

Exercise: Stakeholder Negotiations*

Introduction:

In this exercise you will face a strategic problem while working in a group to analyze and make decisions about an outsourcing situation. Other groups will have a different (and often conflicting) recommendation concerning this same problem. After individual and group analyses, all groups will convene to discuss, debate, and defend their positions, ideas, and preferences. The primary focus is to develop a process for analyzing a problem, work with others to understand it, and negotiate a solution that considers competing interests.

Purpose:

1. To allow participants to experience strategic negotiation to consider “outsourced” facilities;
2. To understand that strategic decisions must consider multiple perspectives; and
3. To support reflective analysis of group processes including leadership behavior and gaining consensus.

Group Size:

Any number of groups of preferably seven (7) members in each, but as few as five (5) if necessary

Time Required:

One class session of 125 minutes (plus pre-work and longer discussion or debriefing if desired) but minimum of 70 minutes if Introduction and Background are assigned as homework and there is no final lecture

Related Topics:

Global strategic management; Group decision making; International operations; Leadership and negotiation; Value chain analysis

Exercise Schedule:

The following schedule is approximate.

	Unit Time	Total Time
Introduction – Brief overview of above	5 min	5 min
Step 1. Pre-Work – Individual reading on outsourcing, industry overview, and company strategy (optional as homework but strongly encouraged if time is short)	n/a	n/a
Step 2. Prepare for Group Discussion – Read role and plan how to negotiate	30 min	35 min
Step 3. Conduct Group Discussion – Multiple stakeholder roles and negotiation	40 min	75 min
Step 4. Debriefing – Recommendations and Q&A	30 min	105 min
Step 5. Lecture (optional)	20 min	125 min

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	Unit Time =	Total Time =
Step 1. Pre-Work	n/a	n/a

“To source or not to source, that is the question.”

The instructor will form groups. Individually, read the “Background on Outsourcing,” “Plastics Industry Overview,” and “Outsourcing Strategy for Resilient Resins” below. Ask any clarifying questions when you are done. You will then be assigned to a specific role in your group.

Background on Outsourcing

The contemporary view of global strategic management is to “stick to the core and outsource the rest.” Indeed, the resource-based view (RBV) of the firm suggests that firms leverage core competences that are valuable, rare, difficult to imitate, and optimally organized. There has been an explosion in outsourcing everything from such functions as computer programming, human resources, procurement, customer service, and even R&D to back office operations and call centers. India and China have been attractive locations for their low-cost labor and large markets but are now becoming attractive for their R&D and higher-end manufacturing and services. Other attractive countries and regions are Russia, Eastern Europe, and Southeast Asia with South Africa and several Latin American countries not far behind, and even Dubai is trying to get onto the offshoring map.

The emerging belief is that owning tangible assets is not as important as controlling critical capabilities regardless of where they reside. This position argues that to reduce costs, flatten the organization, increase its flexibility and responsiveness, provide better customer service, improve quality, enter new markets, learn and obtain expertise, and assure reliability, “core functions like engineering, R&D, manufacturing, and marketing can – and often should – be moved outside.”¹ But critics, including unions and local governments, complain that when companies outsource by going offshore, they are merely trying to evade domestic legal, regulatory, or ethical obligations, insisting their intent to cut costs by eliminating jobs, sacrificing the environment, and reducing tax liabilities. In fact, many of these non-government organizations (NGOs) are essentially anti-outsourcing advocates who present its “dark side.”

While outsourcing is the current rage, very few companies are reportedly satisfied with their arrangements. One danger is creating a new or stronger competitor while becoming vulnerable to attack or diminishing one’s own capabilities. Moreover, it is important to differentiate and avoid commoditization that competes only on low price as well as to retain control over mission-critical activities in the value chain. These are difficult to protect since outsourcing relationships require sharing information, collaborating on common activities, demanding just-in-time deliveries, and lots of trust – not merely with partner organizations but with all stakeholders. In the end, each company must decide where to draw its own organization borders to avoid becoming a “hollow corporation” that depends on outside suppliers for virtually all of its activities.

