Create trust, not fear, in manufacturer-retailer relationships

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CREATE TRUST, NOT FEAR, IN MANUFACTURER-RETAILER RELATIONSHIPS

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Manufacturers and retailers are currently engaged in a classic power struggle, each jockeying for a position of relative power. Historically, manufacturers have held the power vis-à-vis their retailers, but increasingly, the latter are turning the tables. Because of the rise of mega formats such as category killers and superstores, mergers and acquisitions, as well as horizontal buying alliances, the retailing sector has become more concentrated. Consequently, the largest retailers today are much bigger than the manufacturers they deal with. The sales of the top six European food retailers exceed those of all European food manufacturers with the exception of Nestlé and Unilever.

This shift in power has manufacturers worried as retailers learn to exploit their new found power for price and service concessions.

While powerful firms can, and often do, exploit their advantage to create fear among their channel counterparts, over the past decade we have constructed a database to address the following questions:

"Is fear the best way for powerful manufacturers and retailers to manage relationships or is creating trust in such relationships more effective than simply wielding one's power ?"

"What policies and procedures help breed trust in manufacturer-retailer relationships?"

The Benefits of Trust

While exploiting one's power may be advantageous in the short run, it tends to be self-defeating in the long run. Exploiting one's power to extract unfair concessions can come back to haunt a firm if power positions change. For instance, when Migros, a supermarket chain in Switzerland, was founded, the large branded manufacturers refused to supply it because of the fear of upsetting their traditional mom and pop retailers. Unable to obtain branded products, Migros was forced to adopt an exclusively private label format. Today it is the largest retailer in Switzerland, with private labels accounting for more than 90% of its sales. Consequently, most major brands find themselves shut out from Migros shelves.

More importantly, manufacturers and retailers are increasingly recognizing the importance of working together to provide the greatest value at the lowest delivered cost. Currently industry experts believe that seamless partnerships between manufacturers and supermarkets would help accelerate the deployment of sophisticated systems such as "Just-in-Time" (JIT), "Electronic Data Interchange" (EDI), "Efficient Consumer Response" (ECR). In the US they have the potential to squeeze 30 billion dollars in excess costs out of the supermarket industry by eliminating superfluous inventory, duplicated functions, and various middlemen. The corresponding figure for Europe is 33 billion dollars. However, putting in advanced systems does not automatically result in these savings. To obtain them, partners must trust each other so that excess transaction and monitoring costs (such as salespersons and purchasing agents) can be eliminated.

Retailers who trust the manufacturer are less likely to seek or develop alternative sources of supply and are more committed to the relationship. In other words, trust breeds fidelity. Surveys show that the average retailer with high trust in the manufacturer generates 78% more sales for the manufacturer than the average retailer with low trust in the same manufacturer.

Creating Trust in Manufacturer-Retailer Relationships

To develop trust, parties, especially the more powerful party in a relationship, must treat each other fairly. Fairness encompasses two distinct types of justice - distributive justice or fairness of outcomes received; and procedural justice or fairness of process. In this context, Marks and Spencer, the British retailer, is a primary example worth analysing in some detail:

Trust demands distributive justice. Distributive justice refers to a party's perceptions of the fairness of earnings and outcomes that it receives from the relationship with its partner. It refers to "pie sharing" or the division of benefits and burdens between partners. While some firms use their power to maximize their own outcomes, others realize they have a responsibility for their partner's profitability. M&S believe that manufacturers, especially in the Far East, are often so keen to get M&S business that they accept prices which are too low to make future investments. Since M&S seek long-term relationships with their suppliers, this is a sub-optimal business practice from the M&S perspective and they discourage it.

Compensating channel partners appropriately by allowing them a fair return can have long-term consequences which are not always immediately apparent. For example, compared to Oldsmobile, Buick cars consistently get higher customer satisfaction ratings even though they are built at the same plant. Why? Buick pays its dealers 15 dollars an hour more for warranty work than Oldsmobile, and how the dealer treats a customer makes a big difference in customer satisfaction. If a customer goes to an Oldsmobile dealer with a problem, the dealer might say, "all cars do that"; while a Buick dealer will fix the problem.

Trust demands procedural fairness

Procedural justice refers to "due process" or the fairness of a party's procedures and policies vis-à-vis its vulnerable partners. Procedurally trust systems are built on the following six principles:

1. *Bilateral communication*, the willingness of the powerful party to engage in two-way communication with its partners. Marks & Spencer encourage their suppliers to be proactive and frank in pointing out M&S weaknesses. They see maintaining an open and honest dialogue as a sign of a healthy relationship and have a number of procedures in place to encourage this. Regular suppliers are given a permanent keycard to enter M&S head offices so that they can feel free to drop by and discuss issues. It is a symbolic gesture that helps them feel on a par with M&S employees.

2. *Impartiality*, the consistency of the company's channel policies across all channel partners. While it is impossible to treat every channel partner identically, it is important to give partners equitable opportunities. When M&S have multiple manufacturers supplying for a single product category, they attempt to ensure that everyone gets a fair share of the business. They try to minimize major changes in the volume of business awarded to these suppliers from one year to the next. Any major shifts only take place over a period of years so