A Study of Partnership Models in Distribution Channels

by

Hirotaka Yamanami

B. A. Economics
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Submitted to the Alfred P. Sloan School of Management and the School of Engineering in Partial Fulfillment of the Requirement for the Degree of

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ABSTRACT

Recently Japanese oil companies have been struggling to provide customers with differentiated services and satisfaction, and to capture their perception. They tried changing the relationship with dealers over multiple distribution channels in order to solve this issue. Through trials and errors the oil companies managed to have dealers under their control by vertical integration, but the vertical integration did not result in positive impact for either the oil companies or the dealers since lack of communication brought about conflict between them regarding marketing approach.

By learning from practice oil companies have been changing their channel control policy from vertical integration to partnerships that enable the oil companies and their dealers to create more intimate and consequently cooperative relationships. Furthermore, their challenge to channel management has resulted in developing new distribution channels by building partnerships with unrelated industries.

This thesis focuses on the dynamics of two partnership models in the distribution channel, vertical partnerships, a new type of relationship between suppliers and their dealers, and horizontal partnerships that are strategic distribution alliances with unrelated industries. First, the driving forces of these partnerships are presented and from that hypotheses are built that determine successful relationships with partners and positive impact for customers. Following that is research and analysis of partnership cases from Japanese oil companies that verify these hypotheses.

Further, key factors are extracted from the cases and their validity is checked by adapting each hypothesis. Finally, key factors are prioritized by using an attribution map and the conclusion is a successful methodology for vertical and horizontal partnerships specific to Japanese oil companies.

Thesis Supervisor: Sandy D. Jap
Title: Assistant Professor of Marketing
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May 16, 2000
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CHAPTER ONE
INTRODUCTION

1. Statement of the Problem

Structural issue

Currently Japanese oil companies are facing an unprecedented crisis. The six major companies are operating at a deficit, and do not have a competitive advantage. They have no clear plans to escape from poor management, and many execute endless restructuring processes. Historically in Japan, the oil business has been protected by government codes whereby organizations that did not possess oil refineries were not allowed to sell oil products to end customers. Such government codes were based on experience from the oil crisis of the 1970s and 1980s. The government aimed to protect profits of the oil companies and encouraged them to discover new oil wells to cope with future oil crises. Japan needed to reinforce its energy policy in order to thrive even if global energy turmoil took place in the future. The codes limited the number of rivals and the market share of Japan’s oil companies was stable, whereby they could gain certain profits. In their distribution channels they promised dealers certain profits without a competitive marketing strategy. The transfer price between suppliers and dealers was dependent on the fluctuation of crude oil price, and dealers adjusted retail prices to make profits. While oil companies had overlapping distribution channels, they did not dare realign the channels because they needed to maintain their relationship with dealers. Owing to protectionism of companies to dealers they did not dare provide customers with distinctive service at the

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1 In spite of government policy, major Japanese oil companies possess few oil well interests. Therefore their refining and distribution business is categorized as “supplier”.

2 Dealers include sub-dealers and wholesalers.
standard market price, customers’ preference was dependent solely on brand image. Thus
the stable relationship between oil companies and their dealers due to government code
caused a fundamental issue in consumer marketing.

In 1996 Japan deregulated the government codes and opened the market to third parties
based on the notion that industries should not be regulated, because the government
thought that the protectionism would hamper growth and competition, and chances to
thrive in the global market.
Third parties such as trading companies, agricultural associations, and British Petroleum
surged into the market as new oil distributors. They immediately dominated the spot
market and sold oil directly to end customers or provided it to retailers at bargain prices.
Markets drastically changed. Price sensitivity to demand leaped, and retail prices\(^3\) dropped.
This decline robbed Japanese oil companies of enormous profits of more than $10 billion.
They sold oil products at low rates to keep customers, however they lost even more profits.
The oil companies tried to maintain transfer pricing to reduce their competitors’ bargaining
power, but could not control the strong force. Then the oil companies ranked potential
retailers and deserted unprofitable ones, which exacerbated the already poor relationship
with their dealers.
Fundamentally this situation caused uncertainty between customers and suppliers. More
importantly they did not improve their value chain, which must be a core competence in
such a commodity business. To survive such a business crisis, they needed to restructure
their value chain drastically. This was an immediate goal for them.

\(^3\) Gasoline retail price: 120 yen/l in 1996 to 90 yen/l in 1998
Analysis of the Value Chain

Before discussing the process to the solution, the structure of the value chain of the oil companies will be broken down and the dynamics that control quality of service and Japan’s oil company profitability will be discussed.

In Japan more than 80% of crude oil comes from the Middle East region, mostly from OPEC nations. They build alliances and strictly control market price though the OPEC committee. The pricing system is a political issue, and even economic powers such as the USA, Japan, and European countries are not allowed to interfere with the OPEC committee. Crude oil is transported by ship over 4,000 miles, therefore transport costs cannot be reduced as long as oil companies invest so much in oil tankers, which sometimes require new infrastructure in ports to load and unload oil.

Regarding refineries, while oil companies are restructuring their processes and reducing overhead, global environmental issues have made the processes more complicated than before. Recently, the green house effect has caused fluctuations in demand as weather has changed unpredictably across the globe. Naturally, oil companies take on risk in controlling inventory, which sometimes forces them to store unnecessary inventory in refineries and oil terminals, which expands production cycles. This pushes up production costs, and transfer prices.

Additionally each oil product requires a different distribution system and unique relationship between the distributors and dealers. For example only 2% of gasoline is sold by distributor (oil companies) to customers, and 45% of fuel oil is sold by distributors to customers. As for residential heating oil, there are intermediate parties between the dealers and customers, fuel wholesalers and fuel retailers, who handle one third of the heating oil in Japan. (See Exhibit 1)
Exhibit 1. Distribution channels for oil products (Japan)

Exhibit 2. Cost Structure in Value Chain*

*Budget Factor for Linear Programming in the 1st quarter 1999: Japan Energy Corporation
By breaking down the cost structure of the value chain (See Exhibit 2), we find that the most effective way to reduce accumulated production costs is to reduce distribution costs. Interestingly the distribution costs are more than 30% of total costs. If oil companies spend a portion of their budget to reduce refining costs by 70%, how much can they reduce overall production costs? The impact of the cost reduction would only be 7%. This cost reduction will soon be obsolete because of future reprocessing requirements to comply with environmental regulations. Spending the same amount to reduce distribution costs will generate more profits\(^4\). When we take into account the change of business environment such as emergence of substitute energy, government policy, climate change and other external forces, reducing distribution costs seems to be the most feasible plan because it is not changed by these factors.

Moreover reducing distribution helps companies to build competitive advantage regarding service. Currently high transfer price decreases profits of dealers. To reduce overhead costs, oil dealers diminish sales staff and hire temporary workers who have lower motivation to serve customers well and lower loyalty to the company. It is only natural that they cannot improve the quality of service until they improve profits.

Effective cost reduction mitigates the high transfer prices, which generates profits for dealers. Then they can reduce the temporary workforce and increase sales staff who play a significant role as a liaison to customers. In this way, a marketing strategy can reach customers much efficiently. Unless dealers increase their sales staff, they might not be able to provide customers with distinctive service, which can build competitive advantage in the commodity business. Reducing distribution costs can improve not only the relationship between suppliers and dealers but also between suppliers and customers.

\(^4\) If they can reduce distribution cost by 70% spending the same amount as refinery restructuring, the expected reduction in overall production cost would be 21%.
How to improve the distribution system?

To reduce distribution costs, what kind of strategy is most effective? Is it feasible to reduce costs with the current distribution system? The answer is ‘No’ because the costs are accumulated by complicated channel management. Oil companies need drastic changes in the distribution system. This means that they should restructure the distribution system radically to provide dealers with economies of scale and added value. Streamlining the distribution system might affect the following factors:

- Change the relationship between suppliers and dealers;
- Change the number of dealers;
- Realign distribution facilities;
- Decrease transfer price;
- Change the structure of dealers;
- Change marketing strategy; and
- Change products provided to customers.

Consequently these factors change the quality of service to customers.

Then, how should we proceed with the restructuring?

There are two types of restructuring processes; one is internal restructuring and the other is external restructuring, which uses complementary assets of other companies. Internal restructuring involves vertical integration and segmentation. External restructuring creates opportunity to consolidate potential distribution channels and create new business opportunities.

2. Overview of a Restructured Distribution Channel

Internal restructuring involves integration between suppliers and dealers. Among the different types of integration, the most popular process is vertical integration because it reduces the number of channels from suppliers to customers and thus effectively eliminates several transaction costs and friction between channels. Therefore, vertical integration is a
logical strategy if (1) the buying decision is complex and highly involved, (2) performance of marketing strategy is poor due to multiple dealers in a channel, (3) customers do not have intimacy with the service, (4) economies of scale are necessary for channel management, (5) the business environment is quite uncertain, (6) channel members frequently migrate to channels of other companies, and (7) sizable transactions are necessary.

"Hard" vertical integration

In the vertical integration process, there are two types of integration. One is "hard" vertical integration and the other is "soft" vertical integration. Hard vertical integration is a means for governing exchange in a market channel. It is carried out when any one of marketing flows is assumed by one organization across any two levels of distribution.

The potential benefits are:

- The creation of secure operations because it reduces transaction costs, combines operations, coordinate processes, and unifies information.
- It reduces interactive uncertainty and creates more stable relationships.
- It mitigates bargaining forces from dealers and builds a more favorable atmosphere.

On the other hand, "hard" vertical integration has numerous inherent difficulties as follows:

- It sometimes reduces flexibility in changing partners.\(^5\)
- It generates costs for managing biases favoring the maintenance or extension of internal operations.
- It eliminates the autonomy of dealers even if they have potential marketing skills. This decreases motivation of dealer employees and worsens the quality of the dealers.

In fact these difficulties worsen the relationship with dealer and supplier, and deteriorate service quality.

\(^5\) "Competitive Strategy" Michael E. Porter, 1980
“Soft” vertical integration

Because of the above oil companies who faced these difficulties tried to modify “hard” vertical integration. The outcome is quasi-integration via the creative use of appropriate influence. This can avoid conflict between suppliers and dealers and build trust, commitment, and coordination. We call this “soft” vertical integration, which means non-market governance such as administered vertical marketing systems and contractual marketing systems, and franchising. Administered vertical marketing systems are those in which marketing activities are coordinated through the use of programs developed by one or a few limited firms. In a contractual vertical marketing system, independent dealers at different channel levels integrate their programs on a contractual basis to achieve systemic economies and increase market impact. If they use legitimate power in the formulation, the system can be more tightly knit than administered systems. Soft vertical integration offers a series of advantages:

- While engendering member loyalty and network stability, dealers can employ a systematic approach and decision making;
- Tasks are standardized and economies of standardization seem to be accomplished easily.
- It is possible to control the cost and quality of the functions performed by various members.
- Only by adopting the systems perspective and by building effective linkages and relationships throughout the entire distribution channel, can suppliers achieve the impact in the market place they seek.

However, this integration has limitations. Once it is accomplished, suppliers have to pour in additional costs and time to keep up relationships and profitability. When they come up against a wall and seek more efficiency to break the wall, the integration might collapse the balance among the channel members, and exacerbate relationships. When other competitors follow the integration, their competitive advantage becomes obsolete. In fact, some Japanese oil companies tried to integrate their distribution channel as a manner of
“soft” vertical integration, but once competitors implemented the same step, the innovator’s benefit diluted. Louis W. Stern says, “there is, to the best of our knowledge, no firm that is totally vertically integrated for a long time.”

3. Key Aspects of Partnerships

Transition from vertical integration to initial Partnership

The other way to integrate a distribution channel is to consolidate distribution systems with other firms or industries. If firms have some credible business contents for other firms and they need to be revolved, they should describe the major changes under way in how corporations are working with each other to create value. Recently a number of firms have tried to redefine their distribution system using partnership. It enables firms to build long-term, high-impact businesses and gain a durable competitive advantage. While firms need initial capital and plenty of time to align the system, the effect will offset the loss once the system works adequately. It also provides firms with an opportunity to move from one business to other business, which cannot be realized by vertical integration. Choosing the best partner among a number of options might lead firms to cut their overhead, reduce management, redesign their distribution channels drastically, accelerate delivery speed, reduce billing problems, improve information systems and automate routine functions more effectively than what they did with vertical integration. These factors consequently increase customer satisfaction by providing better service.

As has been noted, firms should meet three core criteria to form successful partnerships. First, partnerships have to provide benefits to firms’ core business. When firms move beyond conventional relationship, they can attain highly levels of productivity and competitiveness that are not easily reachable through traditional internal vendor

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relationships. One good example is Fedex. It has partnered with Intel to take over part of Intel's logistics. This gave Intel improved and guaranteed delivery time and reduced delivery errors. In a supplier-customer relationship, neither firm wants to make deep-seated changes in what they are doing. But in partnering, both sides are willing to make changes in how they do business as benefits are distributed to both sides. However, true synergy can be realized only if both firms are well prepared to redesign the ways in which they work together through partnering. Mutual change in both partners' basic systems gives positive impact in any partnerships. When both firms are willing to rethink their methods working together, the result will be dramatic, providing adequate competitive advantage.

Second, partnerships build intimacy that leads to incremental change in how organizations work together. It is completely different from the solid relationship formed from the supplier-customer transactional business. Partnership requires information sharing on an entirely different level than vertical integration. Partners routinely share overall business and strategic plans, manufacturing information, confidential costs, and price data. The depth of shared information provides the data that is necessary to solve larger business problems.

Finally clear vision leads both firms to the right process. When partners have a real willingness to change together, they might focus on a distinctive vision among a tremendous range of possibilities. When that vision is set, different capabilities between partners builds common capability in the partnering business. Having a clear common vision has the power to change both organizations drastically.
Because of these factors, partnerships promise tremendous possibility for future success in terms of flexibility, customer satisfaction and cost effectiveness (See Exhibit 3). In fact Japanese oil companies are trying to change channel management from conventional to hard vertical integration, soft vertical integration to partnership. If the change goes well, their capability will be enhanced.

Then how can partnerships create value? The following digs more deeply into the concept of partnerships by focusing on Japanese oil companies.

Opportunities for external partnerships
In the USA, a new gas station and convenience store combination came to dominate in the 1980s. By 1984, gas stations and convenience stores accounted for an estimated 12 percent of the retail gasoline market, up from 1 percent in 1974. By the late 1980s, most major oil companies combined their gas stations with convenience stores. Chevron started its C-stores, Mobil its Mobil marts, Exxon its Exxon Stores, and Sun its Stop-N-Go stores. Oil companies introduced a new “family building” concept, involving separate prefabricated convenience stores, car washes, “gas bars”, and auto service centers. In the 1990s, Japanese
oil companies followed the American oil companies model of combining gas stations with convenience stores.