Given all these complexities, outsourcing seems to boil down to the following considerations:

- What are the global strategy implications of each outsourcing option, especially regarding cost and quality? What are the risks associated with each of these options?
- How will the decision affect a company’s ability to introduce new products or quickly respond to shifting market demands?
- How can a company in general compete without conducting any manufacturing? Is the “hollow corporation” really a viable business strategy or merely a rallying cry for the critics?

¹M. Gottfredson, R. Puryear, and S. Phillips, “Strategic Sourcing: From Periphery to the Core,” *Harvard Business Review* (February 2005): 132.

Plastics Industry Overview

Mr. McQuire: Ben – I just want to say one word to you – just one word –

Benjamin: Yes, sir.

Mr. McQuire: Are you listening?

Benjamin: Yes I am.

Mr. McQuire: (gravely) Plastics.

They look at each other for a moment.

Benjamin: Exactly how do you mean?

Mr. McQuire: There is a great future in plastics. Think about it. Will you think about it?

Benjamin: Yes, I will.

Mr. McQuire: Okay. Enough said. That's a deal.

- From the movie *The Graduate*, 1967

The word “plastics” comes from the Latin *plasticus* which means “that may be molded” that, in turn, comes from the Greek *plastikós* that means “to form.” Plastics are formed by heat softening, forming, and cooling. The manufacturing process “cracks” oil (naphtha) and/or natural gas (ethane) then links it into waxy or solid chains. This is then fed to an extruder that melts it into strands that are cut into pellets or ground into powders and either bagged or placed into storage silos. These granules are later converted to useful articles by one of four main processes: Blow molding, film casting, film extrusion, or injection molding.

Mr. McQuire's admonition to Benjamin was correct: The plastics industry is the fourth largest manufacturer in the U.S., contributes significantly to jobs and exports, and continues to grow more than manufacturing as a whole. Its main customers are:

- Agriculture (e.g., greenhouses, irrigation systems)
- Consumer durables (e.g., furniture, appliances, electronics, telecommunications equipment)
- Industrial (e.g., pipes, building insulation, electrical components)
- Medical goods (e.g., medical disposables and equipment)
- Packaging (e.g., films, rigid containers)
- Textiles and wrappings (e.g., floor coverings, strapping, cord, fibers)
- Transportation (e.g., automotive and aircraft)

A coating of plastic resin is often used to coat woven textile, non-woven cloth fabrics, or other materials for specific applications. Coated fabrics have a wide variety of uses. For example, they can provide a flame retardant barrier, protection from ultraviolet (UV) rays, protective clothing, waterproof garments, industrial clothing, bags or backpacks, gaskets and seals, conveyor belts, bags and luggage, and tents and tarps. Many small firms have entered into this fabric coating sector, offering specialized products and services.

Plastics consumption is roughly evenly divided between Europe, North America, and the rest of world. There are approximately 150 significant producers and tens of thousands of consumers globally. The three major production and trading hubs for plastics are Rotterdam, Singapore, and the U.S. Gulf Coast (primarily Houston). Growth of plastics consumption is slowing, with little differentiation between the major producers as the industry matures and its products become commodities. The one exception is China, where coated fabrics consumption is projected to continue to grow. Its 10,000 local companies cannot meet growing demand because of increasing costs, short supplies of raw materials, lagging technology and equipment, low quality, small scale, and pollution control requirements. The gap is filled by burgeoning imports. Nonetheless, China remains an attractive source of supply as the industry consolidates and the government invests in infrastructure, especially transportation, warehouses, and ports. Tremendous trade barriers and unfair competition remain, however.

