

## **Selecting Relationship Type in Facility Services**

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# SELECTING RELATIONSHIP TYPE IN FACILITY SERVICES

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## Abstract

The expansion of existing outsource contracts and the outsourcing of the strategically more important services have created the need to develop relationships based on a more collaborative approach. Since collaborative relations do not work in every situation, there is the need to develop an understanding of the different relationship types. The aim of this paper is to identify the factors that influence the choice of relationship type and the factors that distinguish collaborative relations from adversarial relations. The research is qualitative, based on thematic interviews, informal discussions and focus group interviews. Empirical findings are compared to and linked with the findings in the literature. The results indicate that transaction cost economics could be used to support decisions related to the selection of relationship type in facility services. When selecting a partner for a collaborative relationship, the perceived potential for long-term improvement as a result of joint learning processes is more important than the immediate financial benefits. In an adversarial approach, the most important criterion for selecting the service provider is often price.

**Keywords:** facility services; inter-organisational relationships; sourcing strategy; transaction cost economics

## INTRODUCTION

Growing competition has increased the amount of attention being paid to client satisfaction and the reduction of fixed costs in many local markets (Ancarani et al. 2004), including the Finnish property market. Companies need to supplement their core competences by creating alliances with other providers of complementary competences to satisfy their customers. Productivity and quality improvements are not achievable unless the other business providers want to support the joint supply chain effort against other supply chains, and create innovations to the best of their abilities alongside their partner organisation (Macbeth 1994). As a result of these trends, companies have been involved in looking at optimal relationship types related to non-core activities such as facility services.

Facility services can be divided into technical (i.e. building services) and non-technical services. They are mostly intangible services, even though there is usually some production of material included in them. Nevertheless, services can be described by service contracts, and their performance can be measured against key performance indicators (Hinks and McNay 1999, Gilleard and Yat-lung 2004). In contemplating a mix of building services such as technical building maintenance, and non-technical services such as cleaning, ground maintenance, and waste management, it is easy to see the diversity of the tasks involved (see Atkin and Brooks 2000, Ancarani et al. 2004). In his study of facility services Salonen (2004) identified the specific characteristics in the studied case. These may be classified as the duration of the service, the required skills and expertise and the importance of the service to the client and end-users. Most of the facility services are quite simple but there are also some very challenging tasks. Whilst accommodation services such as cleaning do not require high levels of expertise, services such as statutory equipment testing and the maintenance of major appliances do (Atkin and Brooks 2000).

In Finland, companies began a downsizing transition during the 1980's. More and more operational functions, such as cleaning and real estate maintenance, were outsourced. This phenomenon was accelerated by the economic depression in the early 1990's, when the amount of outsourcing was increased and also management functions were often outsourced. At first, many companies focused on price as the most important factor in purchasing. This, in turn, resulted in adversarial relations with their suppliers. As existing outsource contracts were expanded and strategically more important services were outsourced, it was realised that relationships based on a more collaborative setting were also needed (Incognito 2002). Currently, problems exist in describing the optimal type of relationship and defining the different factors that influence the choice of relationship arrangement under certain purchasing situations.

As Gadde and Snehota (2000) state, some relationships with suppliers are important because of the volume of business they represent, others because they affect the future of the company in that they are sources of technical development and important for product or service quality and performance. The impact of a specific supplier relationship depends on how it fits into the operations and strategy of the buying company and how other customer and supplier relationships are affected by it. This means that the role and value of a particular relationship cannot be assessed based on its product or service content only.

The extent of relational co-operation varies widely, while the profusion of terms describing relational approaches can often confuse the uninitiated. Often, so-called relationships can account for a range of relationship types, such as strategic partnering and arm's length co-operation. Clearly, not all relationships are the same, and there may be risks in treating them as if they were (Bensaou 1999, Möller and Halinen 1999, O'Toole and Donaldson 2000). This is in line with Miettinen et al. (2004) who suggest in their research that in facility services the term partnering is used rather loosely and to refer to a variety of different relationship types.

This study deals with the choice of relationship type. The focus is on the relationship between the client and the facility service provider. Clients are defined in the study as the property owners or managers, and the service providers are the companies that provide facility services. The objective of the study is to identify the factors that influence the choice of relationship type, and the factors that differentiate collaborative relations from adversarial relations. The research questions in this paper are defined as follows:

1. What are the factors that influence the choice of relationship type?
2. What are the differences between adversarial and collaborative relationships?

