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UNFAIR DISTRIBUTION OF VALUE GENERATED IN BUSINESS RELATIONSHIPS

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Abstract:
The subject of interest of the author of this article is the phenomenon of unfair distribution of value generated by firms in a relationship / alliance. The purpose of this article is to identify the mechanism and the factors which enable unfair distribution of value between firms. The research hypothesis put forward refers to the influence of unfair distribution of value on the firm's standing. The author has mentioned the criteria which may be applied in the evaluation of fairness of value distribution. The study presented in the article has used the case study method. Based on the analysis of a specific firm, unfair value distribution was determined and the mechanism of unfair distribution plus factors which made the firm analyzed tolerate such distribution were identified. In addition, financial results were presented which demonstrate deterioration of the firm's standing.

Keywords: value distribution, value generation, value appropriation, unfair behavior, relations

1. INTRODUCTION

Under conditions of hypercompetitive corporate environment, establishing relationships and joint venture is one of the most frequently applied undertakings. Extensive literature exists describing the emergence, functioning and success or failure factors of such ways of running a business. Distribution of jointly generated value seems to be a key moment for the evaluation of relationships established between firms. There are criteria for establishing whether distribution of such value is fair. However, sometimes they are difficult to apply in practice, and some participating firms are not always prone to apply the same. Consequently, in some relationships the value is distributed in a way which grossly violates the principles of fair distribution, which leads to a situation where some entities appropriate a disproportionately large portion of the generated value, obviously at the expense of other stakeholders.

The article discusses only such relationships where two independent entities allocate a portion of their resources to implement a joint undertaking. Other forms of business combinations are not the subject of interest of the author.

The article has adopted a hypothesis that unfair distribution of value leads to deteriorating financial results of some participants in a relationship, and in extreme cases may even lead to bankruptcy.

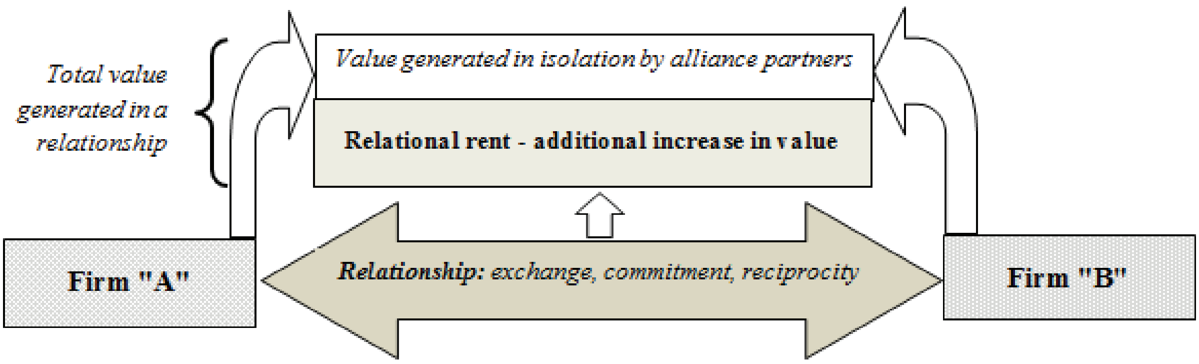
The purpose of the article is to define a mechanism of unfair value distribution and identify factors of unfair distribution of the generated value.

The case study method has been applied, which is qualitative in nature, which seems to be justified by the relative novelty of the subject of interest of the author (Tsang, 2013) - appropriation of value by participants in relationships between firms.

2. FUNCTIONS OF BUSINESS RELATIONSHIPS

Firms establish relationships for expected benefits. A particular form of such benefits is relational rent defined as a supernormal profit jointly generated in an exchange relationship that cannot be generated by either firm in isolation. Relational rent is created through joint idiosyncratic contributions of the specific alliance partners. The source of relational rents are selected relationship attributes. (Dyer, Singh, 1998) As a rule, relational rent is referred to the value generated by firms. The figure below presents a relationship as a source of relational rent.

