SUPPLY CHAIN MANAGEMENT

The Importance Of Building Social Capital

by **Roger McGrath Jr. and William L. Sparks**

Most of the past decade can be described in terms of economic uncertainty. Recent events, from megamergers and the meltdown of Enron to the terrorist attacks of Sept. 11, 2001, have had enormous economic ramifications.

Regardless of the source, be it economic or political, a great deal of stress is placed on the supply chain during a downward course in the business cycle. Yet most firms intuitively know maintaining the integrity of the chain is critical to both surviving the downturn and responding to the increase in customer demand that results from the inevitable upward turn in economic fortunes that follows.

An evolving view of the supply chain reveals building social capital by enhancing the relationships in the chain can strengthen it. Affinity groups—semiformal groups that cut across the supply chain structure—are useful in initiating efforts to build social capital.

In 50 Words Or Less

- **Organizations must maintain the integrity of their supply chains in times of economic uncertainty.**
- **Building social capital among organizations in the same supply chain creates value for all involved.**
- **Affinity groups afford members in similar positions at different organizations the opportunity to build strong relationships.**

Evolving View of the Supply Chain

The classical view of the supply chain can be best conceptualized as the stages and accompanying organizations directly and indirectly involved in fulfilling a customer request. The simplest view of the supply chain is the classical economic view, which reflects an arm's length market relationship.

This simple view of supply chain relationships is also captured in transaction cost theory, which presupposes the costs associated with transactions. In essence, it formalizes the costs required to carry out a market transaction, including finding a firm that is willing to provide the goods or services you are seeking, discussing the terms of the arrangement, conducting negotiations, preparing contracts and other documents and undertaking inspections needed to ensure contract compliance and quality control.

A great deal of time and effort are typically directed at guarding against opportunistic behavior on the part of the other party. These efforts increase the transaction costs associated with supply chain endeavors. In a buyer-supplier relationship, the buyer sees these costs in the effort of developing, monitoring, addressing problems and gauging opportunism in the relationship.

While a transaction costs analysis has been used to explain interorganizational relationships for several decades, its economic foundations tend to exclude social factors. Behavioral researchers have added a dimension to these relationships called "relationalism."[1] This view extends the fundamental economic model by considering social factors, such as trust, interdependence and a long-term perspective, and the impact these factors have on performance.

Friends and family trade more and on different terms than do the estranged and strangers.

This intuitive sense of the importance of supply chain relationships is supported by the collective experience and knowledge of the international experts who participate in the International Organization for Standardization's technical committee, ISO/TC 176, that focuses on quality management and quality assurance. The quality management system standards of the ISO 9000 series are based on eight quality principles. Principle eight concerns mutually beneficial supplier relationships and states, "An organization and its suppliers are interdependent, and a mutually beneficial relationship enhances the ability of both to create value."[2]

The growing importance of these issues was underscored recently when the *Harvard Business Review* convened a panel of leading thinkers in the field of supply chain management, where the dominant topics discussed were people and relationships.[3] Examining the concept of social capital provides a better understanding of the significance of supply chain relationships.

Social Capital

Social capital can be best thought of as the human elements, such as learning, trust and innovation, that are created and enhanced during interpersonal interactions. In *Bowling Alone: The Collapse and Revival of American Community*, Robert Putnam provides a view of social capital at a community and national level. He observes the term social capital "turns out to have been independently invented at least six times over the 20th century, each time to call attention to the ways in which our lives are made more productive by social ties."[4]

Don Cohen and Laurence Prusak define social capital as "the stock of active connections among people: the trust, mutual understanding and shared values and behaviors that bind the members of human networks and communities and make cooperative action possible."[5]

The importance of networks and active connections among people is obvious within organizations. Chrysler created platform teams to break down the walls between various disciplines, such as engineering, design and manufacturing, inside the company. Still, new walls were sometimes created around the vehicles themselves. Chrysler responded by creating larger teams and groups of teams to facilitate communication. The company has an overall strategy team to provide the vision, product teams organized around vehicle type (small vehicles, premium vehicles and family vehicles) and cross product component teams.[6]

