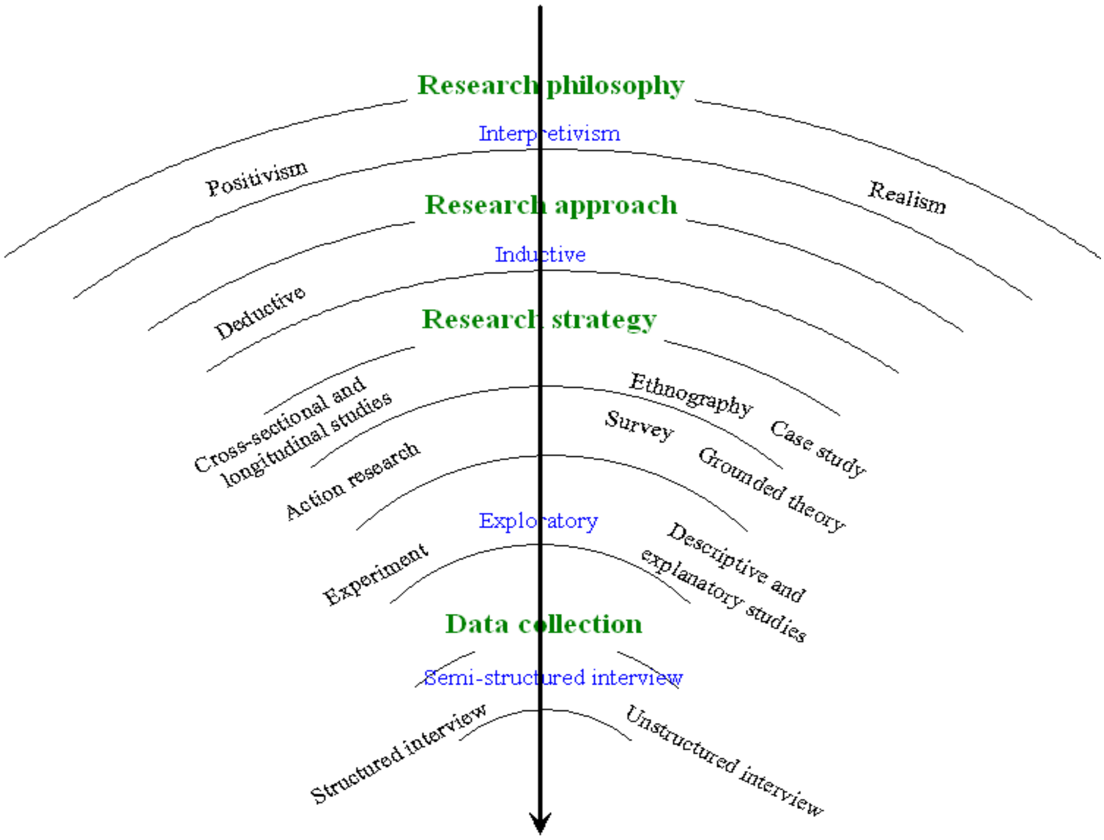


Fig. 4.1 Research methodology diagram

## 4.2 Research philosophy

There are three types of research philosophy paradigms, positivism, interpretivism and realism paradigms (Saunders et al., 2003).

### 4.2.1 Positivism

Positivism (quantitative, scientific approach) is a type of research philosophy which declares natural (empirical) sciences to be the sole source of true knowledge and rejects the cognitive value of philosophical study. It emerged in response to the inability of speculative philosophy to solve philosophical problems which had arisen as a result of scientific development ((Remenyi et al., 1998). It involves an emphasis on a highly structured methodology to facilitate replication (Gill and Johnson, 1997) and on quantifiable observations that lend themselves to statistical analysis (Saunders et. al, 2003). Positivism holds that an accurate and value-free knowledge of things are possible. It holds out the possibility that human beings and their actions and institutions can be studied as objectively as the natural world. (Fisher2003). The researcher should be independent of and neither affects nor is affected by the subject of the research (Remenyi et al., 1998).

### 4.2.2 Interpretivism

Interpretivism (qualitative approach) is a type of research philosophy which incorporates the subjective meanings motivating people's actions in order to be able to understand what is happening (Easterby-Smith et al., 2002); it involves gaining rich insights within this complex world which may get lost because of the value of law-like generalizations (Saunders et al., 2003). It involves any kind of research that produces findings not arrived at by means of statistical procedures or other means of quantification (Strauss & Corbin, 1990). Interpretivism is critical of positivism because it seeks to collect and analyze data from parts of phenomena and positivism can miss important aspects of a comprehensive understanding of the whole. Interpretivism proposes that there are multiple realities, not single realities of phenomena, and that these realities can differ across time and place (Neill, 2006).

### 4.2.3 Realism

Realism is the third type of research philosophy which shares some philosophical aspects of positivism, at the same time recognizing that people are not objects to be studied in the style of natural science (Saunders et al., 2003).

The interpretive research philosophy was deemed most appropriate for this research in order to explore and discover the details of each type of relationship between buyers and suppliers. It was considered that this type of research philosophy would help the researcher in this study to understand the behavior involved in each of the relationships between buyers and suppliers, by being involved in the richness, depth and complexity of phenomena; especially given that the human behavior factor is involved in and affects the data collected and that the data collected is affected by and interacts with human behavior. A positivist approach was not suited to the nature of the research topic because it believes that reality is separate from the individual who observes it, therefore entirely infeasible for this study. The researcher was a part of the research phenomena and needed to interact with the interviewee respondents. Furthermore, positivism is usually used for laboratory experiments, field experiments and surveys, research methods that involve large amounts of empirical data that can be analyzed statistically. Thus this approach was not at all appropriate for an exploratory study investigating the understanding between two parties by conducting a limited number of interviews relating to a highly sensitive research topic. Respondents to participate in this research study were very difficult to find and obtaining a larger sample simply was not possible.

## 4.3 Research approach

The research approach adopted can be either deductive or inductive (Saunders et al., 2003).

### 4.3.1 Deductive

The deductive research approach makes conclusions based on previously known facts. It is a valid form of proof (Sparknotes, 2006), starting with a general case and deducing specific instances. It is used by scientists who take a general scientific law and apply it to a certain case. Deductive conclusions can be valid or invalid (Changingminds.org, 2002). Researchers using a deductive research approach should be independent of what is being observed, and they are more likely to work with quantitative data. There are three characteristics of the deductive approach. First of all, causal relationships between variables should be explained. Secondly, concepts can be measured quantitatively. Finally, a deductive approach involves generalization, implying the necessity to select samples of sufficient numerical size (Saunders et al., 2003).

### 4.3.2 Inductive

The inductive research approach is the process of reaching a conclusion based on a set of observations. In itself, it is not a valid method of proof, because it does not imply that the pattern of situations which are observed is true (Sparknotes, 2006). It starts from a specific case or cases and derives a general rule (Changingminds.org, 2002). Researchers using this approach need to understand the nature of the problems by conducting interviews to collect necessary data, and they are more likely to work with qualitative data. Using a small sample size might be more appropriate than a large one, as with the deductive approach (Easterby-Smith et al., 2002).

For this study the researcher had to be involved in each piece of data collected and interact with it. The research variables could not be measured quantitatively. The inductive research approach was therefore appropriate for this research study because it helped the researcher to organize observations between buyers and suppliers and assisted the understanding of what was happening in each type of relationship by conducting interviews with both buyers and suppliers. A deductive approach could not be used in such a study as this one because the researcher needed to have direct involvement in what was said in interviews and interacted with each individual respondent, which is not the case in the deductive approach, which emphasizes that researchers should be independent of what is being observed. Further, a deductive approach was not appropriate for such a qualitative study as this one because it involves quantitative data or evidence, measured by scale, range, frequency etc. of phenomena. Additionally, this type of approach is usually highly detailed and structured, and its results can be collated and presented statistically. This study involves less tangible aspects and an unstructured approach because of the data collection difficulties which demanded greater flexibility.

## 4.4 Research strategy

There are many research strategies that can be employed. Some of these belong to the deductive and others to the inductive research approach. These research strategies are: experiment, survey, case study, grounded theory, ethnography, action research, cross-sectional and longitudinal studies, and exploratory, descriptive and explanatory studies (Saunders et al., 2003).

### 4.4.1 Experiment

Experiment is known as the classical form of research. Both the experimental and scientific method have several features in common. The design of experiments attempts to balance the requirements and limitations of the field of science in which one works so that the experiment can provide the best conclusion about the hypothesis being tested (Cooper and Schindler, 2003).

### 4.4.2 Survey

This type of strategy is usually associated with a deductive approach. It allows the collection of a large amount of quantitative data from a sizable population. Data is often obtained by using questionnaires (Saunders et al., 2003). The questions are usually structured and standardized to reduce bias and ensure reliability, generalization and validity. Researchers are always complaining that their progress is delayed because of their dependency on others for collecting information (Belson, 1981).

### 4.4.3 Case study

The case study can be based on any mix of quantitative and qualitative evidence (Yin, 2002). It is an appropriate method for those interested in gaining a rich understanding of the context of their research. It has the ability to answer “why” as well as “what” and “ how” questions and its data may be obtained using questionnaires, interviews, observation and documentary analysis (Marsick and Watkins, 1997).

### 4.4.4 Grounded theory

The basic idea in the grounded theory strategy is the need to read and re-read textual database as a corpus of field notes, to discover or label variables and their interrelationships. The phrase "grounded theory" refers to theory that is developed inductively or deductively from a corpus of data or a series of observations. Data collection starts without any formation of an initial theoretical framework (Borgatti, n d).

### 4.4.5 Ethnography

Ethnography is considered a branch of the inductive approach. This type of strategy emanates from the anthropology field (Saunders et al., 2003) and is used for research focusing on the sociology of meaning through close field observation of socio-cultural phenomena. Ethnography presents qualitative description of human social phenomena, based on fieldwork. The research process needs to be flexible and responsive to any change which may occur in what is being observed, especially as the researcher is continuously developing patterns of thought (Gold, 1997).

### 4.4.6 Action research

This is one of the research strategies which seeks to improve the quality of practice and its performance (McKay, 1992). Action research has been described as an informal, qualitative, formative, subjective, interpretive, reflective and experiential model of inquiry in which all individuals involved in the study are knowing and contributing participants (Hopkins, 1993). Action research has the primary objective of providing a framework for qualitative investigations by researchers in complex working classroom situations (Gabel, 1995).

### 4.4.7 Cross-sectional and longitudinal studies

This type of strategy is used when the conditions or problems being studied change over time, and when there is no data on the previous status of the problems. The cross-sectional design looks at changes over time by taking a number of cross-sections of the population at the same instant in time (Eachus, 2006). It often employs the survey strategy to collect data. However, it may use qualitative methods, conducting interviews over a short time of period.

In a longitudinal study, research is followed over time with continuous or repeated monitoring of the complexity or status of the problems being studied. It may take decades. Because of the repeated observations it is more powerful than cross-sectional observational studies (Saunders et al., 2003).

### 4.4.8 Exploratory, descriptive and explanatory studies

The exploratory strategy is valuable to studies using in depth questions to assess phenomena to seek new insights. The greatest advantage of this strategy is that it is flexible and adaptable to change. A researcher using this type of strategy must be willing to change direction as a result of new data or insights that appear. It does not mean that there is no specific direction, but the research starts out broad and becomes progressively narrower as the research progresses. There are three ways to conduct exploratory research: research of the literature, talking to experts in the subject and conducting focus group interviews (Saunders et al., 2003).

A descriptive study is used when a researcher wants to portray an accurate profile of persons, events, situations or phenomena (Robson, 2002). A descriptive study could be a piece of exploratory research and it should have a clear picture of the study before the data is collected (Saunders et al., 2003).

Explanatory studies emphasize the studying of phenomena or a situation in order to explain the relationships between variables (Saunders et al., 2003).

Although certain strategies might have been desirable, the most appropriate one to deal with this research study was the exploratory one. Combining strategies is often a popular approach, especially as triangulation is useful and provides additional credibility to the data. This was not possible here. The research aimed to find out what was happening between buyers and suppliers. To achieve this it needed to explore each relationship by conducting face to face interviews and asking in depth questions which is part of an exploratory strategy. The researcher knew that collecting such data would not be easy, and that many obstacles and difficulties would be faced; especially given that most buyers considered this type of data as confidential after Saudi Arabia joined the World Trade Organization (WTO) in December 2005 (GATT agreement, The General Agreement on Tariffs and Trade). At the same time, it is very hard for suppliers to divulge any opportunistic behavior against buyers. Therefore, many changes in the direction of the data collection had to be made and many new insights were revealed during the period of the data collection. A case study strategy would have entailed concentration on only one industry, and going into greater depth in specific companies, which, once more, was simply not possible. The researcher was also aiming to involve many different buyers and suppliers working in different industries and services to achieve the generalization which is one of the characteristics of this study and distinguishes it from previous studies that have concentrated on the automotive industry.

### 4.5 Research model

The research model was built after the research literature had been reviewed, and the research objectives and questions were set. The research model involves all the components which affect the buyer and supplier relationship. These components were categorized and classified in meaningful way, describing the flow of the relationship in terms of testing the effect of each component on the relationship between buyer and supplier in general and its effect on the category to which it belongs. For example, in terms of causes, it was found from the literature that there are many causes of either moral hazard or adverse selection problems between buyers and suppliers. Some of these causes are mentioned as causes of agency problems in the literature, such as a one-shot or short term contract (Sharma, 1997), cultural differences (Ekanayake, 2004), unsatisfactory compensation (Conlon and Parks, 1990; Kanter, 1987), improper agent selection (Stump and Heide, 1996) and outsider owners (Li and Simerly, 1998). The others are drawn from the outsourcing literature, which indicates how missing outsourcing reasons and benefits, factors of agent selection and factors for successful outsourcing can cause some of the problems found in the literature. For instance, missing an agent's qualifications factor to serve a buyer causes problem for that buyer. These causes build up to two kinds of problems as found in the literature (problems category) of either moral hazard or adverse selection, which affect the outsourcing relationship negatively.

Then, from the agency literature, the researcher found that there were strategies that could be used to reduce the effects of agency problems or control supplier opportunistic behavior (controlling category), which is beneficial to achieve a successful outsourcing relationship, such as contract type (Nilakant and Rao,1994, p.6), monitoring (Mahaney and Lederer, 2003; Tosi and Katz, 1997; Eizenhardt, 1989), incentives (Jensen and Meckling, 1976; Groff and Wright, 1989; Tosi and Katz, 1997; Ekanayake, 2004, p.8), programmability of the task (Eisenhardt, 1989, p. 62), principal knowledge (Sharma, 1997, p.773; Logan, 2000), customized investment (Dyer and Ouchi, 1993; Sharma, 1997; Li and Simerly, 1998 ) , and community reputation (Sharma, 1997) . It was also found that one of buyer and supplier relationship classifications could be used as a control strategy, the exit-voice relationship type (Helper,1991). Furthermore, the other components were derived from studying deeply outsourcing reasons and benefits, factors of agent selection and for successful outsourcing, which were found in the outsourcing literature. Finally, the research model presents the effects category, which is a result of agency problems on the outsourcing relationship. Its components were derived from the effects of agency problems on outsourcing literature, such as effect in terms of cost, quality, right decisions, competition, innovation, delivery on time and monopoly. The identification of these categories was guided by the purpose and objectives of the research, which involved studying buyer and supplier relationships (outsourcing) in the Saudi Arabian market by discovering the causes of problems which exist in each type of relationship, how they can be controlled and what are their effects.

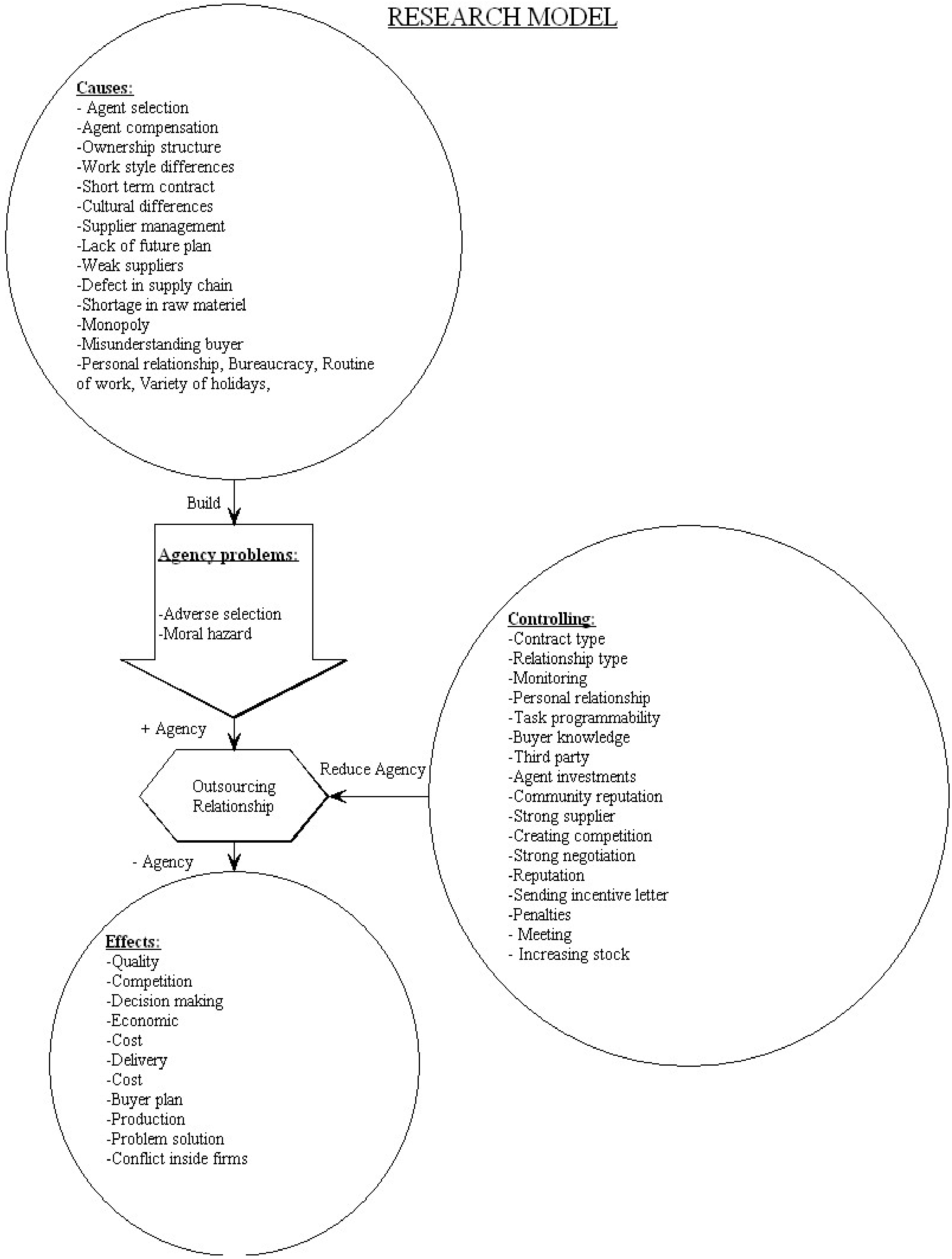


Fig. 4.2: Research model

This is why the conceptual model consists of four main factors, which are: causes of problems, problems, strategy of problem control and effects, and each category has components derived from the agency, outsourcing and buyer and supplier literature (see Fig 4.2).

## 4.6 Data collection

After the researcher had selected the interpretive research philosophy, the inductive research approach and the exploratory research strategy, interviews were found to be the most appropriate method of data collection since an interpretative approach (qualitative in nature) was adopted for the investigation. Maykut & Morehouse (1994) stated that" The data of qualitative inquiry is most often people's words and actions, and thus requires methods that allow the researcher to capture language and behavior. The most useful ways of gathering these forms of data are participant observation, in-depth interviews, group interviews, and the collection of relevant documents. Observation and interview data is collected by the researcher in the form of field notes and audio-taped interviews, which are later transcribed for use in data analysis"(Maykut and Morehouse, 1994, p.46). Participant observation and the collection of relevant documents are not appropriate in such research because the researcher expected that the research theme is so sensitive. Buyers and suppliers will not discuss this issue openly, they will be very conservative, and they will not allow the researcher to obtain any documents from them because it is classified as confidential data, especially after the (GATT) agreement. So, using interviews enabled the researcher to gather valid and reliable data. At the same time, there are problems of carrying out interviews such as the interviewer can affect the data if he/she is not consistent, it is very time consuming (setting up, interviewing, transcribing, analyzing, feedback, reporting), it is not used for a large number of people, the Interviewer may be biased and ask closed questions, it is costly (transportation, time, telephone bills…etc), the data can be understood and transcribed by interviews in different ways (evaluated, 2006). But, the researcher took all these problems in his account during the process of this research and overcome them.

Interviews are classified into three types: structured, semi-structured and unstructured interviews (Saunders et al., 2003).

### 4.6.1 Structured interviews

A structured interview (also known as a standardized interview) can be used within a quantitative (questionnaires) or qualitative (identical set of questions) research method. The aim of using the structured interview is to ensure that each interviewee is presented with exactly the same questions and this ensures that answers can be reliably aggregated. The researcher should read out questions exactly as they appear in the survey and in the same tone of voice, to give all interviewees the same opportunity and freedom to answer each question (Kvale, 1996). The responses, received from structured interviews, are usually recorded on a standardized schedule with pre-coded answers (Saunders et al., 2003). Structured interviews were not appropriate for such a study as this one, in which flexibility was important for the data collection, which was constrained by a number of limitations. For example, the researcher would be stuck with specific interview questions; he would not have been able to add or subtract questions. Additionally, the respondents would have been unable to answer questions in any detail or depth. Further, the format of question design would have made it difficult for the researcher to examine complex issues and opinions, even using open-ended questions.

### 4.6.2 Semi-structured interviews

A semi-structured interview is considered a two way communication and can be used both to give and receive information. Unlike the structured interview, where details of questions are prepared ahead of time, semi structured interviewing starts with more general questions or topics. Not all questions are designed and phrased ahead of time. The majority of questions are created during the interview, allowing both the interviewer and the person being interviewed the flexibility to probe for details or discuss issues. Semi-structured interviewing is guided only in the sense that some form of interview guide, such as the matrix described below, is prepared beforehand, and provides a framework for the interview. Although the researcher has a list of themes and questions to be covered, interviews may be varied from interview to interview, which means that the order of questions is notfixed, and the researcher may omit some questions in particular interviews, depending on the flow of the conversation. The responses received from such interviews are usually recorded by note-taking or tape- recording (Saunders et al., 2003).

### 4.6.3 Unstructured interviews

This type of interview is used when researchers wish to explore a general subject in depth. There is no specific set of questions asked in a predetermined order although the researcher needs to have a clear idea about the subject. An unstructured interview can go in any direction depending on the conversation flow, so it gives interviewees the opportunity to talk freely about their opinions and beliefs in relation to the subject, with guidance from the interviewer (Easterby-Smith et al., 2002).

The researcher knew that the research topic involved very sensitive issues and that most buyers and suppliers would prefer not to discuss them. The researcher therefore decided to use semi-structured interviews to collect the research data. The semi-structured interview was deemed the most appropriate type of interview because it is flexible enough to give the researcher the ability to change interview direction and to open up new aspects of the subject during the discussion. A list of questions had been set in advance in accordance with the research model and they were used to guide the interview. At the same time, the researcher gave the interviewees complete freedom to answer or not the question after the researcher had read it out. When the researcher felt that an interviewee did not wish to answer a question, or that the answer was not logical, the researcher tried to ask the same question in different ways with the purpose of answering the question or checking the previous answer to achieve validity and reliability.

## 4.7 Interviewees

### 4.7.1 Selecting the interviewees

The researcher found that the most appropriate interviewees for such research were people responsible for purchasing on the buyers' side and for selling on the suppliers' side. The purchasing department was chosen on the buyers' side because it had full information about suppliers, their history and behavior. Similarly, the sales department on the suppliers' side was chosen because this department was responsible for agreeing the supply of buyers' orders according to their requirements. The researcher could therefore understand how they dealt with buyers and what factors could affect the relationship between them. The total number of participating buyer and supplier firms was 57, distributed across manufacturing and service industries, as shown in tables 4.1, 4.2 and 4.3. These sectors have been chosen because they found that they are the most rapid growing and developing in Saudi Arabia market after petroleum and petrochemical, and they have a significant effect to Saudi economy as described below.

Table. 4.1 Interviewee classification

| | Manufacturing | Service | Total |
|---|---|---|---|
| Buyers | 27 | 13 | 40 |
| Suppliers | 11 | 6 | 17 |
| Total | 38 | 19 | 57 |

Table. 4.2 Manufacturer classification

| | Manufacturing | | | | |
|---|---|---|---|---|---|
| | Packing | Glass | Food | Petrochemical | Total |
| Buyers | ~ | 2 | 8 | 17 | 27 |
| Suppliers | 3 | ~ | 3 | 5 | 11 |
| Total | 3 | 2 | 11 | 22 | 38 |

Table. 4.3 Services classification

| | Services | | | |
|---|---|---|---|---|
| | Transportation | Stationery | Communications | Total |
| Buyers | 3 | 6 | 4 | 13 |
| Suppliers | 2 | 2 | 2 | 6 |
| Total | 5 | 8 | 6 | 19 |

### 4.7.2 Interviewees' market position

#### 4.7.2.1 Glass

According to the information provided by the Ministry of Commerce and Industry, there are 23 glass factories in Saudi Arabia, 8 of them in Riyadh, 11 in Jeddah and the rest in Dammam. These factories produce 104,397 tons per year, which is not sufficient for the Saudi market. The data shows that the Saudi market imports 186,308 tons per year from Germany, Thailand, China, the United States, Japan and Korea (Ibrahim, 2002).

#### 4.7.2.2 Packing

Saudi Arabia is considered one of the most developed countries in the packing industry. Studies show that the number of packing factories has increased by 80% over the last five years (Shihap, 2007).

#### 4.7.2.3 Food

There are 550 food factories in Saudi Arabia, and they employ 46,000 workers.. Because of the successful policies of the Saudi Arabian food industry, such as encouraging factories to export their production and give full attention to their quality monitoring, Saudi Arabia has become an attractive market for foreign companies and local investors. Studies show that improvements made in the packing industry in Saudi Arabia have played an important role in the success of the food industry. Production in food factories has increased by 53% within the last five years. Additionally, studies represent that there is a 4.5% annual fixed incremental rate of exports from the food industry in Saudi Arabia (Argaam, 2007).

#### 4.7.2.4 Petrochemical industry

There are 639 factories working in the petrochemical industry in Saudi Arabia. Investment in this industry has been increasing. It was 0.5 milliard (Reyal Saudi) (Milliard =1000 million) in 1980 and it is expected to rise to 70 milliard (Reyal Saudi) between 2005-2012. Saudi Arabia produces 120 petrochemical products (Alnouami, 2005).

#### 4.7.2.5 Transportation

There are 350,000 trucks in Saudi Arabia, and they transport 1.9 million tons of commodities around the country. Investment in this sector is approximately 2 billion (Saudi Riyal) (Ministry of Transportation, 2007).

#### 4.7.2.6 Stationery

Sales in this sector account for 500 million (Riyal Saudi) per year, and the market index shows that it is increasing by 10 % annually, especially because of increases in the number of students. There is strong competition among companies. Saudi Arabia imports more than 15% of its requirements yearly from Germany, Thailand, China, Syria and Egypt. At the same time, China exports 50% of Saudi stationery products. Investment in this sector is 400 billion (Riyal Saudi) (Alshadi, 2006).

#### 4.7.2.7 Communications

The communications market in Saudi Arabia is growing rapidly and is considered the largest market in the Middle East. There are only two main companies that provide communication services in Saudi, but there are thousands of small and medium shops, which provide communication equipment and accessories (Communication and Information Technology Commission, 2007).

## 4.8 The data collection process and problems

### 4.8.1 Process

From the beginning, the researcher decided to separate the data collection into two phases. The first phase involved collecting all the buyer data and the second involved following up, reviewing and completing the data that the researcher thought had been missed during the first phase of interviews, and which needed to be explained more fully by the interviewees. The second phase also involved collecting all data about suppliers. 40 interviews were conducted to collect buyer data within three months. The 40 interviews involved 88 recorded hours, and each buyer discussed 4 relationships (not necessarily 4 different types of relationship), resulting in a total of 64 market exchange, 30 captive buyer, 22 strategic partnership and 44 captive supplier relationships, accounting for a total of 160 different types of relationships across the 40 different buyers (see table 4.4). Supplier data was collected by conducting 17 interviews within 27 days. The 17 interviews involved 34 recorded hours.

Table 4.4 The number of relationship types in the study

| Relationships | Total |
|---|---|
| Market exchange | 64 |
| Captive buyer | 30 |
| Strategic partnership | 22 |
| Captive supplier | 44 |
| Total | 160 |

#### 4.8.1.1 First phase

After the researcher had prepared the interview questions, gained access for the study and acquired the list of the 500 largest companies in Jeddah from the commercial chamber in Jeddah, he started to contact by telephone and personal visits those responsible in their purchasing department to set an appointment to conduct the interviews. He constructed a schedule of interviews indicating the company's name, the interviewee's name, the interview location and the time of the interview. It is important to note that it was assumed the interviewees did not know what the agency principle is. That is why, the questions were set to be open and wide to allow interviewees talk as much as they wanted (semi structure interviews), and then the researcher classifies the collected information. The researcher started the first interview using open-ended questions (see appendix B), with one of the buyers, but the researcher found that the interviwee failed to indicate the relationship type when the second question was asked "what kind of relationship exists between you and suppliers? Discuss", and most other responses did not match the research questions, and that the interviewee was attempting to divert the direction of the interview in general. At the same time, the researcher felt that the interviewee was very conservative and afraid to say what was really happening, especially where the interviewee felt that it was a confidential issue, although the researcher added a letter of introduction (a sworn statement and identification papers, (see appendix A and D) to be shown and read before the interviews had started to encourage interviewees to be more open with the researcher.

After the first interview, the researcher decided to change his interview strategy by adding in close-ended questions (see appendix C) for buyer (first part-second part) and supplier to be used in parallel with the open ended ones as a guide for the interviews, and the buyer questions were divided to two parts.

#### 4.8.1.1.1 Relationship classification questions

The first part buyer close ended questions is for relationship classification were used to assess the type of relationship between buyer and supplier by using each relationship characteristics as mentioned in the literature (Bensaou,1999) (see section 3.5.3). For example, the question (second question) "What kind of product does the supplier provide you?" has four answers A, B, C and D. Each answer has been taken from the specifications and characteristics of product of each relationship (Bensaou,1999) such as (A) for market exchange relationship, (B) for captive buyer relationship, (C) for strategic relationship, and (D) for captive supplier relationship. Another example, the question (third question) of choosing the information-sharing mechanisms between buyer and supplier has also four choices A, B, C and D. Each choice represents the mechanism of information-sharing of specific relationship such as (A) for market exchange relationship, (B) for captive buyer relationship, (C) for strategic relationship, and (D) for captive supplier relationship as demonstrated in Bensaou study (1999) (see section 3.5.3). Those questions are related to relationship category in the framework (outsourcing relationship).

The researcher has asked all the relationship classification questions (buyer first part close-ended questions) to all buyers interviewed to make sure the interviewee has indicated the right type of the relationship. It is important to mention that relationship classification questions were asked at the same time while the interview is running where the researcher and the interviewee are sitting together at the same time (moment), which means the researcher would resolve any conflicts in answer that may occur while the interviewee was trying to classify the relationship type. This approach assisted the researcher to make sure that the relationship type indicating is correct because as soon as the researcher found that the interviewee gave conflicting or unclear answers, he tries to clear that by giving explanation about the characteristics of the relationship and discussing the relationship between the buyer and supplier in detail to discover the right answer.

The researcher has found three types of interviewees. The first type does not know relationship classifications between buyers and suppliers at all, and has not heard about them before. In addition, it is found this type does not classify their suppliers in their actual work and they are not organised. The researcher exerted a lot of time and effort to let these buyers be aware about the relationship classifications and characteristics to classify relationships by giving them a deep and in detail explanation. With this type of buyer, the researcher discussed with the interviewees each relationship with their suppliers in detail to discover the right relationship type between them because most of their answers were ambiguous and needed a lot of clarifications. That is why, some of their answers of relationship classification questions do not match with the relationship classifications (see appendix F, red color buyers). There were six buyers in such a type out of forty of which are two in food industry, three in petrochemical industry and one in communication industry (see appendix F, red color buyers). For example, the first relationship in the second buyer in the food industry, the relationship is strategic partnership (C), but the answers which was found three (C) in questions 2,4 and 6, two (D) in questions 5 and 7 and one (B) in question 3. After this answers appeared, the researcher gave them a deep and in detail explanation about the relationship classifications, and discussed the relationship in detail to discover the right relationship type, which is strategic partnership.

The second type has a general idea about relationship classifications and characteristics. Furthermore, they are organized, and they classify their suppliers depending on their experience and work approach. With such type of buyers, the researcher just gave them a general idea about the research classifications according to Bensaou study (1999) and what each classification characteristics are. Most of their answers were clear and close to the answers of relationship classification questions (buyer close-ended questions (first part)). That is why many of their answers need more discussion in detail to discover the relationship type. There were twenty nine buyers in this type, which are two in glass industry, six in food industry, twelve in petrochemical industry, two in transportation industry, four in stationery industry and three in communication industry (see appendix F, green color buyers).

The third type of buyer has a very good knowledge about the relationship classification between buyers and suppliers. This is because the buyers are global companies and they are experts and a very known brand in their industry. In addition, they are found well organised, and their classifications for their suppliers are very close to the research relationship classifications, so it was easy with this type to classify the relationship clearly. There were five buyers in such type, which are two in petrochemical industry, one in transportation industry and two in stationery industry (see appendix F, white color buyers).

It is important to mention that the differences between the interviewees' answers and the relationship type in the questions may relate to the following reasons:

The first reason is that there is some overlap between the four relationship types. This overlap makes some confusion for the interviewees to give the answers that match with relationship types in the questions. For example, in the third question, there is some overlap between captive buyer relationship (B) and strategic partnership (C), where captive buyer information-sharing mechanisms (B) are "Broadband" and important exchange of detailed information on a continuous basis. Frequent and regular mutual visits and strategic partnership information-sharing mechanisms are broadband, "frequent" and "rich media" exchange and regular mutual visits and practice of guest engineers. This issue was resolved by giving more explanation and discussing the relationship classification more.

Secondly, the relationship characteristics which are stated in Bensaou study (1999) came from conducting 447 surveys among managers in three U.S and eleven Japanese automobile manufacturers. This means that the differences between the research buyers' industry and the Bensaou study industry (automobile) could make a difference in the buyers' answers.

The third reason is that Bensaou study industry was conducted in U.S and Japan, but the research was conducted in Saudi Arabia. The difference between the two study countries where they were conducted do not allow the interviewee in giving the answers that match with relationship types in the questions.

The fourth reason is that, for the first type of buyers, they may gave different answers because there was still confusion in relationship classifications with this type of buyer even after the researcher gave them in detail explanation. For the second type of buyers, although the different answers are small, these differences may come from the differences between their own relationship classifications and the Bensaou study classification.

Finally, deciding the relationship type occurred after the researcher clarified all confusion, resolved all conflicts and discussed the relationship in detail with the interviewees which assists the interviewees to find the right relationship. It is important to mention that the special case of the market exchange relationship was discovered at this stage. In this case, because of buyers' interests, buyers preferred to deal with suppliers with captive buyer relationship although the relationship was diagnosed as market exchange relationship. This special case occurred either because buyer was considering cheap price as an essential factor in choosing suppliers, or board members assertion to deal -or continue to deal- with a specific supplier. The buyers explained these cases while the researcher was resolving conflicts and confusion and discussing the relationship between buyers and suppliers in detail with the interviewees. For example, six of the purchasing managers in the petrochemical industry, two in stationery industry and two in communication industry mentioned that for some products buyers insist on dealing with specific suppliers because such suppliers are offering cheaper price for their products (see section 5.2.5). However, there are still some differences in the answers. The researcher refers this to the differences in the countries and industries between Bensaou study and this research. For example, in the petrochemical industry (third buyer), the relationship type is captive supplier, and the answer should be (D) in the fifth question, but the answer is (C). The researcher refers these variances to the differences in market characteristics between Bensaou study (U.S and Japan) and this research (Saudi Arabia), or the differences in the industries between Bensaou study (automobile) and this research (many industries).

All relationship types were determined by complete agreement between the interviewees and the researcher after the relationship was explained and discussed in detail between the researcher and interviewee.

#### 4.8.1.1.2 Agency questions

Buyer close-ended questions (second part) were used to ensure that the direction of the interviews was correct, and to fit the research model (see appendix C). They were not intended to restrict interviewees, but to encourage them to be more cooperative. Because of the stated reasons in the above (responses did not match the research questions, interviewee was attempting to divert the direction of the interview, and interviewee was very conservative and afraid to say what was really happening) the researcher added close-ended questions (second part- buyer questions), which are also related to research framework. For example, the first closed question (second part- buyer questions) is related to agency problem causes category in the framework. , the second closed question in the second part is related to agency problems' control category. It is important to restate again that close-ended questions (second part-buyer questions) were used in parallel with the open ended ones as a guide for the interviews only, and they were not all answered by the interviewees (some of them were answered only depending on the flow of the interview). They were used only when the researcher feels that the interviewees try to mislead the direction of interview or do not want to answer the question, so they are not used all of them, and they are not counted (see appendix E). For example, the first question was asked to twenty nine relationships out of one hundred and sixty relationships. The responses were as: five for (a), four for (b), seven for (c), three for (d), four for (e) and six for (f).

Open-ended questions (appendix B) are also stated related to the theoretical framework (research model). For example, the question, "what are the causes that led to suppliers giving rise to these problems? Discuss", is related to agency problem causes category in the framework. Also, the question, "what are the problems do you face with suppliers? And how was their behaviour? Discuss", is related to agency problems category in the framework. Another example, the question, "what kind of relationship exists between you and suppliers? Discuss", is related to effected relationship category. In addition, the question, "how do you control suppliers?", is related to agency problems' controls category. Finally, the question, "How do these problems affect you?", is related to effects category.

The researcher found that the changes meant that the information obtained was of more value. All interviews were recorded after permission had been obtained.

#### 4.8.1.2 Second phase

The researcher used this phase to review and complete the buyer data after the previous buyer data had been transcribed. The second phase was also used for the collection of supplier data. Supplier data was collected for gathering more information to enhance the research value, and fulfill the information that might be missing from buyer point of view. Suppliers' data concentrate on the causes which prevent suppliers to act opportunistically and the causes which encourage suppliers to act opportunistically from suppliers' point of view. Supplier contacts were collected from the buyer interviewees in first phase. Introductory papers (a sworn statement and identification papers), were used in all supplier interview to encourage interviewees to be more open with the researcher. All suppliers were too sensitive and conservative, and they refused to identify their relationship type; that is why questions used in the interviews were open ended and closed ended questions which compel interviewees to give incorrect answers. The researcher contented himself by asking the same questions in different ways to obtain the data he needed, preparing close ended questions in advance to use within the dialogue when it is needed. The same as buyer close-ended questions (second part) supplier close-ended questions were used in parallel with the open ended ones as a guide for the interviews only, and they were not all answered by the interviewees (some of them were answered only depending on the flow of the interview). They were used only when the researcher felt that the interviewees were trying to mislead the direction of the interview or do not want to answer the question, so not all of them were used, and they were not counted (see appendix E). For example, first question was asked to three suppliers only out of seventeen, and the responses were as two (Yes) and one (No).

### 4.8.2 Problems

There were many problems faced during the data collection stage. The main problem was gaining access to buyer and supplier firms. Most of them were not interested in setting an appointment with the researcher. They usually justified not giving an appointment because they were busy, that they did not have enough time to set aside with the researcher. The researcher discovered that this reason was not true most of the time, because when the researcher could not gain an appointment with any one of them, he tried to contact his friends or relatives first to assist in setting an appointment. The researcher also tried to contact the same person many times by telephone or personal visits until that person was convinced to set an appointment.

By using these methods of gaining access, the researcher found that most of them were not busy at all, but that they wished to avoid setting an appointment intentionally, especially after discovering what was the subject of the research. Most buyers and suppliers did not want to discuss this issue because it was classified as confidential, especially after the (GATT) agreement. For these same reasons, the researcher could not obtain any documents from them or conduct more interviews.

The researcher found that, even after gaining an appointment with some of the buyers and suppliers, some of them refused to conduct the interview, without offering any reasons, which wasted a lot of time. Similarly, some buyers and supplier refused because they were facing problems in the market, and hence did not want to discuss such issues at that time.

Another problem was that, after the first interview, it was found that most buyers and suppliers were very conservative, whereby the researcher needed to divide each interview into at least two meetings to allow the interviewees to be more comfortable in answering the research questions thereby building a good climate between the interviewee and the researcher, which also consumed a lot of time. Consequently, sometimes the researcher used the first meeting only to build up a social relationship between himself and the interviewee, not discussing the research issues untill the next meeting.

Additionally, some buyers did not wish to give the researcher their suppliers' names or contact numbers to protect their competitive position in the market, or else they feared that the researcher might talk to suppliers about what they had said, which might create problems between buyers and suppliers. Similarly, suppliers did not like to mention buyers' names in their interviews, because the researcher might know the buyer, which might also cause problems. In fact, the researcher did not tell suppliers from whom he had gained their contact numbers; if the researcher had told a supplier that he had obtained his contact number from a specific buyer, that supplier would not be open. In general, the researcher felt that most suppliers were not open enough in answering the research questions because they thought that the researcher was spying; consequently suppliers were more conservative than buyers.

### 4.9 Data analysis

After the researcher had collected the data from the first and second phases, he started to analyse the data personally. The first step was to transcribe all the data, which took a very long time long. The second step was to translate the transcribed data from Arabic into English because Arabic was the main language of all the interviews. This also took a long time, especially as no good translation program exists on the market between these languages. After the all data had been translated into English, the researcher classified all the data into categories and units according to the research model, which indicated a meaningful relationship between the categories. The researcher found that there was valuable data to assist in the understanding of each relationship, such as the relationship creation incentives. The researcher then started to write up the findings of the buyers' and suppliers' interviews and to define the relevant diagrams of the findings.

### 4.10 Ethical issues

The researcher regarded ethical issues as an important success factor for the research process. First of all, privacy was given full consideration during the research process. The interviewees' name were kept anonymous, as most of them had requested. Secondly, the researcher dealt with all data with discretion and complete confidentiality. Anything that interviewees said or gave (documents) during the interviews was not used against them at all, and they would not be judged on the basis of it. All the data was used only for the research purpose. Finally, all interviewees knew about the recorder tape before interviews began, and anyone refusing to be recorded was respected.

### 4.11 Research reliability and validity

Reliability and validity were given a high level of consideration during the process of collecting the data. Firstly, the researcher conducted`40 interviews (88 recorded hours) in the first phase and 17 interviews (34 recorded hours) in the second across many industries in the market, which give the research both variety and depth by studying the types of relationships in depth in many industries in the Saudi market. Secondly, the study used open ended and close ended questions in parallel, asking the same question in different ways to ensure the validity of the data collected. Thirdly, the researcher avoided putting any pressure on the interviewees, or acting in any way suspiciously, which might have affected the quality of the data collected, to encourage the interviewees to concentrate on answering questions comfortably. Fourthly, all interviews were conducted at interviewees' convenience to ensure that they were concentrating on answering the questions comfortably. Fifthly, the other reason for using the introductory papers (a sworn statement and identification papers), was to convince interviewees that the all data collected would be used only for academic purposes without mention of names, neither persons' nor companies' to enable them say what they thought rather than what their bosses wanted them to say. Sixthly, close ended questions were used at the beginning of the interviews to indicate and classify the right relationship between buyer and supplier. Finally, before the interviews were started, the researcher tried to represent to the interviewees the importance of the research to encourage their involvement in it.

### 4.12 Summary

The researcher found that the most appropriate methodology for this research was an interpretivist research philosophy, an inductive research approach and an exploratory research strategy. Interviews (semi-structured interviews) were found to be the most appropriate method of data collection to gather valid and reliable data. This chapter has discussed the data collection and analysis processes, along with the problems faced during data collection. The researcher has presented the conceptual framework (model), which forms the basis of the study and which is used to structure the findings that are presented in the next chapter. Finally, ethical, reliability and validity issues were discussed; they were given a high level of consideration during the process of collecting the data.

# CHAPTER FIVE

# CHAPTER FIVE

# FINDINGS

## 5.1 Introduction

### 5.1.1 Overview

This chapter presents and analyses the data collected from buyers and suppliers. For the buyer data each relationship was classified according to relationship incentives (which provoked the relationship to be created), causes and problems (which types of problems occurred and what their causes were), control mechanisms (used to control problems) and effects on the relationship. In each relationship, the researcher gave an overview about the position of the each relationship comparing with other relationship (how many relationships have been studied, which industry has the highest proportion in the relationship). Also, the researcher provided tables that classify the interviewees' comments according to the number of responses and their industries in each category (relationship incentives, causes and problems, control mechanisms and effects). In addition, the study described how problems and their causes occurred in each type of relationship, and gave diagrams which can help the reader to follow the problems occurrence. Additionally, control mechanisms were described in each relationship, and the researcher provides controle mechanisms digrams for each relationship. Finally, the researcher explained the effects of the problems and their causes on each relationship type.

The supplier data was analysed according to the causes which prevented suppliers acting opportunistically and those which encouraged suppliers to act opportunistically with buyers.

### 5.1.2 The data collection process and analysis

#### 5.1.2.1 First phase

After preparing the interview questions and acquiring a list of the 500 largest companies from the Chamber of Commerce in Jeddah, the interviewer contacted their purchasing departments to set up their interview appointments and prepared the schedules for each company with interviewee's name, place and time. The questions assumed that the interviewees were not aware of 'agency principle' to encourage them to answer questions without any preparations. In the first interview open-ended questions (see appendix B) were with one of the buyers, but the researcher found that the interviewee failed to recognize the relationship type when the second question "What kind of relationship exists between you and suppliers? Discuss" was asked. Further responses did not match the research questions as the interviewee attempted to divert the interview's direction. This interviewee was afraid to share what was really happening at his company especially when the questions dealt with confidential issues, despite the letter of introduction (a sworn statement and identification papers, (see appendix A and D) was shown to him before the interview.

##### 5.1.2.1.1 Relationship classification questions

The first part buyer's close ended questions on relationship classification were used to assess the type of relationship between buyer and supplier by using each relationship's characteristics as mentioned in the literature (Bensaou, 1999) (see section 3.5.3). For example, the question (second question) "What kind of product does the supplier provide you?" has four probable answers A, B, C and D. Each of the answers has been taken from the specifications and characteristics of product of each relationship (Bensaou, 1999) such as (A), for market exchange relationship, (B), for captive buyer relationship, (C), for strategic relationship, and (D) for captive supplier relationship. Further, the (third question) on choosing the information-sharing mechanisms between buyer and supplier has also four choices A, B, C and D. Each choice represents the mechanism of information-sharing of specific relationship such as (A) for market exchange relationship, (B) for captive buyer relationship, (C) for strategic relationship, and (D) for captive supplier relationship as demonstrated in Bensaou study (1999) (see section 3.5.3). All these were taken into account by the researcher.

The researcher has found three types of interviewees. The first type does not know relationship classifications between buyers and suppliers at all. The second type has a general idea about relationship classifications and characteristics. Furthermore, they are organized, and they classify their suppliers depending on their experience and work approach. The third type of buyer has a very good knowledge about the relationship classification between buyers and suppliers. This is because the buyers are global companies having well known product brands. The differences in these three types were duly taken into account and every effort was made and enough time was spent in explaining to each type what classifications and characteristics in their relationships with buyers, sellers and principals actually were so that the researcher could extract the closest to true information required for his research work.

#### 5.1.2.1.2 Agency questions

Buyer close-ended questions (second part) were used to ensure that the direction of the interviews was correct, and to fit the research model. They were not intended to restrict interviewees, but to encourage them to be more cooperative. In cases of reticence on the part of the interviewee to provide confidential information related to their companies, they were assured by the researcher that all information provided by them would remain strictly confidential and this was guaranteed in writing to them. In some cases the interviewee was asked open ended questions or closed and open ended questions in parallel and this worked in pacifying their fears and hesitations as appearing in appendix E.

The researcher found that the changes made meant that the information obtained was of more value. All interviews were recorded after required permissions had been obtained.

#### 5.1.2.2 Second phase

The researcher used this phase to review and complete the buyer data after the previous buyer data had been transcribed. The second phase was also used for the collection of supplier data. Supplier contacts were collected from the buyer interviewees in first phase. Introductory papers (a sworn statement and identification papers), were used in all supplier interview to encourage interviewees to be more open with the researcher. All supplier questions were open ended because the researcher thought that such interviews were too sensitive and that close ended questions could compel interviewees to give incorrect answers.

## 5.2 Market exchange

Market exchange (Bensaou, 1999) is a relationship type which can be created between buyers and suppliers. 64 market exchange relationships were studied by conducting 40 buyer interviews (27 as a market exchange relationship and 37 as a special case in market exchange relationship (section 5.2.5)). The market exchange relationship seems to be the most common in the Saudi Arabian market with 64 relationships from a total of 160, followed by the captive supplier relationships in the second place (44 relationships), the captive buyer relationship in the third place (30 relationships) and lastly the strategic relationship (22 relationships) (see table 5.1).

At the same time, the study found that the food industry has the highest proportion in market exchange relationship in manufacturing sector (see table 5.2). It was found that the food industry proportion in the market exchange relationship is 59.3%, as in the captive buyer relationship is 25%, in the strategic partnership is 6.25% and in the captive supplier relationship is 9.3%. Additionally, the study found that the glass industry has the highest proportion in market exchange relationship in manufacturing sector (see table 5.2). It was found that the glass industry proportion in market exchange relationship is 37.5% where in captive buyer relationship is 25%, in strategic partnership is 12.5% and in captive supplier relationship is 25%. Furthermore, it found that the transportation industry has the highest proportion in market exchange relationship in services sector (see table 5.2). It was found that the transportation industry proportion in market exchange relationship is 58.3%, as in captive buyer relationship is 25%, in strategic partnership is 8.3% and in captive supplier relationship is 8.3%. So, the data represents that there is a significant proportion in market exchange relationship.