Actually there are some driving forces that caused Japanese oil companies to have to build partnerships with other businesses for the following three reasons.
First, many of the oil companies seek partners who share their distribution channel. Reducing logistics costs by aligning their distribution and supply chain is a critical strategy in the restructuring process. It is much more rational than other restructuring plans such as reducing the number of employees and shrinking the scale of manufacturing plants. But Japanese oil companies have difficulty in forming a clear vision of partnering since few of them have ever experienced such partnering. But once they build partnerships successfully, they could hold an advantage in Japan for a while.
Second, e-commerce has the potential to combine the distribution channels of Japanese oil companies. As e-commerce is becoming specialized in the service business, that portion of costs in the supply and distribution channel must be very significant. A simple example is amazon.com\(^7\) (Amazon), which sells books, toys, video games, home electronics, music software, and home improvement products, etc. Amazon’s supply chain is very diversified. When customers look for an array of items, they usually look to Amazon or a specialty store. In this situation, price and time are key factors that determine where a customer will buy the item. Price and delivery time is dependent on their distribution systems. To build a competitive advantage against its rivals, Amazon must rationalize its distribution system.
In a similar view Amazon’s partnerships with oil companies can enable it to reduce time and logistics costs. Diversified logistics of the oil companies based on a distribution map fits with Amazon’s concept. As a potential distribution point both Amazon and the oil companies can share a vast site in the oil terminal, while the oil companies need to shrink facilities through restructuring. Not only oil terminals but also gas stations offer strategic

\(^7\) Currently their market is only in the USA, but sooner or later similar business will dominate Japanese market.
delivery points where customers can pick up a variety of goods easily by car. This opportunity also gives customers an opportunity to buy gas, and save time. Otherwise they have to visit a specialty shop and a gas station separately. Moreover by doing this, a partner’s vehicles can be refilled at the oil company’s facility, and they can provide the partner with gas at a cheaper price in their oil terminal. Thus if oil companies partner with e-commerce companies, both can add value for not only suppliers but also for customers. Finally, partnership can be realized by an alliance with category killers such as Wal-Mart and K-Mart. They have the potential to build a shopping complex that attracts customers by providing a variety of products. If a gas station combines category killers and provides customers with automatic refilling, cleaning, or mechanical maintenance service while they are shopping, customers can be provided a number of services within a certain time.
Reducing time for buying such commodity products enhances customer satisfaction. From the viewpoint of oil companies the partnership gives customers distinct value without adding sales people. The partnership with category killers might create an alliance of distribution systems for the same reason that an e-commerce partnership would. Sharing distribution systems provide economies of scale in terms of numbers of drivers, and numbers of managers and employees who control the operations at the distribution point. Consequently, their partner can cut fuel costs efficiently.
By these three aspects oil companies have immense capability to build partnerships, and the time to do so has come.

4. Apprehension

However, Japanese oil companies have to select their partners very carefully because whether they can build competitive advantage by partnering or not is dependent on the partner’s attributes, assets, goals and management style. Thorough analysis of partners regarding location, scale of channel, marketing skills, type of facility and future capability is a crucial step before approaching any partner. Immense hidden costs such as switching
costs are generated when changing conventional relationships with current dealers to new partners. If a partnership doesn’t work due to systematic or managerial conflicts, it causes serious damage to both partners. To remove such risks, the oil companies must closely analyze their potential partners to determine who to partner with and how to proceed to achieve long-term mutual success.

5. Overview of the Process in Partnership Analysis

The theory presented serves as an impetus to elucidate on partnering mechanisms and capability further. To discuss the validity of partnerships the following key notions will be applied in later chapters.

- What underlying forces have brought about the partnership revolution?
- How can firms decide on suitable partners?
- How should firms draw a blueprint to align partnerships?
- How can firms coordinate relationships with conventional distributors?
- How can firms gain a competitive advantage for themselves and their partners?
- How do three key factors; impact, intimacy and vision, impact partnerships?
- How can firms manage partnerships when business environment changes?

In chapter 2 and 3, partnerships built in internal channels are discussed. To elucidate the model clearly I will analyze a successful case and unsuccessful case, and extract key elements. Theory and hypothesis are drawn from articles that specialize in the distribution channel. Through this process, critical issues underlying partnerships are examined and testing of the hypothesis is begun.

Chapter 4 and 5, research analysis of partnership models used by Japanese oil companies, introduce the external partnership model. The hypothesis will be built by examining cases
and academic theories on the dynamism of partnerships and the differences between models.

In the final chapter, key notions about two types of partnership models are described. Then, those notions are prioritized to adapt them to Japanese oil companies based on the assessment of advantages and disadvantages of various factors involved. Finally, the consistency of the assessment is checked, its weaknesses are pointed out, and then necessary improvements to the assessment are suggested.
CHAPTER TWO
THE ROLES AND OBSTACLES OF VERTICAL PARTNERSHIPS

1. The Driving Force of Vertical Partnerships

In this chapter an internal partnership model is introduced, where the relationship between suppliers and dealers gets closer than with vertical integration as discussed in the previous chapter. Since the partnership is based on internal linkages between suppliers and dealers, it is called a "vertical partnership".

From unsuccessful vertical integration to a partnership

In the oil, cosmetic, automotive and pharmaceutical industries vertical integration was developed as a means to enhance relationships with dealers. This came to be known as "Keiretsu" in Japan in the 1970s. However, in the 1980s when growth levels in these industries became sluggish, structural defects in hard and soft vertical integration occurred. The emergence of new types of distribution systems such as mass merchandize and discount stores changed customer behavior drastically. For instance, before this occurred, customers were loyal to particular brands that ensured a certain quality of goods and services to customers even if the brands were a little more expensive than their rivals. With the new distribution system customers noticed that quality of products were quite similar whether they bought them at conventional retailers or the new distributors, and that the price was much cheaper at the new distributors. This increased uncertainty between customers and conventional dealers, so that dealers began to find it difficult to predict customers' demand. To mitigate this difficulty, suppliers had to enhance dealers' marketing skills in order to recognize the adequate number of products they had to produce as precisely and quickly as possible. This way, suppliers emphasized the relationship
between suppliers and dealers and divided the relationship with dealers into two types. One was a dilute relationship between suppliers and dealers who had very little core competence compared to the new distributors. The other type built strong relationships between suppliers and dealers who had a core competence (customer acquisition rate, scale of business, marketing methods) compared to new rivals. For suppliers, potential dealers who had many customers and high sales volume accounted for not only a significant portion of sales but also precious marketing resources. This gave suppliers incentive to build much closer relationships with potential dealers. (See Exhibit 4)

Exhibit 4. Relationship between Suppliers and Dealers in the 1980s

Moreover suppliers tried to differentiate themselves from new distributors in terms of quality of service rather than price competition. As potential dealers accumulated know-how about customer service through experience, suppliers tended to rely on their service quality more than dealers without competitive advantage.

With regards to managerial participation among potential dealers, suppliers segmented dealers into two types, captive dealers and independent dealers. Suppliers participated in management of captive dealers and carried on hard vertical integration. On the other hand
suppliers allowed independent dealers to manage themselves as they liked in order to pursue high efficiency without conflicting with suppliers. (This means soft vertical integration.)

However, coordination between managerial control and efficiency was very difficult for both sides. To maintain relationships and high level of sales, suppliers had to provide for potential dealers. Especially in the case of soft vertical integration, suppliers impelled dealers to increase their sales force, but totally relied on their marketing strategy to avoid conflicts with dealers. Was this an adequate strategy?

In the 1980s major US oil companies implemented incentive programs for “soft vertically integrated” dealers. The oil companies announced the program to their dealers at monthly conferences. The aim was to provide the dealers with certain profits if they implemented the incentive program that the suppliers planned. (See Exhibit 5)

**Exhibit 5. Incentive program implemented by major US oil companies (1988)**

<table>
<thead>
<tr>
<th>Oil company (Suppliers)</th>
<th>Outline of incentive program for dealers</th>
<th>Incentive transfer price to dealer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amoco</td>
<td>New SS construction, Promote new image program</td>
<td>2 ¢/gal. for 3 yrs, 0.5 ¢/gal.</td>
</tr>
<tr>
<td>Conoco</td>
<td>Remodeling gas station</td>
<td>$5 M (~100 M gal/mon Sales), $15 M (100 M gal/mon Sales)</td>
</tr>
<tr>
<td>Exxon</td>
<td>Alter ID, price signboard, refill space design at gas station</td>
<td>10% injection to investment more than $80 M, $10 M when sales increase more than 1 M gal/yr</td>
</tr>
<tr>
<td>Mobil</td>
<td>Alter exterior and interior of facilities as Mobil required</td>
<td>2 ¢/gal. * last year’s sale volume</td>
</tr>
<tr>
<td>Sun</td>
<td>Alter exterior of facilities as Sun’s image change requires</td>
<td>0.35 ¢/gal. bonus when alteration is consistent with image program, 50-100% injection to investment</td>
</tr>
<tr>
<td>Unocal</td>
<td>Achieve the target sales volume (Exterior alteration is optional choice)</td>
<td>0.5 ¢/gal. bonus when achieving target sales, 50-100% injection if chose option</td>
</tr>
</tbody>
</table>

Gasoline distribution Research Paper in USA, Oct 1990, Kyodo Oil Co
Basically these programs did not mean that the oil companies interfered in dealers’ marketing methods directly, but rather supported their marketing indirectly. Whether dealers would accept the incentive program or not was dependent on their own decision-making. The oil companies wanted their dealers to enhance or maintain close relationships. What was the outcome of this program?

Consequently the program was not successful because about twenty percent of dealers could not participate in this program. Dealers who declined the incentive program believed that they could increase sales volume by exerting their marketing skills. As a result the relationship between suppliers and these dealers fell apart. Eventually twenty percent of dealers broke off their relationship with the oil companies and disbanded. The conclusion was that, due to management intervention, the oil companies spoiled the relationship with some dealers and consequently weakened their distribution channels.

The main reason for this failure was an incomplete relationship between the oil companies and dealers. “Soft vertical integration” could not create mutual association. It made it difficult for both parties to build common vision, mutual respect and relationships. As the oil companies did not consider the dealers’ competence and norms, the program created a bilateral force. Naturally the dealers felt uncertainty about the oil companies which weakened ties.

When suppliers and their dealers faced these negative factors, the relationship became worse. This is the disadvantage of vertical integration. Vertical integration causes problems when each side tries to implements new strategic plans. The relationship is so fragile and unstable that suppliers cannot execute a new, sometimes drastic, corporate strategy without thorough discussion with each dealer.

Hence these days such vertical integration is old-fashioned and not flexible if firms have to change their strategy quickly with their dealers in order to thrive under fierce competition.
Emergence of vertical partnerships

Once suppliers decide on a strategy, they must next think about relationships with dealers where they will generate implements, assess and improve upon strategic plans without any conflict from the other side. The degree of dialogue must be not unilateral (strong force from suppliers to dealers) but bilateral. This means that suppliers and dealers are in an equal position to consider a strategy by taking into account the other side. This is the essence of vertical partnerships.

Will it be easy to change a relationship from conventional vertical integration to vertical partnership? The following are some pros and cons of the transition.

"Pros" of transition from vertical integration to vertical partnerships:

- Vertical partnerships are the sole way to improve the conventional integration system without any disadvantages for both sides. They do not need to change external factors such as corporate identity due to a merger and acquisition, so that the transformation cost can be kept as low as possible to both sides.

- Vertical partnerships can transform conventional norms between suppliers and dealers (vertical integration) to new conglomerate norms very naturally.

- Vertical partnerships identify the core competence of dealers not only subjectively (from the perception of dealers) but also objectively (from the perception of suppliers). In practice suppliers intervene in dealers' management (hard vertical integration), but this generates conflict between them, which deteriorates flexibility. The partnerships remove this difficulty.

"Cons" of transition from vertical integration to vertical partnerships

- To build real vertical partnerships, both partners need to make a tremendous effort through many trials and errors. They have to be patient and confident with their partners, otherwise uncertainty in the transition process makes it difficult to build new
relationships. Typically it takes time to build complete confidence. Because of this, building vertical partnerships takes more time than building vertical integration.

- Vertical partnerships require common goals and consequently a definite strategic process. With respect to this point, both partners have to re-align their internal corporate structure. If each is resistant to this restructuring process, building the partnership could be difficult.

- Vertical partnerships are not always successful. Sometimes conflict of corporate norms and managerial style causes negative results. Suppliers have to select partners carefully based on their business environment, and the suppliers must align fundamentals where both suppliers and dealers can join without any resistance. Otherwise, unsuccessful partnerships result in the loss of a potential channel.

From the above-mentioned pros and cons, the key to building vertical partnerships is to transform a unilateral relationship between suppliers and dealers to a bilateral and associative one, where common objectives, strategic processes and consequently new norms are built.

2. Building a Hypothesis for Vertical Partnerships

Considering these factors, how then should vertical partnerships be defined? In this small chapter some hypotheses to define the vertical partnership are shown.

