Proposing an operational classification scheme for cooperative buyer/seller relationship levels

Michael D. Clements
University of Wollongong, clements@uow.edu.au

David L. Dean
Lincoln University

David A. Cohen
Lincoln University

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Developing an Operational Classification Scheme for Cooperative Buyer/Seller Relationship Levels
Michael Clements, David Dean, & David Cohen – Lincoln University

Abstract
Successful buyer/seller relationships have become recognised as essential for firms to remain competitive in the marketplace. Today’s business climate encourages firms to not just compete on product or service attributes, but also on their ability to differentiate themselves from other firms. Supply chains provide firms this point of differentiation ensuring firms better competitive positioning as a result of being able to leverage themselves on the strengths of the supply chain, not just on the individual strengths of the firm. However, to maintain an effective role as a participant in a supply chain, firms must be able to develop and maintain cooperative relationships with other firms. In order to develop these relationships, firms need to be able to distinguish between different levels of relationship and be able to understand which relationships are worth developing further and which ones are not.

Whilst supply chain literature acknowledges firm progression from transactional to relational exchange, there is less agreement of the number of levels of both buyer/seller relationships in this theoretical continuum. This article provides a theoretical continuum of relationship levels based on cross-discipline literature and identifies objective classification criteria for relationship levels from both the buyer and the seller. Economic, behavioural and relational research is collectively used to explain the complexity of the ever-evolving nature of inter-firm relationships. The article concludes by establishing research model that proposes these levels of relationships are identifiable for both the buyer and the seller.

Introduction
Buyer/seller cooperative relationships have become an essential tool for firms to enhance their organizational performance in the marketplace (Dwyer, Schurr and Oh, 1987; Morgan and Hunt, 1994). The relationship concept applies to buyers and the sellers at the firm level, where certain levels of inter-firm relationships enable participating firms to benefit from using other firms’ resources as well as their own to satisfy their customers. The supply chain literature agrees in principle that as firms progress from one-off transactions to fully cooperative relationships the potential for benefits increase significantly (Dwyer et al., 1987). However, there is divergence in terms of the number of levels of this theoretical continuum and the distinguishing factors between these levels. Part of the confusion stems from the fact that relationships with little cooperation are best explained using economic precepts, while the complex nature of highly collaborative relationships are best explained through behavioural and specific relational theories. This disparity has limited the comparability of research findings and could be a stumbling block for future theory development in the area.

Even if there was agreement in the number and names of relationship levels, disagreement remains in terms of how researchers can objectively classify relationships into these levels (Donaldson and O’Toole, 2000). Major directions of classification include life cycle approaches, performance expectations, and the value placed on the relationship. However, these are as likely to appear as dependent variables and therefore a much more promising
classification scheme comes from relationship attributes, characteristics and structure (Webster, 1992; Dwyer et al., 1987; Morgan and Hunt, 1994; Donaldson and O’Toole, 2000). Using structural elements to classify levels, researchers would be free to compare and contrast behavioural, attitudinal, and performance changes across the relationship levels.

The purpose of this article is to offer a theoretical continuum of relationship levels, based on the relevant work across several disciplines in the literature, identifying specific and distinguishable levels and objective criteria for classification.

To achieve this, relationship theories across economic, behavioural, and relational areas are examined which mirror the evolving complexity of inter-firm relationships and increasing importance of collaboration. This is followed by a review of various relationship level continua that have been suggested or used in the literature and a discussion of the differences found.

From these conclusions, four relationship levels are proposed and described and a research model is offered including objective classification of the relationship levels and their classification for future research.

Economics and Relationships
Economic exchange highlights the importance of firms trading together for the purpose of increasing profit and market stability. These forms of exchange concentrate on the need for structural exchange to maximize production and reduce transaction costs from both an efficiency and an organizational-based economic perspective.