### 5.2.1 Relationship incentives

In general, a relationship can have more than one incentive. The study found that when buyers needed many orders which have simple specifications and characteristics, continuously, buyers looked for suppliers who offered a cheaper price, had a good reputation, easy communication and stability in the market. They also inspired enough confidence to supply orders according to the buyer's requirements by succeeding with a trial shipment. So, it was clear that price, reputation and economy, easy communication and stability and supplier encouragements were all incentives for the creation of the market exchange relationship (see Fig 5.1).

Table 5.1 The summary table of buyer – supplier relationships / interviewee sectors

| Relationships | Manufacturing | | | | total | Services | | | total | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | Packing | Glass | Food | Petrochemical | | Transportation | Stationery | Communications | | |
| Market exchange | ~ | 1/2* | 8/11 | 9/11 | 18/24 =42 | 2/5 | 4/5 | 3/3 | 9/13 =22 | 27/37 =64 |
| Captive buyer | ~ | 2 | 8 | 15 | 25 | 3 | 1 | 1 | 5 | 30 |
| Strategic partnership | ~ | 1 | 2 | 10 | 13 | 1 | ~ | 8 | 9 | 22 |
| Captive supplier | ~ | 2 | 3 | 23 | 28 | 1 | 14 | 1 | 16 | 44 |
| Total | ~ | 8 | 32 | 68 | 108 | 12 | 24 | 16 | 52 | 160 |

* Market exchange relationship/ special case in market exchange relationship

Table 5.2 The percentage of industries in each relationship type

| Relationships | Manufacturing (%) | | | Services (%) | | |
|---|---|---|---|---|---|---|
| | Glass | Food | Petrochemical | Transportation | Stationery | Communications |
| Market exchange | 37.5 | 59.3 | 29.4 | 58.3 | 37.5 | 37.5 |
| Captive buyer | 25 | 25 | 22 | 25 | 4.1 | 6.25 |
| Strategic partnership | 12.5 | 6.25 | 14.7 | 8.3 | ~ | 50 |
| Captive supplier | 25 | 9.3 | 33.8 | 8.3 | 58.3 | 6.25 |

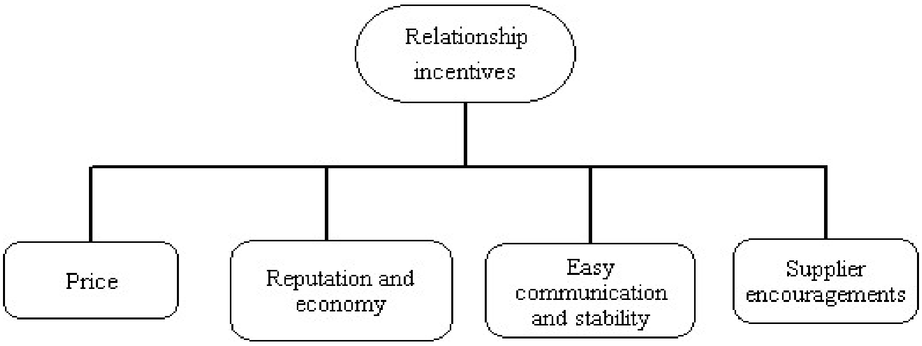


Fig 5.1: Market exchange relationship incentives

Table 5.3 Relationship incentives of market exchange relationship

<table>
<tr><th colspan="3">Relationship incentives</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Price</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>7</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Buyers looked for suppliers who could provide products or services to them at a lower price.</td></tr>
<tr><td></td><td>8 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>3</td><td>2</td><td>1</td><td>2</td></tr></table></td><td>Buyers depended on strong competition between suppliers to get the cheapest orders in the local market.</td></tr>
<tr><td></td><td>12 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>4</td><td>1</td><td>1</td><td>3</td><td>3</td></tr></table></td><td>Buyers went to the Far East such as China to get what they want at the cheapest prices if orders have the specifications which buyers need or products do not have special specifications; even if the products are available in the local market.</td></tr>
<tr><td>Reputation</td><td>6 relationships<table><tr><td>F</td><td>P</td><td>S</td></tr><tr><td>3</td><td>2</td><td>1</td></tr></table></td><td>Buyers did not like to deal with Far East countries because they had a bad reputation in providing orders as required.</td></tr>
<tr><td></td><td>24 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>7</td><td>8</td><td>2</td><td>3</td><td>3</td></tr></table></td><td>Buyers mentioned that reputation was a very important factor to create such a relationship with Far Eastern suppliers, even if the buyers were</td></tr>
</table>

<table>
<tr><td></td><td></td><td>looking for cheaper prices. Reputation was also important for the choice of intermediate broker, who works between the buyer and supplier.</td></tr>
<tr><td>Easy communication and stability</td><td>19 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>6</td><td>2</td><td>2</td><td>2</td></tr></table></td><td>Buyers preferred to deal with suppliers who were stable in the market and who could be easily communicated with to solve any problems which might occur; even if the prices offered by these suppliers were a little higher than those of the others.</td></tr>
<tr><td>Supplier encouragement</td><td>22 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>6</td><td>2</td><td>2</td><td>3</td></tr></table></td><td>Buyers were convinced to deal with a specific supplier on the basis of success in a trial shipment.</td></tr>
</table>

#### 5.2.1.1 Price incentive

Price factor found that it is one of the important incentives in the market exchange relationship as it is shown in table 5.3

#### 5.2.1.2 Reputation and variables exchange rate incentive

If there are no suppliers in the local market who can supply orders to buyers, the study found that, although there were many suppliers who could provide the same products to buyers at competitive prices from the Far East, some buyers did not like to deal with these countries because of their services' reputation for not providing orders as required (see table 5.3). This type of buyer felt that many suppliers in these countries did not have enough commitment to serve buyers as they wished; so, buyers went to European suppliers to deal with them and bear their high costs instead of dealing with Far Eastern suppliers. In contrast, other buyers preferred to deal with Far Eastern suppliers and bear their burden than deal with European suppliers to protect themselves from the instability of high European currency exchange rates. In general, the reputation was a very important factor to create such a relationship.

#### 5.2.1.3 Easy communication and stability

Although there were many suppliers who could provide orders to buyers at competitive prices in a market, table 5.3 shows that buyer usually preferred to deal with suppliers who are stable in the market and could be easily communicated with. Easy communication with suppliers may be created over a period of time of dealing with each other or supplier willingness to help overcome obstacles for buyers to achieve their goals. For example, a supplier might send his representatives to buyers frequently to help them if there are any problems that buyers face with their products or allocate a specific representative for each group of buyers.

#### 5.2.1.4 Supplier encouragement

Table 5.3 indicates that the supplier tried to convince the buyer to deal with him by trial shipment, which was the first shipment sent by the supplier. If the buyer found that the supplier provided the required quality and on time delivery and the prices were reasonable compared to other suppliers, he would continue to deal with him/her.

### 5.2.2 Causes and problems

Table 5.4 shows that there are general situations in this relationship occur at the beginning of a problem and working with a supplier.

Table 5.4 Market exchange relationship causes and problems

<table>
<tr><th colspan="3">Causes and problems</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>General situations</td><td>8 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>4</td><td>2</td><td>1</td><td>1</td></tr></table></td><td>At the beginning of a problem, suppliers denied it and did not agree about its occurrence, especially if it had been in the quality of the order provided. However, after buyers invited suppliers to see the problem for themselves on the buyer’s production line or in the final product, the supplier relented and cooperated with the buyer.</td></tr>
<tr><td></td><td>22 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>6</td><td>1</td><td>3</td><td>3</td></tr></table></td><td>Buyers had started work with a supplier on the basis of a trial shipment and tested the supplier’s commitment.</td></tr>
<tr><td></td><td>24 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>7</td><td>2</td><td>3</td><td>3</td></tr></table></td><td>Suppliers succeeded with the trial shipment, and most problems occurred after a period of gaining regular contracts from buyers.</td></tr>
<tr><td>Moral hazard problem</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>5</td><td>2</td><td>2</td><td>2</td></tr></table></td><td>Buyers used an inappropriate supplier selection method. Buyers gave the price factor a lot of attention to chose suppliers</td></tr>
<tr><td></td><td>16 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>5</td><td>6</td><td>2</td><td>3</td></tr></table></td><td>Buyers mentioned that, suppliers switched from buyer to buyer easily depending on their interests because of the strength of competition between suppliers</td></tr>
<tr><td>Taking new decisions</td><td>21 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>8</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Buyers were taking new decisions to improve their method for choosing suppliers by giving attention to other factors than price such as machine model year, supplier reputation, their position and stability in the market,</td></tr>
</table>

<table>
<tr><td></td><td></td><td>and sometimes buyers were changing their supplier after they faced problems when dealing with them.</td></tr>
<tr><td></td><td>12 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>4</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Buyers who did not have a quality monitoring or control department, were creating such a department, and buyers, who already had one, emphasized that the checking of received orders should be done carefully and early on to avoid any delay in delivery, which affected buyers’ competitive position.</td></tr>
<tr><td></td><td>4 relationships<table><tr><td>F</td><td>P</td><td>C</td></tr><tr><td>2</td><td>1</td><td>1</td></tr></table></td><td>Buyers were making a new agreement with suppliers about checking orders. The agreement stated that order checking should be done before supplying the orders by the quality department of the buyer to save delivery time and to avoid delay in delivery and customs penalties, which all affected buyers’ competitive position if there were any defects in orders (see Fig 5.2)</td></tr>
<tr><td>Future plan</td><td>13 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>4</td><td>4</td><td>1</td><td>2</td><td>2</td></tr></table></td><td>Buyers did not have a future plan, or they did not have a good future plan, sometimes buyers ordered a large amount of products from suppliers suddenly, which led to confusion in a supplier’s plan, or gave suppliers a chance to misuse circumstances.</td></tr>
<tr><td></td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>6</td><td>2</td><td>3</td><td>2</td></tr></table></td><td>Buyers did not recognized the mistake they were making because of lack of good order planning.</td></tr>
<tr><td></td><td>8 relationships</td><td>Buyers were already</td></tr>
</table>

<table>
<tr><td></td><td><table><tr><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>2</td><td>2</td></tr></table></td><td>creating a planning department.</td></tr>
<tr><td></td><td>14 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>4</td><td>3</td><td>2</td><td>3</td><td>2</td></tr></table></td><td>Buyers were in the process of creating a planning department.</td></tr>
<tr><td>Packaging material</td><td>8 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>2</td><td>2</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>The study found that packaging material was very important for buyers because they reused it for another product to reduce their operational costs, or it needed to be special material to conserve orders.</td></tr>
<tr><td>Suppliers behavior</td><td>15 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>4</td><td>6</td><td>1</td><td>3</td><td>1</td></tr></table></td><td>Suppliers either shirked their responsibilities by saying that the buyer was in a hurry, which was why orders were sent as they were, or they did not pay penalties caused by their malpractices.</td></tr>
<tr><td>Frequent changes in a supplier's management</td><td>18 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>7</td><td>4</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>The study observed that suppliers, who changed their management frequently, shirked their responsibilities to buyers, because the new supplier's management denied or changed some of the agreements or decisions which previous management had entered into with buyers, especially verbal agreements made because of a personal relationship built over a period of time of dealing with each other. A supplier's new management did not understand how buyers could be affected negatively by these changes</td></tr>
<tr><td>cultural differences</td><td>15 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>6</td><td>5</td><td>1</td><td>2</td><td>1</td></tr></table></td><td>Buyers insisted on dealing with certain suppliers, although they knew that there were other suppliers who could provide them</td></tr>
</table>

<table>
<tr><td></td><td></td><td>with the same products, but, because of the long relationship between buyer and supplier and some buyers’ customers, who asked for a specific supplier franchise, they kept dealing with them to a limited extent to retain their competitiveness in the market.</td></tr>
<tr><td>Supply chain</td><td>9 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>4</td><td>2</td><td>2</td><td>1</td></tr></table></td><td>Suppliers did not work on buyers’ behalf because of defects in the supply chain.</td></tr>
<tr><td>Brokers</td><td>12 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>1</td><td>5</td><td>2</td><td>3</td><td>1</td></tr></table></td><td>Buyers preferred to deal only with brokers for products which are in high demand (high consumed) than to deal with a supplier directly to avoid any problems with the supplier and to guarantee continuity of product supply.</td></tr>
<tr><td></td><td>12 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>7</td><td>4</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Brokers were not honest, and always worked for their benefit, which led to a tense relationship between buyers and suppliers because information was concealed from either one or both parties, whereby they shirked their responsibilities.</td></tr>
<tr><td></td><td>8 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>3</td><td>2</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>They were developing mechanisms of communication between themselves and brokers to make the relationship smoother. For example, they asked a broker to indicate a specific representative for them with full authority to solve any problems and give the buyer any required information.</td></tr>
<tr><td></td><td>8 relationships</td><td>Buyers took the decision</td></tr>
</table>

| | | |
|---|---|---|
| | F P T S C<br>1 3 1 1 2 | not to deal with brokers and they dealt with the supplier directly after experiencing such problems with brokers |

The study revealed that there was only the moral hazard problem in the market exchange relationship. It was found that the causes of the moral hazard problem were using an inappropriate supplier selection method, the buyer having no or a poor future plan, buyer and supplier dependency on a weak broker, changing the supplier's management frequently and no commitment from the main supplier to serve the next supplier in the chain (see table 5.5).

Table 5.5: Market exchange relationship problem causes' table

| | | Causes | Responsible | First effects | Second effects |
|---|---|---|---|---|---|
| Problems | Moral hazards | Using inappropriate supplier selection method<br>Dealing with unsatisfied supplier about compensation<br>Dealing with unqualified supplier | Buyer | Delay in delivery<br>Quality<br>Increasing cost to buyer | Buyer's competition affected negatively |
| | | No or bad buyer's future plan<br>Confusing supplier's plan<br>Missused circumstances by supplier because of rush | Buyer | Delay in delivery<br>Quality<br>Increasing cost to buyer | |
| | | Buyer and supplier dependency on a weak broker<br>Missunderstanding between buyer and supplier<br>Broker inability to serve buyer and supplier | Both | Delay in delivery<br>Increasing cost to buyer | |
| | | Changing supplier's management frequently<br>Changing in most previous management decisions | Supplier | Increasing cost to buyer<br>Confusion in most buyer's future plan and decision | Forcing buyer to take a new decision, change old decision,or not take decision |
| | | No commitment from main supplier to serve th e supplier<br>No commetment from supplier to serve the buyer | External | Delay in delivery<br>Quality<br>Increasing cost to buyer | |

### 5.2.2.1 Moral hazard

Figure 5.2 is explained in detail to facilitate the readers to follow all figures as follow.

**Cause of the problem (A):** The study revealed in table 5.4 that, in the market exchange relationship, buyers used an inappropriate supplier selection method.

Effects: Choosing a supplier on the basis of cheaper price means the buyer sometimes deals with a supplier who is dissatisfied with the compensation (B) or a non qualified supplier (C).

**Action (D):** Table 5.4 represents that many suppliers in the market exchange relationship switched from buyer to buyer easily depending on their interests. Suppliers who were dissatisfied with their compensation, who were not convinced about their compensation (even if it had been agreed at the beginning), did not work in these buyers' interests intentionally and gave priority of delivery to another buyer because they found that the second buyer paid more than the first one.

In addition, suppliers did not work intentionally in buyers' interests when a supplier tried to reduce the required specification of an order's packaging to save money or when suppliers' management decided to use non standard materials in their production to save money, which in turn affected order quality.

Additionally, suppliers did not work in buyers' interests intentionally when they did not sending orders as required caused problems with customs, who did not allow orders to be handled to buyers. Furthermore, when they shirked their responsibility to buyers by transferring any causes of problems to others, or when they did not pay the customs penalties.

**First effect of an action (D):** gaving priority of delivery to another buyer caused delay in delivery for the first buyer or a shortage of raw material, which in turn affected buyers' production not being completed, especially if suppliers did not give buyers notice in advance.

Providing poor order quality caused delay in delivery to buyers because of orders being refused and suppliers being asked to resupply those orders to the required quality or specification, which all took time.

Not sending orders as required caused problems with customs (see table 5.4). Customs either asked buyers to dispose of orders, return them, or pay penalties which caused increases in costs and delays in orders to buyers. Sometimes suppliers did not pay the customs penalties the result of orders remaining on the quay side because of supplier malpractice to complete their paper work as intended which also caused increases in costs and delays in orders to buyers.

**Action (E):** unqualified suppliers did not work in buyers' interests unintentionally, when these suppliers lacked the technical and administrative capabilities to do what the buyer needed.

Also, when the supplier did not have expert technicians who could provide buyers' orders on time with the required level of quality, or used old machines with unfixed settings that could not produce orders to required specifications.

In addition, when the supplier's management did not have enough experts to keep the relationship between suppliers and their employees smooth (lack of administrative capabilities), which sometimes meant that technicians did not put all their effort into producing orders as required.

Furthermore, when suppliers hired salesmen who were not familiar with a buyer's industry (weakness of suppliers' salesmen performance).

**First effect of an action (E):** Lack of technical capabilities affected required quality and time of delivery.

When the supplier did not have expert technicians (who could provide buyers' orders on time with the required level of quality) or use old machines with unfixed settings, buyers would be affected negatively. Buyers would not accept orders if their quality was inadequate. In this case, buyers either asked the supplier to resupply orders or looked for another supplier who could supply orders to the required specifications, which caused difficulties in the buyer's production process because of shortage and delay in materials.

Lack of administrative capabilities affected required quality and time of delivery because technicians did not put all their effort into producing orders as required, which in turn affected order quality, or did not fix machines which break down often because of their age quickly enough to avoid any delay to buyers.

weakness of suppliers' salesmen performance caused problems with buyers because suppliers' salesmen did not understand buyers' quality requirements and the importance of delivery on time and they did not have good enough communication skills to build the right relationship between themselves and the buyers, which sometimes caused delay in delivery to buyers.

**Second effect:** Table 5.4 reveals that some buyers have been taking new decisions to improve their method for choosing suppliers to avoid problems. Also, buyer's competition was effected negatively (see section 5.2.4.2.1 and 5.2.4.2.2)

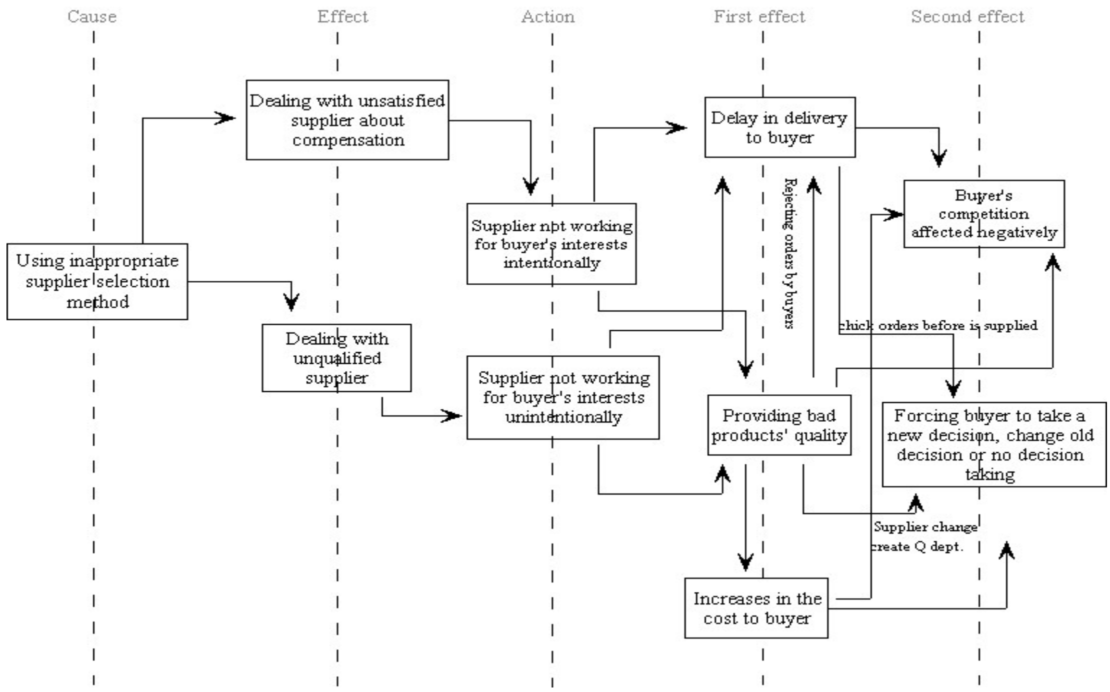


Fig.5.2: Using inappropriate supplier selection method causes and effects

Table 5.4 shows that because of missing future plan by buyers, some suppliers became confused because they might have commitments to other buyers or they did not have enough raw materials to produce to the buyer’s needs, which caused delay in delivery to buyers. The study found that, in a rushed situation, a supplier tried to get raw materials from any main supplier, even if the main supplier was not the usual one, to a produce a buyer’s orders quickly and such a main supplier might use poor raw materials. In this case, the supplier would provide poor quality orders to the buyer, which caused delay in delivery because of refused orders by the buyer. The study also found that sometimes orders imported from external suppliers did not conform with the required packaging specifications, such as the supplier not writing those specifications on the outside of the order packaging or inside on the order documentation, as required by the buyer, or they delayed in sending documents for orders on time because of a rushed situation, which exposed buyers to problem with customs unintentionally, which in turn increased costs to the buyer and endured delay in delivery.

Additionally, when buyers did not have a (good) future plan, they gave suppliers a chance to misuse circumstances. Sometimes suppliers sent orders before they had completed all specifications according to the buyer's needs because they either wanted to save money or they were busy with other buyers and did not wish to occupy more of their storage space because of other orders; so they expected that buyers would not notice these incomplete specifications, such as not writing or printing order specifications on an order's packing or not using a good type of packaging material. As mentioned before, table 5.4 revealed that packaging material and specifications was very important for buyers, but if order specifications were not written or printed on orders by suppliers, buyers were affected negatively by delay in delivery or increases in costs from customs. In some cases, when suppliers felt that buyers were in a hurry to receive orders, they asked for increases in prices to gain an advantage from this circumstance. The study found that sometimes buyers used orders, which had been received from a supplier, without inspecting the quality because buyers were in a hurry to process orders in their own production process because of their customer needs. In this case, buyer competitiveness was affected negatively if the orders were not as the buyer required (see Fig 5.3). Table 5.4 shows suppliers' behavior in such situations. The study found that buyers visited recognized the mistake of missing plan, so they try to solve this mistake as mentioned in table 5.4

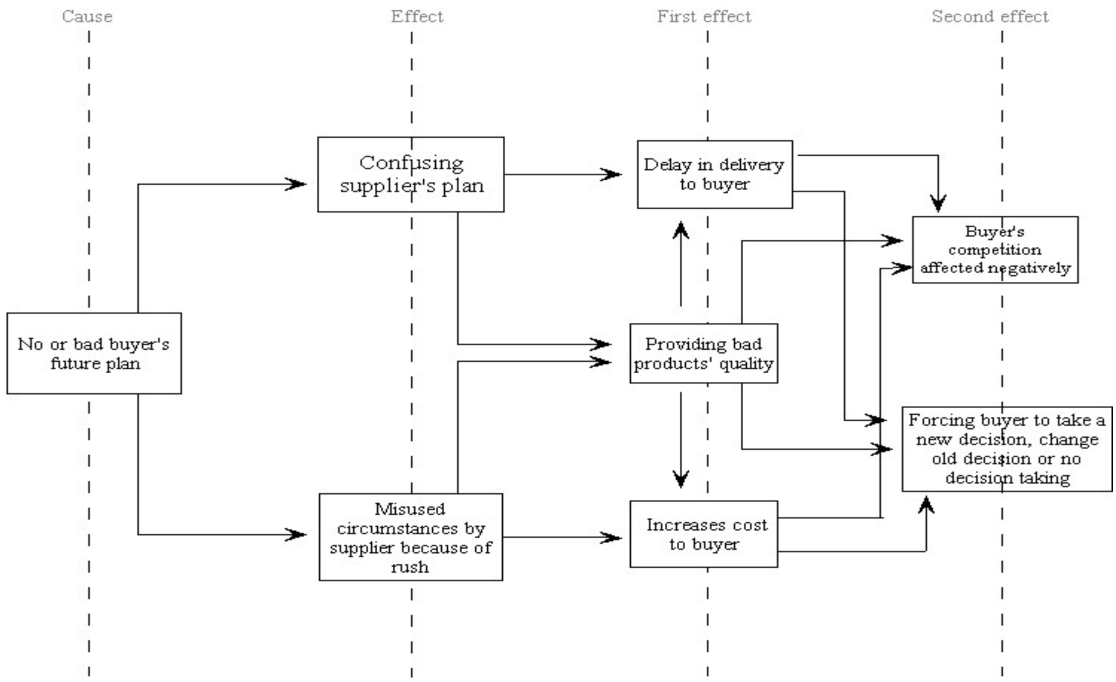


Fig 5.3: No or bad buyer’s future plan causes and effects

Table 5.4 represents that frequent changes in a supplier’s management affected a buyer’s competitive position in the market and their decisions. The study also observed that frequent changes in a supplier’s management decreased communication between buyers and suppliers and hence their mutual understanding. Changes in agreements or decisions made by previous management increased buyer costs and confused buyer future plans and decisions. Increases in the buyer’s costs were caused when the supplier decreased the percentage of discount, no longer provided free extra services, or increased the price, which compelled buyers to look for another supplier.

Confusion also arose, which occurred in the buyer’s future plan because of changed previous agreements, when suppliers made changes to an order’s specification, such as colour or size, without giving notice to the buyer to prepare the market to accept these changes. These changes affected buyer competitiveness in the market negatively, with buyers having to stop production, which affected buyer competitiveness by giving a chance for new competitors to enter the market or allowing current competitors to take the buyer's market share.

Confusion also arose when a supplier's new management changed the payment method by asking the buyer to pay for the order in advance, which did not correspond with the buyer's payment method with their customers, therefore affecting the relationship between buyers and their customers (see Fig 5.4).

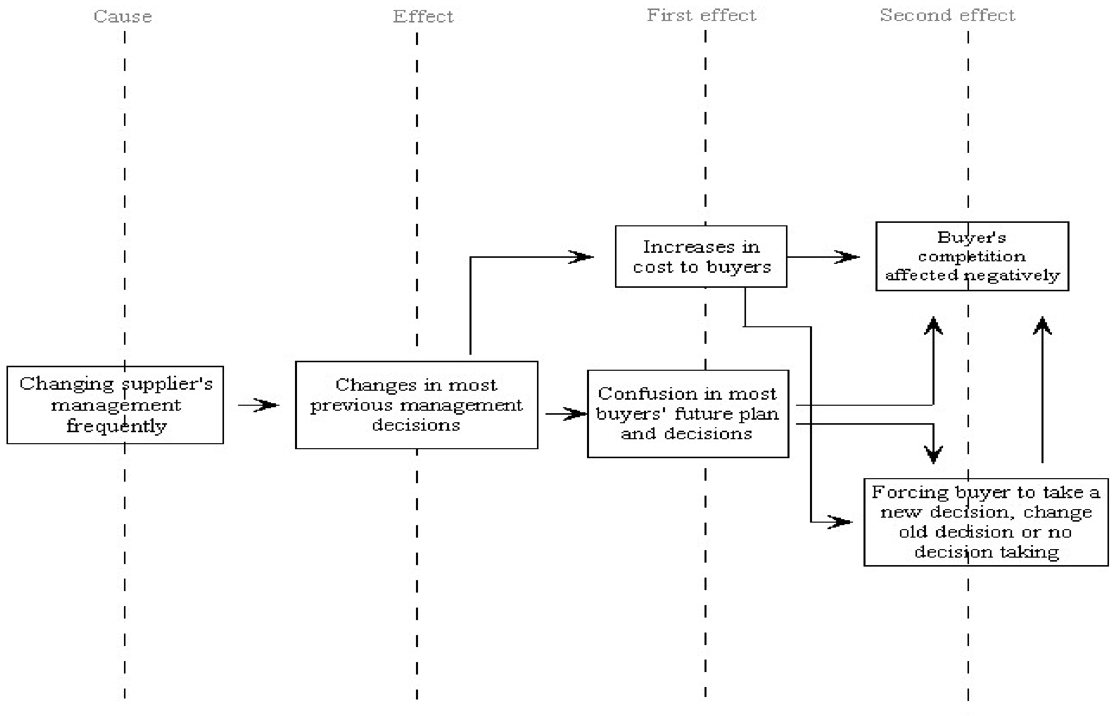


Fig 5.4: Frequent changes in a supplier's management causes and effects

The study found that sometimes cultural differences between buyer and supplier in different countries could affect their relationship. Some cultures did not agree to change their policy or decisions, even if they affected buyers negatively or they did not match the buyers' market. But, table 5.4 reveals that buyers insisted on dealing with certain suppliers because of the long relationship or their customers' demand.

Suppliers' commitment to serve buyers depends on main suppliers' commitment (a supplier who is prior the supplier in supply chain) to serve suppliers. Table 5.4 shows the number of affected relationship by the supply chain. The success of the relationship between buyer and supplier depends on the success of the relationship between main supplier and supplier. Any defects in the main supplier and supplier relationship affect the buyer supplier relationship.

Main suppliers did not work on their suppliers' behalf because they felt that they deserved higher prices than those they were receiving, so they did not put all their capability into providing the quality that was needed, which in turn affected buyers' products. Providing poor quality to buyers caused delays in delivery because of consequent refused orders by buyers. Main suppliers stopped providing orders to suppliers until these suppliers agreed to increase the prices they pay or to any other requirements, which caused increases in prices and delays to buyers. These problems affected buyers' decisions and competitiveness. The buyer's decision was affected by either stopping a production line, which affected the buyer's competitiveness, or finding another supplier who could provide the orders that they needed (see Fig 5.5).

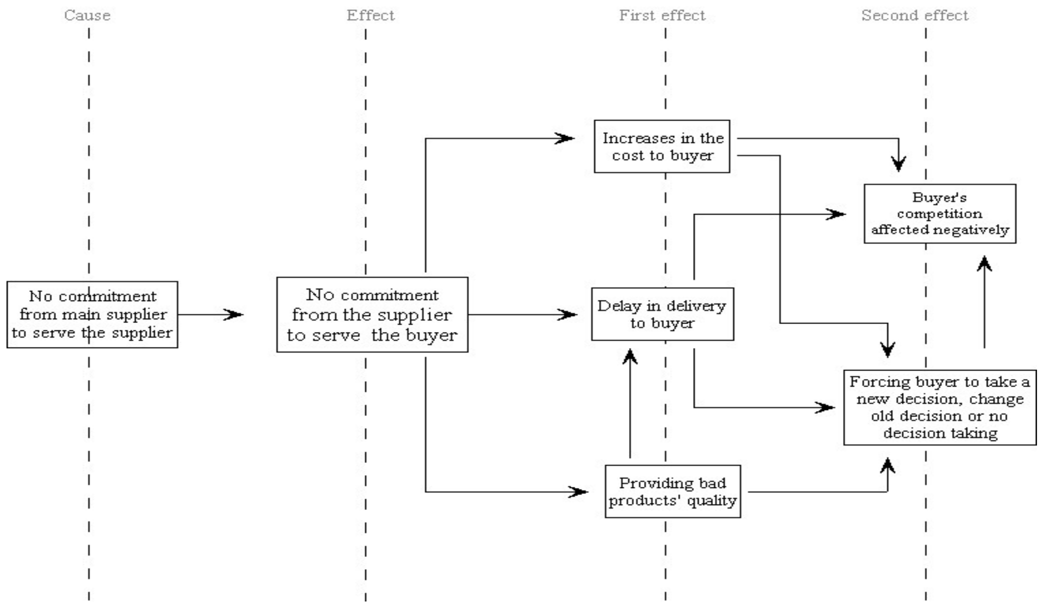


Fig 5.5: No commitment from main supplier to serve supplier causes and effects

Table 5.4 shows that buyers preferred to deal with brokers for products which are in high demand to avoid any problems with suppliers, but the study revealed that buyer and supplier dependence on a weak broker caused problems between them. Many such cases were observed. These brokers gave wrong information to suppliers or withheld information from suppliers if they were responsible for any malpractices that had caused a problem as it is mentioned in table 5.4. It was noticed that such brokers tried to make a secret agreement between themselves and suppliers, or else they cut all communication with buyers. However, in many cases suppliers relented after finding out that the problem had been caused by the broker, and they cooperated with the buyer to solve the problem. The main two problems with this kind of broker were not completing and sending order paper work and documents on time, which caused problems with customs. This could affect the order's quality because of long storage and exposure to the sun. The other problem was the incapability of brokers to convey orders on time. The buyer's decision was affected by this (see Fig 5.6). Table 5.4 represents that buyers were changing their approach in dealing with brokers.

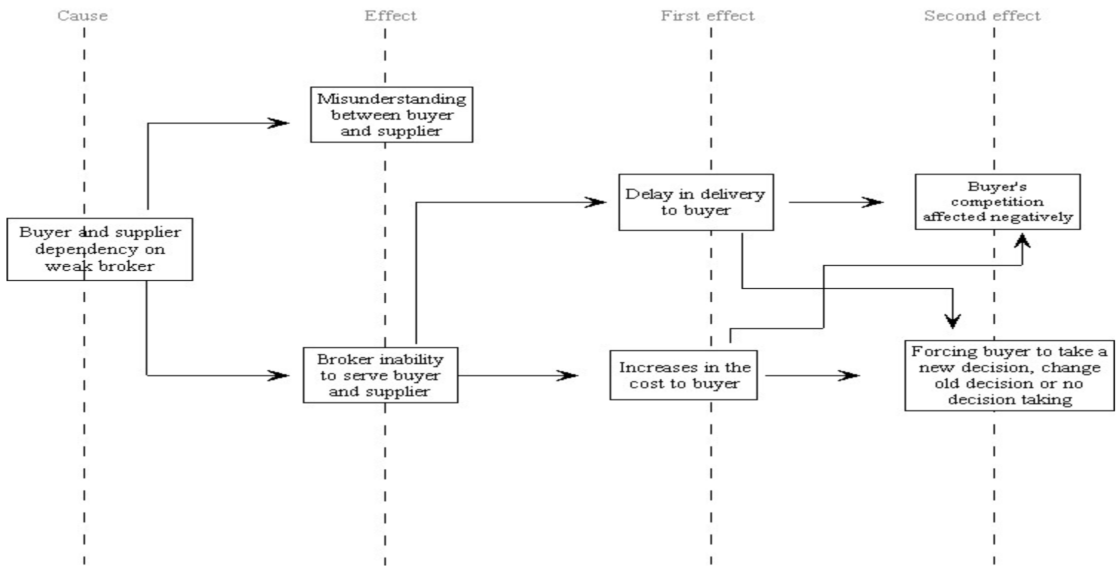


Fig 5.6: Buyer and supplier dependency on a weak broker causes and effects

### 5.2.3 Problem control

The study revealed that the supplier can be controlled by contract and relationship type, by making work more programmable, and by using a strong broker (see Fig 5.7).


Fig 5.7: Problem control diagram

### 5.2.3.1 By contract and relationship type

Because there were many suppliers who could provide the same orders to buyers, buyers in the market exchange relationship did not exert a lot of effort to control suppliers. If buyers did not like to deal with a supplier, they exited from the relationship and looked for another supplier directly, especially if there had been defects in the quality of orders. Table 5.6 shows that buyers use this mechanism to force suppliers to work on their behalf. However, because some buyers' customers wanted a specific franchise involved in their orders provided only by a supplier not preferred by buyers, they continued to deal with this supplier in a limited way.

Table 5.6 Market exchange relationship Problem control

<table>
<tr><th colspan="3">Problem control</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>By contract and relationship type</td><td>21 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>7</td><td>1</td><td>2</td><td>2</td></tr></table></td><td>Buyers used outcome based contracts and an exit relationship to force suppliers to work on their behalf, especially when the buyer was a big name in the market and needed a lot of the supplier's products.</td></tr>
<tr><td>By making work more programmable</td><td>21 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>6</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Buyers found that, if they had a well organized plan, suppliers would be controllable and easy to follow up, and the chance of misused circumstances by suppliers was diminished.</td></tr>
</table>

### 5.2.3.2 By making work more programmable

Table 5.6 reveals that when buyers planned and organized all their processes and procedures, a supplier became more careful to work in buyers' interests. Buyers who had created a planning department in their organizations avoided confusion arising from unexpected orders.

#### 5.2.3.3 By using a strong broker

The study observed that when buyers depended on a strong broker with a good reputation, this protected them from the opportunism of a supplier or a weak broker. When buyers used a strong broker, suppliers knew that the strong broker dealt with many suppliers around the world, and that his/her knowledge and awareness about the market were so high that he/she could affect their position in the market negatively if they did not put all their effort into working in their buyer's interests. Hence, they were very careful.

### 5.2.4 Effects on the relationship

#### 5.2.4.1 First effects

##### 5.2.4.1.1 Delivery

Many causes can affect delivery to buyers negatively. These causes were using an inappropriate supplier selection method, the buyer having no or a poor future plan, buyer and supplier dependency on a weak broker, and a lack of commitment from the main supplier to serve the supplier. Any delay in delivery to the buyer led to delay in delivery to the buyer's customers, which encouraged that buyer's customers to look for another supplier (buyer), which in turn affected the buyer's competitiveness (see Figs 5.2, 5.3, 5.5 and 5.6).

##### 5.2.4.1.2 Cost and price

Costs and prices were increased to buyers because of no or a poor buyer's future plan, buyer and supplier dependency on a weak broker, a supplier's management changing frequently and no commitment from the main supplier to serve the supplier. Increases in costs to buyers forced buyers to cut these increases from their profit instead of adding them to their prices to customers to protect their competitiveness in the market and to prevent their customers going to their competitors. At the same time, cutting these increased costs from buyers' profit affected their growth, development and their employees' satisfaction by not giving or decreasing their annual increment (see Figs 5.2, 5.3, 5.4, 5.5 and 5.6).

#### 5.2.4.1.3 Quality

Poor quality meant that either the order packaging, which had been sent by the supplier, did not comply with the specifications that had been previously agreed or the order's quality had not been up to the buyer's requirements. Providing poor quality to the buyer affected the buyer negatively by increases in costs or delays in delivery to the buyer. Sometimes it affected a buyer's competitiveness directly when the buyer used the order or released it to the market without inspection. Sometimes providing bad quality to the buyer encouraged that buyer to look for another supplier, which represented a kind of delay in the order to the buyer. Order quality was affected by using an inappropriate supplier selection method, no or a poor buyer's future plan or a lack of commitment from the main supplier to serve the supplier (see Figs 5.2, 5.3 and 5.5).

#### 5.2.4.1.4 Confusion in buyer's plan

The study observed that a buyer's plan was affected by changing the supplier's management frequently. Confusion in a buyer's plan led to a tense relationship between the buyer and their customers because any confusion in the buyer's plan led to confusion in the buyer's customer plan, which caused annoyance.

This tension gave the buyer's customer a reason to look for another supplier (buyer) (see fig 5.4).

### 5.2.4.2 Second effects

#### 5.2.4.2.1 Decision making

The buyer's decision was affected by using an inappropriate supplier selection method, no or a poor buyer's future plan, buyer and supplier dependency on a weak broker, changing the supplier's management frequently, or a lack of commitment from the main supplier to serve the supplier. These have all been mentioned above (see Figs 5.2, 5.3, 5.4, 5.5 and 5.6).

#### 5.2.4.2.2 Competitiveness

Table 5.7 reveals that when buyers delay order delivery to their customers or increase the cost of orders, customers look for other buyers. This potentially increased the market share percentage of buyers' competitors or allowed new competitors to enter the market. The study also found that a buyer's competitiveness was directly affected negatively when buyers used a supplier's products without inspection, as mentioned in the quality section (see Fig 5.8).

Table 5.7 Market exchange relationship effects

| Effects | | |
|---|---|---|
| Issue | Relationship | Comment |
| Competitiveness | 23 customers | Customers stopped dealing with these buyers and started to look for other buyers in the market who could provide the same products at reasonable prices and on time. |

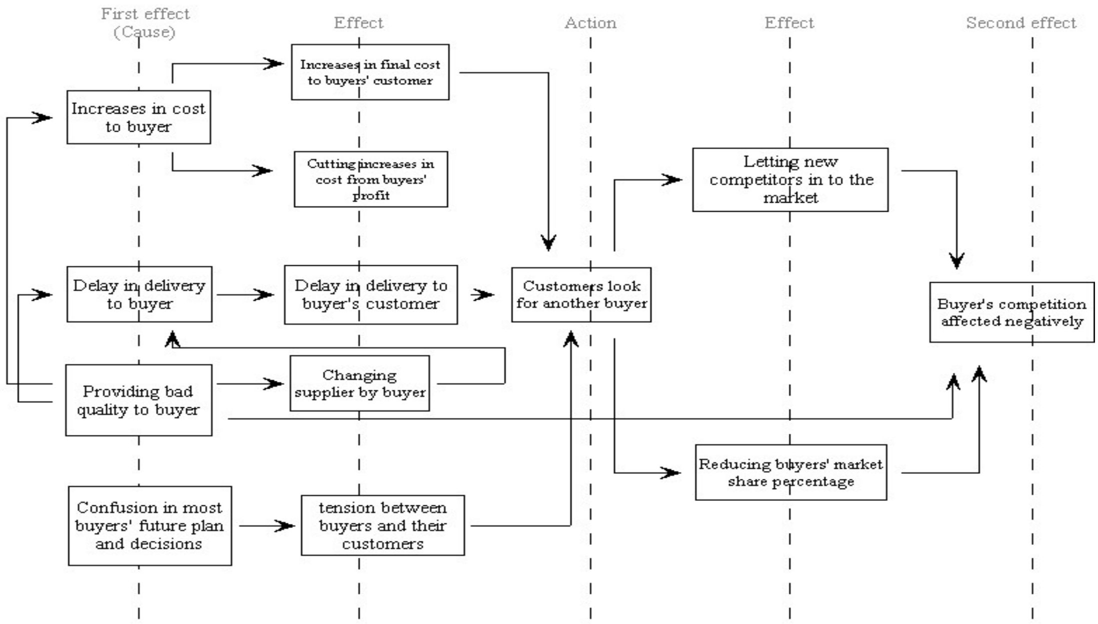


Fig 5.8: Causes of competitiveness effects

### 5.2.5 Special case in market exchange relationship

The study revealed that there was a special case, which might be created between buyer and supplier in market exchange relationship. In this case, buyers preferred to deal with suppliers under a relationship which was different from the market exchange relationship characteristics because of their interests.

In this case, buyers wanted the relationship to be that of captive buyer with a specific supplier, though they had many choices of suppliers. The study found that most characteristics of market and relationship indicated that the relationship between buyer and supplier was classified as market exchange, but the buyer liked to be a captive buyer. The study found that, even if the supplier’s product was a standard one, did not need advanced technology to be produced, there were many suppliers who could provide the same products to buyers, suppliers shifted from one buyer to another easily, and buyer and supplier spent a limited amount of time together, all of which are market exchange relationship characteristics; buyers made a lot of effort to deal with a specific supplier as a captive buyer. It is important to mention that the orders could be very important to buyers' production, and they had to use them continually.

### 5.2.5.1 Special case relationship incentives

The study observed that there were two incentives for buyers to act in this way. These incentives were price and personal interest (see Fig. 5.9).

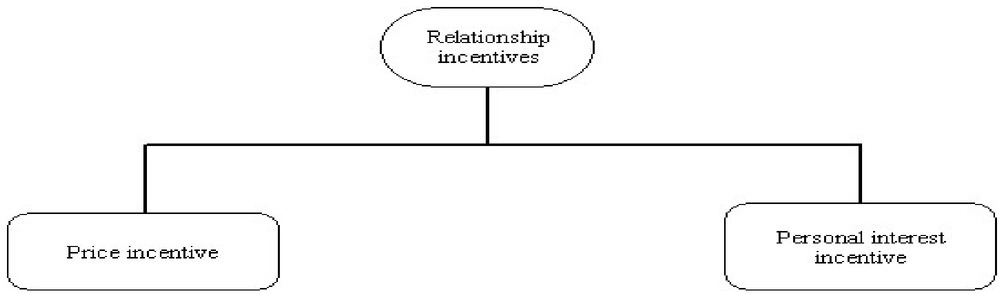


Fig. 5.9: Special case relationship incentives

#### 5.2.5.1.1 Price incentive

There were two reasons for price to be a factor motivating buyers to change their relationship with suppliers. First of all, the study observed that some products, which were produced in government factories, were sold at a cheaper price than from other producers because they were supported by government. Table 5.8 represents that a price encouraged buyers to take most or all what they needed from such supplier. Buyers tried to get such products, but if they could not obtain them all from government factories, they obtained the rest of the order from other suppliers. Secondly, the supplier did not have enough knowledge about the market. Table 5.8 reveals that buyers dealt with a supplier, who did not have enough knowledge about the market. The study noticed that buyers did this with orders which did not require customization or particular specifications. The study also found that buyers tried to adapt to a supplier’s problems without any complaints to gain full advantage from the lowest price.

Table 5.8 Price incentives of market exchange relationship special case

<table>
<tr><th colspan="2">Price incentives</th></tr>
<tr><th>Relationship</th><th>Comment</th></tr>
<tr><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>8</td><td>7</td><td>1</td><td>2</td><td>1</td></tr></table></td><td>A price encouraged buyers to take most or all what they needed from suppliers, who were supported by government even if there were other suppliers who could provide the same orders.</td></tr>
<tr><td>17 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>3</td><td>4</td><td>4</td><td>3</td><td>2</td></tr></table></td><td>Buyers dealt with a supplier, who did not have enough knowledge about the market, and he offered the cheapest price in the market (however, the buyer knew that and had good knowledge about the market). Buyer kept dealing with the supplier as a captive buyer to reduce operational costs.</td></tr>
</table>

- **Causes and problems**

The study revealed that there was only the moral hazard problem which occurred because of price incentive. Table 5.9 shows that suppliers who were supported by the government, did not act opportunistically intentionally, except maybe in the case of a personal relationship between the supplier’s manager or a seller’s manger and a specific buyer, whereby that buyer was given priority to receive orders first, which caused a delay in delivery to other buyers, but this tended to occur only to a limited extent. Additionally, table 5.9 represents that although there was a lot of demand for suppliers production, who were supported by the government, they did not have a specific production plan, which caused the same problem. Table 5.9 reveals also that suppliers, who did not have enough knowledge about the market, did not act opportunistically intentionally. The study revealed that these suppliers were weak, and they did not have a good plan or system to process their work, which might cause delay in delivery time to the buyer. Table 5.9 represents that suppliers attributed any delay to technical problems, and others apologized for the delay in supplying orders because of many reasons. The study found that these suppliers were very clear, their behavior was understood and they did not withhold any information; they always responded to any inquiries that buyers had (see Table. 5.9).

Table 5.9 Market exchange relationship special case causes and problems

<table>
<tr><th colspan="3">Causes and problems</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Moral hazard problem</td><td>17 relationships out of 20<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>7</td><td>2</td><td>1</td></tr></table></td><td>Suppliers, who were supported by the government, did not act opportunistically intentionally. the causes are bureaucracy and routine for decision making, which sometimes led to a lack of raw material for repair parts of production machinery or delay in the maintenance schedule. Other causes were the variety of holidays taken and shortage of work time, which led to either an increase in the length of maintenance shutdown time or a delay in production. Both of these causes affected the time of delivery to the buyer negatively.</td></tr>
<tr><td></td><td>16 relationships out of 20<table><tr><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>8</td><td>6</td><td>1</td><td>1</td></tr></table></td><td>Suppliers, who were supported by the government, did not have a specific production plan, which entailed suppliers either accepting more than their capacity or not working to their full</td></tr>
</table>

<table>
<tr><td></td><td></td><td>capacity.</td></tr>
<tr><td></td><td>16 relationships out of 17<br><table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>3</td><td>3</td><td>4</td><td>3</td><td>2</td></tr></table></td><td>Suppliers, who did not have enough knowledge about the market, did not act opportunistically intentionally. They offered lower prices purely because they did not have enough knowledge about the market, not because of any hidden agenda.</td></tr>
<tr><td></td><td>11 relationships out of 17<br><table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>3</td><td>2</td><td>1</td><td>3</td><td>2</td></tr></table></td><td>Suppliers attributed any delay to technical problems, and others apologized for the delay in supplying orders because they denied having received the requested order form, especially if it had been sent by fax, and asked the buyer to resend the form after they had already taken many days to prepare the order for the buyer.</td></tr>
</table>

Table 5.10: Price incentive problem causes table

<table>
<tr><th colspan="3">Price incentive</th></tr>
<tr><td rowspan="6">Moral hazard</td><td>1- Governmental suppliers</td><td></td></tr>
<tr><td>Cause</td><td>Effect during operation production</td></tr>
<tr><td>Personal relationship<br>Bureaucracy<br>Routine of work<br>Variety of holidays<br>No a production plan</td><td rowspan="3">Delay in delivery</td></tr>
<tr><td>2- No market knowledge with supplier</td></tr>
<tr><td>No a good production plan or system<br>Bad management</td></tr>
</table>

- **Control**

Suppliers, who were supported by government, could not be controlled and that was why the buyer should accommodate their problems. At the same time, buyers mentioned that they tried to minimize the effects of delay in delivery by making a decision to increase their stock percentage. In this case, buyers visited suppliers and met their management frequently to explain how their products were important to buyers' production to convince them to provide the full percentage of the order. Buyers usually dealt with other suppliers to receive orders when the main supplier could not provide the full percentage of the order (see Fig. 5.10).


Fig. 5.10: Problem control diagram

Suppliers, who did not have enough knowledge about the market, could be controlled by buyers, giving them an indication that they could exit from the relationship at any time, because of the presence of other competitor suppliers who were willing to provide the same order whenever the buyer needed (see table 5.11). At the same time, buyers were very careful not to put too much pressure on the supplier by threatening with exit from the relationship so as not to allow the supplier to become demotivated and then lose the enthusiasm to work on the buyer's behalf. The study found that because buyers wanted to stay with a supplier, they did not go further down the route of exiting from the relationship; they preferred instead to demonstrate that they were serious about exiting from the relationship, but without taking any action. Table 5.11 shows that buyers avoided the effects of any delays by many ways, and shows how buyers forced suppliers to work on their behalf. In this case, buyers worked hard to receive any market information updates so as to gain maximum advantage from the lower prices and to understand the limitations on their decisions (see Fig. 5.11).


