# Shrinking Core, Expanding Periphery: The Relational Architecture of High-Performing Organizations

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If you were to build a company today from the ground up, what kind of organizational strategy and structure would you design to ensure its long-term success? What behaviors would you seek to encourage? What conflicts would you try to circumvent? What culture and values would you attempt to instill? If you were to create an ideal in terms of an operating model for success, what would it look like?

One thing is certain: whatever organization you might construct, whatever the industry, whatever the competitive playing field, the organization would be built on *relationships*. According to our research, winning organizations are discovering that capital takes many forms, not just financial, and that effectively exploiting and leveraging relational capital is an important route to long-term success. Defined as the value of a firm's network of relationships with its customers, suppliers, alliance partners, and internal sub-units, "relational capital" is fast becoming one of the major currencies of modern commerce.[1]

Historically, companies focused their expertise and business processes on managing physical assets (e.g., manufacturing facilities, products, retail locations) and more recently on intellectual assets (e.g., R&D, patenting). Now, however, companies are increasingly applying a disciplined approach to managing their network of relationships, effectively treating these relationships as assets—increasingly precious assets.

Winning companies define relationships in a very consistent, specific, and multi-faceted manner. While competitors may close business deals and dub them "relationships," top-performing companies take a more expansive and

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long-term view. They focus extraordinary enterprise-wide energy on moving beyond a transactional mindset as they develop trust-based, mutually beneficial, and enduring relationships with key constituencies both inside and outside of their organization.

Ironically, as top performers extend their organizational borders, reach out to external partners, and render their borders more porous, they are simultaneously contracting their organizational centers and outsourcing increasing portions of their activities. They are shrinking their core by increasing focus on fewer activities while outsourcing the remainder to strategic partners. This has led to an explosion of partnerships on the vertical dimension that includes ties up and down the value chain. At the same time that they are shrinking their core, top performing firms are expanding their horizons by trying to provide customers with greater sets of products and services, many of which may come through partnerships with other firms and are bundled together into what are loosely called customer solutions. This has led to an expansion of partnerships on the horizontal dimension with firms that may provide complementary offerings to their own. This "shrinking core, expanding periphery" phenomenon is evident across an array of industries and is one of the hallmarks of a new operating model—what we call the "*relationship-centered organization*." The relational architecture that such firms create provides them with a pathway to profitable growth by allowing them to simultaneously focus on their top and bottom lines. They manage their costs through shrinking the core and enhance revenue streams through expanding their periphery. This sounds easier than it is to execute and therein lies the ultimate differentiator of successful firms.

## Methodology

In order to explore the ways in which relationship-centered organizations are developing in today's business world and to discover the lessons that we can learn from these developments, we conducted a survey of *Fortune 1000* companies. One hundred twelve CEOs and other senior executives from these companies across a range of industries responded to a questionnaire comprising 115 questions on the organizational challenges and imperatives companies perceived in their markets. Of these firms, one hundred that were on the *Fortune 1000* list in both 2000 and 2002 were retained for analyses. We then stratified the performance of these firms into quartiles based on their total returns to shareholders for the five years from 1995-2000 and 1997-2002 in order to isolate those distinguishing attributes that differentiated top-quartile respondents from the others as well as to control for the market bubble in the late 1990s.[2] Needless to say, the gap in the valuations assigned top- and fourth-quartile respondents in 2000 is dramatic, with a less dramatic gap in 2002 driven by the overall market

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decline. The core of our analysis is to elucidate the attributes of the firms that were sustained performers—that is, in the top quartile in both 2000 and 2002.

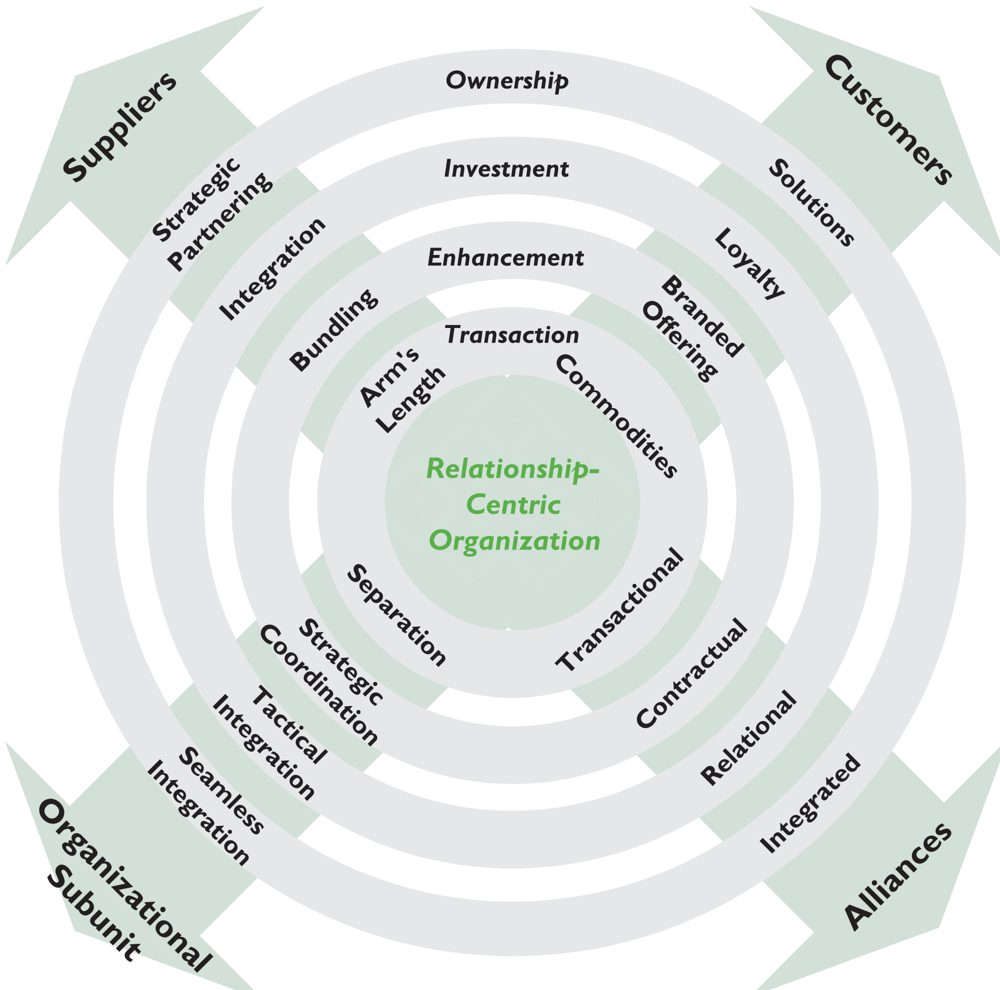
In addition to the survey, we conducted interviews with leaders at top-quartile firms who were willing to discuss their responses in more detail. We also conducted a workshop on best practices in which we invited all participating firms to send a representative.[3] Our research was specifically designed to uncover not only the "what" of successful organizational relationships but also the "how." It is one thing to recognize that winning organizations sell solutions or share information and collaborate with their internal and external partners, but it is another thing entirely to be able to describe exactly *how* they execute these behaviors to assure superior results and what the journey looks like as they embark on this endeavor.

One of the companies we studied that exemplifies this focus on relational capital is Starbucks. Starbucks has long understood the importance of relationship building, not only with its customers, but also with its suppliers, alliance partners, and internal business units. Indeed, the "Starbucks experience" is predicated on the creation of enduring, multi-faceted relationships. While brewed from high-end arabica beans, Starbucks coffee is ultimately a high-priced commodity in a reasonably competitive space. To retain its market leadership, the company needs a tie that binds consumers to its brand on a very personal level, and that tie should not be just the coffee, but also the relationship the local Starbucks barista enjoys with his or her daily customers. Starbucks focuses the bulk of its energies on solidifying that relationship. It creates a comfortable coffeehouse environment in which a "My Starbucks" relationship can easily develop. It staffs its stores with well-trained, highly motivated baristas who enjoy one of the best compensation and benefits packages in the retail industry. Its line organization is closely aligned with internal staff units that support them. It searches the world for the highest quality coffee beans and builds a long relationship with the subsistence farmers who produce it. It allies with or acquires partners who can supplement its brand experience with music or ice cream or a flight to Chicago. In short, it develops a multidimensional relationship with its customers, which in turn rests on the multiple relationships it cultivates as a company with between its internal sub-units, suppliers, and alliance partners.[4]

## Leveraging Relational Capital

As companies refocus around their core businesses and build a simultaneously expanding-shrinking firm, they have become increasingly reliant on their ties to four sets of critical stakeholders that span both vertical and horizontal axes and include customers, suppliers, alliance partners, and intra-organizational business units. As they involve customers in product/solution development, share more and more information with vendors, and build wider and longer bridges with existing alliance partners (sometimes forging new ones), they are also developing more collaborative relationships among organizational sub-units, at every level. Exhibit 1 depicts how successful companies move

**EXHIBIT 1.** The Multi-Faceted Nature of the Relationship-Centered Organization




outwards from the center on one or more of the four dimensions. On each of these relationship dimensions, successful firms work their way up a ladder in which they intensify their collaborative efforts with that particular constituent.

