BUSINESS/INDUSTRIAL MARKETING

Module for AAU School of Commerce

Department of Marketing Management

Compiled by
Mulugeta Gebre-Medhin

October 2021

TABLE OF CONTENTS

CHAPTER 1 INTRODUCTION TO BUSNESS MARKETING

Learning Objectives

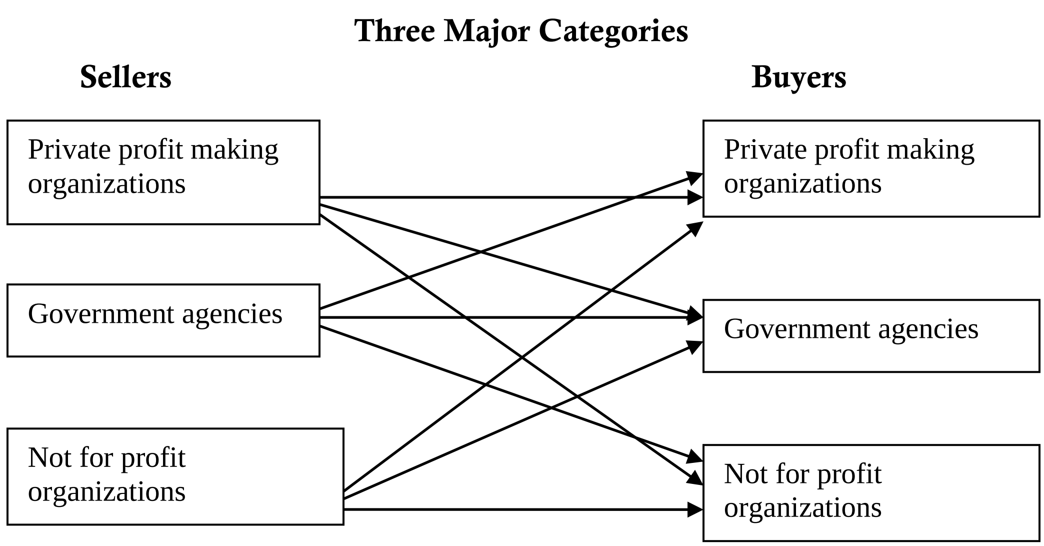
Upon completion of this chapter a student will be able to:

- Obtain an overview of business marketing
- Become familiar with the terminology of business marketing
- Define business and business products
- Learn to classify industrial products according to how goods are used.
- Identify the characteristics that differentiate business marketing from consumer marketing

1.1 An Overview of Business Marketing

Marketing delivers a standard of living. In the case of business marketing, this standard is delivered to business organizations, public agencies, and not-for-profit organizations of all kinds, large or small. Exhibit 1-1 is a simplified view of the buying and selling activities of the three major participants in industrial or business markets: private, profit making organizations at all kinds and sizes; public institutions (government agencies) at all levels; and not-for-profit institutions.

Exhibit 1-1 A simplified View of Buyers and Sellers in Business Marketing



1.2 Business Marketing Terminology

As the first step in your study of business marketing you will need to become familiar with some marketing terminology as it is used in this course.

Marketing is the creation and adaptation of products and services to provide greater utility or value to customers than do competing products and services. Marketing involves selection of potential customers (target markets) and management of the marketing mix (product, price, place, and promotion).

The **marketing concept** includes three key ideas:

1. the principal focus of the marketing manager is to provide customer satisfaction;
2. the entire organization must be coordinated as an integrated system in which all employees and departments are aware of their roles in the organization/customer relationship and work together to maintain that relationship; and
3. the long-range goals of the organization (profit, stability of employment, service to society, a favorable public image, and so forth) must be fulfilled.

A consumer is an individual who purchases goods and services for self-gratification. Self-gratification may result from acquiring, attending, consuming, or using the purchase (such as the enjoyment obtained from eating a chocolate candy bar or watching a rented video-tape) or from giving the purchase to another person (such as the pleasure the buyer experiences in anticipating the appreciation that will be exhibited by the recipient of the gift).

A business marketer or an industrial marketer is an individual or an organization that sells goods and services to other businesspeople, businesses, institutions, or organizations. The business marketer may also be called a business-to-business marketer or seller.

A business buyer is an industrial or business purchaser who buys for reasons other than self-gratification or self consumption. Typically, the purchase or rental is made for one of three reasons:

(1) to incorporate the product or service into the products or services that the organization produces (for example, AMCE purchases laminated safety glass for auto windshields);

(2) to facilitate the operation of the organization (for example, East Africa Bottling purchases automobiles for distribution and its salespeople): or
(3) to resell the product or service (for example, a retail store like Bambis purchases packaged food products to resell immediately, without any modifications, to consumers).

Business marketing is the marketing of products and services to organizations rather than to households or ultimate consumers. The purchase is made, not for self-gratification, but rather to achieve organizational objectives. Business marketing is also called business-to-business marketing, industrial marketing, commercial marketing, institutional marketing, government marketing or organizational marketing.

In past years, texts dealing with business marketing were titled "Industrial Marketing and many courses in business schools today are still called "industrial marketing." However, the term business marketing offers a more realistic and comprehensive image of the ***non consumer marketing world***. It avoids the confusion that may arise when, for example, a firm manufactures hair shampoo and then sells it to distributors and retailers. Although the product in such a case clearly is a consumer product, the decision-making and purchasing behavior of the distributor or retailer is very different from that of a consumer. Thus we find that ***business marketing is employed throughout the distribution channel up to the time of sale of the product to the retailer.***

In business marketing the purchasing decisions throughout the distribution channel are based on very rational economic considerations involving such issues as:

a) potential demand,
b) inventory levels,
c) shelf-space availability,
d) promotional support offered by the manufacturer, and
e) profitability of the product.

Business customers usually are organizations rather than individuals (although there are many single-proprietor businesses in operation). Business customers' requirements typically are:

a) thoroughly specified and
b) more technically complex.

Furthermore, the success, the economics of operation, and the profitability of the organization are strongly dependent on:

- what items are purchased,
- how they are purchased,
- when they are purchased, and
- the reliability and consistency of supply of those goods.

Business marketing consists of individuals and organizations that acquire goods and services used to produce other products and services that are sold, rented, or supplied to others. This market includes buyers from many types industries: manufacturing, construction, transportation, communication, banking, finance, insurance agriculture, and mining. It also encompasses a range of organizations that do not have profit as a primary goal. Government agencies- federal, state, municipal, etc are considered business markets. So too are such institutions as hospitals, churches, prisons, schools, colleges, and universities. Even the Red Cross can be classified as part of the business market. The justification is that:

a) their evaluation of competing suppliers and their products tends to be more formalized and professional, and more carefully evaluated against the institution's objectives.
b) the buying decision processes of nonprofit organizations are more similar to decisions made by profit-making businesses than to the self-gratifying purchase decisions arrived at by consumers.

1.3 Business Product Classification

Some products can be identified clearly as industrial products: forklift trucks, bulldozers, pallets, injection molding machines, and jet engines are industrial or business products. Still other products with little or no adaptation may be considered either business or consumer products, depending on the circumstances in which they are purchased and used. For example, identical computers may be found in word processing applications in the office and in the home. And what about flowers and plants? In the home we know they are consumer goods. But in the office, they play the role of business goods.

Consumer goods are classified as:

1. convenience goods
2. shopping goods
3. specialty goods and
4. unsought goods.

The basis for this classification system is the variability in the buying behavior of consumers. Thus consumer goods are classified according to how people buy.

With business goods, there is a remarkably low degree of variability in buying behavior (see Exhibit 1-2). Consequently, the consumer goods classification system does not help business marketers to classify business goods. Since most businesses follow the same pattern of search, evaluation, approval, and purchase for goods and services, we must find a classification scheme that points out other types of differences in product groupings.

Exhibit 1-2 The Business Buying Decision Process

1. Recognition of needs
2. Definition of characteristics and quantity of item needed
3. Development of specifications to guide procurement.
4. Search for and qualification of potential sources
5. Acquisition and analysis of proposals
6. Evaluation of proposals and selection of suppliers
7. Selection of order routine
8. Performance feedback and evaluation

Source: Patrick J.Robinson, C.W. Faris, and Y.Wind, *Industrial Buying and Creative Marketing* (Boston: Allyn & Bacon and the marketing science institute, 1967). Pp. 13-18

The traditional method of classifying business products is based on how the goods are used. This system consists of the seven categories listed in Exhibit 1-2 and described in the following sections.

Exhibit 1-3 Business Goods Classification

	Standardization or Grading	Used Across Various Industries	Risk of Obsolescence	Requires High-Level Approval	Credit Necessary	Emphasis on OEM Specifications	Delivery is Important
1.Capital equipment and investments							
Land, buildings, other companies		M	M	P	M		
Single purpose equipment			P	P	P	P	
Multipurpose equipment	P	P		P	P		
2. Accessory equipment	P	P					
3. Component parts							
Standardized	P	P				P	P
Custom			P			P	P
4. Process materials	P	P				P	P
5.Maintenance, repair, and operating (MRO) supplies	P	P				M	M
6. Raw materials	P	P				P	P
7. Services							
Technical				P			
Non-technical		P					P

P = Present M= May be present

1. Capital Equipment and Investments

Capital equipment and investments require significant financial expenditure. Thus, marketers may have to extend credit to the buyer, assist the buyer in securing funds or loans, or offer the buyer leasing agreements. The high cost of capital expenditures also means that the buying organization's top executives will be involved in the purchase decision. Capital equipment items are always installed in a fixed location. Capital equipment and investments can be sub-categorized into:

i) land, buildings, and other companies;

ii) single-purpose equipment; and

iii) Multipurpose equipment.

i) Land, Buildings, and Other Companies - Land, buildings, and other companies (takeovers) typically involve lengthy negotiations and are the largest investments a firm will make.

ii) Single-Purpose Equipment - Typically, single-purpose equipment is ***custom made*** for only one company or industry. For example, a conveyor system is custom-designed to traverse a certain factory configuration at a specific speed and varying a stated maximum load. Customized equipment requires much interaction and negotiation between the technical sales and service people of the seller and the engineering staff of the client.

Older custom made equipment can pose problems. Because of its specialized nature, it is extremely difficult to find buyers for used single-purpose equipment. Thus, if the buyer's products change rapidly (requiring different production equipment) or if the single-purpose machine is easily made obsolete by technological innovation in the machine producing industry, the buyer faces high risk levels. Consequently, buyers of single-purpose equipment plan for shorter replacement periods and have to put more money aside annually for equipment replacement. All of these factors suggest that the astute business marketer may have to extend credit terms or help the client secure a loan if a sale of new equipment is to be consummated.

iii) Multipurpose Equipment - Multipurpose equipment, such as boilers, compressors and hoists, is used by most manufacturing industries. Such equipment has a ***horizontal market*** that is, a market extending across many industries. The product life cycle tends to be quite long, resulting in lower risk of obsolescence and longer replacement periods. The broad market for these products guarantees relatively easy sale of used equipment, and indeed, used equipment brokers play a role in bringing together buyers and sellers of older machines. The standardization of multipurpose equipment means that business marketers do not have to be involved in as much detailed selling, service, or negotiation with customers as in the case of single-purpose equipment.

2. Accessory Equipment

Accessory equipment includes such readily movable items as spot-welders, hand-held drills, and forklift trucks in industrial settings, and personal computers and furniture in office settings. Accessory equipment and machines are standardized, and their marketing involves routine selling and negotiation. Their relatively lower cost permits most to be considered current expense items that is; their cost can be charged as an expense in the purchase period rather than having to be deducted in portions over several years of operation, as is the case for capital equipment purchases. Thus accessory equipment does not require high-level executive approval prior to purchase. High demand and extensive horizontal markets for accessory equipment permit the use of distributors.