Fig. 5.11: Problem control diagram

Table 5.11 Market exchange relationship special case problem control

| Problem control | |
|---|---|
| Relationship | Comment |
| 10 relationships out of 17<br>G F P T S C<br>1 3 2 1 2 1 | Buyers increased and retained a certain percentage of stock to avoid the effects of any delays, whilst others made their work more programmable by applying changes to their way of working to assist the supplier to work for them. Buyers made their work more programmable by establishing a good plan for future orders. |
| 8 relationships out of 17<br>G F P S<br>1 3 2 2 | Buyers used outcome based contract and exit relationship type to put pressure on the supplier to work on their behalf. |

- **Effects**

Actually, there were no effects for both these reasons because if orders were delayed by suppliers, who were supported by the government, buyers could make up for any shortfall in orders provided with another supplier. Additionally, if the second reason had been the cause of the delay in delivery, buyers were not affected because they would have already increased their percentage of stock (see table 5.11). In short, there were no negative effects for buyers in terms of their competitiveness in the market and their relationship with their customers. The buyer decision making was only affected during the production operation, but it did not affect the buyer in the market, because, as has been said before, he/she had already prepared himself/herself to resolve problems.

**5.2.5.1.2 Personal gain incentive**

The personal gain incentive arose when one or more board members insisted on continuing to deal with a specific supplier, although there were problems, and there were many suppliers who could provide the same order or service at a lower or the same price but with higher commitment. The study found that in such firms purchasing departments disagreed about continuing to deal with such suppliers, but they did not have the authority to take a decision. These board members took a decision to establish a long term contract with the supplier without reviewing this decision with the purchasing department, which knew exactly how the supplier had behaved and what was his history.

- **Causes and problems**

Adverse selection is the first problem that occurred because of personal gain incentive. The study revealed that such suppliers withheld information and their behavior was not clear to buyers. When buyers had any inquiries about the market, production or rumors, suppliers did not give buyers a quick response, which left buyers confused or delaying in making the right decisions. By acting in this manner, the supplier was trying to gain an advantage from the circumstances. They increased the cost of orders or services without giving any notice to buyers in advance because they were sure that buyers could not receive these orders or services from anywhere else because of the agreement they already had. They hid the real causes which affected the order price.

Moral hazard is the second problem. The study found that these suppliers shirked their responsibilities by not paying any penalties due to the buyer or to others because of their malpractice according to the contract. Additionally, they did not provide orders or services in accordance with buyers' needs and requirements as a package; they provided orders with whatever was available. This sometimes created a problem with customs. Moreover, they sometimes delayed delivery time because they supplied orders to other buyers. The study also found that they did not put their effort into solving problems that buyers faced with them.

The study indicates that these problems were created because supplier selection had not been carried out properly from the beginning but had been dependent on the personal interest of one or more board members not looking to the organization's interests, or insisting to continue dealing with a specific supplier, as mentioned by the purchasing department (see Table. 5.12 and Fig. 5.12).

Table 5.12 Personal interest incentive problem causes

| Personal gain incentive | | |
|---|---|---|
| | **Cause** | **Effect** |
| Adverse selection | Using inappropriate supplier selection method "Suppliers depend on their relationship with one or more of board members" | Increases in the cost to buyer |
| Moral hazard | | Increases in the cost to buyer<br>Tension inside the buyer's firm<br>Delay in delivery |

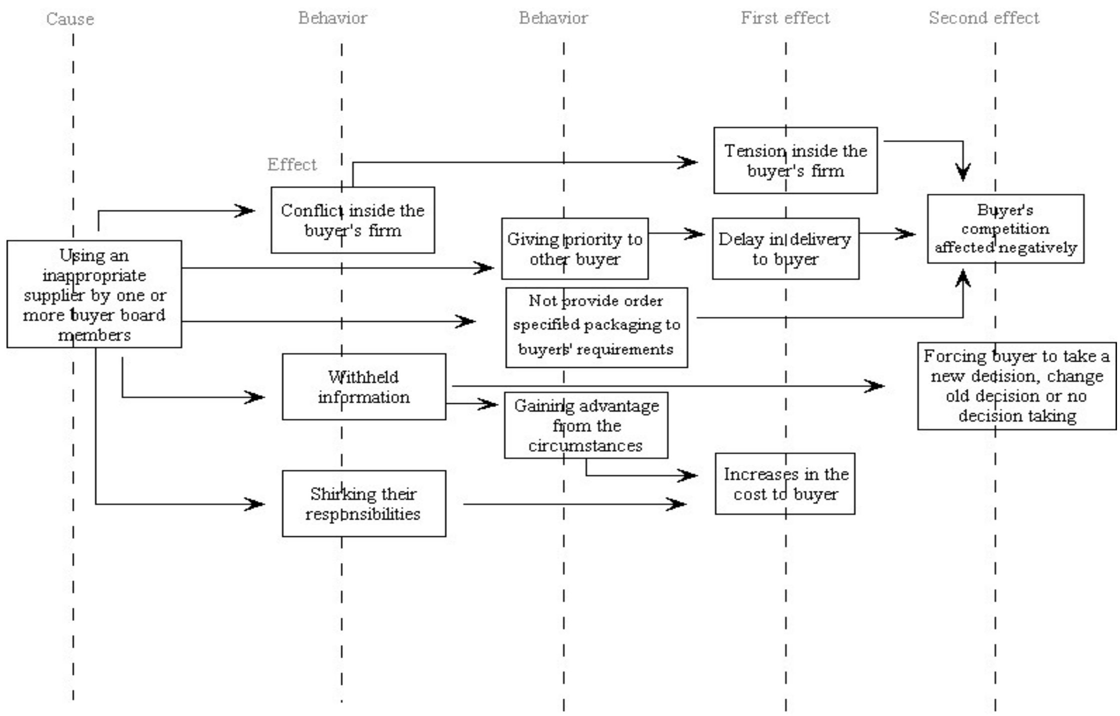


Fig 5.12: Using inappropriate supplier causes and effects

- **Control**

The study found that it was not easy to control such suppliers because they were sure that there were no further decisions to be made against them. They depended on their relationship with one or more of the board members, who had an financial interest in continuing to deal with them.

- **Effects**

The study noticed that because the opinions between the buyer's purchasing department and one or more members of the buyer's board were not consistent with each other regarding a supplier, this entailed the member of the buyer's board passing the requested order form personally to the supplier, which led to a tense relationship. At the same time, the buyer's purchasing department tried to avoid dealing with that supplier by sending a percentage of the requested orders to another supplier. Hence, because of the above, this led to a conflict inside the buyer's firm. Because of this conflict and no responses from such suppliers regarding inquiries, the buyer's employees became demotivated, which affected their work negatively. For example, one senior management interviewed in petrochemical industry contained that their employees were becoming depressed, they transferred the file of this supplier to another department. Additionally, when suppliers increased costs suddenly, this affected the relationship between buyers and their customers negatively, especially if buyers had set the prices of orders with their customers in advance. The study noticed that when buyers' customers found that there are changes in the prices (which had been agreed before), frequently they looked for another supplier, which affected buyers' competitiveness in the market, and allowed either new competitors to enter the market or existing competitors to take a percentage of buyers' share in the market.

Delay in delivery to buyers also affected their competitiveness negatively. It encouraged buyers' customers to look for another supplier (buyer) for their orders. Buyers' purchasing departments visited, two from the communications industry, one from the glass industry and a further two from the food industry, mentioned that when they lost customers, it was difficult to entice them back again. Even if they agreed to come back, they did so under certain conditions (like a decrease in price), which affected buyers' profit negatively. The buyer's profit was also affected when suppliers did not pay penalties to others (such as customs), which in turn affected the buyer's growth and employee satisfaction by not giving out their annual bonus. Although the order's quality was not affected in this case, suppliers did not provide order specified packaging to buyers' requirements (such as the desired order size or amount in each package), which affected buyers' competitiveness negatively by encouraging their customers to look for another supplier (buyer). But buyers' purchasing departments, three in the petrochemical industry, three in the stationery industry and one in the communications industry mentioned that, although quality provided was acceptable, they could find better quality with another supplier (see Fig. 5.13).

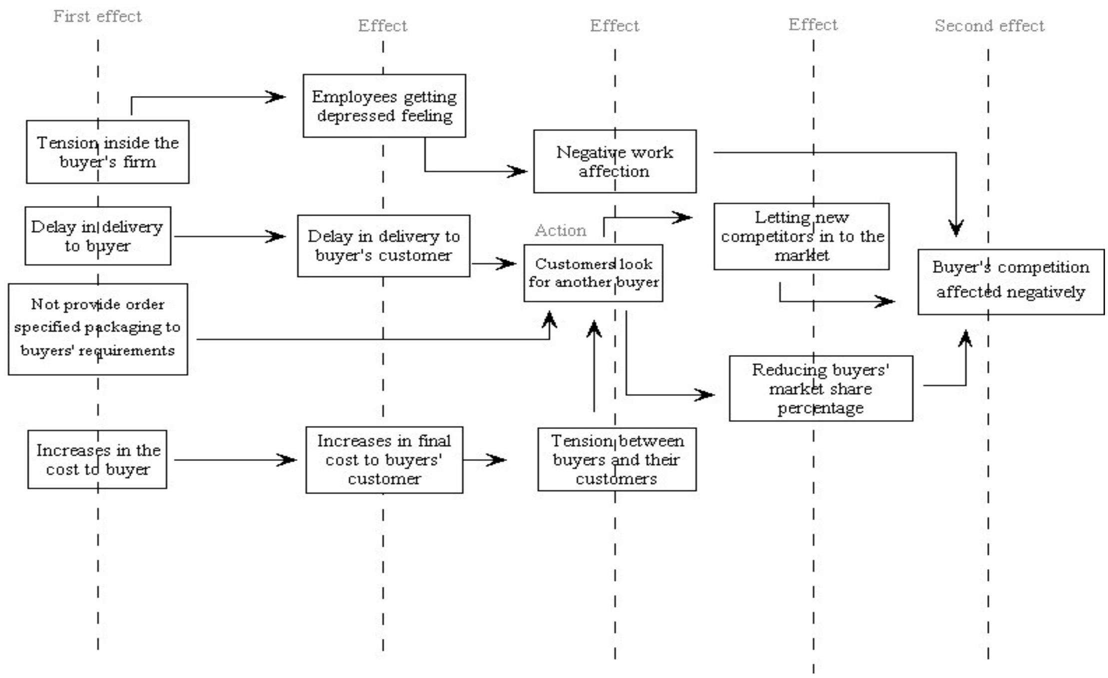


Fig. 5.13: Causes of competitive effects

## 5.3 Captive buyer relationship

The captive buyer relationship (Bensaou, 1999) is the same as any relationship between buyer and supplier; it has incentives for its creation and is exposed to problems and tensions caused by buyer or supplier, with these problems affecting buyers negatively. The study showed that indispensable products were very important to a buyer's production. 30 captive buyer relationships were studied from 160 relationships. (see table 5.1).

### 5.3.1 Captive buyer relationship incentives

There were many incentives creating the captive buyer relationship, which are: the presence of one supplier only in the market, the buyer using the supplier's products over a long time, lack of time to change supplier, governmental legislation, buyer needs and buyer competitiveness (see Fig 5.14).

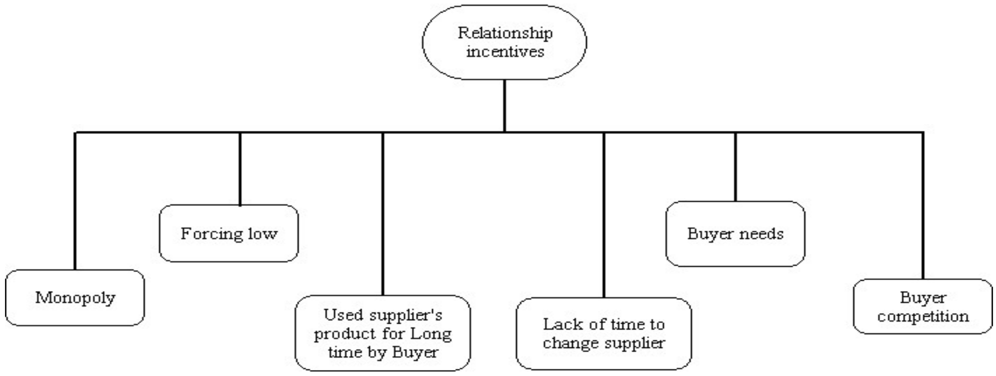


Fig 5.14: Captive buyer relationship incentives

**5.3.1.1 Monopoly**

If there is only one supplier in the market, the buyer is forced to deal with him.

**5.3.1.2 Use of supplier's product over a long time by buyer**

After a long time of using specific products, the buyer found himself stuck with a specific supplier product because his employees had become more familiar with it, his franchise had become part of it, or any changes would increase costs.

**5.3.1.3 Lack of time to change supplier**

When the buyer did not have enough time to look for another supplier who could provide the buyer's product on time, he/she dealt with the supplier even if he/she felt there was opportunism. This occurred when the buyer was in a hurry to receive the order. Products were needed urgently because each stoppage day for the buyer's production was too costly for him. Hence, the buyer did not have enough time to look for a cheaper supplier. In this case, the buyer would deal with whomsoever he knew, even if the supplier's price was more than what the buyer had expected. There might be conflicts or other problems between them, but the buyer preferred to deal with that supplier instead of inviting other bigger problems if he dealt with another supplier.

### 5.3.1.4 Governmental legislation

Table 5.13 reveals that buyers did not want to lose the benefits that they receive from the government because of dealing with local suppliers. These suppliers were protected by certain commercial laws, defined by the government to protect local Saudi industries, such as increases in customs duties for foreign products.

Table 5.13 Relationship incentives of captive buyer relationship

<table>
<tr><th colspan="3">Relationship incentives</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Governmental legislation</td><td>23 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>6</td><td>12</td><td>2</td><td>1</td><td>1</td></tr></table></td><td>Buyers did not want to lose the benefits that they receive from the government, such as reduction in factory land leasing costs, decreases in import duty and other duties which was why the buyer continued to deal with local suppliers.</td></tr>
<tr><td>Buyer competitiveness</td><td>29 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>8</td><td>14</td><td>3</td><td>1</td><td>1</td></tr></table></td><td>Buyers preferred to deal with suppliers who were not their competitors. Even if these supplier charged the buyer more than other suppliers (the buyer's competitors)</td></tr>
</table>

### 5.3.1.5 Buyer needs

If the buyer needed special requirements in supplied products, such as high technology or high quality, these requirements tended to be available from specific suppliers only. Therefore, the buyer dealt with an expert supplier in the knowledge that the supplier had the expertise, work capabilities and skilled technicians to do the work. Hence, buyers were encouraged to deal with this supplier to make sure that they were getting the best products in the market; to keep the buyer's final products up to the best possible standard.

#### 5.3.1.6 Buyer competitiveness

Table 5.13 represents that buyers were forced to deal with a specific supplier because the other suppliers were the buyer's competitors in the market., so it was not logical for the buyer to give his/her competitors power by dealing with them.

### 5.3.2 Causes and problems

As with any kind of relationship between buyer and supplier, adverse selection and moral hazard problems occur. These problems were caused by the supplier and external reasons. It was easy to notice when a rift occurred with the supplier who was gaining all the advantages. Table 5.14 shows that using a long or short term contract was not a cause of increase or decrease in suppliers' working on buyers' behalf in the captive buyer relationship because, wherever suppliers' interests lay, suppliers would continue without concern as to whether the contract is long or short. And, it is noticed that suppliers had a bad reputation in the market among buyers (see table 5.15).

Table 5.14 Captive buyer relationship causes and problems

<table>
<tr><th colspan="3">Causes and problems</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>General situations</td><td>24 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>2</td><td>6</td><td>12</td><td>3</td><td>1</td></tr></table></td><td>Suppliers preferred to use short term contracts to be more in control in any unexpected circumstances, such as shortages in raw material. But, even if the supplier had a long term contract, that supplier</td></tr>
</table>

<table>
<tr><td></td><td></td><td>might end the contract if he found it to his benefit to do so.</td></tr>
<tr><td></td><td>22 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td></tr><tr><td>1</td><td>7</td><td>13</td><td>1</td></tr></table></td><td>In the captive buyer relationship, suppliers had a bad reputation in the market among buyers.</td></tr>
<tr><td>Adverse selection problem<br>Suppliers’ bad management</td><td>7 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>1</td><td>1</td><td>3</td><td>1</td><td>1</td></tr></table></td><td>Suppliers’ bad management caused delays in delivery to buyers, which encouraged the buyer to review old decisions or take new decisions.</td></tr>
<tr><td></td><td>9 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>2</td><td>4</td><td>2</td><td>1</td></tr></table></td><td>Suppliers’ bad management caused increased the cost of operations to buyers, which encouraged the buyer to review old decisions or take new decisions.</td></tr>
<tr><td>Taking new decisions</td><td>16 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>1</td><td>5</td><td>8</td><td>1</td><td>1</td></tr></table></td><td>Buyers thought about increasing their percentage of stock, extending their storage area or trying hard to find another supplier</td></tr>
<tr><td>Desire of suppliers to keep buyers</td><td>10 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>4</td><td>2</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>Suppliers withheld information that they had about services or products to prevent buyers from dealing with another supplier.</td></tr>
<tr><td></td><td>5 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td></tr><tr><td>1</td><td>1</td><td>2</td><td>1</td></tr></table></td><td>Buyers visited explained that sometimes their supplier hid the fact that he/she was selling the same products at a lower price to that buyer’s competitors outside the country because of the benefits which the supplier received from the other country’s government so as to keep gaining advantages from selling the same products at a higher price.</td></tr>
<tr><td>Morale hazard<br>Cultural differences</td><td>7 relationships<table><tr><td>F</td><td>P</td><td>C</td></tr></table></td><td>The study discovered that suppliers, who differed in</td></tr>
</table>

<table>
<tr><td></td><td><table><tr><td>2</td><td>4</td><td>1</td></tr></table></td><td>nationality from the buyer, set a high price for services, insisted on following their own policies, even if this caused problems to the buyer, such as no returns on product, no technical support from the supplier, or not giving any facilities to the buyer for payment.</td></tr>
<tr><td></td><td>9 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>1</td><td>3</td><td>3</td><td>1</td><td>1</td></tr></table></td><td>Suppliers' representatives set for some buyers higher prices than for others because of either correspondence of nationality between buyers' and suppliers' representatives, or because the supplier's representative wished to be more loyal to the supplier to keep their position.</td></tr>
</table>

Table 5.15: Captive buyer relationship problem causes' table

| | | Causes | Responsible | First effects | Second effects | |
|---|---|---|---|---|---|---|
| Problems | Advers selection | Bad management<br>Bad supplier's production plan | Supplier | Delay in delivery<br>Increasing cost to buyer | Buyer's competition affected negatively<br>Forcing buyer to take a new decision, change old decision or not take decision | Economy |
| | | A desire of suppliers to keep buyers<br>Withheld information by supplier | Supplier | Delay in delivery<br>Increasing cost to buyer | | |
| | Moral hazards | A shortage in row material in the market<br>Increases in row material prices<br>Made decision by supplier's government | External | Delay in delivery<br>Increasing cost to buyer | Buyer's competition affected negatively | |
| | | Cultural differences between buyer and supplier<br>Misunderstanding between buyer and supplier | External | Delay in delivery<br>Difficulties in buyer production<br>Increasing cost to buyer | | |
| | | Monopoly<br>Using short term contract by supplier | Supplier | Delay in delivery<br>Increasing cost to buyer | | |
| | | Supplier's fear from main supplier<br>Made decision by supplier against buyer<br>Supplier chain affected negatively | External | Delay in delivery<br>Increasing cost to buyer | | |

#### 5.3.2.1 Adverse selection

There were two causes for the adverse selection problem, which were bad supplier management and the desire of suppliers to keep buyers. Both of them were caused by the supplier.

Table 5.14 represents that, when the suppliers had bad management, this would affect all their existing and future production plans, which meant suppliers could not follow up and take the right decision about production; they took more orders than their capabilities allowed for, so they failed to provide what the buyer was asking for on time. In other words, sometimes suppliers kept accepting orders without any plan, which caused difficulties with providing orders to buyers on time because the supplier's production capability was insufficient for the number of accepted orders. Therefore, the supplier did not tell buyers about any difficulties. When suppliers experienced this problem, they usually asked for increases in the service price first, then gave first priority for delivery to buyers who agreed to these increases and delayed delivery to those who did not agree to them. Buyers who decided not to agree to this increment or face delay in delivery looked for another supplier who might ask a higher price (see Fig 5.15). Whether the buyer paid the increase or not, table 5.14 shows that buyers are encouraged to review old decisions or take new decisions.

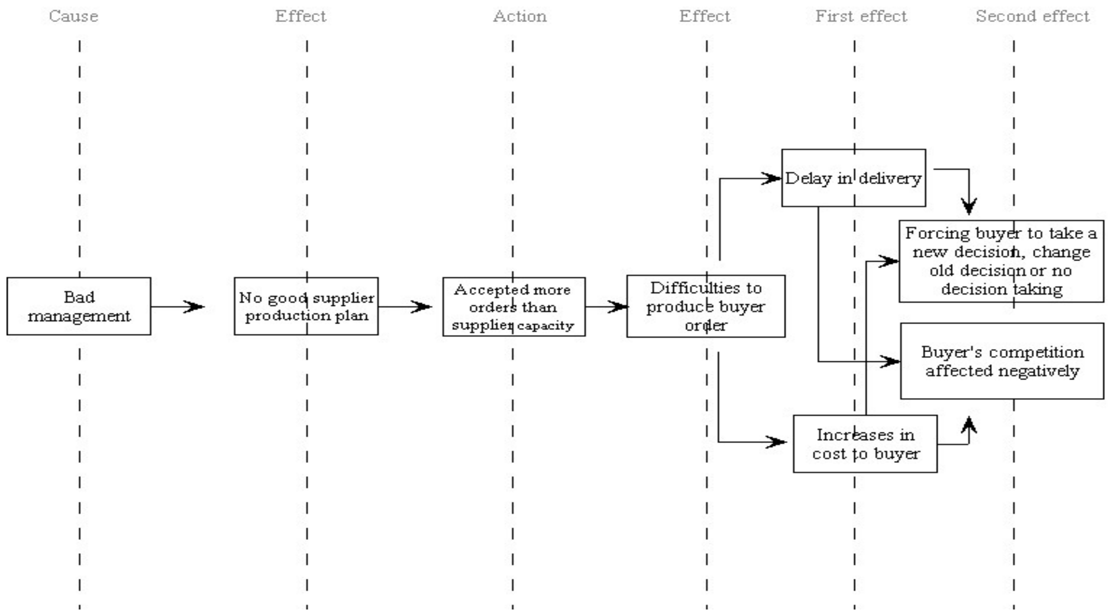


Fig 5.15: Bad supplier management causes and effects

Table 5.14 reveals that because of the desire of suppliers to keep buyers dealing with them alone, suppliers withheld information. For instance, even if supplier selection had been carried out properly by the buyer, buyers did not know about all problems inside the supplier firm. Some of the problems were beneath the surface and hidden from the buyer by the supplier before they worked together, such as internal conflict.

Internal conflicts detracted from the supplier working on the buyer's behalf, either because of a weakness in monitoring their employees who were working with the buyer or increasing the prices of the service or giving delivery priority to another buyer because of personal interest, which increased the cost to one buyer and delays in delivery. Internal conflicts, especially those which caused difficulties in production, meant that the supplier could not honor commitments to the buyer to provide orders on time, which in turn caused delay in delivery.

Other examples were that the supplier did not give the buyer manuals or instructions for using products to force buyers to come back to the supplier with any requirements, which in turn caused delays in delivery. The supplier might also increase service prices suddenly and without any justification to avoid any discussion about these increases or to give the buyer insufficient time to change supplier, even if these increases had not been in the original contract. These increases caused increases in costs to the buyer, who was forced to accept them to protect his/her competitive position in the market.

Further, the supplier did not tell the buyer about his/her plan, such as any shut down of production, till the last minute in order not to give the buyer time to change supplier or at least have more stock; even if the buyer asked the supplier about it, the supplier did not respond to any inquiries; despite this the supplier knew he could not deliver to the buyer. Withholding this information by the supplier panicked the buyer's decision about production, by forcing the buyer to buy from competitors, if those competitors supplied the same product, or from other suppliers at a higher price, which caused delivery delays, increased costs to the buyer or affected the buyer's competitive position in the market.

Moreover, table 5.14 represents that Concealing the information of selling the same products at a lower in different country did not allow the buyer to set a proper price in the local market, which caused the buyer to close his/her production line (see Fig 5.16).

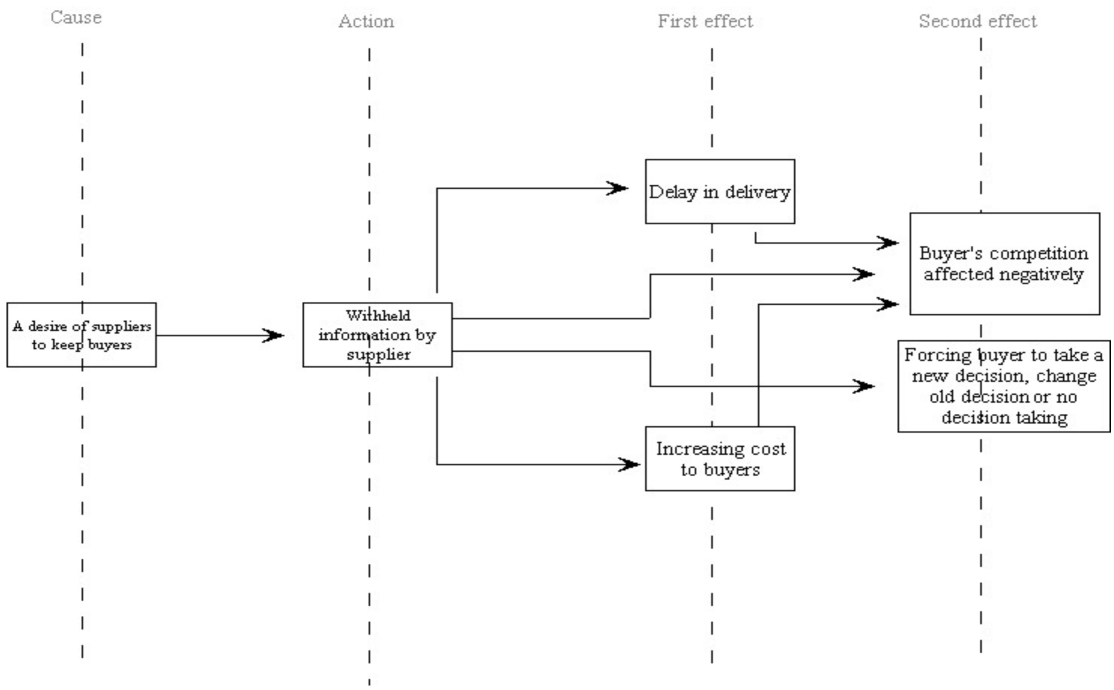


Fig 5.16: The desire of suppliers to keep buyers causes and effects

### 5.3.2.2 Moral hazard

There were many causes of moral hazard in the captive buyer relationship arising from external reasons and the supplier. External reasons were shortage in raw materials in the market and cultural differences between buyer and supplier. The supplier can cause moral hazard by using a short term contract and from a fear of the main supplier.

The study found that, if there was a shortage in raw materials in the market, this would increase the raw material price and push the supplier government to take decisions that could affect buyers negatively, such as stopping the export of raw materials to foreign countries and limiting the use of raw materials for local usage only. At the same time, the supplier did not tell the buyer about this problem, and did not reply to buyer inquiries, his/her office or his/her representative in the buyer country. When the raw material price was increased in the market, the supplier misused this circumstance for his/her benefit by asking suddenly for an increased price for the buyer's order or for more of the order, either for stock orders ready for the supplier to deliver to gain full advantage from these increases, or for a new order, even if there had been an agreement between buyer and supplier for a specific price, which once more caused increases in costs to the buyer. Whenever the government took a decision to stop exporting supplier production to foreign countries because of a shortage in raw materials in the market, the supplier asked the buyer to increase cost of production many times to take advantage from this situation, even when the government had accepted to export production again, which increased costs to the buyer. Additionally, because of a government's decision, a buyer might be affected negatively by delayed order deliveries (see Fig 5.17).

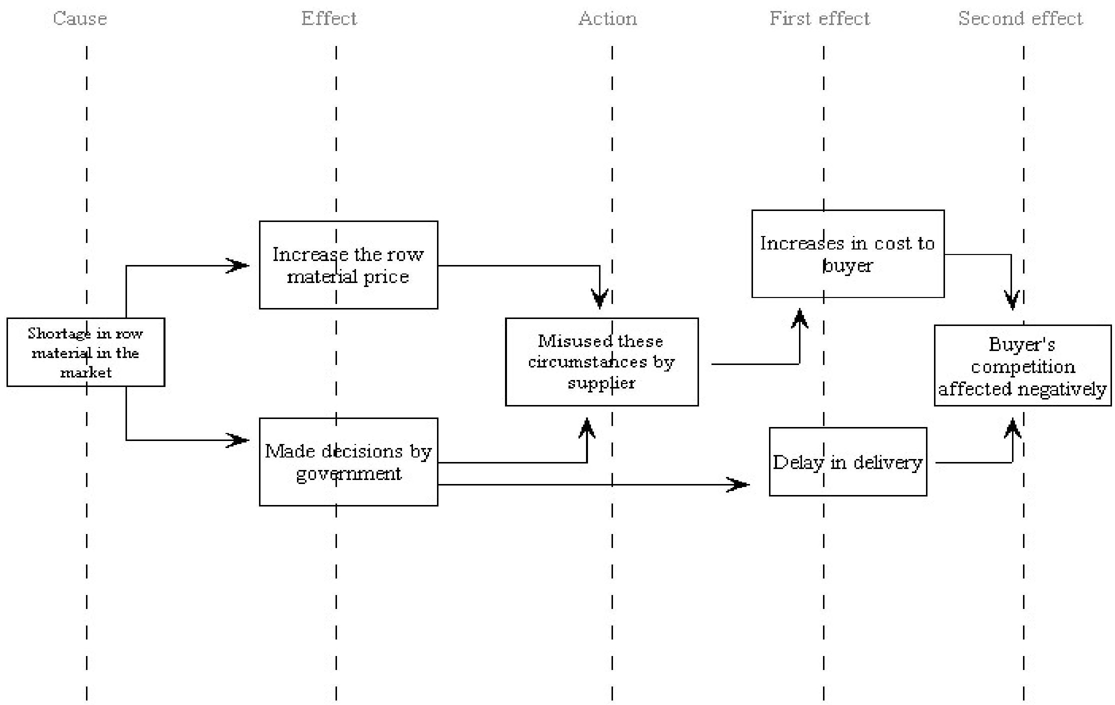


Fig 5.17: Shortage in raw materials causes and effects

Cultural differences between buyer and supplier related to differences in nationality between buyer and supplier. Table 5.14 reveals that these differences created misunderstanding between buyer and supplier because of differences in behaviour between the nationalities, and there might be differences in ways of thinking and priorities, which caused increases in costs to the buyer.

The supplier insisted not to return any buyer order, even if it had been ordered by mistake, which meant increases to buyer costs without benefits. At the same time, no technical support from the supplier left the buyer facing difficulties with production, which affected buyer delivery to the final customer. Not providing any facilities to the buyer for payment caused problems between the buyer and their customers, especially if the supplier used different payment methods from those used by the buyer. For example, three petrochemical, one food and one transportation suppliers in a captive buyer relationship took order payment once before production or on delivery, but the problem remained that this method of payment was not appropriate for buyers because most of them dealt with customers on a credit basis, which entailed buyers having to confront difficulties in their production process caused by shortages of raw materials. Sometimes the supplier deliberately increased the invoice amount to keep prices for the buyer secret from supplier competitors; after the buyer paid the bill, the supplier refunded the increases (see Fig.5.18).

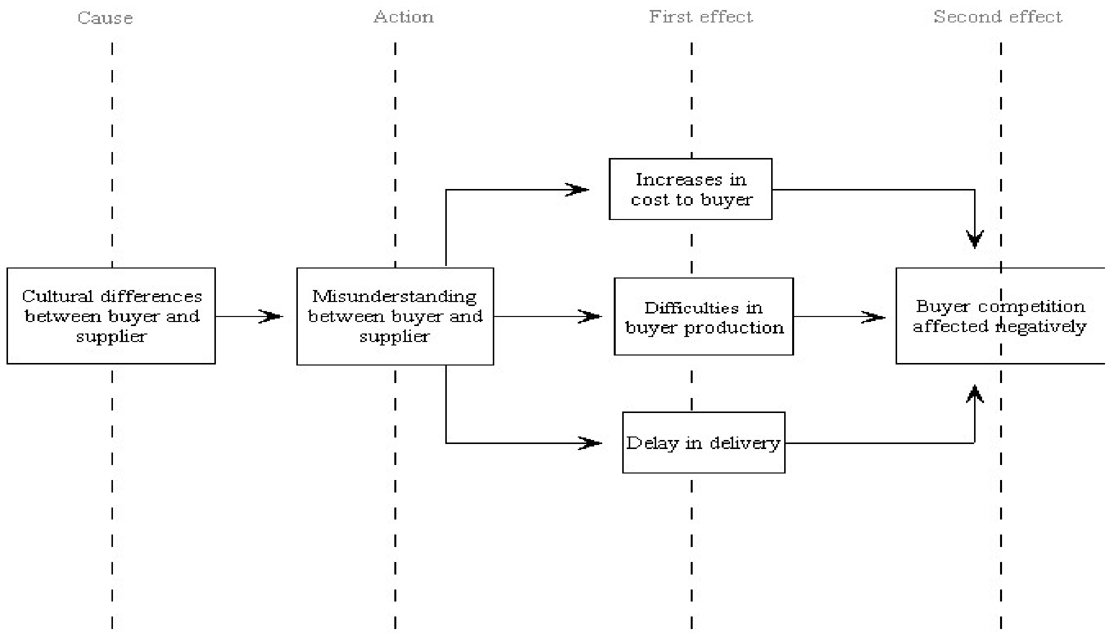


Fig.5.18: Cultural differences between buyer and supplier causes and effects

In a captive buyer relationship, when the supplier knew that he/she was the only one who could provide the products or services in line with market needs, that supplier used a short term contract. By using a short term contract, the supplier misused any circumstances that could provide more benefits, such as shortages in raw materials, in labor, or a default in the supply chain. It was easy for the supplier either to change buyer to another if he/she felt that benefit from another buyer would be greater or asked the buyer for increases in order prices, which the short term contract made it easy for the supplier to do. If the supplier changed buyer suddenly, this might cause a sudden stoppage in delivery which entailed the buyer facing problems with production, especially if he did not have enough stock; this did not prepare another supplier to work with that buyer, nor was there enough time to change to another, which caused delays in delivery. In a captive buyer relationship, the supplier could stop delivery at any time and change buyer if he/she found it to his/her benefit to do so (see Fig.5.19).

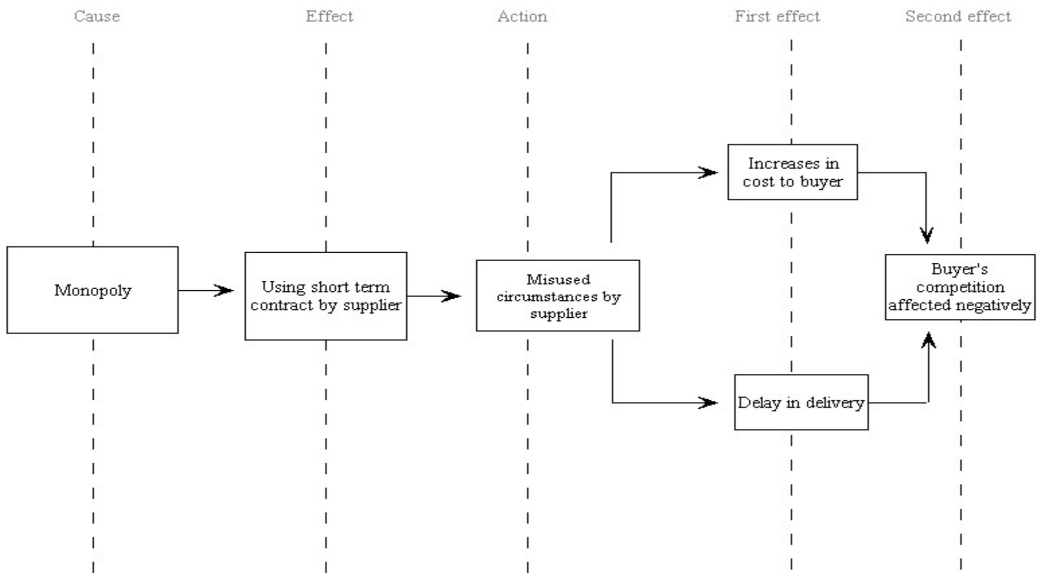


Fig. 5.19: Monopoly causes and effects

When a supplier feared that his main supplier might stop providing products or cancelled the agency office between them, the supplier took decisions that supported the main supplier, even if these decisions were against the buyer's interest, such as increases in prices or delays in delivery. At the same time, a supplier might fear the main supplier affecting the supply chain negatively by lack of commitment, which caused delayed order delivery and increased costs to the buyer (see Fig 5.20).

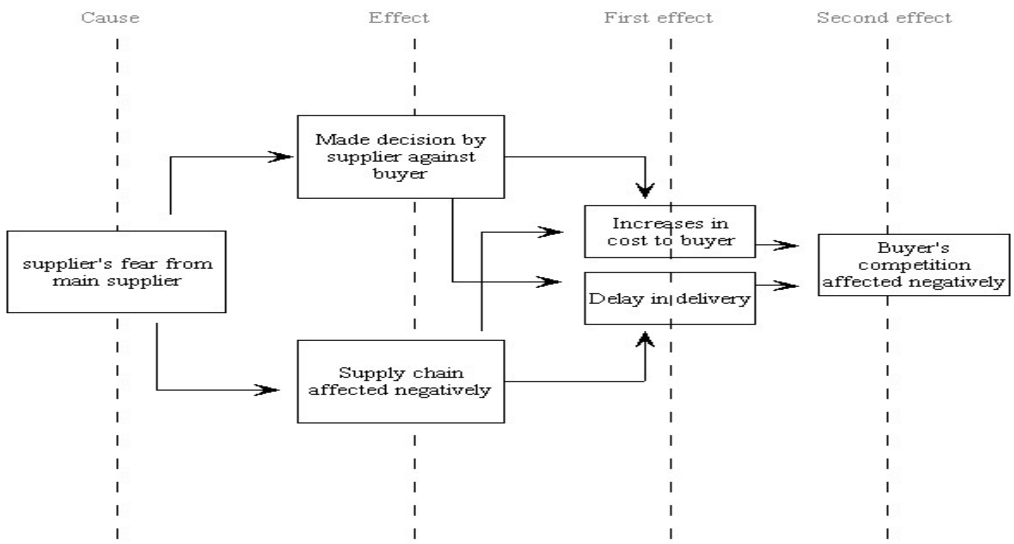


Fig.5.20: Supplier fearing the main supplier causes and effects

### 5.3.3 Problem control

Supplier control in the captive buyer relationship was hard. Although contracts were awarded to a supplier to provide orders to the buyer at certain prices, table 5.16 represents that suppliers did not abide by contracts, and refuse any negotiation by buyers about a service's cost. Suppliers depended on sudden factors in their behavior with buyers not to give the buyer a chance to quit and force buyers to complete contracts as arranged.

Table 5.16 Captive buyer relationship Problem control

<table>
<tr><th colspan="3">Problem control</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>General situations</td><td>26 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>7</td><td>14</td><td>2</td><td>1</td><td>1</td></tr></table></td><td>Suppliers wrote into the contract that prices were not necessarily binding to gain any chance to increase their profits.</td></tr>
<tr><td></td><td>12 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>1</td><td>2</td><td>6</td><td>2</td><td>1</td></tr></table></td><td>It was noticed that suppliers refused any negotiation by buyers about a service's cost increment or a delay in delivery.</td></tr>
<tr><td>Outcome based contract</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>12</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>Buyers used an outcome based contract so they were not concerned about suppliers' work details, which put pressure on the supplier to work on the buyer's behalf in some way.</td></tr>
<tr><td>Creating competition between suppliers</td><td>17 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>10</td><td>3</td><td>1</td></tr></table></td><td>In this relationship, buyers depended on other strong suppliers in the market to control their suppliers by creating competition between them.</td></tr>
<tr><td></td><td>20 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>6</td><td>11</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>Buyers interviewed found that when suppliers felt that a buyer was going to deal with another</td></tr>
</table>

<table>
<tr><td></td><td></td><td>supplier, suppliers tried to satisfy the buyer as much as possible by doing what the buyer asked for immediately, even if they had refused to do so before.</td></tr>
<tr><td>Reputation</td><td>25 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>7</td><td>14</td><td>2</td><td>1</td></tr></table></td><td>The study revealed that suppliers would work for buyers' interests and resolved most complicated problems, especially if suppliers were dealing across the world.</td></tr>
<tr><td>Making work more programmable</td><td>25 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>8</td><td>13</td><td>3</td><td>1</td></tr></table></td><td>Buyers interviewed found that, if they planned their orders, and ordered from suppliers from other countries, buyers saved their production from delays or cost increases, and avoided being let down by their supplier.</td></tr>
</table>

The supplier manner with the buyer was one of "take it or leave it" because the supplier knew about the needs of the buyer for products or the product was demanded in the market because of its special quality provided, and he was the only one who could provide the buyer's order. The supplier usually used a threatening voice with the buyer (see Fig.5.21).

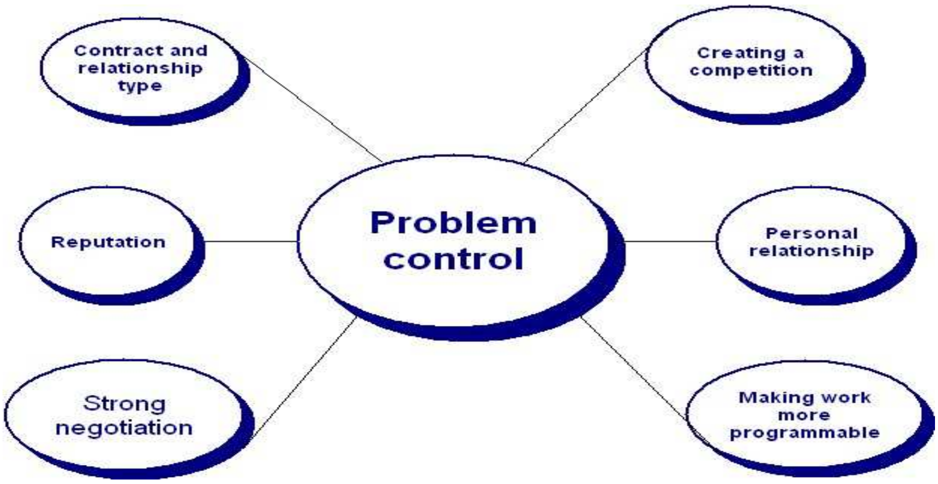


Fig.5.21: Problem control diagram

### 5.3.3.1 By contract and relationship type

Table 5.16 shows that, in the captive buyer relationship, buyers used an outcome based contract, In general, even if the buyer used an exit relationship strategy, it was still not sufficient, especially if there were no other suppliers in the market with whom the buyer could deal, or the buyer's order specifications could only be met by one specific supplier, such as quality of product.

For instance, although one of the buyers in glass industry was suffering with his supplier, he couldn't leave that supplier because the buyer knew that this supplier was the best in the market for quality, even if the supplier did not abide by the cost of orders and time of delivery stated in the contract. The study found, however, that the exit relationship strategy was effective if there was another supplier in the market who could provide the required quality and fulfill the buyer's specifications (see control by creating competition).

It was also found that leaving a supplier in a captive buyer relationship should be done secretly. In other words, before the buyer exited from a relationship with a specific supplier, he should make sure that the next supplier's product had all the specifications that the buyer needed after making many trial orders; then exit gradually. A secret way was needed to allow the new relationship to be built at a distance from the supplier because the buyer had found that if the previous supplier knew about the buyer's intention to deal with a new supplier, that supplier tried to ruin this new relationship. At the same time, it was not easy for the buyer to switch from one supplier to another in a captive buyer relationship. The buyer was not guaranteed to find an available supplier because, in such relationship, suppliers were few and most of them already supplied to other buyers and had no spare capacity. Even if buyers found a new supplier, that supplier would ask for much higher prices because of capacity pressures, so most of buyers preferred to stay with their original suppliers.

#### 5.3.3.2 By creating competition

Table 5.16 represents that buyers use this mechanism to control suppliers. The study revealed that the buyer, who had enough time to change supplier for another forced that supplier to work on the buyer's behalf. For example, four buyers in the petrochemical industry, four buyers in the food industry and two in the transportation industry mentioned that when a supplier was alone in the market, that supplier was asking much higher prices for services or products than was deserved, and did not respond to any of the buyer's inquiries. However, once another supplier entered the market and felt that the buyer was going to deal with the new supplier, the original supplier quickly responded to the buyer's enquiries, tried to be clear with the buyer and decreased the price of products or services.

#### 5.3.3.3 By personal relationship

Personal relationship had a limited effect in controlling the supplier in the captive buyer relationship. However, it was still very helpful to let buyers know about suppliers' situation, such as when and how long a shutdown would last to give the buyer a chance to make decisions that could reduce the negative effects of the problems, such as increasing stock before the supplier's shutdown.

#### 5.3.3.4 By reputation

Table 5.16 reveals that a supplier fearing a bad reputation worked hard on the buyer's behalf. This fear came from suppliers being afraid that a bad reputation might affect their relationship with other buyers. For example, one supplier in the petrochemical industry was not cooperating with the buyer, but because the buyer chairman was a board member in many big companies around the world producing the same goods and the supplier collaborated with the buyer after knowing this; the supplier feared that relationships with other buyers would be affected negatively.

#### 5.3.3.5 By strong negotiation

Expressed strong negotiation by buyers allowed them to drive a hard bargain to force suppliers to work on their behalf. In a captive buyer relationship, expressed strong negotiation by buyers gave suppliers the indication that there was another supplier that could provide buyers' orders in the market, which encouraged suppliers to bend to buyers' requests and work for buyers' interests in the short term to absorb buyers' intention to deal with other suppliers and to take time to measure their strength in the market compared with other suppliers. However, after suppliers had ascertained that there were no other suppliers in the market, or that there were suppliers who had left the market, or that they were the strongest suppliers in the market, they returned to working for their own benefits.

#### 5.3.3.6 By making work more programmable

Table 5.16 shows that because of the difficulty for the buyer to control the supplier in such a relationship in the local market, the buyer tried to deal with other suppliers from other countries, which were less expensive than the local supplier and were committed to provide what the buyer needed on time, giving them enough time through planned orders to avoid dealing with the local supplier.

### 5.3.4 Supplier supporting factors to act opportunistically

There were many factors that supported suppliers acting opportunistically with buyers because of agency policy (see section 2.3.1), the long procedures of commercial arbitration, government decisions and monopoly (see Fig 5.22).

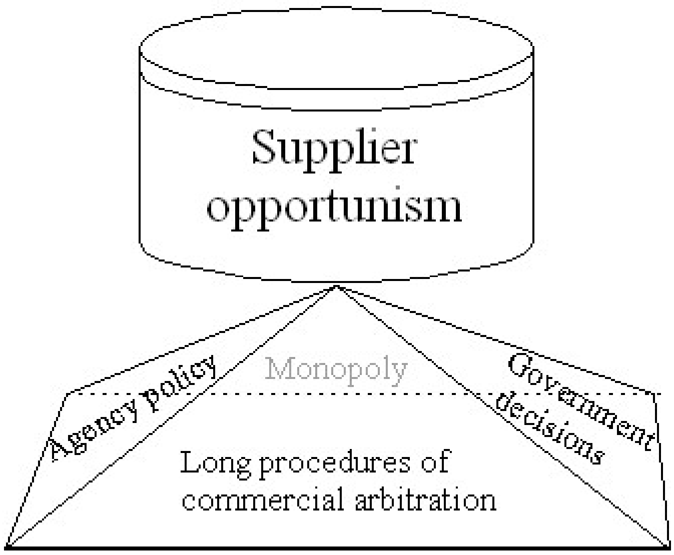


Fig.5.22: Supporting factors of supplier opportunism

### 5.3.4.1 Agency policy

Agency policy did not allow the main supplier to sell products directly to the buyer. The main supplier sold orders via an agency in the buyer's country. Therefore, buyer was forced to deal with the local supplier, even if the supplier's reputation was not good. Table 5.17 represents buyers' behavior to avoid dealing with such suppliers.

Table 5.17 Supplier supporting factors to act opportunistically

<table>
<tr><th colspan="3">Supplier supporting factors to act opportunistically</th></tr>
<tr><th>Feture</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Agency policy</td><td>14 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>5</td><td>2</td><td>1</td><td>1</td></tr></table></td><td>It was noted that buyers interviewed had tried to make a connection with another supplier in another country who dealt with same main supplier, to avoid dealing with local suppliers.</td></tr>
<tr><td></td><td>28 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>7</td><td>15</td><td>2</td><td>1</td><td>1</td></tr></table></td><td>The study revealed that, because buyers did not have enough storage capacity, suppliers took most products or materials from the main supplier continuously and stored them in their large warehouses; the supplier thereby felt in control of the buyer.</td></tr>
<tr><td>The long procedures of commercial arbitration</td><td>10 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>C</td></tr><tr><td>1</td><td>4</td><td>4</td><td>1</td></tr></table></td><td>Because of the long procedures of commercial arbitration, suppliers were not concerned if they acted opportunistically or disregarded clauses of the contract.</td></tr>
</table>

### 5.3.4.2 The long procedures of commercial arbitration

Table 5.17 reveals that the long procedures of commercial arbitration between buyer and supplier put the buyer in a weaker position in this kind of relationship, and encourage suppliers to act opportunistically. When the supplier acted opportunistically, the buyer preferred to clear up problems through cordial solutions, especially if it was not easy for the buyer to get orders from anywhere else; the supplier's product was indispensable to the buyer's production process or else there was not enough time for the buyer to change supplier.