In answering these questions the aim is to help the participating companies to develop their business in the future. The answers will also point to guidelines for future research.

## **RESEARCH METHOD**

Most of the literature in the area of purchasing and supply management has traditionally concentrated on the purchasing of goods. Various researchers have pointed out that organisational buyers view the purchasing of services as being essentially different from the purchasing of goods (Jackson et al. 1995, Grönroos 2000). It has also been recognised that the manner of purchasing of certain services varies between different types of services. Further earlier studies on the purchasing of facility services were limited; it was clearly necessary to seek a deeper understanding of the subject under exploration through an empirical study. The aim of the empirical study was to provide deeper insight into the evaluation of relationship types as a part of sourcing strategy formulation and relationship management, and to fill in the gaps between theory and practice. The empirical findings are compared to and linked with the literature.

This paper reports on the results of two different research projects. The first project studied sourcing strategies in facility services. In the second project, the quality and type of relationship between clients and service providers were studied. Using the data from two independent research projects made it possible to view relationship types from two different perspectives, which increases the reliability of the results (see Voss et al. 2002).

The data in the two projects was collected using thematic interviews, which were conducted at the interface of a service provider and a client. These interviews with different themes were comprised of questions concerning the elements of sourcing strategies and the type of relationship between these two interest groups. The interviews were recorded and later transcribed. These transcripts were then coded manually

with Atlas.ti ® software to produce the categorization of the data. The categories helped the researchers to structure the research data.

Interviews were conducted in the spring and summer of 2003. All interviews were conducted in Finnish, which was the native language of both the interviewers and the interviewees. Each interview lasted from one to one and a half hours, and altogether 41 higher-level managers (i.e. at the strategic and tactical level of the organisation) from 9 client and 10 service provider companies were interviewed in 37 interviews. The strategic level was chosen because people at this level are assumed to have the best knowledge of the business environment and future trends. The managerial level was chosen because it consists of people who are involved with procurement planning and sourcing decisions, and because it represents people who are responsible for managing a relationship after it is established. All the 19 participating companies are major players in the Finnish property market and they participated in the two projects as corporate research partners. By interviewing these companies, a comprehensive sample of best practices was attained.

According to Woodside and Wilson (2003), multiple sources (i.e. data triangulation) are needed to gain a more comprehensive understanding of the same event. Thus, the primary qualitative data was supplemented with further evidence from secondary sources. These were informal discussions and focus group interviews. Focus group interviews are defined as a research technique that collects data through group interaction on a topic determined by the researcher (Morgan 1997). The focus groups consisted of representatives of clients and service providers and were directed by the researchers in order to outline the practical problems related to the development of sourcing strategies, and to deepen the understanding of the research group of different types of relationships.

## **RESULTS AND DISCUSSION**

In this chapter, the factors that influence the choice of relationship type are first presented, after which the nature of collaborative relations is compared with the nature of adversarial relations. Results are presented in a way, which combines the opinions of interviewees with the literature related to transaction cost economics (TCE).

### **The factors that influence the choice of relationship type**

Since companies are always seeking to economize or reduce costs, the successful sourcing strategies for a company must be those that constantly address the issue of which type of internal or external relationships are most useful for achieving a particular purpose (Cox 1996). Whether a company makes or buys, that is produces for its own needs or procures a service from an outside supplier, turns largely on the transaction costs of managing the transaction in the firm. Where each transaction takes place depends on the attributes of that transaction, on the one hand, and the costs and competence of alternative modes of governance, on the other. Thus, the relevant question in facility service buying is which parts of the key business process under consideration should be acquired externally and which should be provided internally (Ancarani et al. 2004). Such a make or buy decision requires the buying company to carry out a full evaluation of the strategic importance of the service to the company's performance (Kraljic 1983, Blumberg 1998). By assessing strategic importance, facility managers can determine the need to control their own activities and the buying company's position against the characteristics of the supply market.

TCE is used as a theoretical basis in many articles investigating the level of collaboration in buyer-supplier relationships (see Williamson 1985, Heide and John 1988, Reve 1990, Cox 1996). TCE maintains that the key dimensions for describing transactions are asset specificity, uncertainty and frequency. Of the three, asset specificity is the most important and most distinctive (Williamson 1996). Williamson's (1985) analysis combines TCE with governance theory to determine the optimum type of relationship a company should develop depending on the characteristics of investment (i.e. the asset specificities) and the frequency of buying transactions. However, as Blumberg (2001) states, frequency is an obvious dimension in determining the optimum type of relationship, but volume is more appropriate if the meaning of frequency is less clear. The volume of co-operation describes the amount of money that is at stake. Frequency has two dimensions in facility services. The need for facility services is usually continuous and relationships with service providers are based on long-term contracts. While the frequency of purchasing transactions is low, and the frequency of service transactions is a mix of regularly recurrent and one-off service events, the concept of frequency is somewhat unclear.