3. Component Parts

Component parts are manufactured items, subassemblies, or completely assembled units that are incorporated into the buyer's final product. There are two types of components,

1. standardized and
2. custom

Standardized components conform to industry accepted dimensions and performance specifications. Batteries, tires and headlights are examples of standardized components in the vehicle market. Such products can be held in inventory by distributors and sold "off-the-shelf".

Custom components, on the other hand, can involve elaborate specifications. Forgings, castings, automotive windshields, and timing motors are examples of custom components designed to the exact specifications of the buyer.

Because many components wear out with use and need replacement, components have the potential for significant ***replacement sales***. Also, the manufacturer using the components to build a product may buy substantial volumes of components and be a very important customer for the component supplier.

Original Equipment Manufacturer (OEM) - The purchaser that uses component parts in some larger, final product is called an original equipment manufacturer (OEM). Thus, in the automotive business, Toyota is an OEM, and the component parts purchased by Toyota (tires, door handles, and so forth) are referred to as ***OEM parts***. The manufacturers that sell components to Toyota are called ***OEM parts suppliers***. Component parts suppliers must not only rigorously meet OEM specifications, but also ensure that the quality of the components is consistent and that their delivery is reliable so that OEM can hold inventories at a low level. Japanese OEMs, such as Toyota, have achieved extremely low inventory costs by demanding that their suppliers provide just-in-time (JIT) deliveries. This indicates that business marketers must use short, direct channels of distribution to capture OEM business.

After-Market - Some components such as vehicle batteries, tires, headlights, fan belts, and air and oil filters are subject to degradation or wear and present a sizable market, called the **after-market** or **replacement market**. Where such components do not lose their identity in the final product, it is possible to establish brands, such as Toyota filters, Bridgestone tires, and GE head lights. Many component manufacturers vie (compete) for a share of the after-market. For any component say, auto tires one of these competitors is the OEM parts supplier. The rest are called **will-fit component suppliers**.

The implications of the after-market can be important to the business marketer.

- First, the user of an expensive equipment or product that requires a replacement component will be relatively insensitive to price. The after-market, therefore, can be quite lucrative.
- Second, when it comes time to replace a degraded component, a significant proportion of OEM product owners feel more confident when they purchase the OEM part rather than a will-fit part.
- Third, the existence of several competitors hotly contesting after-market business suggests that the part manufacturing firm, that is the designated OEM supplier, will have a distinctive competitive advantage over all of the will-fit part suppliers.
- Fourth, potential component suppliers will be willing to yield price concessions to the OEM, not only to obtain the substantial production-run order of the OEM, but also to win the **follow-on business** of the more profitable (per unit) after-market.
- Fifth, business marketers in the after-market all use a **pull strategy** in advertising their components that is, they promote their products to final OEM product owners, who in turn place a demand for these products on the suppliers, thus "**pulling**" the product down through the marketing channel. For example, the tire manufacturers all advertise directly to consumers.
- Finally, such advertising also may help influence the OEM in the choice of which component manufacturer to select as the OEM parts supplier.

4. Process Materials

Process materials are manufacturing materials that tend to lose their identity and may even be ***indistinguishable*** in the final product. Examples of process materials are sheet metals, textiles, cement, chemicals, electrical and electronic circuit wiring, and additives. The replacement market for process materials is not substantial. The business marketer may have to provide some technical assistance to customers, finds price competition keen because competing suppliers are readily available, and must provide reliable delivery because the customer's production is dependent on availability of materials.

5. Maintenance, Repair, and Operating (MRO) Supplies

Maintenance, repair, and operating (MRO) supplies are used to facilitate operation of the organization but do not become part of the final product in the way that component parts and process materials do. Maintenance and repair items include cleaning agents and tools, paints, and light bulbs. Operating supplies include such items as lubricants and coolants for factory machinery, heating fuels, gasoline for company vehicles, and office supplies, such as envelopes and printer, fax, and reproduction papers.

These items are characterized as having extensive horizontal markets and are relatively low cost, current-expense items. They are usually purchased routinely, in small quantities and do not require high-executive approval. The MRO supplier's marketing efforts are similar to those associated with consumer products, and typically the channel of distribution for MRO goods is relatively long and indirect. The exception is when long-term systems contracts are negotiated, for perhaps a year's anticipated needs.

6. Raw Materials

Raw materials such as agricultural products or natural gas may enter the production process with little or no alteration. They may be marketed as either OEM or user products. Because of volatility of supply and sometimes extreme price fluctuations, raw materials markets may exhibit vertical integration.

7. Business Services

Business services are the fastest-growing segment in industrialized nations. Business services may be technical, such as computer repair contracts, or non technical, such as janitorial service. Non technical services usually can be sold across horizontal markets. Typically, the reliability of delivery of the service is important. Business services are often purchased from sources outside of the organization because they can be performed more quickly, more reliably, or more inexpensively by specialists who make the service their full-time activity. The buying organization also may avoid investment in equipment and supplies that are necessary to perform the service. As a business "product," services are treated as a current-expense item. Nevertheless, their purchase may be negotiated at fairly high executive levels in the buying organization.

Exhibit 1-4 Summary of Classification of Industrial Goods and Services

Type	Characteristics	Examples
Capital Equipment	Often referred to as "installations" Exhibits inelastic demand Usually involves direct distribution Requires close cooperation between buyers and sellers	Machinery, machine tools, robots
Accessory Equipment	Used to facilitate production, administrative, or marketing activities Exhibit elastic demand Distribution channels often longer Standardized and less costly than capital equipment.	Office equipment, personal computers, desk top printers, hand tools, fire extinguishers
Process Materials	Generally bought per specifications Prepared by the customer (user) Cannot be regrouped in the finished product Most marketed to OEMs or to distributors who sell to OEM market Considerable emphasis on price and service in the sales process	Chemicals, plastics, cement.
MRO supplies	Facilitate the production operation Short life and less expensive Usually standardized specifications Longer channels of distribution	Paint, cleaning supplies, filters, pens, greases, lubricating oil.
Component parts	Become part of other product Identified and distinguished easily Consistent quality required Delivery schedule critical	Timing devices, switches, spark plugs
Raw Materials	Basic lifeblood of industry Become part of manufactured product Exhibit inelastic demand Usually bought in large quantities Large of short channel of distribution	Farm products, lumber, iron ore, etc.
Business Services	Support organizational operations Spectacular growth Specialized providers Cost effective	Banking, insurance, financial, advertising, marketing research, consulting, etc.

1.4 Differences between Business Marketing and Consumer Marketing

This section examines differences between business marketing and consumer marketing with respect to:

1. market structure,
2. marketing philosophy,
f) buyer behavior,
3. purchasing decisions,
4. marketing research,
5. product/ service mix, promotion, distribution mix, and price

1. Market Structure

Market structure refers to the characteristics used to describe the group of organizations that buy the products and services of a business marketer. These factors include competition, demand, and price elasticity of demand, market and buyer size, and location of the market.

a. Competition - Business markets have fewer sellers and fewer buyers in any market segment than do consumer markets. ***Competition in business markets tends to be more oligopolistic*** (fewer sellers and many buyers), whereas ***consumer markets are more monopolistic*** (many buyers and sellers, and differentiation among competing products).

b. Demand - Whereas ***consumers initiate a direct demand*** with their purchases, the demand for business products or services depends on the level of activity that the buying organization (the business marketer's customer) can generate in its own markets. Thus ***business demand is derived*** (second-or third hand, or more). This derived demand would not exist if the customer organization, in turn, could not find customers or clients for its own products or services.

c. Demand Levels - The organizational buyer may use a piece of production equipment to produce 10,000 units per year. Thus, a second machine is required only if sales are expected to exceed 10,000 units. As a result, there is no direct one-to-one relationship between the customer's (for example, a retailer's) sales fluctuations and the business marketer's sales. This accentuates the swings in derived demand, making sales to business buyers far more volatile than changes of demand experienced in consumer markets by a retailer.

d. Reverse Elasticity - When organizational buyers see prices start to decline, they may postpone buying in the expectation of obtaining an even lower price later. The opposite holds if the organizational buyer anticipates continuing price increases. In this case, when prices begin to rise, more volume than is immediately needed is purchased to avoid paying even higher prices later. Such reverse price elasticity of demand is infrequent in consumer markets.

e. Total Market Size - Business markets include not only the various early, value-adding stages of manufacturing and distributing consumer goods, but also the sales of business goods and services to manufacturing, processing, commercial, institutional, and government organizations. As a result, the business market is significantly larger indeed, four times larger than the consumer market.

f. Size of Buying Unit - The organizational buying unit often called central buying unit (CBU), decision-making unit (DMU), multiple buying influence (MBI), or buying center usually involves several individuals.

- One reason is that various departments of an organization are affected by the purchase. For example, in the factory, the purchase of certain machinery may affect output quality (quality control department), the plant manager's budget, machinist productivity (the union), the acquisition of funds (finance department), the engineering department, and a purchasing agent.
- Another reason is that many minds often can make a better decision.
- A third point of view is that group membership removes the decision-making responsibility from any single individual. This can be quite useful if the decision turns out to be a poor one. For the business marketer, the group of people involved in the purchasing decision represents a veritable "who's who" in the buying organization. Each individual imposes different perspectives, expectations, and requirements on the purchase. In contrast, the consumer purchase usually involves an individual or, at most, one or two family members.

g. Market Geography - In industry after industry, business marketers tend to concentrate geographically because of the availability of natural resources or of a skilled work force, the distribution advantages, or the desire to be close to customers. Thus, business markets tend to be geographically concentrated, and business marketers travel significant distances from one cluster of customers to another. Consumer markets are more diffuse, generally spread out according to population location.

2. Marketing Philosophy

The concepts or philosophies of business marketing differ substantially from those of consumer marketing. One basic difference we have already mentioned is that ***consumer goods are usually classified according to how they are purchased (convenience, shopping, specialty, unsought), and industrial goods are categorized according to their use or buying situation (task) or degree of customization.*** Other significant differences occur in the areas of market segmentation, investment requirements, market perspective, tactical marketing emphasis, innovation, buyer/seller interaction, reciprocity, key accounts, and customer education.

a. Market Segmentation. Consumer marketers use demographics (age, income, location) and socio-psychological dimensions (attitudes, preferences, personality, and lifestyle) to segment their markets. Business marketers, on the other hand, use emporographics (industry, end market served; level of technology, ownership), SIC (Standard Industrial Classification) codes, and characteristics of the buying units (number of influences, ad hoc versus standing committees, centralized versus decentralized, annual volume of purchase) to segment their markets.

