The Problem with Win-Win

Why the notion of 'win-win' in collaborative long-term buyer-supplier relationships is as misguided as it overused

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Creating mutually advantageous "win-win" outcomes is frequently considered best practice, just as partnering was a decade ago. As a result, like partnering, the win-win concept suffers from the same type of use and abuse that is likely to render it a meaningless concept.

This White Paper challenges the view that win-win outcomes are best practice and contends that buyers seeking to achieve such outcomes are guilty of poor and misguided thinking.

This is because a true win-win, in which both parties simultaneously achieve their ideal outcomes, is not feasible under any circumstances. By its very nature, buyer and supplier exchange is always contested.

Despite this, it is argued that long-term collaborative relationships are still an extremely useful tool in the armoury of a buyer seeking improved value for money.

Furthermore, even if a win-win is not feasible, the challenge for buyers is to understand not only what is the appropriate way to manage long-term collaboration such that value for money is achieved, but also how their own operational and commercial interests can be maximised.

This challenge of creating competence in collaborative sourcing is explained through analysis of four short case studies. In two of the cases it is shown how a competent buyer can use collaboration to achieve exceptional value for money and also maximise operational and commercial interests.

Two further cases show how incompetent buyers pursuing, what initially appear to be win-win outcomes, end up being taken advantage of by more commercially competent suppliers, who are maximising their own commercial and operational interests at the expense of the buyer.

All four cases show that when collaboration occurs, there is always one party who is likely to be receiving relatively more from the exchange than the other.

Can Buyers Achieve Win-Win Collaborative Relationships with Suppliers?

When an organisation requires supply inputs that are critical for the delivery of its own final product or service, being able to acquire those that are relatively superior to those of their competitors can be a source of competitive advantage.

In order to achieve this, buyers have to move from a reactive and arm's-length to a more proactive and collaborative way of working with suppliers. Often the presumption is that, by providing long-term and mutually beneficial outcomes, collaboration will provide both parties with a win-win (positive sum) outcome.

It is clear that collaboration in these circumstances can create better value for money for buyers than arm's-length and market-tested approaches. This is particularly true for critical and high-value categories of spend that necessitate the heavy investments of time and resource required to make collaborative supplier development work effectively.

Despite this, even when this approach to relationships is operationally superior to arm's-length ways of working, it is still possible for it to be implemented in a commercially sub-optimal fashion.

If buyers fail to understand the risks of post-contractual opportunism that can occur when they enter into long-term collaborative relationships, and if they allow suppliers to create high switching costs operationally, then the buyer may not receive the currently best available value for money deal in the market, but a sub-optimal offering from which it is difficult to exit.

If this scenario occurs, then the supposed win-win may give way to a win-lose (zero sum) or win-partial win (non-zero sum) outcome favouring the supplier.

The fact that there is operational benefit to both parties may mask the commercially contested nature of outcomes that arise in long-term collaborative relationships. This happens for three major reasons. First, as the figure overleaf shows, a win-win is only one outcome and there are eight others that can occur in business exchange.

FIGURE 1

THEORETICAL POSSIBLE OUTCOMES IN BUYER AND SUPPLIER EXCHANGE

Value Capture by the Buyer (VFM)	Not Acheived	Partially Achieved	Fully Achieved
Fully Achieved	**A** Buyer Wins Supplier Loses	**B** Buyer Wins Supplier Partially Wins	**C** Buyer Wins Supplier Wins
Partially Achieved	**D** Buyer Partially Wins Supplier Loses	**E** Buyer Partially Wins Supplier Partially Wins	**F** Buyer Partially Wins Supplier Wins
Not Achieved	**G** Buyer Loses Supplier Loses	**H** Buyer Loses Supplier Partially Wins	**I** Buyer Loses Supplier Wins

Value Capture by the Supplier (Value from Supply)

KEY: OUTCOMES

- Positive Sum
- Non-zero Sum
- Zero Sum
- Zero-Zero

Second, since buyers and suppliers, objectively, have commercial interests that are not fully commensurable – in other words, both parties cannot simultaneously achieve their ideal commercial goals – all exchange between buyers and suppliers (whether arm's length or collaborative) is contested, and a win-win is not in fact feasible.