The strategic importance of the transaction is in relation to its asset specificity (Cox 1996). Asset specificity can take many forms. Williamson (1985) distinguishes four types of asset specificity: (1) site specificity, as where successive stations are located in close proximity to one another so as to economize on inventory and transportation expenses; (2) physical asset specificity that relates to the development of specific equipment and systems tailored to a particular business need; (3) human asset specificity, which arises when workers have developed extensive job-specific knowledge and expertise; and (4) dedicated assets, which are discrete investments made to meet unique specifications or volume of production at the behest of a particular buyer. Later, two other types of assets specificity have been added: (5) brand name capital, which refers to image-enhancing investments, and (6) temporal specificity, which calls for time-critical investments (Williamson 1996).

Highly specific (idiosyncratic) transactions are ones where the assets required for production are extensively specialized (Williamson 1985). A shared database (e.g. computerized management system) between a client and a facility service provider was mentioned as an example of an idiosyncratic investment. According to Anderson and Weitz (1992) the level of idiosyncratic investments is dependent on specific knowledge. Some of the specific investments may be transferable to other relationships, but some of the knowledge is useful for particular relationships. The termination of relationship would be accompanied by a loss of idiosyncratic investments, and this factor may motivate attempts at maintaining long-term relationships. This is in line with Heide and John (1988) who state that a company with more specific assets committed to the relationship is more dependent on the relationship for its success. Underlying the arguments of above, the results indicate that investment-specific knowledge and systems seem to have an influence on structural bonding between a client and a facility service provider.

Under high asset specificity and regarding core competences the contract must be controlled internally by the organisation (Cox 1996). High asset specificity refers to the skills and expertise that are the core competencies of the company in sustaining their ability to make a profit in a market and that are necessary for the company in attaining its strategic goal (see Reve 1990, Hamel and Prahalad 1994). Thus, when activities and capabilities have a critical effect on the performance of the client company (Krumm et al. 1999) or they are nearer to the core competences of the company, the more vertical the integration is likely to be considered and the more the organisation's own control is needed (Reve 1990, Cox 1996). For instance, from a real estate investor's point of view, property management is an important function, because the property management company is responsible for the letting of premises, maintaining the working conditions of building users and the value of properties (c.f. Barrett and Baldry 2003). In this case, collaborative relationship (e.g. partnering) may be chosen. On the other hand, collaborative relationships are challenging governance structures to manage. If parties are able to generate co-ordination mechanisms such as trust, they may be able to create a most efficient solution with a major joint surplus (Blomqvist et al. 2002).

The basic argument is that the higher the specificity of the assets, the greater the mutual dependence of the companies is. Therefore, the costs involved in switching are high (Kock 1991). Switching costs are the costs incurred in changing suppliers. The higher the switching costs are, the greater the specific investment, which each party has made in the relationship, and the greater the tendency to choose a collaborative strategy. Switching costs can result from human as well as physical investments. Standard products will usually have lower switching costs than customised products (Campbell 1985). A high degree of service customisation exists when the service process is adapted to suit the needs of a particular buyer (Silvestro et al. 1992) and a unique service packet is compiled for each buyer. Based on our study, customization seems to be needed in the case of knowledge intensive service tasks that can be utilized only in a particular relationship.

Low asset specificity refers to those skills or areas of expertise that are not the key to the success of the company. Low asset specificities (i.e. non-specific transactions) are activities, which are of standardised types and for which continuity have little value, since both parties can easily arrange new trading relations regarding them (Williamson 1985). This corresponds with Bensaou's (1999) view that each party can turn to the marketplace and shift to another business partner with low switching costs and minimal damage. As low asset specific goods and services represent residual competences, the contract can be based on competitive market criteria (Cox 1996). This is also suggested by Insinga and Werle (2000) who state that non-key activities, which have little value, cannot be sources of competitive advantage, in which case weak relationships are appropriate. Thus, external contracts can be adversarial (see Cox 1996) and partnerships

cannot offer any advantages (see Virolainen 1998). For instance, according to interviewees answering from a property owner's perspective, non-technical service contracts tend to be adversarial because they are not that important in maintaining the value of properties at an appropriate level. This is not the case with technical service contracts.