Exhibit 1-5 Differences between Business Marketing and Consumer Marketing

	Characteristic	Business Marketing	Consumer Marketing
Market	Competition	Oligopolistic	Monopolistic
Structure	Demand	Derived	Direct
	Demand levels	More volatile	Less volatile
	Reverse elasticity	Frequent	Infrequent
	Total market size	Larger	Smaller
	Size of buying unit	Group	Individual
	Market geography	Concentrated	Diffuse
Marketing	Market segmentation	Emporographics	Demographics
Philosophy	Investment requirements	Strategic	Tactical
	Market perspective	Global	Regional/national
	Tactical marketing emphasis	Profit performance	Market share
	Innovation	Technology-push	Demand-pull
	Buyer/seller interaction	Relationship	Transactional
	Reciprocity	Frequent	Rare

	Key accounts	Important	Nonexistent
	Customer education	Strong	Weak
Buyer Behavior	Customer/prospect mix	Small	Large
	Order size and frequency	Large, infrequent	Small, frequent
	Purchasing motives and skills	Rational, professional	Emotional, self-gratifying
	Contractual penalties	Common	Never
	Buying power	Strong	Weak
	Vendor loyalty	Strong	Weak
	Purchase involvement	Greater	Smaller
Purchasing Decisions	Decision-making process	Complex, lengthy, observable	Simple, short, non observable
	Purchase risk	Very high	Low
Product/Service Mix	Product Life cycle	Shorter	Longer
	Product specification	Customized	Standardized
	Branding	Corporate family	Individual product
	Purchase timing	Requirement planning	Immediate use
	Degree of fabrication	Value-adding stages required.	Mostly finished goods
	Type of packaging Services	Protective Much more, pre-and post-transactional	Promotional; Less, point-of-purchase
	Equipment compatibility	Good	Poor
	Consistency of quality	Critical	Not vital
	Industrial design	Less frequent	More frequent
	Systems selling	More frequent	Less frequent
Promotion	Promotional emphasis	Personal selling	Mass advertising
	Promotional objectives	Preparing for sales call	Positioning product and firm
	Promotional themes	Rational, factual	Fanciful, imaginative
	Role of salesperson	Problem solving	Persuasion
	Sales promotion tools	Specification sheets, catalogs, direct mail, trade shows	Coupons, samples, point-of-purchase displays
Distribution Mix	Channel length	Short, direct	Long, indirect
	Channel complexity	Complex	Simple
	Product knowledge	Strong	Weak
	Channel coverage	Direct, exclusive	Intensive, selective
	Delivery reliability	Crucial	Not critical
Price	Competitive bidding	Common	Rare
	Price negotiation	Common	Rare

	Leasing	Common	Rare
	Product life cycle costs and benefits	Important	Usually ignored
	Discount structures	Complex	Straightforward
	Promotional pricing	Seldom used	Frequently used

b. Investment Requirements - Business marketers tend to have higher strategic investments that is, investments in capital equipment and research and development (R&D). For example, it takes $100 million to build a silicon fabrication line and a computer chip manufacturer must have several of them to be competitive. Consumer marketers' investments are more tactical that is, directed more toward marketing activities (researching their huge customer base and promoting to mass markets).

c. Market Perspective - Consumer marketers typically seek regional or national markets because their products are created to appeal to local tastes and they can find sufficient sales volumes at home. Business goods and services are less dependent on regional tastes and preferences. Furthermore, their specialized technologies and limited applications often require that customers be sought abroad to achieve economic production volumes and to justify high R&D costs and capital investments. Even a country with a large production in, for example, electronic equipment, may import as much as it exports. Business marketing must, therefore, have a more global perspective of markets, in terms of both customers and competitors.

d. Tactical Marketing Emphasis - Most consumer marketers are concerned with seeking market share and sales volumes (frequently hoping for future profit as a result). Business marketers are more likely to have a sizable share of highly segmented, smaller, specialized markets, resulting in more restricted sales volumes. Thus, business marketers tend to focus on profit performance and profit improvement in the short run.

e. Innovation - In consumer markets, innovation involves greater emphasis on style and incremental changes to products that can justify model changes. Innovation tends to be more of a ***demand-pull*** type (new products are developed as a result of assessment of consumer needs and wants). In contrast, innovation in business markets is characterized by R&D ***technological-push*** and radical-breakthrough developments that may revolutionize entire industries.

f. Buyer/Seller Interaction - Because business marketers deal with a smaller number of customers, frequently on a face-to-face basis, they are more sensitive and responsive to their customers' requirements. In that sense, business marketers are far more customer oriented than are consumer marketers. Consumer marketers' relations with customers usually are distanced by long, indirect channels of distribution and are reduced to a mass of transactions made at "arm's length." Organizational buyers and sellers usually enter stable, long-term relationships in which each depends on the other for continuing business success. Thus, strong loyalty is developed between buyer and seller in organizational markets.

g. Reciprocity - Frequently in business markets, two organizations could be buyers of each other's products or services. For example, an automobile manufacturer requires computer word processors, and a computer manufacturer requires automobiles for its sales force. In such a situation, reciprocity may be practiced. "I will buy from you if you buy from me." Business marketers frequently use reciprocity as a tactic to win sales in the business market. This situation rarely is possible in the consumer market.

h. Key Accounts. Key accounts are firms whose business is so important that its loss could significantly impair the marketer's sales volume, profitability, or corporate image. Clearly, business marketers must maintain close contact with these important customers to maintain its supplier status. No similar situation exists in consumer markets.

i. Customer Education. For many business marketers, customer education is an important part of the marketing strategy. IBM gained a successful niche in the mainframe computer market by sending its representatives to spend periods of months, even years, in the customer's company, working side by side with the customer's staff to write and run programs and help them learn how to use IBM equipment. Typically, business and industrial equipment has more complete instruction manuals, specification sheets, and repair and maintenance books than does consumer equipment.

3. Buyer Behavior

Business buyer behavior depends on a number of factors. Business buyers have more personal contact with suppliers, buy infrequently but in large quantities, and tend to be very objective and professional in buying. Because their dollar purchases are large, they can penalize nonperforming suppliers, but are very loyal and work closely with reliable suppliers

a. Customer/Prospect Mix -Markets are composed of customers and those who may in the future become customers (prospects). Whereas consumer marketers' customer bases range from the thousands to the hundreds of thousands and, for some, the millions, business marketers' customers range from as few as one major buyer to a few thousand. For this reason, business marketers tend to be closer to their customers and more in tune with customers' buying behavior.

b. Order Size and Frequency -Although the number of customers in organizational markets may be small, their orders tend to be quite large in number of units, dollar value, or both. In contrast, consumer buyers purchase in small quantities and frequently.

c. Purchasing Motives and Skills - The purchasing motives of organizational buyers relate to maintaining and furthering the organization's goals. These motives are ***rational, economic, objective, and profit or efficiency oriented*** compared with the more emotionally based, self-gratifying motives underlying consumer purchases. Business buyers are technically qualified purchasing specialists. Their career experiences in purchasing are augmented by attending continuing training courses and seminars in buying. In large companies they may specialize in the purchase of certain commodities and products.

d. Contractual Penalties - Organizational buyers may build substantial penalties for nonperformance into contracts with their suppliers. For example, a contract may specify that the business marketer must pay Birr1,000 for every day's delay in delivery of an order, or even higher penalties for delay in the construction of a building or in the completion of machinery installation in a plant. Such penalties are never part of consumer markets.

e. Buying Power - If an industrial manufacturer's plant is running under capacity, or a customer's order today has the potential of significant follow-on business in the future, or if the order represents a sizable portion of the marketer's business, the customer can exert a strong influence on the business marketer's price, product design, delivery, and other dimensions of the business. Such buying power never exists in consumer markets. The aggressive use of buying power by a purchasing officer to encourage or persuade a supplier to sell a product or service that more closely meets the buyer's particular requirements is called **“reverse marketing".**

f. Vendor Loyalty - Organizational buyers often exhibit strong loyalty to their current or in-supplier. In general, vendor loyalty is a characteristic of the strong interdependence between organizational buyers and their suppliers. The industrial buyer who changes vendors faces high switching costs, such as the effort of training a new supplier in the intricacies of the buyer's particular business, the possible loss of confidential trade secrets if the supplier is abandoned, and the high cost of identifying and qualifying an alternative supplier. In contrast, consumer loyalty to specific retailers or product brands is weak, and the consequences of brand or supplier switching are not serious to the consumer.

g. Purchase Involvement - The organizational buyer's involvement in a purchase is much greater than that of a consumer. The business buyer must plan the firm's requirements and specify technical and delivery details of the purchase, frequently with the assistance of the suppler. The business buyer may help the supplier develop the capability to supply what is needed, may negotiate for many months with the supplier, and must monitor supplier performance over the life of the contract.

4. Purchasing Decisions

Purchasing decisions can be complex and lengthy and usually involve several people in the buying organization. They also have tax and accounting implications for the firm. Furthermore, the business buyer must evaluate the risks inherent in the purchase.

a. Decision-making Process - The organizational purchasing decision process typically is complex, involving several functional areas of the buying organization, each with different points of view. Committees discuss the pros and cons of a purchase using documented data, proposal, purchase specifications, competitive bids, vendor analyses, and reports. Business buyers also often have the option of making a product or providing the service themselves rather than simply buying it. The organization decision-making process is observable and progresses through distinctive stages (see Exhibit 1-1). It can also be quite lengthy. In contrast, the consumer purchasing decision process is relatively simple and short. It takes place in the buyer's mind and cannot be observed. Although consumers may be able to make a product or provide a service themselves, this option is generally not as available to the consumer as it is to the business buyer.

b. Purchase Risk - The business buyer's risk can be very high. It is greatest in the new-task situation, in which the buying situation has not been countered before. Risk is least in the straight re-buy situation, in which purchasing involves simply reordering. But even in a straight re-buy there are risks, such as the delivery risk (late or incomplete shipment or damaged goods). Performance risk is reduced by purchasing from large, well-known, and reputable companies and by continuing to buy from the same supplier (vendor loyalty). Consumers' purchases also involve risk, usually proportional to the dollar value of the purchase. But in most cases the risk is relatively minor, and the consumer simply switches to a competing product (e.g., a different brand of candy bar) or doesn't buy the item again if dissatisfied.

5. Product/Service Mix

The product/Service mix is an area of marketing with the greatest number of differences between consumer and business markets. Business products have shorter product life cycles, are less likely to be branded, and are precisely specified by buyers for a future use. Packaging is mainly for protection, and services associated with the product are extensive. Business products usually are manufactured to specific industry technical and quality standards, but functionality overrides their aesthetics. Often total systems are offered to provide comprehensive solutions to the business customer's needs.

a. Product Life Cycle - The business product life cycle (PLC) is shorter than that of consumer products because of the rapidity of technological change and innovation in business markets.

b. Product Specification - Organization products involve far more customization to the customer's technical requirements and specifications than do consumer products, which for the most part have been pre-specified by the supplier, are standardized, and cannot be adjusted or modified. The consumer usually can only select from a smorgasbord offering.

c. Branding - Business products generally are identified by a corporate family brand, such as Caterpillar tractors, whereas consumer products are more frequently identified by individual product brands, such as Tide laundry detergent.

d. Purchase Timing - Consumers usually buy products for immediate use, whereas organizations buy products to fit a requirement planning sequence. Consequently, business typically purchases products to be stored in inventory before they are needed for actual use.

e. Degree of Fabrication - Most consumer goods are purchased as finished end products. A large portion of business purchases are materials and components that must undergo further value adding stages.

f. Type of Packaging - Packaging performs two major Functions: ***protection of contents*** and ***promotion***. The protection aspect is more important in business product packaging, whereas promotion plays the more significant role in consumer product.

g. Services - Organizational customers demand and receive more services in association with products than do customers in the consumer market, and pre-and post transaction service is proportionately greater in the business market. Business market services range from delivery services to technical services. In contrast, consumers expect and find more point-of-purchase services, such as credit and display services, and receive fewer pre- and post transaction service.

h. Equipment Compatibility - Business buyers expect various pieces of equipment they purchase to match and work well together. For example, electronic broadcasting, time-coding, and editing equipment must conform to industry technical standards and mounting panel dimensions. In contrast, consumer equipment such as household appliance exhibits a wide variety of technical specifications and dimensions and is unlikely to match well, even when offered by the same manufacturer.

i. Consistency of Quality - The smooth and uninterrupted operation of a business organization depends on the uniform and predictable quality of its inputs. These characteristics are not critical to consumers and are less prevalent in consumer products.

j. Industrial Design - Industrial design creates products that are not only functional, but also aesthetically pleasing and ergonomically sound that is, they compensate for the limitations of the human body. Good industrial design is more often encounter in consumer products than in business products.

k. Systems Selling - Systems selling involves offering a complete package of products and services, including design, installation, and service, thereby providing a comprehensive solution to a customer's requirements and problems. IBM's offering of hardware, software, maintenance, and in-company customer training is an example of systems selling. Far more systems selling is available to organizational buyers than to consumers.