Early efficiency based theories sought to understand how structured exchange could provide an advantage for participating firms such as contracting out specialized tasks to external specialist middlemen, who were able to provide a service at a lesser cost than could the producer itself (Mallen, 1973). These ‘functional spin-offs’ could be mutually beneficial, to the producer, and to the specialist. Classical, microeconomic theories note the need for the exchange to be performed in a structured manner that provides a firm with benefits such as specialization, (Stigler, 1951) reduced transaction costs, (Mallen, 1973) and reduction in risk and uncertainty (McGarry, 1951). Coase (1937) observed that coordination and costs must be considered when determining why firms internalize certain exchange functions and out-source others. This observation was furthered by Mallen (1973), who recognized that firms (hierarchies) and markets provide alternative forms of organizing economic exchanges, thus recognizing the potential influence of opportunism and uncertainty (Hill, 1990).

While these economic theories explain how we enter and exit discrete transactions, not all exchange relationships are discrete. Continuing economic exchange is also possible, and requires control measures to regular cost / benefit decisions, reduce uncertainty and minimize transaction costs. However, as relationships continue, non-economic factors such as power, dependence, and trust become forces in the success of the relationship, so the economic transaction theories are left for more complicated behavioural theories.

Behavioural Theories of the Relationship
In contrast to economic theories, behavioural exchange recognizes the impact of other behavioural related variables outside of the control of the firm. These behavioural
variables influence the quality and type of exchange achieved between buyers and sellers. The variables include, control (Stem, 1967) power (Frazier, 1983; Gaski, 1984; El-Ansary and Stern, 1972; Gaski and Nevin, 1985), dependence (Emerson, 1962; Frazier, 1983), cooperation, conflict (Stem and Reve, 1980), and satisfaction (Hunt and Nevin, 1974; Lusch, 1976).

Under behavioural theories such as Resource Dependency Theory (RDT) (Pfeffer and Salancik, 1978), we look at why firms need to trade together, and Political Economic Paradigm (PEP) provides a framework of how firms can balance dependence through social interaction. These theories recognize the importance of analyzing exchange from both economic and behavioural perspectives, underscoring the complexity of relationships. Both these theories acknowledge the complexity of relationships and seek to explain how relationships are formed, suggesting that they cannot be understood by examining them from only one perspective.

Understanding the influence of power as a concept is central to understanding how one channel member can influence another channel member (Hunt and Nevin, 1974; El-Ansary and Stern, 1972; Stern, 1967; Cox, 1999; Heide, 1994; Gaski, 1984; Frazier, 1983). Emerson (1962) suggests that the influence of power is based on the level of dependence of one firm on another. The party with less dependence in a dyadic relationship possesses more power.

An organization creates its base of power by determining the resources it has to influence decisions. The worth or value of these resources, and how they are utilized, helps to determine the type of sentiments they represent and their influence in the behavioral process (Stem and Reve 1980; Skinner, Gassenhiemer and Kelley, 1992; Scheer and Stem, 1992, Lusch and Brown, 1982).

Dependence upon other firms is another strong influencing factor on why firms choose to do business together. Dependence comprises three core elements: the degree of importance of the resource to the firm, the extent of the discretion the supplying party has over the resource, and the scope of alternative options (Pfeffer and Salancik, 1978). Whereas power is determined by the control of resources, dependence is a function of the resources not held by an organization (Pfeffer and Salancik, 1978).

“...Conflict is inevitable in most relationships,” (Fontenot and Wilson, 1997, p 7).

The minimization of conflict helps create an opportunity for the building of positive relationships that exists with cooperation and satisfaction (Anderson and Narus, 1984). Stern and Reve (1980) define conflict as a hindrance to the accomplishment of individual or mutual goals, whereas cooperation greatly increases the potential for successful attainment of individual and mutual goals, at the expense of a certain amount of autonomy (Morgan and Hunt, 1994). The adoption of a mutual focus provides participating parties a more equitable share in the establishment and daily development of the relationship and this in turn reduces the power and dependence issues that create conflict in relational exchanges.

The behavioural influences of control, power, dependence, conflict and cooperation are acknowledged as influential in determining the firm’s ability to develop exchange relationships. However, as relationships further develop into collaborative partnerships,
power and dependence is not sufficient to understand why firms remain and continue to
develop these relationships.