Figure 1: Relational rent as an additional increase in value achieved through a relationship between firms



Source: own compilation based on: Dyer, Singh, 1998.

However, benefits from a relationship are as a rule perceived more specifically as the results of functions assigned to relationships. They have been characterized in the table below.

Table 1: Functions of business relationships

	Functions	
	Direct: value which firms can derive directly from a relationship and which is not achieved by other entities or alliances.	**Indirect:** value which is not derived directly from a relationship between two entities, but instead can be acquired by other alliances or in the future.
Supplier's perspective: functions of the relationship which contribute to the supplier's profitability.	*Volume function*: customers purchasing a large portion of the suppliers' production make the production surpass a certain threshold under conditions of utilizing capacities and achieving economies of scale. *Safeguard function:* under depressed market conditions, all customers are valuable for the organisation, may bring benefits, even if conditions for organisations may not be particularly favourable.	*Market function*: recommendations from current customers may support suppliers to enter new markets and establish commercial relationships. *Innovation function*: product and process innovations developed together with a customer may improve the value of the supplier's offerings to this customer in the future.
Customer's/buyer's perspective: functions of the relationship which contribute to the customer's profitability.	*Volume function*: suppliers offer discounts for larger quantities. *Safeguard function*: suppliers may fulfill customer needs when such needs change in terms of volume and type.	*Market function*: a supplier helps the customer establish contacts with potential exchange partners *Innovation function*: by support for innovation obtained from a supplier, customers may obtain extensive market information and accelerate the process of product development, engaging in projects which are bigger, more risky and have a longer time horizon.

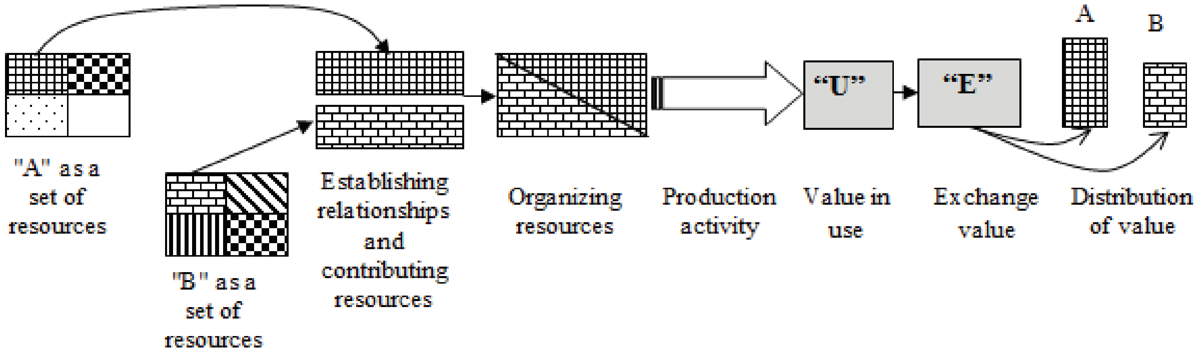
Source: Fang, Chang, Peng, 2011.

3. GENERATING AND DISTRIBUTING VALUE IN A RELATIONSHIP

As indicated in table 1, relationships have various functions. Apart from the functions mentioned above, it is worth paying attention to the possibility of supplementing the broadly defined corporate resources. This function is particularly important when a resource-based view (RBV) is employed in analyzing a firm. (Barney, 1991) With this approach in mind, the process of establishing and functioning of ties between firms can be described as follows.

A firm (named A) develops an idea for a new type of value in use or a new method of providing the value in use already known. If the available resources are insufficient to implement the idea, the lacking resources can be obtained in isolation or by establishing a relationship with an entity which has such resources. If the second solution is chosen (which is justified by e.g. shorter time), firm A needs to find an entity which disposes of such resources and will be willing to establish relationships under which it will make use of such resources (named B). After defining cooperation terms (formalizing the relationship), firm A proceeds to organizing the business which is to lead to the effects mentioned above and under its supervision productive use of merged resources of A and B takes place. The value in use generated in this way is delivered to customers and exchange value is realized by means of a sales transaction. This value is divided between A and B. Such division also involves distribution of relational rent generated by both firms. The process described above is schematically shown in the figure below.