6. Promotion

Business promotion focuses on rational, economic themes. Personal selling dominates the business marketer's promotion mix. The salesperson primarily seeks to solve business customers' problems, and often is supported by a group of inside (telephone) salespeople. Business advertising is used to prepare the customer for the sales call and is augmented by a range of sales promotion tools, including trade shows.

a. Promotional Emphasis - Because the organizational buyer requires the help of the supplier in solving technical problems and because the buyer negotiates with the supplier, the business marketer's promotion mix emphasizes personal selling. Consumer marketers must reach multitudes of customers and therefore use mass promotion techniques, with the heaviest emphasis on advertising.

b. Promotional Objectives - The cost of personal selling is extremely high. Hence, the objective of organizational promotion is to prepare the customer for the sales call by presenting information about the selling organization, its product lines, its customer mix, and its areas of specialization. Then, during the sales call, the salesperson will be able to devote valuable time to the more difficult and productive activities of problem solving and negotiation, rather than answering a lot of questions for which the customer should already have answers. Consumer advertising concentrates more on positioning products relative to competing products.

c. Promotional Themes - Messages directed to organizational buyers emphasize factual, relational, and economic issues, such as technical specifications, performance characteristics, and enhancement of the customer's efficiency and profits. In contrast, consumer appeals are more emotional and stress feelings and self-image. Consumer promotional claims are more imaginative and less factual.

d. Role of the Salesperson - The business salesperson is primarily a technical problem solver, providing information solutions. Product training is extensive and the salesperson usually has a thorough background and experience in the industry. In contrast, the consumer salesperson recognizes that there are many similar competing solutions for the consumer's needs and therefore relies less on information and more on persuasion. Consumer salesperson training focuses less on product knowledge and more on developing selling techniques. **Inside salespeople** who contact customers solely by telephone are widely used in the business market. They inform customers of inventory levels and product availability, solve customer problems over the telephone, and solicit new prospects for outside salespeople to visit. Inside salespeople are not used extensively by consumer marketers.

e. Sales Promotion Tools - Organizational sales promotion makes more use of specification sheets, catalogs, direct mail, trade shows, and exhibits. Consumer marketers, on the other hand, rely more on coupons, sampling, and point-of-purchase displays.

7. Distribution Mix

The distribution mix differs between consumer and business marketing. Business channels are shorter but more complex, and channel members have greater product knowledge. More direct, selective, or exclusive channels are used, and delivery reliability is crucial.

a. Channel Length- Business distribution channels tend to be short and direct because of the customer's needs for technical assistance and assured delivery. The geographic concentration of business customers facilitates shorter channels and provides sufficient sales volume to support dealerships, branches, and direct calls by salespeople. Channels for consumer products usually are much longer and more indirect.

b. Channel Complexity - Although business channels generally are shorter, they tend to be more complex than channels for consumer products because of the many different types of businesses and classes of customers that make up organizational markets. A manufacturer of an industrial product such as refrigeration equipment may sell to the government, to OEMs in several different industries, to contractors, to repair and maintenance companies, and through various types of distributors and manufacturer's agents in different territories. In contrast, a manufacturer of a consumer product such as corn flakes would sell to supermarkets, hotels, restaurants, and convenience stores through a food broker.

c. Product Knowledge - Business channel members must be thoroughly familiar with the technical aspects of the products they handle and the industries and commercial organizations to which they sell. In contrast, retailers' product knowledge is weak. Retailers concentrate on maintaining inventories, providing product display, and offering credit and delivery service.

d. Channel Coverage - Because of the mass of buyers and the diffuse nature of consumer markets, consumer marketers most frequently use intensive and selective channels of distribution. Smaller numbers and greater concentrations of customers in organizational markets provide more opportunities for business marketers to use direct or exclusive distribution approaches.

e. Delivery Reliability - Late delivery, misdirected shipments, and damaged goods, although annoying, nevertheless usually are not disastrous for consumers. On the other hand, in business markets reliability is crucial and has a direct impact on profitability. Shipment expediting and vendor performance analysis are therefore important functions in business markets. Organizational customers may also negotiate JIT arrangements, impose nonperformance penalties on their suppliers, and periodically evaluate various logistical alternatives.

8. Price

Because acquisition costs represent a large proportion of a business's total costs and have a direct impact on profit, organizational buyers use every means to achieve better supply prices. Consumers do not engage in such meticulous analysis and generally tend to be less price sensitive than business buyers. Organizational buyers frequently use competitive bidding and negotiation to arrive at a purchase agreement. Leasing is another means of avoiding large capital outlays. Business marketers must pay particular attention to the customer's evaluation of the cost and benefits of the purchase throughout the product's life cycle. Business marketers usually offer customers a complex of discount opportunities but rarely trade off lower price as an alternative to promotion.

a. Competitive Bidding - Organizational buyers make extensive use of competitive bidding, ranging from the less formal solicitation of quotations to the very formal sealed-bid tender requests that are used by government agencies to avoid any appearance of underhandedness. Some companies have policies requiring a minimum number of price quotations for every acquisition. Price comparisons in consumer markets are usually informal, are often based on impressions rather than facts, and are usually limited to homogeneous shopping goods.

b. Price Negotiation - Price negotiation is a common practice in business markets, with various tradeoffs in specifications and product/service requirements changing throughout the negotiation process.

c. Leasing- Organizational customers often use leasing as an alternative to financing a large purchase because of the current expense balance sheet implications of leasing versus ownership. Consumers seldom use leasing arrangements.

d. Product Life Cycle Costs and Benefits - The price of a purchased business product is only one of the various cost considerations evaluated by organizational buyers. A manufacturing customer when buying a production machine must consider the lifetime costs and benefits of the purchase. These might include such factors as faster machining speeds, higher output, lower energy consumption, lower maintenance costs, lower repair costs, lower downtime for setup, greater functional flexibility, higher resale price as used equipment, or lower disposal costs. A manufacturer, considering several alternative components to purchase, might also evaluate their prices, benefits, ad costs in terms of value added from the end customer's perspective. This is part of a manufacturer's value analysis of the product's manufacturer.

An intermediary in the distribution channel must consider how long a particular purchase will incur inventory costs. A business organization must also consider the effect of a purchase on its employees and the union. All business buyers must weigh the effects of technological (and style) obsolescence on purchases and their potential for adaptation, modification, or upgrading as technology changes. These considerations may make the acquisition price considerably less important than the lifetime costs and benefits for the organizational purchaser. Such careful evaluations are not as common in consumer markets.

e. Discount Structures. Many business products are marketed under published list of book prices. A complicated set of discounts is subsequently applied to the list price; these discounts depend on such factors as

- The class of customer (government, distributor, dealer, and user)
- The volume of purchase (single purchase quantity, annual requirement)
- The services performed by the customer on behalf of the seller (discounts for advertising, delivery)
- The seller's need for business (to provide work for an underutilized manufacturing plant).
- The probability of follow-on business
- The perceived relative buying/negotiation power of the buyer

Unlike the discounts structures for business products, consumer discounts are more straightforward.

Summary

Marketing delivers a standard of living by creating products and services that provide utility to customers. Marketers are guided by the marketing concept of the total enterprise operating as an integrated system to provide customer satisfaction and to achieve its organizational goals. Business marketers choose to provide satisfaction to other businesspeople and businesses, government institutions, and nonprofit organizations. These customers purchase goods and services to incorporate in the goods and services that their firm products, to further the operation of their organization, or to resell the goods (as an intermediary). Consumers are individuals who buy for self-gratification and whose purchase motives are in large measure emotionally based. In contrast, business markets are composed of organizations whose purchases are mainly rationally and economically motivated.

Consumer goods are classified as convenience goods, shopping goods, specialty goods, and unsought goods. Business products may be classified according to use into seven main categories: capital equipment and investments, accessory equipment; component parts; process materials; maintenance, repair and operating (MRO) supplies; raw materials; and business services. Two other classifications systems may also be used. The Buy grid Model groups products according to the newness of the purchasing situation in the buying organization. The third approach is based on the degree of customization.

Business markets are four times larger than consumer markets. The differences between business marketing and consumer marketing are both substantial and significant. These differences exist in the areas of market structure, marketing philosophy, buyer behavior, distribution mix, and price.

Discussion Questions

1. Why is it important to avoid the term consumer when referring to organizational buyers?
2. Can a product be both a consumer and a business product simultaneously? If it is physically the identical product, why would it be important to classify it as either a "business" or a "consumer" product?
3. Why is the consumer goods classification system of little use to business marketers?
4. Organizational buyers are typified as being more rational than consumers. Describe three situations in which business buyers may appear to be behaving in a more emotional way.
5. Why is the term industrial marketing falling from favor and being replaced by the term business marketing?

CHAPTER 2 THE NATURE OF DEMAND IN INDUSTRIAL MARKETS

Learning Objectives

Upon completion of this chapter a student will be able to:

- Define direct and derived demand
- Describe the chain of derived demand and its implications
- explain how a firm can stimulate derived demand
- Develop a step-by-step demand evaluation model

Overview

One of the keys to effective marketing of business goods and services is an understanding of the buying behavior of the individuals and institutions that comprise industrial and organizational markets. Buying behavior results in demand registration of business's requirements in terms of the quantities and the qualities (specific attributes) of goods and services to be purchased. The level of demand in business marketing is frequently expressed in terms of the dollar amounts that buyers have spent or that potential buyers are willing to spend.

In this chapter we will examine demand, paying particular attention to the business marketing implications of derived demand. Then we will explain a systematic method for analyzing and evaluating demand for a product or service in a defined geographic region.

2.1 Demand Defined

Demand can be defined as the volume of a specific product a customer or customer group in a particular geographic area buys during a specified period of time. Business demand differs from consumer product demand in a number of significant aspects. Further, there is joint demand for some industrial goods.

Derived Demand

All demand for industrial goods is derived form the demand for consumer goods and services. ***Derived demand*** can be defined as the demand for a business product that is linked to demand for consumer goods. Purchases made by business buyers, institutions, and organizations are expressions of derived demand – that is, they are derived from the demand generated by the customers or clients of the organization.

Thus, the demand for plastic bottles to be sold to Coca-cola would be directly related to the demand by consumers for the soft drink.

Direct Demand

Direct demand is generated by individuals who buy goods and services to satisfy their own personal needs. The end objective of the purchase is personal gratification in one way or another. In this role, we are known as “consumers". We are not buying to further the ends of a business or to make a profit. Consumer direct demand is the origin of all other demand.

Inelastic Demand

Because of the derived demand for business products, there is less opportunity for business marketers to stimulate primary or direct demand through price cuts than there is for consumer goods marketers to do so. Therefore, the primary or direct demand for business products is more price inelastic than that for consumer products. ***Inelastic demand*** takes place if price changes have little impact on the quantity of goods or services demanded. For example, automobile manufacturers purchase headlights as component parts for automobiles. If the price of headlights goes down, the automobile manufacturers are not very likely to greatly increase their purchase of headlights.

Fluctuating Demand

The demand for industrial goods and services tends to be more volatile than the demand for consumer goods and services. This fluctuating demand is especially true of the demand for new products and equipment. A given percentage increase in consumer demand can lead to a much larger percentage increase in the demand for plant and equipment necessary to produce the additional output. This phenomenon is referred to as the ***acceleration principle.*** An increase in consumer demand of only 10 percent can result in as much as a 200 percent increase in industrial goods demand in the next period.

Joint Demand

Joint demand exists in situations where two products are used together and are demanded together. The demand for a number of business products, such as raw materials and component parts, is affected by joint demand. Joint demand occurs when two or more items are used in combination to produce a product. For instance, a firm that manufactures hammers needs the same number of handles as it does hammer heads; these two products are demanded jointly. If the supplier of handles cannot furnish the required number, and the hammer producer cannot obtain them elsewhere, the producer will stop buying hammer heads.