**Relational Exchange Theories**

Whilst the relational exchange concept contributes to other relational concepts, such as
relationship marketing, channel theory, and networks, it is of special focus in this review
as it is a recognized beginning of behavioral exchange between buyers and sellers.
Further, it provides an understanding of the relationship continuum from the most basic
transaction (discrete) through relational development, progressing into varying levels of
long-term relationships. This journey of relationship development, with mutual benefits as
its goal, begins as a two-party relational exchange.

Relational exchange can be characterized as a series of regular transactions over a long­
term period (Fontenot and Wilson, 1997). In the initial stages of understanding of
relational exchange, Macneil (1980) and Donaldson and O’Toole (2000) identified that the
existence of bilateral relations where parties work together to achieve common goals
results in fostering reliable repeat business. Parties that engage in establishing and
maintaining relational bonds benefit from reduced uncertainty and increased exchange
efficiency (Dwyer, Schurr and Oh, 1987). These relational bonds include contractual
relations, joint marketing programmes, and long-term relationships (Fontenot and Wilson,
1997).

The defining characteristics of relational exchange are based on its creation by way of
adhoc voluntary development. Dwyer et al. (1987) note that exchanges can be intra-firm
in the form of vertical integration, or inter-firm in the form of long-term relationships.
They further focus on the relational exchange concept as a means of developing buyer /
seller relationships in channels. For this exchange to develop and become reliably
recurrent there needs to be a level of quality achieved in the relationship and commitment
by both parties to the relationship. Successful relational exchange between firms develops
characteristics desirable to firms such as trust, commitment and communication (Fontenot
and Wilson, 1997).

It is necessary to understand the importance of inter-firm commitment in developing stable
buyer / seller relationships. Similar to trust, definitions of 'commitment' also vary
depending upon context and application in a relationship. It can range from as little as an
informal agreement to financial contribution to specific assets for long-term exchange.
Commitment is the willingness of a firm to provide resources for the purpose of
demonstrating their dedication to the continuation of a relationship (Fontenot and Wilson,
1997; Kumar, 1996; Cann, 1998). This level of dedication depends upon the involvement
of a firm in the relationship, and at an advanced stage, denotes a level of relationship
satisfaction that precludes potential exchange partners who could provide similar benefits
(Dwyer et al., 1987).

Commitment signifies, to successful relationships, a pledge of continued relational
exchange that implies a willingness to sacrifice short-term goals for long-term benefits
(Dwyer et al., 1987; Anderson and Weitz, 1992). The quality of a relationship is both a
precursor to and a result of a firm's motivation to invest in a relationship. Quality
relationships in turn produce mutual commitment and a willingness to invest in specific
relational assets (Anderson and Weitz, 1992; Morgan and Hunt, 1994).
To reduce opportunism in a relationship, commitment in relational exchange cannot be disproportionate between firms. Commitment signifies the highest form of relational bonding between firms (Dwyer et al., 1987) and contributes to the longevity of long-term relationships (Gundlach, Achrol, and Mentzer, 1995).

Communication plays an important role in the ability and the desire of a firm to advance their trading relationship. Communication has a significant influence on the ability of trading partners to form strong relationships (Berry, 1995; Holden and O'Toole, 2004; Mohr and Nevin, 1990). The sharing of information in a manufacturer / wholesaler relationship is critical, as accurate immediate information on production requirements improves both partners’ decision making ability by reducing uncertainty (Hogan, 1998). Open communication is associated with trust between relationship partners (Morgan and Hunt, 1994; Anderson and Narus, 1990; Berry, 1995). Collaborative communication in exchange relationships relies on mutual cooperative attitudes and helps regulate compliance amongst relationship members (Morgan and Hunt, 1994). Since satisfaction refers to the meeting of expectations between buyers and sellers, it is proper that communication contributes to these expectation evaluations, in that it enhances the way that exchange partners perceive each other (Williams and Spiro, 1985).

Successful relationship outcomes influence the firms’ willingness to further develop their trading relationships. Relationship outcome is the operationalized construct that captures the costs and benefits of maintaining the relationship, compared to the expected outcome value of the relationship (Anderson and Narus, 1990). Relational exchange will therefore continue or cease, dependent upon satisfactory achievement of expected relationship outcomes (Fontenot and Wilson, 1997).