Third, since most buyers do not properly understand their own objective economic interests, most buying is based on subjective conceptions of reality. This often leads to "false consciousness" by buyers about the true operational and commercial outcomes from exchange.

When entering into long-term collaborative relationships it is normal for buyers to believe (subjectively) that the best way to manage them is for both parties to seek a win-win outcome. This appears to be common sense because, if the relationship is to be long-term and both parties must make dedicated investments in the relationship, it only makes sense if both achieve something from the relationship.

This is what most buyers intuitively mean when they say that they expect a "win-win outcome" to occur that is mutually advantageous.

There is, however, a problem with this thinking. To say that both parties receive something from a relationship does not tell us anything about how much (itals) they receive. Both parties can sustain relationships when they achieve their ideal (a win) or when they only partially achieve it (a partial win). Thus, it is possible theoretically to argue that relationships can be sustained over time with either positive sum (win-win) outcomes or with non-zero sum outcomes (win-partial win; partial win-partial win; or partial-win-win).

This means a win-win may not be required to sustain long-term collaborative relationships, and there are certainly real-life cases when long-term relationships exist even though there is a zero sum (win-lose) outcome.

Furthermore, the ideal win for a buyer is to receive continuous improvement in operational functionality and continuous reductions in the total cost of ownership. But if the buyer is to achieve this objective ideal outcome, it can only be achieved at the expense of the supplier, who must make low or normal returns.

This is because whatever operational functionality the supplier can provide must always cost it something commercially. The ideal win for a supplier, on the other hand, is to make above-normal returns at a given level of operational performance.

In such circumstances there is an unavoidable tension and conflict of interest in business relationships between buyers and suppliers. If the buyer achieves their ideal goal the supplier cannot simultaneously achieve theirs, and vice versa. Win-win, or positive sum, outcomes are therefore not feasible in buyer and supplier exchange in practice. This implies that all buyer and supplier relationships must be based on non-zero sum, zero sum or, occasionally, zero-zero outcomes.

Competent collaborative sourcing recognises that commercial contestation must be retained throughout the relationship. Incompetent collaborative sourcing occurs when buyers suffer from false consciousness and assume that the principles of contested exchange can be ignored when long-term relationships are entered into.

It is worth remembering that, for suppliers, achieving long-term collaborative relationships is one of the surest ways by which they can close markets to their competitors.

In these misguided circumstances, buyers normally lock themselves into long-term operational ways of working and then lose control over the supplier commercially because of a naive view that win-win outcomes are achievable.

The four case studies that follow demonstrate that collaborative ways of working can be highly successful for competent buyers, but a recipe for disaster for the unwary.

Examples of Competent and Incompetent Collaborative Sourcing

The four cases below reinforce these theoretical arguments about competence and incompetence in collaborative relationship management.

To the untutored all of these cases may appear to be examples of win-win outcomes, but detailed analysis of these long-term collaborative relationships reveals that is not the case in practice, and that very different outcomes occur, some of which favour the buyer and some that definitely do not.

Example 1
Win-Lose: Telecommunications and IT Sourcing

A buying organisation required high-quality telecommunications services to manage its business effectively. The company involved was in food manufacturing and telecommunications and IT (although critical to operational performance) was not a core competence, or an area in which it could afford to maintain the highest levels of investment in state-of-the-art technology.

Given this situation, it decided to work closely with a supplier for seven years to ensure “world-class” operational performance.

Managers in the buying organisation decided to set a required operational performance standard for bidders at a stretch level that was way in advance of current performance of 87%. This was deemed to be the minimum acceptable level for any supplier entering into a short-term relationship.

However, because they wanted to see if any suppliers could achieve a higher performance level, potential suppliers were told that the current performance level was actually 92%.

Furthermore, the successful bidder would have to guarantee to improve these levels by 1% per annum over the next seven years, until they reached 99% performance.

If this was achieved, the buyer intimated that the supplier might then expect to receive a further seven-year roll-over contract. On the downside, if the supplier failed to meet the minimum performance level, then it would have to pay a penalty of £100,000 a year and the buyer would not pay anything for the service at all.

A well-known telecommunications and IT supplier won the contract and, over its term, did eventually achieve the 92% performance required, but only in the last two years of the contract.