Outsourcing Strategy for Resilient Resins

Resilient Resins is a \$100 million sales, 80-year-old company based in Sunday, Mass. that designs, manufactures, and markets engineered membranes and plastic sheeting for a wide array of end uses: Construction (e.g., roofing, doors, membranes, etc.), decoration (e.g., signage, banners that span rafters or hang from beams in malls, etc.), military flexible tank material, tent material, and miscellaneous specialty products (e.g., dock shelter, roll up door, oil boom, medical, etc.). The Exhibit shows some of these end products manufactured by Resilient's customers along with Resilient's trademarks.

Most fabrics are made of nylon, polypropylene, polyester, cotton, or wool fibers. The manufacturing processes applies a thin coating or printing of plastic film to a *substrate*,² such as roll of paper, fabric, film, or other textile, so it can serve some function (e.g., water or chemical resistance, durability, thermal properties, colorfastness, printability, strength, resist cold, anti-stain or low-surface energy, chemical release, hydrophilicity, vapor and gas diffusivity, electrical conductivity, abrasion resistance) or used for decoration. These polymer coatings are typically based on polypropylene, polyester, or polyethylene. Achieving this property entails the following four stages (see the Figure):

1. **Research & Development** – Discover various chemical formulas for polymer (plastics) coatings added to fabrics to achieve the desired properties of finished products. This step is very proprietary due to the significant amount of R&D spent, and Resilient Resins has no intent to invest in alternative technologies.
2. **Manufacture or Purchase Substrate** – Polyester, nylon, or various armed (Kevlar, carbon, etc.) fiber are knit or woven into an unprocessed fabric. Referred to as *greige*,³ it contains no dyes, bleach, washing, printing, or any finishing whatsoever so that it can serve as a substrate onto which the polymer coatings will be applied. This fabric is made and sold as a commodity in the U.S., Asia, and elsewhere for end-use in garment manufacture, upholstery, luggage, as well as for industrial purposes.
3. **Extrusion Coating** – Coating processes are used to enhance and alter the physical properties, material surface, and appearance of a fabric affecting its overall physical and mechanical properties. Formulated polymer compounds are rolled onto one or both sides of the fabric substrate. They are subsequently cured, cut, trimmed, seamed, and assembled. Sometimes they are also digitally printed on as a service to customers. This step requires heavy investments in equipment.
4. **Sales** – The final coated fabric is sold to printers of roofing/awning materials and other construction applications, decorations for retail, printers of billboards, and fabricators of tents and portable tanks.

Polyester-base material is knit and/or woven at one of Resilient Resins' three company-owned plants in Pittsfield, Massachusetts and Houston, Texas with another \$2-\$3 million in knit polyester product (about 15% of their total requirement) purchased from Pakwong, a South Korean firm with manufacturing facilities in China. Coating and post-coating process work is done in Massachusetts and Texas. Approximately 40% of current business is in the market for roofing materials which requires less customization and post-coating compared with, say, the company's digital printing business which demands a greater level of service. Customers are distributed across the U.S. and range from shopkeepers who buy custom awnings to billboard operators who order signage to the U.S. Army which buys fabric fuel tanks.

The largest customer is Paradise Real Estate, one of North America's largest mall developers that has become more demanding with threats to purchase elsewhere. Paradise intends to build in China, in which case it might want to get its supplies from someone other than Resilient. For instance, it might purchase stage 2 from another vendor and have someone else provide the final service. Since it builds and manages malls, it wants a low-cost and reliable supplier of roofing, loading dock doors, decorative awnings, and

²A "substrate" is a stratum or layer that lies underneath another. For biological or chemical substances, it is a substance that an enzyme acts upon.

³The word "greige" comes from gray textiles that are unfinished woven fabric from the loom.

banners to serve its construction in the U.S. as well as its new construction in China. Its managers are trying to understand if they can purchase all these things from Resilient Resins or if they should get “clever” and eliminate them by going directly to some Chinese manufacturer. Paradise has to figure out if it is willing to put up with much lower service levels (e.g., suppliers that do not speak English and perhaps do not understand its needs) or if it wants to continue purchasing from Resilient. It could also advocate a sourcing arrangement whereby Resilient would get lower costs (e.g., from Korea or a China joint venture) and pass on the savings, or it could tell Resilient that it is taking its business directly to an Asian source such as Pakwong or a Chinese vendor.