#### 5.3.4.3 Government decisions

When a government makes decisions that support local industries, such as increasing customs allocation, the supplier was supported, in an indirect way, to act opportunistically because the supplier knew that the buyer could not easily import orders from outside because of the increased customs duties, so the buyer was forced by this governmental decision to deal with the local supplier, even if the buyer did not wish to do this. Additionally, the pressure put by the government on buyers by giving them benefits, forced the buyer to deal with the local supplier, who in turn abused this pressure for his own benefit.

#### 5.3.4.4 Monopoly

Monopoly in the local market also supported the supplier acting opportunistically by increasing prices, delaying delivery, withholding information, or imposing a payment method, which might not be appropriate for the buyer, especially if a supplier belonged to the government. The supplier knew there was no other supplier who could provide the buyer's order, so this guaranteed that the buyer would deal with only that supplier in the local market who could then concentrate on competing in the international market for more profit, and needed to cooperate more with international buyers because of competition.

### 5.3.5 Effects on the relationship

#### 5.3.5.1 First effects

##### 5.3.5.1.1 Delivery

The study found that because of delayed orders, buyers faced difficulties in operations, which caused delays in orders to the final customer, which affected buyers' competition negatively. Orders were delayed by suppliers because of a lack of a good supplier production plan, a desire of suppliers to retain their buyers, a shortage in raw materials in the market, cultural differences between buyer and supplier, monopoly and a supplier's fear of the main supplier (see Figs 5.15, 5.16, 5.17, 5.18, 5.19, and 5.20).

##### 5.3.5.1.2 Cost and price

Table 5.18 represents that increased costs and prices to buyers by suppliers increased final costs to buyers' customers, which was not preferable to most buyers to keep their competitive position at a certain level. Cost and price were increased to buyers by the supplier because of lack of a good supplier production plan, a desire of suppliers to retain buyers, a shortage in raw materials in the market, cultural differences between buyer and supplier, monopoly and the supplier's fear of the main supplier (see Figs 5.15, 5.16, 5.17, 5.18, 5.19, and 5.20).

Table 5.18 Captive buyer relationship effects

| Effects | | |
|---|---|---|
| Issue | Relationship | Comment |
| Cost and price | 24 relationships<br>F P T S C | Buyers preferred to cut any increases from their |

<table>
<tr><td></td><td><table><tr><td>5</td><td>14</td><td>3</td><td>1</td><td>1</td></tr></table></td><td>profits than add them to final customer prices. But, when buyers cut these increases from their profit, this would affect their growth in the market and would constitute an obstacle to buyer development. Furthermore, the buyer would lose the loyalty of employees because of reduced employee satisfaction resulting from no increment to their salaries.</td></tr>
<tr><td>Decision making</td><td>19 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>12</td><td>1</td><td>1</td><td>1</td></tr></table></td><td>Buyers were forced to make a new decision or change a previous decision or to make no decision at all.</td></tr>
</table>

#### 5.3.5.1.3 Production

Buyers' production was affected negatively by the supplier. Buyers faced difficulties in producing their goods because of no technical support from suppliers or in not receiving the raw material from their supplier on time because of the differences in payment method between them. Buyers' production was further affected because of cultural differences between buyer and supplier (see Fig 5.18).

### 5.3.5.2 Second effects

#### 5.3.5.2.1 Decision making

Table 5.18 shows that buyers' decisions were affected by lack of a good supplier production plan and a desire of suppliers to retain their buyers (see Figs 5.15 and 5.16).

#### 5.3.5.2.2 Competition

Buyers' competition was affected by delayed orders and increased costs and prices from suppliers to buyers. These effects occurred when buyers increased costs and prices or delayed orders to their final customers, which had not been agreed by final customers. Buyers' customers would look for another supplier (buyer) who could provide what they needed on time and without any increases in price. This movement affected the buyer's competitive position in the market as a result of loss of credibility. In addition, buyers' competitive position was affected by allowing another supplier (buyer) to enter the market, or by giving their competitors a percentage or full share of the market (see Fig.5.23).

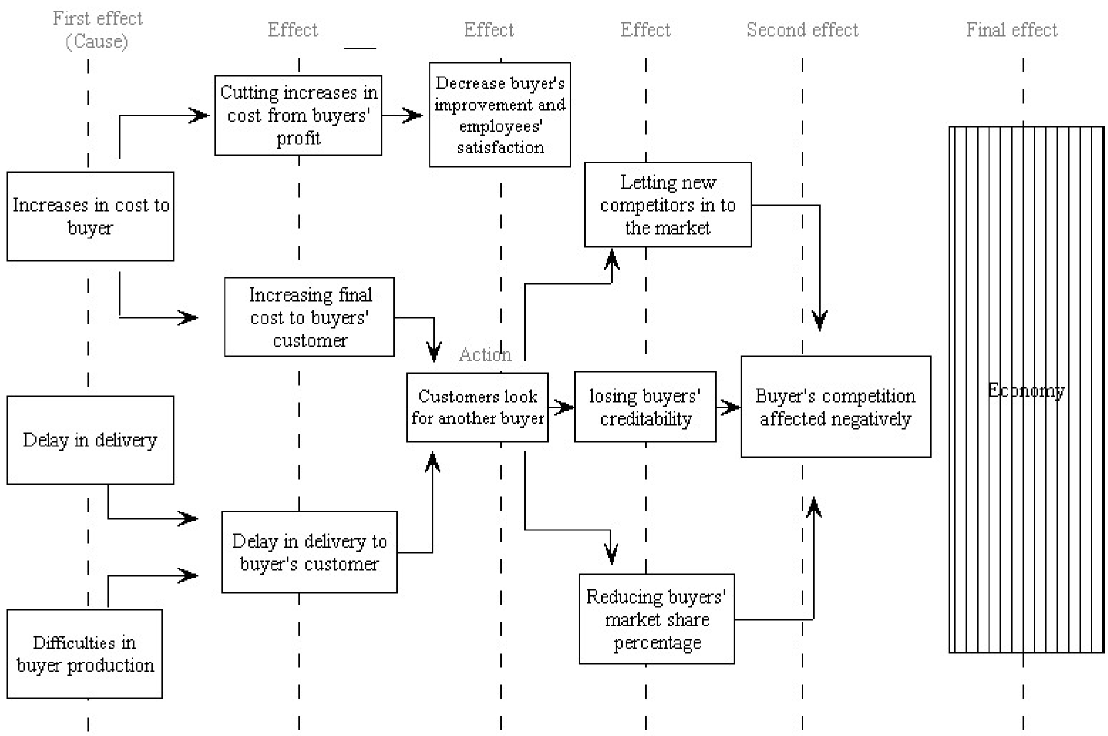


Fig. 5.23: Causes of competitive effects

### 5.3.5.3 Final effects

#### 5.3.5.3.1 The economy

The economy was also affected negatively in the captive buyer relationship. When the buyer tried to avoid dealing with the local supplier because of high prices or delays in delivery, that buyer would look for another external supplier or broker to acquire material at a lower price or on time, which meant a lot of money would be transferred outside the country. Transferring liquidity outside the country affects the growth of economy in the buyer's country. The economy of the buyer's country is affected by not providing openings for new companies or factories or expanding those which already exist, which in turn stifles new job opportunities, thereby increasing unemployment, which is a big problem (see fig 5.23).

## 5.4 Strategic partnership

Data was collected from companies in the Kingdom of Saudi Arabia. Data analysis revealed that strategic partnership (Bensaou, 1999) is built between buyers and suppliers depending on achieving their mutual interests and the dependence of each party upon the other, which guarantees the power of competition and staying in the market for both parties. It is the same as any kind of relationship; strategic partnership is exposed to problems and tensions which are caused by buyers or suppliers. 22 strategic relationships were studied (see table 5.1). Sometimes buyers overlooked a supplier's behavior if it did not affect the achievement of their goals, and they felt it beneficial to be with that supplier. For example, buyers might accept an increased price from suppliers if it is acceptable and there were explicable reasons for this increment. All issues between buyers and suppliers should be clear and understandable because, if not, misunderstandings might break a relationship.

The study found that the Communications industry has the highest in strategic partnership proportion in services sector (see table 5.2). It was found that the communications industry proportion in strategic partnership is 50%, as in market exchange relationship is 37.5%, in captive buyer relationship is 6.25% and in captive supplier relationship is 6.25%.

The study showed that each party in such a relationship put all capabilities to serve the other party to achieve respective goals, but at the same time, table 5.19 shows that buyers did not like to deal with one supplier alone. Moreover, buyers might exit from a strategic relationship, whatever its strengths, if they felt any opportunism from the supplier side, but at the same time, they were keen on the continuation of the relationship even if there had been some conflicts that did not affect their main interests. Most of problems and tensions between buyers and suppliers were solved by either coexistence with them or finding solutions, which did not harm the main interests of either party.

Table 5.19 General information in strategic relationship

<table>
<tr><th colspan="2">General information</th></tr>
<tr><th>Relationship</th><th>Comment</th></tr>
<tr><td>16 relationships<br><table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>7</td><td>1</td><td>5</td></tr></table></td><td>Buyers worked on the principle of “don’t put all eggs in one basket”, which is why they did not like to deal with one supplier alone to avoid any shortage in case of an emergency circumstance, and pushed suppliers to work hard for their interests.</td></tr>
</table>

### 5.4.1 Strategic relationship incentives

The study showed that strategic partnership creation was affected by many incentives, such as supplier geographical location, personal relationship and common growth and understanding, which were built on along the relationship period (see Fig.5.24).

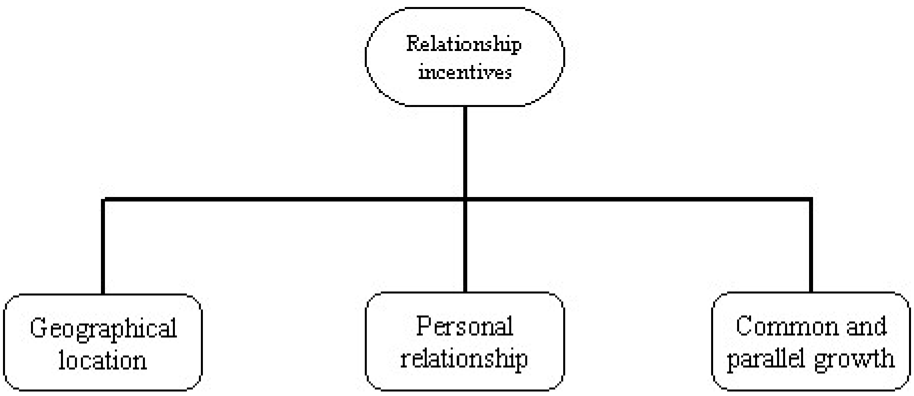


Fig.5.24: Strategic relationship incentives

#### 5.4.1.1 Geographical location

Geographical location was one of the important factors that encouraged buyers to create a strategic partnership with suppliers who were close to them or who were in the same area, even if there were other suppliers who might supply the same products at a cheaper price, to guarantee that they received what they wanted easily or sometimes to support local products.

#### 5.4.1.2 Personal relationship

Personal relationship was a significant factor inducing a strategic relationship to be created between buyers and suppliers. The presence of a friendship or a family relationship might give rise to a level of understanding and positive discussion between them on the basis of achieving their interests. Personal relationship eased the communication between buyers and suppliers, developed confidence between them and resolved any administrative or technical obstacles, or even personal problems that might occur between workers to harm the relationship.

#### 5.4.1.3 Common and parallel growth

Common and parallel growth for both buyers and suppliers, in a lot of companies that were visited, created strong strategic partnership. The relationship, which had been built upon a historical background, produced an implicit union between them that depended on common interests and the service produced by each party to the other, even if there were strong competitors in the market. In general, it could easily be seen that strategic partnership created a good working atmosphere between buyers and suppliers, one marked by clarity, frankness, understanding and open dialogue.

### 5.4.2 Causes and problems

Strategic relationship was exposed to adverse selection and moral hazard problems from different causes, but to a lesser degree compared with other kinds of relationship. Problems could be caused by the buyer, supplier, buyer and supplier, or an external reason, and suppliers acted opportunistically, gaining benefit in all cases, although they might not be at the root of the cause (see table 5.20).

Table 5.20: Strategic partnership problem causes' table.

| | | Causes | Responsible | First effects | Second effects |
|---|---|---|---|---|---|
| Problems | Advers selection | No or a poor buyer's future plan<br>Discouraging the feasibility study to the supplier<br>Commitment to other buyers<br>Lack of raw material | Buyer | Delay in delivery | Buyer's competion affected<br>Forcing buyer to take a new decision, change old decision, or not take any decision |
| | | Delay in supplier's compensation<br>Difficulties in production and to cover operation cost | Buyer | Delay in delivery<br>Increasing cost to buyer | |
| | | Using short term contract<br>Supplier feeling insecure | Buyer | Increasing cost to buyer | |
| | Moral hazards | Misunderstanding buyer<br>Assuming incorrect assumption | Supplier | Forcing buyer to take a new decision, change old decision, or not take any decision | |
| | | Bad security conditions in buyer or supplier countries<br>Difficulties to deliver orders<br>Delivery and insurance cost<br>Increased<br>Difficulties in supplier movement | External | Delay in delivery<br>Increasing cost to buyer<br>Delay in solving problems | Buyer's competion affected<br>Forcing buyer to take a new decision, change old decision, or not take any decision |
| | | Differences in work style between buyer and supplier<br>Buyer suffering from work style differences | Both | Increasing cost to buyer | |
| | | Not improving in supplier's employees skills<br>Buyer suffering from work style differences | Suppler | | |

In general, suppliers exercised all their abilities to do the work for which they were being paid. For example, six purchasing managers, three in the petrochemical industry, two in the communication industry and one in the food industry mentioned that such suppliers responded quickly to buyers' requests by using all their capabilities and information to achieve buyers' goals, such as providing and sending all urgent requests by fast shipping instead of normal cargo, bearing the burden and storage costs of buyers' orders, supplying to the buyer on an unexpected date and time and supplying all buyers' orders as required, even if buyers had upgraded their specifications after ordering the goods and the orders proving more expensive than what had been originally agreed.

Additionally, suppliers' behavior was always clear to buyers, allowing buyers to verify that whatever they did was on their behalf. They avoided suspicious behavior, and they always coordinated with buyers concerning all measures and decisions about work, and they answered all buyers' questions and responded to all buyers' inquiries. For example, all information was regularly exchanged by telephone, mail, fax or meeting. For instance, before suppliers started shutdown activities, they informed their buyers when the shutdown would start, how long it would take, and if this shutdown was due to normal maintenance or was an emergency case, and passed all information about it to buyers. They kept buyers well-informed about all of these events so that buyers could prepare themselves for any emergency that might arise. Moreover, suppliers put all their efforts into achieving buyers' goals, and all their actions determined outcomes by abiding by a policy of clarity and transparency. They bore all their responsibilities to buyers, and they did not shirk their responsibilities because of self- interest. For example, suppliers abided by agreements and continued to supply products to exact specifications, times and dates or according to buyers' requests, even after knowing that buyers might leave them or they were at the end of the contract.

Furthermore, suppliers took the same action as buyers towards risk. In other words, suppliers shared risk with buyers, For instance, suppliers bore the delaying of their compensation when buyers experienced difficulties in their work, and sometimes external suppliers gave buyers more discount for products when currency exchange rates increased between the buyer's and supplier's country to assist buyers to avoid any increases in final product cost to their customer. Additionally, suppliers gave buyers priority for their urgent orders to support their position in the market and in the face of their customer, paying for fast shipping to ensure buyers received their orders at the exact time. Additionally, suppliers had their employees and technicians work on weekends and holidays on buyers' behalf, or sent their employees to work with buyers' employees and technicians for the same purpose, or suppliers bore all the costs and efforts of any changes that might occur after production.

#### 5.4.2.1 Adverse selection

It was noticed that, if there was no or a poor future order plan from the buyer, the supplier's production would be confused, causing delays in submitting orders to the buyer. This delay was caused by the supplier's commitment to produce orders for other buyers, which meant suppliers delaying a non-prioritized buyer's orders. A lack of raw materials for the supplier's needs might delay orders to the buyer, or discourage a feasibility study for the supplier, especially when it was not beneficial for suppliers to stop mass producing specific products and change all machine settings and adjustments because of the buyer's requirements for another product. Hence, they delayed delivery until they had used up mass production products or accumulated all orders for this product so that it was beneficial for them to produce it. But, at the same time, suppliers did their best to supply buyers' orders to the best of their ability to support the buyer. Table 5.21 represents that this factor, no or a poor future order plan from the buyer, was one of the most important factors affecting the buyer and supplier relationship adversely. (See: Fig.5.25).

Table 5.21: Market exchange relationship causes and problems

<table>
<tr><th colspan="3">Causes and problems</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Adverse selection problem<br>Order planning</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>9</td><td>1</td><td>8</td></tr></table></td><td>Buyers found that getting their orders depended on their good order planning. found the importance of their good order planning to get orders on time.</td></tr>
<tr><td></td><td>16 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>9</td><td>1</td><td>3</td></tr></table></td><td>Buyers researched were trying to develop their order planning by creating a production planning section or a processing planning section</td></tr>
<tr><td>Long term contracts</td><td>18 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>7</td><td>1</td><td>7</td></tr></table></td><td>Buyers liked to put suppliers under pressure by using short term contracts</td></tr>
<tr><td></td><td>10 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>5</td><td>1</td><td>2</td></tr></table></td><td>Suppliers tried to get most benefit for themselves in the shortest time by misusing circumstances.</td></tr>
<tr><td></td><td>17 relationships<table><tr><td>G</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>8</td><td>1</td><td>7</td></tr></table></td><td>Buyers now felt that giving long term contracts to suppliers would give suppliers the security to encourage them to work for the buyer’s benefit.</td></tr>
<tr><td></td><td>13 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>6</td><td>1</td><td>4</td></tr></table></td><td>Buyers researched were thinking about changing to long term instead of short term contract.</td></tr>
<tr><td>Moral hazard problem</td><td>11 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>2</td><td>5</td><td>1</td><td>3</td></tr></table></td><td>Suppliers felt that they did not have to take any action against certain problems because they felt it would not affect either the buyer’s or supplier’s main goals</td></tr>
</table>

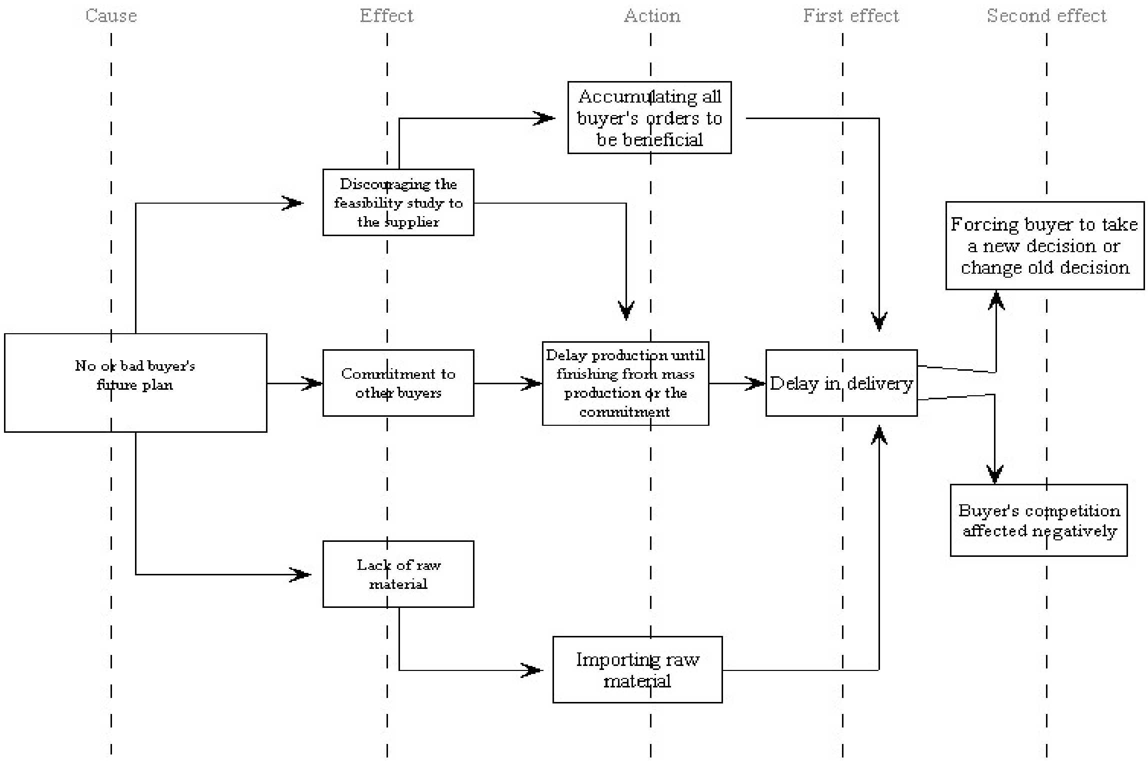


Fig.5.25: No or poor future order plan causes and effects.

In some cases, if compensation was not fair for the suppliers or they did not receive it regularly, they would try to misuse all circumstances to their own good, such as increasing service costs or cost of raw material or labor because of shortage in availability. For example, two buyers in the petrochemical industry and one buyer in the food industry mentioned that if suppliers found that a raw material price had increased by five percent, they would ask buyers for eight percent. Or, even if there was a shortage in a certain material or labor availability, they would ask for an increment. This factor allowed suppliers to face difficulties to complete and cover their production operations costs, which meant that buyer orders were delayed; suppliers could not provide what the buyer wanted with these kinds of difficulties. Buyers felt that suppliers should not be upset when facing such difficulties, because suppliers were sure they would receive their compensation, even if it was delayed (see Fig.5.26).

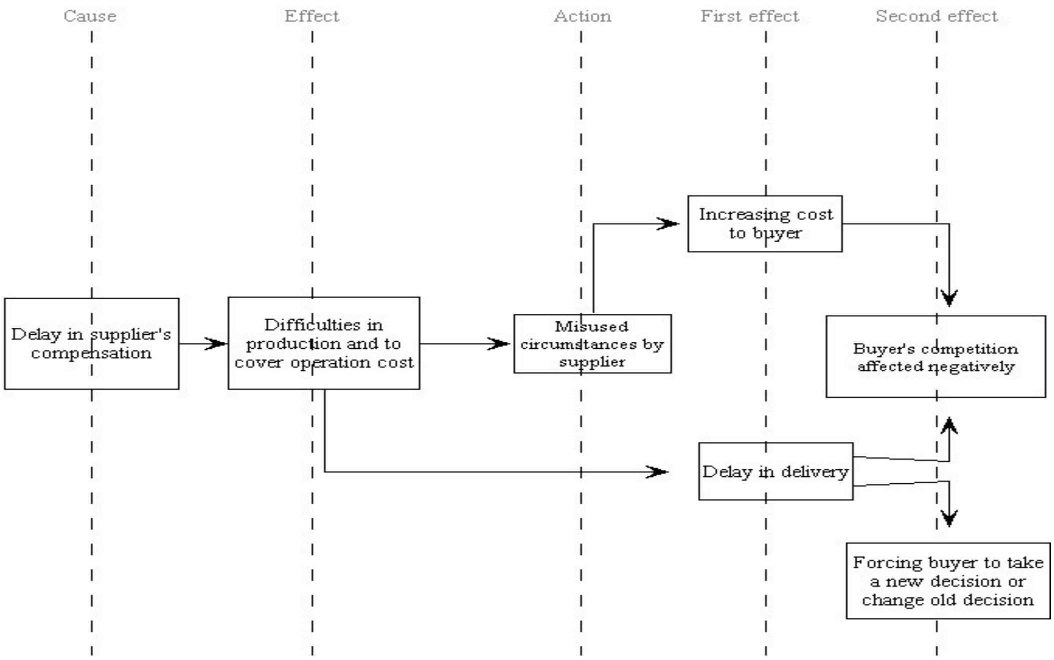


Fig.5.26: Delay in supplier's compensation causes and effects

Moreover, suppliers preferred to have long term contracts to be more secure. At the same time, table 5.21 shows that buyers liked to use short term contracts, so these differing priorities caused a problem, and that was why some suppliers were pushed to think in their interest more than in the buyer's interest. For example, suppliers gave other new buyers priority for their orders if these buyers were willing to pay more, and tried to increase their service costs if they felt that their products were in demand (see Fig. 5.27).

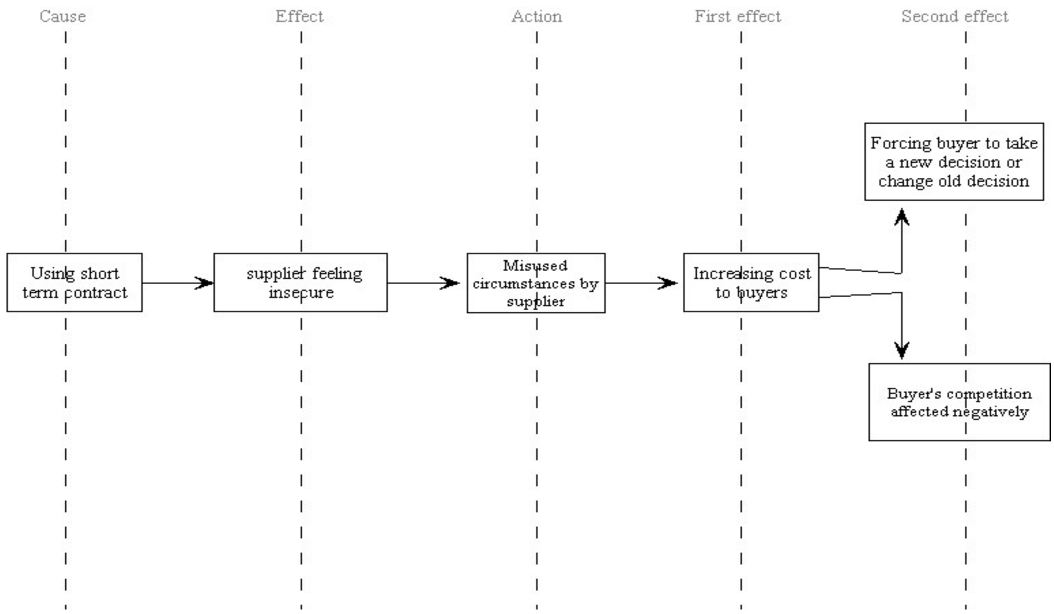


Fig.5.27: Using short term contract causes and effects

Table 5.21 indicates that buyers changed their preference about contract terms. All the above reasons show that there was an asymmetric information problem between buyer and supplier, and this was why suppliers chose to delay orders or increase their service costs according to information that they had which buyers did not.

**5.4.2.2 Moral hazard**

Table 5.21 reveals suppliers' manner against certain problems when they felt it would not affect either the buyer's or supplier's main goals. For example, buyers' purchasing departments interviewed, two in the communications industry and one in the glass industry, mentioned that suppliers might not make changes to certain administrative procedures and they thereby did not encourage their employees to develop their performance or improve work performance by providing incentives to suit buyers' requirements, nor did they assist them by giving them training. At the same time, buyers suffered from this style of work because the supplier's did not match the buyer's system, and buyers felt they were affected negatively by having to exert so much effort, or by hiring new employees or by buying a new system, to make the necessary changes in order to match the system, which caused increasing costs to the buyer. Alternatively, a decision might have to be made to change their work style to suit what the supplier did, such as delivery processes and billing forms and techniques, which had not been originally discovered, especially if buyers and suppliers were not in the same country.

Suppliers were convinced and satisfied as long as their work was regular and moved along in the way they wanted it to. Suppliers in these situations were stuck with old systems, which they could not replace or update; they feared any change to a new system that did not match their abilities or the skills of their employees, and might cause confusion in their work performance, so they considered that they did not need to make any changes just because of differences in viewpoints of a problem between themselves and the buyer (see Fig 5.28).

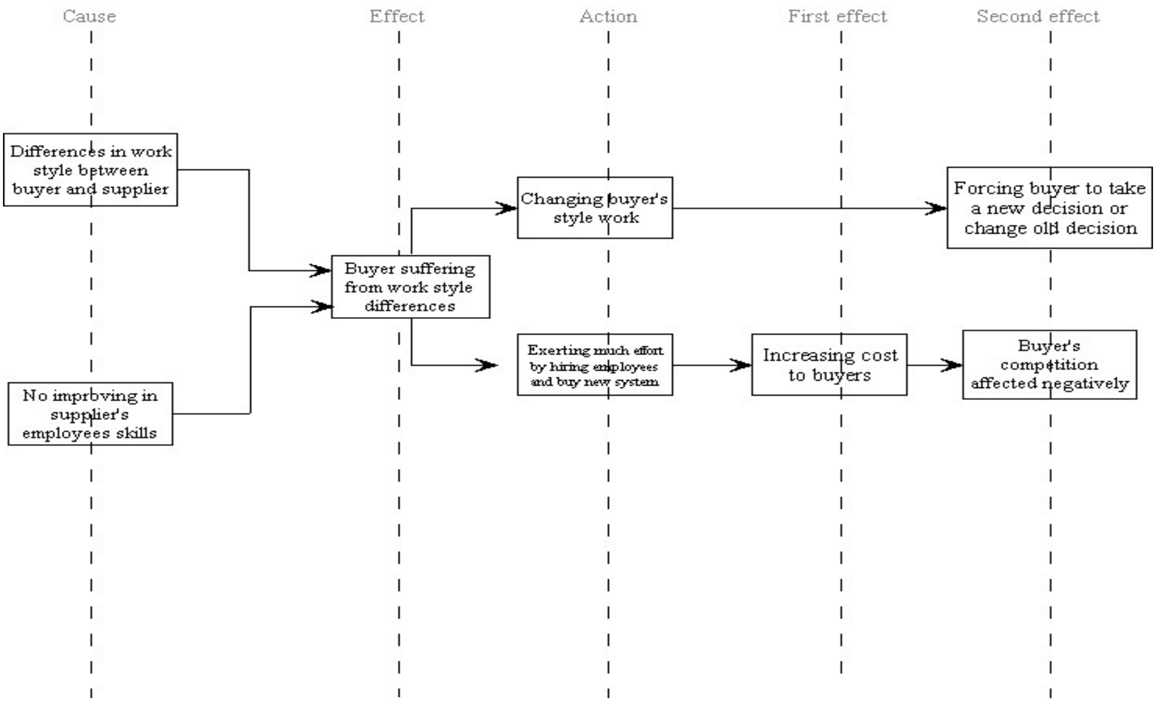


Fig.5.28: Differences in work style and not improving the supplier's employee skills causes and effects

In some situations, suppliers misunderstood buyers. This happened when suppliers felt that buyers could not leave them, and they were totally dependent on their loyalty towards them, which was an incorrect assumption. Suppliers in this situation thought buyers would agree to any request, but they did not, so the relationship between them became tense, which caused a new decision to be made or an old one to be changed. For example, three buyers in the petrochemical industry and one in the food industry mentioned that suppliers thought buyers should accept any increase in their compensation, whenever and however they wanted it because of their efforts, which was not right and caused the buyer to reconsider the relationship with the supplier. Buyers accepted increases only if they were justified and there were reasons for them, such as an increase in shipping, labor or raw material costs (see Fig 5.29).

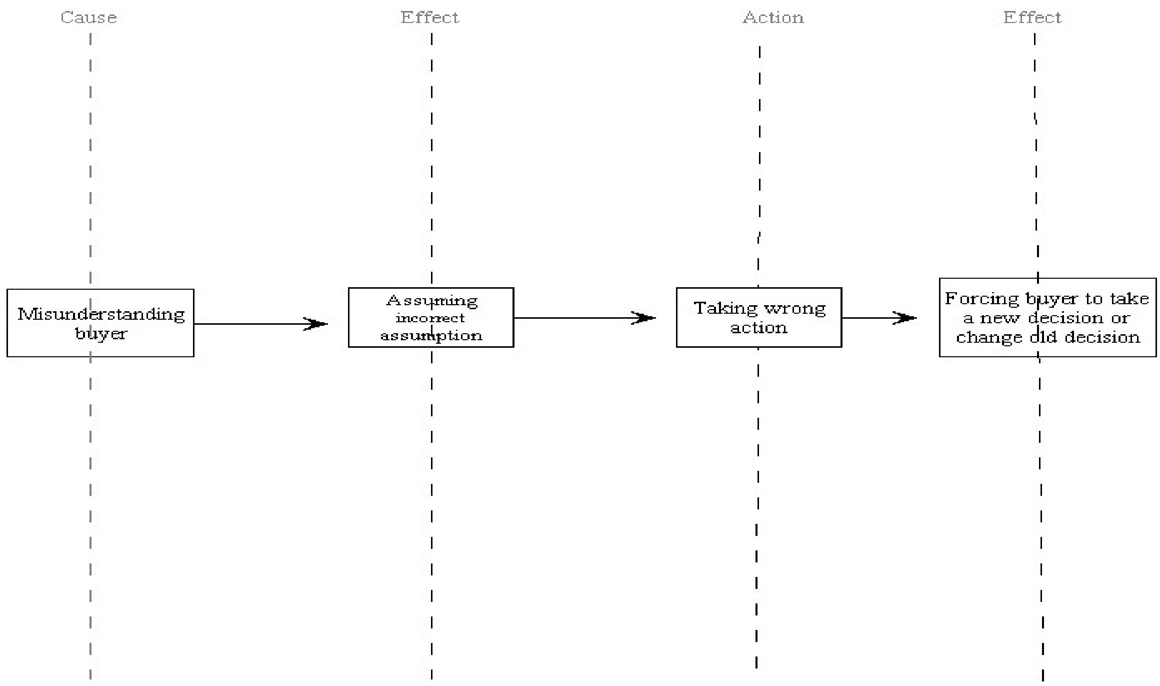


Fig.5.29: Misunderstanding buyer causes and effects

Poor security conditions in the buyer or supplier countries, if they were from different countries, could cause difficulties to deliver orders, difficulties in a supplier's movement, or increases in delivery and insurance costs. Because of insufficient security, either in the buyer's or supplier's country, buyers might not receive their orders on time, such as happened during the first and second Gulf War, which led to buyers having to decide to extend their storage to increase their stock percentage. Difficulties in a supplier's movements meant problems were not solved or a solution was delayed because suppliers were not able to go to the buyer's country to deal personally with their needs and requests to solve problems or support them, especially if they were from western countries, given what is happening now because of terrorism, which forced buyers to reconsider communication channels with suppliers, and seek ways to keep themselves connected with suppliers at all times. Delivery and insurance costs increased costs to buyers. All the above reasons showed that the supplier took different actions toward risk from the buyer and shirked responsibility because of self interest (see Fig. 5.30).

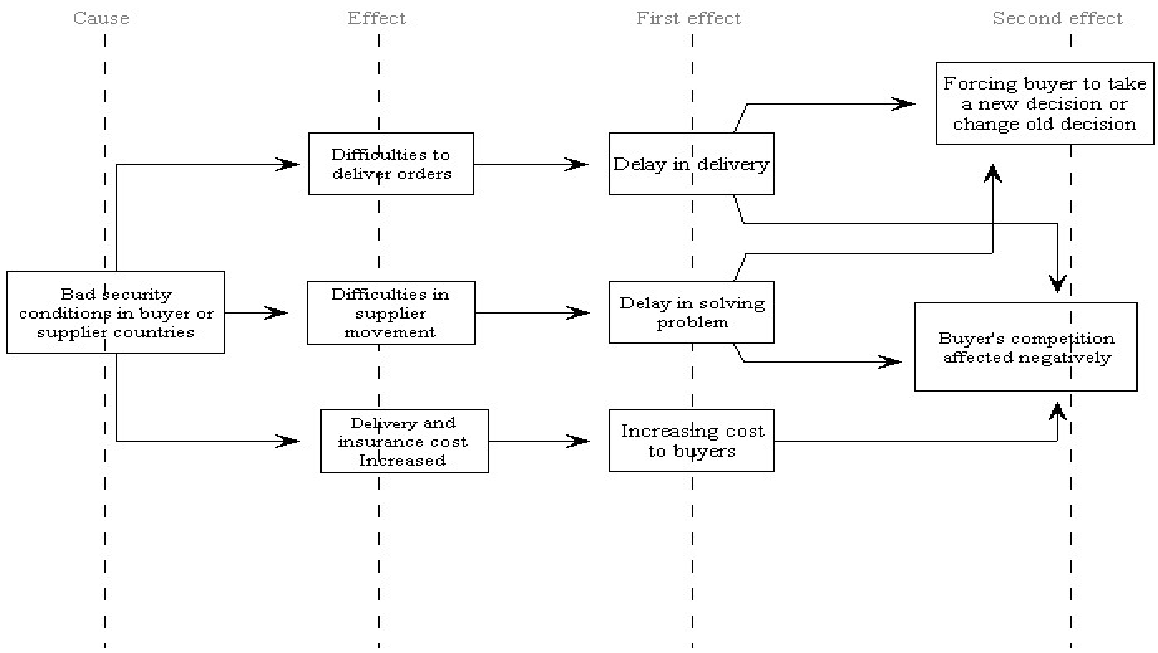


Fig.5.30: Poor security conditions causes and effects

From the above it was clear that, even if there were problems and obstacles between buyers and suppliers in their relationship, it was still considered a strong relationship because each party tried to satisfy the other party by doing what they ask and solve problems through dialogue and discussion, trying to resolve and control any problems through regular meetings and reviewing all procedures to suit each party.

### 5.4.3 Problem control

The study revealed that buyers applied different approaches to compel suppliers to work for their benefit and to keep the relationship flowing smoothly without tensions (see Fig.5.31).

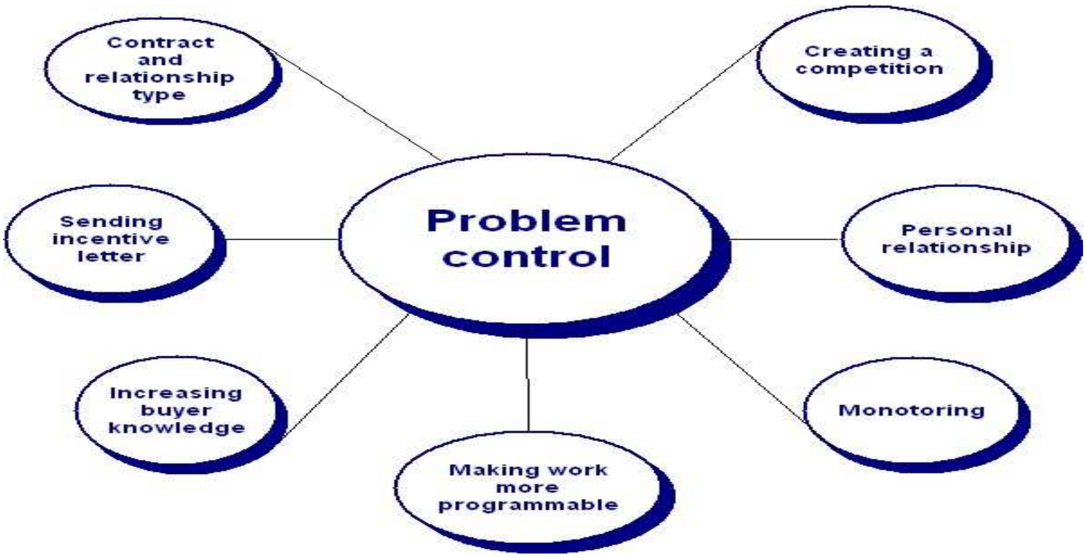


Fig. 5.31: Problem control diagram

#### 5.4.3.1 By type of contract and relationship

Table 5.22 shows that buyers used a behavior based contract. This approach represented buyers using a voice relationship to handle any problems that might arise. However, they still noted that the exit type of relationship could be used as a final solution if they noticed that the problem would not be solved or be delayed to force the supplier to act.

Table 5.22 Strategic relationship problem control

<table>
<tr><th colspan="3">Problem control</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Using a behavior based contract</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>9</td><td>1</td><td>7</td></tr></table></td><td>Buyers used a behavior based contract because they liked to share all work details with suppliers and to diagnose any problems that might occur and solve them early on before they became serious, and to put in place a mechanism that prevented them appearing again.</td></tr>
<tr><td></td><td>11 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>5</td><td>1</td><td>3</td></tr></table></td><td>Buyers preferred dealing with at least one other supplier, even if this supplier asked for a higher compensation.</td></tr>
<tr><td>Building personal relationships</td><td>18 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>7</td><td>1</td><td>8</td></tr></table></td><td>Buyers built strong personal relationships with the supplier’s decision making management to use it for resolving any problems that might need a long time to be resolved in the usual way.</td></tr>
<tr><td>Monitoring</td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>8</td><td>1</td><td>8</td></tr></table></td><td>Buyers controlled suppliers by monitoring, holding monthly meetings and mutual visits between them.</td></tr>
<tr><td>Making work more programmable</td><td>17 relationships<table><tr><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>8</td><td>1</td><td>7</td></tr></table></td><td>Buyers made all their processes and procedures more planned and organized to ease supplier control and follow up, and to avoid any confusion that might arise for suppliers from unexpected orders.</td></tr>
<tr><td>Incentive</td><td>15 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>1</td><td>7</td><td>1</td><td>5</td></tr></table></td><td>Buyers controlled suppliers in such a relationship by sending them incentive letters to improve and develop their work performance, and helping them to do so by</td></tr>
</table>

| | | |
|---|---|---|
| | | sending people from the buyers' side. |

#### 5.4.3.2 By creating competition

Table 5.22 shows that buyers preferred dealing with at least one other supplier. Buyers put their main supplier in competition with other suppliers, but buyers tried to manage the work distribution between both of them.

#### 5.4.3.3 By personal relationship

Table 5.22 reveals that buyers use this mechanism to control suppliers' behavior. This kind of relationship surpassed all bureaucratic mechanisms and personal problems between employees, and eased the solving of all problems and obstacles.

#### 5.4.3.4 By monitoring

Table 5.22 shows that buyers also controlled suppliers by monitoring. They held monthly meetings and mutual visits between them to be aware early on of any problems from the beginning and try to solve them, or to make sure all procedures and decisions were made on their behalf. This kind of meeting increased the awareness of buyers about suppliers and permitted them to prepare well in advance for any emergency.

#### 5.4.3.5 By making work more programmable

Additionally, table 5.22 represents that buyers use this mechanism to control and follow up suppliers. The study found that the more buyers were well planned and organized in their work, the more controlled were suppliers and worked on the buyers' behalf.

#### 5.4.3.6 By increasing buyer knowledge

Buyers' market knowledge was one of the factors that could prevent suppliers from engaging in any behavior that achieved their self-interest only, and forced them to work on buyers' behalf. As one of the buyers said, "suppliers think twice before they carry out any opportunistic action if they know buyers are aware of what is going on in the market".

#### 5.4.3.7 By incentive

Finally, table 5.22 shows that buyers controlled suppliers in such a relationship by incentive. Buyers also informed suppliers that, if they did not carry out this kind of improvement, both parties' position in the market could be affected negatively. Further, by making the supplier's compensation a function of his outcome, in as much as the outcome was in the interest of the buyer, supplier compensation was therefore better.

### 5.4.4 Effects on the relationship

#### 5.4.4.1 First effects

##### 5.4.4.1.1 Delivery

Buyers delayed delivery to their customers, especially when the supplier delayed orders to the buyer because of no or a poor buyer's future order plan to the supplier, a delay in the supplier's compensation from the buyer, and poor security conditions in the buyer's or supplier's countries (see Figs 5.25, 5.26 and 5.30).

##### 5.4.4.1.2 Cost and price

Buyer operational cost was affected by many factors: delay in the supplier's compensation, no improvement in the supplier's employee skills, using a short term contract and poor security conditions in buyer or supplier countries. These factors increased buyer operational costs (see Figs 5.26, 5.27, 5.28 and 5.30).

#### 5.4.4.1.3 Problem solution

Poor security conditions in buyer or supplier countries affected how quickly problem solving decisions were made, which usually delayed the decision. Delay in problem solving decisions affected the buyer's decisions and competitiveness in the market (see Fig 5.30).

### 5.4.4.2 Second effects

#### 5.4.4.2.1 Decision making

Buyers' decision making was affected by no or a poor future order plan from the buyer, delay in compensation, using a short term contract, differences in work style between buyer and supplier, misunderstanding the buyer and poor security conditions in the buyer or supplier countries. These reasons could force the buyer either to make decisions suddenly that changed their future plans or change decisions in the recent plan without advance preparation (see Figs 5.25, 5.26, 5.27, 5.28, 5.29 and 5.30).

#### 5.4.4.2.2 Competition

Competition was affected negatively by the effects of delaying delivery and increasing costs, as discussed. Delaying delivery to the buyer caused a delay in delivery of products to the final customer. This meant that the final customer would look for someone else who could provide the same product on time to replace the previous provider. Hence, the buyer's market position was affected either by reducing their market share percentage or letting new competitors come into the market. The same thing happened with increasing costs to buyers; this increase was either added to the final product, which was undesirable for the final customer, entailing that customer looking for other suppliers who could provide the same product at a lower price, or this increase was deducted from the buyer's profit. Table 5.23 shows that buyers preferred not adding the increment to the final product price. Competition was also affected when buyers gave another supplier the major percentage of work to put the main supplier under pressure and to force that supplier to work on their behalf. This would cause the buyer's competition to be affected negatively because they lost some advantages (with the old supplier), which were benefits for them, such as quick response, saving a lot of time and effort in communication and mutual understanding. Buyers consumed a lot of time in monitoring and following up a new supplier, therefore they lost their concentration for necessary improvements in their work and they paid for it, which increased their costs, whereby competitors had the chance to be superior to them (see Fig 5.32).

Table 5.23 Strategic relationship effects

<table>
<tr><th colspan="3">Effects</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Cost and price</td><td>19 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>C</td></tr><tr><td>1</td><td>2</td><td>7</td><td>1</td><td>8</td></tr></table></td><td>Buyers preferred to cut the increased costs from their profit rather than adding it to the final product price.</td></tr>
</table>

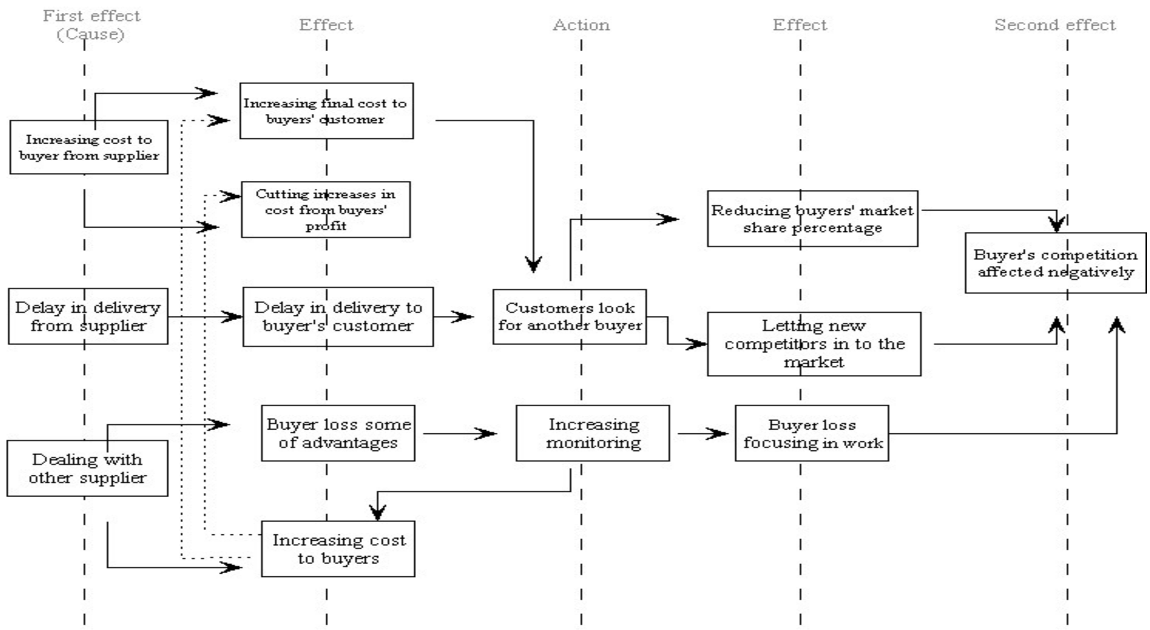


Fig. 5.32: Effective causes of competition

## 5.5 Captive supplier relationship

The captive supplier (Bensaou, 1999) relationship is the fourth relationship which can be created between buyer and supplier. 44 captive supplier relationships were studied from 160 relationships (see table 5.1).

According to table 5.2, the researcher found that the petrochemical industry has the highest proportion in captive supplier relationship in manufacturing sector. It was found that the petrochemical industry proportion in captive supplier relationship is 33.8%, as in market exchange relationship is 29.4%, in captive buyer relationship is 22% and in strategic partnership is 14.7%. In addition, the study found that the Stationery industry has the highest proportion in captive supplier relationship in services sector. It was found that the stationery industry proportion in captive supplier relationship is 58.3%, as in market exchange relationship is 37.5%, in captive buyer relationship is 4.1% and in strategic partnership is 0%.

### 5.5.1 Captive supplier relationship incentives

There were two main incentives to create the captive supplier relationship. They were aggressive competition between suppliers and buyer strength in the market (see Fig 5.33).

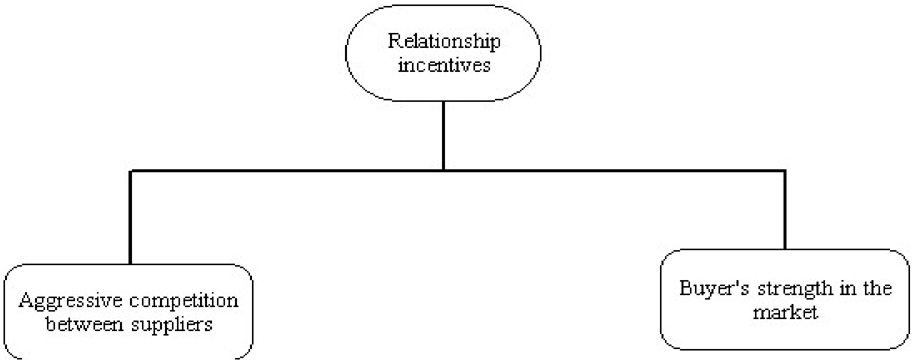


Fig.5.33: Captive supplier relationship incentives

#### 5.5.1.1 Aggressive competition between suppliers

Table 5.24 shows that high quality products with cheaper prices is important factor for buyers. Because of the products, high technology and a continuous need for improvement and development, and because there was strong competition between suppliers, the supplier worked on the buyer's behalf. In the captive supplier relationship, suppliers always reviewed their prices to be more attractive to buyers, and they gave encouraging discounts from time to time to retain buyers. Although there were many suppliers in the market, a buyer sometimes preferred to deal with specific suppliers because of extra services, which were provided along with the order, such as availability for the buyer to store orders in the supplier's storage facility. Additionally, in the captive supplier relationship, buyers created competition between suppliers by dealing with more than one supplier to provide the same order at the same time by giving each one a percentage of the order to force suppliers to work in their interests and to ensure continuity of order provision if any supplier faced problems. However, sometimes it was not easy for the buyer to find other suppliers who could provide the same order because certain orders needed a particularly high level of technology in their production and that technology was not available for all suppliers. The study found that sometimes buyers overlooked some supplier malpractice, such as delay in delivery, because of the other benefits obtained from dealing with a particular supplier.