It did consistently achieve performance scores in excess of the 87% level that the buyer had historically achieved, but did not receive any payments at all and, in fact, lost money over the term of the contract to the tune of £700,000, plus the costs of their own time and effort.

This was clearly a win-lose outcome favouring the buyer. The buyer worked closely with the supplier operationally and assisted it in achieving increases in performance that far outstripped anything that the buying organisation had been able to achieve using short-term arm’s length relationships in the past. The supplier also worked closely with the buying organisation and tried to achieve the stretch performance improvement targets that it had agreed.

Unfortunately for the supplier, its sales team had signed the contract without taking the trouble to checkwhether the 92% minimum standard, never mind the stretch targets, could be achieved. They had simply won some revenue and achieved bonuses for themselves, leaving the project team to manage an impossible relationship post-contractually.

Example 2
Partial Win-Partial Win: Professional Design Services

This second case is about a mining company that initially awarded a long-term contract to single-source suppliers for design and specification work for waste removal.

Initially, the buying organisation had awarded two-year contracts, but with annual extensions for a further three years if the supplier met minimum standards of cost reduction and service level delivery. The buying organisation believed the contractual relationship was based on win-win. This was because it was receiving its minimum performance standards and the supplier was receiving a long-term contractual relationship.

During a review of the strategy, brought about by a cost challenge in the buying business, we discovered that the supplying company had used the opportunity of becoming a single-source supplier to backward integrate in the supply chain and take over the operational delivery of the waste removal work.

The organisation was also in control of the detailed design and specification liaison work with the regulatory authorities that authorised the level of work that should be undertaken.

It was discovered that the supplier was operating opportunistically and making excessive double-digit returns by the use of double counting and other nefarious invoicing techniques. The supplier was also designing inflated amounts of work that needed to be undertaken in order to increase its revenue and force the buying company to pay for more work than was technically required.

From a perception that the buyer was in a win-win situation, it soon became apparent that it was either close to a lose-win or at best a partial win-win situation favouring the supplier.

It was possible after this review, using the carrot of a continuation of the long-term relationship and the stick of open-book collaborative costing, to restructure the way the supply chain was managed and to ensure that the supplier was only able to achieve returns of 8%, while also accepting some stretch operational improvement targets.

This ensured that the eventual relationship was a partial win-partial win outcome that was far more favourable to the buyer. It was not possible to achieve a full win for the buyer in this case because the location of the waste removal work, and the dominance of the preferred supplier in this marketplace, created switching problems and lack of contestation.

Example 3
Win-Partial Win: Capacitor Supply
In this case the buying company was able to achieve exceptional performance improvement with preferred suppliers, while also ensuring that the suppliers did not make anything other than normal returns from the relationship.

The buying organisation was a final assembly company making personal computers for which it required capacitors as part of the sub-assembly process. The supply market for capacitors was highly contested with many potential suppliers (although of variable competence).

The buying organisation had historically used short-term arm's-length relationship management approaches. Over time, the company came to realise that this approach was sub-optimal because the short-termism did not allow it to work closely enough with any of the suppliers to iron out operational performance and delivery problems.

The company decided, therefore, to select three preferred suppliers and to invest considerable amounts of its own time and resources in working closely with them on operational performance improvement.

The buying organisation did not, however, ignore commercial leverage. In return for a long-term commitment it ensured that the suppliers would only be granted a guaranteed minimum share of the business, and that they would have to compete for the remaining volumes.

In addition, suppliers had to agree to open-book costing and allow the buying organisation to audit their books and operational processes.

This form of collaboration resulted in a win-partial win rather than a win-win outcome. This is because the buying organisation received continuous improvements in operational performance and cost reductions, but suppliers were only ever able to make a low return below 4%, whatever level of revenue they received annually.

Example 4
Partial Win-Win: Drilling Rig Sourcing
The final case relates to an exploration company drilling for oil and gas in one location that required the use of the drilling rigs of a preferred supplier.

The exploration company had used the same drilling rig supplier for over 10 years, and its rigs had (through extensive joint operational collaboration) been modified to meet exactly the drilling requirements of the exploration company.

This, plus the continuous learning that the supplier's operational staff had acquired by working for the exploration company and understanding what was required operationally, had resulted in the drilling performance of the rigs (measured by the speed of drilling without incidents) being the best in the world for this exploration company.