After two years of contract manufacturing for Resilient Resins, Pakwong has indicated interest in licensing Resilient Resins’ coating technology and reselling under its own brand in the U.S. and elsewhere. As a result, Resilient Resins now faces the threat of a potential new entrant into its home market and wishes to explore whether it has the option of leveraging China’s production base and huge potential market to its own advantage. To further this end, President Jim Driver located a Chinese vendor, Shenzhen New Materials, at a trade show a year ago and has already purchased four shipments worth around \$65,000 each. Shenzhen New Materials owns extrusion coating machinery similar to Resilient’s and is interested in discussing a joint venture. The pricing from Shenzhen New Materials is better than Pakwong currently offers but quality, delivery, and service are less consistent as seen below.

	Pakwong	Shenzhen New Materials
<i>Price</i>	<ul style="list-style-type: none"> • 3% below U.S. 	<ul style="list-style-type: none"> • 4.5% below U.S.
<i>Quality</i>	<ul style="list-style-type: none"> • Consistent to specifications 	<ul style="list-style-type: none"> • Some non-critical variances
<i>Delivery</i>	<ul style="list-style-type: none"> • Consistent 	<ul style="list-style-type: none"> • 2 of 4 shipments were late
<i>Service</i>	<ul style="list-style-type: none"> • English language, frequent communication, provides letter of credit 	<ul style="list-style-type: none"> • Lower level of English, frequent communication, willing to finance 30 days

There are numerous local competitors throughout the U.S., with a handful of very large global companies which are also considering sourcing alternatives both for low cost supply and for market entry. Fortunately for now, Resilient Resins’ solid reputation within its industry enables it to maintain a top leadership position in the industry. Unfortunately, the U.S. market is growing very slowly forcing additional domestic sales be based on cost. Even so, Resilient Resins is reluctant to face such giants as 3M, BASF, Ciba, DuPont, GE, and WL Gore. Hence, continued growth and profits requires some sort of international expansion. Should it successfully go global, the increased sales would be met from either more sourcing of low-cost raw materials or offering customized products and providing exceptional services; in either case, Resilient Resins is reluctant to invest in more production capacity in its Houston plant. It already has some experience overseas since its CEO Peter Plante visited China in the very early 1980s to service construction customers in Shanghai. The group has not sold product into China in recent years, and to do so now requires a broad overview of related markets to determine whether a sales initiative is viable.

CEO Plante does not want to make a major move overseas (especially a joint venture with a foreign partner) as he thinks there’s plenty of business in the U.S. He is willing to export, however, through an overseas agent who understands the local market, customs, language, politics, and laws as this entails less investment and risk. He is not adamantly opposed to entering China or any other market, and someone with evidence might be able to change his mind. He “knows what he does not know” and is concerned about moving too quickly to commit with another company that operates in an unfamiliar culture.

When your group is ready, proceed to Step 2.

Exhibit: Sample Product Uses by Existing Customers



Zodiac™ signs and banners



PortiTank™ fuel storage bladders



GungHo™ waterproof boots



ThermoTile™ plastic roofing sheets



DockWrap™ inflatable dock shelters



DryWrap™ waterproofing membranes



ThermoGuard™ non-woven tent fabrics



Roll'Em™ roll-up doors



ArmorTile™ engineered plastics



Source: Developed by Janet Carmosky of China Prospects, Albany, N.Y.