If there is a lack of critical value regarding the performance of the client, the activities can be provided by multiple providers (Krumm et al. 1999). Having multiple suppliers reduces the client's dependence on one supplier. With multiple suppliers, the client is able to choose more than one supplier for a specific purchase and exercise buying power by allocating and changing the size of an order given to any supplier (Cunningham 1982). The buyer is always in the position of being able to choose alternative sources of supply because there are multiple sources of supply in the market place and relative certainty exists concerning replacement goods and services from alternative suppliers (Cox 1996). On the other hand, according to interviewees, a wide supplier base may be problematic if the client is seeking a collaborative relationship with the supplier. It tends to lead to an adversarial relationship arrangement because buyers that have scarce resources may not have enough time to manage multiple relationships in a collaborative way.

### **Comparison of adversarial and collaborative relationships**

Compared to adversarial relations, collaborative relationships are based on a longer-term commitment and usually the impact of the success of collaborative relations on both parties' business is more significant. As a result, there is a need for continuous development. As respondents saw, it is necessary that both parties participate in the development process and suggest potential development targets. This is in line with Macbeth's (1994) and Mohr and Spekman's (1994) views. Participating in development is a sign of commitment to the future of the relationship, whilst also enabling both parties to have the information needed to develop the relationship to their mutual benefit.

As Ellram (1991) states, mutual benefits should arise, if a collaborative approach is chosen. These benefits are necessary, for example, in encouraging the parties to take part in development activities. The interviewees generally described a mutually beneficial relationship with the win-win metaphor where each party, in addition to their own success, gains from that of their partners. This means that both parties support each other's business and the other's existence is dependent on the other one's success. This corresponds to Mohr and Spekman's (1994) view that the level of dependence also results from a relationship in which both parties gain mutual benefits from interaction. Respondents also believed that collaborative relationship should mean more than just financial benefits to participants. Although most factors are eventually linked to financial gains, these types of benefits may exist. The feeling of mutuality and mutual respect in the relationship are examples of these types of softer benefits.

In adversarial relations both parties have their own goals within the relationship. From the client's point of view the most important thing is that services are provided as promised. Service providers see adversarial relations as business opportunities, which provide a steady cash flow and do not require any extra effort other than holding the operational service provision.

In adversarial relations service providers are not able to put effort into development activities because there are no longer-term guarantees of business. When there is no conditional necessity for continuous development from the client's point of view and the switching costs to another supplier are low, relationships can be based on shorter-term contracts. When purchased facility services are not especially complex, buyers are able to specify their requirements down to the last detail without the need for alternative suggestions from the service providers. In such cases the most important criterion for selecting the service provider is often price. This corresponds to Webster's (1992) view that in the case of occasional transactions the price contains all of the necessary information for both parties to conclude the exchange. Thus, the buyer need not consider any inter-organisational ties beyond the transaction level of interaction (Cooper and Gardner 1993). While this approach often results in a lower purchase price, it assumes that there are no differences in the suppliers' ability to provide value added services, technology gains, process innovations, and other means of gaining differential advantages (Spekman 1988).

Collaborative relationships are based on mutually agreed and clearly defined goals. As Mentzer et al. (2000) state, conflict between the parties is possible, if there is no congruence between the short- and long-term goals of the buyer and those of the supplier. Based on our study, it seems to be that goals can be a combination of either the respective goals of the parties or their mutual goals. Above all, it is important that

both parties know what these goals are and accept them as such. Both short- and long-term goals are needed, especially if the outsourced function is a strategic one from the client's point of view. The main purpose of goals is to direct the development of the relationship.

In collaborative relationships, interactions are frequent and not just problem-driven. Meetings are arranged regularly. Some of them involve information sharing with a view on preventing difficulties. Others are arranged explicitly for reasons of relationship building (Macbeth 1994). These findings were supported in our study. According to interviewees, information sharing should be systematic in collaborative relations and there is a need for an open discussion about the problems that each company faces in their own operation. Furthermore, parties should report any need for change, development ideas and new innovations without being prompted. In addition, future needs and financial factors are communicated openly. In adversarial relations there is interaction between organisations at the beginning of the relationship and later in most cases, only when problems occur. People who are involved in interaction mostly represent the operational level.