One of the ways to approach building a hypothesis is to note the difference between vertical integration and partnerships. Both models have similar aspects in terms of a long-term continuous relationship based on the confidence that either partner feels for the other. But there is a significant difference. In the vertical partnerships, suppliers regard dealers as equals. Of course in practice it is very difficult for suppliers and dealers to be equal due to different scales of business and organization structure. The important point is whether
suppliers respect their partners’ standpoint and treat them as if they play as significant role as themselves or not. In other words, whether the relationship is bilateral or not is a very critical factor. No matter how if the relationship is soft or hard, vertical integration works with unequal force that results in unilateral duty of dealers to suppliers. Vertical partnerships replace unilateral force with bilateral force. Bilateral force builds a relationship where information from both sides is. This association must be based on the assumption that both furnish autonomous information. In other words a bilateral relationship cannot be maintained for a long time unless both possess their own information network and competence to deal with an enormous source. The difference between bilateralism and unilateralism is whether each can adapt information to decision-making flexibly or not. In partnership, with bilateral communication, both can associate decision-making to some degree while the autonomy of decision-making is highly respected.\(^8\) The association of decision-making requires the autonomy of both sides in order for partners to properly make complementary judgements. It is impossible for one party to judge all information on one side. It implies that vertical partnerships are different from heteronomy. In contrast, although vertical integration makes it a principle to respect dealers’ intents, dealers have to comply with suppliers’ intentions in order to control power between suppliers and dealers. Even if the relationship is “softly” vertically integrated, dealers have to take into account suppliers’ intent in significant situations. Dealers fall into heteronomous situations due to suppliers’ underlying power. Because of these differences between vertical integration and partnerships, it is asserted that partnerships allow dealers more autonomous management, and thus the first hypothesis is built:

**(Hypothesis 1): Suppliers regard potential small dealers as important partners, and they desire association and bilateralism with these members. Partnership is sometimes generated by the necessity of a strategic alliance.**

\(^8\) Masahiro Maruyama “Analysis of economy in distribution channel”, Sobunsha, 1988
The other aspect of vertical partnership is its ability to improve the relationship between suppliers and customers. Recently suppliers have voiced a desire to get marketing information directly from customers through dialogue marketing. The value of dialogue marketing is that suppliers can absorb novelty and creativity though intimate communication with customers. They have a variety of preferences and their sensitivity to new trends is crucial for suppliers to develop new products before other competitors to get “first mover” advantage. Suppliers have recognized that creative service is one of the most profitable assets they can develop, and their service development determines whether they can dominate the market or not. The recognition is based on a notion that unilateral control hampers firms from being creative, and in contrast, free communication with customers helps to build creativity because they provide various points of view. In fact the age of power marketing by potential manufacturers has ended, and dialogue marketing has become adaptive function that has replaced conventional power marketing. Dialogue marketing emphasizes that firms and customers are at equal positions when communicating with each other. It is different from a conventional relationship between suppliers and customers, and suppliers play a role as speakers and customers as auditors. Bilateral communication is required not only between dealers and suppliers but also between suppliers and customers.

By building vertical partnerships with dealers, suppliers try to build dialogue with customers. Through the value chain, dealers play an interface role between suppliers and customers, so that the suppliers need to strengthen the mutual dialogue with dealers in order to revitalize communication with customers. As vertical partnerships enable dealers and suppliers more transparent in terms of communication, suppliers can get more information from customers, and subsequently build alliance with customers more promptly.

And this logic supports the next hypothesis.
(Hypothesis 2): Partnerships improve communication between suppliers and consumers through incorporated connection with dealers, and it gives suppliers resources to improve marketing methods.

It is asserted that vertical partnerships expedite and enhance innovation in a new partnering team.

In vertical partnerships each partner is regarded as a center that creates marketing innovation. This departs from the past notion where channel members used to be an object controlled by suppliers. Marketing innovation develops new types of service and new ways to enter the market. New ways of entrance involve distribution systems and new information system to support the distribution system. If the communication level is enhanced by the partnerships, information for marketing innovation can be transferred more frequently. To build the situation, the partners must try to make opportunities for communication. By building opportunities for communication, each can prevent the other from self-complacency, and communication builds the mixture of each creation from their knowledge and experience. When information is exchanged redundantly, each partner can enter another partner’s domain and point out a problem. Thus, the impetus to create should stem from all partners and each can be a potential leader for innovation.
The process to expedite innovation has four stages, strategy planning, allocation of each role among partners, implementation and evaluation of each role. (See Exhibit 6)

(1) Strategy planning
In this stage, each collaborates with its partner to make a strategic plan using each information source and knowledge. Each partner’s vision has to be clarified thoroughly in order to build a common vision. In most cases, a firm plays a central role and develops a common vision as the leader. Once all partners agree on common vision and tactics, they must agree on their direction and goals to proceed.

(2) Allocation of roles
In this stage each partner clarifies its strengths, and devotes efforts to keep them. If there is a lead firm, it sets each role by taking into account each strength. Once each role and responsibility is clarified, each partner is to provide other partners with beneficial information and to point out problems even if it is out of its own domain. This helps all partners receive every specialization and mutual support.
(3) Implementation

At this stage, high communication realizes innovative action. Lorenzoni and Baden-Fuller\(^9\) advocate that this develops two types of innovation, the borrow-develop-lend principle and a learning race.

The borrow-develop-lend principle means that a central firm purchases or borrows ideas from third parties and lends them to partners as added value. The advantage is that each partner can reduce time and costs to develop the initial idea.

The “Learning race” encourages competition to achieve a common objective among partners. The partners must recognize that they have to take into account the risk that competition might destroy a partnership when one partner does not have adequate skills or information resources. To avoid this situation the central firm must research each partner’s skills and resources thoroughly before building vertical partnerships. If they are unbalanced, firms should reconsider building the partnerships.

(4) Evaluation of roles

Rewards are allotted in proportion to the contributions of each partner in order to maintain incentives to generate innovation. The following is an example of vertical partnerships where a central firm successfully evolved the skills of its partners by rewarding each role.

Seven-Eleven Japan has been developing hot bread from its oven bakeries as its competitive advantage against rivals. In fact, demand for its bread has been increasing as western style meals became more common in Japanese households. As Seven-Eleven Japan possessed the know-how to market this product, the company built a vertical partnership with four potential bakeries. The contract of the partnership with the four companies was to develop and produce a new type of hot bread and distribute it to Seven-Eleven Japan. Initially Seven Eleven Japan gave them lots of information regarding marketing data in order to remove uncertainty in the partner businesses and built

\(^9\) Lorenzoni and Baden-Fuller “Creating Strategic Center to Manage a Web of Partners” California Management Review Vol 37, 1995
fundamental confidence. It recognized the core competence of its partners, such as regional branding, types of bread they specialized in and production costs and then it played a role as a central firm in the partnership. Through discussion with four partners, Seven Eleven Japan set a common objective for the project where the key goal was to market a warm feeling, produce varieties of bread at low cost including logistics. Through collaborated strategic planning each partner set its role in terms of the region they were responsible for and type of bread. For example a partner who specialized in producing curry-flavored bread increased production in urban areas where many families wanted to buy it in the morning. Seven Eleven Japan researched the market thoroughly in order to match their distribution with demand. At weekly meetings Seven Eleven Japan reported marketing trends, suggested new product concepts, and assessed new products with all partners. They debated on how to improve product quality, how to produce at a lower cost and how to adjust logistics in order to improve the quality of the products. By taking into account each regional market and its production capacity, the raw materials for the bread were purchased in cooperation, which reduced production costs drastically. Innovative ideas were generated not only by Seven Eleven Japan and the partner bakeries, but also by the group’s raw material producers.

Regarding the evaluation of each partner’s responsibility, Seven Eleven Japan tried to increase its purchase volume from partners who cooperated positively and achieved fruitful outcomes. When it was raw materials, Seven Eleven Japan tried to purchase higher volumes for other kinds of products\(^{10}\), beyond the scope of partnering products. Thus it built a competitive situation in order to enhance incentives to innovate certain products among partnering firms.

Regarding betrayal activity, its partners had business relationships with other firms despite their high dependency on Seven Eleven Japan, and it was possible for them to leak trade information to others. However, this behavior looked absurd because the information was

\(^{10}\) This refers to transactions between Seven-Eleven Japan and its four partners which were not categorized as partner business.
consistent only with the partnering system of Seven Eleven Japan where purchase, production, supply chain, product development and marketing were linked. No matter how much Seven-Eleven's innovative know-how was copied, it was very difficult for other firms to apply it through the whole value chain. Moreover betrayal activity damaged the relationship between the betraying partner and other partners, and the betrayer did tremendous damage to its own business. Due to this fact, betrayal activity was effectively restrained.

From this case and discussion, the collaboration of innovative firms enhanced the popularity of products, market efficiency and knowledge revolution of each partner if they stepped up appropriately to the partnership. From this recognition the following hypothesis is built.

*(Hypothesis 3): Through partnership, suppliers can give partners incentive to innovate their marketing strategy.*

While vertical partnerships have much merit, transforming former relationships to the partnership is often difficult. One of the main reasons for this is that firms sometimes face difficulty in transition due to independent factors among partners. To develop the partnership successfully, partners have to develop information technology so that each partner can get information fairly and promptly through the partnership. Without the development of such technology, firms cannot share information with other partners. Enhanced data processing, by taking advantage of IT, plays a significant role in enabling firms to build partnerships easily since utilization of IT among partners provides suppliers with choices in building a partnership. When suppliers shift these skills and knowledge to dealers and become equals in terms of knowledge sharing, the possibility of realizing the partnership increases a lot. Thus enhancement of data processing in dealers and a shift of intellectual assets from suppliers to dealers creates an ideal business environment to build a
partnership for suppliers who have engaged in conventional channel management such as vertical integration.

The second obstacle in transforming relationships is similar to a prisoner’s dilemma (suppliers are skeptical about acts of treachery from dealers) due to a lack of information exchange and profitability. As firms cannot judge whether partners are completely cooperative or not, they cannot decide to build the partnership. In fact oil dealers who have low loyalty to oil companies change brands if they can get more profit from an act of treachery than from current brand. It is difficult for oil companies to build a partnership with such dealers.

The third obstacle in transforming a partnership is that partners are apprehensive about the probability of partnership dissolution since the partnership needs investment in a particular property once the partnership is implemented. This inclination exists in vertical partnerships rather than horizontal partnerships. Investment generates greater risk for small dealers than large firms in horizontal partnerships. While large firms can make alternative plans to utilize the investment to align their own vertical partnership even if the horizontal partnership fails, small dealers have no choice but utilize the invested property for the partnership.

The fourth obstacle in transforming partnerships is that dealers tend to fall into a dilemma between risk evasion and status quo. Suppliers sometimes try to control the activity of partners in order to prevent them from an act of treachery. In this situation dealers fear that a change in the relationship with their supplier (from a conventional relationship to a partner) might cause unexpected risk due to changes in the status quo.

Finally, relationships where dealers have often succeeded often hampers the partnership process because they think that they cannot expect more success by forming another relationship.

With these obstacles in mind another hypothesis is built as follows.
(Hypothesis 4): When firms begin to form a partnership, they usually face uncertainty in terms of communication levels and management systems, which are obstacles to successful formation of the partnership.

As mentioned above, four hypotheses of vertical partnerships were presented. In the next chapter these hypotheses are explored by introducing the case of a vertical partnership in Japan’s oil retail business.
CHAPTER TREE
VERTICAL PARTNERSHIP CASE STUDY IN JAPAN'S RETAIL OIL BUSINESS

In this chapter, the case of a vertical partnership between a Japanese oil company and its dealers is researched. Initially the partnership was incomplete in that partner firms could not provide customers with value added service. But by detecting issues and resolving them, they could build a more complete vertical partnership than before, where the partner dealers organized a union. They had more opportunity to exchange information and management skills, and the cooperative relationship helped them to enhance their service levels to customers.

1. Momentum to Build Vertical Partnerships

As is discussed in Chapter 1, the liberalization and de-regulation of the domestic oil market in Japan diminished the profitability of oil companies (suppliers) drastically. To cope with the situation, suppliers curtailed sales promotion activities such as advertisements, which had used a significant portion of their marketing budget, and they also reduced transfer prices to dealers in order to support their management. Infrequent sales promotion weakened brand identity and customer loyalty diminished as gas stations were selected on other factors such as exclusive service, attractive prices, and convenient location. Some dealers lost revenues, and they had to reduce labor costs to keep certain profits. As customers visit gas stations on a regular basis, reduced labor costs increased the working pressure of employees and deteriorated the motivation of each employee which subsequently deteriorated service quality.

To ensure profits for dealers, oil companies manipulated the transfer price, and this resulted in strengthening the bargaining power among oil dealers.
Retail prices decreased rapidly and the profitability of dealers worsened when oil companies gave up the operating transfer price. Under this circumstance the quality of service deteriorated and dealers could not prevent the loss of customers. (See Exhibit 7)

Exhibit 7. Bargaining Force and Service Deterioration

This shows the miserable outcome of game theory, and implies that dealers will not be able to continue their business unless they profit from businesses other than oil sales.

A manager of the Retail Marketing Department of Japan Energy Corporation (JE) said “The era when oil dealers can make a profit from their conventional oil sales has ended. We have to create new businesses and implement portfolio services in the gas station, otherwise the number of gas stations will be reduced by one third.”

Actually many oil dealers have a side business such as a car wash, oil change, wheel change, quick car maintenance or miscellaneous car products. They lead customers to buy these products or services, and build a clientele of repeat customers.
For suppliers and dealers, shifting from the core oil retail business to portfolio services means:

(1) They build well-balanced profitability from many kinds of businesses. Of course, they cannot disregard the conventional oil retail business. They position oil retail momentum to invite customers and generate profits from this new service.

(2) Portfolio service in gas station costs more today than before. They have to pay attention to the correlation between profits and costs in each business, and try to reduce costs by leveraging the synergy effect.

(3) As the portfolio business needs segmented customers\(^{11}\), the relationship between customers and dealers has to be improved. This means that the marketing force is not unilateral but bilateral. Naturally the relationship between dealers and suppliers has to be improved. Unless the relationship grows, the portfolio business will not be successful.

(See Exhibit 8)

Exhibit 8. Vision of portfolio business

\(^{11}\) Customer preference to the added service varies, so that gas stations have to choose profitable customers and measure their preference to new service.
To align portfolio services, JE launched a new marketing plan called Value 5 Project in 1997. As a new challenge for a new profit zone, JE began to participate in their management meetings and collaborated in developing new businesses. Until this partnership JE only advised Value 5 on marketing strategy and leveraged marketing promotions. The objective of Value 5 was to get by with a 5 yen/l (18 ¢/gal) or lower margin in their oil retail business supported by profits from other services and an efficient labor force (actually JE set the objective as time management index\(^\text{12}\)). JE received a monthly rental fee for Value 5\(^\text{13}\) from participating dealers, but it could be reimbursed fully from improved profits. By building a core competence in other services, dealers could compete in the fierce bargaining war, and JE could receive certain profits from rental charges and oil sales where the transfer price was the level it had been before the bargaining war. JE positioned the dealers implementing the Value 5 project as core dealers among their conventional dealers.

2. Unsuccessful Result at its Initial Stage

After this experimental year, the records of Value 5 dealers showed increased profits. Among the profit areas, maintenance increased by 50%, while oil sales increased by 3%. However, the superiority index\(^\text{14}\) showed that the total score was below the target score. (Competitive advantage ratio: 2.0, evaluated score: 60%, (See Exhibit 9))

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\(^{12}\) Generated profits per employee per hour.

\(^{13}\) JE regarded Value 5 as a product not a plan, therefore they charge a fee when partner dealers participate in Value 5.