Figure 2: Generating and distributing value in business relationships



Source: own compilation

Generating value, in particular relational rent, is intrinsically linked to the distribution of this additionally generated value.

A firm intending to continue cooperation with partners with whom they are already in relationships, should be interested in maintaining the same. One of the key determinants of relationship continuation is distributive justice related to the value generated during a relationship as perceived by partners. This need can be explained by referring to the theories of justice according to which relationship parties review the contributions made in the relationship versus received results. (Sternberg, 1998, p. 113 – 121) One of the possible results of assessing the situation as unjust is the wish to resign from a relationship. Based on the theory of organizational equilibrium proposed by March and Simon (March, Simon, 1964, p.139), a relationship between two entities can be viewed from the perspective of contributions made by both parties in the relationship and incentives received for such contributions. In such a case, identifying lack of equivalence between contributions and incentives may lead to the decision to quit the relationship. Dilatoriness of one of the parties may also contribute to terminating a relationship. (Hirschman, 1995, p. 12)

The need of justice in distributing the value generated during a relationship should also be viewed from the perspective of development opportunities, in particular of smaller entities participating in a relationship. Unfair distribution of generated value leads to limiting their development opportunities (e.g. investments, exchange of technical equipment), and in extreme cases it may pose a threat to their survival with all the related consequences (e.g. increase in the number of the unemployed).

No matter how ambiguous the term "justice" is, attempts are made to define the criteria which a division should meet to be found fair. For the purposes of evaluating the distribution of value generated by firms participating in a relationship, the general principles of evaluation of equity of final allocation formulated by H.P. Young can be adopted here: (Young 2003, p. 229, 230)

1. acceptability - no claimant should be worse off than under his initial entitlement;
2. transparent inequity - no claimant should receive less of everything than another claimant who has an equal share. More generally - no claimant should receive a smaller percentage of value than their initial share expressed as a percentage of everything;
3. no envy - no claimant should strictly prefer another's portion to his own;
4. consistency - every subgroup of claimants should fairly divide the common property allotted to them as a group;
5. replicability - every fair allocation for a given subgroup should be fair when imitated by similar subgroups in the population;
6. monotonicity - when the bundle of common property grows, no one's welfare should decrease.

The set of criteria presented above should be treated as some form of idealization since, as P.H. Young claimed, no method meeting all the listed criteria exists. (Young, 2003, p. 230)
Factors which determine the share of firms in the distribution of generated relational rent should be considered in the context of distributive justice. D. Lavie (Lavie, 2006) has distinguished factors which determine such distribution. They have been described in the table below.

Table 2: Factors determining the proportion of relational rent appropriated by a firm

No.	Factor	Description	Components	Influence on rent distribution
1	Relative absorptive capacity	Firm's ability to identify, access, assimilate and exploit external knowledge.	Idiosyncratic resource stocks, path dependencies, heterogeneous communication channels.	The better the absorptive capacity of the focal firm, the higher the proportion of relational rent appropriated by the same.
2	Relative scale and scope of resources	The scale and usefulness of resources from the perspective of generating value.	Level of diversity/similarity of contributed resources, size of resources contributed to a relationship,	The bigger the scope of resources in the context of pursued business, the higher the share in generated value, bigger non-idiosyncratic resources do not increase the share in generated value.
3	Contractual agreement	Formal agreements signed at the time of alliance formation.	Specification: payoff structure in an alliance, title to information, reviews, arbitration and final provisions. Provision of formal warranties. Determining the distribution of common benefits *ex ante*.	A favorable contract may provide the firm with exclusive access to network resources, specify a relatively high share of returns on joint activities, protect the firm's internal resources from misappropriation by defining the scope of shared/divided resources, ensure legal remedies that secure the firm's investments in the alliance.
4	Relative opportunistic behavior	Opportunism - devious and self-interested behavior aimed at pursuing one's own interest.	Opportunistic behavior in an alliance may cause: tendency to cheat in mutual agreements, unilateral decreasing of involvement in joint activities, emphasis on particular interests which maximize short-term own benefits at the expense of joint benefits of partners.	The more opportunistic the firm, the higher the proportion of relational rent, recognizing opportunistic behavior of a firm will make partners limit the scope of collaboration and knowledge transfer which are critical for the creation of relational rent.
5	Relative bargaining power	Ability to force one's own interests during negotiations, even despite the resistance of the other party	Ability to operate jointly, Access to critical information, Causing high cost of exchange for the other party, Low cost of refraining from a relationship.	A firm with a relative bargaining power may obtain a disproportionately large share in the generated value.