Along each of these four dimensions, the relationship progresses from transactions to collaboration until, in an ideal world, a company and its key stakeholders all have a vested interest in the continued health and productivity of their relationship. What may start as an arrangement entailing minimal coordination and cooperation quickly expands into one that encompasses synchronous coordination and active cooperation. Suppliers are strategic partners, internal sub-units are mutually aligned collaborators, alliance partners are part

of a mutually reinforcing set of business relationships, and satisfied customers are collaborating on co-developing and receiving solutions.

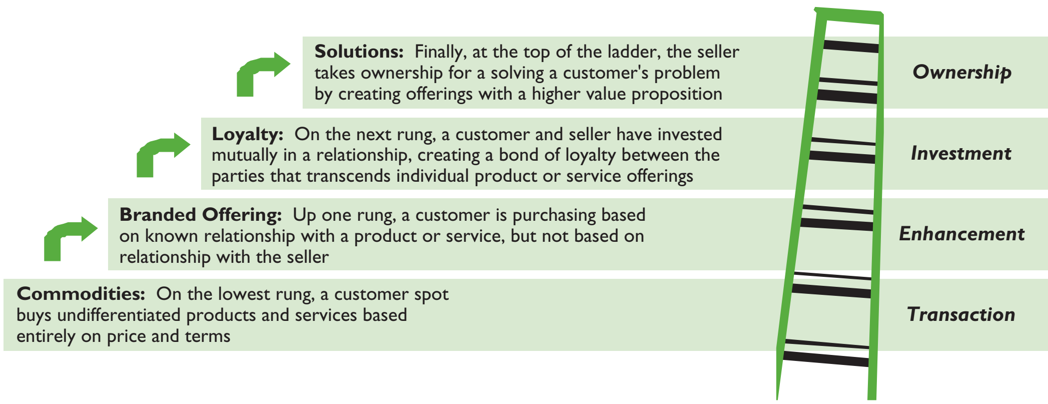
The relationship-centered organization with its relational architecture depicted in Exhibit 1 is a networked, agile, and highly adaptive entity that transcends traditional boundaries as it develops deep and collaborative relationships with internal sub-units, customers, suppliers, and alliance partners. Such organizations appreciate that their competitiveness in today's marketplace and the lure of achieving profitable growth hinges on their ability to leverage their "relational capital" by extracting full value from their various partners—both internal and external, spanning both vertical and horizontal boundaries—and they are creative and consistent in this endeavor. As markets globalize and as keeping pace with innovation becomes increasingly challenging, the complexities involved in running a business multiply. The majority of our survey respondents agreed that product/service attributes, information systems, and organizational structures are, in general, becoming more complex. As a result, the successful firms are reaching out more and more to access appropriate expertise, adopting a multidimensional approach as they expand their universe of critical relationships.

### *First Dimension of Relational Capital: Customers*

While customers have long been hailed as the "boss" in bumper sticker slogans and corporate values statements, their central role in sustaining the economic fortunes of the modern enterprise is being freshly acknowledged. No longer is the customer merely the "someone" who buys your product or service; rather, he or she is the "someone" whose problem your organization exists to solve.[5]

Furthermore, the expectations of these "someones" are on the rise. While fifty-nine percent of our survey respondents found meeting customer expectations to be a significant challenge in the past, eighty-four percent now consider it to be a significant challenge in moving forward. Sixty-eight percent of the companies we surveyed project that it will be increasingly difficult to access new customers, and fifty-two percent believe it will be difficult to access new geographical markets. Underlying this drive to cement high-value customer connections is the recognition that while retaining customers remains far easier than acquiring them, ultimately both are important. Relationship-centered organizations joined their poorly performing peers in acknowledging the difficulties associated with attracting new customers and entering new markets in the current environment in our survey. An important element underlying the challenges in serving customers profitably is the growing pressures of commoditization that plague a wide range of industries today as a result of which firms are forced to compete on price. Through the confluence of an array of factors ranging from growing international competition and maturing technologies to open standards and reduced willingness to pay by customers for premium products, many industries face emerging pressures of commoditization. These can be particularly deadly in technology-intensive industries where firms must still generate enough of a surplus to invest in innovation and development.[6]

**EXHIBIT 2.** Customer Relationship Ladder

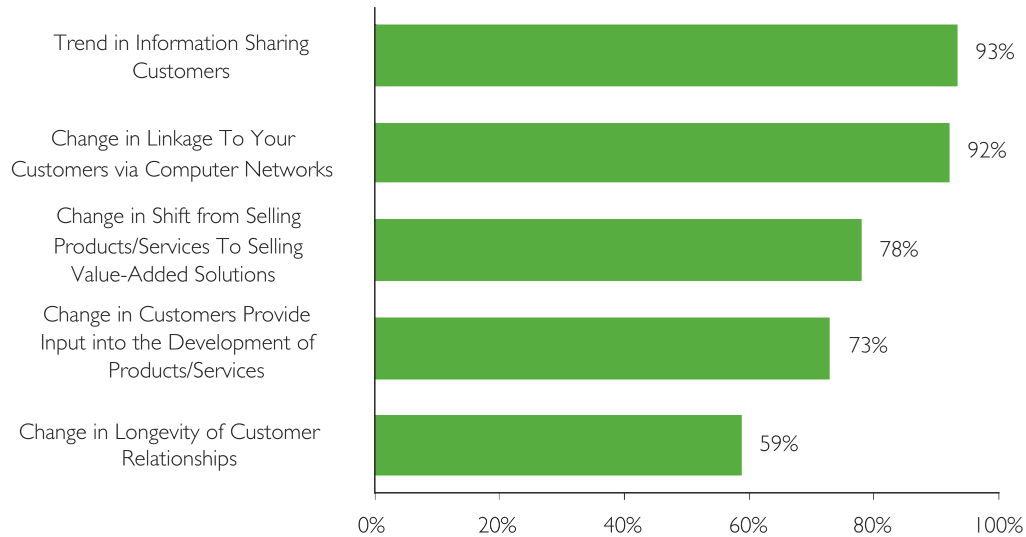



What distinguishes relationship-centered organizations is their reaction to these mounting challenges and expectations. More than two-thirds of the top-quartile firms we surveyed devote primary strategic focus to meeting customer expectations and building long-term customer relationships, a much higher percentage than the bottom-quartile companies who are far more focused on cutting costs and shedding underperforming assets. Relationship development, as one might expect, thus seems to take a back seat when the question of corporate survival is at stake.

At the same time that winning companies are building new relationships, they are also strengthening the ones they have already formed by climbing a ladder of increasing mutual responsibility and mutual commitment within these customer relationships. This becomes particularly important for those firms seeking ways to differentiate themselves by extending their product/services to encompass a broader array of offerings that solve customer problems. As companies climb these ladders together with customers, they each share more of the burden of sustained collaboration and realize more of the mutual benefit (see Exhibit 2).

On the lowest rung of the customer relationship ladder, no significant relationship exists between buyer and seller, as products are only commodities—bought and sold transactionally—and are not differentiated from each other in the marketplace. In order to move one rung up from this state, companies must strengthen the relationship between their customers and their products. This is achieved by forming a set of expectations about a product in the customer's mind and creating a brand that represents the company's implicit promise to deliver against those expectations in the future. The relationship here is between the customer and the product, not between the customer and the seller; the relationship would thus be expected to move with the product if, for example, the brand were sold to another company. At the third tier of the ladder, the two

**EXHIBIT 3.** Trends in Customer Relationships, All Respondents




parties invest in one another's success—in economic terms, by creating a "switching cost" that creates a bond of loyalty between the two companies. This could take many forms, including physical (e.g., co-location or establishing facilities in near proximity to one another), intellectual (e.g., sharing and/or licensing intellectual property), personnel (e.g., dedicating staff to work the interface across the companies), and monetary (e.g., "gain sharing" or other financial rewards for mutual success). At the highest rung of the ladder, the customer-seller relationship is strongest, transcending and redefining the traditional boundaries of the two companies. Here the seller takes ownership for success of a portion of the customer's business, offering a solution to a problem that the customer faces, and receives compensation not based on the volume of products or services, but on a successful outcome from the buyer's standpoint. Of course, a given company may operate at multiple points on the ladder simultaneously. Many leading companies have effectively segmented their customer base and created offerings tailored to different customer segments, with differing depths of relationships.