\(^{14}\) The survey was performed by Consumer Life Advisor. The survey evaluated whether the Value 5 gas stations had a competitive advantage compared to other brand competitors in terms of five points. Competitive advantage ratio means that the objective competitive advantage of Value 5 dealers versus that for other competitors, and the target ratio was 2.0.
After analysis, it can be seen that service in the portfolio business was not enough to reach the target score. From the professional perspective, the new businesses had not performed well. This meant that not only employees, but also managers of the dealers and their partner, JE, did not execute the new business appropriately. (See Exhibit 10)

While customer satisfaction and perception of the new business were less than the targeted level, the total evaluation satisfied the target level. From the two sets of data, three key points appear.
Exhibit 10. Customer perception and satisfaction at Value 5 stations

First, often migrating to a new business takes more time than expected. The exhibits imply that there was uncertainty in the planning, implementation and execution process, which reflects that the new business was not totally working.

Second, multiple services in a gas station enhance customer satisfaction and perception. Customer perception was driven by novelty due to change of layout of the gas stations. It seemed that these gas stations set up gas refill pumps in the most visible sites. But this does not always prompt customers to refill their cars. The manager of JE said, "Customers notice the gas refill service at first and then this recognition links to other services." The higher level of customer satisfaction was the advantage of Value 5's strategy.

Finally, while customer satisfaction of the new businesses was not enough to satisfy the target level, the total score was more than each score. This means that customers were satisfied with multiple service despite the fact that the quality of new service was still low. It seemed that the synergy effect worked in this case. However, what was of concern was the quality level of the new service. Incomplete implementation of the new service failed to enhance the quality level of the new service. The education of employees and service
know-how was not sufficient to improve the services to the target level. It generated a risk
that the overall customer satisfaction would deteriorate unless the service quality of the
new business was improved. The high evaluation, which was greater than target level, was
driven not by absolute quality but by a superficial outlook and the effect was tentative.
Because of the uncertainty of management, the number of installed Value 5 stations was
only 28% of the target number.
The analysis of JE and partner dealers is as follows.
(1) JE could not position the Value 5 project as a distinctive business among a variety of
distribution channels.
  • JE and its partners could not build an organizational structure consistent with their
vision and agreed-upon process. As there were no solid principles and associated
rules, the decision-making process was not systematic, and most responses to
customers were determined by the employees’ judgement. Each role in the
partnering organization was very vague.
(2) Through the implementation stage, data mining and visualization were not aligned
appropriately.
  • The system set up to gather marketing information was delayed for the
implementation process. Marketing information builds decision trees. Tree-based
methods are good for identifying important variables, nonlinear relationships with
customers and interactions between predictor variables, and they work well when
predictors are numerous and many of them are irrelevant. Because of these factors
they could not execute proper customer acquisition and retention.
(3) Recognition gap about Value 5 between JE and dealers.
  • Due to a lack of interaction, dealers’ understanding of the Value 5 concept was
incomplete, so employees could not execute the plan effectively. Value 5 was not
implemented as JE conceptualized because JE participated in the partnership at a
divisional level, not at a corporate level. Though the Value 5 project should have
been consistent with JE’s marketing policy, the division in charge of the partnership
did not communicate marketing policies to other sales divisions well. Because of that, communication between dealers and JE’s marketing department, not division, was not revitalized.

(4) Obstacle of conventional business customs and norms on the dealer’s part.

- The method of participating in Value 5 was too drastic for dealers to change their norms quickly. In particular JE mandated that dealers participate in its promotional events that scared dealers. This robbed dealers of a sense of liberty and autonomy and such force generated friction between them and JE.

- Since the partnering contract, which was based on the rental fee, was determined not by mutual discussion but by JE, unilateral force from JE worked at the initial stage. Such obstacles generated the gap that hampered collaboration.

3. Improving the Vertical Partnership

After the unsuccessful partnership, JE tried to improve the partnering relationship. First they improved on the uncertainty of dealers by approaching them at a corporate level. At the corporate level JE created a much clearer vision than the two had before.

- Value 5 was positioned as a core business strategy among corporate retail restructuring plans.

- JE clarified the role of headquarters, the marketing department and dealers\(^{15}\) in the Value 5 project.

- In JE, the marketing division adopted common vision of Value 5.

Second, JE tried to remove obstacles between partnering dealers and itself, and improved the relationship with frequent dialogue. It also aimed to increase the number of potential dealers participating in the Value 5 project. To give concrete details, JE did the following:

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\(^{15}\) It is just a conceptualization of JE for agreement at corporate level through discussion with dealers.
• Regarding the mandatory promotional events, JE asked dealers to participate voluntarily, and the contents of the promotion would be a collaboration among all partners.

• JE built a committee with partners, where each member’s role was equal. This committee decided on indispensable factors necessary for Value 5’s success. The committee’s decisions were accepted by JE vertically and horizontally, and were consistent with corporate strategy.

• Regarding the rental fees for the Value 5 project, JE clarified the impact of the project in order to remove the negative impact of the fee.

Third, JE emphasized to dealers that they were aware that the terms of partnership faced difficulty in terms of independent business levels by building partner union among dealers. This could be resolved. In each area gas station had networks and supported their business mutually. They identified one flagship station that played a role as the center firm which controlled the regional partnerships, and other stations played distinctive roles as satellites. Regarding hard maintenance and periodical mandatory inspections for the new joint businesses, they networked with outsourcing companies such as sheet metal firms, large maintenance factories and painters which were all linked from the center gas station. (See Exhibit 11)
Fourth, the roles of each station were defined clearly. The partners devised common rules and a service manual to standardize their partnering business. Each customer order and information was linked through an IT network, and in this way network stations began to grasp customer orders at once. The network enabled all regional partners to exchange not only customer information but also marketing information such as customer behavior, and marketing strategy through IT and weekly meetings. IT also linked JE’s marketing branch and headquarters and realized interactive communication with partners.

Fifth, they strengthened the implementation process through detailed weekly briefings with managers and partner dealers. Their employees had an opportunity to learn the new system as potential service representatives.

Owing to these five improvements, the partners now have a common vision, from the corporate level of JE down through to the partner stations. Information and knowledge is now shared among partners, and the communication level has enhanced drastically. As a
result each employee now plays a significant role, and customer satisfaction has increased significantly.

4. Key Results from the Case

In this case, we can see the differences between the unsuccessful initial partnership and the current successful partnership. This is clarified this by contrasting the four hypotheses defined in Chapter 2.

*(Hypothesis 1): Suppliers regard potential small dealers as important partners, and they desire association and bilateralism with these members. Partnership is sometimes generated by the necessity of a strategic alliance.*

In JE’s case, its concern for the partnering business was very different. During its unsuccessful stage, JE participated in the partnering business at the divisional level. No matter how much JE communicated with its partner, the case showed that bilateral communication was not be successful until JE’s executive and corporate departments participated in the partnering business. Real mutual communication was necessary and was enhanced only when JE placed its partners on an equal level at a later stage, when JE’s tremendous information about marketing and corporate strategy made the vision clear and built a sense of intimacy for the partners. In the unsuccessful case, only the divisional manager and service staff took part in the business, and they wanted to make remarkable progress in the partnership. Without any concerns at the corporate level, the division level tended to manage the partner firms by leveraging the supplier’s market power. JE’s executives could assess the division objectively and give the division proper advice. JE’s different concerns for each partner generated uncertainty for JE and some of its partners. It is natural that each partner has different advantages and disadvantages in terms of their location, scale of business, employees’ intellectual level, skills and information level.

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While JE and its partners built a certain vision during the unsuccessful stage, strategic processes were different due to different business environments and competency among partners. The process went smoothly with some potential partners, but did not move smoothly with others. This reflected unclear profitability and generated a gap among them, which resulted in uncertainty.

In addition while JE built a relationship with each partner during the unsuccessful stage, JE and its partners did not have an opportunity to build a mutual relationship. This generated uncertainty for JE because it could not measure the conscientiousness of each partner to JE. At the successful stage, the intention of partnership was a strategic alliance where all partners and JE had a common objective and strategic process.

The partners built a viable union, and the communication level among the partners improved tremendously. JE communicated not only with each partner dealer but also with the union. This removed a sense of uncertainty among partners. It made each partner recognize that JE regarded all partners as equals. As a result JE removed the sense of mistrust and revitalized the association with its partners.

*(Hypothesis 2): Partnerships improve communication between suppliers and consumers through incorporated connection with dealers, and it gives suppliers resources to improve marketing methods.*

During the successful stage, JE’s “area dominant strategy” increased the amount of business each dealer (gas stations) did and the variety of customers. As the partners’ vision and process was common, all the marketing information was shared among all the partners and JE. The shared information and business enhanced the competitive environment among the partner dealers, where the more one contributed in terms of information and marketing skill the more rewards the partners shared. This enhanced communication levels with customers. As information was gathered only from customers, each partner tried to realize dialogue marketing. All customers’ complaints, requests and gratitude for services were shared between the unions and JE. The common vision greatly impacted the partners and
JE. JE could gather customer data, and with their marketing resources it could mine the data, and respond to particular customer behavior and preferences. The data mining was shared with partners and served to reinforce information. The new intimacy that JE developed with partners helped JE communicate more easily and precisely with its partners than before.

Thus the common vision and process among partners enhanced communication levels with customers, increased the quality and quantity of customer information, and helped build a positive relationship with partners. This enabled JE to give feedback to its partners and reinforced marketing information. As the marketing strategy becomes more sophisticated, consumer marketing can be strengthened.

(Hypothesis 3): Through partnership, suppliers can give partners incentive to innovate their marketing strategy.

At the unsuccessful stage the marketing resources of the partner dealers was information from customers and JE only, and the partners’ objectives and rules were different. Surely, the partnership was forming to some extent, but the effect of partnership was weak. Successful partnership took place when partners formed common objectives and decided to join forces for clear reasons.

First, in JE’s case, the volume of marketing information was different. The partner union enabled each partner to communicate clearly with one another and to share a variety of information. Types of customers and their behaviors are different dependant on where gas stations are located (i.e., residential area, main highway, industrial zone, etc) even within the same city. JE’s marketing manager said, “Before improving Value 5 we did not know that there were so many customers who were eager for one-day inspection services in some regions. Information on the availability of each partner, communicated through IT infrastructure, gave the partners a chance to meet customers’ requests. This enabled all partners to provide customers with Just-in-Time service.”
It is natural that increased information helps to create innovation. The mutual information sharing enhanced the quality and quantity of customer feedback that helped JE to innovate its service to customers, which resulted in contributions to other partners and JE. Additionally competition among partners stimulated marketing innovations which evolved from customer information. Competition does not always disrupt activity; if anything, it often enhances the creativity of the partners. Hence efforts to differentiate services based on shared information (and evaluated by partners and JE), encouraged every other partner to create a better service.

In this case, mutual information sharing enhanced the quality and quantity of information that in turn created innovation. Innovative marketing skills were shared and this stimulated other partners to realize the benefit of the partnership at the higher level. As a result the benefits generated mutual confidence of partners, enhanced collaboration by partners and consequently decreased acts of treachery. Such a reinforcing loop was not built by the one-to-one partnership at the unsuccessful stage.

(Hypothesis 4): When firms begin to form a partnership, they usually face uncertainty in terms of communication levels and management systems, which are obstacles to successful formation of a partnership.

During the unsuccessful stage, the vision of the partnership was not clarified and the impact was not assessed before implementation. As the implementation phase began, partners faced trials and errors, and the partner dealers could not set rules nor create manuals for new services. This was the outcome of undifferentiated service in the new business. To improve the partnership, JE and its partners took time to develop a common vision, strategic process, and to provide subsequent education to employees of the dealers and JE. (See Exhibit 12)
Exhibit 12. Strategic process of improved Value 5

<table>
<thead>
<tr>
<th>2 months</th>
<th>4 months</th>
<th>3 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>① Introduction of new Value 5</td>
<td>② Discussion of concept of Value 5, and proposition of strategic process</td>
<td>③ Strategic process planning</td>
</tr>
<tr>
<td>Dealers: Executives, marketing staff, manager of gas station</td>
<td>Dealers: Executives, marketing staff, manager of gas station</td>
<td>Dealers: Executives, marketing staff, manager of gas station</td>
</tr>
<tr>
<td>JIE: Branch managers, chief officers, officers and service representatives</td>
<td>JIE: Chief officers, officers and service representatives</td>
<td>JIE: Chief officers, officers and service representatives</td>
</tr>
<tr>
<td>Vice president, managers, Partnering project teams and marketing manager at HQ</td>
<td>Managers, Partnering project teams and marketing manager at HQ</td>
<td>Managers, Partnering project teams and marketing manager at HQ</td>
</tr>
<tr>
<td>Education: JE, HQ</td>
<td>IT planning, installation: Dealers followed up by IT division in JE</td>
<td>Restoring: Dealers followed up by branch officers and representatives in JE</td>
</tr>
<tr>
<td>Opening</td>
<td>IT division managers and technical staff</td>
<td>HQ in JE supports when required</td>
</tr>
<tr>
<td>Education: JE, HQ</td>
<td>IT order, infrastructure: Dealers followed up by IT division in JE</td>
<td>Restoring: Dealers followed up by branch officers and representatives in JE</td>
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<td>HQ in JE supports when required</td>
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The key lessons from these results are as follows.

(1) Vertical partnerships will not work without a common vision and subsequent strategic processes. During the unsuccessful stage, the vague vision and strategic process of JIE’s partnership generated conflict, so that JIE could not afford to expand the partner business with more dealers. Meticulous strategic plans to create a common vision led both sides to join forces more cooperatively. It could remove uncertainty between JIE and its partners.

(2) Partners therefore need more time to align their processes before implementing the partnership. During the unsuccessful stage, JIE and partners made little of strategic process before implementation because the partnership system was based on the one-to-one relationship and JIE thought that it was fairly easy to change the process. At the successful stage, when JIE built the one-to-partners relationship (see Exhibit 11), JIE spent 9 months preparing their process before implementation, which reduced trial and error and built a norm for organization practices among partners and JIE.
(3) Additionally, complicated partnerships need support via IT particularly in marketing and data processing, where IT can help expedite reactions to customers’ request. In fact the dynamics of successful vertical partnership is based on intelligent communication, enhanced by IT. Thus IT experts have to take part in the partnership project in the initial stage so that the IT system is consistent with the partnership’s focus and goals, which can be optimized through good communication.
CHAPTER FOUR
THE ROLES AND OBSTACLES OF HORIZONTAL PARTNERSHIPS

1. The Driving Force in Horizontal Partnerships

Another approach to building partnerships is through the horizontal model, where multiple firms in different value chains or businesses build intimate relationships in order to add value to their business. In this chapter the focus will be on the roles and obstacles of horizontal partnerships.

