Personal connections key to strong supply chains

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Credit: AI-generated image (disclaimer)

Amid a pandemic when limitations on disinfecting wipes, toilet paper and drugs brought attention—and disruption—to supply chains, new research involving Washington University in St. Louis delivers something of an answer to improving these lines of business:

Work with who you know.

While most of the business world builds success from existing relationships, four scientists including Xiumin Martin from the Olin Business School crunched data to find that personal connections between suppliers and vendors particularly improves the efficiency of the supply chain. To be precise, such rapport results in better overall performance, less restrictive and longer-lasting contract terms, and crystallized communication.

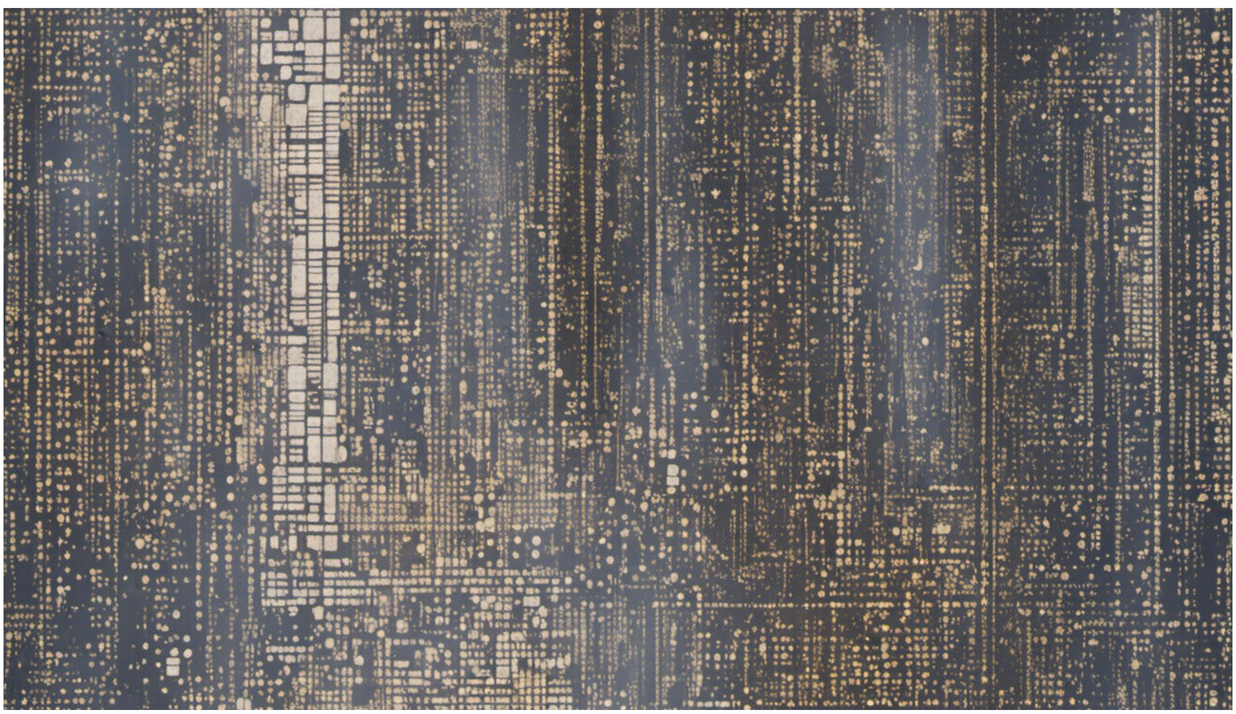
"Recent years witnessed significant increase in the complexity of supply-chain relationship due to outsourcing," said Martin, professor of accounting. "Such increased complexity pushes my co-authors and me to think about how some fundamental issues concerning information asymmetry are addressed in this new regime. We examined this question by focusing on personal connections because the world has also become increasingly connected."

The research team—Martin along with Ting Chen of the University of Massachusetts Boston, Hagit Levy of the City University of New York and Ron Shalev of the University of Toronto—studied 2000-11 data from public companies, though private businesses may even more keenly rely on personal, existing relationships.

In their paper, forthcoming in the *Review of Accounting Studies*, the researchers focused on previous education and work connections between suppliers and vendors. They showed such a personal relationship proved a successful way to select suppliers in a chain that has become more complex amid outsourcing and this global economy/information age.

In compiling their 12-year-long data set, they used a database called BoardEx—listing universities, employment histories, charitable involvements and board memberships—to try to find supplier-customer connections. Through another database, Compustat Segment, they were able to determine long-running business relationships between 1,430 suppliers and 2,630 customers.

Ultimately, they focused on just two relationships: university and work connections. They found 7.4% of the sample had educational connections and 21% had either educational or past-work relationships. Looking at the organizational charts, they discovered 0.5% connections between CEOs and 15.2% between non-C-level executives.



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Such personal connections increased the likelihood a vendor will select a supplier by 60% over baseline probability, the scientists learned.

Connections between C-Level executives show statistically stronger effects than those between lower-level executives, though the COO—who oversees most firms' supply chain—has a more pronounced effect on supplier selection than a CEO or CFO.

They also studied when that connection was broken—say, one of the parties in the relationship leaves their employer or retires. There, they found that the supplier-customer relationship ended earlier after a departure of a connected executive than after a departure of an unconnected executive.

Boiled down, these prior college or work connections:

- increased a vendor's chance of being selected as a supplier;
- relaxed procurement-contract terms;
- improved firms' operating efficiency;
- expanded geographical areas to choose supplier-chain partners when there are limited choices nearby; and
- smoothed out exchanges of information.

Simply put, these businesses know one another. And that enabled them to make more accurate assessment of supply-chain risks, helped to reduce costs, facilitated more timely updates and improved the effectiveness of monitoring the supplier along the chain.

They found the utility of the relationship by breaking down such factors as: product quality and reputation; delivery reliability/on-time delivery; competitiveness of cost; manufacturing capability; management leadership; technical capability; research and development; financial risk; and production flexibility to customer requests.

The data showed that 27%—or one in four—contracts were between connected parties, and on average, the contracts lasted six months longer

(48 months vs. 42 months) in duration than two parties with no connection. The less restrictive contract terms translated into product warranties, the ability to inspect supplier's plants, supplier-paid liability or property insurance, and pre-scheduled periodic meetings often used to address risk and moral-hazard issues.

"The COVID-19 crisis has significantly disrupted supply chains," Martin wrote in the paper. "It will be interesting and important to examine whether personal connections have an influence in counteracting such disruptions and fostering a more resilient and robust supply chain network."

More information: papers.ssrn.com/sol3/papers.cf … ?abstract_id=3010000

Provided by Washington University in St. Louis