Table 5.24 Relationship incentives of captive supplier relationship

<table>
<tr><th colspan="3">Relationship incentives</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Aggressive competition between suppliers</td><td>38 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>3</td><td>20</td><td>1</td><td>12</td><td>1</td></tr></table></td><td>Buyers asked suppliers to provide high quality at cheaper prices to continue dealing with suppliers.</td></tr>
<tr><td>The buyer’s strength in the market</td><td>35 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>2</td><td>17</td><td>1</td><td>13</td><td>1</td></tr></table></td><td>The study revealed that when the buyer was strong and had a known franchise in the market, most suppliers worked to be on that buyer’s supplier list. Suppliers wanted to gain an advantage from working with such a buyer by joining their name with the buyer’s name to achieve a strong marketing position.</td></tr>
<tr><td></td><td>40 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>20</td><td>1</td><td>13</td><td>1</td></tr></table></td><td>Buyers gave the supplier’s reputation and position in the market a great deal of attention before they chose to deal with that supplier</td></tr>
</table>

### 5.5.1.2 The buyer's strength in the market

Table 5.24 represents that suppliers wanted to gain an advantage from working with strong buyers. Table 5.24 shows also that supplier's reputation and position in the market are very important for buyers to deal with that supplier.

### 5.5.2 Causes and problems

Captive supplier relationship was exposed to adverse selection and moral hazard problems from different causes (see table 5.25).

Table 5.26 reveals several general points in this relationship about sharing problems preferences.

Table 5.25: Captive supplier relationship problem causes' table

<table>
<tr><td rowspan="5">Problems</td><td></td><td>Causes</td><td>Responsible</td><td>First effects</td><td>Second effects</td></tr>
<tr><td rowspan="2">Adverse selection</td><td>Using Short term contract<br>Supplier in secure feeling</td><td>Buyer</td><td>Delay in delivery<br>Quality</td><td rowspan="2">Buyer's competition affected negatively</td></tr>
<tr><td>Frequently changes in supplier's management<br>Reduction in communication and amount of shared information<br>Delay in production because of differences in view of supplier work</td><td>Supplier</td><td>Delay in delivery</td></tr>
<tr><td rowspan="2">Moral hazards</td><td>No or bad buyer's future plan<br>Confusing supplier's plan<br>Missused circumstances by supplier because of buyer rush</td><td>Buyer</td><td>Delay in delivery<br>Increasing cost to buyer</td><td rowspan="2">Forcing buyer to take a new decision, change old decision, or not take decision</td></tr>
<tr><td>Bad supplier's management<br>Supplier's growing getting out of proportion to the buyer's growing<br>Weakness in internal montoring<br>No suppliers' order plan</td><td>Supplier</td><td>Delay in delivery<br>Quality</td></tr>
</table>

Table 5.26 Captive supplier relationship causes and problems

<table>
<tr><th colspan="3">Causes and problems</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>General points</td><td>38 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>1</td><td>22</td><td>1</td><td>12</td><td>1</td></tr></table></td><td>Suppliers did not share problems which they faced and solutions which were applied.</td></tr>
<tr><td></td><td>42 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>23</td><td>1</td><td>12</td><td>1</td></tr></table></td><td>Buyers preferred that their supplier share problems and solutions with them because they might be able to assist the supplier to find better solutions.</td></tr>
<tr><td></td><td>33 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>2</td><td>3</td><td>17</td><td>1</td><td>10</td></tr></table></td><td>Buyers knew about the supplier’s problems, they still continued dealing with those suppliers; because they were convinced that to keep dealing with old suppliers with known defects was better than dealing with new ones with unknown defects.</td></tr>
<tr><td></td><td>18 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>1</td><td>8</td><td>1</td><td>5</td><td>1</td></tr></table></td><td>The study found that, even if the supplier had built a good history along the relationship, 18 of them tried to hide from buyers the production changes that they applied.</td></tr>
<tr><td></td><td>15 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>1</td><td>7</td><td>1</td><td>4</td><td>1</td></tr></table></td><td>Buyers created a problem when they tried to reduce their cost of operations by canceling their storage facility whilst still depending on the supplier to provide orders in a continuous manner and without preparing a good operational plan between both parties.</td></tr>
<tr><td>Adverse selection problem</td><td>18 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>7</td><td>1</td><td>5</td><td>1</td></tr></table></td><td>Suppliers applied some modifications because the contract would not be beneficial for them, though they had a long term contract.</td></tr>
<tr><td></td><td>21 relationships</td><td>Suppliers because of this</td></tr>
</table>

<table>
<tr><td></td><td><table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>1</td><td>10</td><td>1</td><td>6</td><td>1</td></tr></table></td><td>insecure feeling caused by continual threats to drop suppliers, and aggressive competition between suppliers, they were afraid to apply any modifications in their work processes to serve the buyer better and an incentive was thereby given to the supplier to withhold information.</td></tr>
<tr><td></td><td>24 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>11</td><td>1</td><td>7</td><td>1</td></tr></table></td><td>Buyers, who felt that the problem was caused by using a short term contract, changed it to a long term one and they felt that the supplier relationship was better than before.</td></tr>
<tr><td>Moral hazard</td><td>16 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>2</td><td>7</td><td>1</td><td>4</td><td>1</td></tr></table></td><td>Suppliers tried to gain an advantage by increasing the order’s price when they knew that there was a shortage in the raw material of the buyer’s order or request in the market.</td></tr>
<tr><td></td><td>38 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>21</td><td>1</td><td>10</td><td>1</td></tr></table></td><td>Buyers recognized that any delay in delivery or increase in cost would affect the buyer’s competitiveness in the market.</td></tr>
<tr><td></td><td>27 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td></tr><tr><td>2</td><td>2</td><td>20</td><td>3</td></tr></table></td><td>Buyers had started to review their procedures in order planning, and others had created an order planning department.</td></tr>
<tr><td></td><td>23 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>2</td><td>12</td><td>1</td><td>6</td><td>1</td></tr></table></td><td>Buyers referred to this reason (when the supplier did not expand work practices and develop production lines by adding new machines to the same extent as the buyer expands and develops his work) by claiming that sometimes they felt that the supplier put maximum effort and gave a lot of</td></tr>
</table>

<table>
<tr><td></td><td></td><td>attention to solve a problem, but the results were less than expected. So, this weakness in the supplier’s service affected time of delivery to the buyer because of poor quality of services or products which were provided by supplier, which in turn affected the buyer’s competitiveness in the market.</td></tr>
<tr><td></td><td>38 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>22</td><td>1</td><td>10</td><td>1</td></tr></table></td><td>The delay which is cased by bad supplier management problem hampered buyers in expanding their work.</td></tr>
<tr><td></td><td>20 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>2</td><td>2</td><td>8</td><td>1</td><td>7</td></tr></table></td><td>Although there were many suppliers who could provide buyers’ requests in the market, buyers insisted on continuing to deal with the same supplier, and they tried to assist the supplier as much as possible to overcome this problem by helping with development and improvement of his/her capabilities.</td></tr>
<tr><td></td><td>26 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>2</td><td>1</td><td>12</td><td>10</td><td>1</td></tr></table></td><td>Buyers they were helping the supplier either because of the personal relationship which had been built over a long time of dealing together or the personal relationship dependent on the personal interest of the decision maker in the buyer’s company.</td></tr>
<tr><td></td><td>16 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>1</td><td>7</td><td>1</td><td>5</td><td>1</td></tr></table></td><td>Buyers helped suppliers because they felt comfortable dealing with them and communicated well.</td></tr>
<tr><td></td><td>28 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>14</td><td>1</td><td>8</td><td>1</td></tr></table></td><td>Buyers who faced delay in delivery because of lack of a good raw material order</td></tr>
</table>

| | | |
|---|---|---|
| | | plan or weakness in internal. monitoring decided to change this kind of supplier. |

**5.5.2.1 Adverse selection**

Table 5.25 shows captive supplier relationship problem causes and effects. The study revealed that the duration of contract affected the relationship between buyer and supplier. Using a short term contract gave a supplier an insecure feeling, which encouraged the supplier to hide any information which might cause that buyer to exit from the contract. But, the problem was that sometimes such information should be known to the buyer to allow him take further action against what has happened; because it might affect the buyer in some way. Withholding information occurred when the supplier applied changes in production strategy after starting to deal with the buyer because of using a short term contract. Table 5.26 shows that this type of supplier felt that they needed to reduce the cost of production by applying some modifications to production procedures; because the contract would not be beneficial for them, especially if something, out of their control occurred, such as increases in prices of raw materials, and there was not enough time for the contract to be beneficial for the supplier. Some of these changes did not match the buyer's specifications, which caused problems on production lines and a delay in delivery to the buyer who refused the order and asked the supplier to reproduce it or looked for another supplier.

This delay in delivery affected buyer competitiveness in the market if the buyer did not have enough stock to fulfill commitments to customers whilst solving the problem, which was why some buyers decided to extend their storage capacity to avoid any shortage in orders which could affect their competitiveness. Table 5.26

represents a long term contract does not prevent suppliers to act opportunistically in such situation. They depended on the agreement between the main supplier and buyer, which meant that the buyer had to use approved items, so that the buyer was forced to deal with a specific supplier, even if there were other suppliers. At the same time, table 5.26 reveals that an insecure feeling which was a result of using a short term contract made the supplier lose interest in developing and improving himself because he did not have sufficient motivation to do so. The supplier felt that the buyer might not continue to work with him/her. During the time, this caused a decrease in the supplier's capability and ability to serve the buyer, which affected time of delivery to the buyer directly or order quality, which caused consequent delay in delivery to the buyer (see Fig.5.34).

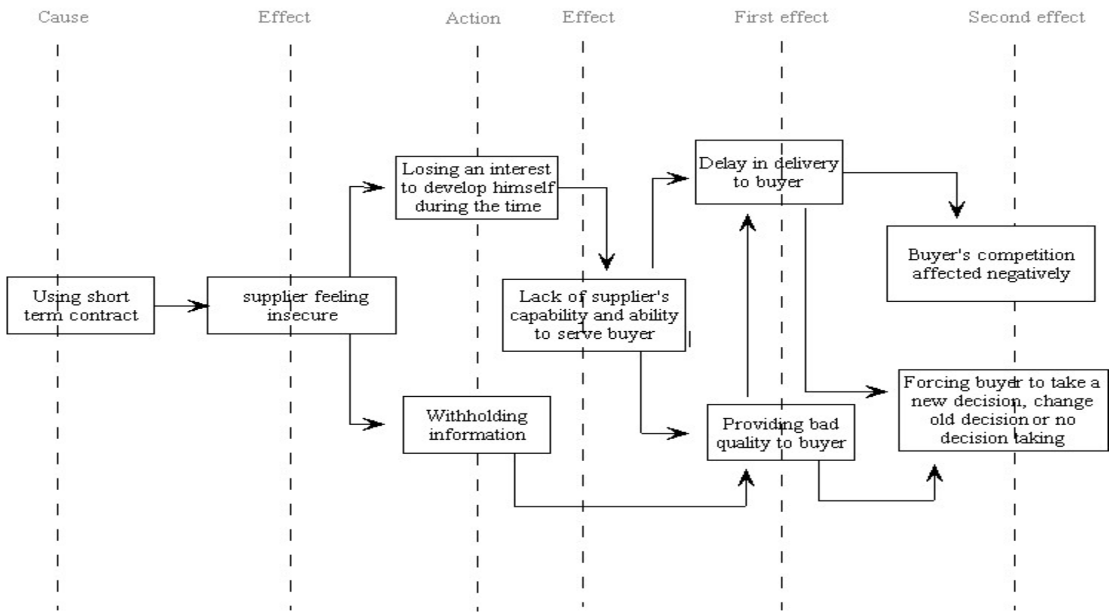


Fig. 5.34: Using short term contract cause and effects

Table 5.26 represents that buyers changed their strategy for using a short term contract.

The study also revealed that, if there were instability and frequent changes in the supplier's management, this would lead to reduced communication between buyer and supplier and the amount of information which the buyer knew about the supplier. This usually occurred when each management changed the specified person responsible for buyer communication or changed the mechanism for sharing information, which caused instability in the relationship. This reason caused delay in delivery to the buyer because of delay in production resulting from changes in decisions and views among management about the way the supplier works. At the same time, the study found that sometimes, if there were problems within the supplier management, this would reduce communication with the buyer, transparency of information, and the quality of orders provided or services to the buyer negatively.

The study found that, because of a reduction in information about the supplier caused by a deficiency of communication between buyer and supplier, buyers could not assist the supplier when that supplier faced a problem because they did not know about the problem and its causes. It was also mentioned that, if the supplier found himself responsible for any malpractices (which might cause the buyer to exit from the relationship), or had to pay a penalty, a supplier withheld information and did not tell the buyer about the real cause of the problem which had occurred (see Fig 5.35).

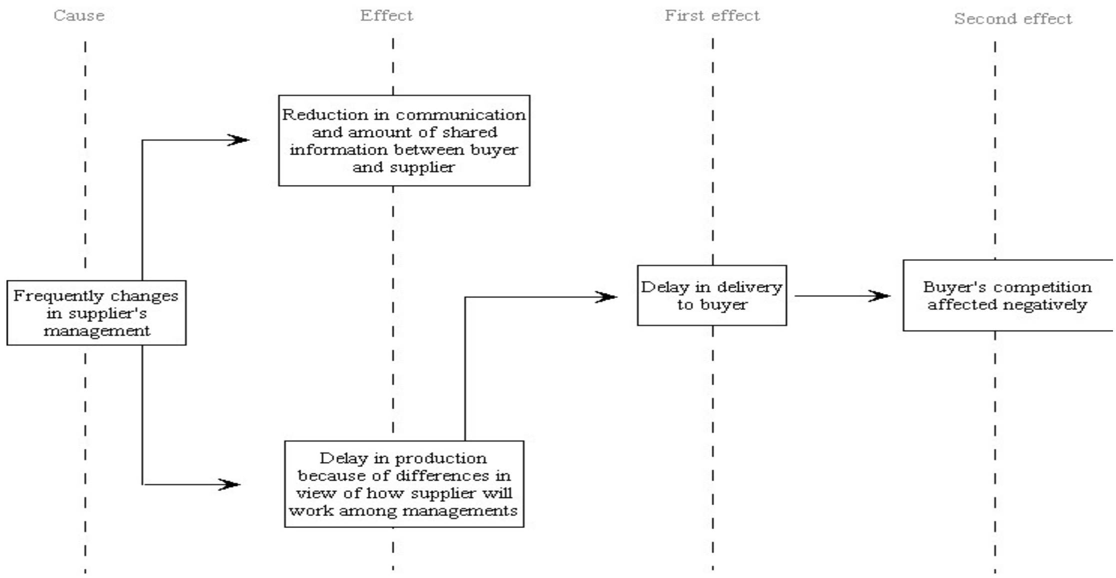


Fig 5.35: Frequent changes in the supplier’s management causes and effects

#### 5.5.2.2 Moral hazard

The study revealed that when the buyer did not have a future order plan, the supplier’s production or order plan would also be confused. Suppliers were confused because the buyer sent orders suddenly, and raw materials might not be available in the market, or might be out of the supplier’s stock and need time to be ordered. Sometimes there were orders in stock with the supplier ready to be delivered, but the supplier could not provide them to the buyer because they were for another buyer. The study noticed that, when a supplier requested raw material orders suddenly from the market, they could only be found at a higher price than if they were requested as planned orders, which meant that there were consequent increases in costs to the buyer.

Additionally, the same thing happened if there was a shortage of raw materials in the market, and the supplier requested raw materials suddenly, they would be at a higher price, which meant that there were once more increases in costs for the buyer. The study found that the time, which was consumed by the supplier to order raw material, or to produce an order, which was requested suddenly, caused delay in delivery to the buyer. The study also found that when the buyer did not have a future order plan, a chance was given for a supplier to act opportunistically against a buyer by misusing circumstances. In many cases, it was noticed that when a buyer requested an order from a supplier suddenly, the supplier accepted the order without telling the buyer that the requested order would not be delivered on time, and time would be needed to prepare it to prevent the buyer from going to another supplier. In this situation, it was observed that suppliers tried to gain time by denying that the order's form had been received and when the buyer called the supplier after many days to follow up the order, the suppler asked the buyer to send the order's request form again, thereby gaining an advantage for many days to prepare the order, which consequently caused a delay in delivery to the buyer. Table 5.26 also represents that suppliers tried to gain an advantage when they knew that there was a shortage in the raw material, which caused increases in costs to the buyer. It was also noticed that sometimes when suppliers knew that the buyer was in a hurry and the buyer's order would be delivered from outside the country, suppliers tried to gain an advantage by increasing the order's price and they attributed these increases to differences in currency exchange. The study observed that any delay in delivery or increase in cost would affect the buyer's competitiveness in the market (see Fig.5.36).

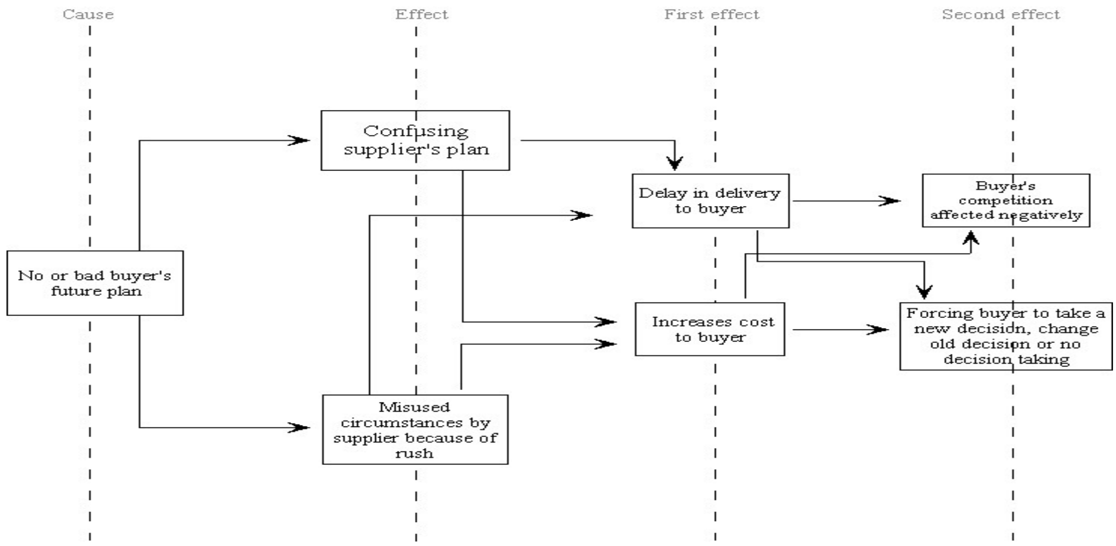


Fig.5.36: No or a poor buyer’s future plan causes and effects

Table 5.26 shows how many buyers visited recognized these effects are, so some of them had started to review their procedures.

The study found that bad supplier management potentially affected the buyer negatively in three different ways. First, it was very important for the buyer and supplier to have the same level of capability and ability to succeed. Hence, when a supplier did not grow and develop or improve capability to serve buyer, that supplier could not support the buyer’s work, which had expanded during the time. This supplier’s lack of capability could occur when the supplier did not develop the skills of his employees to solve problems rapidly, improve solutions or create production methods. This could also occur when the supplier did not expand work practices and develop production lines by adding new machines to the same extent as the buyer expands and develops his work. Table 5.26 reveals what buyers visited referred to this reason.

Some buyers tried to solve delay problems resulting from this by requesting orders earlier than actually needed, using the time to ensure that they would receive them on time if there was any delay. But, the problem was that sometimes the supplier provided the order on time, which caused a problem to the buyer because they orders needed to be stored until used. Table 5.26 represents that the delay which is cased by this reason affected expanding buyers work, and buyers tried to assist the supplier as much as possible to overcome this problem because of many reasons.

Secondly, bad supplier management, which did not have enough management tools and ways to control and manage the firm's operations to ensure if operations were effected properly or not, affected the level of internal monitoring. This weakness in internal monitoring entailed poor production, which was not what the buyer needed. The reason behind poor production might be the supplier firm's lack of a quality control department to monitor production. Another reason might be the engaging in operations of non specialist or uneducated workers, cheaper workers, hired by the supplier management to reduce operational costs. Poor production quality caused a delay in delivery time to buyers because orders were refused or another supplier sought, which in turn affected the buyer's competitiveness.

Finally, poor management caused a delay in delivery to the buyer because of lack of a good raw materials order plan in the supplier firm. This plan is very important because it ensures the continuity of raw material supply for the buyer's order. This delay affected the buyer's competitiveness. The study found that this kind of management tried to deny responsibility for the problems to escape paying penalties at the beginning, but after their responsibility was approved, they collaborated with the buyer. Table 5.26 represents that buyers who faced delay in delivery because of lack of a good raw material order plan or weakness in internal monitoring took a new decision against this kind of supplier (see Fig.5.37).

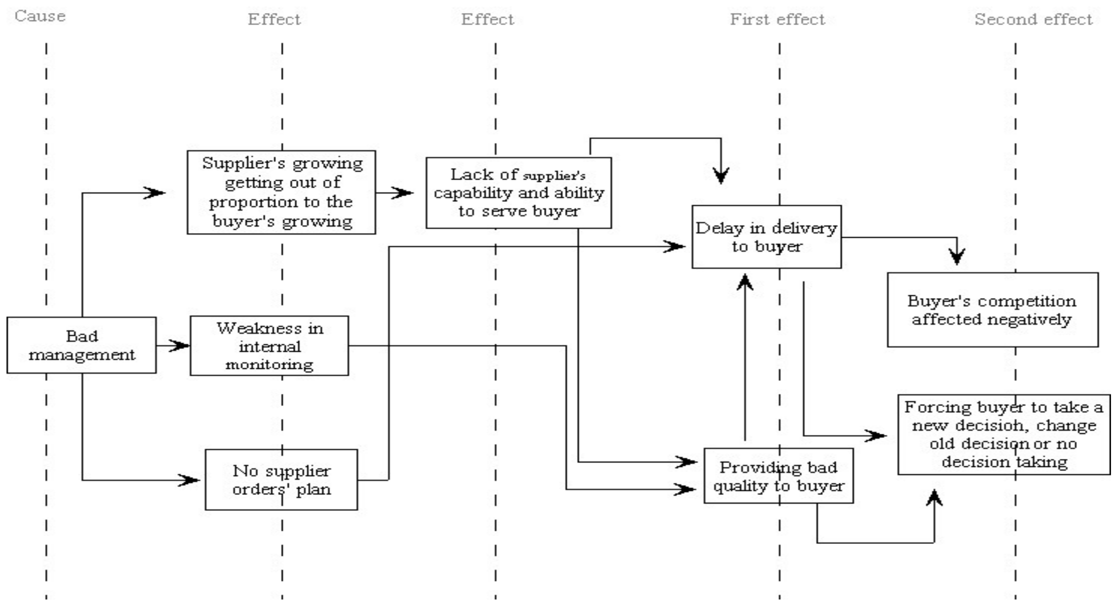


Fig.5.37: Poor management causes and effects

### 5.5.3 Problem control

The study found that buyers controlled suppliers by contract and relationship type, making work more programmable, increasing buyer knowledge, monitoring, creating competition, and using penalties (see Fig.5.38).

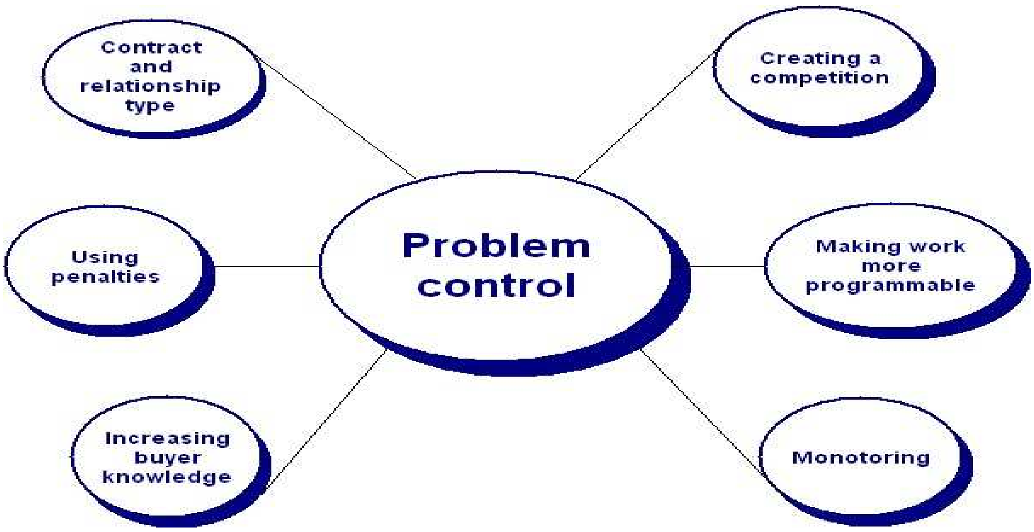


Fig.5.38: Problem control diagram

#### 5.5.3.1 By contract and relationship type

In the captive supplier relationship, when the buyer felt that the supplier was not working totally in his interests by withholding information or delaying delivery, buyers used an outcome based contract, to put pressure on the supplier to serve them with no opportunistic behavior, and a behavior based contract, to encourage the supplier to work for what they needed.

A voice relationship was used, in the captive supplier relationship, at the beginning of the problem, and the buyer tried to assist the supplier if he could do anything to overcome the problem, but if it was not solved or the buyer felt that the solution to the problem was outside the supplier's capability, the buyer finally exited. Table 5.27 represents that the study revealed that using an exit relationship was highly effective with all suppliers generally, and specially, with a supplier who increased costs to the buyer. The study noticed that, before the buyer exited from the relationship, he/she usually sent a number of exit threatening letters to force him/her to work in his/her interest, which meant that buyers did not exit suddenly. Table 5.27 shows buyers behavior if they use exit relationship.

Table 5.27 Captive supplier relationship Problem control

<table>
<tr><th colspan="3">Problem control</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>By contract and relationship type</td><td>40 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>21</td><td>1</td><td>12</td><td>1</td></tr></table></td><td>Suppliers backed off when they felt that the buyer was going to exit from the relationship and tried to satisfy him/her.</td></tr>
<tr><td></td><td>15 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td></tr><tr><td>1</td><td>1</td><td>7</td><td>1</td><td>5</td></tr></table></td><td>Buyers did not exit from the relationship for ever, they just stopped dealing for a time and then came back, especially with a supplier who apologised for his/her behavior, and</td></tr>
</table>

<table>
<tr><td></td><td></td><td>promised to work on the buyer’s behalf.</td></tr>
<tr><td>By making work more programmable</td><td>33 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>18</td><td>1</td><td>9</td><td>1</td></tr></table></td><td>Buyers felt that they avoided delays in delivery and increases in cost.</td></tr>
<tr><td>By monitoring</td><td>39 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>22</td><td>1</td><td>10</td><td>1</td></tr></table></td><td>Buyers preferred to hold meetings with suppliers because they gave a good chance for them to know how the supplier’s work was progressing, and their behavior, and allowed them to check and discuss if the supplier was preparing to produce and provide orders on time or not to avoid any justifications for delay.</td></tr>
<tr><td>By creating competition</td><td>37 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>2</td><td>19</td><td>1</td><td>13</td><td>1</td></tr></table></td><td>Buyers found that creating competition between suppliers was an effective way to control them.</td></tr>
<tr><td>By using penalties</td><td>42 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>22</td><td>1</td><td>13</td><td>1</td></tr></table></td><td>Suppliers were careful to provide services or orders to the buyer’s requirements when penalties were used by buyers.</td></tr>
<tr><td></td><td>15 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>5</td><td>1</td><td>4</td><td>1</td></tr></table></td><td>Buyers who had not added penalty conditions before in the contract with a supplier in the past, insisted on adding them in after they found suppliers were more compliant, with an improvement in their work behavior.</td></tr>
</table>

### 5.5.3.2 By making work more programmable

To prevent any opportunistic behavior, buyers made their work more programmable, and made the mechanism of work very clear between themselves and suppliers. Table 5.27 reveals that by using this strategy buyer felt they had advantages. Buyers gave suppliers enough time to prepare orders for them by sending the order list six months or a year in advance. Buyers separated their orders throughout the year instead of concentrating most orders into one period of time. Buyers applied changes to their work procedures to be more suitable for the supplier's capabilities. After the buyer sent the list of orders over the year, when an order delivery date became close, the buyer sent a letter to the supplier as a reminder about the forthcoming order, and the supplier sent a confirmation that the order would be delivered on time or not. If it was not, the buyer needed to look for another way to receive delivery of the order, or he/she might change his/her production plan early by stopping that particular production line, which might consequently have knock–on delay to another; so, there needed to be enough time for the buyer to do this.

#### 5.5.3.3 By increasing buyer knowledge

This is another way which can assist the buyer to control the supplier. When the supplier felt that the buyer was close to the market and knew its details, the supplier could not withhold information. As the buyer knew a great deal about the market, supplier justifications would decrease, because he/she could not justify increases in price or delay in delivery by using reasons that buyers already knew about.

#### 5.5.3.4 By monitoring

Monitoring was a very effective way to control the supplier. Monitoring could be achieved by holding regular meetings with the supplier to be aware of any problems that might occur and their causes from the beginning so that the situation could be assessed closely, comparing with the supplier's capability. Through such meetings, buyers could discuss solutions to problems with the supplier before they were applied, and suggest other potential solutions, or assist in their situation. Table

5.27 represents that these meetings forced suppliers to work in buyers' interests because buyers were very close to them and they had a lot of information about them, thereby decreasing the amount of information which could be withheld by the supplier.

### 5.5.3.5 By creating competition

When buyers dealt with only one supplier it would not be easy for the buyer to stop dealing with him/her even if he/she engaged in malpractice. Table 5.27 shows that buyers preferred to deal with more than one supplier if possible to controls suppliers behavior, but sometimes the contract between a buyer and a main supplier forced the buyer to deal with a specific supplier, who already had an agreement with a main supplier to provide approved items or products. Creating competition among suppliers was achieved by moving all or some of the percentage of business between suppliers for a specific supplier at one particular time or gradually because of supplier malpractice, which forced the supplier to cope with this malpractice successfully to keep his/her percentage of work. The study found that this mechanism assisted buyers to reduce the percentage of information withheld because at least they knew that there was another source of information, and this guaranteed that the supplier would work on buyers' behalf because each supplier wanted to retain a higher percentage of work than the others. The study also found that buyers' purchasing department employees preferred to deal with more than one supplier to avoid pressure from their senior management, if the supplier did not conform to buyer's requirements. It was noticed that because senior management wished to achieve their sales target, buyers' purchasing department employees became devastated after going to great effort to solve problems with the supplier without results, and senior management put pressure on them to find solutions.

#### 5.5.3.6 By using penalties

Table 5.27 reveals that using penalties forced the supplier to think a lot before he acted opportunistically, and forced him to work in the buyer's interests continually, as stated by buyers. Suppliers were afraid of gaining a bad reputation, which could occur when the buyer took him to court because of malpractice, or when the supplier had to pay penalties to buyers. Some suppliers' view was that paying penalties to buyers was better than going to court to protect their reputation. Table 5.27 represents the importance of having penalty conditions in the contract.

### 5.5.4 Effects on the relationship

#### 5.5.4.1 First effects

##### 5.5.4.1.1 Delivery

Delivery to the buyer was affected negatively by using a short term contract, by frequent changes in the supplier's management, no or a poor buyer's future plan, and poor supplier management. Delay in delivery affected buyer's competitiveness (see Figs 5.34, 5.35, 5.36 and 5.37).

##### 5.5.4.1.2 Cost and price

Increases in cost and prices of orders to buyers affected buyers' competitiveness in the market. Cost and price were increased because of no or a poor buyer's future plan. (see Figs 5.36)

##### 5.5.4.1.3 Quality

Buyers' profits could also be affected when a supplier provided poor quality to buyers, especially with orders which had been released directly on to the market without inspection. Table 5.28 shows that the effect came from a reduction in sales which could occur as a result of poor product quality and poor reputation. Providing orders which did not conform to the buyer's required specifications caused a delay in delivery to the buyer's customers because the order could not be processed, which meant the buyer had to ask the supplier to provide the order again or receive it from another supplier. Order quality was affected by poor supplier management and using short term contracts (see Figs 5.34 and 5.37).

Table 5.28 Captive supplier relationship effects

<table>
<tr><th colspan="3">Effects</th></tr>
<tr><th>Issue</th><th>Relationship</th><th>Comment</th></tr>
<tr><td>Quality</td><td>33 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>2</td><td>1</td><td>19</td><td>10</td><td>1</td></tr></table></td><td>Buyers took back the released order from the market, even if they lost most of their profit, to protect their reputation in the market.</td></tr>
<tr><td>Decision making</td><td>37 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>1</td><td>22</td><td>1</td><td>11</td><td>1</td></tr></table></td><td>Buyers who faced problems with suppliers because of dealing with one supplier only, took a decision either to change supplier or create competition by dealing with other suppliers.</td></tr>
<tr><td></td><td>29 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>S</td><td>C</td></tr><tr><td>2</td><td>2</td><td>18</td><td>6</td><td>1</td></tr></table></td><td>Buyers took the decision that they needed to create new departments to avoid problems with suppliers, such as a quality department to check any order provided, or a purchasing department to classify suppliers according to their history and performance</td></tr>
<tr><td>competitiveness</td><td>29 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>2</td><td>3</td><td>14</td><td>1</td><td>8</td><td>1</td></tr></table></td><td>Buyers cut increases in cost and prices from their profit to protect their competitiveness in the market.</td></tr>
<tr><td></td><td>37 relationships<table><tr><td>G</td><td>F</td><td>P</td><td>T</td><td>S</td><td>C</td></tr><tr><td>1</td><td>3</td><td>20</td><td>1</td><td>11</td><td>1</td></tr></table></td><td>Buyers established a fixed price contract with their customers; however it was not fixed with their</td></tr>
</table>

| | | |
|---|---|---|
| | | supplier, so when the supplier increased the cost of orders to the buyer, the buyer could not always add them into their final costs. |

**5.5.4.2 Second effects**

**5.5.4.2.1 Decision making**

Table 5.28 represents that when buyers felt that the problem was caused by them in some way and it was necessary to apply changes or take new decisions in their plan or procedures for the problem to be solved, they did so. However, problems arose when a buyer took a decision to deal with an external supplier, whereby buyers had to pay customs duties, which represented increases in costs to the buyer. Sometimes buyers, who already had changed supplier and faced problems with new suppliers, took a decision to return to the previous supplier. Buyer decision making was affected because of no or a poor buyer's future plan, poor supplier management and using short term contracts (see Figs 5.34, 5.36 and 5.37).

**5.5.4.2.2 Competitiveness**

Buyer competitiveness was affected negatively by delay in delivery to buyers, increases in costs to buyers or providing bad quality. Delay in delivery to buyers caused a delay in buyer production which caused delay in delivery to the buyer's customers. Any delay in delivery to the buyer's customers gave a reason for those customers to look for another supplier (buyer) who could provide the same products on time. In this situation the buyer was affected negatively, either by allowing new competitors to enter the market or losing their percentage of work on behalf of an existing competitor. The same thing occurred when cost and prices were increased to the buyer; if buyers passed these increases on to their customers, customers would look for another supplier (buyer), who could supply the same products or services at cheaper prices, which meant buyers losing their percentage of work to others. Table 5.28 represents that buyers protect their competitiveness in the market. However, when the buyer cut these increases from his/her profit, the buyer's growth and his employees would be affected negatively.

Providing poor quality to the buyer affected the buyer's reputation directly if the buyer used supplied orders without inspection. It also affected the buyer's delivery time negatively when the buyer refused orders because of poor quality, and asked the supplier to resupply the order, or find another supplier to supply the order, which all took time. This additional time meant delay in delivery to the buyer's customers, especially if there was not enough stock available until the problems had been solved (see Fig.5.39).

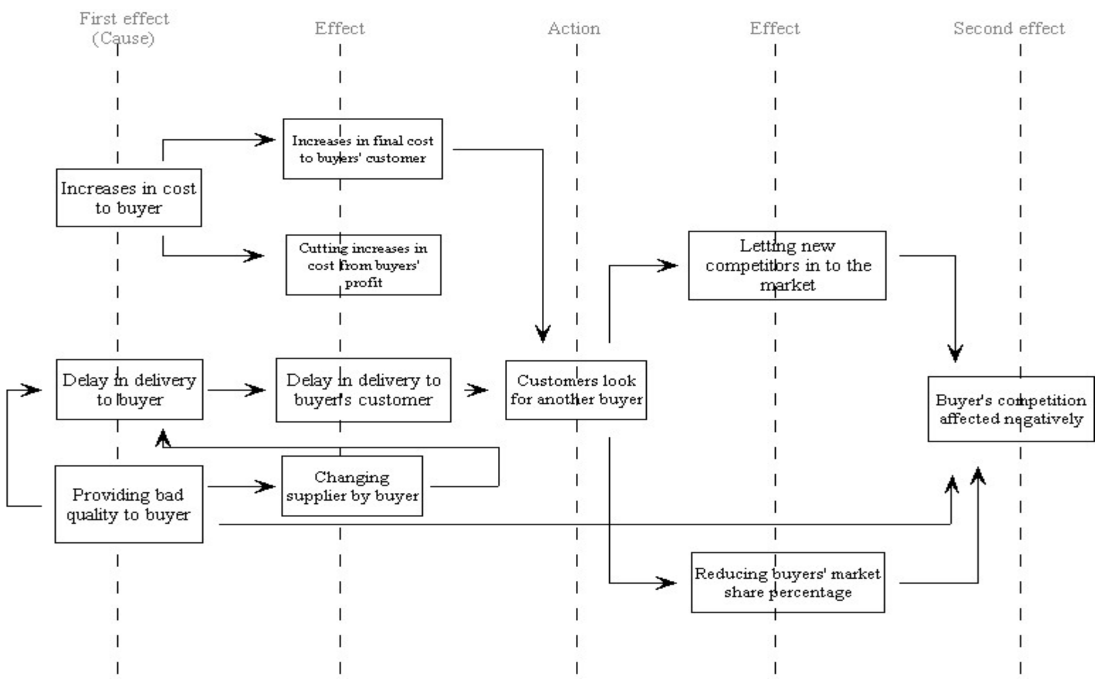


Fig.5.39: Causes of effects on competitiveness

### 5.6 Supplier interviews

Suppliers refused to identify their type of relationship with buyers, so that is why suppliers' interviews have not been classified according to relationship types as buyer interviews. The supplier data was analyzed according to the causes which prevented suppliers acting opportunistically and those which encouraged suppliers to act opportunistically with buyers.

#### 5.6.1 Causes which prevent suppliers acting opportunistically

Suppliers classified buyers on three levels. The first level was key account, second level cash account and the third level was small account. Key account holders were buyers who ordered large or medium sizes of order continuously from suppliers. This type of buyer dealt by credit, and the study found that most of these buyers were multinational or governmental companies. Cash account holders were buyers who might order large or medium sizes of order, but not continuously. They usually dealt by order and paid cash. Small account holders were buyers who usually ordered small sizes of order continuously or discontinuously and they usually paid cash. The study revealed that, if there were any problems with supply of orders, such as shortage in raw material, suppliers were concerned to supply continuously, without discontinuity, by providing from stock first to key account buyers, then they took care of cash accounts and finally small accounts. Sixteen out of seventeen suppliers paid a lot of attention to key accounts; even if there were increments in prices, they did not apply them. But, if suppliers could not bear these increments, and there was shortage, they contacted with all buyers and asked for the increments, supplying to whoever has agreed to pay these increments from stock. It is important to mention that they started to contact key accounts first. However, suppliers visited said that most key account buyers agreed to these increments because they had enough knowledge and information about the market. If not, suppliers let buyers feel the cause of the problem by not supplying the required orders, even if it was a key account; because it was an emergency case (problem).

After conducting many interviews with suppliers, the study revealed that there were many different reasons preventing suppliers to act on their own behalf with buyers. These causes were: continuity and long relationship with buyer, order size, buyer strength in the market, buyer selection, supplier image, strong supplier system, buyer knowledge, penalty conditions, buyer follow up, order simplicity, buyer stability and loyalty and using an exit relationship strategy or outcome contract.

#### 5.6.1.1 Continuity and long relationship with buyer

The study found that the longer and more historical their relationship, the fewer problems existed between buyers and their suppliers. Thirteen suppliers cited this reason because of the personal relationship and friendship between employees which is created over a long time. These relationships increased the understanding, sharing and transferring of information between buyers and suppliers, and solving any problem that might occur before they became too serious. In general, suppliers stated that personal relationship and friendship between buyers and suppliers encouraged the relationship between them to be successful.

The study found that using a long term contract prevented suppliers acting opportunistically because they depended on such a long term contract for actual operations, the production plan, the raw materials' order plan and setting future plans, such as an expansion plan. The raw materials order plan was important; fourteen suppliers mentioned that when this kind of raw material was a consumer product, which could be missed at any time, or its prices were not stable in the market, a raw material plan was beneficial in this case. Fifteen suppliers out of seventeen felt that they were more loyal toward buyers who used a long term contract or had a long relationship with them. It was also found that suppliers encouraged buyers to use a long term contract by giving them payment facilities, discounts or free assistance to complete their job, such as assistance in product design or financing.

Eleven suppliers said that they provided all these types of assistance to encourage buyers to continue in the market strongly, which in turn benefited suppliers to be in the market; especially if there was strong competition among suppliers in the market. In other words, when a supplier assisted a buyer to be in the market successfully, that supplier would be in the market successfully, and would make sure that his/her customers were with him. In general, suppliers gave such buyers priority, responded quickly to solve problems and helped buyers, even if the problem was not in the supplier's responsibility or area.

Although there were many advantages from using a long term contract, six suppliers mentioned that there were disadvantages, such as the risk of fixing the price over a long time, which was hazardous for suppliers if the prices changed in the future and at the time of delivery, with consequent higher storage costs for the supplier, but still most suppliers visited preferred to accommodate these types of hazard in order to gain a long term contract. It is important to mention that, if buyers might exit from the relationship, this forced suppliers to work on their behalf. They usually gave priority to the key account buyers and then to cash account buyers.

#### 5.6.1.2 Order size and dealing with more than one supplier

A large order also forced fifteen suppliers out of seventeen to be committed to buyers because they wanted to convince the buyer to continue dealing with them or to return to them. However, if there was any clash in orders between a buyer who had a long relationship and a buyer who had a large order, suppliers gave priority to the buyer with whom there had been a long relationship, even if the order was smaller. Dealing with more than one supplier put fourteen suppliers in a competitive situation. Each one was looking to win over the competition by focusing on the order size, knowing that failure to achieve that buyer's goal would entail that buyer changing his/her percentage of work to another supplier. This was why a supplier worked hard on the buyer's behalf. Because there were other competitors, the supplier could not tell the buyer an untrue cause or reason for a problem; he was aware that there was another source of information for the cause or reason that could be checked.

#### 5.6.1.3 Buyer strength in the market

The study found that suppliers paid a lot of attention to governmental and multinational buyers and were always looking for these types of buyers. 15 suppliers gave this kind of attention because governmental and multinational buyers were classified as strong partners in negotiations and suppliers were guaranteed payment without delay. At the same time, suppliers knew that these types of buyers usually used long term contracts, which was desirable. This was why suppliers usually provided extra free services for them, even if these were not part of the suppliers' specialty, and they gave them a competitive price in the market to encourage those buyers to continue dealing with them, and to gain their confidence.

Sometimes suppliers might agree to any compensation being delayed when buyers had a financial problem so as to continue dealing with them. Suppliers knew that being with such buyers was beneficial for them as an advertisement in the market. They also knew that if there were any defects in the orders or they were not up to the required specification, this kind of buyer would refuse the order, and would ask for replacements, which represented a huge loss for suppliers; hence they worked hard for them. The study also found that fourteen suppliers out of seventeen preferred to deal with such kind of buyers because they are professional, they know exactly what they want, and they are specific with their orders, so if suppliers faced any problems, buyers would understand the situation because of their knowledge about the market. In contrast, other types of buyers often did not understand such a situation because of lack of knowledge or experience, and they did not know their exact requirements, or they did not wish to understand the situation, which caused problems with suppliers by refusing the order after it had been delivered or insisting on receiving their order even if there were obstacles

#### 5.6.1.4 Buyer selection

The study found that, if suppliers were selective about the buyers who they were dealing with, this would decrease the tendency to act opportunistically. For example, paying a supplier on time was a large incentive for that supplier to work with the buyer in the desire that the buyer would be loyal. But, if the supplier dealt with a buyer who had a bad reputation for paying suppliers on time, the supplier took a down payment at least for the raw materials used for the order; with the remainder of the payment due before order delivery. Alternatively, the supplier apologized, and did not deal with that buyer from the beginning. This was why fourteen suppliers were so selective in choosing buyers with whom they were going to deal. In other words, a financial guarantee was an important factor that encouraged suppliers to work in the buyer's interest. Suppliers selected buyers who had a good reputation in the market. They chose buyers who paid without any delay. Five suppliers mentioned that they did not deal with buyers who had a different payment procedure from them. For example, some buyers' financial systems depended on credit payment, which was not appropriate for some suppliers. In other words, suppliers did not deal with buyers who had a bad reputation in the market for payment, in their relationship with other suppliers, or whose position or industry were not stable. Four suppliers refused to deal with buyers who used a supplier's product for their automatic production line only, because this kind of production might cause problems if there were any defects in the supplier's product, even if it was a small defect, which created problems for suppliers to repair these defects or loss when buyers returned the order.

Fifteen suppliers mentioned that before they signed a long term contract with a buyer, they just agreed to supply one order for cash, using this order as a trial order. If they felt that this buyer was too demanding by making a lot of contact by telephone or visits, by changing the delivery time, or by asking suppliers to store the order in their storage, they did not sign up for a long contract.

Moreover, fourteen suppliers said that they did not deal with buyers who they knew ordered raw materials too difficult to obtain. Furthermore, if suppliers felt that buyer specifications and requirements exceeded their capabilities, they did not take on the order so as to protect their reputation in the market. Thirteen suppliers also refused to take on the order if the compensation was not satisfactory. However, some of them said that they agreed to sign a contract even if the order's compensation was not satisfactory, if the order was for special buyers who represented a benefit for the supplier to join his name with that buyer's name, or a buyer with whom the supplier wanted to have long term contract because of the buyer's strength.

Five suppliers agreed to sign a contract even if the order's compensation was not satisfactory if the product had been affected negatively in the past, whereby suppliers wished to regain the buyer's confidence by producing that product more cheaply. The study found that when suppliers felt that a buyer could not indicate exactly what he needed, they assisted him to do so, because suppliers believed that if there was any mistake in the order's specifications, suppliers would be affected negatively. The study also revealed that not all suppliers behaved as discussed above; six suppliers accepted to take an order, even if they felt it might cause a problem during order preparation because they believed that if they did not take the order, another competitor supplier would take it.

#### 5.6.1.5 Supplier image

The study found that their image in the market was very important for sixteen suppliers out of seventeen, which was why they did whatever they could to enhance their image. They tried hard to connect their image in buyers' mind with honesty. For example, they did not increase prices until they had carried out a study to indicate a reasonable price and discussed it with the buyer. They also tried to deliver the order on time without defects to the best of their ability.

#### 5.6.1.6 Strong supplier system

The study found that sometimes agency problems occurred with suppliers' employees' personal behavior, which gave the supplier a bad reputation in the market; because they represented their firm. Six suppliers mentioned that they should have a robust system to follow up their representatives so as to prevent them acting opportunistically. Ten suppliers revealed that it was important for suppliers to be selective in choosing their sales employees generally and their representatives especially. They should also provide training to improve their employees' qualifications when they deal with buyers, thereby resulting in a good relationship between buyers and suppliers. On the other hand, thirteen suppliers mentioned that buyers should also pay attention to their purchasing employees by using a robust system to follow their activities. The study found that sometimes purchasing department employees pushed suppliers to act opportunistically. Twelve suppliers believed that some purchasing employees ran them down in front their companies' owners so that those buyers did not deal with them because of the purchasing employees' agenda. They did this because suppliers refused to pay a bribe to purchasing employees. Or, buyers' employees were weak in indicating the order's specifications. Sometimes they demanded specifications that were difficult to produce, and they were not necessary. But suppliers agreed to them with consequent supplier agency problems so that they did not lose those customers. Additionally, sometimes buyers' purchasing department employees behaved unprofessionally with suppliers' sales employees, which caused personal conflicts between them that might lead to supplier agency problems, such as delay in delivery, increases in prices or adding tough conditions into the contract. The study found that these conflicts tensed the relationship between them, which was why buyers should also follow up their employees' activities.

#### 5.6.1.7 Buyer knowledge

The study revealed that buyer knowledge about the market and industry prevented thirteen out of seventeen suppliers from acting opportunistically. Suppliers, who had much knowledge within the industry, tended to work hard on the buyer's behalf. They knew that any excuse that might be used to justify an opportunistic action would be immediately recognized. Nonetheless, eight suppliers preferred to deal with such buyers because, if suppliers faced or caused any type of problems, these buyers would understand the situation better than other buyers. For example, if the raw material's price was increased in the market for some reason, some buyers refused the increase if they were not aware of the real cause of this increase; however, if they were aware of the cause, they accepted it. Fifteen suppliers worked to increase their buyers' knowledge about the market to facilitate communication between them. Thirteen suppliers mentioned that they knew if a buyer was aware of the market or not from the first negotiation between them. If their collaboration was strong, that supplier would work hard for the buyer and be loyal. Five suppliers mentioned that if they found that a buyer did not have market information, they acted opportunistically against him by increasing prices; until they felt that he/she started to understand the market; then they decreased the prices as a discount.