If a firm wants to diversify its business to acquire more consumers along with its marketing information to improve marketing, it needs to invest in particular assets that could pose a tremendous risk in the future. The more unfamiliar the firm is with the new investment, the riskier its outcome from its investment. But if the firm builds a partnership with other firms, who have enough experience and assets, the driving risk and subsequent hidden costs may be mitigated. This relationship is called a “horizontal partnership.”

In horizontal partnerships, firms aim to build a closer relationship with unrelated firms and to join resources and programs to exploit an emerging marketing opportunity. A strategic feature of a network of partnerships is that members in the system are closely linked for the sharing of information. Members of a partnership exchange not only data about best practices, but also ideas, feelings, and knowledge about customers, other suppliers, and the markets. Members who specialize in a particular function have access to other members who perform similar tasks, and share their knowledge. It not only creates a

16 Lee Adler defined this relationship as symbiotic marketing in his monograph, 1966.
broad level playing field within the network but also encourages members to build competitive advantage over rivals.

But building partnerships with diverse businesses do not always succeed because relationships between unrelated industries require tremendous efforts to find a common goal. To dig deeper into the dynamics of the partnership, the advantages and disadvantages generated by the partnership are clarified below.

**The “Pros” of horizontal partnerships**

- Most firms do not hesitate to exchange information and skills with their partners because in most cases they are not rivals in the same market but players in a different category of business. Moreover the partnership enables members to obtain more and higher quality information from various sources and points of view, which enhances judgement and facilitates rapid response to emerging market opportunities. Information condensed through the network is "thicker" than that condensed through the brokerage market, and is "freer" than in a typical hierarchy.

- An initial relationship with partners is not the same as those in conventional distribution channels, where suppliers and dealers face conflicts due to different scales of power. Since partners are different types of players in different markets, they do not have major power conflicts even if the scale of firms is different. As the initial relationship is quite equal in horizontal partnerships, partners do not have to address power conflicts in the initial stage as shown in vertical partnerships.

- By building horizontal partnerships, firms can furnish different kinds of tangible and intangible assets. Dealers in vertical partnerships have marketing knowledge in particular areas and they are sliver players in the value chain. Also their scope of business is narrow, and their focus is down-to-earth and short-term oriented. On the other hand horizontal partners in general have a broader business scope and take charge of the whole value chain, so that their expertise is diversified. Their view is
hypothetical, creative, and long-term oriented. It furnishes the firms with wider viewpoints.

- Horizontal partnerships expand the scale of business which enables members to realize an economies of scale. The scale ranges from administration costs to marketing budget. Members can reduce labor costs as each employee plays several roles, and they can also reduce other fixed costs by sharing assets. The decision-making process is streamlined and it increases speed in responding to problems.

- Regarding marketing, firms can acquire different segments of customers who could not be acquired in conventional business even with a huge marketing budget. This results from the novelty of partner business for customers who feel that the partnership business gives them the opportunity to select something from a wider variety of products than before. This is similar to the notion of “category killers” such as Wal-Mart and K-Mart. By displaying various products at one site, they give customers a range of products and consequently, they don’t have to stop at other sites. It also reduces shopping time and increases the opportunity to buy more products.

- Another advantage of horizontal partnerships is the positive force of brand identity. If each member has already built brand identity in their market, the partnership creates a dual-brand, where loyal customers from each firm visit the partnering store. It creates an opportunity for these customers to buy products of the partner’s brand. Firms need not spend huge budgets for frequent TV and radio advertisements and leaflets in order to acquire new customers.

- Finally, an increased number of customers create another marketing resource, word-of-mouth. Firms can also survey customers’ evaluation of partners’ businesses and report the outcome to their partner. The objective survey is different from the subjective survey often offered at stores. The tone of voice of customers changes if they feel that their opinion will not affect customer service directly. (This notion comes from the psychological relation of cause and effect in Japan. Most Japanese hesitate to express opinions directly about complaints through interview performed by service providers.)
The “Cons” of horizontal partnerships

- The criterion to select a partner varies; type of industry, market share, scale of business, type of products, core competence, demographics of customers, organizational structure, corporate culture, and norms are major factors. Plenty of factors to determine the desirability of a partner makes it very difficult. On the other hand, vertical partnerships are easy to build because suppliers know most of the features of a prospective partner through channel management. Additionally different features among firms makes it difficult to realize that a partnership can be linked to more than three firms. Even if there is a perfect opportunity to succeed in a venture by forming a partnership with multiple firms, the difficulty of selecting partners spoils the opportunity. Thus horizontal partnership is generally composed of two firms. Even if partnership is planned between two firms, it is often difficult to build. This is confirmed by a manager who needed a good fit: "We have had many potential interrelationships with company X in several areas of business, but we have never signed an agreement. We have very different management attitude and practices, and the agreement would have been negatively influenced and quickly failed." Actually, not many firms can fit the ideal needs of a partnership. Many Japanese firms spin-off business units to create potential vertical partners since they have a cultural affinity and mutual understanding, which makes the partnership easier. Thus building horizontal partnerships is very difficult when there is uncertainty between firms, and the difficulty increases when the partnership is built among a number of firms with very different styles, cultures, histories, aims and values.

- To avoid conflict, firms must balance the level of motivation to partnership businesses. Firms adjust their level of participation in a partnership depending on partner’s participation level. If a partner requires the firm to participate in it deeply, the firm has to devote more energy to be placed in the business.
2. Building a Hypothesis of the Model

To enhance a firm’s advantages and handle the disadvantages that were discussed, it is necessary to identify some key factors that will drive the partnership. To identify the key factors some hypotheses in forming horizontal partnerships will be constructed. The hypotheses are also determinants for selecting partners, the most important step in the partnering process.

Marketing concepts and implementation are shared between firms in a partnership. Here partnerships differ from most conventional organizations, which neither share their concepts of strategy with other organizations nor insist that their partners share their ideas with them in a constructive dialogue.

Subcontracting relationships are usually deeper and more complex, and many firms share their notions of strategy with their subcontractors, but the sharing is nearly always limited. Horizontal partnerships demand even greater levels of commitment and information interchange, and it is common for firms involved in the partnership to exchange ideas about strategy and to look for strategic fit and even reshape strategic directions. In horizontal partnerships, firms consciously influence and shape the strategies of partners, and obtain ideas and are influenced themselves in return. Such interdependence is a driving force in such horizontal partnerships.

To strengthen this hypothesis, an unsuccessful partnership between US oil companies will be cited. For more than ten years, US oil companies have been developing partnerships with typically unrelated firms such as car wash services, fast food franchises, oil exchange experts, wheel replacement services, and liquor retailers. The reason they developed these partnerships was to utilize information resource about customers and their supply chain and to acquire the partners’ customers without spending more on advertising. Despite the fact
these firms are commoditized businesses, oil companies and their partners did not have unique marketing information and supply chains, and customer behavior was quite independent. Based on these factors partnerships were built and each partner expected that their businesses would flourish. However, after implementation the partnership business faced several difficulties and did not realize significant profits. The reason for the partnership is their poor level of communication. Marketing information and customer data were exchanged at management levels, but not at the employee level. Independent work and lack of clear communication at lower levels hampered the exchange of information and skills.

This unsuccessful case suggests that firms must ensure that the information between partners flows freely and is not confined to higher levels of the hierarchy. Communication can be a costly activity, but this should not stop firms from developing effective communication systems which with the Internet, can be more readily accomplished. Clear communication is an indispensable factor for successful partnerships. Communication system does not need to be only electronically based, but should include all other methods of communication in each level of employee.

Even in horizontal partnerships, firms must try to develop their core competence by themselves since they need to maintain in-house capability. But firms have to clarify their limits, what their core competence is and what the necessary resources they should absorb from their partners are. For example a firm’s brand name is promoted by the activities of the partners who see the brand as a shared resource. They are encouraged to ensure its success and quite often these efforts helped the brand to become famous in short period of time. While brand and marketing are not so vital in produced goods markets, they remain important, and partnering firms neglect these at their peril. Their importance is highlighted by the experiences of one of the less successful organizations. Some firms have problems as a result of the inability of their members to relinquish many of the aspects of marketing to partners.
To prevent this, firms in the partnership should build a common management system where they can frequently exchange complementary assets, marketing information and customer data, not only at the management level but also at the workplace level. When firms do everything by themselves they lose tremendous flexibility in being able to change their business scope because the subjective perception makes the firm insensitive to changes in their business environment. With objective perceptions from partners, the partnership gives members the flexibility of being able to change as circumstances change. Because of these aspects, the following hypothesis is asserted:

(Hypothesis 5): While firms develop core competence by themselves, they seek complementary assets from partners, which must be exchanged at all hierarchical levels within the firms.

Competitive success requires the integration of multiple capabilities (e.g., innovation, productivity, quality, and responsiveness to customers) across internal and external organizational boundaries. Such integration is a big challenge to most firms. Firms who wish to build partnerships must rise to this challenge and create a sense of common purpose across multiple levels in the channel and across different sectors. They achieve a combination of specialized capability and large-scale integration at the same time. In building their partner's capabilities and competencies, they must provide a unique perspective to their partners on the nature of the competitive process. This perspective permits the partners to take a holistic view of the network, seeing the collective as a unit that can achieve competitive advantage. In this respect, the whole network acts like a complex integrated firm spanning many markets.

Of all the battles firms face, the most difficult is the battle between firms adopting different strategies and different approaches to the market. In these battles, the winners are usually those who use fewer and varied resources in novel combinations. Partnering firms fit this category, for they have typically dominated their sectors by stretching and leveraging
modest resources to great effect. Most important are new ideas on the nature of strategizing and structuring. Strategizing is a shared process between partners: the restructuring of relationships between the partners is a key part of the strategy. Thus these positive factors build the other hypothesis:

*(Hypothesis 6): Horizontal partnerships cannot only enhance firms' sales force but also create new styles of service and strategy.*

Leveraging the skills of partners is easy to conceive but hard to implement. The difficulties occur because partner must operate effectively to make the system work, but the negative behavior of a partner can bring the whole system to a halt. Members need to contribute all the time without fail for the successful partnership. This is a considerable demand. The typical organizational response to such a need is to circumscribe the contracts with outsiders in a tight legalistic manner. But this is not always wise; contract making and policing can be difficult and expensive. Formal contracts are relatively inflexible and are suitable only where the behavior is easy to describe and is relatively inflexible. But in horizontal partnerships the relationships are creative and flexible and so very difficult to capture and enforce contractually.

In building horizontal partnerships, firms must develop a sense of trust and reciprocity in the partnering system at the initial step. Each party agrees to perform its obligations in the partnership. This aspect has similarities to contracts in the sense that obligations are precisely understood. In contrast, from a network or alliance perspective, specific tasks are prescribed for important activities, each promising to work in a particular manner to resolve future challenges and difficulties as they arise. This means that each partner will promise to deliver what is expected, and that future challenges will also be addressed cooperatively. If partners make light of uncertainties and difficulties in the relationships at the initial stage, it becomes fairly difficult to resolve them once the tasks are done. If one
party goes beyond (in the positive sense) the traditional contract, others will reciprocate later. (See Exhibit 13)

Exhibit 13. Difficulty of enhancing trust in horizontal partnerships

Trust reciprocity is a complement, not substitute, to other obligations. If partners do not subscribe to the trust system, they can hold the whole system hostage whenever they are asked to do something out of the ordinary, or even in the normal course of events. Such behavior will cause damage to all, and the system will break up. Only with trust can the system work in unison.

Because of these reasons the third hypothesis is addressed:

(Hypothesis 7): Firms in horizontal partnerships need to invest intellectual assets, but the investment faces uncertainty until trust removes it. Firms must remove it first, otherwise they fear the uncertainty and tend to hesitate partnering.
As mentioned above, three hypotheses of horizontal partnerships are presented.
In the next chapter these hypotheses are explored by introducing cases of horizontal partnerships between Japan’s oil companies and other industries.
CHAPTER FIVE
AN ANALYSIS OF HORIZONTAL PARTNERSHIPS THROUGH CASES AND DATA

1. A partnership between a Gas Station, McDonalds and Blockbuster Video

The following case is the first known horizontal partnership among a gas station owned by Nippon Oil Co, McDonalds, and Blockbuster video in Japan. The business started in a residential area of Kobe, where many different oil company dealers competed fiercely for customers. Initially, the gas station had begun the business without a partnership because it was located along a regional main road in a central area of the town that connects directly from a huge residential zone to Kobe meaning that they could acquire plenty of customers without any marketing effort. Their market share was about 6.7% of the total regional gasoline demand, and it is relatively high compared to many competitors. However, a few competitors soon established gas stations taking advantage of the fine business environment. One specialized in service quality, and was located 3km from the gas station, and another who focused on competitive price, was located 4km from the gas station. To survive the competition, the gas station had to furnish a distinctive service. First, it changed its gas refill service from full service to self-service and reduced the sales price. It was the first to provide self-service in the area.
Second, fortunately they knew that McDonalds and the rental video store were planning to launch a joint venture in the area, so the oil company approached these firms and suggested that they develop new kinds of services with partners. As both McDonalds and the rental video firm were franchised, their decision-making process was quite simple.
Due to the transparency of their management systems and common vision of each business they had become dominant in their respective fields, which ideally would facilitate a partnership.

The self-service gas could reduce the number of employees effectively, but it deteriorated their service to the customers. For them, a partnership was an opportunity to counter the lack of service because it could provide customers with other kinds of service. Customers could not only buy gas but could also buy snacks, take a short lunch, and select movies for their evening entertainment. Moreover, the partnership could create the opportunity to refill the gas for customers whose main purpose was to go McDonalds and/or the rental video store. If all these firms partnered, they would not need to leverage additional marketing to acquire new customers.

For McDonalds and the rental video store, the incentive of the partnership was to attract regional customers at lower marketing cost. As it was the first store in the region, it would have cost a lot to acquire customers if they had launched their store independently. By building a partnership they could capture the consciousness of customers as a multi-service entity, so that they could save advertising costs. Another incentive of the partnership for these firms was to get a new layer of customers and increase this information as a future marketing tool. While the service of McDonalds and Blockbuster was very popular with the youth population, many middle-aged people with young children and older people were not familiar with their business. On the other hand, the gas station had acquired many loyal customers middle-aged and older. By building the partnership, McDonalds and Blockbuster had an opportunity to attract these customers. In fact, they launched showy sales promotions by issuing coupons in the gas refill stage.

Additionally, Blockbuster video has the potential to capture repeat customers. Customers have to visit the store at least twice to borrow and return videos. Moreover, once the store serves popular videos, many customers tend to visit the store to borrow them. This also gives the gas station and McDonalds opportunity to gain more customers.
Finally, the joint sales campaign did not only impact the sales of McDonalds and Blockbuster but also improved those of the gas station as well due to word of mouth from its loyal customers. Because of these expectations, Nippon Oil Co, invited McDonalds and Blockbuster successfully without the limited terms of contracts.