Source: own compilation based on: Lavie 2006, Coff, 1999, Williamson 1998, p. 60.

4. RESULTS OF EMPIRICAL STUDIES

The basic types of activities comprising the profile of the analyzed firm (let's call it CF) were: casting of iron, treatment and coating of metals, mechanical processing of metal elements, wholesale trade services of hardware, plumbing and heating equipment and supplies. It should be stressed that the analyzed firm did not deal with retail sale of any products, including its own. This resulted in the following negative consequences: lack of direct information link with the market, delayed inflow of due amounts for sold products, delayed reaction to changes on the market and creating the structure of manufactured products.

The firm's material resources were created with the view to pursuing business in line with its profile, i.e. first of all the manufacture of iron products. The firm's resource structure was dominated by material resources. The table below presents selected data on the firm's assets in 2009.

Table 3. Net value of selected assets of CF

No.	Name of group of assets	As at the end of 2009 (net)
1	Intangible assets	8,493.91
2	Structures and buildings	3,186,621.61
3	Plant and machinery	540,270.30
4	Vehicles and other means of transport	0

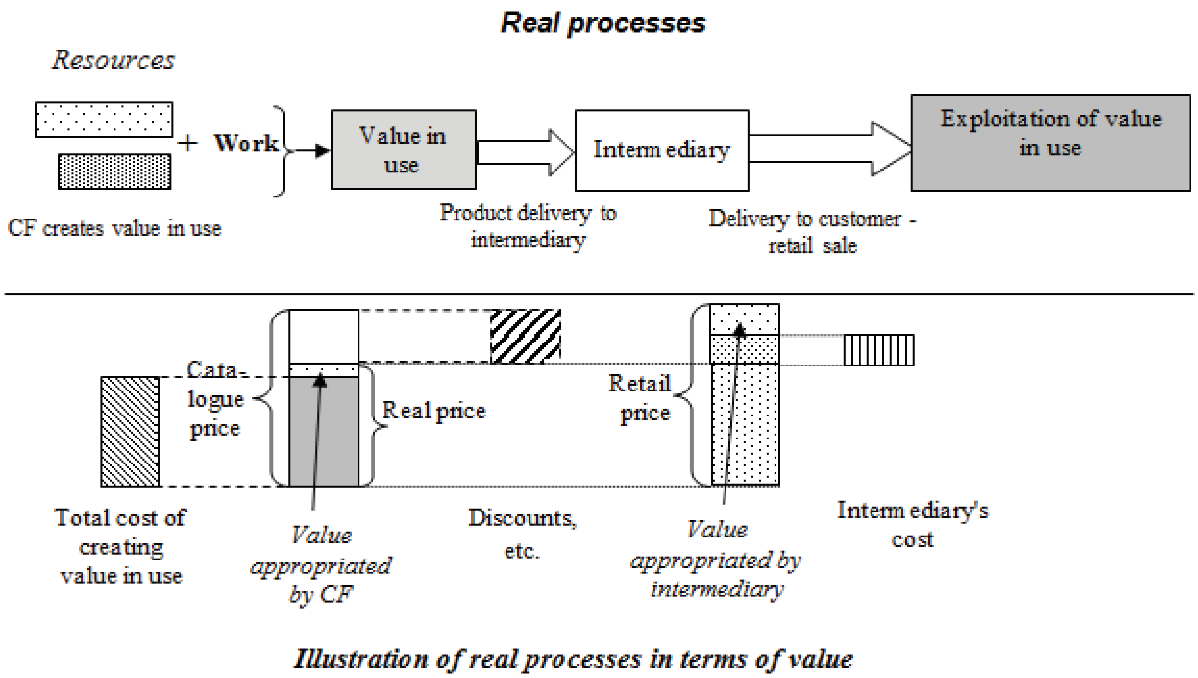
Source: own compilation based on internal documentation of CF