Our survey and our field interviews supported our contention that top-quartile companies are ahead of their peers in moving their relationships with customers up this ladder. Winning companies are more engaged in key collaborative behaviors with customers. These firms are experiencing deeper connection with their customers in five major ways: information sharing with customers; linkages to customers via computer networks; shifting from selling products and/or services to selling "value-added solutions;" customer input into the development of products and services; and the longevity of customer

relationships (see Exhibit 3). Across these five dimensions, we saw uniformly high levels of intent to share information with customers and link to them via computer networks among top- and bottom-quartile performers (responding at a level of five or greater on a seven-point scale). In fact, in 2002 the difference between the Sustained Performers and bottom-quartile performers was only 5% for information sharing (with 100% of sustained performers reporting to us that they planned to increase the amount of information they shared with customers), and 95% of bottom-quartile performers reporting to us that they planned to do the same. Furthermore, computer networks seem to be the medium of choice, with 100% of Sustained Performers reporting the plan to increase sharing using the internet, and 95% of bottom-quartile performers reporting plans for the same.

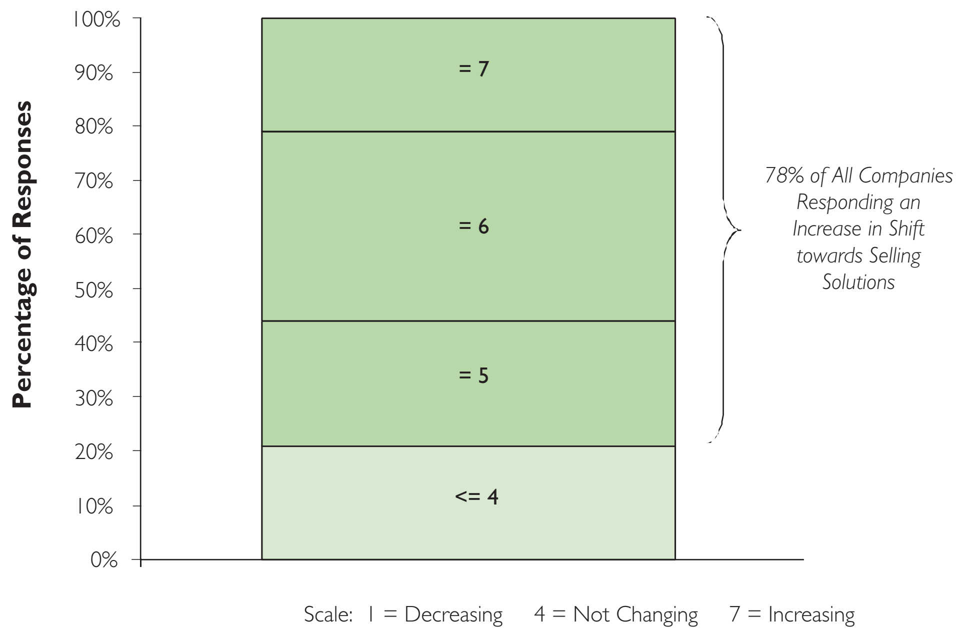
The differences in practices between Sustained Performers and the other companies in the survey were most pronounced in the shift from selling products and services to providing integrated solutions, the amount that customers provide input into the development of new products/services, and the focus on the longevity of customer relationships.

*From Selling Products to Providing Customer Solutions*

An important consequence of the move by top performing firms to pay greater attention to their customers has been the shift from selling products to selling what has loosely been described as customer solutions. In an increasingly competitive and transparent global environment where customer expectations are on the rise, it has become harder for many established companies to maintain their profit margins while selling traditional products and services. Established industry players are confronting the reality that product-based differentiation is more costly and difficult to maintain than ever before, and product differences are increasingly less meaningful. Value has, in effect, migrated downstream from suppliers toward customers. Rather than continue to accept the inevitable, companies of all descriptions in diverse industries are looking for opportunities to differentiate by developing higher-margin "solutions" businesses.[7]

Our survey indicated that most companies are trying to climb the rungs of the customer relationship ladder as they move from a singular product/service orientation to a more blended solutions-driven approach (see Exhibit 4). A solution is not—despite what many believe—an extension of an existing product line or the mere bundling of services with products. It is instead a fundamentally new approach to *creating* incremental value in the system for the customer and, by extension, for the solution provider. A solution is typically developed as a combination of products, services, and knowledge (e.g., risk management, performance guarantees, and customer consulting), and is a supplier's customized response to a customer's pressing business need. It is the logical next step in the customer value proposition, one that promises increased profits, stronger customer relationships, and greater competitive differentiation to those providers who get it right (see Exhibit 5 for some examples across a range of settings). For

**EXHIBIT 4.** Survey Question: To what extent do you see a shift from selling products/services to selling value-added solutions?




example, rather than selling simply lubricants, which may be tough to differentiate and may typically be purchased as commodities at the lowest available price, a solution value proposition could combine the products with deep expertise in the application of lubricants to a particular situation. This would make a shift from a pure "product" sell to selling a combined set of products and services that together enhance machine performance and guarantee the maintenance of the enhanced level of performance over time.

As companies transition from transacting in products and services to developing value-added solutions *in partnership with* their customers, the risks they naturally assume increase. A common lament we hear among fledgling solutions providers is, "Our customers are thrilled, but we're not making any money." One of the critical distinguishing features of a true solutions relationship is that value is *not* reapportioned but rather new value is created, and *shared*. Hence in structuring solutions, winning companies and their customers focus on the creation of value and on the establishment of performance monitoring metrics that will both measure gains and distribute them equitably.

Moreover, top-quartile companies make sure they build solutions with the "right" customers. They rigorously segment their customer base according to relative cost-to-serve and profitability. Clearly, successful companies want to focus their greatest efforts on enhancing the value proposition they offer to their most productive relationships. Not every customer is interested in buying

**EXHIBIT 5.** Evolution of Solution Value Proposition

| Industry | Traditional Product | Value-Added Services | Traditional Value Proposition | | Solution Value Proposition |
|---|---|---|---|---|---|
| Truck Manufacturing | • Trucks | • Financing<br>• Service | "We sell & service trucks" | ⇨ | "We can help you reduce your lifecycle transportation costs" |
| Chemicals | • Lubricants | • Product support<br>• Application design<br>• Materials analysis | "We sell a wide range of lubricants" | ⇨ | "We can increase your machine performance and uptime"<br>• Maintenance analysis<br>• Performance guarantees |
| Pharmaceuticals | • Drugs | • Product support<br>• Outcomes-driven information database | "We sell pharmaceuticals" | ⇨ | "We can help you better manage your patient base" |
| Telecom | • Phones | • Billing | "We can serve multiple needs (e.g. voice, data)" | ⇨ | "We can be your single- point connection to the world" |
| Pharmacy Benefit Management | • Benefit plan manage-ment<br>• Mail order prescription delivery | • Administration<br>• Breaking bulk | "We can lower your healthcare costs" | ⇨ | "We can be your single-source for all benefits management, including long-term care and disease management" |

solutions. One of the companies we interviewed as part of our survey categorized customers as gold, silver, bronze, and lead, reserving special resources and attention for its gold and silver clientele—while encouraging the "lead weight" to shop elsewhere. Examples abound of companies trying to advance their customer base up this value ladder. At the same time that they focus their attention on select customers, successful firms are also attentive to extending the duration of those relationships. One attribute on which top-quartile survey respondents differed was on the degree of emphasis they placed on improving the longevity of customer relationships: while 67% of Sustained Performer respondents thought it was critical, 50% of bottom-quartile firms thought it was critical (as indicated by a response of five or greater on a seven-point scale on the survey questions).[8]

At the same time that successful firms focus their efforts on crafting solutions for select customers, they also see the value in engaging customers in crafting those solutions. As a result, another observed attribute that sets Sustained Performers apart from their peers is the willingness to incorporate customer input into product and service designs. Our survey showed that fully 92% of Sustained Performers planned to increase the amount of collaboration with customers during product development, as compared to 73% for the overall survey respondents (as indicated by a response of five or greater on a seven-point scale on the survey questions).[9]

The move towards selling solutions appears in different shades in different industries. In many traditional business-to-consumer markets, this takes the form of a shift from offering products to endeavors to offer experiences or lifestyles as Starbucks has tried to do. In many business-to-business markets where manufactured products are bought and sold, this manifests itself in the form of trying to combine a broader array of products with complementary services to create a more comprehensive offering for the customer. Many pure services firms have also embraced these ideas as well and offer solutions that encompass a broader array of services that are provided to customers in a more accessible manner. In all these instances, the solution provider tries to use a solutions approach to get closer to the customer and create some meaningful differentiation between their offerings and those of others. Perhaps since so many firms are now embracing this concept, the next logical question is—are solutions going to become table-stakes and a commodity as well in the years to come?

One example of a consumer centric company that has tried to broaden its offering in this way is Harley Davidson. Through its Riders' Edge program, Harley Davidson tries to deepen its connection and build closer relationships with their customers. It provides its network of independent dealers with all the tools and resources they need to get potential customers over the biggest hurdle to owning a Harley: securing a license to drive it. Harley Davidson, in partnership with state DMVs, has created an educational safety course to teach people how to drive a motorcycle. After teaching customers to drive the bike, Harley dealers then schedule you for a road test, and ferry you there; they even lend customers the bike to take the test—all of this for $250 which is credited to your purchase of a Harley Davidson motorcycle when you pass.