The Chain of Derived Demand

Assume that a company manufactures ball point pen. Its customers are direct customers. Thus the demand for these pens is a direct demand. The pen company buys metal ball-tips, plastics barrels, and ink to make the pens. Each supplier to the pen manufacturer is supplying into a business market and faces a derived demand. If consumers buy more pens (direct demand), then the suppliers are called upon to deliver more plastic barrels, ink, and so on (derived demand).

Note that each of these suppliers, in turn, purchases materials and supplies from other firms. Thus a chain of derived demand is established, with suppliers several times removed depending on the initial consumers' direct demand for pens to generate derived demand for their products.

2.2 The Implications of Derived Demand

The concept of derived demand is perhaps the most important idea in business marketing with many significant implications for the marketing mix. Changes in the business marketer's price may shift market shares among competitors but are not likely to affect overall industry demand. Price elasticity of demand (relative price sensitivity) depends on how crucial reliability is to the buyer and the profit impact on the buyer of the price change. The business marketer's promotional efforts may benefit from use of a telescopic marketing strategy. In distribution, changes in demand may be magnified by the acceleration effect, the whiplash effect, inventory policies, speculation, and discontinuities associated with capital goods purchases.

1. Price and Profit Impact

Derived demand carries three implications for the pricing of business products and services:

a) difficulty in expanding overall demand,
b) relative price insensitivity, and
c) relative price sensitivity.

a. Difficulty in Expanding Overall Demand - Generally speaking some rule-of-thumb ratio can be established to estimate overhead, administration and sales costs, and profit as a percentage of the goods. If we assume that these components amount to 50 percent of the price of any finished product, the other 50 percent would be the cost of materials. However, in most cases the cost of materials is much lower than 50 percent of the cost of the finished product. Consequently, if the business marketer is able to reduce the cost of purchased materials, the cost savings that can be passed on to the end-market consumer will be very small. Thus it is virtually impossible to expand total market demand by lowering the price of a component sold in the business market.

b. Relative Price Insensitivity (industrial buyers) - In industries in which industrial products feed production lines, the customer is likely to view price as relatively unimportant in comparison with such supplier attributes as assurance of stability in product specifications and reliability in consistently meeting delivery dates. The buyer will pay more to prevent breakdown in capital equipment and to keep the assembly line moving. A slightly higher cost of supplies in such a case is a small price to guarantee against downtime (the period during which equipment cannot be used) and to avoid the cost of paying workers who cannot produce output.

Organizational buyers are also willing to pay a higher price if purchases promise to make their products more attractive to the customer. Again, business marketers must keep in mind their customer's customers.

c. Relative Price Sensitivity (industrial marketers) - In comparison with the direct-demand consumer market, in which personal gratification and even whim may lead to purchases without great concern for price, derived demand tends to respond more often to pressure on price. One reason for this is the profit-generating potential of any cost reductions the business buyer can achieve. If, for example, Sony earns a return of 5 percent on sales revenue, the company must sell $100 worth of radios to earn $5 profit. On the other hand, if the company can cut its costs by $5, this represents immediate profit. Often it is much easier to find cost savings than to increase sales by twenty fold. Because of this immediate impact on profits, business buyers often place great pressure on their suppliers. However, business marketers can insulate themselves from such pressure if their product or service plays a critical role (as in the case of assembly-line supplies) or if they have created a competitive advantage for their product or service.

2. Promotion

Because of derived demand, business marketers must direct promotional efforts to more targets than just their immediate customers. They may need to use pull promotion to increase derived demand by stimulating their customer's customers to specify the marketer's specific material, component, or service thus pulling the product through the distribution channel from a lower level.

What this means is that the multiple buying influences at the customer level (production, finance, quality control, plant mangers), all of whom may be recipients of promotional messages, may be joined by another layer of multiple buying influences at the customer's customer level. Given a sufficient promotional budget and demonstrable results for effective pull strategies, the business marketer's task may become extremely complex.

Telescopic Marketing strategy - Telescopic marketing is a somewhat more sophisticated technique using promotion to increase derived demand for a business marketer's product or service. In telescopic marketing, the marketer stimulates direct demand for an end product containing the marketer's product. This in turn increases derived demand for the business good or service. Thus telescopic marketing is something more than a simple pull promotion strategy.

In a **pull promotion strategy**, the marketer sells a product through the distribution channel, with no intervening manufacturing or processing stage. In a **telescope marketing strategy**, the marketer sells to an intermediate manufacturer or processor. Consequently, the product, component, or materials undergoes an intervening manufacturing or processing stage before it is purchased by the end customer. Furthermore, the product or qualities promoted in telescopic marketing and bought by the end customer are products or qualities other than the specific item sold by the telescopic marketer.

Factors Permitting Use of Telescopic Marketing - Not every business marketer can use a telescopic marketing strategy. Since the company is promoting something other than the identifiable product it manufactures, competitors can also benefit from its efforts. Thus a company that is considering telescopic marketing should have a high market share in the product. The major factors that permit the use of telescoping marketing are the following:

a) Telescopic marketing is a feasible strategy for products or processes that are patentable or that have high entry barriers.

b) Telescopic marketing is made much easier if the business marketer's customers represent a high market share in the industry. The end market must be sufficiently large to generate enough derived demand for the product to warrant the investment in telescopic promotion.

c) Telescopic marketing is likely to bring the greatest derived-demand benefits if current penetration of end markets is small. But the shrewd marketer also must consider the availability of direct and indirect substitutes and how long they will take to eat into the new market. For example, aluminum cans have now displaced most tin plate cans in the carbonated beverage business.

d) The state of the economy is another variable affecting the feasibility of a telescopic marketing strategy. Since in telescopic marketing the product or service is not immediately identified with the business marketer, the marketer receives no spin-off benefits, which it would in the case of institutional advertising. Since the marketer's benefits depend solely on the sale of other companies; products, telescopic marketing is more risky in a poor economy.

e) Finally, the marketer should weigh the advantages and disadvantages of the item to be promoted from the perspective of the manufacturers, processors, and other channel members intervening between the marketer and the end user. The new item should have obvious advantages to these channel members or, at the very least, lack negative attributes. It is extremely difficult to use telescopic marketing effectively if the transition costs to channel members are high.

3. Distribution

The chain of derived demand forms a channel of distribution characterized by dramatically wide swings in inventories and expectations. This boom and bust volatility can be caused by shifts in tastes and preferences at the consumer direct demand level, by inventory policies, by technological developments, or by changes in economic conditions. It is exacerbated at times by the speculative purchasing or organizational buyers.

a. The Acceleration Effect -A change in direct demand at the consumer level has an acceleration effect on the business market. For instance if the overall business demand decreased by a larger absolute amount than the decrease in consumer demand, it is also likely that distributors, jobbers, and retailers, which base their inventory levels on some multiple of current sales, will further reduce their inventories. This will have an accelerating or multiplying effect on inventory levels back through the channel.

b. The Whiplash Effect - The small fluctuations in retail demand that are reflected in inventory patterns at each level of the channel are called the whiplash effect. For example, assume that the typical retailer figures an inventory requirement on the basis of sixty days' supply of goods to meet the current sales level. The retailer might check inventories every two weeks, place an order with the distributor, and receive delivery two weeks after the order is placed. With relatively stable demand, adequate cycle quantities are on hand, and there is sufficient safety stock to cover delivery delays. Distributor and manufacturer inventories would be managed in a similar fashion.

c. Volatility in Longer Channels - When organizational buyers are trying to assure adequate supplies of components and material for production in their company they too will establish an inventory objective for each item they buy. This is usually sufficient for a particular production run or, on long runs, for some time period say sixty or ninety days. The inventory objectives is based on forecasted sales of the particular products, perhaps for the next six or twelve months. Just as in the preceding retail example, increased demand for the consumer or business end product and optimism about continued high demand lead the buyer to increase inventory objectives, whereas pessimism and decreased sales reduce these objectives considerably. Thus demand volatility for supplies and components in longer distribution channels is the result not only of shifts in demand, but also of inventory policies and expectations.

Summary

Business demand is defined as the volume of a specific product a defined customer or customer group in a particular geographic area buys during a specified time period. Direct demand is generated by consumers' purchases, which are based on personal gratification. In contrast, business buyers purchase goods and service for use in the products and services that they, in turn, produce for facilitating the operation of the enterprise or for resale. Thus business purchases are not an end in themselves but rather depend on demand generated by others. Business demand therefore is a derived demand. Indeed, business demand can be traced back through a chain of derived demand to a consumer direct demand that initiates the sequence.

Of greatest important to the business marketer is recognition of the implications of derived demand for the business marketing mix. Price may be used to shift market share away from competitors but most likely will prove ineffective in expending total market demand. The customer may apply pressure on the business marketer's if dollar purchases are sufficiently large that a price reduction will add significantly to the buyer's profit. But if the customer is concerned that late delivery or inconsistent input quality may prove costly, the buyer is likely to be fewer prices sensitive.

Although institutional promotion and pull promotion are useful, some business marketers use a telescopic marketing strategy to increase derived demand for their company's offering. Telescopic marketing is a promotional technique for increasing derived demand for a business product or service by stimulating direct demand for an end product or service containing the business marketer's good or service. The product or qualities promoted in a telescopic marketing strategy (and bought by the end customer) are products or qualities other than the specific item sold by the telescopic marketer.

The chapter concludes with a model for evaluating the demand for existing and new business products and services. The model begins with known values of domestic production, imports, and exports; it then examines the impacts of derived demand, complementary products, and direct and indirect substitutes. Company products are analyzed and a market potential for the company is estimated. Next the business marketer checks to see that corporate marketing objectives are being met and that other corporate constraints are not being violated. Since it costs money to achieve objectives, these costs must be estimated and weighed against the benefits they create. Calculations of returns on investment can be reevaluated using different estimates of sales volume to arrive at a realistically achievable corporate market share and sales revenue. The model provides a structured approach to the analysis of the market and its impact on the firm.

Discussion Questions

1. What conditions are necessary for a company to employ a-telescopic marketing strategy?
2. Under what conditions could a business marketer expand the total demand for a product class using pricing strategy?
3. Why is the customer's customer so important to the business marketer?
4. Discuss relative price sensitivity and relative price insensitivity in business marketing.
5. A manufacturer of fine paper sells through distributors to various printers. The marketing manager is considering using a pull promotion strategy. Should advertising be directed at printers? At publishing companies? Since there are multiple buying influences at each level, how would this affect the promotion strategy?

CHAPTER 3 INDUSTRIAL BUYER BEHAVIOR

Learning Objectives

Upon completion of this chapter a student will be able to:

- Analyze the factors that affect business buying decisions using Webster and Wind Model and decide which factors are likely to be important in different situation.
- Understand that each business purchase is a process over time and analyze specific purchase and plan marketing activity to relate to each stage in the buying process.
- Categorize different purchases according to what is being bought, the experience of the buyer, and the uncertainties that the buyer faces.
- Analyze Jagdish N. Sheth model of consumer behavior and discuss its marketing implications.
- Understand the nature of buyer/seller relationships as part of an overall portfolio and understand the issues in building a strategy for that portfolio.

Overview

In this chapter we try to answer a number of questions that are important to understand business buyer behavior and the nature of the relationships between buying and selling companies in business markets. These questions are as follows.

1. What are the factors that affect buying decisions and who is involved in buying?
2. What is the process of business buying and how does that process vary for different purchases and under different circumstances?
3. What are the motivations of the business buyer and what abilities does a marketer need to be able to respond to them?
4. What are the characteristics of buyer/seller relationships and what do these mean for the business marketer?

3.1 Webster and Wind Model - Factors Affecting Buying Decisions

No buying decision is ever taken in isolation. Each decision is influenced by factors having to do with the buying company and the individuals who are involved. In this section we examine these factors using an analysis model developed by **Webster** and **Wind** in 1972 that has formed the basis of many later attempts to understand business buying. As shown in exhibit 3-1, this model groups the various factors into four levels of buying influences: environmental, organizational, buying center, and individual.