Once the partner business started, the gas station shared customer data with partners through input in the POS\(^{17}\) system, and in this way they mined the data as a useful marketing tool.

As a result, McDonalds and Blockbuster increased their regional customer successfully, and the sales volume of the gas station increased outstandingly. Exhibit 14 shows the increase of market share of the gas station after the partnership was formed.

Exhibit 14. Impact of the Gas Station (market share) due to the horizontal partnership

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17 Point-of-sale system. Firms can gather real-time sale data through the system
If the gas station had continued the business without forming a partnership (by providing self-service only), their market share would have increased to 10%. With the partnership the actual sales increased to 13% of the market share. The outcome can be attributed to the gas station’s successful acquisition of core complementary assets from its partners.

However, the partnership didn’t always go well. They struggled to maintain their relationship for the following reasons.

(1) Depending on the design of the partner store, customers could not see what service was provided. For example, if it were difficult for drivers who came from another region to notice McDonalds, they would not acquire their loyal customers. This decreased the customer acquisition rate, and affected the partnership negatively.

(2) Each firm’s service level determined the customer satisfaction to the partnering business. In fact customers complained about the service of the gas station after it reduced the number of employees after the self-service transition. The complaint affected the image of the partner businesses although McDonalds and Blockbuster did not change their service.

(3) Difficulty in the partnering campaign.
Initially McDonalds issued a coupon that discounted hamburgers by 50% when customers refilled gas totaling more than 5 gal. Once they changed the regulation that a coupon was issued for customers refilling gas totaling more than 7 gal, customer felt that both McDonalds and the gas station deteriorated their service.

2. A partnership between JE and am/pm

Driving Force
This case is a horizontal partnership between JE (gas station) and am/pm (convenience store). JE focused on mass-merchandising its product (gasoline) by setting a lower price than its rivals. While this “area dominant strategy” in a vertical partnership (Chapter 3, 4)
was a distinctive channel strategy, its sales volume was limited because of the small size of the regional market. JE needed to develop a new larger channel with low cost and high volume to expand the scale of its business.

To avoid conflict between JE and dealers due to the transfer price issue, JE tried to launch a new direct channel that was basically self-administrated but easy to manage. In other words, JE focused on a sort of franchise system as a new channel, in which a certain margin was ensured and this dissolved transfer price issue.

Not only this issue but also JE's brand image became vague due to encroachment of non-brand dealers (retailers). To appeal with the brand to customers, the new channel had to provide customers with a differentiated service.

As a solution to these issues, in 1996 JE built a new channel through a horizontal partnership with am/pm (convenience stores). *(See Exhibit 15)*

In fact am/pm at the time was planning to diversify their service, and was looking for a potential partner. Like the partnership model of Nippon Oil Co, McDonalds and Blockbuster video, am/pm runs a franchise, whereby the simple management enabled them to have a flexible decision-making process. This is also a positive driving force to build a horizontal partnership.
Initial identification (Vision)

Before deciding to form the partnership, JE and am/pm analyzed the advantages and disadvantages of its partner independently, and assessed the impact of their partnership. And then they exchanged ideas on their partnering goals, roles and related issues. This helped them to develop a common vision of the partnership. When the vision was built, they formed a partnership contract.

As an initial process of forming a partnership, they conceptualized the partnering business. 

Exhibit 16 shows the initial concept of the partnership. They identified five key sensitivities: safety (safe for all customers in oil sales, especially self-service), simplicity (easy accessibility to a variety of services), cleanliness (building a positive image for customers), cost (providing products at competitive prices and generating profits by mass-
merchandise sales), and convenience (reducing time for purchases). These key components reinforced the collaboration to a target and built common consciousness in the partnership.

**Exhibit 16. Key concept of the partnership**

![Diagram showing the key concepts of the partnership: Safety Conscious, Simplicity, Convenience, Cleanliness Conscious, Low Costs Conscious.]

**Framework of partnership**

After agreeing to partnership, they formed a framework to implement the partnership. The framework was based on four key factors, strategic intent, business structure (decision-making process), development process (how to implement the partnership business to be consistent with the common vision), and profit plan (drawing a blueprint for the partnership business plan as compared to an independent business plan). Along with the four factors, they decided on ways to provide customers with differentiated service. Then they decided where to locate the store, how to design it, and how to operate the business. Management, logistics, and information systems served to reinforce interaction between operations and the facility. (See Exhibit 17.)
Based on this framework, the joint management team was organized whereby the strategic process and customer information were controlled, and the framework was referred to whenever they launched a new partnering store.

**Impact**

As Exhibit 18, below, shows, the result was different among the stores. At store A, revenue of am/pm increased continuously while sales of JE fluctuated and did not increase effectively. At store B both the revenue of am/pm and JE increased considerably, and their sales were highly correlated. At store C, sales of am/pm increased gradually while revenues of JE fluctuated and did not increase effectively. Store D shows that the partnering business did not produce positive results. Why did they have such different outcomes? Was this due to customer behavior? In contrast, in store B, both results are highly correlated, and both could increase the revenue.
Exhibit 18. Trend of sales in partnering stores

This shows that the effect of the partnership worked differently. It depends on the location of the store. The reason for this is that the behavior of the targeted customer in each location was different from what they had expected initially. For example, at store A am/pm customers did not buy JE’s gas while at the same time JE’s customers bought goods at am/pm. Exhibit 19 corroborates this trend.
### Exhibit 19. Customer behavior at Store A

<table>
<thead>
<tr>
<th>Time/customer</th>
<th>JE only</th>
<th>JE→am/pm</th>
<th>am/pm only</th>
<th>am/pm→JE</th>
<th>Visit am/pm on foot</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit</td>
<td>Number of cars</td>
<td>Number of cars</td>
<td>Number of cars</td>
<td>Number of cars</td>
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</tr>
<tr>
<td>7:00-</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>8:00-</td>
<td>3</td>
<td>9</td>
<td>12</td>
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<td>0</td>
</tr>
<tr>
<td>9:00-</td>
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<td>9</td>
<td>9</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>10:00-</td>
<td>21</td>
<td>9</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>11:00-</td>
<td>15</td>
<td>18</td>
<td>6</td>
<td>0</td>
<td>12</td>
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<td>30</td>
<td>27</td>
<td>0</td>
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<td>9</td>
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<td>0</td>
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<td>19:00-</td>
<td>6</td>
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<td>15</td>
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<td>15</td>
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<td>22:00-</td>
<td>27</td>
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<td>357</td>
<td>180</td>
<td>150</td>
<td>3</td>
<td>159</td>
</tr>
</tbody>
</table>

The number of customers who refilled gas after stopping at the convenience store is only 3 while the number of customers who stopped at the convenience store after refilling gas is 180. One third of the customers who bought gas also visited convenience store. This does not mean that the customers who stopped at the convenience store as their main purpose of shopping did not buy gas. (Some customers tended to refill gas first, and then visit am/pm.) This trend might be due to the store’s visibility from the highway. A manager of JE commented that “Actually some customers who enter from the am/pm side could not identify the gas station because they park their car in front of the convenience store, where it is difficult to see the refill stage.” Therefore the layout of the store might have influenced the customers’ behavior. The data also shows that the number of customers who visited the convenience and gas station store was nearly equal to number of cars that visited the
convenience store only. As they were not interested in buying gas, JE could not expect them to become new customers. Thus the location to launch the partnering business has different impact on each partner.

Customer voices are also crucial factors in determining the impact of the partnership. The following are complaints of customers who bought gas self-serve. Most of complaints are about the time consumed in buying self-service gas and paying for it.

- "Walking to the convenience store to pay always bothers me. It does not offset the cheaper price of gasoline."\(^{18}\)
- "Because the cashier in the convenience store always seems to be busy, I am afraid that it takes more time to refill gas than in the past with full-service."
- "When staff in the convenience store are free, they should come to the gas pumps to help refill gas or provide some additional service."

Interestingly there were no complaints about the service at the convenience store, and all customers seemed to be very satisfied with the service. While the partnership improved the total level of service, it generated a gap between the partners in terms of quality of service. Thus regarding customer satisfaction, impact of each business was not equal.

**Intimacy**

As the management of this partnership was controlled by a common management team, their communication level was very high compared to other partnerships presented in this thesis. Customer information was shared between partners on all levels, and the marketing strategy of each store was decided through a joint decision-making process. IT systems provided timely information about sales from stores to the common management team.

\(^{18}\) Self-service requires customers to pay for gas at the convenience store by themselves.
However, at the corporate level, there was an obstacle to building trust. The partnership had a different impact on each company although each had the same vision and objective during the initial step. As shown in Exhibit 18, the impact on each company was different depending on location of the partnership store. To expand the partnership, JE and am/pm had to discuss this issue thoroughly to remove the uncertainty, but actually it was a rather difficult task since getting the same impact to both firms is difficult. Due to the location problems, this hampered the expansion of the business.

Another issue arose regarding brand value. As the stores were managed by multiple brands, customers’ perception (especially poor image for some brands) damaged partner’s brand image. For example when a customer was unsatisfied with store’s service when purchasing JE’s gas, am/pm’s image was also damaged.

Furthermore, when customers who needed help refilling gas asked a clerk in am/pm for help and they were not helped, they developed a bad image of both JE and am/pm.

To address the brand issue problem both partners consolidated their brands into one. JE tried to change their brand into am/pm, but this caused conflict with other JE channels since JE had filled all their channels with their own brand. Moreover launching the partner business in the area where other channels already existed caused conflicts since successful partnership cannibalized other channels in the same region. Because of that JE faced difficulty selecting where to develop the horizontal partnerships with am/pm in order not to conflict with their other channel dealers.

3. Key Findings from the Cases

From these two cases some key variables that affect partnerships either positively or negatively are extracted. They are classified into three categories, based on the hypotheses presented in Chapter 4.
(Hypothesis 5): While firms develop core competence by themselves, they seek complementary assets from partners, which must be exchanged at all hierarchical levels within the firms.

(1) The partnership between the gas station, McDonalds and Blockbuster video
First, the core competence of the gas station was its potential to acquire regional customers from its well-established customer base. Due to the good location of the gas station and its long-term history (which created strong brand identity), before launching this 3-way partnership, most of the regional customers noticed the gas station and it had many loyal customers in the region. As McDonalds and Blockbuster video had no shops in the area, the popularity of the gas station helped them rapidly promote themselves to the regional customers.

Second, the gas station had already acquired a broad range of customers, from teenagers to retirees in their 90s. The gas station’s age-diversified loyal customers gave its partners an opportunity to acquire new customers whom they may not have been able to attract otherwise.

On the other hand, McDonalds and Blockbuster video had core competencies in their young and family-oriented customer base, which they had acquired from a wider market than the gas station. Customers of McDonalds and Blockbuster video would come to the store at lunchtime or mid-night when the gas station clientele would generally be sparse and they would also buy gas. Through this partnership, the gas station could gain new, younger customers, and from a wider area. Additionally customers of McDonalds and Blockbuster video could better promote their sales by offering hamburgers at special low prices or by stock piling popular and new movies which in turn would bring more customers into all three stores. This is what the gas station could not execute on its own, and thus, the partnership increased all three firms’ customer bases.
Thus each business in this partnership attracted a distinct segment of loyal customers, which gave the partners incentive to further promote their sales. Moreover, the regional identity of the gas station's business accelerated the expansion of its partners' businesses. Marketing promotions enhanced all three firms' opportunity to acquire new customers.

(2) The Partnership between JE and am/pm

JE's core competence is its brand identity and customers' confidence in its products and service. Its new self-service system attracted more customers who wanted to refill gas at cheaper prices. Actually cheaper price was not what am/pm desired. JE wanted to increase its customers without lowering the prices of its products. Additionally am/pm did not have a large drive-in clientele; most customers visited the convenience store on foot. Am/pm sought customers who drove their cars to the store to increase their sales and to gather new market information.

On the other hand, am/pm can attract customers by displaying various kinds of products at small sites, and this is what JE cannot furnish. Various products sold at am/pm attract customers who have not planned to purchase them before visiting the shop. This is am/pm's marketing skill developed internally. JE expects to profit from the marketing skills of am/pm and seeks them to consolidate their products such as motor oil and car care goods to increase their sales. JE regards these products as the core source of profits. Moreover this type of partnership reduces labor costs. They can do business by deploying one or two employees per store, who can collect money and provide service for both the gas and car supplies along with the convenience store products. As JE wants to reduce the number of employees by installing self-service, they expect am/pm to help them consolidate their staff, and also benefit from am/pm's excellent management system.
The key finding from this case is that all three firms benefited from their partners' core competencies such as strong brand identity, price bargaining power, a targeted segment of customers, efficient human resource management and marketing skills to control and develop various products internally. Since it is difficult to do it all by themselves, these elements are considered by partners as complementary assets, which equip them with competitive advantage compared to rivals.

(Hypothesis 6): Horizontal partnerships cannot only enhance firms’ sales force but also create new styles of service and strategy.

(1) The partnership between the gas station, McDonalds and Blockbuster video
In this case, each partner acquired new customers successfully, without having to tremendously increase their marketing budget as they would have if they remained independent. Each firms’ sales promotions in effect increased their partners’ customers base. In other words, if Blockbuster video offers a two-for-one video rental deal, customers will come to the complex and not only rent a video but also buy gasoline or hamburgers and French fries.

The partnership provides customers with various activities at a small site. Customers refill gas, buy lunch or snacks, along with videos to enjoy at home. Such a service complex creates an opportunity for firms to provide products that customers have not planned before stopping in the complex. This is similar to the style of shopping mall, where a variety of businesses at one site attracts customers to buy goods and eat in food courts; this shopping behavior is not planned when shoppers start out, but they end up buying when they come across novelty items. Because of the adequate scale of the site compared to a shopping mall, the partnership helps customers reduce the time it takes to choose and buy a variety of products effectively and customers who are very busy can feel free to visit it. Customer satisfaction induces positive word of mouth promotion to potential customers who have not
yet visited and stimulates repeat-buying behavior. The service complex thwarts potential competitors because of its market force and the synergy it creates between the partners.

(2) The Partnership between JE and am/pm

In addition to the above results, customers are drawn to the partnering store as a one-stop service entity within which they can drive to, park easily, and shop quickly. The partnership helps customers to build such added value in terms of service. Thus the gas station has been able to slough off its conventional image as gasoline provider with an undifferentiated service.