Harley Davidson's devotion to helping customers fulfill their dreams does not end there. It actively cultivates a network of Harley Owners Groups (or H.O.G.s) across the country, with a dues-paying chapter in 1,200 dealer communities. In fact, one of the conditions of being a Harley Davidson dealer is that they foster a local H.O.G. by organizing rallies, rides, and other Harley-centric activities in their service area. Now 800,000 owners strong, H.O.G.s do a lot to spread the Harley Davidson mystique. An active rental program also acts as a great feeder system for new purchases. Credit services, branded parts and accessories, and a full line of Harley Davidson attire and merchandise complete the

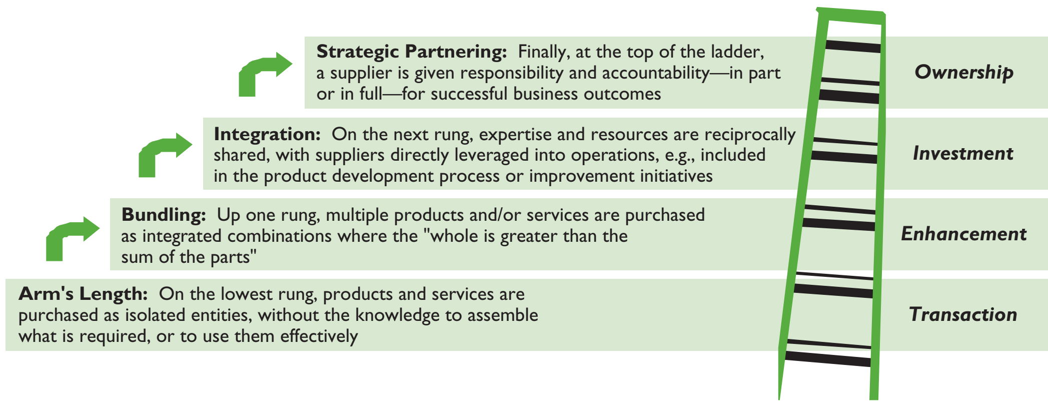
portfolio of customer products and services. Harley Davidson does not pitch price or specs, it pitches a "lifestyle."

Teradata, a Division of NCR, is another example of a technology company that has transformed itself from a traditional product- or service-centric organization into an organization focused on solutions that are targeted to major corporations in key industries around the world. In the mid-1990s, NCR began the process of consolidating a portfolio of hardware, database software, and services into a combined offering focused on customers, and soon began complementing its core database offering with complementary applications and services. Today, Teradata has consolidated and coordinated its entire company around providing such solutions, which are combinations of Teradata's portfolio of hardware, software, and services aimed at specific business problems in specific industries—such as Yield Management for Airlines, Contract Compliance in the transportation industry, Customer Retention for retail banks, and Network Optimization for communications companies. The typical solution sale at Teradata is on average about ⅓ hardware, ⅓ software, and ⅓ professional services. The goal is to make a solution that is greater than the individual parts, which occurs when Teradata develops a full understanding of the customer problems and creates an offering that can solve those problems.

A key component of Teradata's solution orientation arises from its close partnerships with customers that can be seen in how it develops software. Rather than build its own isolated applications around its own internal expertise, Teradata partners with its key customers to build integrated solutions to industry specific problems, infusing key insights from select customers to create applications that fully leverage Teradata's key strengths. An example of this approach is National Australia Bank, who partnered with Teradata to develop Relationship Optimizer, an Analytical CRM solution that enables customer-oriented and personalized dialogs with hundreds of thousands or even millions of customers of major B2C businesses, such as retail banks. This application has allowed the bank to not only create an effective communication channel with its large number of customers, but it also allows them to identify discrete individual customer "events" every day and react to them in a timely manner (events are such things as unusual deposits or a discontinuance of an automatic paycheck deposit). Such events in turn allow the bank to identify potential opportunities for the bank to contact the customer and provide a product or service to those customers in a proactive and timely manner. This joint project between Teradata and the National Australia Bank has resulted in a reliable and successful application that is now in its fourth generation (Teradata CRM) and is now being leveraged by other industries worldwide.

In addition to partnering directly with select customers, Teradata also provides multiple venues to easily connect customers with each other and share knowledge and best practices. Along with its annual users conference where best practice customers share their insights and experiences with others, Teradata regularly schedules webinars throughout the year and invites customers and

**EXHIBIT 6.** Supplier Relationship Ladder




other experts to engage in interactive dialogue with a business or technical user of a specific solution. The customer usually leads the dialogue, not Teradata.

Quest Diagnostics is another company that has helped extend the longevity of its customer relationships by developing a comprehensive "wellness" solution designed to help large employers contain costs and reduce employee absenteeism. Based on an evaluation of employees' blood tests, lifestyle, habits, hereditary factors, and modifiable risks, Quest's Blueprint for WellnessTM program red-flags looming health risks to the employees of client customers and helps companies manage existing ones through robust disease management programs. Individual employees receive a confidential and fully customized report, while employers receive the data in aggregate with meaningful comparisons (e.g., with industry norms, prior year results) and return-on-investment data. Detailed health reports, interventions, and hotlines provided by Quest allow clients to better manage their workforce and health care expenditures on a continual basis. Moreover, they help Quest develop a direct relationship with individual employees, who are playing a greater role in health care decision making as they assume more and more of the associated costs.

### *Second Dimension of Relational Capital: Suppliers*

Relationship-centered organizations recognize the importance of maintaining strong and enduring ties with key suppliers as markets become more dynamic and demanding. They see the importance of building partnerships in this critical vertical dimension of the value chain as crucial to their success.[10] As firms realize the importance of cost containment in increasingly competitive markets, they see the logic of "shrinking their core" and begin to shift activities previously viewed to be core to their business to external suppliers. In doing so, they hope to reap benefits from economies of scale or depth of specialization. The globalization of the manufacturing and services industries has made it

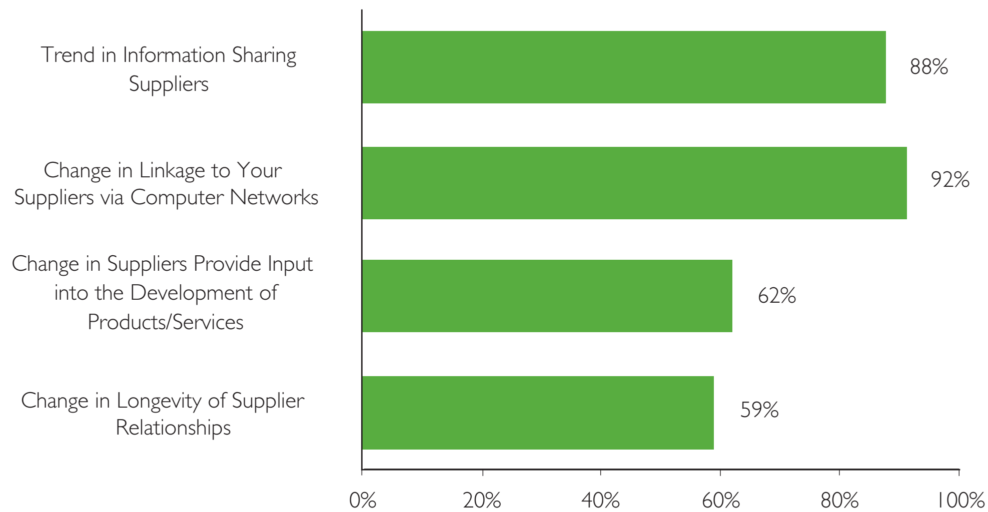
advantageous for firms to tap into local expertise on very economical terms. In doing so, they recognize that suppliers are an integral part of the value they offer their own customers, especially as complete solutions—which require more pieces from suppliers—constitute a greater part of their "product" mix. Consequently, relationship-centered organizations are climbing a relationship ladder with suppliers (see Exhibit 6).

The most basic form of relationship that a company can have with its suppliers is one in which the company purchases each product or service as an isolated transaction. Interaction with the supplier occurs only to place the order, take delivery of product, and arrange for payment; in an increasingly electronic world, this "interaction" may occur entirely between machines. Moving one rung up from this "transaction" level, companies work with their suppliers to leverage their knowledge and expertise. On this "enhancement" rung, a richer and broader dialogue occurs, including discussion of the company's objectives for the products and services, exploration of alternatives, and often a contractual agreement that formally establishes a relationship that transcends the transaction. This might include, for example, the supplier providing ongoing services to accompany a traditional product offering, in order to help the company achieve the best possible results from the supplier's product.