Given this, it was of the view that it had created a win-win outcome for itself and for its supplier. The latter had received all of the demand volumes for 10 years and the operational performance of the rigs was the best in the world for the exploration company.

Unfortunately, during a review of this strategy as part of a value improvement exercise, it soon became apparent that the buying company had lost the plot commercially in this collaborative relationship.

What it had in fact created operationally was a locked-in relationship with almost impossibly high switching costs. The location in which the drilling took place was very remote, and the rigs had been modified over the years at the buyer's expense to ensure drilling performance improvements, such that they could not be used elsewhere and there were no other rigs capable of the same performance that could be used from other suppliers.

This meant that the buyer had created a dependency on the supplier. Although the exploration company was receiving exceptional operational performance, it was at the cost of providing the supplier with the highest commercial returns (with profits in the high double-digits) being earned by any drilling rig supplier anywhere in the world.

This was clearly a partial win-win, rather than a win-win, outcome favouring the supplier. The buying organisation received significant operational benefits, but had to pay through the nose for them.

If it had adopted a more far-sighted approach to the commercial, as well as the operational, consequences of its sourcing strategy, a range of alternative win-partial win approaches could have been used to provide the same operational benefits, but at a much lower total cost of ownership.

How to Manage Collaborative Relationships Appropriately

All of these cases show that what may appear to be win-win outcomes are, in fact, far from it. Indeed, collaborative exchange between buyers and suppliers never produces win-win outcomes, because it is always contested. Collaboration nearly always results in non-zero sum outcomes.

When buyers enter into long-term and highly collaborative relationships, the rules of the game of commercial exchange are not suspended. Furthermore, they have to recognise that searching for a win-win is a fundamental error that can blind managers to the reality of the buyer and supplier exchange.

It behoves managers, therefore, to train themselves and their colleagues in the rules of the game of contested exchange. It is also necessary for them to understand that, if they subjectively misconceive this reality, they are likely to be taken advantage of by those suppliers who understand the rules of the game better than they do.

In the past, this uncritical use of a concept was a problem for those who unthinkingly entered in partnering and alliance relationships with suppliers. It is to be hoped that the same mistakes are not about to be made by the unthinking use of win-win in the future. This is because, as Karl Marx once said: "History repeats itself, once as tragedy and twice as farce."

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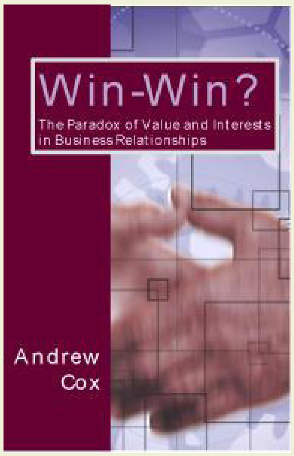
Further Reading

1. Andrew Cox et al, *Business Relationships for Competitive Advantage: Managing Alignment and Misalignment in Buyer and Supplier Transactions* (Palgrave Macmillan, 2004).
2. Andrew Cox, "Business Relationship Alignment: On the commensurability of value capture and mutuality in buyer and supplier exchange", *Supply Chain Management: An International Journal*, Vol 9, No 5 (2004), pp.410-420.
3. Andrew Cox, *Win-Win? The Paradox of Value and Interests in Business Relationships*, (Earlsgate Press, 2004).



CHECKLIST:

5 steps to avoiding myopia in collaborative relationships

My colleagues and I have found that misunderstanding the rules of the game in this way, and having "false consciousness" about the commercial consequences of operational collaboration, is a fairly common mistake made in business. Given this, managers who wish to avoid the pitfalls of false consciousness in collaboration may wish to consider the following five steps to avoid myopia:

1. Fully understand the difference between reactive arm's length and proactive collaborative operational ways of working.
2. Understand the full range of commercial outcomes that are objectively feasible in buyer and supplier exchange (see Figure on Page 2).
3. Avoid the mistake of searching for win-win (positive sum) outcomes.
4. Recognise that contested exchange is inevitable when working collaboratively with suppliers.
5. Seek to maximise operational and commercial value creation and value capture whenever non-zero sum or zero sum outcomes are feasible.