With respect to strategy implementation, the partnership is also different from a non-partnering business. The partner’s common conceptualization, goals, marketing, and vision, and subsequent strategic process allow partners to adapt each strategic intent. Each marketing concept and strategy is equally shared and applied to the common strategic process. This creates a synergy effect that usually increases the value and revenues of the individual firms or the partnership as a whole. The optimal case is “Store B”\(^{19}\) where both businesses’ sales increased with an equally high correlation rate as the outcome of a common vision and strategies (strategy complex).

The partnership enables members to position the business as a distinct channel with thorough integration of services and strategic planning, which inevitably enhances the partners’ competitive advantage.

However, it sometimes generates conflict among channels, which will be discussed in the next section.

\(^{19}\) See the exhibit 18
(Hypothesis 7): Firms in horizontal partnerships need to invest intellectual assets, but the investment faces uncertainty until trust removes it. Firms must remove it first, otherwise they fear the uncertainty and tend to hesitate partnering.

(1) The partnership between the gas station, McDonalds and Blockbuster video
While workable partnerships, once underway, generally enhance the resources, marketing reach, and profits of partners, this success does not completely remove a sense of mistrust that partners generally feel towards each other. In this case, McDonalds and Blockbuster video had wanted to build a partnership with the gas station to enhance their customer base. From the perspective of McDonalds and Blockbuster video, building a partnership with only the oil company was not preferable because another oil company might have had a stronger competitive advantage in another area, and they wanted to take advantage of the strength as partnership. A lack of loyalty to one’s partners can deteriorate trust between partners. Once a firm fails in the situation, it is very difficult to recover. As is shown in Exhibit 13, building trust is much harder once firms expand the scale of partnering business. To avoid damaging trust with a partner, firms must confirm the scale and scope of partnership with partners and agree with partners that they do not build other partnerships that cannibalize the partner’s business.

(2) The Partnership between JE and am/pm
As I mentioned before, building competitive advantage through horizontal partnerships\(^{20}\) can cause conflict with other distribution channels when the partnering business is implemented in the same area of other channels. In fact, JE was apprehensive about this issue and tried to mitigate the conflict by planning the horizontal partnership where there were no other strong channels. As a result, JE hesitated to expand the partnership

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\(^{20}\) Mentioned in hypothesis 6
aggressively. This attitude hampered the rapid development of the partnering business, and caused a conflict with am/pm who wanted to launch partnering stores quickly.

As an alternative remedy to this problem, JE considered changing its brand name into its partner's brand at the partnering store so that JE did not have to handle the conflict with other channels. But changing the brand name would negatively influence customer perceptions because customers did not acknowledge am/pm as an oil seller. Furthermore, in this situation JE would not be able to take advantage of its brand identity, and it might miss its loyal customers.

Regarding revenue impact, as illustrated in Exhibit 18, it was very difficult for each partner to generate the same level of revenues. The gap created uncertainty as to the benefits of the partnership for those who did not make comparable profits. This makes a partner prudent with future installations of partnering business, and the partnership loses velocity of its expansion.
CHAPTER SIX
DISCUSSION AND CONCLUSION

In the previous chapters the primary points of two partnership models were identified. Various issues facing companies in the partnership planning and implementation process, along with the benefits and risks involved in a partnership were examined. The primary benefits are that partnerships can generate tremendous value and increase revenue if the partnership works well. It was also noted that for a partnership to be successful, all parties must develop a sense of trust. In this chapter, first key points about vertical and horizontal partnerships are summarized, then suggestions are made on how to configure these for Japan’s current oil business. Following this analysis, the key points of these partnerships when they apply to Japan’s oil industry will be prioritized. Finally, the suggestions are evaluated and points that need to be explored further are identified.

1. Summary of Key Points in Vertical and Horizontal Partnerships

From these cases and hypotheses, key factors that can determine the successful or failure of vertical and horizontal partnerships are identified.

Vertical Partnerships
(Hypothesis 1)

• Equal positions between suppliers and dealers

In successful partnerships, the supplier abolishes the conventional rank in the distribution channel, and makes the most of partners’ advantage. The relationship between suppliers and dealers is transformed from bilateral force of suppliers to equals. It creates an atmosphere of open communication and as a result, knowledge is freely shared with all partners and suppliers. Free communication enhances the quality of information that is
shared and helps exploit the assets of each partner, which have not been exchanged before. This information sharing results in the enhancement of the competence and credibility of all the members of the partnership.

- **Level of commitment**
  Member participation in the partnership should be on an equal level. For example, commitments among corporate executives enhance the trust level, and communication among store employees increases customer information. Additionally, participation from all corporate levels\(^{21}\) is preferable because the decision making will be more consistent with the partners' corporate vision.

- **Impetus and positive attitude**
  A strong impetus to work together and a positive attitude are necessary for successful partnerships. For example, strategic alliances realize their true potential by combining resources and focusing them on a common vision. But all parties must have a strong impetus to merge the companies into a workable relationship. Without any impetus, it is difficult to change the relationship.

**(Hypothesis 2)**

- **Communication system**
  Communication is a core resource of partnership, so it is necessary to build a common system to share information frequently in order to increase communication level. Weekly and monthly meetings are indispensable to support the system. These help suppliers to recognize what each partner's business is going on and to get customer information more promptly.

\(^{21}\) This means that executive of supplier and dealer takes charge of partnering business.
• **Give and take relationship**

It is important not to forget the give and take system between suppliers and dealers. Customer information is originated by dealers. Suppliers have to return feedback to partners as incentive to gather further customer information.

• **Data mining and feedback**

Suppliers collect information from dealers and mine the data. Data is shared with partner dealers, and it is also used as marketing tool to other channels. It is revitalization of information among channels. It enhances the total quality of the channel.

(Hypothesis 3)

• **Broader information sharing enhances the capability of partner dealers**

Through partnerships dealers can link partner-to-partner information with customer-to-supplier information. This gives both suppliers and dealers the opportunity to learn more marketing methodology, which is a key resource to innovate their marketing skills. To realize information sharing, installing an IT network across the partnership is necessary. IT also supports the ability to transfer suppliers and dealers information about customers who want to have a particular service promptly; this increases the opportunity for customers to get better and more diverse services at dealers.

• **Build a competitive situation and manage conflict**

To stimulate marketing innovation, suppliers must align the competitive situation among partner dealers. In this situation each partner has an incentive to enhance its marketing skills. But at the same time competition causes conflict among partner dealers. Suppliers have to manage conflict between their partner dealers and act as a coordinator of conflict.
(Hypothesis 4)

- **A Successful partnership must be process oriented**

Even if a partnership goes well, it could be unsuccessful if its framework is not solid. The framework entails a common partnership concept and common vision and a thorough impact analysis before entering into the partnership. If partners make light of this point during the initial step, and the rules and norms of partnership are vague, the relationship would collapse when they face difficulty. Building a solid framework helps partners to change their strategy flexibly with a cooperative relationship.

- **Scale of partnership**

Since vertical partnerships allow for the participation of many dealers, the system becomes more complicated as the number of member increases. Moreover linkage of outsourcing firms with the partnership complicates the system more. The greater the scale of the partnership the more costs increase, and the partnership’s losses mount, often becoming uncontrollable. Therefore the partnership has to contain an adequate number of dealers to function well.

**Horizontal partnerships**

(Hypothesis 5)

- **Assess correlation of type of customer**

If each type of customer among partners overlaps completely, the partnership business cannot expect to gain new customers. In sharp contrast if each type of customer is absolutely independent, it is difficult for partner firms to expect the synergy effect in terms of customer acquisition since customers do not use partner’s store. To avoid this risk, firms must assess what type of customer they can acquire by themselves and what type of customer they might be able to get from their partners.
● **Achieve high communication level**

Partner firms must ensure periodically that the information between them flows freely and is not filtered, and that the communication system is not only electronically based but also includes all methods of communication. They have to check whether the quality of information from their partners is equivalent to their quality.

● **Common management system**

This is an alternative way to remove the barriers between partners and to encourage the exchange of complementary assets, including intellectual, physical and personnel assets. A common management system should include a data and strategy center composed of partner firms. This center essentially controls the partnership.

(Hypothesis 6)

● **Scale of site, visibility of service**

Generally, the greater the types of services provided, the more the customer can choose from and buy. But what is important, for retail stores and services such as gas stations, is the scale of the site and visibility of service. One key to a successful relationship is clear communication between partner-to-partner and partner-to-customer. If either of these is disregarded, firms cannot succeed in the partnership.

● **Interaction of strategic notion**

A successful partnership needs all parties to jointly envision and build a common strategic notion. Common goals and strategies and subsequent strategic processes have to be composed of a mixture of different strategies and different approach to the market. To lead a partnership successfully firms have to build a solid framework based on common concepts. (See Exhibit 17)
• Adequate number of employees for a variety of service

One of the driving forces of customer satisfaction is whether customers time buying the service or product. Even if the service is diversified, partnership cannot increase customer satisfaction when customers have to wait for long time to receive the service. A variety of services cause erratic customer behavior, because customers often buy products or service they did not expected before visiting the shop. Reduced number of employees by partnerships may not be able to take care of a fluctuating number of customers. Firms have to coordinate the adequate number of employees to cope with the fluctuation.

(Hypothesis 7)

• Precise assessment of partner’s resource and synergy effect

When the actual impact of partnership is different among partners, this creates a gap in partners’ common vision which deteriorates trust and damages cooperative working arrangements. The gap results in a (1) difference in expected impact and real impact and (2) different impact levels for each partner. Once a firm loses its attractiveness to a partner due to a lower level of impact than its partner’s, it is quite difficult to recover the relationship. This results from a misjudgment in a firm’s resources and organizational synergy effect at the initial stage. To avoid these problems, each partner must identify and discuss about its impact and ways to ameliorate the problem with partners before building the partnership.

• Consider cultural similarities and differences

Horizontal partnerships are usually composed of several different business entities, often from different types of industries. These differences sometimes cause “impedance mismatch” or cultural clashes within the firms. These differences can translate into differences in (1) Risk assessment methods and factors, (2) Sensitivity to risk, (3) Time frames needed for decision-making, (4) Methods of managing compensation and rewards, and (5) Long-term strategies. These corporate or cultural differences can sometimes cause
conflicts with partners once the business is established. To avoid these problems, firms have to identify and address these potential problems carefully. If they miss or disregard them, these differences would pose a tremendous risk to the partnering business.

- **Prevent conflict with other channels**
  When building the partnership, firms have to pay attention to other distribution channels. When a partnership (considered a new channel) is built in a particular region where other channels exist, the new channel can sometimes cannibalize other channels by robbing them of customers. This generates conflict among channels. Firms have to take into account other channels in the same region when they plan the partnership.

2. **Implementation of Key Partnership Strategies for Japan’s Oil Industry**

In this small chapter, steps to implement the key factors of successful partnerships for Japan’s oil industry are introduced. First, the steps that need to be taken for implementation are listed and then the advantages and disadvantages of the implementation evaluate are evaluated. Regarding the disadvantages, potential solutions are drawn up.

**Vertical partnerships**

(Hypothesis 1)

- **Equal positions between suppliers and dealers**
  (1) Assess various factors of dealers, and identify potential partners
  (2) Select potential partners and begin discussions with each to further assess potential advantages (e.g. type of distinctive service they can provide), disadvantages (e.g. location), and goals (e.g. new type of service, new customer acquisition), along with potential conflicts in style, strategies, and goals.
  (3) Halt bilateral force from the supplier and communicate with each other from an equal standpoint as partners.
(4) Establish partner dealers’ network that increases the ability to communicate with each other and suppliers.

(5) Collaborate with partners to improve disadvantages by linking other partner members’ advantage or by leveraging supplier’s intellectual asset, and dissolve difference among partner dealers.

Pros: -Create new relationship, which enhances trust between suppliers and partner dealers.
      -Identify dealer’s core competence.
      -Improvement communication level by cooperation.
      -Each dealers can exert equal performance.

Cons: -Deteriorate loyalty of dealers who are not selected as potential partner.

How to handle cons: -Relinquish disloyal dealers or advise them to make them gain some competitive advantage about service.

● Level of commitment

(1) To build a strong level of commitment, corporate executives from all parties must participate in the conceptualization stage (initial talks on potential partnership)

(2) At the strategic planning stage, the same level (e.g. marketing directors and departmental managers) discuss potential partnership plans with each other.

(3) At the implementation stage, the same level of management takes charge of the following steps.

Pros: -Consistent with corporate strategy.
      -Transparent organizational decision-making.

● Impetus and positive attitude

(1) Identify a common partnership vision through frequent discussions about capabilities (between suppliers and dealers).

(2) Build strategic concepts at the initial stage of partnership.

(3) Plan subsequent strategic processes based on the strategic concept.
(4) Once the plan is completed, create the norm to be consistent with the process.
Pros: - Change conventional relationship and create cooperative atmosphere.
Cons: - Difficult to manage relationship when strategy has to be changed.
How to handle cons: - Prepare alternative incentive to manage relationship.

(Hypothesis 2)

- **Communication system**

(1) Install an up-to-date electronic communications system among dealers along with a POS system.

(2) Set frequent meetings among partner dealers at different personnel levels (mid-level and gas station employees, managers, executives) to discuss marketing strategy.

(3) Administer the meeting by participation of all partners (from all levels of the employee chain).

(4) Rotate the chairman of the meeting among partner dealers periodically.

(5) The chairman will set the specific agenda about marketing issues they are concerned about in each meeting.

Pros: - Supplier can quickly understand managerial and structural issues of the partnership, including customer voices.

- This strategy helps maintain a cooperative relationship.

Cons: - Difficult to coordinate periodical meeting schedule.

- Who is the actual leader of debates?

- Mandatory attendance creates frustration from some partners.

How to handle cons: - Divide meeting members and set more meeting opportunities to mitigate the schedule conflict.

- Supplier should play a role as supervisor.
Give and take relationship

(1) Initiate a partnership-wide reward system for partners who have contributed significantly to other dealers and suppliers by sharing customer information. (e.g. allocate more marketing promotion budget as reward)

Pros: - Dealers are motivated to gather and share information.
Cons: - Not clear who assesses the quality or quantity of information (contribution), and how to assess it.

- Some dealers sometimes become frustrated about the assessment result.

How to handle cons: - Standardize the assessment methods, so that the assessment can be carried out by each dealer.

- Partners need to discuss methods of assessment and constantly work to improve it.
- Since arbitrage can be a source of conflict, rewards must not be adjustment of transfer price.

Data mining and feedback

(1) Suppliers furnish data mining system and skills, and accumulate all information.
(2) Suppliers give partner dealers feedback of all information at all times.
(3) Partners use this information as a marketing tool for other channels.