In the 1990s, Chrysler's profitability per vehicle numbers were consistently higher than Ford's. Jeffrey Dyer, a professor at Brigham Young University, suggests the reason was Chrysler recognized the fundamental unit of competition was no longer the individual firm but the extended enterprise. Dyer sees this as "the group of companies that collaborate to produce a finished product."[7]

The Social Capital Interest Group (SCIG) at Michigan State University provides a more formal definition of social capital:

> ... the potential benefits, advantages and preferential treatment resulting from one person or group's sympathy and sense of obligation toward another person or group. Social capital also includes the potential benefits, advantages and

> preferential treatment that originate from one person's sympathy and sense of obligation toward his or her idealized self.[8]

In its analysis of social capital, the SCIG presents several findings that shift our focus from intraorganizational to interorganizational:

- Social capital alters the terms and level of trade. Friends and family trade more and on different terms than do the estranged and strangers.
- Social capital makes important the external consequences of one's actions when the consequences are experienced by the objects of one's feelings of sympathy and obligation. One does not pollute the river when the downstream users are family members. Thus, social capital defines what economists and others call externalities.
- Social capital alters access to a wide range of goods and services. Access to legal services, housing support, public services, educational services, employment opportunities and welfare benefits may all depend on one's social capital.
- Social capital alters the cost of entering into contractual obligations. Contract enforcement and liability threats reduce the incentives to enter into contractual obligations. Social capital reduces the cost of contract enforcement and the likelihood of costly litigation.

Ray Kroc, founder of McDonald's, used the power of mutually beneficial relationships to create the world's largest restaurant franchiser. Kroc noted the most important service he provided for his first franchisees was coordinating food and paper supplies and obtaining discount prices for his volume. He told suppliers to price their products not on the initial order, but on the future volume they would get if he succeeded. Kroc created an intense commitment to McDonald's by the way he selected and treated his suppliers.

Kenneth Smargon, son of the founder of Interstate Foods, the shortening supplier to McDonald's, notes the following:

> Other chains would walk away from you for a half a cent, [but] McDonald's was more concerned about quality. [It] didn't chisel on price and [was] always concerned with suppliers making a fair profit. A lot of people look on a supplier as someone to walk on. But McDonald's always treated me with respect even when [it] became much bigger and didn't have to.[9]

Developing social capital in the supply chain and the subsequent mutually beneficial supplier relationships have several significant benefits:

- Increased ability to create value for both parties.
- Flexibility and speed of joint responses to changing market or customer needs and expectations.
- Optimization of costs and resources.

To achieve these benefits, organizations need to create supply chain relationships that will lead to:

- Establishing relationships that balance short-term gains with long-term considerations.
- Pooling expertise and resources with partners.
- Clear and open communication and information sharing.

Affinity Groups

One way to build social capital and achieve these goals is to use affinity groups.

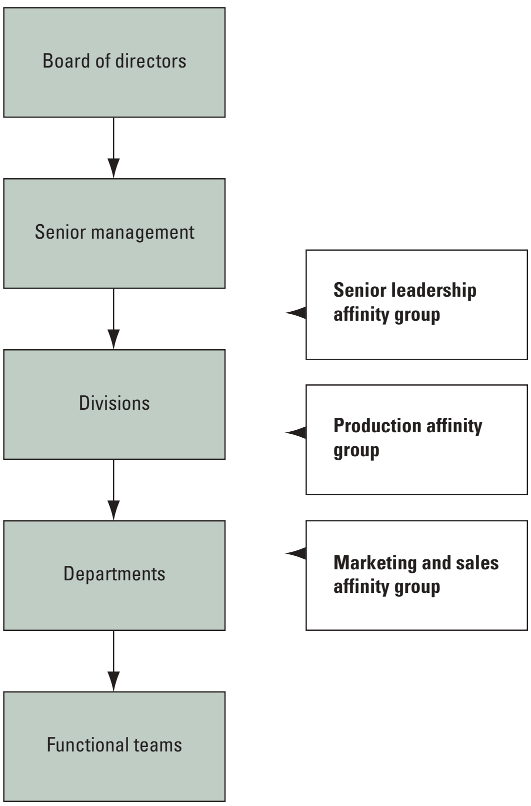
Originally developed as an intraorganizational mechanism for developing cross functional teams in the Department of Energy (DOE), affinity groups consist of members of an organization who share similar job titles, roles and responsibilities. Dominic J. Monetta, director of the DOE's new production reactor (NPR) program in the early 1990s, recognized the need to create a formal channel to facilitate the dissemination of the social capital existing in the NPR program's informal organization.[10]