#### 5.6.1.8 Penalty conditions

The study found that if there were penalty conditions in the contract between buyer and supplier, the supplier worked harder in the buyer's interest, and was more committed. Sixteen suppliers feared these penalties because they might lose benefits in the contract.

#### 5.6.1.9 Buyer follow-up

The study revealed that buyer follow-up was effective in preventing 13 suppliers from acting opportunistically. When suppliers felt that they were followed up through buyer visits, telephone calls, meetings or letters, they were forced to work on buyers' behalf, and it was difficult for them to act opportunistically. Seven suppliers said that they did not like being followed up. In contrast, ten suppliers said that they liked to deal with such buyers because they helped them to organize their work. For instance, when suppliers dealt with programmable buyers in terms of order size and delivery time, this assisted them to be organized and set a good plan for the future. The study found that buyers could be good followers up by making tasks programmable because they could observe suppliers clearly, and it was easy for buyers to indicate any defects in the systems or tasks. The study revealed that when buyers hired an auditor to follow up a supplier, that supplier tried to do his best to achieve the buyer's goal. Auditors usually kept on visiting suppliers and wrote notes about their work. By the end of each visit, they gave suppliers the notes taken to resolve issues, and they checked these notes in the following visit to assess what actions had been taken to correct them. The study found that auditors were usually hired by key accounts. Additionally, the study found that suppliers were very careful to supply orders according to buyers' requirements when those buyers had a quality monitoring department.

#### 5.6.1.10 Buyer/order simplicity

Simplicity of buyer related to simplicity of the buyer's order and simplicity of the buyer's dealings with the supplier. The study found that fourteen suppliers preferred orders to be simple because sometimes the complexity of a buyer's order could create agency problems, especially when suppliers were busy. Suppliers might increase the order's price, delay delivery (giving priority to another buyer), or change the order's specification which might not affect the order's quality, but produced orders which the buyer did not want.

It is important to mention that an order's specification should not be changed by the buyer during the production process because, if this happened, the supplier lost profit margin because of changes in design, which might in turn push the supplier to act opportunistically. Six suppliers said that changing an order's specifications during the production stage might affect their efficiency negatively by having to change machine settings, which took a lot of time. The study also found that if a buyer was simple to deal with, and gave a supplier more freedom or chances to resolve a problem when he was dealing with the supplier this might prevent the supplier acting opportunistically, and helped the supplier to feel more confident and loyal towards the buyer. For example, when a buyer understood a supplier, the supplier felt that he should be honest with the buyer if he faced any problems. Hence, the supplier made the buyer aware of the situation early to share information and made a proper decision with that supplier.

If a buyer found that there was a small defect (not in quality) in the order supplied, and it was accepted after a discussion with the supplier to compensate the buyer by providing an extra discount, an adjustment to a subsequent order could be made or any other compromise compensation, instead of refusing the defective order and sending it back; this encouraged the supplier to work on the buyer's behalf, because if the buyer refused the order and sent it back to the supplier, this action might demotivate the supplier's employees, and cost the supplier time and money. It is, however, important to mention that key account buyers did not accept any defects, and refused any compensation that the supplier might offer. This type of account holder accepted only to reproduce or resupply the order without defects.

In contrast, the study revealed that when suppliers found that a buyer did not understand a problem, or was not cooperative, a supplier never told a buyer the truth, or transferred the cause of any problem elsewhere so that he/she would not be affected, even if he/she had caused the problem or was responsible for it.

The study also found that if the buyer's employee scrutinized personal habits or dress of a supplier or he was always suspicious about the supplier's honesty, the supplier might act opportunistically with that buyer, refusing or delaying the order or increasing the order's price. Most of these situations also arose with cash account and small account holders. In general, suppliers were annoyed by buyers who expected too much.

#### 5.6.1.11 Buyer stability and loyalty

It was observed that 15 suppliers did not act opportunistically with buyers who had stability in the market. When suppliers dealt with stable buyers, they sought to have a long term relationship with them, because they felt secure, and it was a good chance to continue working stably in the market. Hence, they worked hard on buyers' behalf to assist buyers to be successful in the market.

When suppliers felt that buyers were loyal toward them, they worked in the buyer's interests. This feeling encouraged thirteen suppliers to give buyers a good price and high commitment. The study found that, when suppliers felt that buyers were honest with them, and they responded to any questions that the supplier might ask, suppliers worked hard for buyers. However, when suppliers felt that buyers were not serious in working with them, that they just wanted to steal some of their ideas, suppliers did not cooperate with them at all.

#### 5.6.1.12 Using the exit relationship and outcome contract

Using an exit relationship and outcome contract with suppliers pushed them to work on the buyer's behalf. When buyers used an exit relationship, suppliers tried their best to achieve the buyer's goals. They feared that if they did not work hard to gain the buyer's confidence, that buyer might go to another competitor. Using an outcome contract put a lot of pressure on suppliers to fulfill their commitments without acting opportunistically. Suppliers knew that causes of any malpractices, which might occur, would not be accepted because buyers looked only for results; they did not look into the details.

### 5.6.2 Causes which encourage suppliers to act opportunistically

There were two types of causes that encouraged suppliers to act opportunistically. The first type involved the causes which were out of the supplier's hands (external causes). The second type involved the causes which were related to the supplier (internal causes).

#### 5.6.2.1 External causes

The study found that there were many external causes that encouraged suppliers to act opportunistically, such as problems from the main supplier, the supplier accomplishing work depending on the work of another supplier, differences between the buyer's and supplier's procedures, difficulties in order transportation and delay in documentation procedures from customs or other parties.

##### 5.6.2.1.1 Problems from the main supplier

The study found that six suppliers acted opportunistically because the main supplier did not fulfill his/her commitment to the supplier; hence the supplier could not fulfill his/her commitment to buyers. For example, the main supplier did not supply raw material to the supplier on time, which confused the supplier's plan with buyers. Alternatively, if the main supplier did not supply an order to the supplier requirements and specifications, this in turn affected buyers' order requirements.

##### 5.6.2.1.2 Work depending on the work of another supplier

Sometimes suppliers did not carry out a buyer's requirements because their work depended on the accomplishing of work by another supplier. Hence, the supplier had to delay the supplied order until the other supplier had finished the work to avoid storage costs if the order was ordered early.

#### 5.6.2.1.3 Differences between the buyer's and supplier's procedures

Sometimes differences between the buyer's and supplier's financial procedures caused the supplier to act opportunistically with the buyer when suppliers could not supply a required order on time, especially at the end of a year. The order was delayed when the buyer placed many orders at the same time at the end of the financial year because it is not permitted to transfer money from the current year to the next year, which made it hard for the supplier to produce the order on time. Differences between the buyer's and supplier's procedures in order handling also encouraged the supplier to delay the delivery time, especially if a buyer was a governmental one. Most suppliers handled orders from the harbour to buyers directly to save storage costs, but this method was not suitable for governmental buyers who changed delivery time frequently and handling procedures took a lot of time, whereby the suppliers did not plan for the order early on. Additionally, when there were differences in the payment method between buyer and supplier, this might cause a supplier to delay the order to the buyer. The study found that some buyers used a credit method to pay the supplier, which did not accord with the supplier's methods for receiving their compensation; this was why suppliers did not give such buyers priority or they did not sell to buyers until they paid.

#### 5.6.2.1.4 Difficulties in order transportation

The study revealed that sometimes order delay was caused by transportation companies, outwitting suppliers' hands. Shortage in vessels or trucks might delay orders being supplied on time, or sometimes truck drivers had another agenda, which was different from the main work purpose, which caused a delay in delivery. Furthermore, sometimes transportation companies had commitments to other suppliers to convey their orders, and they gave them priority, which caused delays for buyers.

#### 5.6.2.1.5 Delay in documentation procedures from customs or other parties

The study found that delays in delivery might occur with documentation procedures caused by customs or other parties such as commercial attaches, in embassies.

### 5.6.2.2 Internal causes

The study found that there were many causes that forced suppliers to act opportunistically, such as a supplier’s preference of one buyer over another, a supplier’s work environment, new competitors entering the market, working in more than one industry, a lack of qualified workers and the harshness of buyers.

#### 5.6.2.2.1 The supplier’s preference of one buyer over another

Sometimes a supplier preferred one buyer over another which led him to act opportunistically against other buyers. A supplier preferred one buyer over another because of a long relationship between buyer and supplier, a long term contract, the size of the buyer’s company, a buyer’s commitment to pay a supplier regularly, a buyer’s understanding and cooperation, a buyer’s loyalty to suppliers, bribery paid by the buyer or personal relationships or interests. A supplier might give priority of delivery, production or choosing raw materials, cheaper prices or extra free services to a preferred buyer, which were not given to non preferred buyers.

Some stated that they provided orders that were not according to buyers’ requirements (small differences), but which were hard to recognize by non preferred buyers. These defective orders might be produced by mistake during production processes for other buyers or during a specific order, but a supplier preferred to send such an order without telling a buyer about the mistake than incurring losses. Eleven suppliers mentioned that, although some buyers were preferred, key account buyers were given the first priority for all their requirements. The study observed that, even if a supplier had a full schedule of orders to buyers, he/she might cancel one buyer order on behalf of another buyer who would pay more money or produce more benefits. This tended only to be done with cash and small buyer accounts. But, before a supplier cancelled the buyer's order, he/she asked for the same increment or benefits offered by the new buyer; if a buyer agreed to pay, then a supplier would not cancel the order; if not a supplier would go with the new buyer's offer. Additionally, five suppliers abused buyers who had a bad reputation by accepting to deal with them at a higher price than supposed, because they knew that other suppliers would not deal with this kind of buyer.

#### 5.6.2.2.2 The supplier's work environment

The study found that suppliers, who did not have a healthy work environment among their employees or between employees and senior management, acted opportunistically because this environment allowed employees (representatives) to create their own agenda, and worked for their own interest without concern for the company's interests; which gave an image that the supplier (as a company) was acting opportunistically against buyers.

The study also noticed that, if there was a lack of stability in the supplier management that might affect the relationship with buyers negatively because of changes in the supplier's representatives with each management; it was better for the relationship to have the same representatives for a long time. Changes in the supplier's management caused difficulties for the employees to be followed-up (monitored) thereby de-motivating them from working on the buyers' behalf because of their feeling of instability. This also created conflicts within the supplier firm which precluded effective decision making.

Furthermore, it was observed that sometimes the differences in employees' culture caused conflicts among them. Each culture strove to have the right in making decisions over the other cultures without concern for the buyers' interests, which in turn affected these buyers. The same phenomenon occurred with buyer firms; each culture tried to be close to the source of decision making to affect it by trying to give orders to specific suppliers without considering the firm's interests.

#### 5.6.2.2.3 New competitors entering the market

The study revealed that new competitors entering the market might force some existing suppliers to act opportunistically with their buyers to gain as much benefit as they could without looking to the buyer's benefit. Seven suppliers criticized governmental decisions which permitted other suppliers to enter the market. Most of the new suppliers accepted to take orders at a cheaper price without concern for the quality of orders or services because of the competition. However, eleven suppliers said that, although there were new entrants, they were not affected at all, because they increased their commitment toward buyers to encourage them to continue dealing with them.

#### 5.6.2.2.4 Working in more than one industry

The study found that when suppliers worked in more than one industry, they could not concentrate on working on buyers' behalf because suppliers' management were careless. They did not follow up their employees to check if they were working for buyers' interests or not. They also could not follow up their customers and their comments.

#### 5.6.2.2.5 Lack of qualified workers

Seven suppliers employed unqualified workers to save on operational costs, and such workers might cause problems with buyers. The study found that some of these workers were not qualified to work on production machines, which resulted in poor quality production, that did not meet buyers' requirements, or they did not understand buyers' needs. Further, eleven suppliers did not pay enough attention to training to improve their employee skills for buyer needs. Some employees did not know the importance of their work to buyers, which caused problems. It is also important to mention that fifteen suppliers complained about Saudi employees; they were temperamental and austere in their dealing, and they were guaranteed award of the job by governmental law. They did not therefore work hard to build up a good relationship with buyers. The study revealed that supplier representatives were very important because they represented the supplier's image in the buyer's mind.

#### 5.6.2.2.6 Harshness of buyers

Thirteen suppliers mentioned that when buyers were harsh in dealing with suppliers, they applied for penalties if there was any malpractice; suppliers consequently became secretive and they withheld information to avoid penalties which might be applied by buyers. Suppliers said that if buyers did not collaborate by providing more than one way to resolve the problem, sticking with only one method, suppliers were encouraged to act opportunistically.

## 5.7 Summary

In this chapter, the researcher has analyzed the data collected in the way which assisted him to understand each type of buyer and supplier relationship according to the research conceptual model. The researcher found valuable data which describes the Saudi Arabian market precisely, such as the relationship creation incentives. The data has been classified into categories and units according to the research model, and a meaningful relationship between the categories has been indicated. The chapter that follows interprets and discusses these data findings, once more according to the conceptual research model.

# CHAPTER SIX

# CHAPTER SIX

# DISCUSSION

## 6.1 Introduction

As mentioned before, the researcher studied how 'agencies' affects buyer-supplier relationships (Market exchange, captive buyer, strategic partnership and captive supplier) in Saudi Arabian markets. In this chapter, the study answers the research questions stated in chapter one as follows, after analysis of the collected data in chapter five.

## 6.2 Answers to the research questions

### 6.2.1 *Q1: What are the incentives that create each type of relationship?*

The researcher found that there was a correlation between relationship incentives (the elements that induced creation of each relationship type between buyer and supplier which have been discussed in detail in chapter five covering each type of relationship (section 5.2.1, section 5.3.1, section 5.4.1, section 5.5.1)), as also reasons for outsourcing. This issue was also discussed in the literature as appearing in chapter three (Greaver, 1999; Outsourcing Institute, 1998). In both, relationship incentives and outsourcing reasons have been described and emphasized as being buyer's incentives to deal with specific suppliers. Relationship incentives may correspond with outsourcing reasons in a direct manner (giving the same outsourcing reasons as those stated in the literature) or in an indirect manner (helping to achieve the objective of outsourcing reasons). But, the study found that not all relationship incentives have been covered in the literature related to outsourcing reasons. In some cases, certain relationship incentives were found to be based on other factors which induce the buyer to deal with a specific supplier.

Relationship incentives are two-fold; one, when buyer wishes to deal with the supplier voluntarily, two, when compulsory reasons (circumstances) force the buyer to deal with the supplier under a special type of relationship. Whether it involves the buyer's wishes or compulsory reasons, the buyer sometimes gains advantages from dealing with the supplier, and at other times the buyer deals with the supplier out of compulsion, without necessarily gaining any advantages in return.

#### 6.2.1.1 Market exchange relationship

The data analyzed showed that in market exchange relationships, the incentives which help create such relationships are reputation of vendor, high profit rates, easy communication, stability of vendor services and the encouragements offered or delivered (see section 5.2.1).

The price incentive was mentioned in relation to 'outsourcing' as appearing in the literature ( see section 3.2.2). In the market exchange relationship, buyers depend on the availability of many suppliers and their competitiveness, to gain orders or services at a lower price, either from the local market or foreign markets, such as Far Eastern, European or North American market. It is found that one of the advantages of outsourcing is to obtain reductions in service and product costs (Outsourcing Institute, 1998). In such cases the buyer chooses a supplier, who can assist him in achieving this profit related goal. The study found that the choice of the supplier corresponded to the buyer's wishes and buyer gaining advantages. One purchasing manager in the stationery industry said, "We are always looking for cheaper prices to survive. Most of our customers do not like to pay more for stationery products, and there is strong competition in this industry even if we deal with Far Eastern suppliers".

The study found reputation and high exchange rate incentive were not directly mentioned in the literature in connection with outsourcing reasons but only in an indirect manner. The researcher found that buyers, who had gone to the European or North American markets, justified their action for getting what they wanted from these markets based on the supplier's good reputation on quality and/or commitment to serve buyers. Three companies in the petrochemical industry believed that dealing with these suppliers put buyers in a stronger position in terms of their competitiveness in their native market, by gaining access to world class qualities and capabilities. But sometime and because of negatively high European currency exchange rates, buyers keep on dealing with Far Eastern suppliers. This incentive was classified as 'buyer's wishes with advantages'.

Easy communication, stability and supplier encouragement contribute to outsourcing reasons in an indirect manner. These incentives were considered by the researcher as supplier characteristics, which depended on each supplier's capabilities. However, these were very important factors to assist buyers in gaining benefits from outsourcing. These incentives helped the buyer to concentrate and focus on core business instead of following up with the supplier, which was one of the outsourcing reasons cited by Greaver (1999). Easy communication assists the buyer in avoid time waste in getting or exchanging information. Stability assists the buyer in work with confidence whereas supplier encouragement gives the buyer the assurance and confidence in conducting business. Two of the purchasing managers from the food industry and four purchasing managers from the petro-chemical industry mentioned that they preferred to deal with European suppliers rather than Far Eastern suppliers because of the formers' high commitment, even when the prices charged by these suppliers were a little higher. These incentives also corresponded to buyer's wishes and buyers gaining advantages.

In the special case relationship, there were two incentives, which were price and personal gain. In this case, though a buyer might have supplier choices, the buyer wants the relationship to be that of a captive buyer with a specific supplier. The study found that there were advantages for the buyer which motivated this reaction, such as reduction in costs as a first incentive and fulfilling the interest of one or more board members as a second incentive.

The reduction in cost factor usually induced buyers to deal with suppliers, and was considered one of the most important reasons for activities to be outsourced (Outsourcing Institute, 1998). One of the purchasing managers in the food industry said “why should we pay more if we can get the same goods with the same quality or better sometime from supported suppliers”. Furthermore, two petro-chemical companies kept dealing with a single supplier for a long time because the supplier did not realize that he/she has been selling below market price because of lack of market information.

Personal gain: Even if this advantage was termed as opportunism by one or more board members against their firms interests, the researcher considered it as a factor on which the supplier was selected. This incentive was not mentioned in the outsourcing reasons in the literature, and it was considered as a new factor which induces the buyer to deal with a specific supplier to create the special relationship. The study noticed that one board member in the petro-chemical industry always insisted on dealing with a specific supplier because of his personal relationship with this supplier.

#### 6.2.1.2 Captive buyer relationship

The data has identified six relationship incentives which create the captive buyer relationship in the Saudi market. These incentives were the presence of one supplier only in the market (monopoly), the buyer using the supplier's products over a long time period, lack of time to change supplier, governmental legislation, "buyer needs" and buyer competitiveness (when the buyer was forced to deal with a specific supplier because the other suppliers were also the buyer's competitors in the market, and the buyer does not want to give his/her competitors power by dealing with them) (see section 5.3.1).

Some of them occurred because of compulsory reasons without providing benefits or advantages for the buyer, except those permitted by the supplier. For example, the presence of one supplier only in the market (monopoly) forced the buyer to deal with a supplier he does not want. Another example, using the supplier's products over a long time period forced the buyer to deal with the same supplier. Additionally, lack of time to change supplier forced him to deal with the same supplier without gaining any advantage. Also, buyer competitiveness incentives (when the competitor buyer is also a supplier) forced the buyer to deal with a specific supplier even if there were no advantages to be gained. All these incentives were considered as new factors which induce the buyer to deal with a specific supplier, promoting the creation of the captive buyer relationship. All of these were not mentioned in the outsourcing reasons in the literature of this research, which is one of the significant findings to emerge during research work. The researcher found that government legislation incentives also forced buyers to deal with local suppliers in order to benefit from advantages by doing so (see section 5.3.1.4, 2.3.2 and 2.4.5), such as reduced costs of leasing factory land and decreased import duties. Even if this was compulsory, there were still advantages and benefits for the buyer in dealing with the supplier. Hence, this contributed to the outsourcing reasons in an indirect manner (Outsourcing Institute, 1998).

Yet another "buyer needs" incentive which creates the captive buyer relationship was not the same as other incentives in this relationship because the buyer's special requirements were the main incentive to deal with a specific supplier; possibly because of a need for high technology or high quality that he/she could not produce/manufacture themselves. The buyer therefore gained advantages from dealing with the supplier, implying that the buyer was gaining advantages (reasons) from outsourcing, and this corresponded to outsourcing reasons in a direct manner (Outsourcing Institute, 1998).

#### 6.2.1.3 Strategic partnership

Strategic partnership incentives were found to be related to geographical location, personal relationships and common growth understanding, which had been built up during the relationship period (see section 5.4.1). All of them corresponded with outsourcing reasons in an indirect manner (Outsourcing Institute, 1998; Greaver, 1999), and they were classified by the researcher as the buyer's wishes with advantages.

The buyer gave the geographical location factor high importance in building a strategic partnership with the supplier, giving the buyer advantages from outsourcing, such as timely delivery, reduction in transportation costs and close monitoring of supplier. For example, some of interviewees, two from the communications industry, one from the glass industry and a further two from the food industry, mentioned that they were dealing with packing suppliers which were close to them, geographically. One of the purchasing managers in the food industry said that "in our experience, we found that the communication, observing and close controlling of suppliers close geographically are better than of distant suppliers".

In Saudi Arabia, personal relationships are very important factors that can affect the whole life of either a person or a firm. Hence, the presence of a friendship or a family relationship might give rise to a level of understanding and positive discussion between the buyer and the supplier, which induce the creation of the strategic partnerships. However, supporting their respective interests business was still the basis of their business relationships. The buyer gained many advantages from building a strategic partnership with the supplier by developing a personal relationship, such as smooth communication and rapid problem resolution, whenever cooperation to satisfy the buyer's interests was high. Two purchasing managers in the petro-chemical industry mentioned that they deal with three suppliers because of the strong relationship between them and the chairman of the boards of their directors on the supplier side.

Further, common and parallel growth for both buyers and suppliers created a strategic partnership between them. This relationship was built upon a historical background and produced an implicit alliance between both parties that depended on common interests and the service produced by each party for the other, allowing buyer gains from most of the outsourcing advantages.

**6.2.1.4 Captive supplier relationship**

The research found that two incentives contributed to creating a captive supplier relationship. According to the data they are: aggressive competition among suppliers and the buyer's respective strength in the market (see section 5.5.1). Both incentives corresponded to outsourcing reasons in an indirect manner (Outsourcing

Institute, 1998; Greaver, 1999).

Strong competition among suppliers in the market implied that suppliers provided high quality at a cheaper price with high commitment to on-time delivery so that buyers agreed to continue or start dealing with them. In this case the buyer could choose among suppliers who could fulfill requirements and work for his/her interests. Furthermore, when the buyer was strong and had a known franchise in the market, most suppliers wanted to supply him. The suppliers also worked hard to remain a supplier for such a buyer. One of the purchasing managers in the food industry and another in the stationery industry said that “a lot of suppliers strive to put their sign beside our franchise signing as working with us”. The buyer gained a number of advantages from both incentives, such as reduction in costs, improvement in quality, increased commitment to on-time delivery or on additional services.

#### 6.2.1.5 Summary

In short, the relationship incentives create buyer and supplier relationship types. Some of them corresponded with outsourcing reasons (Outsourcing Institute, 1998; Greaver, 1999). in a direct manner such as price incentive and “buyer needs” incentive, or in an indirect manner such as reputation and high exchange rate incentive, easy communication, stability and supplier encouragement incentives, governmental legislation incentive, geographical location incentive, personal relationship incentive, common growth incentive, understanding incentive, aggressive competition among suppliers incentive and the buyer’s respective strength in the market incentive.  The other incentives which were not mentioned in the outsourcing reasons in the literature, which is one of the significant findings such as  personal gain incentive, presence of one supplier only in the market (monopoly) incentive, using the supplier's products over a long time period incentive, lack of time to change supplier incentive and buyer competitiveness incentive.

### 6.2.2 *Q2: Which problems exist in each type of relationship?*

*Ekanayake (*2004) mentioned that there were two main agency problems, adverse selection (the misrepresentation of the agent's ability) and moral hazard (the lack of effort on the part of the agent) (see section 3.3.3). From the data collected, the study found that both may not to occur in each or every type of relationship. Both might occur or only one. For example, in the market exchange relationship, the moral hazard problem was the only problem type that was observed (see section 5.2.2). In the captive buyer, strategic partnership and captive supplier relationships both types of problems occurred, adverse selection and moral hazard (see section 5.3.2, 5.4.2 and 5.5.2). In the special case of the market exchange relationship the moral hazard problem only occurred with the price incentive (see section 5.2.5.1.1), and adverse selection and moral hazard with the personal interest incentive (see section 5.2.5.1.2).

The study also found that the causes for the problem could arise in following ways: from the supplier intention, when for instance, the supplier intended to withhold information because of the supplier's desire to keep buyers dealing with them exclusively (see section 5.3.2.1) OR from the buyer intention, where for example the buyer intended to choose a supplier on the basis of cheaper price (see section 5.2.2.1). Problems could also arise from external reasons, where for instance if there was no commitment from the main supplier to serve the next supplier in the chain, which represented a defect in the supply chain (external) (see section 5.2.2.1 and 5.3.2.2). Further problems may arise, due to internal buyer firm's problem (without buyer intention), where for example the buyer had no or poor future plans, which would be an inside the buyer firm problem (see section 5.2.2.1, 5.4.2.1 and 5.5.2.2). Finally, there could by an internal supplier firm's problem (without supplier intention), where for instance the supplier's management were being changed frequently, which qualifies as a problem inside the supplier firm (see section 5.2.2.1). Hence, it might not be the supplier who caused the problems, but by acting in an opportunist manner because there was the chance for them to gain additional advantages.

### 6.2.2.1 From the buyer perspective

#### 6.2.2.1.1 Using short term contract

The study found that buyers liked to use short term contracts because they liked to put suppliers under pressure. At the same time, suppliers preferred to have long term contracts to be more secure. So, using a short term contract made the supplier feel insecure. Therefore, some suppliers were pushed to prefer their own interests over buyer's interest. This occurs in strategic partnerships. For example, two petro-chemical industry suppliers, one food industry supplier and one of the transportation industry suppliers gave Third Party buyers priority on their orders if these buyers were willing to pay more. They also tried to increase their service costs whenever they felt that their products were in demand.

Sometimes this reason (using short term contract) encouraged the supplier to hide information from the buyer to keep dealing with him even though this information was very important to the buyer ( see section 3.3.4.1, 5.4.2.1 and 5.5.2.1). Four suppliers, one in the glass industry and three in the food industry, mentioned that withholding information occurred when they applied changes in their production strategies after commencing to deal with the buyer because they felt that their need to reduce production cost by applying some modifications in their production procedures because, otherwise, the contract would not remain beneficial to them. Some of the changes made did not match the buyer's specifications, which caused problems on the buyer's production lines and delays in their delivery to their buyers, who refused to receive their orders, asking the supplier to replace their order or they would look for another supplier. One of the food industry suppliers said, "An insecure feeling which was a result of using a short term contract made the supplier lose interest in developing and improving himself because he/she did not have sufficient motivation to do so". The supplier felt that the buyer might not continue to work with him/her. This caused a decrease in the supplier's capability and ability to serve the buyer, which in its turn affected the time of delivery to the buyer directly or change in order quality, which caused consequent delays in delivery to the buyer. This happened only in a captive supplier relationship.

**6.2.2.1.2 Improper agent selection**

Choosing a supplier on the basis of a cheaper price means the buyer sometimes deals with an unqualified supplier or a supplier who is dissatisfied with its compensation (see section 3.3.4.4). The study found that suppliers switched from buyer to buyer easily depending on their interests, and suppliers who were dissatisfied with their compensations, caused intentional delay in delivery for the buyer (see section 5.2.2.1). For instance, one petrochemical industry company supplier, and two food company industry suppliers, intentionally workd against buyers' interests when suppliers' management decided to use non-standard materials (reduce the required specification) in their production to save money, which in turn affected order quality and delays in delivery. Another example, sending orders with wrong documentation caused problems with customs, which did not allow orders to be handed over to buyers in time or not at all. In such cases, customs either asked buyers to dispose of their orders or return them or pay penalties, which caused increases in costs and delays in orders getting delivered to buyers.

Unqualified suppliers did not work against buyers' interests intentionally. The study found that these suppliers lacked the technical and administrative capabilities to do what the buyer needed. Lack of technical and administrative capabilities affected required quality and time of delivery. For example, the researcher found that three suppliers, one worked for a communication industry company, others with petrochemical and stationery industries, did not have expert technicians who could provide buyers' orders on time with the required level of quality, and used old machines with unfixed settings which could not produce orders to required specifications, affecting the buyers, negatively. Consequently, buyers would not accept orders if their qualities was inadequate, which caused difficulties in the buyer's production process due to shortage and delay in materials. In addition, two of the purchasing managers in food industry said that "lack of administrative capabilities in a supplier affected their required quality and time of delivery. This occurred when the supplier's management did not have enough experts to keep the relationship between suppliers and their employees' smooth, which sometimes meant that technicians did not put all their efforts into producing orders as required, which in turn affected order quality; alternatively, they did not fix the machines with breakdowns quickly enough, often because of their age, to avoid delays to buyers".

Furthermore, weakness of suppliers' salesmen performance caused problems with buyers. The study found that one of the transportation industry suppliers hired salesmen who were not familiar with a buyer's industry, did not understand buyers' quality requirements and the importance of timely delivery and did not have enough communication skills to build the right type of relationship between themselves and the buyers. Therefore, conflicting business policies and delays in delivery to buyers occurred. This happened in the market exchange relationship not in other types of relationships.

**6.2.2.1.3 Cultural difference**

Cultural differences between buyer and supplier relate to differences in the nationalities of buyer and supplier. These differences create misunderstanding between buyer and supplier because of differences in behavior between the nationalities, including differences in the ways of thinking and in priorities, which cause increases in costs to the buyer (see section 3.3.4.2). One of the purchasing managers in the food industry said, "The supplier insisted on not accepting the return of any of its orders, even if ordered by mistake, which meant increases in costs to us". Also, "sometimes we did not get technical support from the supplier, which left us facing difficulties with our production, which affected our delivery to the end customer". Another purchasing manager in the petrochemical industry said, "Not providing any facilities to us for payment caused problems between us and our customers, especially if the supplier used different payment methods from those used by us". For example, some suppliers took payment for order before production or on delivery, but the problem remained because these methods of payment were not appropriate for buyers because most of them dealt with customers on credit basis, which entailed buyers having to confront difficulties in their production process caused by shortages of raw materials. Another example from a different culture in which the supplier sometimes deliberately increased the invoice amounts to keep prices for the buyer secret from supplier's competitors; then, after the buyer had paid the bill, the supplier refunded the excess amount. This occurred in captive buyer relationship.

#### 6.2.2.1.4 Unsatisfactory compensation

The study found that if compensation was not fair for the suppliers or if they did not receive it regularly, they would try to take advantage of every opportunity to make gain, by increasing service costs or cost of raw material or labor costs on the excuse of shortages in their availabilities (see section 3.3.4.3). The researcher found that two of the petrochemical industry company suppliers and one in the communication industry company supplier would ask buyers for an eight percent increase in such raw material price where the actual increase had only increased five percent. Or, even if there was no real shortage of certain materials or of labor, they would still ask for an increase. So, because of this factor suppliers would not end up providing what the buyer actually wanted. Buyers felt that suppliers should not be upset when they did not receive their compensation regularly, because suppliers were sure they would receive it, even if it was delayed; nonetheless, some buyers were considering how to improve payment mechanisms in order to receive their orders on time. One of the purchasing managers in the petrochemical industry said, "In the strategic partnership, we should be flexible in ways which suite the supplier so that they are satisfied with their compensations and apply a new technology approach such as wire payment". This occurred in strategic partnership.

#### 6.2.2.1.5 Buyer poor future order plan

This happened in the market exchange relationship, the strategic partnership and captive supplier relationships. The researcher found that when the buyer has a poor future order plan, he/she causes problems by confusing the supplier's plan or giving the supplier a chance to misuse circumstances. In this situation the buyer may be forced to accept the order, even if it did not conform to his requirements. For the same reason (no or poor future order plans from the buyer), the supplier's production will get confused because of commitments to any other buyer or due to lack of raw materials or lack of supplier benefit (profits) to stop mass production of certain products or changes made in machine settings or making such adjustments simply to comply with the buyer's requirements for a different product. One of the packing suppliers mentioned, "if the buyer does not provide his order plan in advance, our production plan will be confused which may cause problems either in order requirements or order delivery".

#### 6.2.2.1.6 Poor supplier management

Another cause for problems arises when poor supplier management does not have a good future plan to balance production capability and order acceptance. The buyer will then be affected negatively because of difficulties in order production. This happens in captive buyer, captive supplier and special case market exchange relationships. For example, the study found that one of the suppliers, who works with one of the petrochemical industry buyers in transportation services, delays a lot of order deliveries because of lack of trucks. The main cause of the problem was that the supplier has not had future plans for buyer requirements, which caused problem to the buyer. In another example, the study noticed that one the suppliers in the food industry keeps accepting orders for more than his production capacity which then causes delivery problems for buyers. Poor supplier management potentially affects the buyer negatively in different ways: when supplier management does not develop or improve capabilities to serve the buyer while the buyer has expanded its production; when supplier management does not have enough management tools and mechanisms to control and manage the firm's operations in order to ensure that their operations are effected properly. This raises problems between buyer and supplier because of order quality. This happened in the captive supplier relationship. One of the purchasing managers in the glass industry said, "We noticed that there were defects in the color of printing ink in packing orders because one worker, who worked with a packing supplier used to change the percentage ingredients of our packing order by his own decision, which means there is no control of operation by this supplier".

#### 6.2.2.1.7 Frequent changes in a supplier's management

This happens in the market exchange relationship and in the captive supplier relationship. When there are frequent changes in a supplier's management, this will give the supplier's new management a chance to behave opportunistically by shirking their responsibilities to buyers, or when changes occur in the specific person responsible for buyer communication or the information sharing mechanism. This causes instability in existing relationships and affects the buyer negatively. Some of interviewees, two in the communications industry, three in the stationery industry, mentioned that changes in supplier management frequently disrupt their plans and affect their decision making, negatively.

#### 6.2.2.1.8 No commitment from the main supplier

This happens in the market exchange relationship and in the captive buyer relationship. When there is no commitment from the main supplier to serve the supplier, this will cause problems to the buyer. The study noticed that one of the food industry suppliers provided a defective order (honey) to a buyer. After an investigation it was found that the problem was not from the supplier, it was from the farmers (main supplier) who decreased the order quality to increase their profit. Problems also arise when the supplier fears that his main supplier may force him/her to support the main supplier's decision against the buyer, even if this goes against the buyer's interests. As a result, this affects the supply chain, which in turn affects the service commitment from the supplier to the buyer. Two purchasing managers, one in the petrochemical industry and the other in the communication industry said, "When we found any defects in supplied order of spare parts, the supplier supported main supplier decision whatever it is, and never stand with us."

#### 6.2.2.1.9 Weak brokers

When the buyer and supplier depend on a weak broker, this may cause problems, especially if the broker is not honest and works only for his/her benefit. This happened in the market exchange relationship. One of the purchasing managers in the glass industry and two in the communication industry said, "Brokers are very important links between buyers and suppliers, because as much as they are professional in practice their work, the relationship between buyer and supplier will be successful”. Furthermore, because of the wish of suppliers to keep buyers dealing with them alone, suppliers withhold information about services or products to prevent buyers from dealing with another supplier. This occurred in the captive buyer relationship. Three of the purchasing managers in the petrochemical industry and one in the food industry mentioned that some equipment suppliers do not provide manuals with supplied equipments in order to prevent us knowing what exact spare parts which we need and to not understand how the equipment could be fixed. In general, they want us to keep contacting them for all any of our needs.

**6.2.2.1.10 Shortage of raw materials**

If there is a shortage of raw materials in the market, this shortage will increase the prices of raw materials (the supplier can gain an advantage from these increases by increasing the price above than what may be necessary). This cause sometimes pushes the supplier government to make decisions which affect buyers negatively in order to protect their state industries. This allows the supplier to misuse the circumstances to gain advantage from these decisions, which represents bad behavior on the part of the supplier’s management. This occurred in the captive buyer relationship. For example, five years ago the French government decided to stop the export of aluminum raw materials because of shortages. This led some suppliers asking for high increase in price of raw materials from the buyers who then decided to place their orders on foreign overseas suppliers. All this affected buyers, negatively.

#### 6.2.2.1.11 Differences in work style

Another cause arises when there are differences between buyer and supplier work style, and the supplier does not take action to adapt to the other work style, or encourages employees to improve their work performance by providing incentives to suit their buyers' requirements. In such cases, the buyer will be affected in terms of operational costs and decision making. This occurred in the strategic partnership. One of the purchasing managers in the communication industry mentioned that they invested a lot of money and time in a new information technology 'receipts system' and make it a part of their supplier 'receipts system', which ended up increasing their operational costs.

#### 6.2.2.1.12 Supplier misunderstanding

When the supplier misunderstands the buyer and assumes that the buyer will agree to any of their requests and then does not do so, problems between them will arise, and the relationship becomes tense, which affects the buyer negatively. This happened in the strategic partnership. The study noticed that because of the long relationship between one of the buyers in the petrochemical industry and his supplier, the suppliers assumed that any increases in the price will be accepted by the buyer, but it turned out they would not. The buyer refused this increase and discussed it with supplier, which made their relationship quite tense.

#### 6.2.2.1.13 Poor security conditions in the buyer or supplier countries

Additionally, poor security conditions in the buyer or supplier countries, if they are different, could cause difficulties in delivery of orders, difficulties in supplier's movements and increases in the delivery and insurance costs. This occurred in the strategic partnership. Four of the purchasing managers, one in the glass industry, two in the petrochemical industry and one in food industry mentioned that they faced a lot of problems and delayed delivery of a lot of orders to their customers during the First and Second Gulf Wars.

#### 6.2.2.1.14 Supplier's work characteristics

There are other causes that affect the buyer's work negatively, which are: the supplier's work characteristics, such as bureaucracy, working practices, varieties of holidays or lack of a production plan. A personal relationship between the supplier's manager and the seller's manager whereby a specific buyer affects another buyer negatively in cases when the specific buyer is given priority in receiving his/her orders first. Personal interests of one or more of buyer board members, who insist on continuing to deal with a specific supplier, which does not comply with the buyer's requirements, all these cause problems to the buyer as a firm in the special case of the market exchange relationship. One of the purchasing managers in the food industry said, "Suppliers should provide all information that the buyer needs clearly without any biased preferences between buyers"

#### 6.2.2.1.15 External owners cause

Although external owners may affect the relationship between buyer and supplier negatively because of the limitation in ability to evaluate and control managers, by giving managers the chance to work for their own external owners' special interests (Li and Simerly, 1998) (see section 3.3.4.5). None of the buyers interviewed mentioned this cause. This can be explained by the type of management hierarchy in Saudi firms. In general, most Saudi Arabia firms are controlled and guided by the firms' private/family owners (25,506 privet firms out of 26,658 total firms, see section2.3) who have full authority and ability to evaluate manager behavior and the firm's workings. Even when such a firm is listed on the stock market, or has several different owners, it is still the establishers who tend to have majority equity shares in the firm in order to retain their authority in guiding the firm. However the study found that in a different way the cause as mentioned by food, petrochemical, glass and communication industries suppliers earlier that sometimes the buyer did not choose employees carefully which then caused a problem is correct. This kind of problem occurred when purchasing department employees tried to avoid dealing with suppliers because suppliers refused to pay a bribe, when buyers' employees were weak in indicating order specifications, which led to the suppliers who agreed to produce these orders to have supplier agency problems. In order not to lose their customers, especially when buyers' purchasing department employees behave unprofessionally with suppliers' sales employees causing personal conflicts between them which lead to supplier agency problems, buyer firms should follow up on their employees' performances.

On the supplier side, the researcher also found the same problem. Sometimes the supplier did not encourage employees to develop their performance or improve work performance by providing incentives to suit buyers' requirements. Sometimes, when the supplier did not have a robust system that could follow up their representatives' personal behavior, problems might arise. Representative selection should be done carefully by both buyers and suppliers. This concludes that problems could occur because of employee behavior and their personal agendas.

#### 6.2.2.1.16 Summary

In short, from the above causes, the study found that there were some causes which corresponded with the causes mentioned in the literature in chapter three which might induce problems. These were the one-shot or short term nature of the relationship's (Sharma, 1997), cultural differences *(Ekanayake, 2004)*, unsatisfactory compensation (Conlon and Parks, 1990), improper agent selection (Stump and Heide, 1996). However, the researcher found that there were additional causes that might create agency problems than those which were stated in the literature. These causes are: buyer poor future order plan, poor supplier management, frequent changes in a supplier's management, no commitment from the main supplier, weak brokers, shortage of raw materials, differences in work style, supplier misunderstanding, poor security conditions in the buyer or supplier countries, supplier's work characteristics. This represents the differences between Saudi firms and those in other countries, which is another significant finding. This leads to the conclusion that, although there are many common causes of problems, each market has different ones depending on the characteristics of that market. However, these causes may be found in other markets around the world but these have not been studied, yet.

#### 6.2.2.2 From the supplier perspective

From the supplier interviews, there were causes pushing them to act opportunistically. These causes were divided into two sections: external causes (out of the supplier's hands) and internal causes (arising from the supplier's intention). All these causes were discussed in chapter five in detail (section 5.6.2).

The external causes were:

1. Problems from the main supplier
2. Work depending on the work of another supplier
3. Differences between the buyer's and supplier's procedures

4. Difficulties in order transportation
5. Delay in documentation procedures from customs or other parties

The internal causes were:

1. The supplier's preference of one buyer over another
2. The supplier's work environment
3. New competitors entering the market
4. Working in more than one industry
5. Lack of qualified workers
6. Buyer's harshness

Buyers should give these factors a great deal of attention, and try to assist suppliers to overcome them, because some of them can be solved by buyers, such as buyer harshness. At the same time, suppliers should not capitulate, and should try to resolve the causes, which may give the supplier (representatives) a reason to act opportunistically as opposite reaction or as revenge. They need to improve their systems, employees and abilities to concentrate on their core product to become robust competitors in the market because of internal and external reasons, both.

### *6.2.3 Q3: How can these problems be controlled and what are their effects in terms of understanding the reality of the outsourcing relationship, and how it can be improved?*

The study found that each relationship type used appropriate mechanisms, and the presence of problem controlling mechanism did not mean that, as soon as a mechanism was used, the problem/problems would be solved or not occur again.

Using a problem controlling mechanism might stop or prevent the occurring of problems, or decrease their negative effects. However, a problem control mechanism could be applied to control the supplier's behaviors, which caused problems. The researcher found that problems can be controlled as follows:

### 6.2.3.1 From the buyer perspective

#### 6.2.3.1.1 Market exchange relationship

It was found that the market exchange relationship used a contract (outcome-behavior based contract) and relationship type (exit-voice relationship type) in an outcome-based contract, compensates agents for achieving certain of the principal's goals or outcomes. A behavior-based contract compensates agents for performing certain tasks or behaving in a certain way whereas in a relationship type or an exit relationship type, when a buyer has a problem with a supplier, finds a new supplier. In a voice relationship type, the buyer works with the original supplier to resolve the problem), making work more programmable, using a strong broker to control problems (see section 5.2.3). Two of these mechanisms have been mentioned in previous studies, contract and relationship type strategy (Mahaney and Lederer, 2003; Helper and Sako, 1995) and making work more programmable (Eizenhardt, 1989), but using a strong broker has not been considered before. Buyers and suppliers prefer to deal with a broker than to deal with each other directly to decrease operational costs, so the presence of brokers in this relationship is important for both. Additionally, because the orders (products/ services) are consumed, and a large amount is continuously needed, dealing with brokers is a good idea for both (buyer and supplier) for continued working. One of the purchasing managers in the petrochemical industry said, "Using a broker in continuously consumed products allows us to concentrate on our core works”. Buyers and suppliers found that using a strong broker mechanism was useful, especially after buyers and suppliers found that many problems could be caused between them by a weak intermediary or broker.

The controlling mechanisms used in the special case of the market exchange relationship, where the government is the supplier (nationalized or state industries), were dealing with another supplier and meeting with such a supplier ( see section 5.2.5.1.1). The objective of dealing with another supplier was not to create competition, as in the other types of relationship, but to reduce the negative effect which might occur from delays in delivery, by making up for the reduction in the order quantity. Two purchasing managers in the food industry mentioned that they always deal with another supplier in parallel with the governmental supplier because they do not have full confidence that he/she will supply their order continuously.

Meeting with the supplier was also an effective mechanism to exhort the supplier to provide orders on time because in a personal meeting the buyer could represent his/her actual situation in the field, which encouraged the supplier to understand the situation. One of the purchasing managers in the stationery industry said that “meeting is a fabulous way to resolve any problem or misunderstanding with the supplier”

The controlling mechanisms used in the special case, where the supplier lacks market knowledge, were: contract and relationship type to make work more programmable (see section 5.2.5.1.1). The researcher found that, because suppliers did not have enough knowledge about the market, they were weak and hence, did not have a good plan or system to organize their works, thus making work more programmable for them. This was the appropriate mechanism to control such suppliers and reduce the negative effects. Further, using an exit strategy and outcome based contract forced them to work for the buyer's interests, and this corresponds with what suppliers visited emphasized during their interviews. Two of the food industry company suppliers and two of the stationery company suppliers said, "When buyers use an exit relationship, suppliers try their best to achieve the buyer's goals. They fear that, if they do not work hard to gain the buyer's confidence, that buyer may go to a competitor or work with more than one supplier, which would put us in a competitive situation".

Unfortunately, the researcher found that there was no mechanism which could control the supplier who dealt with the buyer because of the personal interest incentive of one or more board members who insisted on continuing to deal with a specific supplier in the special case of the market exchange relationship.

#### 6.2.3.1.2 Captive buyer relationship

In the captive buyer relationship, the mechanisms used to control supplier behavior were (see section 5.3.3): contract and relationship type (Mahaney and Lederer, 2003; Helper and Sako, 1995), creating competition, personal relationship, reputation (Sharma, 1997), strong negotiation and making work more programmable (Eizenhardt, 1985). As with the market exchange relationship, some of these mechanisms have been discussed in the literature before, and others have not. The buyer in this relationship needs and depends on the supplier, so these mechanisms may not be entirely effective, but they can help.

Creating competition (see section5.3.3.2), personal relationship (see section 5.3.3.3 and strong negotiation (see section5.3.3.5) have not been discussed before in the literature. The effectiveness of creating competition mechanism depends on the presence of a competitor supplier in the market or the way this can give an impression to the supplier that the buyer may work with another supplier. The suppliers visited emphasized the factor of the buyer dealing with more than one supplier to prevent them acting opportunistically and forcing them to work hard on the buyer's behalf so as not to lose their percentage of work to their competitors.

The personal relationship mechanism represents the business culture in Saudi Arabia. In Saudi Arabia this factor plays a very important role in people's life. Through personal relationships a lot of problems can be solved, and this behavior reflects on the buyer and supplier relationship. One of the purchasing managers in the glass industry said, "Personal relationship is an important key in Saudi Arabia".

Strong negotiation was a very effective way to control supplier behavior, especially at the beginning of the contract, or when the buyer and supplier were still negotiating the contract before signature, but this could be risky. This mechanism was important because it represented the strength of the buyer to deal with another supplier or his knowledge about the market, or the fact that he was not dependent on that supplier, which encouraged the supplier be careful with him, thereby reducing opportunistic supplier behavior. The buyer might give this feeling to the supplier, even if he did not really have another choice on controlling the supplier. From the supplier's side, three of the petrochemical industries visited, the company suppliers and two of the food industries visited, the company suppliers cited the factor of buyer strength to prevent the supplier acting opportunistically because suppliers knew that such buyers had a lot of information about the market, and they knew exactly what they wanted (they were specific in their orders). Hence, acting opportunistically would be difficult for them.

#### 6.2.3.1.3 Strategic partnership

In the strategic partnership, the controlling mechanisms found in the research were (see section 5.4.3): contract and relationship type (Mahaney and Lederer, 2003;

Helper and Sako, 1995), creating competition, personal relationship, incentives (Jensen and Meckling, 1976), increasing buyer knowledge (Sharma, 1997), monitoring (Tosi and Katz, 1997) and making work more programmable (Eizenhardt, 1989).

Creating competition (see section 5.4.3.2) and personal relationship (see section 5.4.3.3) are the only ones which have not been discussed previously in the literature but have been discussed in the captive buyer relationship. There are slight differences between the strategic partnership and captive buyer relationships**.** The differences are: in the strategic partnership, the probability of the presence of more than one supplier in the market is greater than in the captive buyer relationship. This means that the effectiveness of using the creating competition mechanism to control supplier behavior in the strategic partnership is higher than in the captive buyer relationship because the supplier, in a strategic partnership, is sure that there is another supplier in the market willing to acquire any percentage of available work, which is why this mechanism is effective. However, in the captive buyer relationship, the effectiveness of this mechanism depends on supplier knowledge about the presence of another supplier and buyer plans. The supplier may relent for some time if the buyer has a choice, but as soon as the supplier feels his/her position in the market is stronger, he/she may return to previous opportunistic behaviors.

Personal relationships seem to be stronger in the strategic partnership than in captive buyer relationships. This is because there is greater dependency on each other in a strategic partnership. One of the purchasing managers of the glass industry said, “Dependency between us and our suppliers, which has been created for long time, can resolve most of the problems”

#### 6.2.3.1.4 Captive supplier relationship

Finally, in the captive supplier relationship, the mechanisms used were (see section 5.5.3): contract and relationship type (Mahaney and Lederer, 2003; Helper and Sako, 1995), creating competition, monitoring (Tosi and Katz, 1997), increasing buyer knowledge (Sharma, 1997), using of penalties (Jensen and Meckling, 1976) and making the work more programmable (Eizenhardt, 1989).

Creating competition was the only mechanism not previously discussed in the literature in chapter three (section 5.5.3.5). Creating competition and using penalties were very effective mechanisms to control opportunism in this relationship because of the fierce competition among suppliers. Hence, each supplier feared loss of percentage of work to competitors, and this corresponds with what the suppliers visited, stated strongly during their interviews. One of the purchasing managers of the transportation industry said, “If there are many suppliers in the market who can provide the same product, the supplier control will be easy”.