Pros: - Enhancement of value through this customer feedback and information.

Cons: - Frustration from partner dealers due to spillage of partners’ information to other channels.

How to handle cons: - Utilize the marketing data only with channels that do not conflict with partners’ deal.

- Segment distribution channels and give incentive to partner dealers.
(Hypothesis 3)

- Broader information exchange enhances capability of partner dealers

(1) Select type of information to exchange with dealers
(2) Install state-of-art IT systems that connect all partners and all levels at the implementation stage of partnership.
(3) Link the IT system with POS (point-of-sale) systems to make it easy to analyze marketing.

Pros: - This increases volume of information, which can become a new marketing tool for partner dealers.
- Provide customers with a variety of services within a short time.

Cons: - Cost of installation and maintenance.
- Sharing too much information creates a risk of creating false expectations for dealers, and this also increases the possibility of leaking important competitive information.

How to handle cons: - Shift the cost of installation to price of service.
- Categorize the type of information and select only important information when communicating confidential information.

- Build a competitive atmosphere and manage conflict

(1) Establish a reward system for each contribution.
(2) When competition causes conflict, emphasize joint problem solving.

Pros: - The reward system stimulates competition among dealers and fosters innovation.
- The reward system fosters a win-win atmosphere in which grievances are aired and the underlying issues are brought to the surface and addressed.

Cons: - Under this reward system, dealers who cannot get rewards become weaker.
- (Rivalry makes them weaker.)

How to handle cons: - The supplier can provide support to weaker dealers to revitalize them.
(Hypothesis 4)

- A successful partnership must be process-oriented.

(1) Conceptualize the partnership, including individual roles, objectives, and goals.

(2) Create a common vision and objectives.

(3) When facing difficulty, firms should return to (1) and re-conceptualize.

(4) Determine key inputs into the partnership. (e.g. product availability, technical support, pricing and any other relevant areas)

(5) Based on the vision and objectives, plan strategic process for implementation.

Pros: - Help build relationship under common vision.

- Provide flexibility to change strategy.

- Scale of partnership

(1) Categorize market factors. (e.g. number of customers, area segmentation, number of players)

(2) Categorize type of service offered by each dealer.

(3) Link (1) with (2) and determine the appropriate scale of partnership.

Pros: - Controllability of partnership system.

- Optimized service.

- Efficient communication level enhances quality of information.

Cons: - This creates management issues about dealers who do not fit into a specific category.

- Multiple channels of partnership. (new channel entities)

How to handle cons: - Streamline channels and build new channel management strategy to support weak channel.
Horizontal partnerships

(Hypothesis 5)

- **Assess correlation of type of customer**
  
  (1) Draw up a marketing map and set targeted customers in each area.
  
  (2) Approach potential firms and compare target customer with the firm’s loyal customers.
  
  (3) If the type of customers overlaps to some extent, then the oil company can plan a partnership with the firm.
  
  (4) If type of customer of the firm is not what the oil company targets, then the oil company should try to approach other potential firms, and try (2).
  
  Pros: - This approach attracts loyal customers to partnering business.
  
  - It provides an opportunity for the oil company to acquire new customers and extend its customer base.
  
  Cons: - Not so many firms are eligible to build partnerships.
  
  How to handle cons: - The oil companies try to develop horizontal partnerships with multiple firms.

- **Achieve high communication level**
  
  (1) Unite store employees with partners and unify customer information sources.
  
  (2) Distribute the information to both firms.
  
  (3) Both firms must meet frequently to talk about marketing strategy by using this information.
  
  Pros: - All information is equally shared with both firms.
  
  - Increase opportunity to talk about marketing strategy from different viewpoints.
  
  - Rationalized labor costs.
  
  Cons: - Firms need skilled employees to mine customer information.
  
  - Firms need to raise employees’ customer-relations skills in both businesses.
  
  How to handle cons: - Offer education system to let employees know the customer relations of both firms.
- Franchise the partnership business.

*Common management systems*

1. Establish management center composed of representatives from each partner firm.
2. Control all sources of information from stores and each partner firm.
3. The management center decides marketing and management strategy and coordinates partner firms.

Pros: - This strategy creates the synergy effect resulting from the partners’ marketing and management strategies.
   - Offers a means to control different schemes from each firm.
   - Information is shared with all levels of partners equally and precisely.
   - Exploit know-how of direct channel management.

**(Hypothesis 6)**

*Scale of site, visibility of service*

1. Determine scale of site considering number of services offered to customer.
2. Place the service location. The key is easy accessibility from gas refill point to other service.
3. Design display of service at partner store. Equal visibility of both firms’ product or service is necessary.
4. As a follow-up, collect the customer data and re-align (2) or (3).

Pros: - Enhance synergy effect as a service complex.
   - Both firms can reap equal opportunity of sales.

Cons: - Whenever the oil company and its partner change promotional products and services, they also have to change the design of display.
   - Difficult to assess visibility of products and services.

How to handle cons: - Periodically interview customers, and get their input them on display management.
   - If the oil company builds a partnership with a convenience store,
it should utilize the display management of the convenience store.

- **Interaction of strategic notion**
  
  (1) Before forming framework of the partnership, confirm partner’s strategic concept, development plans, expected impact and organizational structure.
  
  (2) Form framework by considering (1).
  
  (3) Once business begins to flow, follow up on whether the direction is consistent with (1) or not.
  
  Pros: - Synergy effect of different strategies enhances capability of partnering business.
  
  - Furnish flexibility to cope with change of business environment.

- **Adequate number of employees for a variety of services**
  
  (1) Mine the data of customer behavior (e.g. most popular day of the week, most popular time of the day, sales promotion terms).
  
  (2) Ensure that the appropriate number of employees staff the stores/stations in proportion to customers.
  
  Pros: - Reduce the service time to increase customer satisfaction.
  
  Cons: - How to manage unexpected customer increases?
  
  How to handle cons: - Staffing stores with employees from other partner stores.
  
  - Simplify employee’s service manual.
  
  - Support employees by IT system. However, this increases costs.

(Hypothesis 7)

- **Precise assessment of partner’s resources and potential synergy effect**
  
  (1) Discuss each competitive advantage and disadvantage with partners before entering into the partnership.
  
  (2) Assess estimated impact of the partnership.
  
  (3) Set an extent of a gap of impact each partner can compromise.
  
  (4) After implementation, assess the gap level of impact.

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(5) If the gap level is more than the extent each partner can compromise, change marketing strategy to mitigate the gap (e.g. re-design the layout of stores and increase visibility for customers, coordinate services with each store, and offer sales promotion for stores that have a lower impact).

Pros: - Prevent the overestimating and underestimating of partner's capability.
   - Reduce the risk of failure for the partners.
   - Equalize the relationship and cooperative behavior and increase mutual trust.

Cons: - Generate opportunity cost by supporting partners.
How to handle cons: - Expect return from the partner after their revitalization.

• **Consider cultural similarities and differences**

(1) At the initial stage, ask partners to participate in building common framework and strategy at the corporate level.

(2) Try to develop portfolio strategies with potential partner to assess partners' sensitivity of risk and decision-making processes.

(3) If (2) is consistent with the firm's culture, then exchange long-term strategy of business.

Pros: - Similar cultural norms and corporate values enhance communication, and create a cooperative atmosphere.
   - Expect transparent decision-making process.

Cons: - This process takes time to grasp, and even if it is done, firms cannot always grasp the insight of the partner.
How to handle cons: - Ask a third party for an opinion of the partner's corporate culture.

• **Prevent conflict with other channels**

(1) Map existing channels in term of marketing force, marketing area, and type of service and categorize strong potential dealers and weak dealers.

(2) Avoid adopting the partnering business in the area where the business conflicts with other potential dealers.
(3) Plan to set partnership in a location where sales force of dealers is very weak.

(4) Categorize these dealers as one channel and collaborate with them to develop different core competencies from this partnering channel.

Pros: - This process creates a symbiotic relationship with other (non-partner) channels, and it enhances the overall capability of channels.
- Streamline conventional channels to enable suppliers to control new channel system.

Cons: - Difficult to manage some dealers whose loyalty is low
How to handle cons: - Cut ties with disloyal dealers and strengthen the relationship with the rest of the dealers.

3. Prioritize Key Factors to Successful Partnerships

Based on these summarized key factors, key factors in each hypothesis are prioritized and recommendations are made. The prioritization of each key factor is determined by the type of attributes.

Methodology
As a methodology, first, the key attributes that are affected positively by key factors in vertical and horizontal partnerships are listed. These attributes are extracted from the hypotheses, key results of case analyses, and the implementation of the results to Japan’s current oil industry are evaluated. Regarding the implementation of results, only the advantages are focused on since the disadvantages must be removed by an alternative action and do not relate to this analysis. Second, these attributes were categorized into four groups: attitude, communication behavior, competence and problem solving, based on the nature of each attribute. For example, parity is a kind of attitude built by both firms’ perceptions of their partners. Third, attributes in each group are prioritized based on the process to function each attribute or on a general norm of marketing. (See Exhibit 20)
Exhibit 2.4: Prioritization map of key factors in vertical and horizontal partnerships.
**Attitude:** Transparency and parity between both firms increases trust. Without trust they cannot build an equal and transparent relationship. Therefore the two attributes are given the highest priority, and trust is the second priority. Once a trusting relationship is built, the attitude of both firms can help create an atmosphere of cooperation or interdependence. Of course, these result from transparency and parity. Because of this cooperation and interdependence are the third priority.

**Communication behavior:** Without motivation, trust, or participation from partners, information is not well exchanged, so that motivation or participation is an absolute term compared to quality and quantity of information and it is thus prioritized first. Regarding the order of quality and quantity information, these can not be defined absolutely, but from a marketing point of view, a small amount of high quality information is preferable to a large amount of low quality information. Thus I prioritize quality of information as second, and quantity third.

**Competence:** Capability and innovative skills are resources that can be used to build core competence such as variety of service or quality of service. They also enable firms to rationalize their management. Therefore they are first priorities; variety of service, quality of service and rationalization are second priorities. Once firms create competence to provide variety of service and quality of service to customers, they can begin to draw loyal customers. Moreover the quality service creates an opportunity to attract new customers by word of mouth from loyal customers. As customer acquisition and customer loyalty are necessary conditions for variety and quality of service, they are third priorities.

**Problem solving:** Controllability of partnership, consistency, capability to find issue and flexibility are all indispensable factors to solve problems. Therefore it is impossible to prioritize these attributes, and thus these are set at the same priority. From a relative point of view, these attributes are a second priority as key points to identify the nature of problem solving, and those located in the first priority are resources to build the key points. Therefore their second priority status seems to be consistent.
Fourth, points to each attribute are given, the first priority gets three points, the second priority two points, and third priority one point. Finally, attitudes are extracted from each key factor earlier in this chapter, and a prioritization map has been prepared. The points for each key factors are aggregated and then the key factors in each hypothesis are prioritized.

4. Strength/ Weakness of Recommendation and Conclusion

Outcome and strength of recommendation

Regarding vertical partnership, the prioritization map demonstrates that there are four significant factors that determine the effectiveness of vertical and horizontal partnerships among ten key factors: (1) equal positions of each partner (2) a clear and open communication system between partners and all levels of employees in a partnership (3) excellent competition and conflict management processes, and (4) process-oriented partnership. These four factors complement one another and they are different steps of vertical partnership and functioning different attribute\(^\text{22}\). When the four factors were ordered along the process of the partnership, (1) equal positions of partners (2) process-oriented strategies (3) clear and open communication systems (4) excellent competition and conflict management. In fact, the process is consistent with the successful case discussed in Chapter 3, so in that respect the prioritization map is consistent with the actual business.

Regarding horizontal partnership, the map indicates that there are five significant factors among nine key factors: (1) high level communication, (2) a common management system, (3) a scale of site, visibility of service (4) an effort to prevent conflict among channels, (5) thorough assessment of the partners’ strengths and weaknesses before the formation of the partnership.

\(^{22}\) There are some redundant attributes, but it does not matter.
Some of them get the same total points in a hypothesis. When contrasting the five significant factors with an actual case in Chapter 5, most of the factors are covered in the cases while some are not evident in the research. This means that there are some successful horizontal partnership models, and each key factor for the models is a little different due to a particular business environment. In this respect the horizontal partnership model must be more complicated than the vertical partnership model.

When comparing the vertical partnership model with the horizontal partnership model, there are some similarities and differences. The map recommends that both partnership models include a modern IT communication system to enhance communication. Regarding managing conflict, vertical partnerships need to focus on internal conflict while horizontal partnerships need to focus external conflict (other channels) rather than internal conflict. This is due to the fact that the vertical partnership restructures the current distribution channel while the horizontal partnership invites new channel members from outside of the current distribution channel.

This implies that there are differences between vertical and horizontal partnerships in terms of scale, relationship with partners and behavior.

**Weakness of recommendations**

However, I have identified some weaknesses, as outlined in the map. First, all primary key factors do not cover all of the important attributes (the first priority attribute) and the key factors of each partnership model do not identify the all of attributes. (e.g. interdependence is not identified in the vertical partnership.) This implies that there might be other important key factors not introduced through this research. Second, there is inconsistency of prioritization. For example, cultural similarities noted in hypothesis 7 is a lower priority than other factors. Most of firms with different cultures/norms would likely face serious difficulties in horizontal partnerships, and some of the firms cannot even overcome the issue. Because of that, cultural similarity should be elevated to higher priority.
These weaknesses reflect difficulty in selecting key attributes and key factors. It implies that there are many types of models for horizontal and vertical partnerships, and it is necessary to research more types in order to develop a more precise prioritization map. On the other hand, there might be another methodology where each attribute and key factor could be better correlated. In that respect it is necessary to try to develop more methodologies through trial and error methods.

Conclusion

Through this research it is apparent that key success factors for both vertical and horizontal partnership models cannot be identified since each partnership case is different due to various industry environments and characteristics of firms. However, this research clarifies a few key driving forces that strengthen partnerships and lead to success.

The key factors for both vertical and horizontal partnerships are a positive attitude towards the partnership, clear and open communication, competencies of each firm and the potential of each firm to jointly solve problems. If partnerships lose any of these, the delicate balance will likely collapse and threaten the relationship. Partnership models have changed with the times. In the near future, new types of partnership such as vertical and horizontal linkage models will emerge, and as a result, channel management methods must change accordingly. Despite the inevitable changes that the market and technology bring, key driving forces will continue to drive partnerships no matter how much the model is transformed. This is because partnerships will continue to link people from different entities in relationships, requiring the basic elements of communication, competency, and the ability to merge skills and resources.
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