THE RELATIONSHIP BETWEEN BUYER'S FINANCIAL STABILITY AND SUPPLIER'S PERFERMANCE FOR INNOVATIVE DEVELOPMENT

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OVERVIEW

In today's competitive business environment, the role of the supply chain has been extended to synchronize innovation process as well as supply and demand (Cecere et al., 2004). In order to improve the effects from such synchronization, many buyer firms support the business activity of their suppliers, especially for the key supplier. The very survivability of the supplier may depend on the buyer's performance especially during financial crises. On the other hand, in return many buyers achieve unique innovative knowledge from their supplier(s). However, for suppliers to achieve innovative outputs, the investment of substantial amount of resources may be needed with inherently higher risks. Consecutively suppliers with weak resources without help of their buyers may not able to produce such innovative developments. In short, we investigate the relationship between the financial stability of the buyer and innovative capability of the suppliers.

THEORETICAL BACKGROUND AND RESEARCH PLAN

Suppliers can possess certain innovative resources which are helpful in differentiating the products and services from competitors (Sidhu et al., 2007). Moreover, buyer firms can utilize this innovative knowledge from their suppliers (Powell et al., 1996) to have advanced technological development throughout the involvement of the supplier (Krause et al., 1998).

For the development of the innovative resources, a firm may need to invest continuously substantial amount of resources in R&D projects. However, most suppliers who are under financial distress or comparatively small size compared to their competitors may not able to make such investments

If existing supplier does not offer innovative resources, buyers may prefer switching to new suppliers to access new technological developments. However, such switch brings potentially high transaction costs. In addition to transaction costs, such switch cuts the long-term relationship between supplier and buyer which had been able to import new resource for buyers from their suppliers. Consecutively, when a buyer starts a new relationship with a supplier, the positive effects in switch may be reduced due to not well established relationship, new supplier may not be easy in sharing hardly earned technological developments with a new buyer at the beginning.

When a supplier has stronger relationship with its buyer who has sound financial stability, the supplier receives positive anticipation from the market. This will eventually leads supplier to secure financial resources under better terms which enables the supplier to develop innovative resources.

We rely on relevant data showing the relationship between suppliers and buyers from COMPUSTAT’s Business Segment database. This dataset includes only major suppliers that have more than 10% of procurement of certain buyer. We use, Altman Z score to measure the financial stability of the buyer. And, for the measurement of the innovative capability for the supplier, we use the change in the R&D intensity of the supplier, which is R&D expenditure is divided by the asset, would be used.

CONTRIBUTION

The result of this study may further encourage suppliers to work with financially more sound buyers in order to achieve better innovative development which would make the entire supply chain more resistant and competitive. Also this study will highlight the true cost of switching suppliers such as losing the productive long term relationship with the existing supplier which contributed highly valuable advances in product line.
In addition, the result of this study may readdress the importance of financial stability of the firm to stably import innovative resources from other firms.

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