The data presented above proves a very high level of accumulated depreciation of assets and a scarce share of intangible resources. In addition it should be stressed that the firm was not in possession of funds which would enable development of resources. Although bearing CF logo, manufactured products were perceived by the buyers as no name products and that is why reputation or loyalty to the seller plays an important role in a selling transaction. A crucial limitation for the CF business was the nature of manufactured products - these were catalogue products, manufactured in line with the requirements (in terms of dimensions) specified in Polish norms, which made it difficult to introduce any product novelties. In addition, these are products relatively rarely purchased by final users, who often followed the opinion of fitters or plumbers, having no possibility to form their own opinion about the products. The situation of CF was additionally complicated by cheap products made in China which appeared on the market but which were sold under the label of one of large domestic competitors.

Products were sold via relatively large entities dealing with the wholesale of sanitary products. These were mainly networks of specialized wholesalers operating on a regional scale, and exceptionally on a national scale. CF sold its products to intermediaries at catalogue prices, which were the same for all customers. However, some of them were able to negotiate discounts, price reductions or rebates which were granted mainly for cash transactions or transactions with short payment dates, total purchasing volume in a given period (6 months, year) or continuity of business relations. In extreme cases, the total of rebates, discounts and price reductions for one customer would exceed 40% of the catalogue price, so the real price could be 60% of the catalogue price.

The relationships established by CF were necessitated by the limited business profile. The companies with which CF established relationships had resources which CF lacked, namely distribution networks enabling delivery of products to final customers. As a result of established relationships, the resources of CF and intermediaries became complementary: CF created value in use which was delivered to customers by intermediaries. The figure below presents the model of operation of the analyzed firm.

Figure 3: Model of generating and appropriating value in the case of CF



Source: own compilation

C. Bowman and V. Ambrosini have developed similar diagrams for firms which deal with production and also trade. (Bowman, Ambrosini, 2000)

The manifestation of the value generated by CF was the catalogue price for which the firm's products are offered to various customers. The value added generated by CF was equal to the difference between the catalogue price and the total cost of creating the value in use offered at the catalogue price. On the other hand, the value appropriated by CF was equal to the generated value less the discounts, rebates and price reductions granted to intermediaries. Then, the value generated by intermediaries was equal to the retail price for which products were sold to customers less the catalogue price and intermediary's costs. The value appropriated by intermediaries was equal to the generated value increased by received discounts, etc.

As we may think, the financial results of CF presented below were to some degree the consequence of the described method of generating and appropriating value by the analyzed firm.

Table 4: Selected financial results of CF

No.	*Name of ratio*	*2007*	*2008*	*2009*
1.	Sales of products, goods and services (in thousands of PLN)	43,416.7	36,009.9	31,112.7
2.	Net profit/loss (in thousands of PLN)	-3,934.1	-4,267.7	-4,811.2
3.	Return on equity (%)	-29.0	-44.4	-89.9
4.	Net return on sales (%)	-9.1	-11.9	-15.5
5.	Earnings per share (EPS)	- 1.9	- 2.0	- 2.3

Source: own compilation

As mentioned above, the total discounts, etc. for some intermediaries reached 40% of the catalogue price. This means that lack of justice in distributing generated value was probable. The table below presents a relevant analysis which includes only these criteria which may be considered to be related to the situation of CF.