Relational exchange also provides firms with the opportunity to develop successful relationships into key resources of firm value. Resource theory’s key premise is the firm’s ability to develop key resources important to the functions of production, distribution, and marketing of its own products (Wernerfelt, 1984; Barney, 1986, 1996; Conner, 1991; Hogan, 1998). Unlike resource dependency theory, a key assumption of resource theory is the firm’s ability to acquire the necessary resources without dependence on other firms in the industry, by “…maximizing the value derived” (Hogan, 1998, p 13) from important relationships. In this theory, achievement of competitive advantage is possible through intangible value attained from key collaborative relationships, which also contain tangible value in shared assets (Hunt and Morgan, 1994; Hogan, 1998; Peteraf, 1993).

Through the economics, behavioural, and relational approaches, there is a variety of explanations offered as to why firms are motivated to form and develop relationships but these explanations seem to apply to specific stages of relationship development. Economic theories focus on the low-collaboration transactions, where opportunism is expected. Behavioural theories tend to explain ongoing relationships where one of the parties has some economic, political, or resource dominance and Relational Exchange theories are interested in the highly collaborative relationships where sharing of resources is the norm. As such, it is important to identify the distinct levels of relationship development in order to determine the most appropriate relationship theory.

**Relationship Continua**

There are two main streams of research that focus on the changes and development of buyer / seller relationships. One stream involves the study of stages in the relationship life
cycle (Ford, 1981; Dwyer, Schurr and Oh, 1987; Cunningham and Homse, 1988; Knox and White, 1991; Moore, 1991; Jackson, 1994; Palmer and Bejou, 1994; Heide, 1994; Wilson, 1995) and the other looks at the structure, characteristics and attributes that contribute to the nature of the relationship (Dwyer et al., 1987; Donaldson and O’Toole, 2000; Morgan and Hunt, 1994; Day, 2000; Webster, 1992). The concentration on attributes, characteristics and structure of the relationship is preferable so it can be used to assess changes in performance and other behavioural and attitudinal characteristics of inter-firm relationships (Day, 2000; Webster 1992; Macneil 1980; Donaldson and O’Toole, 2000).

While there is considerable variation in the number and names of relationships levels, there is some agreement on the beginning and end points. Basic transactional exchange, also known as discrete transactions (Macneil, 1980), positioned at the beginning of the continuum, with collaborative or relational exchange at the opposite end.

Webster (1992) identifies seven stages of exchange along a continuum (Figure 1). However, Network Organizations and Vertical Integration suggest joint ownership and the relationship ceases to be between two firms. Also, some research suggests that Buyer/Seller Partnerships may not be distinguishable from Strategic Alliance (Day, 2000), which may limit its usefulness.

Figure 1  Webster’s Range of Marketing Relationships

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<th>4</th>
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<th>6</th>
<th>7</th>
</tr>
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<tbody>
<tr>
<td>Transactions</td>
<td>Repeated</td>
<td>Long-term</td>
<td>Buyer/Seller</td>
<td>Strategic</td>
<td>Network</td>
<td>Vertical</td>
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<tr>
<td>Relationships</td>
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<td>Partnerships</td>
<td>Alliances</td>
<td>Organisations</td>
<td>Integration</td>
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Day (2000) bridges the end points with opportunities for value-added activities. This concept provides both buyer and seller the chance to develop relationships by adding value to their relationship (see Figure 2). Another contribution of the Relationship Spectrum is that it operationalised the exchanges into identifiable relationships common in business (Day, 2000). It is from these relationship continua that this research proposes its relationship levels.

Figure 2  Day’s Relationship Spectrum

<table>
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<tr>
<th>Transactional Exchanges</th>
<th>Value Added Exchanges</th>
<th>Collaborative Exchanges</th>
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<tbody>
<tr>
<td>Anonymous transactions/Automated Purchasing</td>
<td>Complete collaboration and integration of supplier with Customer or channel partner</td>
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**Relationship Levels**
The four relationship levels proposed in this research are drawn existing relationship continua and include Discrete, Repeated, Long-Term, and Strategic Alliance (Macneil, 1980; Webster, 1992). In choosing the relationship levels, it was important that they
represented a relationship commonly found in practice, and they were sufficiently different to minimize any confusion.