On the third "investment" rung, employees from the supplier become integrated into the company's operations and work as part of a team, side by side with the company's employees. This could be a temporary project-based arrangement such as a product development effort or improvement initiative or even as part of ongoing operations. At the highest rung, the company turns part of its activities over to a supplier, who takes ownership for the successful execution of those activities. These could be mundane back-office transactions such as payroll or entire business functions such as manufacturing or customer care. At this level of "ownership," companies are focusing on what they do best and are accessing all other capabilities through their suppliers. In these relationships, the supplier is given the greatest amount of latitude in terms of how the activities are conducted. Success requires not only the "soft" side of the relationship (i.e., trust and confidence) to be solid, but also the harder side: governance mechanisms that institute strong accountability by measuring and rewarding successful business outcomes. In the extreme, suppliers will in turn become solutions providers. It is important to note that a company will not have the same relationship with each of its suppliers and would therefore be likely to operate at several of the rungs simultaneously. Indeed, we observed that most firms maintain a portfolio of relationships that are on various rungs of the ladder. Firms may even operate simultaneously on multiple rungs with a given supplier for sourcing different commodities or services.[11]

Our survey highlighted the universal importance of close supplier relationships among our respondents (see Exhibit 7). A large percentage—88% of the total respondents—expected increasing info sharing with suppliers, and the vast majority—92%—was experiencing a tightening of computer network linkages with suppliers, more supplier input into development, and more

**EXHIBIT 7.** Trends in Supplier Relationships, All Respondents




involvement in suppliers' operations (as indicated by a response of five or greater on a seven-point scale on our survey questions). All of these specific behaviors point to a more intimate relationship with suppliers where product specifications and cost drivers are increasingly shared. As companies pinpoint where on the value chain they want to play and shed non-core operations, their relationships with suppliers become increasingly vital, especially where critical components and complementary offerings are concerned. Winning suppliers have also recognized this need among their important customers and have tried to work hard to climb this ladder with their customers. Not only have they learned to develop close communication channels and dedicated client teams, but in some instances have collocated staff on customer sites to simplify the coordination of tasks.

One of the ways to strengthen supplier relationships, and to move them from the lowest "transaction" level to one or more rungs farther up the ladder, is to develop and nurture trust between the company and its suppliers. Indeed, successful companies recognize the power of trust in all their business relationships, and they expend tremendous energy developing ways to institutionalize that trust in their procurement process in particular.[12] Developing this level of trust is not easy, but relationship-centered organizations are finding ways to breach traditional organizational boundaries and outsource activities closer and closer to the core. Sustained Performers among our survey respondents try to build long-term relationships with their suppliers. Our survey shows that while overall 59% of respondents anticipated an increase in the longevity of supplier relationships, the difference was stark between Sustained Performers and bottom-quartile companies in our survey: 75% of Sustained Performers intended

to increase the duration and strength of supplier relationships, while only 55% of bottom-quartile companies intended to do so. We have observed again and again that leveraging relational capital with one's suppliers requires true collaboration, a working strategic partnership that transcends traditional product and service transactions as both organizations search for mutual value.

When it works, outsourcing operations to suppliers offers compelling strategic and economic benefits. It results in lower costs, greater flexibility, enhanced expertise and discipline, and the freedom to focus on core business capabilities. At first confined to non-strategic business activities such as cleaning, transport, and payroll, outsourcing is now encompassing even such functions as manufacturing. Not surprisingly, top-quartile companies often lead by example. In their own dealings with customers, they model the sort of supplier behavior that they have come to expect.

Sometimes the value in partnerships with suppliers is measured by both entities not by short-term individual gains but by long-term joint gains. Starbucks, for instance, has a great deal of brand equity invested in its reputation as a company focused on positively contributing to the economic, environmental, and social conditions in the Third World countries where its coffee originates. It works with Conservation International to develop environmentally sound sourcing guidelines designed to foster sustainable coffee farms. Moreover, it works with Fair Trade to help coffee growers form cooperatives and negotiate directly with coffee importers, who are also encouraged to foster long-term relationships with growers and to furnish financial credit. Starbucks pays Fair Trade prices for its Arabica beans regardless of market prices, which quite often fall below subsistence level. In fact, in October 2001 the company announced its intention to buy one million pounds of Fair Trade Certified coffee within the next eighteen months, a real commitment to improving the plight of coffee farmers who have sometimes seen the market price for their coffee drop as a result of oversupply.

The benefits of leveraging relationship capital with one's supply base are manifold. In successful partnerships, both firms gain as they move up their industry's value chain together. Value is not reapportioned; rather it is created and shared. The sharing is often the thorniest part. First of all, how do you fairly measure gains (from a total cost/benefit perspective) and divvy them up so that both parties see a return on their investment so that 2+2= 5, instead of 2+2=3? Relationship-centered organizations have wrestled with this central challenge longer than most and have developed best practices that help them establish win/win relationships with their suppliers. Ultimately, some form of "open book" arrangements combined with joint mutual dependence in which both parties need each other may furnish the transparency necessary to ensure true gain sharing.[13] Building the trust that facilitates that sort of arrangement is not a "feel good" exercise; it is a business imperative.

Starbucks has developed very clear standards and a rigorous process for selecting and maintaining its supply relationships with a wide range of vendors from the farmers who grow its beans to the manufacturer of its cups. Specific criteria, robust training programs, regularly scheduled business reviews, and a

high degree of information exchange all distinguish and guide the procurement process. Starbucks takes a holistic approach, engaging representatives from not only its purchasing operations, but also its technical product development, category management, and even its business unit operations teams to understand—from an entire supply chain perspective—how a supply relationship will ultimately impact operations. Buck Hendrix, VP of Purchasing, says, "We are looking for, first and foremost, quality; service is #2 on our priority list; and cost is #3. Not that we want to pay more than we should, because we negotiate very hard, but we are not willing to compromise quality or service in order to get a lower price."

Once a supplier is selected, Starbucks works diligently to establish a mutually beneficial working relationship. If the relationship is strategic, senior management from both companies will meet face-to-face three or four times the first year and then semi-annually afterward. "Our biggest focus in these sessions is how to team with our suppliers," notes Hendrix. "We want to create a two-way dialogue as opposed to dictating the conversation." Discussions encompass not only Starbucks' expectations, but supplier concerns and suggestions about how to improve the productivity and profitability of the relationship.

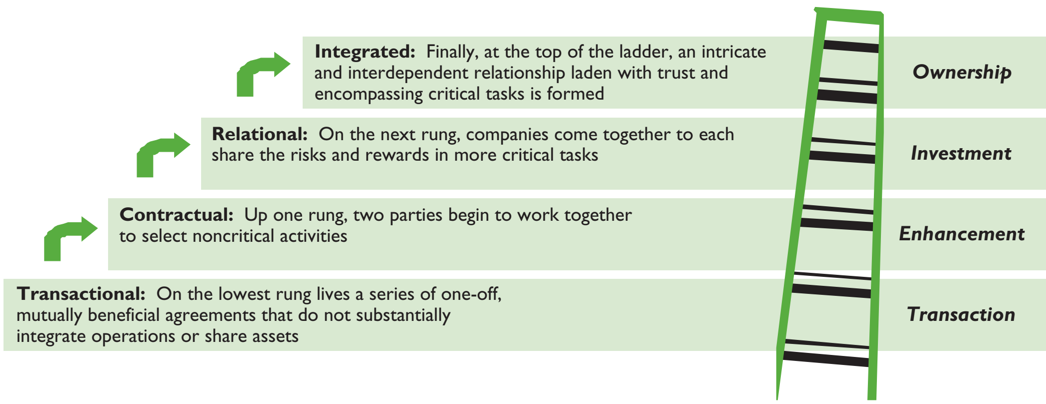
According to John Yamin, VP of Food, "We won't go into partnerships where the vendor won't make money or grow with us." Michelle Gass, VP of Beverages, adds, "Our vendors are willing to do what it takes to stay with us. I am amazed by the flexibility of our vendors, which is driven by our partnerships with them." For example, Solo, Starbucks' cup manufacturer, bought a company in Japan and a manufacturing facility in the UK so they could supply the coffee retailer's operations there. In return, Starbucks has committed to a long-term global supply agreement with the disposable products company. It's this sort of give-and-take that characterizes top-quartile supply relationships.

### *Third Dimension of Relational Capital: Alliances*

The vast majority of the firms we surveyed universally placed a high magnitude of importance in entering and carefully managing their strategic alliances. For example, seventy percent of firms were experiencing increasing linkages to their partners and furthermore, partners were increasing their input into the development of products and/or services in sixty-three percent of the companies.

Increasingly, successful companies focus on what they do best and "alliance" the rest. Thus, as firms "expand the periphery" of their value proposition to customers, they increasingly rely upon not just their vertical connections with their suppliers but also greater connections with their alliance partners who may offer complementary offerings to their own to fill the gaps in their product or service offerings that may constitute an important part of their efforts to offer solutions. These partnerships can be not only with horizontal and vertical members of the value chain, but also diagonal when partners from disparate industries come together to tackle new opportunities. Our survey findings indicate that while 59% of bottom-quartile firms expect to increase involvement of

**EXHIBIT 8.** Alliance Relationship Ladder




alliance partners in product development, fully 75% of Sustained Performers plan such an increase. As they expand their network of alliances in this way, they move up a relationship ladder that parallels the customer and supplier ladders (see Exhibit 8). This ladder begins with one-off, mutually convenient agreements that are often sparked by a specific need or opportunity, but never evolve into anything greater. These "transactional" relationships are often quite simple and may not even involve any financial terms. The Maytag repairman who appears in a car commercial and talks about reliability can help build both brands—but the shared environment is unlikely to evolve into anything deeper between the two companies. At the next higher level, firms evolve towards creating what we call "contractual partnerships" in which firms agree to coordinate select activities that are typically non-critical with each other and stay close to narrowly specified contracts for those select activities. These "enhanced" partnerships can take many forms, such as distributing one company's product through the other's channel.