In collaborative relationships both sides work actively to make improvements in order to help themselves and each other, with an agreed sharing of benefits. It is not just the personnel at the operational level, but also the top management, who participate in the development of the relationship. According to Lee and Kim (1999), top management support is usually considered a prerequisite for every successful outsourcing relation, which is based on a collaborative approach. Respondents saw that the role of top management is to set mutual strategic long-term goals and to try to discover the potential synergies between the operations of the service provider and the client. Top management is also needed to solve conflicts that the staff at the managerial and operational levels is not able to solve and to make decisions about personnel changes at the managerial level, if problems appear to be developing.

According to interviewees, more trust is needed in collaborative relationships than in adversarial relationships. This is in line with the work of Wicks et al. (1999). They suggest that there must be an optimal level of trust, depending on the value of the relationship for the firm. If excessive trust is placed in a business partner, one may be misallocating precious resources or taking unnecessary risks that could have a substantial negative effect on the firm's performance. On the other hand, underinvestment in trust is also problematic. It bypasses opportunities for more efficient and mutually beneficial exchanges and creates significant added risks (e.g. opportunism) and costs (e.g. monitoring).

## **CONCLUSIONS**

TCE could be used to support decisions related to the selection of relationship type in facility services. In addition, TCE emphasizes strategic considerations that are important in deciding whether to make or buy facility services and it also helps clients to make more justified purchasing decisions taking into account the essence of asset specificities. TCE may help justify the reasons for different relationship forms as well as factors that are to be considered when making restructuring purchasing decisions in facility services. Thus, it is also an important part in developing sourcing strategies in facility services.

Companies should evaluate each relationship more thoroughly and decide, which relationship type to apply in each sourcing situation. More precise goal setting for the building of inter-organisational relationships is needed because current goals, if they exist, are often too vague. It is evident that these goals should be based on the overall short- and long-term objectives of the company. In addition, it is necessary for companies to try to change their mindset from an adversarial one to a more collaborative one. However, this does not mean that collaborative relations should be used in every situation. Two firms involved in an adversarial relationship can also have a high-quality relationship.

The more the facility service activity may add value to the client's business, the more collaborative the relationship needs to be. A collaborative approach is chosen in cases where the strategic importance of service is high for the client business, the purchased service is complex, there is the need to share sensitive and strategic information or the purchasing volume is high. As a result, the relationship with the partner is important and a co-operative relationship is necessary to make sure that the partner is conscious of the core business needs of the company and of the changing nature of these needs. The cost of switching suppliers is usually high, and the process will take a considerable amount of time. Thus, the perceived potential for long-term improvement as a result of joint learning processes is a more important factor in partner selection than immediate financial benefits.

In the case of standardised support services without significant strategic importance, the choice of a collaborative approach in facility services is justified by purchasing volume. Purchasing volume per transaction is increased when clients group sites or bundle outsourced services into wider contract packets. Purchasing volume makes it economically profitable to put more effort into relationship development activities. The implementation of wider service packets mean that the number of partners is reduced. This could be a risk, especially in the case of single sourcing. The dependency of the client on the service provider then becomes higher, resulting in greater vulnerability. Additionally, for instance in the Finnish property market, there are only a few alternative facility service providers who are able to provide bundles of services or operate nationwide.

If a collaborative strategy is chosen, increased trust and transparency of information are needed. On the other hand, mutual benefits should be realised. Compared to adversarial relations, collaborative relationships are based on a longer-term commitment and usually the impact of the success of relationship on both parties' business is more significant. Where sensitive and strategic information is shared, mutual trust between the parties is obligatory. There is also a need for continuous development so as to keep the service concept up-to-date and, thus, maintain the client's competitive advantage. These development activities are directed by mutually agreed and clearly defined goals. It is not just the personnel at the operational level, but also the top management, who participate in the development of the relationship. Furthermore, as the relationship deepens, it is necessary to systematise it (e.g. by reporting and meetings) in order to prevent problems related to communication and information sharing.

As the pre-transaction activities, "decisions made before the purchase", seem to have an affect on the post-transaction activities such as managing and controlling the supply network (see also Ancarani et al. 2004, Bröchner et al. 2004), there is the need to investigate those activities that occur prior to using facility services more profoundly. There is also a need for further research in which more exact descriptions of different types of relationships in the real estate industry and guidelines for managing these types of relationship are provided. It would also be interesting to carry out the same studies in different countries in order to find out possible culture-related differences.

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