I. Environmental Factors

The Webster and Wind model divides environmental factors affecting the buying decision into six categories: physical, economic, technological, legal, political, and cultural.

Exhibit 3-1 Levels of Influence on Business Buying

Environmental factors	Physical, economic, technological, legal, political, cultural
Organizational factors	Technology, goals and tasks, actors, structure
Buying center factors	Roles, resources
Individual factors	Status, politics, ethics

1. Physical Environment - The physical environment affecting the buying firm consists of the ***geographical spread of the firm's suppliers and customers***. This factor will affect the firm's costs and the extent of the logistical problems it may face in actually getting the products it has bought. For example, many firms that buy large quantities of components for continuous production favor suppliers that are located in close proximity to their plant. Having a close supplier helps the company keep a reduced inventory and facilitates just-in-time (JIT) delivery schedules.

2. Economic Environment - The economic environment consists of the general situation of economic growth or recession, interest rates, and corporate profitability, within which all firms operate. One frequently neglected aspect of the economic environment is the fact that a company's purchases are often directly related to its own sales or order situation.

3. Legal and Political Environment - The legal and political environment within which business buying takes place refers to the ways in which government legislation affects purchasing, directly or indirectly. For example, environmental production legislation directly affects which products can be bought or sold in some countries. Also, employee protection or labor union laws in some counties will indirectly affect companies' profits and hence their ability to buy some products. This means that companies must be fully aware of the legal and political environment before they enter new international markets.

4. Cultural Environment - The cultural environment of a buying company includes all those national attitudes and beliefs that affect the way business people operate.

II. Organizational factors

Organizational factors affecting business buying behavior relate to the buying organization itself: its technology, its goals and tasks, the actors involved in buying and the organization's structure.

1. Technology - Here we will emphasize a few technological issues that particularly affect how businesses buy. First, to a large extent a customer company is not simply buying products from a supplier, but buying the technologies on which that product is based. These include the suppliers' skills and knowledge in developing designing, and manufacturing the product. No buying company can know everything about what goes into its products, and so it relies on the technology of its suppliers. For example, an automobile manufacturer relies on the technology of fuel injection equipment of manufacturers to ensure the performance and economy of its engines. Thus the way in which a company buys a product, and indeed what it buys, are strongly affected by its level of knowledge of the technologies on which the product is based.

The way in which a company buys will also depend on whether the product has been designed by the company or by a supplier. When the buying company has developed its own design for a component, it will seek suppliers that are willing to make to its design (or blueprint) and are able to offer the best combination of quality, service, price, and delivery. We call this "**make to print**." Under these circumstances, the buying company will not need, nor will it be willing to pay for, the ***design skills, or product technology***, of the seller. Instead, it will be paying for the seller's ***skills in manufacturing*** the product to the appropriate standards and consistency. We refer to this as the **seller's process technology**.

2. Goals and Tasks – Increasingly business buyers are making a ***long-term commitment to suppliers to achieve value and quality improvement***, as opposed to frequently changing suppliers to achieve a ***short-term price advantage***. These two different approaches have many implications for the relationship between selling and buying companies and mean that the business marketer must examine in great detail the strategy and the specific purchasing goals and tasks of the particular buying company. Thus, business marketing is less about assembling a marketing mix that is then offered to a wide, undifferentiated, and relatively passive market than it is about tailoring the marketer's offering to the precise requirements of each customer company.

3. Actors - Another factor affecting buying decisions at the organizational level is the philosophy and motivation of the customer company's individual personnel, or actors. We can expect managers to have different attitudes to buying depending on whether they consider themselves technologists or marketers. Their attitudes will also be different if they are more concerned about the long-term development of their company or its short-term profit. Thus we may expect a very particular set of requirements from a buying company in which the culture of the management is centered on product excellence, such as Mercedes-Benz. Individuals involved in making purchase decisions in such companies will tend to emphasize product reliability and performance rather than price.

4. Structure - The final organizational factor affecting buying decisions is organizational structure-that is, they way in which the buying function is related to the rest of the organization and in particular to the management of the company's operations. In some companies the buying function is **decentralized**, with offices in each manufacturing plant that report directly to local management. Each of these local offices may have to be visited separately by the marketer's sales force. Buyers in these offices are likely to be very concerned with issues that are important to local managers, such as reliability of deliveries and ease of using products. In other companies, buying may be **centralized** at corporate headquarters, far away from local managers. Buyers in these companies are more likely to be concerned with what is important to the senior buyers, such as negotiating lower prices and standardizing the products that are used across the whole company so as to obtain quantity discounts.

III. Buying Center Factors

The third group of factors influencing business buying behavior relate to the buying center. The buying center consists of those people in the organization who are involved either consciously or unconsciously in the buying process. People within the organization who participate in the buying process, often including technical experts and senior management, are members of what is called a **buying center.** A key to success in business markets is understanding customer ***buying behavior.*** The marketer needs to know the roles performed by different members of the buying center and the resources available to them to help make their purchase decision. In organizational buying, it is rare for one person to be solely responsible for the buying decision. Thus, understanding the dynamics of interpersonal influence that drive the buying process may play a key role on formulating successful business marketing strategies.

Roles - Buying center roles are those of initiator, user, decider, influencer, buyer, and gatekeeper.

The **initiator** is the person who recognizes that the company has a problem or requirement. The initiator is not always someone inside the buying company because the company may not realize that it has a problem or may be unclear as to its requirements. We have already seen that buying companies often rely on the technological knowledge of their suppliers. In this case a **salesperson from a potential supplier** may initiate the buying process by pointing the current problem or possible improvement. The **potential users** of a product may also initiate the purchase process or may act to constrain the process by ruling out certain types of products, problem solutions, or manufacturers on the grounds of unsatisfactory previous purchases or poor reputation.

Most often it is the **users** of a product who draw up the initial specification for what is to be sought from the market. They may favor a particular supplier so strongly that they act as de facto deciders. It is often very difficult to spot when a purchase decision is actually made, either because organizations often move toward a particular decision through a process of "creeping commitment " or because the influencers in the company are so skilled at lobbying that the decider's role is little more than to act as a rubber stamp.

Role	Description
Initiator	The person who recognizes that the company has a problem or requirement. The initiator can be a potential user or a potential supplier.
User	Those who will use the product in question. Their influence on the purchasing decision can range from minimal to major. In some cases users begin the purchase process and even develop product specifications.
Gatekeeper	Those who keep a tight control on the flow of information to other members of the buying center. They can open the gate to members of the buying center for some salespeople, yet close it for others.
Influencer	Those who provide information to buying center members for evaluation alternative products or who set purchasing specifications. Normally, influencers operate within the buying center, such as quality control or research and development personnel. Yet, at other times influencers operate outside the buying center, such as architects who create very specific building requirements.
Decider	Those who, in reality, make the buying decision, regardless of whether they hold the formal authority. A decider often is quite difficult to identify since a decider can be a company president, a purchasing director, or a research and development analyst.
Buyer	Those who are assigned the formal authority to select vendors and complete the purchasing transaction. Sometimes other more powerful members of the buying center take the prerogative of the buyer. A purchasing manager who carries out the clerical duties of the purchase order of ten acts in the role of the buyer.

There may be **influencers** in a buying company. If a seller does not identify and communicate with key influencers, he or she might lose the deal, despite technical superiority and competitive pricing. Good business marketers know who the most influential companies in an industry are and cultivate them carefully.

Buyers are the people whose formal task it is to select a supplier and arrange the terms of a deal. For many repeat purchases or lower-value items, the buyer will be the sole member of the buying center. For the purchase of major capital equipment, the buyer's role may simply be to search for and evaluate suppliers and to present this data to other center members.

Companies can only make purchase decisions on the basis of the information they have available. **Gatekeepers** are the buying center members who control the flow of information. Most commonly, the buyer is the gatekeeper, or first point of contract for the salesperson. The salesperson may make a presentation and leave product information with the buyer but won't know it that information is going to be passed on to other members of the buying center. Often secretaries act as gatekeepers, and salespeople employ a host of techniques to get past the secretary and communicate directly with an important influencer or decision maker in the purchase process.

2. Resources - A second aspect of the buying center influencing buying decisions is the resources including ***information*** and ***expertise***. Some companies have a purchasing research department that is able to assist in the buying process by assessing supply markets, product trends, and the characteristics of individual suppliers and products. But in many companies, purchase research is less well developed than is market research. When purchase research is undeveloped, the business buyer is likely to be more dependent on suppliers for information and will have more difficulty in evaluating different competing offerings.

IV. Individual Factors

Business purchases are not made by companies but by individuals within those companies. This means that we need to understand the requirements and motivation of these individuals, as well as those that are stated by the company. Three factors relating to these individuals influence buying decisions: the buyer's status organizational politics, and the ethics of buying.

1. Buyer's Status - The business buyer's status in the buying organization may play a role in the buying decision. Business buyers are often paid less than marketing people of similar seniority, and some buyers occupy a relatively low-status position in the organizational hierarchy. This situation is gradually changing as companies are becoming more aware of the importance of skilled and well-trained buyers. But it is still possible that a business buyer may take pleasure in buying from a prestigious company or gain a sense of achievement and importance by buying expensively. Also, business buyers are often similar to consumers and may know only a little about the technicalities of what they are buying. Like consumers, they may reduce their risks by insisting on well-known brand products that conform strictly to existing industry standards. In this way they hope to avoid criticism by other in their company.

2. Organizational Politics - Buying can often be part of organizational politics, and buyers may use a number of tactics to increase their influence in the company. For example, a buyer may "bend the rules" for someone in the company either in return for a favor or to show that the buyer has the power to act independently. Buyers often value information provided by salespeople if it increases their influence over others in the company.

3. Ethics - The individual motivations of people in a buying company present a question of ethics for the marketer. Many companies prohibit even the smallest gifts from suppliers, and there is strong legislation against corrupt practices in business buying. Nevertheless, some business buyers will seek or be offered a personal inducement to favor one particular supplier. Giving or accepting such a bribe is not only unethical and illegal, it also weakness the position of both parties in any future transaction. In particular, it means that both buyer and seller are likely to be pressured to give or take additional gifts in the future, or even to be blackmailed by the threat of disclosure.

3.2 The Process of Business Buying

The business buying process varies widely. Exhibit 3-5 shows a simplified version of the **Robinson, Faris, and Wind buy-grid**, which helps categorize the process in different circumstances. The **Buy-grid** is widely used in business to make sense of different types of purchasing and the process which these purchases go through. We will use the **Buy-grid** to examine the categories of purchases, known as the **buy classes**. We will also look at different types of products and the stages in the buying process, known as the **buy phases**. Finally, we look at the business buying process in practice.

3.2.1 Buy Classes

Purchases may be categorized into three buy classes according to the newness of the buying situation:

1. new-task,
2. straight-re buy, and
3. modified-re-buy.

1. New-Task - In new-task purchases the company is buying a product or service for the first time or, more properly, facing a problem for the first time. In this buy class the company will have to evaluate a wide range of possible problem solutions or suppliers. The process tends to be time consuming and involves a number of people.

2. Straight-Re buy - Straight-re buy purchases are repeat purchases of products or services, many of which are triggered automatically when existing stocks reach a certain level, as in the case of office supplies, such as paper, pens, or envelopes. The buyer has little involvement in the purchase and makes no evaluation of competing brands before simply repeating the purchase of the same brand as last time. Straight-re buys constitute the majority of business purchases. Companies simply do not have the resources to evaluate each purchase on every occasion, and often the low value of the items means that reevaluation is not worthwhile.