At the third rung of the ladder, the relationship shifts from simply coordinating tasks to active cooperation in which the partners begin to rely upon each other for more critical tasks and the underlying dynamic shifts from mere coordination to active cooperation between the partners. At the top of the ladder, at what we call the "trusted partner" stage, true partnerships form and are sustained, where each company shares resources with one another toward a purpose neither company could achieve without the other.

As firms advance on this journey, they not only climb this ladder with specific partners, but they also begin to create an intricate and interdependent web of entities that deftly collaborate, with each entity possessing a shared stake in the success of others and the combined whole. Entire industries may form such groups of relationships that compete against each other (e.g., in the airline industry we now see competition between Star Alliance and OneWorld and

SkyTeam).[14] As with both the customer and supplier ladders, many companies will operate at multiple points on the ladder, forming different strengths of alliances for different purposes.

Not only are successful firms demonstrating greater propensities to enter into alliances, the ties they are binding are qualitatively different. They are more strategic, deeper, and anything but conventional. Once again, it's all about leveraging relational capital. Successful firms recognize that alliances enable them to do more with less. As they expand their periphery, they need not do it all themselves and can instead leverage their partners' resource base much more broadly and effectively. As a result, they are becoming more creative in identifying alliance opportunities and potential partners with whom they can collectively serve certain target markets. The result is a web of business relationships populated with shifting alliances that relate to one another in new ways.

Alliances typically revolve around four distinct categories of partners that transcend horizontal and vertical boundaries: the channel, the licensee, the complementer, and (increasingly) the competitor. The implications of this expanded alliance building are profound in terms of organizational structure and behavior. The whole notion of "in-house" becomes suspended as companies contend with organizational boundaries that are newly fluid, transparent, and semi-permeable. Web-based collaboration tools have accelerated this "boundarylessness" and enhanced the channels of communication between partners.[15] Among the firms that responded to our survey, sixty-eight percent of firms are experiencing increasing links to their partners via computer networks, and sixty-three percent are experiencing greater input from partners in the development of products and services. With the availability of new communication tools, alliance partners around the world can inexpensively share product specifications, opportunity alerts, blueprints, sales figures, and expertise—all with the click of a mouse. The sharing of this knowledge, in turn, accelerates value creation.

Companies in this new context rely on external partners more and more, not only for cost reasons or to handle peripheral, narrowly circumscribed activities as in the past, but for strategic purposes, such as accessing new capabilities, improving quality, or sharing risk. New and powerful cooperatives are emerging, composed of multiple communities operating in a highly interdependent network and armed with a collective sense of purpose. At the extreme, we are witnessing unprecedented levels of cooperation between direct competitors, a phenomenon dubbed "co-opetition" by some observers.

While firms are exhibiting more enthusiasm towards alliances, there naturally remain hurdles to success. Like supplier relationships, governance and gain sharing are two of the enduring challenges companies must address. In a world where the boundaries within and among firms are collapsing and your business is everyone's business, defining the "rules of engagement" in alliances becomes a tricky issue. Previously guarded business processes are now open—either partially or entirely—to outside partners. Controls, operating protocols, and information technology standards must now be agreed upon and embedded

in the processes of all participants to create the electronically linked, real-time information-sharing network needed to ensure success. Leadership and accountability need to be clearly defined in this space; otherwise, multiple points of contact overwhelm the efficient functioning of the alliance. Partners need to fully understand their respective roles and responsibilities.[16]

For all these reasons and more, several studies suggest that up to 60 to 70 percent of alliances ultimately fail. Those are odds most executives are not inclined to play. However, within those discouraging odds, some companies are struggling with an abysmal track record, while other companies are hitting 90 percent of their alliances out of the park. For companies who discover and hone the right success formula, the alliance game becomes one of increasing the odds rather than simply playing the averages. That success formula is commonsensical and yet eludes many firms. It consists of careful selection, jointly articulated expectations, management flexibility, and performance incentives designed to secure a win/win outcome.[17]

Over the years, Starbucks coffee has been served to millions of United, Horizon, and Canadian Airlines flyers as well as to Marriott, Sheraton, Westin, and Hyatt hotel guests through carefully constructed licensing agreements. Compass cafeterias, Barnes and Noble bookstores, HMS Host airports, and Safeway grocery stores all sell Starbucks coffee by the cup as *licensees*. The company has also extended its product line in logical directions through *complementer* alliances and joint ventures. Its highly successful bottled Frappucino beverage is marketed, manufactured, and distributed through a 50/50 joint venture agreement with Pepsi. Its ice cream—the #1 brand of coffee-flavored ice cream—is made and distributed by Dreyer's, and the packaged whole-bean and ground coffees you see in supermarkets are marketed and distributed by one of Starbucks' arch *competitors* in the at-home coffee consumption arena, Kraft. In stark contrast to its domestic retail stores, which are all company-owned, Starbucks has expanded internationally through joint venture agreements with well-established local players. Today, they have expanded aggressively in disparate markets outside North America sporting the Starbucks name and logo.

Not all of Starbucks' alliances have been so successful. Its early attempts with Pepsi to produce a coffee-flavored carbonated beverage called Mazagran flopped. Attempts to diversify beyond coffee-flavored ice creams to other flavors did not prove fruitful, and some of its more ambitious food-oriented ventures such as the Café Starbucks and Circadia restaurant concepts proved less than successful. Moreover, highly publicized plans to create a Starbucks destination/affinity portal on the Web with all sorts of lifestyle links came to naught. However, in each of these well-calculated risks was embedded a tremendously valuable lesson. The same joint venture that launched Mazagran produced Frappucino, a fabulously successful incremental revenue stream for Starbucks. The experiments with non coffee-flavored ice cream and full-service restaurant concepts helped Starbucks establish parameters on where its brand makes sense to consumers. While the Internet portal never came to pass, Starbucks used what it learned to design a wireless high-speed access network for its stores.

Maintaining these business alliances is, even at the best of times, a challenge, and Starbucks' approach has steadily evolved as its experience grows. According to Gregg Johnson, VP of Business Alliances, "Originally business alliances were intended to bring the Starbucks experience to places where retail could not go…a fairly simple mission with a number of complex components. First, the alliances we build need to be profitable for both partners. Second, they need to be designed around delivering the experience, whether it's through a consumer product (e.g., packaged coffee) or on a United flight. If we are not confident that we can do that, we don't go to the next place. (United, for example, had to replace the coffee-making equipment on all of its planes to meet Starbucks' exacting quality standards.) Third, it has to be a place where the consumer expects to find us. Yes, people expect to find Starbucks in Hyatt hotels, but not at Motel 6 at this point. But what we see is a very natural expansion of those boundaries year after year as consumers become more comfortable associating Starbucks with places and products they did not a few years back."

In developing solutions for its customers, Teradata frequently finds that it does not possess nor desires to possess all the missing links that may be critical for a solution that a distinct industry segment may require. In such instances, it seeks out alliance partners who often provide key components of the solution as well. Some of its alliance partners include firms such as Siebel, SAS, Cognos, Fair Isaac, and Tibco. The offerings obtained from its partners can vary and include elements such as specific consulting services, specialized tools, or applications. Successful partnering is critical to its aggressive growth plans. As a result, even when there is conflict with its partners, they try to retain focus on the bigger picture. Sometimes that takes sacrificing something for the greater good.

With the passage of the Sarbanes-Oxley Act, most companies have quickly learned that changing accounting processes alone will not address these areas sufficiently and that the timely availability of financial information on an ongoing basis across the enterprise is critical. For this enterprises are turning to technology to make their financial information readily available, auditable, and analyzable. Teradata saw this opportunity but also realized that they did not have all the key applications to serve this market in an effective manner. They teamed up with Hyperion, a leading provider of financial applications, to provide their customers greater insight into financial performance. The agreement will allow businesses using a Teradata data warehouse and analytical solutions to link to Hyperion's Essbase XTD platform and applications. The partnership focused on two keys deliverables: drive core technology integration and optimization, and developing products that enable customers to analyze their business results easier and faster. Since 2000, the companies worked together to integrate their respective products by building a Teradata Analytic Accelerator: a set of pre-built analytics and reports centered on a subject area such as General Ledger or Accounts Receivable. The objective of an Accelerator is to get analytics up faster and at less cost than by building analytic applications in the traditional way. A Financial Analyst can look at business results easily via graphs and reports at the summary level using information from the Teradata Enterprise

Data Warehouse. Implementing an Accelerator can shorten the normal development and deployment of an analytic application by up to two months. The two companies have also worked closely in defining how they will support their joint customers in a coordinated manner. The support strategy involves having experts from both companies address customer issues through a single point of contact in a coordinated manner. A customer contacts Hyperion for initial support for technical questions about the Accelerator. If these questions relate to certain specific technical aspects of the solution, an escalation process defines how they pass to Teradata's support organization.