Table 5: Evaluation of fairness of value distribution from the perspective of CF

No.	*Name of criterion*	*Meaning of criterion*	*Evaluation of CF situation with the criterion in mind*
1.	Acceptability	The claimant's final share is not defined as worse than the initial entitlement	Decrease in profitability ratios, in particular return on sales, is the proof of worse share of CF in the generated value,
2.	Transparent inequity	None of the parties has a smaller portion of value than its initial entitlement being a percentage of everything	Decrease in return on sales recorded each year is the proof of a smaller percentage in the generated value,
3.	No envy	No preference of another's portion to one's own occurs	Forced to offer discounts, etc. by the existing circumstances, CF would be willing/prone to limit the same, i.e. to take over some of the value received by the partners
4.	Monotonicity	The growth of the generated value should not deteriorate the situation of any of the parties	Greater value generated in a relationship would not rather deteriorate the situation of CF

Source: own compilation

The financial results of CF presented in table 4 and the analysis conducted in table 5 explicitly demonstrate lack of justice in relationships of this firm with the intermediaries. That being so, it is justified to ask the following question: what factors were decisive for CF not to terminate at least the most unfair relationships? The reply to this question can be obtained following the analysis presented in the table below.

Table 6: Evaluation of CF situation from the perspective of the ability to appropriate value

No.	Factor	Situation of CF
1	Relative absorptive capacity	Limited abilities, in particular with reference to the knowledge about the situation on the market;
2	Relative scale and scope of resources	Highly specialized resources adapted to creating value in use - lack of resources useful in contacts with final customers;
3	Contractual agreement	High level of flexibility in concluding contracts, contracts set out the rights and duties of the parties;
4	Relative opportunistic behavior in an alliance	Exploiting the resource weakness of the firm to obtain price reductions, discounts and rebates;
5	Relative bargaining power	Weakness in negotiations: low exchange costs for CF partners, high exchange costs for CF.

Source: own compilation

First of all, CF weakness was the consequence of the limited scope of operation. The firm was doomed to intermediation of other entities - without them it did not receive exchange value, i.e. due amounts paid by the final recipients of the firm's products. The situation of CF was difficult to such an extent that without concessions to the partners it would not sell its products. Lack of any direct relationships with retailers led to dependence on wholesale intermediaries.

The unfair distribution of generated value was the consequence of the firm's situation and tolerance for such a state of affairs was necessitated by a relatively large scale of production which could not be sold via smaller entities towards which CF would have a stronger bargaining position.

5. SUMMARY

The case of CF described in this article enables a positive verification of the hypothesis put forward in the introduction. The unfair distribution of generated value led to deterioration of the financial standing, the consequence of which was bankruptcy declared in 2012. The analyses performed in the text enabled identification of the mechanism of CF impairment, i.e. extorting rebates, price reductions and discounts by the partners. In addition, factors have been identified for the tolerance of unfair value distribution by the analyzed firm. These were the consequences of a too narrow profile of the firm's business and lack of resources necessary to expand such a profile.

In general it can be stated that in practice there are good and bad sides of business relationships. (Fang, Chang, Peng, 2011) The good sides, related to the positively viewed functions of relationships are generally seen and treated as a stimulus to establish business links. However, relationships can also have their bad sides. One of them is lack of justice in relationships, which may be the result of various factors. However, it is evident that the immediate trigger of unfair business relationships is the approach exhibited by one of the parties to seek, identify and exploit weaknesses of the other party. However, a firm with a weaker position in a relationship, which is at risk of impairment, may resign from a given relationship, improve its position or, while tolerating the injustice, strive to minimize its losses. The analyzed firm ran the production business skillfully and manufactured high quality products. Its key problem was reaching the customers with the products and the information about product parameters, which was the result of the lack of its own distribution network. Lack of means and time to create its own distribution network forced CF to continue the relationships and tolerate their unfairness, which led to the results already described.

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