Organizations may also opt for a straight-re buy because of lack of resources to evaluate alternative purchases, the possible risks in changing suppliers, or sheer inertia. There are considerable costs and risks to both buyer and seller in switching from an established relationship, as well as detailed when we examine the nature of buyer/seller relationships later in the chapter.

3. Modified-Re buy- Modified rebuy purchases are purchases in which the buyer is re-evaluating a product or service that has been bought before. There will be less evaluation than when the buyer has no experience or skill in the purchase, as in a new-task situation, but much more than in a straight- rebuy.

3.2.2 Types of Products

The buy classes are useful shorthand for categorizing purchasing situations. However, the traditional product classifications-capital equipment/investments, accessory equipment; component parts; process materials; maintenance, repair, and operating (MRO) supplies; raw materials; business services; and so forth-also have implications affecting the buying process.

- Some purchases of products or services are so important that on each occasion there will be thorough evaluation. This is likely to be the case for some capital goods, whereas for MRO items there may not be any real evaluation, even when the products are purchased for the first time.
- In MRO purchases, convenience and availability may be more important than specification or even price. The buyer will simply order among the products available from a particular distributor, possibly under a contract that provides for a discount across a wide range of product items.

- Parts and materials form a middle category in which the discretion of the buying organization is at perhaps its greatest. Here the buyer has scope for cost reduction and product improvement by working effectively with a number of different suppliers.

3.2.3 Buy Phases

The process of business buying is not carried out in isolation by the buying company alone. Instead, it is a process of interaction between the buying company and potential suppliers, which will be seeking to influence the process to their advantage. These suppliers can be separated into the in-supplier, which is already supplying the company, and the out-suppliers, which are trying to displace it. We can describe the buying process as going through five stages, called buy phases:

1. identification of need,
2. establishment of specification,
3. identification and evaluation of alternatives,
4. selection of suppliers, and
5. performance feedback.

The marketer who wishes to influence the buyer often faces the difficult task of finding out exactly which stage the buying company is at in the buying process.

1. Identification of Need - The in-supplier is in a stronger position than other suppliers to sow the seeds of need recognition in the buyer's mind. A business can often carry on for years with an unrecognized problem or inefficiency. It is the task of the business marketer's promotional activity, either through advertising or using sales calls or telemarketing to raise this problem in the mind of the buyer.

Exhibit 3-5 The Process of Business Buying by Classes

Buy Phases	Buy Classes		
	New-Task	Straight-Rebuy	Modified-Rebuy
▪ Identification of need	√		
▪ Establishment of specification	√		
▪ Identification of alternatives	√		√
▪ Evaluation of alternatives	√		√
▪ Selection of suppliers	√	√	√
▪ Performance feedback	√		√

2. Establishment of Specification - Even if it isn't the supplier that starts the buyer thinking about a problem, a salesperson can sometimes influence a buyer to specify a problem solution in a way close to the supplier's offering. A marketing company therefore needs to use its sales force to gather intelligence about when and where buying companies are thinking of making a purchase. This task is very much more difficult for our suppliers. Trade directories and suppliers' catalogs are very important to both the buyer and the marketer during the specification phase because for many design problems and engineer may simply refer to a general directory or to catalog of a specific supplier's products for a problem solution.

3. Identification and Evaluation of Alternatives - We have already noted that buying companies tend to buy from the same source of supply as before unless there is some positive reason to change. This may mean that there is little evaluation of alternatives. On the other hand, when the buying company is seeking a new product, it may have great difficulty in identifying a supplier that is either able or willing to produce a product to meet the buyer's particular requirements. In either case, the business buying process is not one of reaction to the sales and marketing efforts of sellers. More often it is a process of search and evaluation of a number of suppliers that may be more or less able to deal with the customer or willing to make efforts to meet its requirements.

4. Selection of Suppliers - The actual selection of a supplier is the direct outcome of the evaluation in the previous buy phase. The selection decision, however, may be made by a different person in the organization by someone who was not involved in the earlier evaluation process. This situation has occurred in a wide range of companies in different international markets.

5. Performance Feedback - Just as a purchase does not start at the point at which the order is signed, neither does it finish at the point at which the product is delivered. The buying company will seek to evaluate performance of the product in use, the cost of the product over its life, and the quality of the supplier's back-up service. This evaluation constitutes performance feedback and will be a major factor in determining what will be bought next time and from whom it will be bought.

3.3 Jagdish N. Sheth Model of Industrial Buyer Behavior

Overview of the Sheth Model

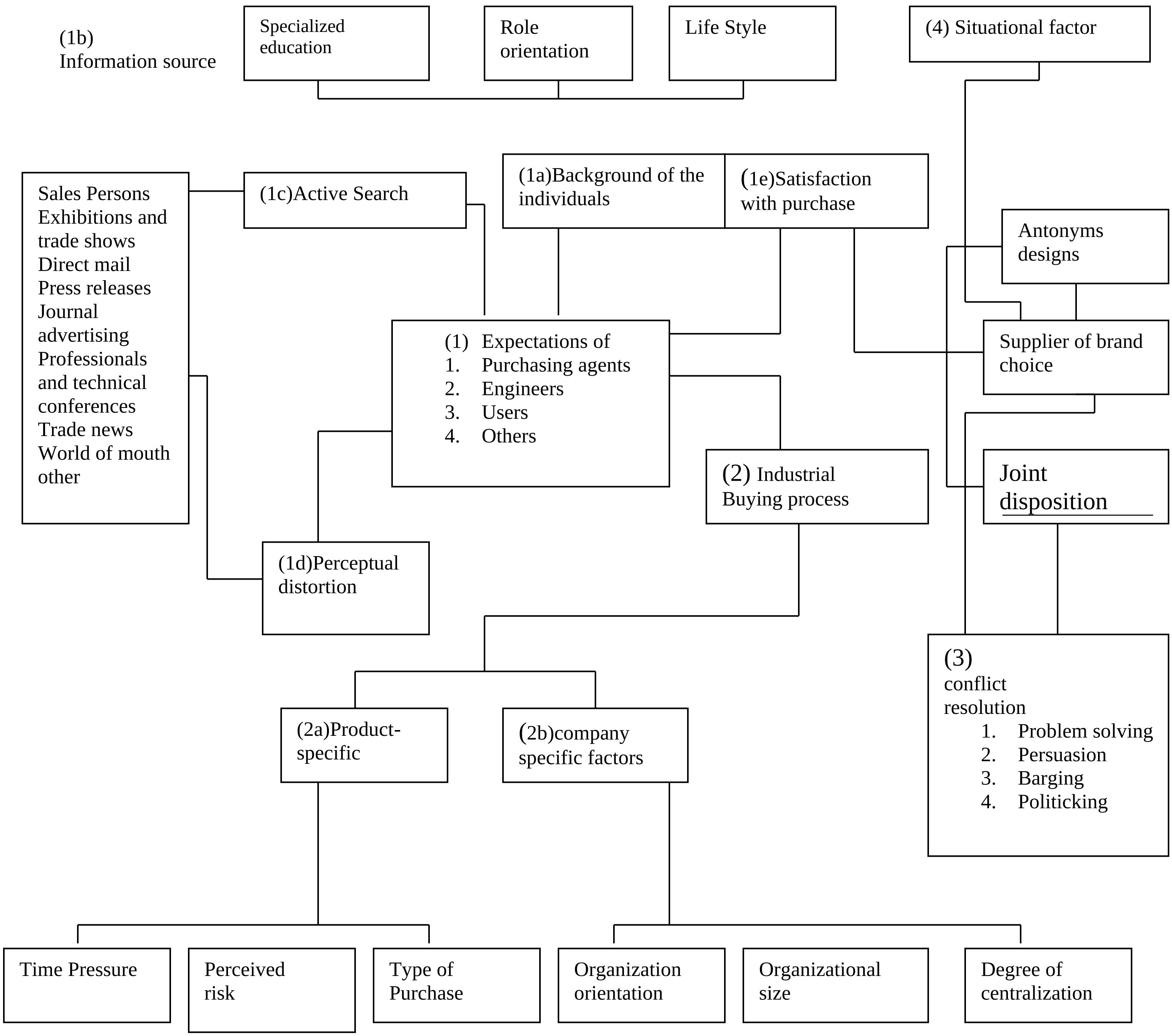
The Sheth model, shown in Figure 5-2, focuses on the complex relationships involved with joint decision making. While the model appears complicated, it is quite useful for examining organizational buying behavior from the perspective of:

1. the conditions that precipitate joint decision making,
2. the psychological world of the individuals involved, and
3. the inevitable conflict among those involved in the decision process and resolution of this conflict.

3.3.1 Joint Decision Making

While methods of reaching buying decisions differ widely, even within the same firm, there appear to be underlying patterns of organizational structure and behavior that establish similarities for analyzing organizational decision making, whereas recent evidence indicates that when supplier loyalty is high, modified or straight rebuy purchasing decisions are frequently made by individuals within the firm. Studies have shown that the number of organizational members involved in a buying decision depends on:

1. the characteristics of the firm (e.g., organization orientation and size),
2. the type of purchasing situation (e.g., routine versus new task),
3. the perceived importance of the product (e.g., risk involved), and
4. the available resource for handling the purchase (e.g., degree of centralization). Sheth refers to these areas in his model as company-specific factors (1, 4) and product- specific factors (2, 3).



Characteristics of the Firm

Two characteristics of the firm appear to have a strong influence on the number of influencers involved in the purchasing decision:

1. the size of the firm as determine by the number of employees and
2. the firm's orientation (e.g., profit versus nonprofit.)

Table 5-2 indicates that as the size of the firm increases, the number of influencers involved in the purchase decision increases. It also indicates that more influencers are involved when the organization is a nonprofit institution or governmental agency. Two variables may account for these findings.

- First, functional areas tend to be more specialized in larger firms.
- Second, nonprofit, governmental, and educational organizations, because of their high visibility, are more accountable to the public sector. Thus, more individuals may be involved as a matter of safeguard and cross-check. It also indicates that as the purchasing situation moves from a modified rebuy to a new task, more influencers are involved.

Buying Center Interaction Patterns

One in-depth study into the social dynamics of the buying center has concluded that the size of the buying center and the amount of interaction between those involved is dependent upon:

1. **Vertical involvement**- the number of organizational levels in the hierarchy (from production people up through the board of directors) exerting influence and communicating within the buying center.
2. **Lateral involvement**- the number of departments, or functional areas that become involved in the purchase decision.
3. **Extensivity**- the total number of individuals involved in the communication network of the buying center.
4. **Connectedness**- the degree to which buying center members directly communicate with one another regarding the purchase.

Purchase Situation Influence - The greater the importance and complexity of the purchase situation, the greater the vertical involvement, the lateral involvement, and the extensivity. Thus, greater numbers of people are involved in the buying center, and they come from other divisions and departments as well as from other levels in the hierarchy.

Organizational Influence - The more complex the organization, as evidenced by more written communications, the greater the lateral involvement and extensivity and the lesser the connectedness. As more written communications are required by a buying organization, more people are called on to help in the buying decision. However, since many of the communications take on a written form (such as purchase orders), there is less face-to-face communication. On the other hand, when sign-off power for purchasing decisions is concentrated at corporate headquarters, as is often the case in formal organizational structures, the degree of connectedness between buying center members tends to be high. This is due to the amount of interaction that must take place to see that everything is in order before the decisions can be moved upward.

Table 5-3 Positive relationships Between Situational\Organizational and Buying Center\Interaction Variables

Interaction patterns	**Organizational vari**	**Structural ables**	**Purchase**	**Situation**	**Attributes**	
	Formalization	Centralization	Importance	Complexity	Novelty	Capital Good vs service
Vertical involvement			+	+		+
Lateral involvement	+		+	+	+	
Extensivity	+		+	+		+
Connectedness		+				

Marketing Implications

The foregoing studies give the marketer important insights for determining the size and interaction of buying center members. Two variables that impact upon buying center size are the firm's characteristics and the type of purchasing situation the firm is in, neither of which is difficult to determine. Secondary data are available for determining organizational size and orientation, and sales people are quite adept at discovering the type of purchasing task customer firms are facing.