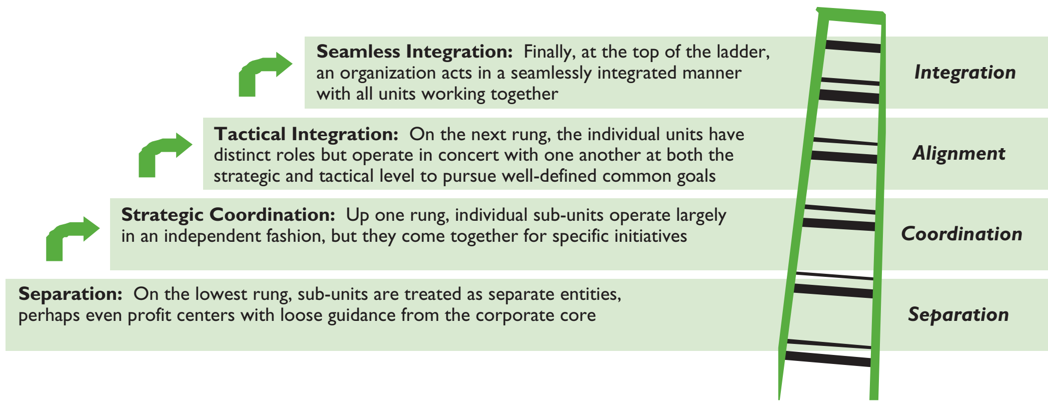
In some instances, it is a customer that forces two firms to work together. One such alliance is Teradata's partnership with Siebel systems to align their suite of applications and make them compatible with Teradata's data warehouse. Both shared a customer—DirectTV, who urged them to work together to make life easier for their customers. As a result of these joint efforts, Siebel provides the analytic tools and related consulting while Teradata provides the data-oriented expertise and consulting.

### *Fourth Dimension of Relational Capital: Internal Units*

Relationship-centered organizations that succeed in the marketplace typically follow the same relational instincts with their own business units and discover the relational capital that is in their very own backyards. This form of capital results from promoting greater collaboration among the firm's own internal business units, which in turn can lead to significant external benefits. Firms must not only create a seamless connection with their external suppliers and alliance partners, but also with their internal business units, which need to come together in a harmonious fashion to offer customers an integrated experience. Hence a similar ladder of increasing responsibility and commitment can be applied to internal relationships at high-performing companies (see Exhibit 9).[18] In the weakest internal relationships, organizational sub-units are treated as separate entities, perhaps even as independent profit centers. There is little interaction among them, with limited sharing of intellectual or human capital. The relationship between the business units and the corporate core is more akin to that of a holding company. At the second rung the organizations operate in a largely independent fashion, but they come together for specific strategic initiatives, where focused pooling of capital and other resources is drawn from to drive to a single corporate objective.

On the third rung, business units are integrated, working towards a common corporate goal. They may have the power to independently define how they reach that goal and are often left by senior management to meet their targets using their own devices. However, they are communally accountable for corporate success; they share capital, infrastructure, and talent across organizational boundaries; and they communicate on a regular basis. The final rung represents a wholly integrated company with "no walls." Information, capital, and talent flow freely across organizational boundaries, if any still exist. While the first two stages afford some basic levels of coordination, the higher levels

**EXHIBIT 9.** Organizational Sub-Unit Relationship Ladder




demonstrate greater levels of active cooperation.[19] The intensity of interaction increases, as does the interweaving of operations and outcomes across the units. None of this comes easy, and several executives we interviewed hinted at the fact that sometimes cooperation with internal business units can be harder than with external partners.

Different levels of the ladder are appropriate for different companies at different stages of their lifecycle and based on their specific strategic goals. Furthermore, the level of interaction may vary among the different business units of a single firm as well as depend on the nature of underlying synergy among their respective operations. Regardless of the level of the ladder, the relationship-centered organizations in our study perform better than do fourth-quartile companies. Business units in high-performing firms communicate more with each other than in low-performing firms (58% vs. 36%) and best practices are deployed with greater frequency across groups/locations (83% vs. 55%—as indicated by a response of five or greater on a seven-point scale). This elevated level of effective communication and coordination fosters accelerated innovation.

One instance of a firm that has successfully invested in enhancing internal collaboration and benefited from it is Jones Lang LaSalle (JLL). In 2001, JLL was one of the largest commercial real estate services companies in the world. The product of a 1999 merger of London-based Jones Lang Wootton and Chicago-based LaSalle Partners, JLL was a global company with more than 680 million square feet of property and more than $20 billion in real estate funds under management in the United States, Europe, and Asia. The previous few years had been financially difficult for JLL. By early 2001, the company's stock price warranted a market capitalization less than the valuation of either of the two original firms. In addition to the lackluster stock performance, the economic downturn in the United States was further depressing sales. Senior management

realized that change was needed to halt the slide in margins and to boost revenue.

In the marketplace, corporate clients were beginning to demand more from their real estate service providers. On the one hand, increasing globalization combined with heightened concerns about fees meant that the real estate marketplace was increasingly commoditized. On the other hand, many companies were no longer satisfied with just being sold a product or service; they wanted a complete solution for their real estate needs. Some of JLL's largest customers—especially the prized global multinationals—sought more integrated services across the globe as an increasing number sought to outsource their entire real estate operations.

Meeting such diverse requests strained JLL's historically independent business units, which offered disparate real estate services and operated autonomously. The company's management realized that significant changes to their traditionally silo-based organization were needed in order to successfully compete on price and integrate their services. Consequently, in 2001 JLL's Americas region underwent a dramatic reorganization, dividing its nine business units into two groups—Corporate Solutions and Investor Services—according to the types of clients they served. Along with bringing its disparate services targeted to large multinational clients under the one roof of corporate solutions, senior management created a new account manager function to better provide JLL's clients with full-service integrated solutions. By establishing a single point-of-contact for JLL's largest clients along with shared accountability, senior management hoped to provide flexible and scaleable resources for clients enabling them to draw on the resources of JLL. In establishing this new organizational arrangement, however, JLL had to tackle several critical internal issues. Most of these revolved around getting the internal business units to collaborate with each other and with the integrating unit that worked with the customers directly. Results so far have been excellent and are a testimony to the efforts put into building a more collaborative internal environment.

In their efforts to differentiate themselves from their competition by providing customers with integrated solutions, Teradata has recognized the importance of aligning their internal business units to create a seamless experience for the customer. To harmonize their internal efforts, they have shifted most of their resources, including technical specialists and industry specialists, into their sales organization. Further, they have devised what management calls a 3-legged stool. The first leg of the stool is the sales account manager who owns the relationship with the customer organization and remains the point person for that firm throughout their interaction with Teradata. The second leg of the stool is the architectural technology specialist who helps specify the customers needs and decides which components of Teradata's offering may make sense for that customer. The third leg is an industry specialist (who also typically resides within the sales organization). This person helps define the industry specific applications that would allow Teradata to customize the solution for the customer. While the sales account manager is the key point person, she or he works

closely with the other two legs of the stool to ensure that the customer has a seamless experience. Along with incentive alignment to ensure that these disparate individuals work closely with customers, the customer-oriented culture is also key. As Bob Fair, Chief Marketing Office at Teradata, suggests, "The glue here is the culture. . . . Since we are trying to embark on a lifelong journey with our customers, we know clearly that the customer is critical and that we all need to work together to help solve the customers problems."

## Combining the Four Dimensions of Relational Capital

To achieve a shrinking core and expanding periphery, successful organizations recognize the mutually reinforcing nature of activities on each of the four dimensions of the relational architecture. Hence, collaboration with customers to offer them solutions necessitates close collaboration with alliance partners, with suppliers, and among internal business units. As a result, what is noteworthy about the relationships built by exemplary firms is their breadth and degree of integration. Winning organizations have moved beyond a single-minded focus on perhaps one or two facets of individual customer, supplier, or alliance relationships and are now developing a more holistic and multidimensional view of their entire network of relationships, one that takes into account the other relationships the firm may have on different dimensions that can create new opportunities for leverage and economies of scale. More and more, these companies' perspectives encompass a broader universe of involved and interacting players who move into and out of the organization with an unprecedented degree of freedom and flexibility.

In this new model, critical relationships along these three external dimensions—customer, supplier, and alliance partner—are no longer distinct and separate from the organization but rather interconnected and synergistic. In developing a total solution for a customer, for example, a relationship-centered organization will readily draw on such resources as complementary capabilities of its alliance partners or its network of key suppliers. Recognizing that its internal sub-units and the employees within them are its ambassadors to customers, a relationship-centered organization will focus on optimizing the former to serve the latter. Top performers build multi-faceted relationships that are interdependent and thus more than "the sum of the parts." Therein lies the difference.