Step 2. Prepare for Group Discussion	Unit Time = 30 min	Total Time = 35 min
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The CEO of Resilient Resins wonders which business model will bring the greatest strategic advantage. He has asked every group to make the strongest case for its recommendations. Your group consists of multiple stakeholders, each representing a different perspective (see Table). Each participant will play the role assigned. Please use the name “tent” you are provided by showing your title to the rest of the group and make sure your role instructions face only you. Participate in the group discussion by being consistent with the information you are provided for your role without divulging specific information to others in your group. Broadly, your role will provide advice to the CEO as to the costs and risks associated with each of the following two options:

1. Continue purchasing polyester and nylon fabric by contract manufacturing with Pakwong, which offers lower cost advantages vis-à-vis manufacturing in Houston (e.g., raw fiber, manufacturing of finished greige fabric, and resins and compounds).
2. Investigate alternate sources of this material that provide greater benefits than the current source, including compatibility for a longer-term relationship involving production and sales for China’s domestic and Asian regional markets (e.g., technical compatibility, sales and marketing capability, etc.).

Keep in mind that you have been using one vendor for some of your needs but another has expressed interest in selling to you. Should Resilient Resins decide to alter its outsourcing, it must next consider the level of commitment to make. It is important for any U.S. operation to monitor and manage its overseas vendors. The following basic options have increasing levels of capital and operational commitments: Establish a China representative office, select an agent, enter into a contractual joint venture, create an equity joint venture, or build a wholly-owned foreign enterprise. Complicating your decision, incrementally larger commitments can also enable Resilient Resins to sell in the China market. For your discussion, organize your outline and approach for the strategy recommendation as follows:

1. Things I will not budge on:
2. Things I am willing to compromise on:
3. Group members I can ally with:
4. Strengths of my recommendations:
5. Weaknesses of my recommendations:
6. What the CEO can expect from my recommendations:
7. What other question I want clarified:

Step 3. Conduct Group Discussion	Unit Time = 40 min	Total Time = 75 min
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When you are done, proceed with your group discussion.

Table: Key Players

Role	Responsibility/Objective	Pros and Cons/ Technical Analysis
Jim Driver (President)	<ul style="list-style-type: none"> ▪ Hired six years ago by the CEO to help run the business and make Resilient Resins grow ▪ Had a failed expensive experiment to expand in Europe (facilities were purchased and sales established, yet it was on the block four years later); wants to avoid another costly mistake ▪ All of the representatives at the discussion want to influence the decision, but willing to listen to everyone to get a better alternative 	<ul style="list-style-type: none"> ▪ Believes that international ventures are necessary for survival in an increasingly global environment ▪ Wants a joint venture partner in China with a low-cost manufacturing base ▪ Wants a sales market in East and South Asia countries
Pakwong (Current Vendor)	<ul style="list-style-type: none"> ▪ Believes that Resilient Resins is declining, without the technology or cost controls to survive once leaner players like it enter the U.S. market ▪ Wants to increase sales of low-end greige substrate from Korea and begin manufacturing some finished goods in U.S. to enter market; even offered to buy the Houston plant ▪ Ready to overlook loyalty if the rewards are great; the only ethical principle in business is winning 	<ul style="list-style-type: none"> ▪ Sales force, customers, and networks in Korea and China give it an advantage over any non-Asian entrants ▪ Substrate production is the most difficult and capital-intensive part of the business, and this is presently outsourced to factories in China
Paradise Real Estate (Major Customer)	<ul style="list-style-type: none"> ▪ One of North America’s largest mall developers ▪ New president wants to find cheaper sources for almost everything ▪ There are tremendous cost advantages in China ▪ Is pursuing mall construction in China 	<ul style="list-style-type: none"> ▪ Its operations director has used Resilient Resins as a preferred vendor for over twenty years ▪ Relies on Resilient Resins service, quick turnaround, reliability, and responsiveness ▪ Leaving will incur hidden costs, unpredictability, and public relations problems
Delores Wilson (Houston Plant Manager)	<ul style="list-style-type: none"> ▪ With twenty years experience, she is loyal to the firm and its workers ▪ Three years ago, her plant’s production dropped significantly below capacity when Resilient Resins began sourcing from China rather than buying a new weaving line for her plant ▪ Suspects Resilient Resins has a long-term plan to move production to a low labor cost country ▪ In spite of the turmoil, morale has remained high due to good union relations 	<ul style="list-style-type: none"> ▪ President Jim Driver said the volumes in this specification are too small to justify owning the weaving equipment, but it is clear that Resilient Resins will not invest in high-tech upgrades for this plant ▪ The union has threatened to strike and protest to government officials if Pakwong buys this plant ▪ Recent tax breaks for Resilient Resins should not cost jobs