*Discrete Relationships*

The discrete relationship is limited to a simple exchange transaction, and often there is a range of suppliers for the buyer to choose from. The Discrete relationship, in effect, is not really a relationship at all, but more a simple one-off exchange that almost exclusively marginalizes relational elements. The discrete relationship is defined by the absence of a relationship or even a transaction record prior to the buyer’s purchase, and anticipates no further exchange between the transaction participants. In the discrete relationship, each party tries to maximize its relational gain at the expense of the other. Each tends to ignore the other party’s identity, and they strictly limit communication to the content of the transaction, avoiding multiple parties and treating the objects of the exchange like commodities (Macneil, 1980).

Usually buyers will engage in horse trading – that is, they will use a selection of suppliers to ensure there is sufficient competition between those suppliers to gain a fair price for their product. This type of limited relationship is also characterized as adversarial or arm’s length, because it puts a low emphasis on joint value creation and is not concerned about inter-firm dependence on each other (Buzzell and Ortmeyer, 1995). Since there is minimal interaction in these relationships, the transactions tend to be measured and decided by price, which becomes the most important criterion for buyers and sellers.

*Repeated Relationships*

This relationship level requires regular interaction between firms. Regularity is central to the existence of this type of relationship. Input dominance exists, and it is often the buyer or the party that establishes the terms and conditions of the supply contract who has the dominant influence or control. Repeated relationships are contractual in nature, with the contractual terms dictated by the dominant party. Communication in this relationship remains transactional and therefore of a formal nature. This lack of strategic communication eliminates the opportunity for competitive positioning for either party.

*Long-Term Relationships*

Traditionally, when a buyer has been using a regular supplier as part of the transaction exchange process, the relationship has the potential to move from a repeated exchange to a longer-term relationship. For this shift to take place, organizations with a prior exchange history will have developed a level of reliance on their exchange partners to perform their jobs. This willingness to depend on exchange partners (Moorman, Zaltman, and Deshpandé, 1992) creates an atmosphere for the relationship to be developed. Cooperative behaviour is an outcome of many credible experiences benefiting both parties as they interact with each other. This may be observed through more open communication, and it often develops into information sharing. The long-term relationship is characterized by an advanced level of embeddedness (Granovetter, 1985) built upon mutual cooperative behaviour, with the aim of achieving mutual objectives.

While the purchasing process is likely to remain formal, the performance measures are likely to cater for more flexibility and interaction than in the case of a less relational exchange. Of low importance is the idea of preserving firm autonomy, as these relationships tends to share risks and benefits, thus motivating information exchange and shared expectation of success. Both firms view the time horizon of exchange as long-term,
but concentrate more on operational issues than strategic ones (Donaldson and O’Toole, 2000).

This relationship level depends on regular mutual interaction to develop the relationship bonds that ensure the relationship’s longevity. Long-term relationship success depends on continuous mutual input from both relationship participants. This input tends to be equal in nature, therefore neither party is significant. Long-term relationships are often contractual, however, the terms of the contract are mutually decided between the two parties. Communication remains formal, even though it is more open. Participants in long-term relationships benefit from long-term contracts, which reduce opportunistic behaviour. Whilst this level of relationship focuses on mutual goals through cooperative behaviour, it does so at an operational level; therefore, no competitive positioning occurs as a result of this level of relationship.

**Strategic Alliances**

Strategic alliances are, by definition, strategically focused, but its definition is broad as these relationships can be made up of various sized businesses, with either vertical or horizontal links, within different industries. Market and environmental pressures constrain a firm’s ability to compete on its own, and therefore increase the need for firms to develop cooperative relationships. In order to compete as an effective alliance, firms need a “….competitive strategy which will provide them a competitive position in an industry” (Porter, 1985, p1). This competitive positioning requires both firms to share a strategic vision, which includes developing a strategy to complement each other’s skills to maximize effective use of their joint resources and expertise.

As a relationship evolves in a long-term direction, unexpected surprises between partners decline, and the pretense of engaging a formal contract for monitoring supply is largely abandoned (Laing and Lian, 2001). However, cooperative relationships are not always sufficient on their own. By broadening the scope of the organization through the formation of an alliance, the firm needs only minimal internal adjustment to share in joint value activities (Yoshina and Rangan, 1995).