## Conclusion

This study sheds light on the particular strategies that top-performing relationship-centered organizations utilize to achieve superior performance by optimizing the architecture of their network of relationships. Our survey indicates that in each of four key relationships—customers, suppliers, alliance partners, and internal business units—what clearly sets sustained performers apart from their peers is a higher willingness to engage these entities and a greater focus on increasing the longevity of the relationships. Our research suggests that

the relational capital unleashed through collaboration not only improves operating performance, but its vehicles—be they solutions, strategic outsourcing agreements, alliances, or acquisitions—help companies leverage assets more effectively, expand into new markets, mitigate risk, and increase market agility. Together, these efforts shape their success by shrinking their core and expanding their periphery to achieve market success.

No one relationship suffices to bring success in today's top competitive environment. Instead, it is a *combination* of distinct and critical relationships and the way they interact across a seamless and transparent organization as a *network* that leads to competitive advantage and value creation. Ultimately, companies want to build operating models that enable customer orders to automatically trigger supplier orders or that appropriately leverage employees as the conduit to the customer. Think of the Starbucks barista or the Harley Davidson dealer or the Jones Lang LaSalle account manager and you have a compelling image of the powerful circle of relationships that winning organizations create and foster. Organizations today are all too often the impediment to their own long-term success when they create barriers rather then facilitate communication and coordination. The relationship-centered organization is, in contrast, moving towards becoming a friction-free facilitator.

Where the emphasis in recent years has typically been on a single dimension—such as outsourcing agreements with suppliers, joint ventures with alliance partners, vision and values exercises with employees to align goals of internal sub-units and achieve greater synergy, CRM tools for aligning with customers—now top performing organizations are operating on all dimensions at once to build a coherent and enduring whole that is greater than the sum of its parts. While the attributes and behaviors of the relationship-centered organization are by no means a guarantee of success, they do tend to differentiate the winners in many industries from the rest of the field. Just as companies manage, monitor, and measure their financial capital, so should they actively manage, monitor, and measure their relational capital. Relationships are a mission-critical asset, and should be treated as such. Relationship-centered organizations recognize this reality and organize in such a way to reflect it.

## Notes

1. Researchers have described related ideas as "network resources" to refer to those resources that become available to firms through their interorganizational relationships. While the focus of such prior research has primarily been on the benefits that accrue to firms through their alliances, our usage of the term relational capital is broader and encompasses connections with suppliers, customers, and between internal business units as well. For a more detailed account of network resources, see R. Gulati, "Network Location and Learning: The Influence of Network Resources and Firm Capabilities on Alliance Formation," *Strategic Management Journal*, 20/5 (May 1999): 397-420.
2. Based on five-year total return to investors from 1995-2000 and 1997-2002 of *Fortune 1000* companies. Includes both price appreciation and dividend yield on stock.
3. Details of the methodology used for the survey and field interviews along with a list of select questions that were asked in the survey are available from the authors upon request. All survey questions were asked on a scale of one to seven.

4. For a detailed account of how Starbucks manages its relationships, see R. Gulati, S. Huffman, and G. Neilson, "The Barista Principle: Starbucks and the Rise of Relational Capital," *Strategy+Business* (Third Quarter 2002), pp. 1-12.
5. A number of scholars have directed attention to the growing customer demands in the last decade, and these include G.S. Day, *The Market Driven Organizations: Understanding, Attracting and Keeping Valuable Customers* (New York, NY: Free Press, 1999); N. Kumar, *Marketing as Strategy* (Boston, MA: Harvard Business School Press, 2003); M. Hammer, *The Agenda: What Every Business Must Do To Dominate the Decade,* 1st edition (New York, NY: Crown Business, 2001).
6. For a complete account of the growing challenges of commoditization and growth, see R. Gulati, "How CEOs Manage Growth Agendas: A Commentary," *Harvard Business Review,* 82/7-8 (July/August 2004): 124-126
7. Some recent articles that elaborate on the theme of customer solutions include N. Foote, J. Galbraith, Q. Hope, and D. Miller, "Making Solutions the Answer," *McKinsey Quarterly,* 3 (2001): 84-93; D. Sharma, C. Lucier, and R. Molloy, "From Solutions to Symbiosis: Blending with Your Customers," *Strategy+Business,* (Second Quarter 2002).
8. The theme of customer relationships and how to create, maintain, and sustain them remains an important one for both marketing and strategy. A recent study of some of the challenges associated with such efforts and a description of that journey can be found in R. Gulati and J. Oldroyd, "The Quest for Customer Focus," *Harvard Business Review* (April 2005).
9. For a recent book that describes such a co-creation of products in collaboration with customers, see C.K. Prahalad and V. Ramaswamy, *The Future of Competition: Co-Creating Unique Value with Customers* (Boston, MA: Harvard Business School Press, 2004).
10. Some researchers have suggested the importance of relationships on another vertical dimension, channel partners. One instance of this rich body of research is N. Kumar, L.K. Scheer, and J.-B.E.M. Steenkamp, "The Effects of Perceived Interdependence on Dealer Attitudes," *Journal of Marketing Research,* 32/3 (August 1995): 348-356.
11. For a detailed account of one such instance of close collaborations that Toyota has set up with its suppliers, see J.H. Dyer, *Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks* (Oxford: Oxford University Press, 2000).
12. In a comprehensive empirical study, Zaheer et al. showed that interorganizational trust mitigates the frequency of interorganizational conflict and enhances performance of buyer-supplier relationships. A. Zaheer, B. McKevily and V. Perrone, "Does Trust Matter? Exploring the Effects of Interorganizational Trust on Performance," *Organization Science,* 9/2 (March/April 1998), 123-141. In another paper, Gulati and Sytch have highlighted the multiple mechanisms through which interorganizational trust emerges from the history of interaction between firms and from the history of interaction between their boundary spanning agents, R. Gulati and M. Sytch, "Does Familiarity Breed Trust? Revisiting the Antecedents of Trust," *Managerial and Decision Economics* (forthcoming 2005). For a recent account of the factors that can engender such positive interaction between suppliers and buyers, see R. Gulati and M. Sytch, "Exploring the Effects of Organizational Interdependence on Performance: The Role of Power and Embeddedness," working paper, 2005.
13. Gulati and Sytch show that joint dependence of business partners in a relationship (the sum of firms' dependencies on each other in a business relationship) greatly enhanced the performance of the relationship by fostering higher levels of joint action, trust, and accurate information exchange. Gulati and Sytch (2005) working paper], op. cit.
14. Some of the following studies have provided a vivid account of the growth of such constellations of firms: N. Nohria and C. Garcia-Pont, "Global Strategic Linkages and Industry Structure," *Strategic Management Journal,* 12/4 (Summer 1991): 105-124; R. Gulati, "Alliances and Networks," *Strategic Management Journal,* 19 (April 1998): 293-317; B. Gomes-Casseres, *The Alliance Revolution: The New Shape of Business Rivalry* (Cambridge, MA: Harvard University Press, 1996).
15. Jack Welch uses this term to describe his goals to open GE up to similar external constituents. J. Welch and J.A. Byrne, *Jack: Straight From the Gut* (New York, NY: Warner Books, 2001).
16. For a recent account of how firms may develop capabilities to enhance their alliance management skills, see J.H. Dyer, P. Kale, and H. Singh, "How To Make Strategic Alliances Work," *Sloan Management Review,* 42/4, (Summer 2001): 37-43. For a discussion of governance and coordination challenges, see R. Gulati, P. Lawrence, and P. Puranam, "Adaptation

in Vertical Relationships: Beyond Incentive Conflict," *Strategic Management Journal,* (forthcoming 2005).

17. For a more detailed account of how firms can deepen their connection with key alliance partners, see Y. Doz and G. Hamel, *Alliance Advantage: The Art of Creating Value Through Partnering,* (Boston, MA: Harvard Business School Press, 1998); J.H. Dyer and H. Singh, "The Relational View: Cooperative Strategy and Sources of Interorganizational Competitive Advantage," *Academy of Management Review,* 23/4 (1998): 660-680.
18. Some recent accounts of the coordination challenges posed by internal units are described in M.T. Hansen and B.V. Oetinger, "Introducing T-Shaped Managers: Knowledge Management's Next Generation," *Harvard Business Review,* 79/3 (March 2001): 106-116. See also M.T. Hansen and N. Nohria, "How to Build Collaborative Advantage," *Sloan Management Review,* 46/1 (Fall 2004): 22-30.
19. For a more elaborate discussion of the distinction between cooperation and coordination, see the following: R. Gulati and H. Singh, "The Architecture of Cooperation: Managing Coordination Costs and Appropriation Concerns in Strategic Alliances," *Administrative Science Quarterly* 43 (1998): 781-814; R. Gulati, P. Lawrence, and P. Puranam "Adaptation in Vertical Relationships: Beyond Incentive Conflict," *Strategic Management Journal* (forthcoming 2005).