Role	Responsibility/Objective	Pros and Cons/ Technical Analysis
Shenzhen New Materials (Outsource Option)	<ul style="list-style-type: none"> ▪ A Chinese competitor of Pakwong’s Chinese plants with a domestic capacity and sales force that is significantly larger than Pakwong’s ▪ Promises to sell at the lowest cost although known to struggle with quality and delivery reliability 	<ul style="list-style-type: none"> ▪ Willing to sell at a loss to obtain new customers in hopes of building a larger client base ▪ Experience has improved its skills in design and development ▪ Must fix problems with quality and reliable delivery
Kim Sanchez, Coordinator of “Keep it Local,” a consortium of unions, NGOs, local government groups, and the industry association	<ul style="list-style-type: none"> ▪ Numerous groups are opposed to outsourcing regardless of rationale ▪ Multiple stakeholders believe in global cooperation, reciprocity of foreign investment, fair tax payments, worker safety, pollution controls, energy conservation, and abiding by international laws; each of these objectives has an economic cost as well as public opinion implications 	<ul style="list-style-type: none"> ▪ State governments in Massachusetts and Texas are concerned about losing jobs and taxes to foreign countries ▪ The Plastics Industry Association (PIA) is concerned that R&D activities will go overseas along with basic production, eliminating highly-paid scientific and production jobs ▪ International trade organizations are worried that the U.S. is losing its competitive edge and any further deterioration in the balance of trade will threaten global stability
Observer/Recorder	<ul style="list-style-type: none"> ▪ All observers represent a management committee and may not offer any advice or opinions 	

Step 4. Debriefing

Unit Time = 30 min **Total Time = 105 min**

Strategic decisions are fraught with much ambiguity and uncertainty, and integrating the many components is difficult because of the trade-offs that require political and personal considerations as much as quantitative and objective measures. This is especially true about outsourcing, which has no simple formula. In this exercise, you experienced both the process and content of engaging in such a task. During the negotiations, you should have noticed the conflicting stakeholder roles and demands. All-in-all, with everyone bringing in their own information, opinions, and perspectives, you should see the larger outsourcing picture. Hopefully, the exercise will show you the importance of thinking through what the entire task entails. Doing so is not easy, straightforward, or painless – but it is also ultimately rewarding!

The class discussion should entail the process issues involving negotiation, communication, and leadership. The observer will identify what occurred that was effective and ineffective. For example, there might have been some missed opportunities for collaboration, some effective strategies for including other perspectives, steps taken for building coalitions, or some cultural clashes. Everyone should be prepared to individually discuss the following questions:

1. What information and data do you need to have before you begin negotiation?
2. How can other perspectives be included to provide information and engender commitment?
3. How does your position impact your ability to innovate and deliver value to your customers?
4. Considering the risks involved with your position, describe a worst case scenario. Are there ways to minimize these risks?
5. How did you perceive your responsibilities in this exercise? Did this change over time?
6. How well did your group work together? Was this harder or easier than working with other groups or in other situations?
7. How important was it to understand the outsourcing process in order to develop an effective group strategy? Did your group develop or establish any rules?
8. In developing your negotiation position, in what ways did you consider your relationships with your customers? If you discovered that your main U.S. competitor is actively exploring ways to outsource its extrusion coating process, would you change your position?
9. If you were to survey your customers to inform your decisions, what questions would you ask?