There are three main reasons why strategic alliances are so important. Firstly, they are a means of minimizing shortages and limitations. Secondly, they provide joint opportunities for development to keep companies competitive (Hii, 1999; Laing and Lian, 2001; Ohmae, 1989; Segil, 1998). Thirdly, they maximize expertise and market knowledge by combining resources (Johnson, 1999; Lorange and Roos, 1992).

This level of relationship is characterized by attributes that reflect a cooperative and strategic focus, such as the desire to achieve a win/win relationship (Ellram and Hendrick, 1995; Segil, 1998; Whipple and Frankel, 2000). Other attributes include the focus of the participants to increase inter-firm loyalty (Ellram and Hendrick, 1995; Joseph, Gardner, Thack and Vernon, 1995) and share goals (Ellram, 1995), while retaining elementary relationship attributes of shortened lead times (Johnson, 1999) and efficiency interactions (Johnson, 1999).

The strategic alliance literature suggests that the ultimate motivation for forming a strategic alliance is the opportunity to create sustainable competitive advantage in the marketplace (Hii, 1999; Johnson, 1999; Vlosky and Wilson, 1997; Sheth and Sharma, 1997, Hausman, 2001), since “…competitive advantage for a firm depends not only on its
own internal capabilities, but also on the scope of its relationship with other companies” (Hii, 1999, p 2).

The main distinction between strategic alliances and long-term relationships is the difference in the level of the focus. Strategic alliances form a strategic vision and communicate at multiple levels with other alliance partners. Long-term relationships remain at a tactical level, communicating with their partners at an operational level for exchange reasons.

**Relationship Classification**

While it is important to have the four different relationship levels, it is also important that future research is able to consistently classify a particular relationship as one of these levels. To achieve this, a classification scheme has been developed based on five structural elements found in all relationships. These elements were drawn primarily from the work of Macneil (1980), Webster (1992), and Donaldson and O’Toole (2000) and include: regularity, input dominance, contractual status, communication status, and competitive positioning.

Regularity refers to the constancy of exchange transactions between the exchange partners. The scope for this criterion begins with two or more exchanges at recurring intervals and progresses towards ongoing regular interaction at the mature level of this concept. Regularity does not recognize one individual exchange transaction in itself. Input dominance refers to the amount of influence and control one exchange partner has over another.

Contractual status represents the degree to which a contract governs the exchange process. Although contracts can be either informal or formal, the scope of this criterion only considers the extent of formal contracts in defining exchange requirements (Lusch and Brown, 1996).

Communication status defines the type and mode of communication links between firms for a given relationship. The scope comprises the type of exchange that the communication is used in, e.g., transactional, operational or strategic, and the degree to which the communication is delivered e.g. formal or informal.

Competitive positioning refers to the ability of the relationship to position both parties in the marketplace in a more competitive position than they would achieve if they were not in this relationship. The competitive positioning criterion revolves around the premise that the relationship enables this change in positioning to occur, and that this positioning change must enable both firms to be more competitive than they would be on their own.

If we apply these structural elements to the relationship levels proposed, it becomes clear how they will be able to classify relationships found in practice into the relationship levels that are so important for research in relationship development.

Figure 3 provides a summary of the relationship classification criteria as they pertain to each relationship level.
From Figure 3, we can see that the discrete relationship is distinctive from the other levels of relationship due to its non-regularity of exchange. This one-off approach minimizes the possibility of this level of relationship contributing in any other relational manner. The repeated relationship is distinctive in that one party often controls it and short-term contracts are used. This too minimizes its opportunity of becoming relational and mutually attractive. The long-term relationship reflects a mutually acceptable operationally focused relationship, whereas the strategic alliance focuses on attainment of strategic goals through competitive positioning.

The next step in the development of these relationship levels and their classification is to use them in empirical research. Armed with the ability to consistently identify relationship levels, researchers will be able to test how other important attitudinal, behavioural and performance constructs change as the relationships develop. For example, researchers could identify how important variables such as performance measurement, trust, opportunism, and relationship value changed as relationships developed.

References