Using penalties (see section 5.5.3.6), which was written into the contract between buyer and supplier, forced the supplier to work continually for the buyer’s interests. From the supplier’s side, four of the petrochemical industries visited, the company suppliers and two of the stationery industry company visited, suppliers emphasized the factor of using penalty conditions to prevent them from acting opportunistically against buyers. Suppliers feared these penalties, because they might lose their profits from the contract. For example, the study found that three of the petrochemical industry companies, two of the stationery industry companies, one of the food industry companies and one of the glass industry companies are all applying penalties on delayed delivery by deducting the penalties imposed from their due payments and allowances.

#### 6.2.3.1.5 Summary

The study concluded that the buyers' and suppliers' culture and characteristics of each market may compel new mechanisms to be tried and used. All the problem controlling mechanisms were found to be applicable in the Saudi market, except the customized investment mechanism (The principal and agent's specific investments in each other make the two parties highly interdependent, at the same time pushing the agent to work in the principal's best interests) (Dyer and Ouchi, 1993). None of the buyers visited mentioned this mechanism. Human cultural behavior in Saudi Arabia is reflected in buyer and supplier relationships. Most Saudis, even in a strong relationship prefer not to make investments with each other; they prefer to work independently/ privately (25,506 privet firms out of 26,658 total firms, see section 2.3). May be this was why the buyer preferred to control the supplier by using mechanisms than the customized investment mechanism.

Also, it is important to state that a decision resulting from a problem in a relationship can be taken for controlling supplier behavior. For example, when the buyer makes a decision to increase the percentage of stock, he also does this to reduce the negative effects which may occur because of delays in delivery.

In addition, the study found that certain mechanisms, found during this study have not been discussed in previous studies by researchers. These mechanisms are: creating competition, personal relationship, strong negotiation and using a strong broker, which is another significant finding in this study. The other mechanisms which have been mentioned in the literature such as contract types are; outcome based contract, behavior-based contract (Mahaney and Lederer, 2003; Helper and Sako, 1995), monitoring (Tosi and Katz, 1997), incentives (Jensen and Meckling, 1976), programmability of the task (Eizenhardt, 1989), principal knowledge (Sharma, 1997), customized investment (Dyer and Ouchi, 1993), community reputation (Sharma, 1997) and using penalties (Jensen and Meckling, 1976).

Finally, the study found that the common mechanism, among the four types of relationships, are; contract and relationship type (as mentioned later) and making work more programmable. This implies that suppliers in the Saudi market can be controlled by threats of using an exit relationship strategy and outcome-based contract which force suppliers to work on buyers' behalf. It was also found that making work more programmable implied a lack on the part of management to improve and develop work in the Saudi market. Haphazard work practices resulted from poor supplier management, a poor future plan with buyers or suppliers, or frequent changes in the supplier's management, were factors from which the problems arose.

Hence, making work more programmable is an effective mechanism to control and resolve the negative effects of these causes in all types of relationship. Maybe this mechanism reflects non Saudi management, which looks only for their own interests (see section 2.3.6), which causes problems.

#### 6.2.3.2 From the supplier perspective

From the supplier perspective, the suppliers interviewed mentioned that there were some causes that prevented them from acting opportunistically against buyers (see section 5.6.1). These causes corresponded with buyers' views and what has been discussed in previous literature. The causes were:

1. Continuity and a long relationship with the buyer

Thirteen suppliers in food, petrochemical, transportation and glass industries cited that because of the personal relationship and friendship between employees, which was created over a long time, the understanding, sharing and transferring of information between buyers and suppliers had increased and due to this, problems had been solved prior to occurrence. In general, four suppliers in the food, glass and communication industries stated that personal relationship and friendship between buyers and suppliers encouraged the relationship between them to become successful because they had depended on long term contracts; past, present and future in the areas of actual operations, production plan, raw materials' order plan and in future planning covering expansion plans.

Fifteen suppliers out of seventeen in different manufacturing and services industries mentioned that they felt that they were more loyal toward buyers who used a long term contract or had a long term relationship with them with encouragement to buyers to use long term contract and get payment facilities, discounts and free assistance in completing their jobs, such as assistance in product designing or in financing.

Although there were many advantages accruing from the use of long term contract, six suppliers in food, petrochemical and transportation industries mentioned that there were still some disadvantages, such as the risk of price fixing for long periods, which was hazardous to suppliers, in case prices changed in the future and at the time of delivery, causing higher storage costs for the supplier. However, the study found that other suppliers visited, preferred to accommodate these types of hazard in order to gain a long term contract. This point has been mentioned in the literature as one of the control mechanisms (Logan, 2000).

2. Order size and dealing with more than one supplier

Fourteen suppliers in the transportation, communication, petrochemical and food industries have mentioned that the buyers dealing with more than one supplier created competition situations among suppliers. This study also found that the order-size factor prevents the supplier from acting opportunistically. For example, in a strategic partnership, the study found that, if a feasibility study was discouraging the supplier (not beneficial) from stopping mass production of specific products and/or change all machine settings and/or make adjustments because of the buyer's requirements for another product, they would not be executed/implemented. Hence, suppliers ended up delaying delivery until they had used up the mass produced products or accumulated all their orders for this product. In such cases, it was beneficial for them to produce it. However, a single large order could prevent this from happening. Hence, "order size can prevent the supplier acting opportunistically", as one of the food industry company supplier said. This point has not been mentioned in the literature, which is significant in this research.

3. Buyer strength in the market

This has been discussed before in captive supplier relationship incentives (buyer's respective strength in the market) , but it can be added here that the researcher found that in a captive supplier relationship, if the buyer was strong and had a known franchise in the market, most suppliers worked to supply to him/her. Suppliers wanted to gain an advantage from working with such a buyer by joining their name with the buyer's name to achieve a strong market position. At the same time, it was found that buyers gave the supplier's reputation and position in the market a great deal of attention before they chose to deal with that supplier. This factor corroborates what was stated by the suppliers interviewed. It found that fifteen of the suppliers, working in glass, food, petrochemical, transportation, stationery and communication industries, paid this type of buyer (state and/or multinational buyers) a lot of attention because they were classified as strong partners, and because suppliers were guaranteed their payments promptly and without delay. They also knew that these types of buyer usually used long term contracts, which was desirable. Hence, they tried to encourage those buyers to continue dealing with them, and to gain their confidence. This point has not been mentioned in the literature.

4. Buyer selection method

Using an appropriate selection method was important not only for the buyer when selecting a supplier to prevent problems from occurring, but also for the supplier to select buyers appropriately in order to prevent them from acting opportunistically. Fourteen of the suppliers visited, working in the glass, food, petrochemical, transportation, stationery and communication industries mentioned that, if suppliers were selective about the buyers with whom they were dealing with, this would decrease their tendency to act opportunistically. Suppliers selected buyers with whom they were going to deal with, dependent on prompt on time payments, good reputation and a stable position in the market. This point has not been mentioned in the literature.

5. Supplier image

Suppliers looked to acquiring a good image in the market, because one of the mechanisms used to control the supplier in a captive buyer relationship is, reputation. A supplier fearing bad reputation was forced to work on behalf of the buyer. This came from suppliers being afraid that bad reputation might affect their relationship with other buyers too. Bad reputation affects supplier image negatively. Sixteen out of seventeen suppliers visited, working in the glass, food, petrochemical, transportation, stationery and communication industries, mentioned that their image in the market was very important for them, which was why they did whatever they could to enhance it. They did not increase prices and try to deliver orders on time without defects to the best of their ability. This point has been mentioned in the literature as one of the control mechanisms as a community reputation (Sharma, 1997).

6. Strong supplier management system

A strong system has not been mentioned in the literature. It was found to be an important factor for both buyer and supplier. The buyer should apply a strong management system where they follow up on their employees, especially purchase department employees, because sometimes they push suppliers to act opportunistically. The supplier should apply a strong system to follow up on their employees in order to prevent them from acting opportunistically against the buyer because of their possible hidden agendas. One of the suppliers to the food industry and one of the suppliers of the petrochemical industry said, "We have to follow our employees and observe them carefully because they may make problems". For example, it was noticed that in a captive buyer relationship one of the problem causes was dealing with a weak broker. This cause affected relationship because the supplier did not have a strong system to monitor the broker, which allowed the broker to cause problems between the buyer and suppliers. Eight of the suppliers visited, working in the glass, food, petrochemical, stationery and communication industries, said, "if we do not keep the brokers under our observation carefully, the broker could refer any of their opportunistic behaviors to us, such as delay in delivery or increase in price because of his private benefits, which may cause tension in the relationship between us and our buyers". Six suppliers visited, working in the petrochemical, transportation and stationery industries, stated that they should have a robust system to follow up on their representatives so as to prevent them from acting opportunistically. A strong system includes having a system of employee hiring and their pre-job or on-job training. The study found that in a strategic partnership one of the problem caused, occurred because suppliers did not encourage their employees by providing them incentives (allowances or rewards) to push them to develop and improve their work performance to meet buyers' requirements. In addition, they did not assist their employees by giving them proper training. In a captive supplier relationship, the study found, one of the problems was caused because suppliers did not select their employees carefully. The suppliers visited stated that it was important for suppliers and buyers to be selective in choosing their sales employees or procurement employees (in the case of buyers) and in particular, their representatives. They should also provide training to improve their employees in fostering good relationships between buyers and suppliers.

7. Buyer knowledge

Buyer knowledge was mentioned many times as a mechanism in strategic partnership (see section 5.4.3.6), captive supplier relationship (see section 5.5.3.3) and the literature (Sharma, 1997) which could be used to control supplier behavior. Eight suppliers in the glass, food, petrochemical industries preferred to deal with buyers, who have good knowledge about the market, because if suppliers faced or caused any type of problem, these buyers would understand the situation better than other buyers. For example, the raw materials' prices were increased in the petrochemical industry, some buyers could refuse such an increase in price, but others aware of the reason for such increases would accept the same.

8. Penalty conditions

Penalty conditions were discussed in the captive supplier relationship (see section 5.5.3.6), but it is important to mention that this cause can also be considered generally as an incentive to control suppliers (Jensen and Meckling, 1976). The study found that it is not only necessary for buyers to use positive incentives to encourage suppliers to work for them, but also negative incentives, such as penalty conditions, can be used to prevent suppliers from acting opportunistically. For example, one of the food industry suppliers said, “We feared these penalties because we could lose the profits in the contract”.

9. Buyer follow-up

This approach was also used by buyers as a mechanism in different types of relationships. The buyer used this mechanism during monitoring, and made tasks more programmable to facilitate a follow-up system. This was one of the effective mechanisms because a problem could be observed and solved early on. Buyer follow-up (monitoring) has been mentioned in the literature (Tosi and Katz, 1997; Eizenhardt, 1989). Thirteen suppliers visited, working in the glass, food, petrochemical, transportation, stationery and communication industries mentioned that when they felt that they were being followed up through buyer’s visits, telephone calls, meetings or letters, they were forced to work on the buyer’s behalf and it was difficult for them to act opportunistically.

10. Buyer/order simplicity

The study noticed that when the buyer knew exactly what the order requirements were, the supplier could not act opportunistically. Such buyers had enough knowledge about the market and production processes and, hence, could assess the difficulties which the suppliers would be facing, if they changed specifications, or if they ordered more than they actually needed. Hence, dealing with such buyers was something which suppliers liked and which forced them to work in their interests. For example, two of the food suppliers visited said, “The weak and dishonest suppliers do not like their orders to be simple because sometimes the complexity of a buyer’s order encourages them to act opportunistically”. Additionally, suppliers in the transportation, stationery, and glass industries stated that, “if a buyer was simple to deal with and gave the supplier more freedom or chances to resolve a problem, this might prevent the supplier from acting opportunistically. This helps the supplier in feeling more confident and loyal towards the buyer". They also mentioned, "If the buyer's employees scrutinized the personal habits or the dress of a supplier or were suspicious on the supplier's honesty, the supplier might act opportunistically with that buyer" (see sections 2.3.6 and 6.2.2.1.15). This point has not been mentioned in the literature.

11. Buyer stability and loyalty

Stability was found to be an important factor for both, the buyer and the supplier. The study found that the stability of suppliers in the market was one of the incentives encouraging the buyer to deal with a supplier in the market exchange relationship. Fifteen suppliers visited in **the** glass, food, petrochemical, transportation, stationery and communication industries stated that when suppliers dealt with stable buyers, they sought to have a long term relationship with them, because they felt secure and also because there was a good chance to continue working stably in the market. On the other hand, it was found that the supplier felt more loyal towards a buyer, who was loyal by supporting and assisting in overcoming difficulties and obstacles because this would in its turn prevent the supplier from acting opportunistically with that particular buyer. Hence, they worked hard on buyers' behalf to assist them in being successful in the market. One of the suppliers visited in the stationery industry said, "Feeling of loyalty from the buyer encouraged us to give him/her a good price and a high level of commitment". This point has not been mentioned in the literature.

12. Using the exit relationship and outcome-based contract

This will be discussed in the next section.

It concluded that, from the supplier's perspective, there were some measures that prevented them from acting opportunistically against buyers which have not been mentioned in the literature such as order size and/or dealing with more than one supplier, buyer strength in the market, buyer selection, strong supplier management system, buyer's order simplicity, buyer stability and loyalty. Buyers should take all these and the other causes into serious account and pay a lot of attention in order to encourage suppliers to deal with them without behaving opportunistically.

**6.2.3.3 Using relationship type as one of the controlling mechanisms**

The researcher also found that one of the classifications of relationship types, the "Exit-Voice" framework (Helper and Sako, 1995), was used by the buyer as a control strategy. For instance, in the captive buyer relationship, when the buyer used an outcome-based contract (An outcome-based contract compensates agents for achieving certain of the principal's goals or outcomes) and exit relationship strategy with the supplier, the buyer knew that this would not prevent the supplier behaving opportunistically, especially if the buyer could not exit from the relationship because the supplier was an expert in buyer's product or was the only one in the market, but it could decrease such behavior to some extent.

The researcher found that, as soon as the supplier felt that a buyer was going to deal with another supplier, that supplier tried to satisfy the buyer as much as possible by doing what buyer asked immediately, even if this had been refused before. Using an outcome-based contract and exit relationship strategy as a control mechanism puts pressure on the supplier to work on the buyer's behalf by warning the supplier that, if he/she behaved opportunistically, there was a chance for the buyer to switch to another supplier without hesitation, which then forced the supplier to build good relationship in order to retain the buyer.

From the supplier side, some of the suppliers visited emphasized this. The researcher found that two factors prevented the supplier from acting opportunistically; in order to have a continuous and long term relationship with the buyer (discussed in continuity and a long relationship with the buyer factor from supplier the perspective) and use an exit relationship and outcome based contract. Twelve suppliers visited, working in the glass, food, petrochemical, transportation, stationery and communication industries said, "using an exit relationship and outcome-based contract encouraged us to work on behalf of the buyer because we feared that if we did not work hard to gain the buyer's confidence, that buyer might go to another competitor, which put a lot of pressure on us to fulfill their commitments without acting opportunistically". Hence, buyers and suppliers agreed that this type of controlling mechanism prevented the supplier from acting opportunistically.

It was found that this strategy ("Exit-Voice") was a common strategy among all types of relationship, the market exchange, captive buyer, strategic partnership and captive supplier. However, it is important to mention that, although this mechanism was applied in all relationship types, it occurred at different levels. It was used in the market exchange relationship as a way to force the supplier not to behave opportunistically because of the pressure of being dropped at any time on account of opportunistic behavior, or the buyer could stop the opportunism by changing supplier immediately because there were other suppliers that could provide the buyer's needs in the market. In the captive buyer relationship, using an exit relationship strategy was not sufficient to control because either the buyer needed the supplier, or there were no other suppliers in the market, but as discussed before, the buyer believed that using this strategy would decrease opportunistic behaviors in some way. In the strategic partnership, an exit strategy could be used as a final solution if the buyer found that the problem would not be solved or continued to force the supplier to act. In the captive supplier relationship, although a voice relationship was used, buyers used an exit relationship strategy when they felt that there was no way to encourage the supplier to work for what they required. It was noted that most suppliers backed off when they felt that the buyer was going to exit from the relationship. Finally, in the special case of the market exchange relationship it was found that the same strategy was used with the supplier, who did not have market knowledge; such a supplier could be forced to work for the buyer's interests by giving suppliers an indication that the buyer could exit from the relationship at any time, because there were other competitive suppliers willing to provide the same order whenever the buyer needed it. However, buyers were careful about not putting excessive pressure on the supplier by threatening to exit from the relationship so as not to allow the supplier to lose losing enthusiasm to work on the buyer's behalf.

### 6.2.4 *Q4: What are the effects of the problems on each relationship in the market? And finally what the effects on the research model in each relationships?*

#### 6.2.4.1 The effects of the problems on the relationships

Outsourcing relationships are affected negatively because of problems which occur. Production unit costs will not be reduced because of an agent's opportunism, quality will not be improved because of potential shortcutting in time or procedures, the right decisions cannot be made because of information that has been hidden from buyers, competition with other agents will be curtailed because of the unethical approaches of the agent and /or orders or services will not be delivered on time. One of the agency problem causes is monopoly which threaten the efficiency effects of the market by reducing competition, which in turn affects economic growth as discussed in final effect later (Tezuka, 1997).

The researcher found that the effects did not all occur at once, but in two or three stages of first effects, second effects and third effects. The researcher also found that there were other effects that occurred before first stage, but these effects were classified as a result of the initial cause of a problem; it was the first stage of effects that affected buyers harmfully.

For example, in a market exchange relationship, when the buyer used an inappropriate supplier selection method such as price, the first result of this cause was that the buyer would deal with unqualified suppliers or suppliers who were dissatisfied about their compensation. These first results led suppliers not to work for the buyer's interests either intentionally or unintentionally. The buyer would be affected negatively by delays in delivery, increases in costs and prices, receiving poor quality and confusion in buyer's plan, which is the first stage of effects as it was discussed in chapter five in detail (section 5.2.2.1).

Another example is that in a captive buyer relationship, when the supplier had poor management, the first result was that the existing and future production plan would be affected, which created confusion by letting the supplier take on more orders than capabilities permitted. This would affect delivery to some buyers and increased the cost of operations to others as the first stage of effects, as it was discussed in chapter five in detail (section 5.3.2.1).

#### 6.2.4.1.1 First effects

The study found that the negative effects of the problem causes on the market exchange relationship in first stage were delivery, cost and price, quality, confusion in buyer's plan (see section 5.2.4.1). Also, in captive buyer relationship, the negative effects were delivery, cost and price buyer's production (see section 5.3.5.1). In addition, in strategic partnership, the negative effects were delivery, cost and price, problem solution (see section 5.4.4.1). Finally, in captive supplier relationship, the negative effects were delivery, cost and price, quality( see section 5.5.4.1).

It is observed that each relationship had different effects from one another because each type has different characteristics and incentives to be created, which react with buyer and supplier behavior, but some effects were common to all (Delivery, cost and price). Delivery, cost and price were affected negatively in the market exchange, captive buyer, strategic partnership and captive supplier.

The researcher found that, even if these effects occurred in all types of relationship, the causes of each were different from one relationship type to another.

For example, in the market exchange relationship the causes which affected buyer delivery negatively were using an inappropriate supplier selection method, the buyer having no or a poor future plan, buyer and supplier dependency on a weak broker, and a lack of commitment from the main supplier to serve the supplier. In the captive buyer relationship, the causes were a lack of a good supplier production plan, a desire of suppliers to retain their buyers, a shortage in raw materials in the market, cultural differences between buyer and supplier, monopoly and the supplier's fear of the main supplier. In the strategic partnership, the causes which affected buyer delivery negatively were no or a poor buyer’s future order plan to the supplier, a delay in the supplier’s compensation from the buyer and poor security conditions in the buyer’s or supplier’s countries.  In the captive supplier relationship, buyer delivery was affected because of using a short term contract, frequent changes in the supplier’s management, no or a poor buyer’s future plan and poor supplier management.

The same thing happened with cost and price. Each relationship had different causes for the same effect, buyer costs and prices. In the market exchange relationship, the causes which affected buyer cost and price were no or a poor buyer's future plan, buyer and supplier dependency on a weak broker, a supplier's management changing frequently, and no commitment from the main supplier to serve the supplier. In the captive buyer relationship, the causes were lack of a good supplier production plan, a desire of suppliers to retain buyers, a shortage in raw materials in the market, cultural differences between buyer and supplier, monopoly and the supplier’s fear of the main supplier. In the strategic partnership, the causes affecting the buyer’s costs and prices negatively were delays in the supplier’s compensation, no improvement in the supplier’s employee skills, using a short term contract and poor security conditions in buyer or supplier countries. In the captive supplier relationship, buyer costs and prices were affected because of no or a poor buyer’s future plan. This explains that each relationship has own characteristics and situations.

The study found that one of the causes of the delivery effect was common among three types of relationship (market exchange, strategic partnership and captive supplier), which was no or a poor buyer’s future order plan.

In addition, one of the cause of cost and price effect was common in both the market exchange and captive supplier relationships, which was no or a poor buyer's future plan. In general, from the researcher view, this represents that future plane is one the most factor missing in Saudi Arabia; it is hardly possible to find a good future plan. This cause is the common cause for the most of Saudi Arabia problems. Therefore, the buyer should improve their future order plan and provide it to the supplier in good time to avoid delays in delivery or increases in costs and prices.

The negative effects of in the market exchange special case were discussed in chapter five in detail (section 5.2.5.1.1 and 5.2.5.1.2).

#### 6.2.4.1.2 Second effects

The study found that in the second stage, the negative effects of the problem causes were on decision making and competitiveness in all relationship type.

The second stage effects were found in all types of relationship (see sections 5.2.4.2, 5.3.5.2, 5.4.4.2 and 5.5.4.2). In this stage, the effects were divided in two types. The first type concerned the effects which occurred on buyer competitiveness in the market. The researcher found that in all relationship types, because of the first effects, the buyer's customers looked for another supplier (buyer) who could provide the same products on time or at cheaper prices. In this situation the buyer was affected negatively, either by letting new competitors enter the market or by losing their percentage of work to an existing competitor. For example, the study observed that in one of the food industry companies competitiveness was affected negatively because its supplier delayed delivering the needed raw material in time, which in result the buyer delayed delivering his/her production to the market, which allowed the competitors to increase his/her percentage of sales. Additionally, the researcher found that buyer competitiveness was affected negatively in the strategic partnership when the buyer dealt with another new supplier (change of supplier), and this change allowed the buyer to increase mentoring of the new supplier, which caused that buyer to lose focus on core work, which affected that buyer's competitiveness. For instance, the researcher found that one of the petrochemical industry company, decided to change the supplier, which was not enough known in the market after its supplier falling to provide the strategic order on time many times. Then, the buyer regularly sent his specialist employees, who were working in production line, to supplier to make sure that the new supplier would fulfill his requirements and observed his production. But the problem was his final production was affected negatively because of absence of these employees. Further, the study found that in the captive buyer relationship the buyer lost credibility in the market because of defect production when customers looked for another buyer to deal with, which in turn affected the buyer's competitiveness in the market.

The second type concerns the effects on the buyer's decisions. The study found that some causes of first effects forced the buyer to change a previous decision, make a new decision or sometimes forced the buyer to stick with a decision without making changes to solve the problem or to decrease its effects or to control the supplier, as in the following example.

In the market exchange relationship, buyers visited were taking new decisions to improve their method for choosing suppliers by giving attention to other factors than price, such as machinery model year, supplier reputation, their position and stability in the market, and sometimes buyers were changing their supplier after they faced problems when dealing with them. The study found that two of the stationery industry companies and three of food industry companies added other factors than depending on only the price factor when they want to choose their supplier such as machinery model year. Additionally, buyers who did not have a quality monitoring or control department, were creating such a department, and buyers, who already had one, emphasized that the checking of received orders should be done carefully and early on to avoid any delays in delivery.

Some buyers were making new agreements with suppliers about checking orders. These agreements stated that order checking should be done by the buyer's quality department before supplying orders to save delivery time and avoid delays in delivery and customs penalties, which all affect buyers' competitive position if there are any defects in orders. The study observed that two of the communication industry companies and one of the glass industry companies decided to check orders using the buyer's quality department in the suppliers' laboratory. This is because the buyers want to save the time if the order was not as buyer requirements, and the order should be sent back to supplier, which affected buyers production by delaying orders, especially the buyers did not have enough stock in that time

Additionally, the buyer was forced in to making decision to stop a production line, which affected competitiveness because there was no commitment from main suppliers to serve suppliers as their customers (buyers) needed, or to change the supplier to another, the same as what happened with honey supplier (see section 6.2.2.1.8). The study also found that sometimes the buyer changed strategy of working because of problems arising from no longer working with brokers. All these causes, in the market exchange relationship, affected the buyer's decisions. This occurred maybe because of the characteristics of the market exchange relationship, such as the shifting from one to another can be done easily and cheaply for both buyers and suppliers, and there were no technology brands embedded in products or processes. Furthermore, contracts used in this relationship were short (see section

3.5.3/ market exchange profile). Hence, the percentage of effect on decision making was high.

In the captive buyer relationship, decision making was only affected by two causes, poor supplier management and the wish of the supplier to retain buyers. When suppliers had poor management, buyers thought about increasing their percentage of stock, extending their storage area or trying hard to find another supplier. For example, the study noticed that two of the petrochemical industry companies and one of the transportation industry company because of the suppliers bad management, the supplier could not follow up and take the right decision about their production plans, so they took more orders than their capabilities allowed for, and they failed to provide what the buyer was asking for on time. Therefore, the buyers' order delayed, which allowed buyers to increase their percentage of stock, extending their storage area or trying hard to find another supplier. Because of the wish of suppliers to keep buyers dealing with them alone, they withheld information that they had about services or products to prevent buyers from dealing with another supplier (if there is), which affected the buyer's process of production decision making by forcing the buyer to buy from competitors, if those competitors supplied the same product, or from other suppliers at a higher price, which caused delivery delays, increased costs to the buyer or affected the buyer's competitive position in the market. This was what happened with one of the glass industry companies and two of the petrochemical industry companies. The researcher found that because the buyer in this relationship was captive, there were not enough choices to change or make decisions, and it was difficult for buyers and costly to locate and shift to another source of supply in this kind of relationship. This was why the decision was affected by only two problem causes.

In the strategic partnership, the buyer's decision making was affected by all problem causes. This meant that the buyer had more choices to make or change decisions; it was found that the kind of decisions involved were to solve and control problems by dialogue and discussion, through regular meetings and reviewing all procedures to suit each party.

When there was no or a poor future order plan from the buyers, this caused problems, which forced buyers to develop order planning by creating a production planning section or a processing planning section. The study observed that because of lacking future order plan from the buyers, three of the communication industry supplier's production plans were confused, which caused delays in submitting orders to the buyer. This forced buyers to develop their order planning. Further, if compensation was not fair for the suppliers or they did not receive it regularly, this caused problems for the buyers, encouraging them to consider how to improve payment mechanisms to receive orders on time. This was the same as what one of the purchasing mangers in petrochemical industry said (see section 6.2.2.1.4). Additionally, when the buyer used short term contracts, this also caused problems for the buyer, which allowed reconsidering the length of the contract, which was why buyers made new decisions to give longer term contracts to suppliers to give them the security to work for the buyer's benefit, which helped to resolve the problems. This was the same as what One of the food industry suppliers said (see section 6.2.2.1.1). Furthermore, when the supplier felt no need to take any action against certain problems, the buyer faced problems and difficulties, forcing him/her to make or change a decision about work style to suit the supplier. The study noticed that one of the petrochemical industry suppliers did not take any action against bill issuing procedures and they thereby did not encourage their employees to develop or improve work performance. At the same time, buyers suffered from this style of work because the supplier's did not match the buyer's system, and buyers felt they were affected negatively by having to exert so much effort, or by hiring new employees or by buying a new system, to make the necessary changes in order to match the system, which caused increasing costs to the buyer. Finally, poor security conditions in the buyer or supplier countries, if they were from different countries, could cause difficulties with order delivery, difficulties in a supplier's movement or increases in delivery and insurance costs. These difficulties forced buyers to decide to extend their storage to increase stock percentage and thereby avoid delay in delivery. Difficulties in a supplier's movements encouraged buyers to reconsider their relationship with western suppliers or look for communication channels with suppliers and seek ways of keeping themselves connected with suppliers at all times. This was the same what happened with four companies, one in the glass industry, two in the petrochemical industry and one in food industry (see section 6.2.2.1.13).

In the captive supplier relationship, the problem causes which affected buyer decision making were: using a short term contract, which encouraged the supplier to conceal information to gain more advantages and lose interest in working on the buyer's behalf, The study found that buyers decided to extend their storage capacity to avoid any shortage in orders and they changed the contract length to a long term instead of short term one, feeling that the supplier relationship was better than before, and others decided to change suppliers. The second cause was that when the buyers did not have a future order plan, they faced problems such as delays in delivery and increases in costs and prices, which forced buyers change work strategy by reviewing procedures in order planning; the others had created an order planning department to avoid such effects. Thirdly, poor supplier management also affected buyer decisions by forcing the buyer to change supplier.

#### 6.2.4.1.3 Final effects

The final effect was found in the captive buyer relationship only (see section 5.3.5.3). The researcher found from some buyers visited that problems, arising from supplier practices against the buyer, affected the economy of the country as a final effect, whereby the buyer tried to avoid dealing with a local supplier because of high prices or delays in delivery; that buyer would look for another external supplier or broker to acquire material at a lower price or on time. This meant that a great deal of money would be transferred outside the country, which affects openings for new companies or factories or the expansion of those which already exist. These effects stifle new job opportunities, thereby increasing unemployment, which is a big problem for any country in the world. These effects warn those responsible in Saudi Arabia that they should study the market carefully before they issue decisions, which on purpose protect and support local industries because some companies (suppliers) may use these decisions opportunistically in their own behalf. This forces buyers to look for other external suppliers, or they may look for another way to contradict these decisions, both of which cause losses in the country.

#### 6.2.4.1.4 Summary

In short, the study found that the negative effects on delivery, cost and price, quality, decision making and competitiveness, have been mentioned in the literature (Tezuka, 1997), on the part of the supplier, but in this study the researcher has determined the real causes which force suppliers to act opportunistically and who are those responsible in more detail.

In addition, the study found that there were other effects than those mentioned in the literature by Tezuka (1997). These other effects were: in the market exchange relationship, the researcher found confusion in a buyer's plan. This confusion occurred because of changing the supplier's management frequently. Another effect was that, because of cultural differences between buyer and supplier in a captive buyer relationship, the buyer might be affected negatively by difficulties in the production process caused by shortages of raw materials due to differences in payment methods or a lack of technical support from the supplier. Additionally, in the strategic partnership the study found that the solution of a problem might be delayed, which meant the buyer suffered from the problem for longer because of poor security conditions in the buyer or supplier countries due to difficulties in supplier movement.

These effects imply that leaders should combat monopoly, because the final effects will damage the economy of Saudi Arabia, especially monopoly occurring with governmental suppliers. Additionally, any commercial arbitration between buyer and supplier should be resolved quickly so as not to give suppliers excuses for acting opportunistically. Buyers know that lengthy procedures of commercial arbitration will ensue if they go to the commercial court, so buyers are forced to deal with external suppliers, which affects the economy of country negatively. Finally, agency policy (see sections 2.3.1 and 2.3.2), which does not allow the main supplier to sell products directly to the buyer, should be discussed because this kind of policy encourages the supplier to act opportunistically. This forces the buyer to act unethically by dealing with an external supplier who deals with the same main supplier, which is not allowed officially, but happens because of personal relationship or personal interests. This will affect the economy of the country for the same reason. The researcher thinks that this effect is found only in the captive buyer relationship because of the factors supporting suppliers acting opportunistically, which was discussed in chapter five (section 5.3.4). These factors are not found in any other relationship, which means that these factors force buyers to deal with external suppliers. But, presence of this effect in the captive buyer relationship does not mean that there is not the same effect in the other types of relationship. This is why Saudi Arabian leaders should review many of their commercial decisions.

#### 6.2.4.2 The effects on the research model

The researcher found that there was a correlation between some of the relationship incentives and the causes of the problems. Sometimes the relationship incentives incited the causes of the problems, either adverse selection or moral hazard, so buyers should be more careful with relationship incentives.

##### 6.2.4.2.1 Market exchange relationship

The causes of moral hazard problems, found in the data collected, in the market exchange relationship were: using an inappropriate supplier selection method (caused by the buyer), the buyer having no or a poor future plan, buyer and supplier dependency on a weak broker (caused by both), changing the supplier's management frequently (caused by the supplier), and no commitment from the main supplier to serve the next supplier in the chain (chapter 5, section 5.2.2.1). The incentives to create the market exchange relationship were: price, reputation and economy, easy communication and stability and supplier encouragement (chapter 5, section 5.2.1). All of these incentives occurred because of the buyer’s wishes upon discovering that benefits would be gained from outsourcing (from his point of view). Hence, when the buyer failed to determine the right factors by which a supplier could be chosen (depending on his/her interests), the buyer would choose an inappropriate supplier. In this case it was clear that there was a correlation between the incentive for the relationship creation (depending on the price factor) and the causes of the moral hazard (using an inappropriate supplier selection method), which meant that when the buyer depended on the price factor alone to choose the supplier, this would cause problems because of using an inappropriate supplier selection method. These problems occurred because of dealing with non qualified suppliers, or a supplier who was dissatisfied with the compensation, which caused delay in delivery to the buyer, poor quality and increases in the buyer's costs because the supplier did not work for the buyer's interests, either intentionally or unintentionally. Three of the petrochemical industry suppliers and one of the transportation industry suppliers said that "unsatisfactory compensation give a chance the suppler to not put all effort in buyer needs"

Additionally, when buyers did not give the reputation issue of the supplier (broker), with whom they were going to deal, high importance, this caused problems for the buyer, such as creating a misunderstanding between buyer and supplier and an inability to serve the buyer and supplier as they wished, which might cause delays in delivery and / or increases in costs for the buyer. In short, the study found that two of the problem causes (using an inappropriate supplier selection method and buyer and supplier dependency on a weak broker) were incited by the incentives of the relationship type, which were the price and bad supplier reputation (broker) (see figure 6.1).

In the special case, there was a correlation between the causes of the problems and relationship incentives. The researcher found that, because of the incentives (price incentive and personal gain), problems occurred. Two problems in the special case were, once more, adverse selection and moral hazard.

The moral hazard problem, which occurred because of the price incentive (poor supplier selection method), arose because of difficult personal relationships between those responsible for governmental suppliers (suppliers who are owned by government) and buyers, bureaucracy, routine of work, variety of holidays in the governmental supplier and no or a poor production plan with the governmental supplier. These problems caused delays in delivery during the production process only. For example, the study noticed that, one of the food industry supplier and one of the petrochemical industry suppliers, because of their personal relationship between the supplier's manager or a seller's manger and a specific buyer, whereby that buyer was given priority to receive orders first, which caused a delay in delivery to other buyers.

Additionally, problems occurred because the buyer dealt with a supplier who did not have knowledge about the market. Dealing with such a supplier caused problems to the buyer because such a supplier was considered a weak one, who failed to serve the buyer as required. The buyer here tended to prepare to solve this problem by increasing percentage of stock to compensate for any shortage in delivery or by dealing with another supplier. Similarly, the buyer in this case tended to deal with such a supplier, even if there were problems, to gain any advantages from being offered a lower price, whereby the buyer was not affected (see figure 6.5)

The cause of the moral hazard problems, which occurred because of the personal gain (interest) of one or more board members (poor supplier selection method), was the supplier dependency on their relationship with this /these members, which entailed non payment of penalties (increases in costs), not providing orders or services according to buyers' requirements and delays in delivery (see figure 6.6).

The cause of adverse selection, which occurred because of the personal gain ( interest) of one or more board members, arose because of the supplier's dependency on the relationship with this /these member(s), which caused the withholding of information and increases in costs of orders (see figure 6.6). One of the purchasing managers in glass industry said that "we do not have any thing to do with the supplier, who are imposed to us to deal with him, one of the problems is that they do not send order on time"

#### 6.2.4.2.2 Captive buyer relationship

In the captive buyer relationship, there was also a correlation between relationship incentives and the causes of the adverse selection and moral hazard problems. There were two causes of the adverse selection problem, which were poor supplier management and the wishes of suppliers to keep buyers (caused by the supplier) (chapter 5, section 5.3.2.1). The causes of the moral hazard problem were: shortage in raw materials in the market (external cause), cultural differences between buyer and supplier (external cause), using a short term contract (caused by the supplier) and the supplier having problems with the main supplier (external cause) (chapter 5, section 5.3.2.2). The relationship incentives were: the presence of one supplier only in the market, the buyer using the supplier's products over a long time period, lack of time to change supplier, governmental legislation, buyer needs and buyer competitiveness (chapter 5, section 5.3.1).

The presence of one supplier only in the market incentive (monopoly) gave the supplier the power to work for his/her own interest; this was why the supplier used a short term contract. Using a short term contract gave the supplier a chance to misuse circumstances, so as to change buyer if this might be beneficial, or put pressure on the buyer to force him/her to accept the conditions and requirements, which caused increases in costs and delays in delivery for the buyer. As the researcher has mentioned before (see section 6.2.2.1.4) that it found two of the petrochemical industry company suppliers and one in the communication industry company supplier would ask buyers for eight percent increase for a raw material price if it had increased by five percent. Or, even if there was a shortage in a certain material or labour availability, they would ask for an increase

Additionally, using the supplier's products over a long time by the buyer incentive increased the desires of the supplier to keep dealing with the buyer, and decreased the chance of the buyer exiting the relationship. This occurred because of the dependency on the supplier products or the cost of applying changes. An increased wish of the supplier to keep dealing with the buyer encouraged the supplier to withhold information which might be beneficial for the buyer in making decisions. As four suppliers, one in the glass industry and three in the food industry, mentioned that withholding information occurred when the suppliers applied changes in production strategy by applying some modifications to production procedures, and some of these changes did not match the buyer's specifications, which caused problems on production lines and a delay in delivery to the buyer.

The lack of time to change supplier incentive also increased the chance of the supplier withholding information which might assist the buyer in changing supplier, so as to retain that buyer dealing. This shortage of information created disrupt on for the buyer as well as lack of time. The supplier withheld the information to make the changes difficult for the buyer. This cause affected the buyer by delays in delivery and increases in costs**.** As the example, has been mentioned before (see section 6.2.2.1.9), that three of the purchasing managers in the petrochemical industry and one in the food industry stated that some equipment suppliers do not provide manuals with supplied equipments to not allow us to know what spare part that we need and to not understand how the equipment can be fixed. This occurred when the supplier knows that the products were needed urgently for the buyer and each stoppage day for the buyer's production was too costly for him.

Governmental legislation to protect local suppliers also gave the supplier a power that could be used against the buyer, under protection of these laws; if the buyer disliked dealing with local suppliers, certain benefits provided by government would be lost. Hence, the supplier acted opportunistically against buyers because of these laws. The researcher considered this incentive as a cause by it self (see Figure 6.2).

#### 6.2.4.2.3 Strategic partnership

The researcher found that, in the strategic partnership, there was no correlation between relationship incentives and the causes of the problems. It was found that all causes occurred independently from relationship incentives (see Figure 6.3).

#### 6.2.4.2.4 Captive supplier relationship

In the captive supplier relationship, however, there was a correlation between the causes of the problems and relationship incentives. The study found that two problems occurred, adverse selection and moral hazard. The causes of adverse selection were: using a short term contract and frequent changes in the supplier's management (chapter 5, section 5.5.2.1), whilst the causes of moral hazard were: no or a poor buyer's future plan and poor supplier management (chapter 5, section 5.5.2.2). It was also found that the relationship incentives were: aggressive competition between suppliers and buyer strength in the market (chapter 5, section 5.5. 1).

The correlation came when the buyer was strong in the market and knew that the supplier was looking for work with him/her, and there was aggressive competition between suppliers, the buyer used a short term contract so that it was easy to move among suppliers according to his/her interests, which gave the supplier an insecure feeling, which in turn caused problems. In short, both incentives incited the causes of problems in the captive supplier relationship. As the example has been mentioned before (see section 6.2.2.1.1) that two of the petrochemical industry suppliers, one of the food industry supplier, and one of the transportation industry suppliers gave other new buyers priority for their orders if these buyers were willing to pay more, and tried to increase their service costs if they felt that their products were in demand (see Figure 6.4).

**6.2.4.2.5 Summary**

From the above, the researcher found that the correlation between some of the relationship incentives and the causes of the problems affects the research model. The main conceptual model consists of four main factors, which are causes of problems, problems, strategy of problem control and effects. However, after the collected data was analyzed, the researcher found that the relationship incentive was other factor which might affect the relationship. Therefore, it has been added to the conceptual model, especially after it was found that the relationship incentive factor could be one of problem causes or could incite problem causes between buyers and suppliers. Hence, the conceptual model was modified. The researcher found that the modified conceptual model was applicable to all types of relationship, but each type of relationship had different model contents (see f Figure 6.1 for market exchange relationship, f Figure 6.2 for captive buyer relationship, Figure 6.3 for strategic partnership, figure 6.4 for captive supplier relationship, and Figures 6.5 and 6.6 for the special case of market exchange depending on the characteristics of each type of relationship). The only difference was that, in the strategic relationship, there was no correlation between relationship incentives and the causes of the problems, but in all the other relationships relationship incentives played a role in initiating the problems. For example, in the market exchange relationship, the study found that two of the problem causes, using an inappropriate supplier selection method and buyer and supplier dependency on a weak broker, were incited by the incentives of the relationship type, which were the price and bad reputation of the supplier (broker). In the captive buyer relationship, relationship incentives, the presence of one supplier only in the market, the buyer using the supplier's products over a long time period and lack of time to change supplier, might incite the causes of problems (monopoly cause and a desire of suppliers to keep buyers cause) and governmental legislation caused problems in direct manner, which means that governmental legislation is considered as an incentives and the problem cause by it self. In the captive supplier relationship, both incentives, aggressive competition between suppliers and buyer strength in the market, incited the using short term contract problem cause. In the special case of the market exchange relationship, both incentives, the price incentive and personal interest incentive, might incite the problem causes of using an inappropriate supplier selection method problem cause, and dealing with a supplier who does not have market knowledge or a governmental supplier. Because there are two reasons for supplier selection for the same incentive (price incentive), there are two causes and two controlling circles, one for governmental suppliers, the other for the supplier who does not have market knowledge. Although the model content for each relationship is different, there are some content elements common to all types.