Affinity groups afford members opportunities to share information, provide feedback on strategic initiatives from different perspectives, solve problems and capture emerging opportunities. They make a formal attempt to capture the emergent behaviors found in the informal channels and networks within an organization. As such, they offer a unique way to tap into the social capital and organizational intelligence of members often found below the formal surface.

By design, affinity groups are horizontal and cross cutting, representing slices of the supply chain in which membership to the group is based on responsibility and duties as opposed to departments and divisions. Affinity groups share the following characteristics:

- Group members have similar titles, duties and responsibilities.

FIGURE 1 Intraorganizational Affinity Groups



- Group member roles are formalized.
- Group meetings are regular and frequent.
- The group develops its own unique charter and mission.
- The group is self-managing, meaning it is responsible for its own processes and output.

Affinity groups contribute to an organization's social capital by connecting the links in the supply chain in some very important ways. Affinity groups:

- Afford ongoing opportunities for members to share information. Because members share similar titles but represent different organizations, critical and relevant information is passed along from customer to supplier.
- Facilitate creative problem solving and collaboration. The affinity group model ensures systems level thinking as members are better able to understand the ripple effects of actions taken by their organization. Members can creatively think outside their organizational box, yet within their supply chain, to most effectively solve shared problems.
- Build trust, cohesiveness and a general appreciation for each member. By spending time together, members learn how to work together effectively while developing a greater appreciation for each organization's role in the supply chain.
- Create a unique group identity and cohesiveness for members based on member status, title and responsibility, instead of organizational affiliation.

Figure 1 illustrates the classical intraorganizational affinity group. When this concept is taken from its original intraorganizational model and applied to a supply chain framework, it creates a novel way to think about human networks, informal relationships and social capital. Figure 2 illustrates an interorganizational supply chain affinity group.

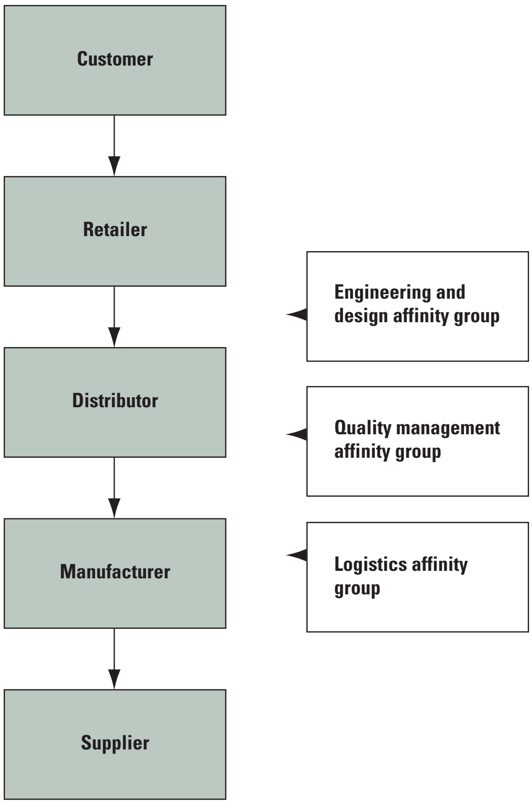
Honda of America has a network of more than 400 supplier companies in North America that supply more than 80% of the parts and materials used in manufacturing. While many of the supplier development programs and activities are similar to those at other automobile manufacturers, Honda is unique in how much time, money and effort it invests in building and sustaining its supplier relationships.