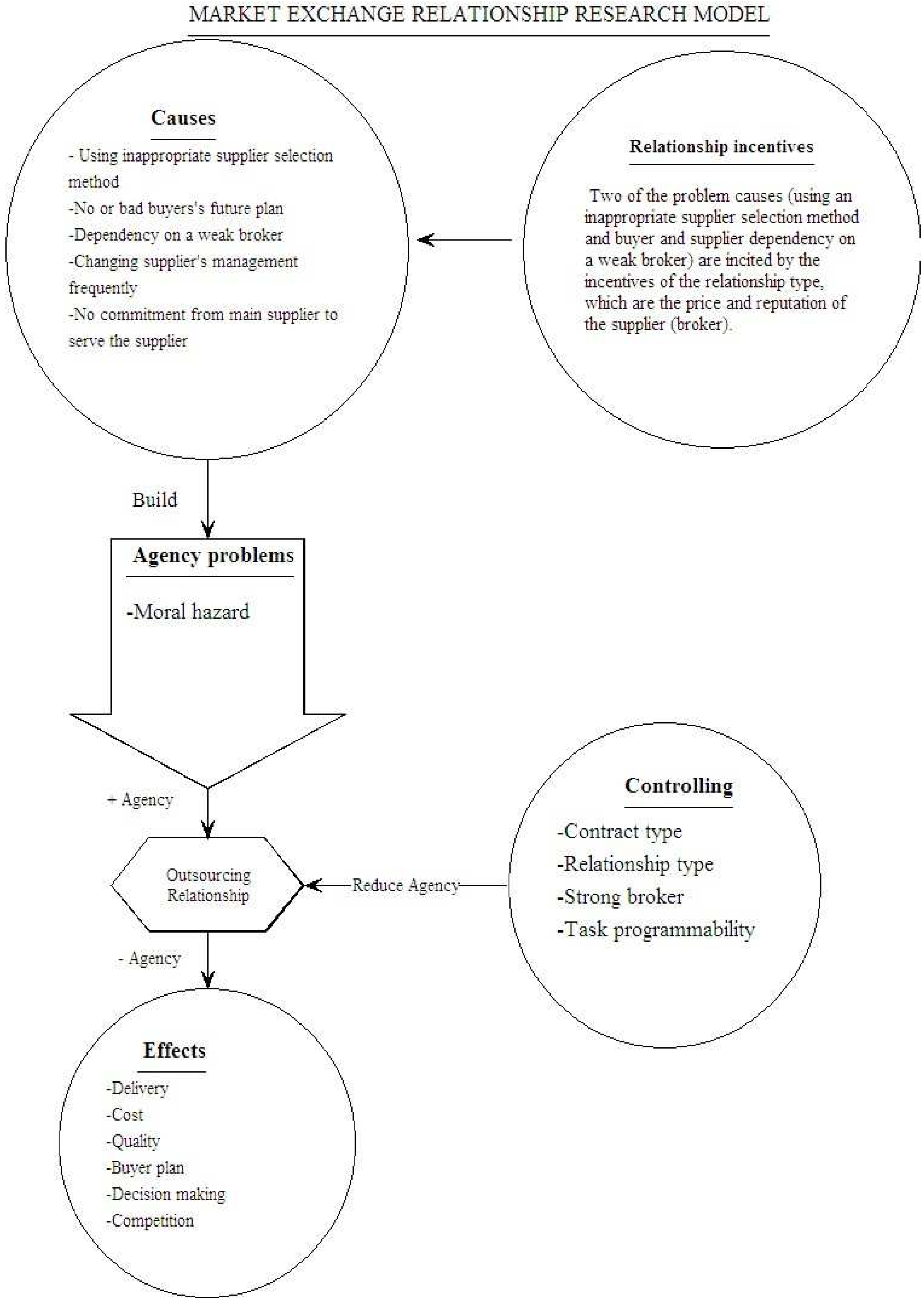


Figure 6.1 Market Exchange relationship research model

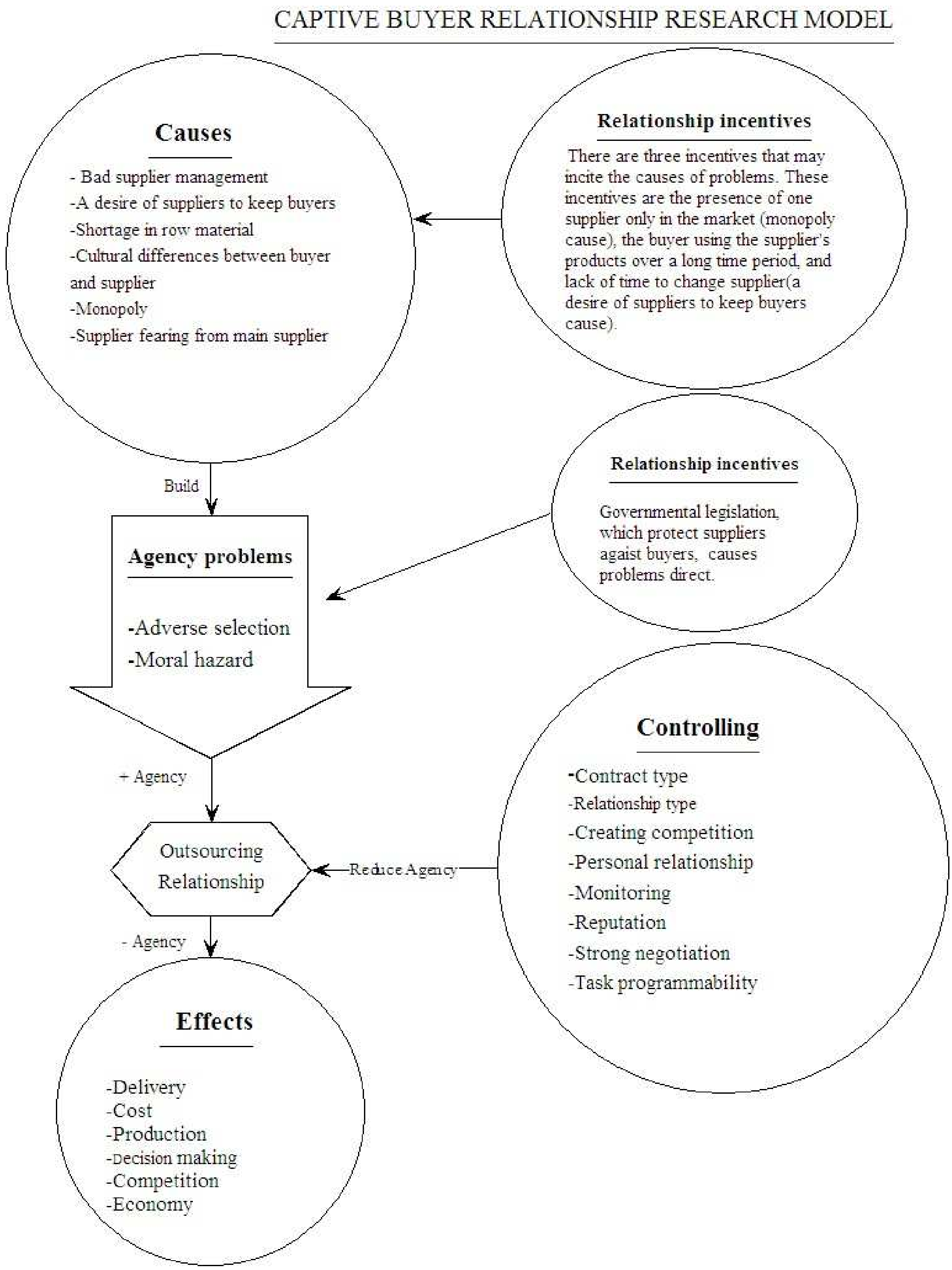


Figure 6.2 Captive Buyer relationship research model

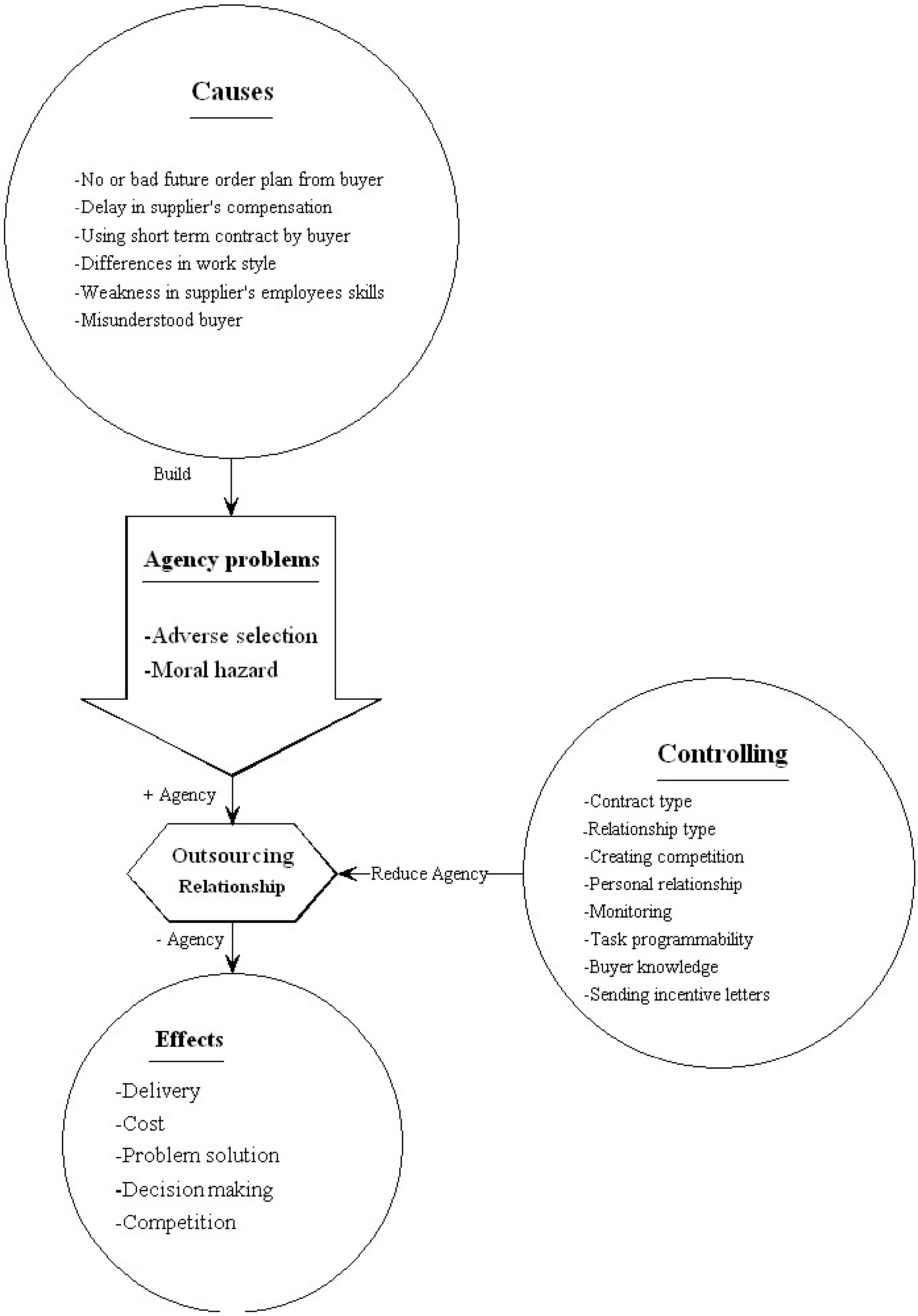


Figure 6.3 Strategic Partnership research model

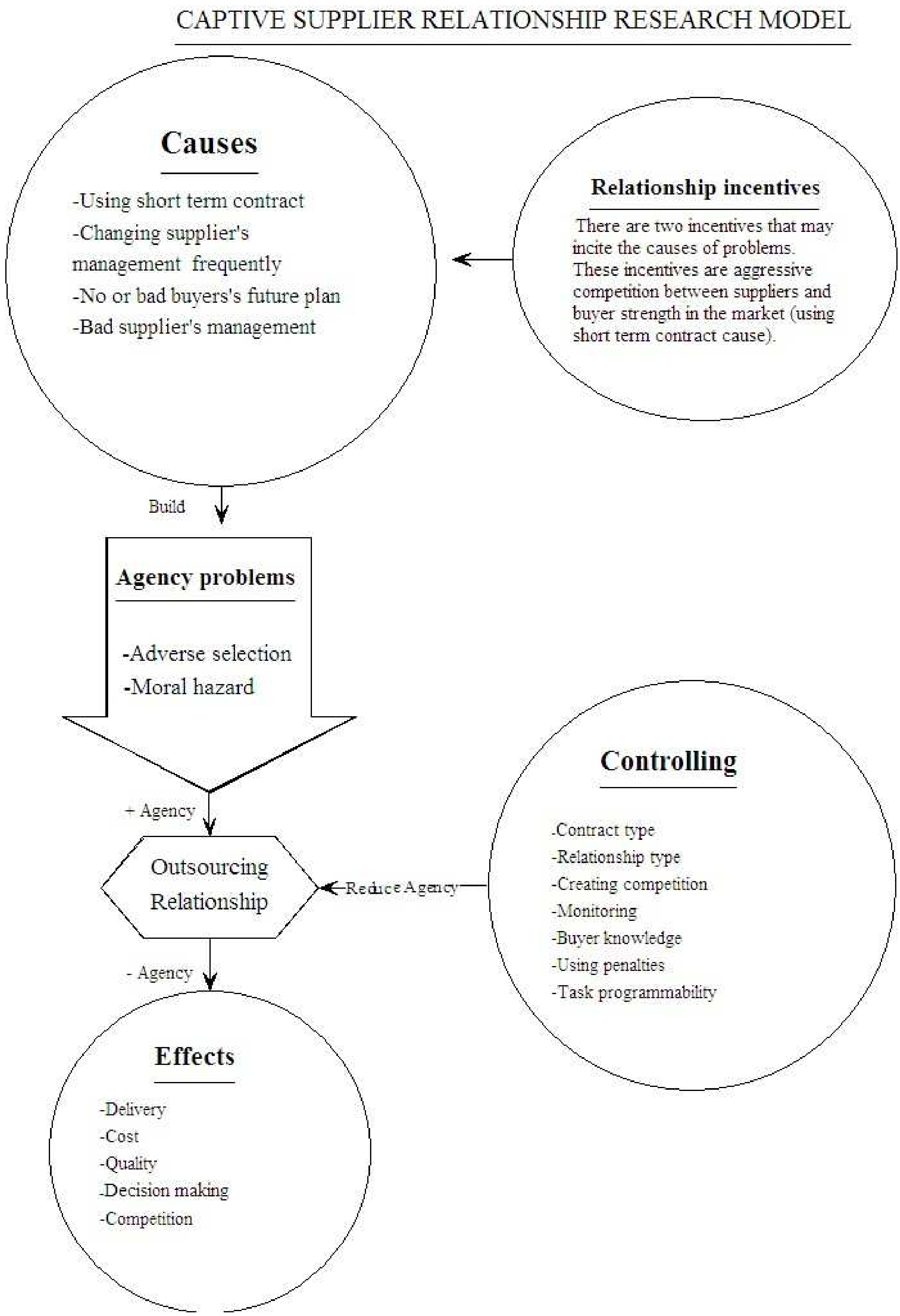


Figure 6.4 Captive Supplier relationship research model

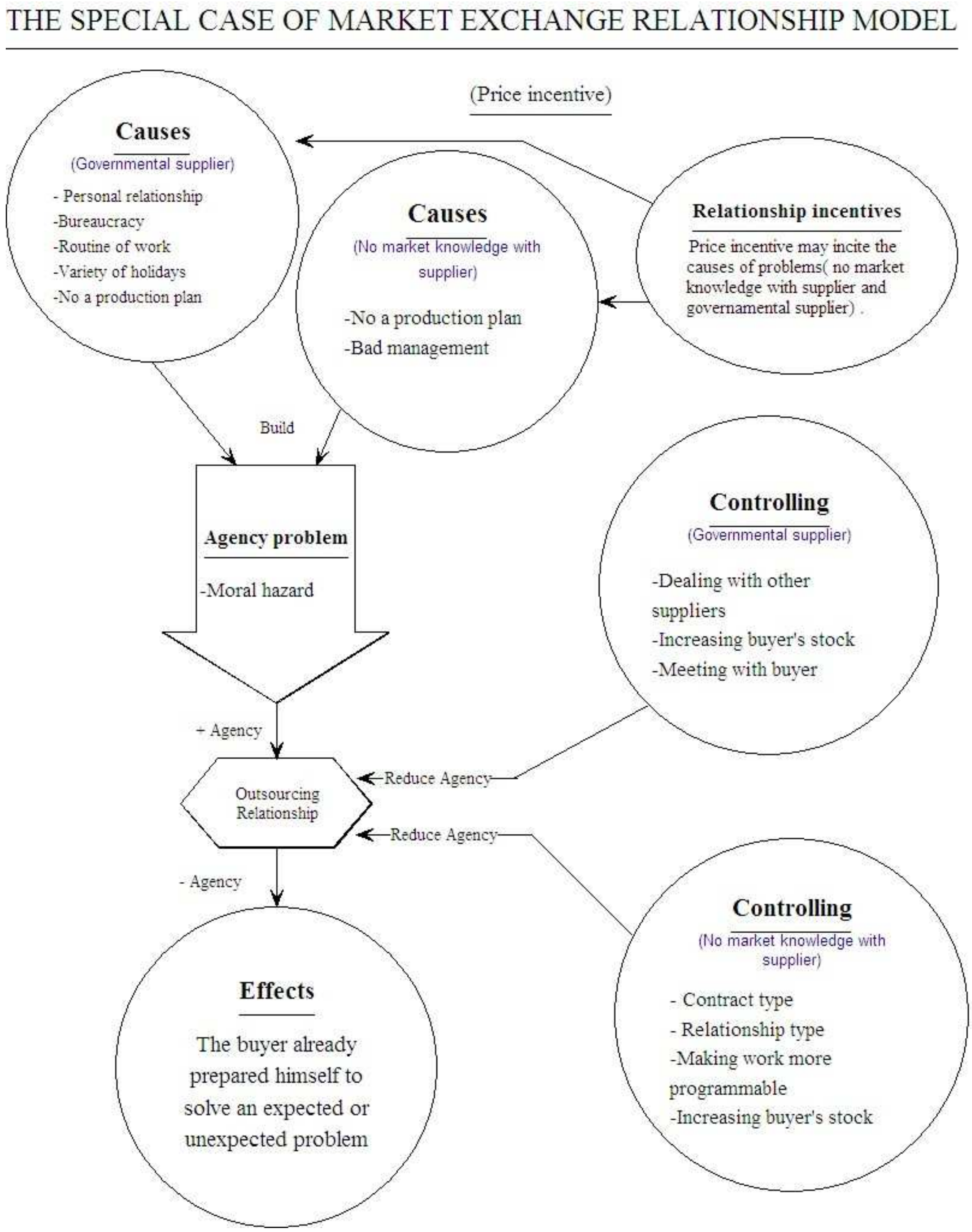


Figure 6.5 The special case research model (Price incentive)

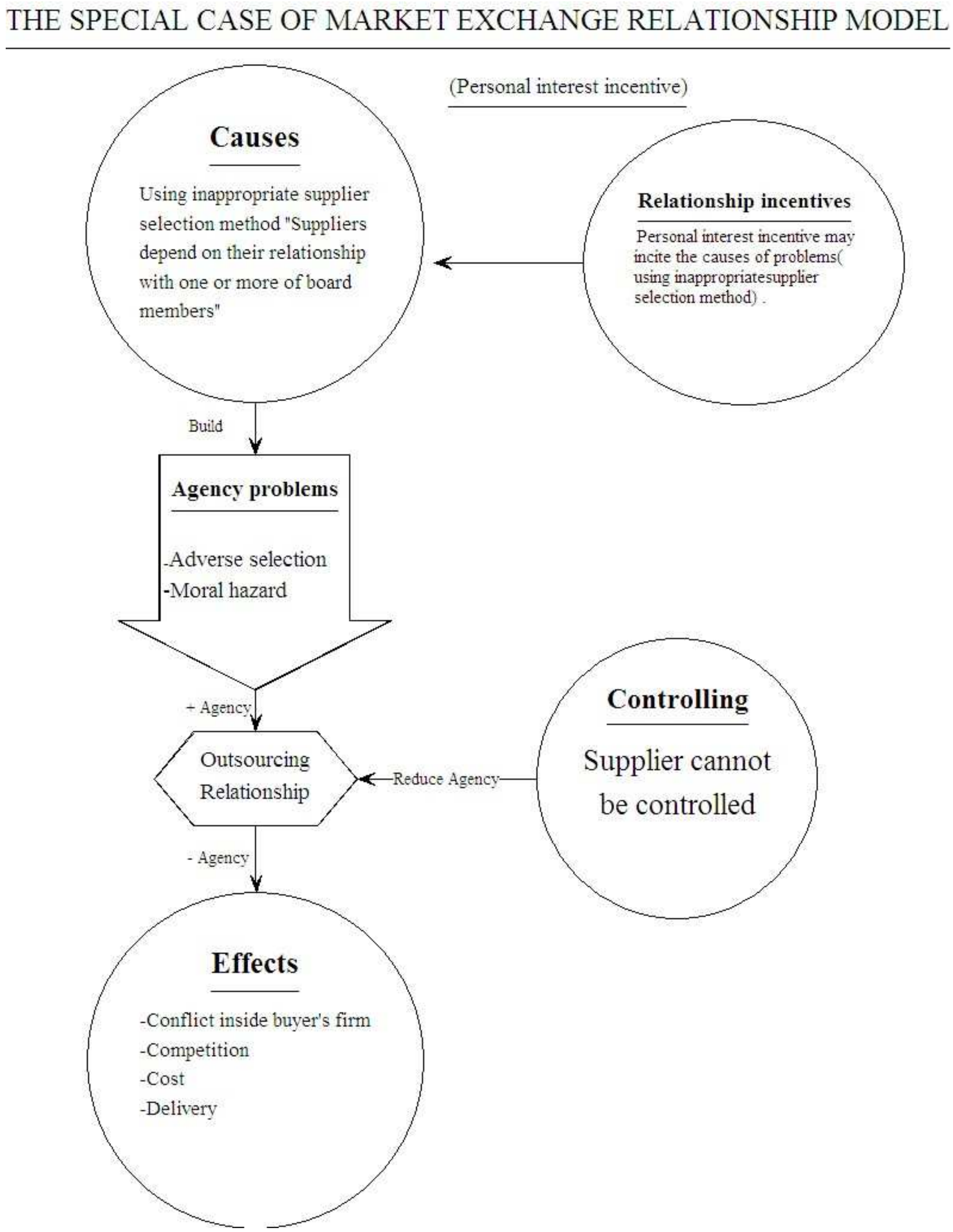


Figure 6.6: The special case research model (Personal interest incentive)

### 6.3 Summary

In this chapter, the researcher has discussed the data collected, and answered the research questions stated in chapter one .The study found that the relationship incentives create buyer and supplier relationship types .Some of them corresponded with outsourcing reasons (Outsourcing Institute, 1998; Greaver, 1999) in a direct manner such as price incentive and “buyer needs” incentive, or in an indirect manner such as reputation and high exchange rate incentive, easy communication, stability and supplier encouragement incentives, governmental legislation incentive, geographical location incentive, personal relationship incentive, common growth incentive, understanding incentive, aggressive competition among suppliers incentive and the buyer’s respective strength in the market incentive. The other incentives were not mentioned in the outsourcing reasons in the literature, which is one of the significant findings such as personal gain incentive, presence of one supplier only in the market (monopoly) incentive, using the supplier’s products over a long time period incentive, lack of time to change supplier incentive and buyer competitiveness incentive.

It was also found that there are other additional causes that may create agency problems than those discussed in the literature. These causes are: buyer poor future order plan, poor supplier management, frequent changes in a supplier’s management, no commitment from the main supplier, weak brokers, shortage of raw materials, differences in work style, supplier misunderstanding, poor security conditions in the buyer or supplier countries, supplier’s work characteristics.

In addition, the study found that certain mechanisms, found during this study which had not been discussed in previous studies by researchers. These mechanisms are: creating competition, personal relationship, strong negotiation and using a strong broker, which is another significant finding in the study. Additionally, the researcher found that one of the classifications of relationship types, the "Exit-Voice" framework (Helper and Sako, 1995), was used by the buyer as a control strategy. Control strategies from both the buyer and supplier perspectives are then discussed.

The study found that there are different levels of effects which occur because of relationship problems between buyers and suppliers (first, second and final). There were no changes to the conceptual model, which was shown to be applicable to all types of relationship.

Finally, the researcher found the buyer should be more careful with relationship incentives because these incentives might cause problems. It found sometimes buyers or external reasons cause the problems which might affect them, hence it is not always true that the supplier is the only party causing problems; however the fact remains that the supplier often gains benefits from these problems. The study represented that the differences between Saudi firms and those in other countries, so it can said that each market has different ones depending on the characteristics of that market.

# CHAPTER SEVEN

## CHAPTER SEVEN

## CONCLUSION

### 7.1 Introduction

The main objective of this research was to study in depth, buyer and supplier relationships (outsourcing) in the Saudi Arabian market by discovering the incentives that create each type of relationship are, which problems exist in each type of relationship, how they can be controlled and what their effects are. This chapter provides the research significance, contribution and suggestions for further research work on this subject.

### 7.2 Research significance

The research significance of this study derives from the following main factors. The first factor is that this study was applied in an area (the Saudi market), which has never been studied from such a perspective. This factor gives the research an importance as a valuable resource for those interested to know more about the Saudi market.

The second factor is that, whilst previous outwith Saudi Arabia studies have been conducted in one manufacturing or service industry sector (United State and Japan, automobile manufacturers), this one was carried out in different manufacturing and service industries in the Saudi market (glass, food, petrochemical, transportation, stationery and communication industries), thus providing rich and varied information from different sectors. This gives the research greater robustness, allowing for general visibility, and representation of the business climate in the Saudi market comprehensively.

The third factor is that the study has been applied across each type of relationship (market exchange, captive buyer, strategic partnership and captive supplier), and represents the problem causes and the occurrence of effects, fostering a deeper and clearer understanding of the differences between each relationship.

Fourthly, according to collected data (chapter5/ table 5.1), the researcher found the following points:

The first point is that the most popular relationships in the Saudi market were the market exchange relationship (64 relationships out of 160, including special case). At the same time, the study found that the food and glass industries have the highest proportion in market exchange relationship in manufacturing sector. Additionally, the study found that the transportation industry has the highest proportion in market exchange relationship in services sector (see table 5.2). This data represents that there is a significant proportion in market exchange relationship, and the majority of required orders in the Saudi market do not need special or customized requirements. The Saudi market depends on standard products especially in food, glass and transportation industries. This reflects the Saudis' nature in which they look for cheaper price in such industries (see section 2.3.6), which lets buyer used standard material as the researcher observed.

The second point, the researcher found that the petrochemical industry has the highest proportion of captive supplier relationship in manufacturing sector and the stationery industry has the highest proportion of captive supplier relationship in services sector. This data represents that the buyer in such industries in Saudi Arabian market are strong and the suppliers are working hard to work with them, which, in fact, reflects the reality of the Saudi market. For example, the Saudi market has SABIC and ARAMCO companies, which are two of the biggest companies around the world in the petrochemical industry (see section 2.3.7).

The third point, the study found that the Communications industry has the highest in strategic partnership proportion in services sector (see table 5.2). This indicates the high competitiveness among communication companies in Saudi Arabia, where each company would like to make strategic alliance with its suppliers to protect their products from copycat.

The fourth point, according to collected data also (chapter5/ table 5.1), it is a convenience sample that the most common sector among manufacturing and services industries is petrochemicals. Among petrochemical it was found that 20 relationships out of 68 are market exchange relationships, 15 relationships out of 68 are captive buyer relationships, 10 relationships out of 68 are strategic partnership and 23 relationships out of 68 are captive supplier relationships. In addition, what these findings show that although the petrochemical industry seems to be a complex industry, it also depends on many of simple industries (standard requirements) (20 relationships out of 68 are market exchange relationships).

The last factor is that, the study made some significant findings which have not been mentioned in previous studies (literature). These shall provide important and valuable sources for those interested in knowing more about the Saudi market and the agency system therein. These findings are as follows:

The study reveals that there was a special case in market exchange relationship, where buyers preferred to deal with suppliers under a relationship which was different from the market and relationship characteristics because of their interests (cheaper price and personal gain). In this case, although most characteristics of market and relationship indicated that the relationship between buyer and supplier was classified as market exchange and buyer had many choices of suppliers (standard and no advanced technology products), the buyer liked to be a captive buyer with a specific supplier (chapter 5, section 5.2.5).

Additionally, under “What are the incentives that create each type of relationship?” research question, this study discovered new incentives that can create buyer and supplier relationship types other than those which have been mentioned in the outsourcing reasons in the literature (Outsourcing Institute, 1998; Greaver, 1999). These incentives are personal gain incentive, presence of one supplier only in the market (monopoly) incentive, using the supplier’s products over a long time period incentive, lack of time to change supplier incentive and buyer competitiveness incentive. At the same time, the researcher found that there was a correlation between some of the relationship incentives and the causes of the problems. It found that sometimes the relationship incentives are linked to the causes of the problems, either adverse selection or moral hazard. Hence, buyers should be more careful with relationship incentives (see section 6.2.4.2). The researcher concluded that Saudi Arabian market characteristics and cultural aspect (corruption) may play an important role in relationship creation between buyer and supplier, and that is why, these new incentives came up here (see section 2.3.6).

Furthermore under, “Which problems exist in each type of relationship?” research question, the researcher discovered other additional causes that might create agency problems other than those which were stated in the literature by Sharma

(1997), Ekanayake (2004), Conlon and Parks (1990), and Stump and Heide (1996). These causes are: buyer's poor future order plan, poor supplier management, frequent changes in supplier's management, no commitment from the main supplier, weak brokers, shortage of raw materials, differences in work style, supplier misunderstanding, poor security conditions in the buyer or supplier countries and supplier's work characteristics. This may represent the differences between Saudi firms and those in other countries, and leads to the conclusion that, although there are many common causes of problems, each market has its special problems, depending on the characteristics of each market. However, those additional causes may be found in the other markets around the world but they have not been identified yet (chapter 6, section6.2 (Q2)).

In addition, under, "How can these problems be controlled and what are their effects in terms of understanding the reality of the outsourcing relationship and how it can be improved?" research question, the study revealed that there are certain additional control mechanisms other than those which have been discussed in previous studies by the researchers (Mahaney and Lederer (2003); Helper and Sako (1995), Tosi and Katz (1997), Jensen and Meckling (1976), Eizenhardt (1989), Sharma (1997), and Dyer and Ouchi (1993)). These mechanisms are: creating competition, personal relationships, strong negotiation and using a strong broker, which is another significant finding in this study.

From the supplier's perspective, there were also some measures that prevented them from acting opportunistically against buyers which have not been mentioned in the literature(Mahaney and Lederer (2003); Helper and Sako (1995), Tosi and Katz

(1997), Jensen and Meckling (1976), Eizenhardt (1989), Sharma (1997), and Dyer and Ouchi (1993)). These measures are order size and dealing with more than one supplier, buyer strength in the market, buyer selection, strong supplier management system, buyer's order simplicity, buyer stability and loyalty. From the buyer's and supplier's perspective, the study concluded that buyers and suppliers may use different control mechanisms than those which has been identified before by the researchers (literature) according to their culture aspect and market characteristics, so each market may compel new mechanisms to be used.

All the known problem controlling mechanisms were found to be applicable in the Saudi market except the customized investment mechanism (The principal and agent's specific investments in each other make the two parties highly interdependent, at the same time pushing the agent to work in the principal's best interests) (Dyer and Ouchi, 1993). None of the buyers visited, mentioned this mechanism. This may because saudis, even in a strong relationship prefer not to make investments with each other; they prefer to work independently, so maybe, this was why the buyers preferred to control the suppliers by using mechanisms other than the customized investment mechanism (see section 6.2.3.1.5).

The study found that suppliers in the Saudi market can be controlled by threats of using an exit relationship strategy and outcome-based contract which force suppliers to work on buyers' behalf. This is because the study found that one of the common mechanisms among the four types of relationship was contract and relationship type. The other was making work more programmable, which implies a lack of management to improve and develop work in the Saudi market. Haphazard work practices were caused by poor supplier management, poor future plan with buyers or suppliers, or frequent changes in the supplier's management from which arose most of the problems found. Hence, making work more programmable (such as setting delivery time tables or sending their future order in advance) is an effective mechanism to control and resolve the negative effects of these causes in all types of relationships. Maybe this mechanism reflects non Saudi managements, which are looking only for their own interests (see section 2.3.6), which causes problems. This happened because the factory owners do not trust the Saudi employees; thereby they do not hire them in manager positions (see sections 2.3.6 and 5.6.2.2.5).

Additionally, under, "What are the effects of the problems on each relationship in the market?" plus, "And finally, what are the effects on the research model in each relationships?" research question, the study has identified effects other than those mentioned in the literature by Tezuka (1997) (delivery, cost and price, quality, decision making and competitiveness). These effects were: confusion in buyer's plan, which occurs because of frequent changes in the supplier's management. Another effect was existence of difficulties in the production process caused by shortages of raw materials due to differences in payment methods or a lack of technical support from the supplier because of cultural differences between buyer and supplier. The last effect was delays in the solution of problems, due to poor security conditions in buyer or supplier countries causing difficulties in movement of supplies. These additional effects show that because each market has it own characteristics and circumstances, the effects which may occur because of agency are different from market to another.

The researcher concludes that because of agency effects and the negative effect on Saudi Arabia economy (when the buyer tried to avoid dealing with a saudi arabian supplier because of high prices or delays in delivery; that buyer would look for another external supplier or broker outside Saudi. Arabia (non Saudi supplier)) to acquire material at a lower price or on time), the government should review many of their commercial decisions. For example, they should combat monopoly, occurring with governmental suppliers who do not allow buyers to go to external suppliers (outside Saudi .Arabia (non Saudi supplier)). Also, any commercial arbitration between buyer and supplier should be resolved quickly so as not to give suppliers excuses for acting opportunistically. (Buyers know that lengthy procedures of commercial arbitration will ensue if they go to the commercial court, so buyers are forced to deal with external suppliers, or accept suppliers' opportunistic behaviors. Finally, agency policy, which does not allow the main supplier to sell products directly to the buyer (see chapter2/sections 2.3.1 and 2.3.2), should be discussed because this kind of policy encourages the bad supplier to act opportunistically (This may force the buyer to act in illegally by dealing with an external supplier (outside Saudi. Arabia (non Saudi supplier)), who deals with the same main supplier, which is not allowed officially. Thereby, the economy of Saudi Arabia will be affected negatively leading to the transferring of large amounts of money out of the country, which affects openings for new companies or factories or the expansion of those which already exist. These effects stifle new job opportunities, thereby increasing local unemployment, which is a big problem for any country in the world. These effects warn those responsible in Saudi Arabia that they should study the market carefully before they take decisions which purposely protect and support local (Saudi) industries because some bad companies (suppliers) may use these decisions opportunistically in their own behalf, forcing buyers to look for other external suppliers (outside Saudi. Arabia (non Saudi supplier)), or they may look for other ways to go around such decisions, both of which will cause losses to the country.

## 7.3 Contribution

This study deals with problems resulting from conflicts of interests that may emerge between buyers and suppliers, and how their negative effects can be minimized. The research model presents the main theoretical concepts showing that there is good reason to believe that the agent will not always act in the best interests of the principal in a straightforward manner in all situations. It was found that relationship incentives induced problem causes affecting the relationship between buyer and supplier, negatively. In addition, control mechanisms try to minimize these negative affects as much as they can. The conceptual model and the above additional theoretical findings therefore represent a rich contribution to the field of agency theory.

## 7.4 Suggestions for further research

The special case in the market exchange relationship should be given more consideration in future research because the study found that special case in the market exchange relationship was the majority in market exchange relationship, and it would be important to discover more about it. There maybe, special cases which could be found related to this case in other relationships.

Additionally, future research could be applied to testing the effects of agency theory inside the buyer and supplier firm and how organizational and human behavior affect the relationship between buyer and supplier, since this study only slightly touched upon the employees' interests.

Another exploratory study could be repeated to discover in greater depth and detail the Saudi market.

This study was applied before (GATT) agreement; a study could be carried out to test the same factors after application of the agreement to evaluate the effects of the agreement on the Saudi market. For example, the captive buyer relationship occurrence may be reduced especially after the main supplier can have the chance to deal with buyers without commercial agents.

Further work could be done in other countries using the research model applied in this research in order to see what the common issues are and/or which problems are specific to the Saudi Arabian environment.

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**APPENDICES**

# APPENDICES

## Appendix A

**تعهد**

**اقسم بالله العظيم بان احفظ اي معلومه تطلعني عليها جهتكم وان اكون امين عليها مهما كانت ولا اطلع عليها اياً كان وان لا استخدمها الا في مجال البحث الذي اقوم به فى رسالة الدكتوراه. كا اتعهد امام الله ان لا اتداول المعلومه او استخدمها في مصلحة اي جهه او ضد اي جهة وان لا اذكر او اشير اسم جهتكم تلميحا او تصريحا عند تناولها في موضوع البحث**

**محمد صالح ميرعالم**

**Undertaking**

**I, undersigned, Mohammad Miralam, swear under oath that I will honor all and any information I shall receive from your company in confidence and shall use the same strictly for the purpose of using the same for my PhD thesis. Further, I shall not pass on such information to any third party for material gain other than the thesis.**

**Mohammad Miralam**

## Appendix B

## Open ended questions

**For buyers**

1. Name at least four suppliers who have dealt with you?
2. What kind of relationship exists between you and suppliers? Discuss.
3. What are the problems do you face with suppliers? And how was their behaviour? Discuss.
4. What are the causes that led to suppliers giving rise to these problems? Discuss.
5. How do you control suppliers?
6. How do these problems affect you?

**For suppliers**

1. How do you know if your goals match with buyer goals or not?
2. Do you always accept your compensation from a buyer? If not, what do you do?
3. Are there differences between buyers? What do you handle these differences?
4. Do you think cultural differences with a buyer can affect your behavior? How?
5. In your view, what factors can force suppliers to behave opportunistically?
6. What are the factors that prevent suppliers behaving in this way? Why?
7. In your view, what problems cause the supplier to act against a buyer?

## Appendix C

## Close ended questions

**Buyer Questions:**

**First part**

1. What is the final product of your firm?

2. What kind of product does the supplier provide you?

   A. Highly standardized products which are based on simple technology that requires little engineering effort and expertise from suppliers.--------

   B. Complex components that require some customization but at the same time they are still based on well-understood, stable technology.-------

   C. Highly customized products that require strong technology and engineering capabilities. Buyers make important investments in critical internal assets for the suppliers to prevent potential risk and damage if the supplier behaves opportunistically. Partners work together from the beginning of concept design to the development of tooling and manufacturing processes to the coordination of just-in-time production and delivery between the two firms------------

   D. Highly complex products or integrated subsystems based on new technology. The supplier puts heavy capital investments in to these products just to stay in the market and to maintain its strong design reputation and superior engineering and manufacturing capabilities.-----------

3. Information-sharing mechanisms between you are:

   A. "Narrow-band" and limited information exchange, heavy at time of contract negotiation and operational coordination and monitoring along structured routines

   B. "Broadband" and important exchange of detailed information on a continuous basis. Frequent and regular mutual visits

C. Broadband, "frequent" and "rich media" exchange and regular mutual visits and exchange of guest engineers

D. Little exchange of information and few mutual visits, mostly from supplier to buyer

4. In your view, which one from the following boundary characteristics is close to your relationship:

A.

I. Limited time spent directly with supplier staff
II. Highly routine and structured tasks with little interdependence with supplier staff

B.

I. Structured task, highly predictable
II. Large amount of time spent by buyer's purchasing agents and engineers with supplier

C.

I. Highly ill defined, ill structured
II. Non routine, frequent unexpected events
III. Large amount of time spent with supplier staff, mostly on coordinating issues

D.

I. Limited time allocated by buyer staff to the supplier
II. Mostly complex, coordinating tasks

5. The climate and process characteristics between you and your supplier are:

A.

I. Positive social climate
II. No systematic joint effort and cooperation
III. No early supplier involvement in design

IV. Supplier fairly treated by the buyer
V. Supplier has a good reputation and track record

B.

I. Tense climate, lack of mutual trust
II. No early supplier involvement in design
III. Strong effort by buyer toward cooperation
IV. Supplier does not necessarily have a good reputation

C.

I. High mutual trust and commitment to relationship
II. Strong sense of buyer fairness
III. Early supplier involvement in design
IV. Extensive joint action and cooperation
V. Supplier has excellent reputation

D.

I. High mutual trust, but limited direct joint action and cooperation
II. Greater burden put on the supplier

6. The market characteristics of this product are:

A.

I. Stable or declining demand
II. Highly competitive market
III. Many capable suppliers
IV. Same players over time

B.

I. Stable demand with limited market growth
II. Concentrated market with few established players
III. Buyers maintain an internal manufacturing capability

C.

I. Strong demand and high growth market
II. Very competitive and concentrated market
III. Frequent changes in competitors due to unstable market
IV. Buyer maintains in-house design and testing capability

D.

I. High-growth market segment
II. Fierce competition
III. Few qualified players
IV. Unstable market with shifts between suppliers

7. The supplier characteristics of this product are:

A.

I. Small "mom and pop" shops
II. No proprietary technology
III. Low switching costs
IV. Low bargaining power
V. Strong economic reliance on buyer business

B.

I. Large supply houses
II. Supplier proprietary technology
III. Few strongly established suppliers
IV. Strong bargaining power
V. Buyers heavily dependent on these suppliers, their technology and skills

C.

I. Large multiproduct supply houses
II. Strong supplier proprietary technology
III. Active in research and innovation (i.e., R&D costs)
IV. Strong recognized skills and capabilities in design, engineering, and manufacturing

D.

I. Strong supplier proprietary technology
II. Suppliers with strong financial capabilities and good R&D skills
III. Low supplier bargaining power

-----------------------------------------------------------------------------------------------

**Second part**

1) When the firm hires another party (suppliers) to perform a service or work, but found that suppliers do not represent their ability to do the work for which they are being paid, hide information, do not put forth maximal effort to achieve goals or have different attitudes toward risk and may prefer different actions to those of the firm. From your experience, the causes that force suppliers to behave in such manner are:

(First tick causes, and then please number each of ticked causes listed below in order of importance to you)

a) Supplier selection was not done properly.
b) Compensation system is not sufficient.
c) Firm owner is external, so he can't evaluate and control managers and suppliers.
d) The mission statement of the firm differs from the mission statement of the supplier.
e) Cultural differences between buyer and supplier
f) Short term contract forces the supplier to work for his own interest

2) A firm can control a supplier by: (please tick those that match your view)

a) Contract type: outcome based contract ------ behaviour based contract
b) Mentoring: information system----- meeting ---- other
c) Relationship type: Exit -------Voice
d) Making tasks are more programmable
e) Increasing buyer knowledge
f) Using a third party
g) Making investments on both sides
h) All of the above

3) The problems that a firm faces from a supplier are: ( Please tick those that match

your view)

a) The firm can't ascertain if the agent accurately represents his or her ability to do the work for which he or she is being paid.
b) The firm does not know if a supplier has made decisions on his own behalf or because of a lack of information that the agent has.
c) The firm cannot be sure if the agent has put forth maximal effort to achieve goals because a supplier's actions do not determine the outcome.
d) A supplier shirks his responsibilities because of a supplier's self-interests.
e) A supplier takes different actions towards risk other than the firm's actions because of different risk preferences.
f) All of the above

4) In your experience, the effects of the above problems on the firm are: (Please tick those that match your view)

a) Quality --------
b) Delivery-------
c) Cost -----------
d) Decision making------
e) Innovation-------
f) Competitiveness-------

**Supplier Questions:**

1) Do you accept work with a buyer you know previously if your missions are different. Yes--------------No

2) Do you think that if your mission statement is different that causes agency problems? Yes----------No

3) What do you do if your compensation was not fair?
   a) Accept it then try to manage
   b) Do not accept

4) Do you accept to work with a short term contract? Yes ------------- No

5) Do you work with different cultural buyers? Yes---------------No

6) Do you think working with such buyers can cause an agency relationship? Yes----No

7) Do you differentiate between buyers? Yes----------No (If you do, depending on what?)

8) In your view, what are the factors that force a supplier to behave on his own behalf?

   a) He does not have the qualifications that a firm needs.
   b) The compensation system is not sufficient to him.
   c) The firm owner is an outside one, so he knows there is no good monitoring.
   d) The mission statement of the firm differs from his mission statement.
   e) Cultural differences between buyer and supplier
   f) Short term contract forces the supplier to work for his own interest

9) What are the factors that prevent a supplier behaving in his own interest?

   a) Contract type: outcome based contract ------ behaviour based contract
   b) Mentoring: information system----- meeting ---- other
   c) Relationship type: Exit -------Voice
   d) Making tasks more programmable
   e) Increasing buyer knowledge
   f) Using a third party
   g) Making investments on both sides

## Appendix D

الغرفة التجارية الصناعية بمحافظة جدة
JEDDAH CHAMBER OF COMMERCE & INDUSTRY

إلى من يهمه الأمر

سعادة مدير عام / رئيس / مالك الشركة الموقـــر

السلام عليكم ورحمة الله وبركاته وبعد

نظراً لما تمثله المعلومات الاقتصادية والاستقصائية من أهمية لرفع مستوى الإدراك والوعي لدى المنشآت الصناعية والتجاريـــة والخدميـــة ولـــدعم التقـــدم المعلوماتي وبناءاً لتطوير البحث العلمي نفيدكم بأن الطالب / محمد صـــالح ميـــر عالم سعودي الجنسية يرغب في جمع بعض المعلومات المفيدة في دراسته المتعلقة برسالة الدكتوراه بخصوص إدارة الجودة .

نأمل منكم التعاون معه بما يفيد الصالح العام ونؤكد علـــى أن المعلومـــات سوف تعامل بطريقة سرية تامة بما تفيد الباحث والمجتمع في دراسته .

وتقبلوا خالص تحياتي ،،،

١٠/١٠
١٤٢٥هـ

٤٠٢

د . ســـهـــل صـــدقـــة قـــــزاز
مديـــر عـــام مركـــز جـــدة لتنمية
المنشآت الصغيرة

**To Whom It May Concern:**

To: president or owner of the company

Greetings,

With reference to the importance and value of information and statistics in the creation of awareness of the market for industrial and commercial purposes leading to their better development and management, we request your company to kindly provide all such data and information which our Eng. Mohammad S. Miralam might require for the purpose of his PhD thesis.

We would sincerely appreciate your kind cooperation in making his work easy and successful.

Yours truly,

General Manager Jeddah Center of
Development of small scale industry
Dr. Sahl S. Qazzaz

## Appendix E

### Buyer closed-end questions (second part)

| Buyer | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Q # | a | b | c | d | e | f | g | h |
| 1 | 5 | 4 | 7 | 3 | 4 | 6 | | |
| 2 | 6 | 3 | 3 | 4 | 7 | 2 | 4 | 5 |
| 3 | 4 | 4 | 6 | 5 | 3 | 2 | | |
| 4 | 3 | 5 | 3 | 5 | 2 | 4 | | |

### Supplier closed-end questions

| Supplier | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Q # | Yes | No | a | b | c | d | e | f | g | h |
| 1 | 2 | 1 | | | | | | | | |
| 2 | 3 | 1 | | | | | | | | |
| 3 | | | 6 | 3 | | | | | | |
| 4 | 5 | 1 | | | | | | | | |
| 5 | 4 | 2 | | | | | | | | |
| 6 | 6 | 2 | | | | | | | | |
| 7 | 7 | 2 | | | | | | | | |
| 8 | | | 2 | 1 | 5 | 2 | 2 | 4 | | |
| 9 | | | 1 | 3 | 2 | 2 | 4 | 3 | 1 | 2 |

## Appendix F

| | Buyer closed-end question (first part) Manufacturing | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Glass industry | Q#2 | Q#3 | Q#4 | Q#5 | Q#6 | Q#7 | Rel. type |
| Buyer#1 | First relationship | B | A | A | A | A | A | ME |
| | Second relationship | C | B | C | C | C | C | SP |
| | Third relationship | D | D | D | C | C | D | CS |
| | Fourth relationship | B | A | A | A | A | A | ME |
| Buyer#2 | First relationship | B | C | B | B | B | B | CB |
| | Second relationship | D | D | D | D | D | C | CS |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | B | B | C | B | B | B | CB |
| | Total: 8 Relationships 3 ME/2 CB/1 SP/2 CS | | | | | | | |
| | Food industry | | | | | | | |
| Buyer#1 | First relationship | D | D | D | C | D | D | CS |
| | Second relationship | A | C | B | B | B | B | CB |
| | Third relationship | B | A | A | A | A | A | ME |
| | Fourth relationship | B | A | A | B | A | A | ME |
| Buyer#2 | First relationship | C | B | C | D | C | D | SP |
| | Second relationship | B | A | A | B | A | A | ME |
| | Third relationship | B | C | B | A | B | B | CB |
| | Fourth relationship | A | A | A | B | A | A | ME |
| Buyer#3 | First relationship | B | B | B | B | A | B | CB |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | B | A | A | A | A | A | ME |
| | Fourth relationship | B | B | C | B | B | B | CB |
| Buyer#4 | First relationship | B | A | A | A | A | A | ME |
| | Second relationship | B | A | A | A | A | A | ME |
| | Third relationship | D | D | D | C | D | C | CS |
| | Fourth relationship | A | A | A | A | A | A | ME |
| Buyer#5 | First relationship | B | A | A | B | A | A | ME |
| | Second relationship | B | A | A | B | A | A | ME |
| | Third relationship | B | C | C | A | B | B | CB |
| | Fourth relationship | A | A | A | B | A | A | ME |
| Buyer#6 | First relationship | C | C | B | C | C | C | SP |
| | Second relationship | B | A | A | A | A | A | ME |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | B | C | B | A | B | B | CB |
| Buyer#7 | First relationship | B | A | A | A | A | A | ME |
| | Second relationship | B | B | C | B | B | B | CB |
| | Third relationship | A | A | A | A | A | A | ME |
| | Fourth relationship | A | A | A | B | A | A | ME |
| Buyer#8 | First relationship | B | A | A | B | A | A | ME |
| | Second relationship | A | A | A | B | A | A | ME |
| | Third relationship | D | D | D | C | D | D | CS |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Fourth relationship | B | B | C | B | B | B | CB |
| | Total: 32 Relationships 19 ME/8 CB/2 SP/3 CS | | | | | | | |
| | Petrochemical industry | | | | | | | |
| Buyer#1 | First relationship | C | B | C | C | C | C | SP |
| | Second relationship | A | A | A | B | A | A | ME |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | A | B | B | B | B | B | CB |
| Buyer#2 | First relationship | A | A | A | A | A | A | ME |
| | Second relationship | B | B | C | A | B | B | CB |
| | Third relationship | B | A | A | A | A | A | ME |
| | Fourth relationship | B | A | A | A | A | A | ME |
| Buyer#3 | First relationship | A | A | B | A | B | A | ME |
| | Second relationship | B | A | B | A | A | A | ME |
| | Third relationship | D | D | D | C | C | D | CS |
| | Fourth relationship | B | C | C | B | A | B | CB |
| Buyer#4 | First relationship | D | D | D | D | D | D | CS |
| | Second relationship | C | C | C | B | C | C | SP |
| | Third relationship | D | D | D | D | D | D | CS |
| | Fourth relationship | D | D | D | D | D | D | CS |
| Buyer#5 | First relationship | B | B | C | B | B | B | CB |
| | Second relationship | D | D | D | D | D | C | CS |
| | Third relationship | C | C | C | C | D | C | SP |
| | Fourth relationship | D | D | D | D | D | D | CS |
| Buyer#6 | First relationship | D | D | D | D | D | D | CS |
| | Second relationship | C | C | C | C | C | C | SP |
| | Third relationship | D | D | D | D | D | D | CS |
| | Fourth relationship | B | B | C | A | B | B | CB |
| Buyer#7 | First relationship | D | D | D | D | C | C | CS |
| | Second relationship | D | D | D | D | C | D | CS |
| | Third relationship | C | C | B | C | D | C | SP |
| | Fourth relationship | D | D | D | D | D | C | CS |
| Buyer#8 | First relationship | D | D | D | C | D | C | CS |
| | Second relationship | A | B | C | B | B | B | CB |
| | Third relationship | B | A | A | A | B | A | ME |
| | Fourth relationship | A | A | A | A | B | A | ME |
| Buyer#9 | First relationship | C | D | C | B | C | C | SP |
| | Second relationship | A | A | A | A | B | A | ME |
| | Third relationship | A | B | B | C | B | B | CB |
| | Fourth relationship | A | A | A | B | A | A | ME |
| Buyer#10 | First relationship | B | B | C | B | B | B | CB |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | A | B | B | C | B | | CB |
| Buyer#11 | First relationship | A | B | A | B | A | A | ME |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | D | D | D | D | D | C | CS |
| | Fourth relationship | B | A | B | A | A | A | ME |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Buyer#12 | First relationship | A | A | A | B | A | B | ME |
| | Second relationship | A | B | A | A | A | A | ME |
| | Third relationship | A | B | C | B | B | B | CB |
| | Fourth relationship | A | A | A | C | A | A | ME |
| Buyer#13 | First relationship | C | C | B | C | C | C | SP |
| | Second relationship | D | D | D | D | D | C | CS |
| | Third relationship | B | B | B | A | B | B | CB |
| | Fourth relationship | D | D | D | D | C | D | CS |
| Buyer#14 | First relationship | C | B | C | C | C | C | SP |
| | Second relationship | B | B | C | B | B | B | CB |
| | Third relationship | D | D | D | D | C | C | CS |
| | Fourth relationship | D | D | D | D | D | C | CS |
| Buyer#15 | First relationship | D | D | D | C | D | C | CS |
| | Second relationship | A | B | C | B | B | B | CB |
| | Third relationship | D | D | D | C | D | C | CS |
| | Fourth relationship | C | B | C | C | D | C | SP |
| Buyer#16 | First relationship | D | D | D | D | C | D | CS |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | D | D | D | D | C | D | CS |
| | Fourth relationship | A | B | C | B | B | B | CB |
| Buyer#17 | First relationship | D | D | D | D | D | C | CS |
| | Second relationship | D | D | D | D | D | C | CS |
| | Third relationship | B | C | C | B | B | B | CB |
| | Fourth relationship | C | C | C | D | C | C | SP |
| | Total: 68 Relationships 20 ME/15 CB/10 SP/23 CS | | | | | | | |

| | Buyer closed-end question (first part) Services | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Transportation industry | Q#2 | Q#3 | Q#4 | Q#5 | Q#6 | Q#7 | Rel. type |
| Buyer#1 | First relationship | B | A | A | B | A | A | ME |
| | Second relationship | B | C | B | B | B | B | CB |
| | Third relationship | A | B | A | A | A | A | ME |
| | Fourth relationship | B | B | C | B | B | B | CB |
| Buyer#2 | First relationship | A | A | A | A | A | A | ME |
| | Second relationship | A | B | A | A | A | A | ME |
| | Third relationship | D | D | D | D | D | C | CS |
| | Fourth relationship | B | A | A | A | B | A | ME |
| Buyer#3 | First relationship | C | B | C | C | C | C | SP |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | B | B | B | B | B | B | CB |
| | Fourth relationship | A | A | A | A | A | A | ME |
| | Total: 12 Relationships 7 ME/3 CB/1 SP/ 1 CS | | | | | | | |
| | Stationery industry | | | | | | | |
| Buyer#1 | First relationship | B | A | B | A | A | A | ME |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Second relationship | D | D | D | D | D | D | CS |
| | Third relationship | D | D | D | D | C | D | CS |
| | Fourth relationship | A | A | A | B | A | A | ME |
| Buyer#2 | First relationship | D | D | D | D | D | C | CS |
| | Second relationship | D | D | D | D | D | D | CS |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | B | C | B | B | B | B | CB |
| Buyer#3 | First relationship | D | D | D | D | C | D | CS |
| | Second relationship | B | A | B | A | A | A | ME |
| | Third relationship | D | C | D | D | D | C | CS |
| | Fourth relationship | D | D | D | D | C | D | CS |
| Buyer#4 | First relationship | D | D | D | D | C | D | CS |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | D | D | D | D | D | D | CS |
| | Fourth relationship | A | A | A | A | A | A | ME |
| Buyer#5 | First relationship | D | D | D | D | D | C | CS |
| | Second relationship | D | D | D | C | D | D | CS |
| | Third relationship | A | A | A | B | A | A | ME |
| | Fourth relationship | D | D | C | D | D | D | CS |
| Buyer#6 | First relationship | D | D | D | D | C | D | CS |
| | Second relationship | A | A | A | A | A | A | ME |
| | Third relationship | D | D | C | D | C | D | CS |
| | Fourth relationship | B | B | A | A | A | A | ME |
| | Total: 12 Relationships 9 ME/1 CB/0 SP/ 14 CS | | | | | | | |
| | Communication industry | | | | | | | |
| Buyer#1 | First relationship | C | C | B | C | C | C | SP |
| | Second relationship | A | A | A | B | A | A | ME |
| | Third relationship | C | C | C | D | D | C | SP |
| | Fourth relationship | C | C | C | C | C | D | SP |
| Buyer#2 | First relationship | B | A | A | A | B | A | ME |
| | Second relationship | C | B | C | D | C | D | SP |
| | Third relationship | C | C | C | C | D | D | SP |
| | Fourth relationship | A | A | A | A | B | A | ME |
| Buyer#3 | First relationship | A | B | C | B | B | B | CB |
| | Second relationship | D | C | D | C | D | D | CS |
| | Third relationship | B | A | A | B | B | A | ME |
| | Fourth relationship | C | C | B | C | C | C | SP |
| Buyer#4 | First relationship | C | C | C | C | D | C | SP |
| | Second relationship | A | A | A | B | A | A | ME |
| | Third relationship | C | C | B | C | C | C | SP |
| | Fourth relationship | B | A | B | A | A | A | ME |
| | Total: 16 Relationships 6 ME/1 CB/8 SP/ 1 CS | | | | | | | |