Dave Nelson, retired senior vice president of Honda of America, notes, "When we select suppliers, we expect to be with them for years. Other companies don't put the appropriate amount of resources against supplier development, so their programs aren't as well received. To score big with suppliers, you have to win their hearts."[11]

Once Honda has built the cost model for a new model year or car model, it passes the cost requirements to its suppliers. If a supplier has difficulty meeting the cost target, Honda will send a team of engineers to work with the supplier. Although this effort is not as formal as the classical affinity group concept, the similarities between Honda's effort and our proposed model are easy to see.

Supply chain management has traditionally been viewed from an economics perspective. Researchers and managers, however, are starting to appreciate the social and relational factors associated with the critical links between suppliers, manufacturers and customers. Social capital, the relational glue of human networks that facilitates cooperation and collaboration, is the critical component that underlies effective supply chains.

FIGURE 2 Interorganizational Supply Chain Affinity Groups



Affinity groups, collegial associations of peers who meet on a regular basis to share information and capture emerging opportunities, offer a unique opportunity to enhance supply chain management. Although originally developed as an intraorganizational mechanism for developing cross functional teams, the affinity group model provides an innovative strategy for developing interorganizational social capital and strengthening the supply chain.

REFERENCES

1. Santiago Gonzalez-Hernando, Victor Iglesias Arguelles and Juan A. Trespalacios Gutierrez, "Exclusivity and Relationalism in Marketing Channels," *The Journal of Business & Industrial Marketing*, Vol. 18, No. 1.

2. *ANSI/ISO/ASQ Q9001-2000: Quality Management Systems: Requirements*, ASQ Quality Press, 2000.

3. Scott Beth, et.al., "Supply Chain Challenges: Building Relationships," *Harvard Business Review*, Vol. 18, July 2003.

4. Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community*, Simon & Schuster, 2000.

5. Don Cohen and Laurence Prusak, *In Good Company: How Social Capital Makes Organizations Work*, Harvard Business School Press, 2001.

6. Matt DeLorenzo, "Letter From Detroit," *Road & Track*, Vol. 53, No. 2, October 2001.

7. Jeffrey H. Dyer, *Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks*, Oxford University Press, 2000.

8. Social Capital Interest Group, "Short Papers From the April 1998 Social Capital Conference at Michigan State University," *Journal of Socio-Economics*, Vol. 29, 2000.

9. John F. Love, *McDonald's: Behind the Arches*, Bantam Books, 1995.

10. Eileen M. Van Aken, Dominic J. Monetta and Scott Sink, "Affinity Groups: The Missing Link in Employee Involvement," *Organizational Dynamics*, Vol. 22, Spring 1994.

11. Dyer, *Collaborative Advantage*, see reference 6.

NOTE An earlier version of this paper was presented at the 14th Annual Quality Management Conference in New Orleans (2002).

ROGER McGRATH JR. *is the nonexecutive chairman of Rosetta Technologies Corp., a technology firm headquartered in Tampa, FL. He is also on the faculty of the McColl graduate school of business at Queens University of Charlotte in North Carolina. He is a Senior Member of ASQ and an ASQ certified quality manager, quality engineer and quality auditor. He holds a doctorate in management from Florida State University in Tallahassee.*

WILLIAM L. SPARKS *is an assistant professor of management science in the McColl graduate school of business at Queens University in Charlotte, NC. He also serves as a managing partner of the Center for Creative Strategy & Innovation in Charlotte. He earned a doctorate in organizational behavior and development from George Washington University in Washington, DC, and is a member of ASQ.*

Please comment

If you would like to comment on this article, please post your remarks on the *Quality Progress* Discussion Board at www.asq.org, or e-mail them to editor@asq.org.