Insight into the degree of vertical and lateral involvement, extensively, and connectedness and how they are affected by both the purchasing situation and organizational structure is quite useful for developing a proactive communication strategy. Marketers who anticipate that various hierarchical levels will be involved in complex purchasing decisions can structure a sales force that embodies individuals who can relate to various hierarchical levels.

The greater the degree of lateral involvement, the greater the potential for diversity of viewpoints in the buying organization. Thus, the potential to influence the buying organization lies in communicating with different functional areas within the firm.

As lateral involvement increases, the more important it is to have a broadly trained sales force with access to the expertise of the different functional specialists within their firm.

Extensively and connectedness affect the buyer's ability to process information. When the various people involved in a purchasing decision communicate directly, information is processed quickly and relatively accurately. However, in those purchasing situations that the buying center will be larger and less connected.

When there are several divisions in the buying firm and the purchasing department is centralized, it should be recognized that face-to-face communications in the buying center will tend to decrease. When a high degree of centralization exists, it may only be necessary to persuade the purchasing manager of the vendor's capabilities. When the purchasing manager's control is low, marketers will find it necessary to influence other members of the buying center, each with a unique perspective of the purchasing problem.

3.3.2 Psychological Factors Influencing Individual Decision Making

Knowledge of the similarities and differences in the psychological worlds of individuals involved in the buying center and how their behavior can affect the purchase decision is critical in directing the firm's communication strategy. It is not unusual to find purchasing, engineering, manufacturing, and marketing personnel involved both individually and jointly at various phases in the purchasing decision process, particularly in a modified or new task purchasing situation. Due to the differences in their psychological make-ups, expectations regarding the potentials of alternative suppliers to satisfy a number of different purchasing criteria will substantially differ in any given purchasing task. Two significant factors, as indicated in Sheth's model, appear to account for these differences:

1. role orientation and
2. information exposure.

Differences in Role Orientation

Because of their different areas of functional responsibility, each individual has a different perception of his role in the decisions process. Thus, they tend to view the importance of the various buying criteria differently. Purchasing agents, for instance, look for price advantage and economy in shipping; engineers look for quality and pretesting.

Due to the fact that organizations typically reward individuals for achieving their respective departmental goals, they will also have experienced different levels of satisfaction with past suppliers. Purchasing agents, for example, are rewarded for economic achievement and engineers for product performance. The result is that the respective objectives and reward criteria of individuals may conflict when applied to a supplier choice decision.

Differences in Information Exposure

Expectations and, thus, objectives are further influenced by the type and source of information exposure. Purchasing agents, because of their position within the organization, are not only exposed to greater amounts of commercial sources of information, but are normally delegated the task of actively searching for information. Personnel in engineering and production, however, typically have a disproportionately smaller amount of information. What information is obtained is often gathered primarily through trade reports, professional meetings, and word of mouth.

Due to individual educational pursuits and life-styles, information is also subject to the individual's cognitive process of selective distortion and retention: the tendency to systematically select, change, and retain information so that it conforms to prior knowledge, expectations, or needs. Therefore, given the different goals and values of these individuals, the same information will be interpreted differently, leading to further differences in expectations and objectives.

Perceived Risk in the Vendor Selection Process

Industrial purchasing decisions often involve an element of functional risk, such as uncertainty with respect to product or supplier performance, or psychological risk, such as negative reactions from other organizational members. The greater the uncertainty in a buying situation and the greater the adverse consequences associated with making the wrong choice, the greater the perceived risk in the purchasing decision.

When uncertainty exists in any given purchasing decision, research indicates that decision makers tend to reduce the level of risk by remaining loyal to existing suppliers who represent a known entity. They also tend to adopt one or more of the following strategies in an attempted minimize or avoid the perceived risk:

1. **Reduce uncertainty** -uncertainty may be reduced by gathering additional information, such as consulting with other influencers or visiting potential suppliers plants.
2. **Play the odds** -through sophisticated, quantitative methods of vendor analysis and selection, often involving expected value analysis, which considers both the probability of an d magnitude of the consequence, the industrial buyer can "play the odds" by selecting the supplier with the most favorable expected value.
3. **Spread the risk** -the consequences of choosing the wrong supplier can also be reduced through multiple sourcing, thus, enabling buyers to choose the proportion of risk to be assumed by allocating it among different suppliers.

A recent study, however, indicates that strategies for handling risk may be related to the way in which decision makers approach the situation. In attempting to reduce uncertainty, buyers may adopt decision-making strategies such as (1) use performance measures (i.e., examining past historical data of current suppliers, looking for guaranteed performance levels, or utilizing break-even criteria), (2) use expected value analysis, and (3) choose between certainty and risk.

Marking Implications

The significance of these findings relate more to out suppliers than to in suppliers. In view of the fact that supplier loyalty represents a formidable obstacle for out suppliers, the most effective strategy approach for out suppliers is to offer performance guarantees as part of their proposals. Out suppliers might also want to consider encouraging split procurement, offering their services as a back up or secondary supplier, and whenever an opportunity exists to service a portion of a new account, be willing to accept it when submitting a proposal.

In developing marketing strategy, however, both in and out suppliers should be aware of buyers' decision strategies in reducing uncertainty and how they affect supplier choice. Industrial sales people should, for instance, emphasize guarantees when applicable or the expected value considerations of their offer.

3.3.3 Conflict and Resolution in Joint Decision Making

Whenever two or more individuals have to reach an agreement over issues such as product specifications, information credibility, vendor capabilities, multiple sourcing, contract terms, or order routines, the potential for conflict exists. The potential for conflict emanates from:

- differences in expectations regarding suppliers,
- differences in the evaluative criteria employed,
- differences in buying objectives, and differences in decision-making styles of the individuals involved.

Whether conflict is good or bad depends upon the type of conflict that emerges and how it is resolved. Conflict that supports the goals of the organization and improves the firm's performance rather than hinders it is good. What is important from the marketer's perspective is resolved. When conflict is resolved through cooperation and the search for a mutually beneficial solution, joint decision making tend to be rational. However, when conflict is resolved through bargaining or politicking, joint decision making tends to be based on irrational criteria.

Conflict-Resolution Strategies

When conflict arises, individuals may resort to several different types of conflict-resolving strategies.

1. **Competing** - "Let's do it my way!". The desire to win one's own concerns at the other party's expense-the desire to dominate, to yield no quarter, to envision the interaction as a win-lose power struggle; assertive, uncooperative behaviors.
2. **Accommodating**-"I see your point of view.": The desire to satisfy the other's concerns without attending to one's concerns-peaceful coexistence, perhaps entertaining long-run motives; unassertive, cooperative behaviors.
3. **Collaborating**- "May be we can work this one out.": The desire to fully satisfy the concerns of both parties-sharing responsibility, problem –solving, in-depth exploration of issues, reaching a mutually beneficial agreement; assertive, cooperative behaviors.
4. **Avoiding**-"Better let the situation cool down before we act.": Exerting an attitude of indifference to the concerns of either party, not immediately

addressing the conflict diplomatically sidestepping an issue. Postponing an issue until a more opportune time, or withdrawal form a threatening situation; unassertive, uncooperative behaviors.

5. **Compromising**-"Let's split the difference!": The desire to reach an expedient, mutually acceptable agreement which is somewhere short of total satisfaction for either party-exchanging concessions or seeking a middle-ground solution; intermediate in both assertive and cooperative behaviors.

Coalition - Perhaps the most prevalent and yet ignored form of conflict resolution found among buying center members is coalition formation. When coalition is used to resolve conflict, individuals within the formation attempt to cooperate with specific other group members to enhance their competitive position with respect to the entire group. Since it tends to enhance the individuals' influence and represents a positive channel for airing and resolving conflict, it may be the most rational approach to conflict resolution.

The type of conflict-resolution strategy that individuals use, however, depends on several mediating variables, such as the characteristics of the purchase situation, the size of the buying center, the network of communication links, and their base of power in the organizational buying decision.

For example, two important reasons for utilizing coalition behavior are (1) the rewards available through various coalitional alternatives and (2) the resource/power positions of group members. It is not unusual for individual objectives and reward criteria to be in conflict when applied to group decision making due to the differences in expectations of the individuals involved. Coalition formation is one way of neutralizing conflict (i.e., joining with other individuals who have the same objectives and reward systems to strengthen one's position in the conflict situation). Coalition formation is also a means of compensating for resource of power inequalities and enhancing one's influence on the decision. When alliances form between weaker group members, more strength results to bargain for control of the group decision.

3.3.4 The Buying Committee

So far, much of our discussion has focused on the buying center. A more formalized buying center, the buying committee, is used extensively in the resellers market and by many industrial organizations, particularly when purchasing is centralized. In the industrial market, institutions such as universities and hospitals often appoint temporary buying committees to make joint decisions regarding which products can best satisfy organizational needs. And, in the commercial market, representatives from engineering, production, and accounting often establish formal buying committees to review and approve major purchases. Committee buying is also prevalent in the government market.

In the typical buying committee, one or two individuals set the direction while "rubber stamp" decision makers go along. Determining who these direction setters are and understanding their motives is the key in selling to buying committees. Committee buying generally involves a lengthy selling process during which the vendor meets much more frequently with individuals on the buying committee than with the entire committee. While the salesperson must provide product-related information to all accessible committee members, the real selling effort needs to be. Identifying those individuals and determining the structure of the decision-making unit depends on an analysis of the seller's past experience with the buying firm with respect to product purchases, technical expertise of committee members, individual personalities and objectives, and organizational structure.

3.3.5 Supplier Choice and Evaluation

Regardless of the diversity of expectations and objectives, buyers seek to find the best possible source of supply for their respective needs. In repetitive purchasing situations, such as a straight or modified rebuy, where buyers are familiar with current suppliers and the purchase involves a standardized product, it may be a simple matter of choosing a supplier from the list of sources already identified and evaluated. A supplier may even be recommended for selection on the basis of reciprocity considerations. For example, in one study it was noted that buyers sometimes want to favor a specific vendor in return for a favor. In a new task situation, or when the purchase involves a substantial expenditure or the quality of the needed products is critical, the selection may involve an extensive search to find the one qualified supplier. When no current source of supply exists, it may even require that the firm work with many suppliers to develop the needed product.

The development of a new source can take months, even years. In some cases, the buying organization may have to help a supplier develop the necessary level of needed performance by providing financing for equipment, by assisting in developing job scheduling and quality control techniques, or by participating in the development of bid preparations and cost accounting procedures.

Supplier Choice Qualifying Process

How buyers choose and qualify suppliers depends upon the type of buying situation and the importance of the purchase in terms of complexity and dollar value. When the procurement need is complex or involves a substantial expenditure, its is common practice for personnel from purchasing, quality control, engineering, and production to evaluate the supplier's facilities and production capacity to ensure, for instance, an uninterrupted flow of product, to evaluate product quality via product samples, to approve technical competency and manufacturing efficiency via plant visits, and to verify the supplier's financial stability. They may even evaluate the supplying firm's position in the industry, its progressiveness, its interest in the firm's order, and its cooperative attitude. Factors important to buyers in the supplier selection process are shown in Table 3-6.

Table 3-6 Ten Criteria Viewed as Most Appropriate in Measuring Buyer's Performance

1. Making purchases that arrive on time
2. making purchases that pass incoming Quality Assurance inspection
3. Making target costs
4. Knowledge of commodities in the buyer's area of responsibility
5. Ability to control purchase order cycle time
6. Ability to cultivate qualified suppliers
7. Ability to perform work with a minimum of errors
8. Ability to determine the bottom price a supplier will take
9. Amount of complexity of commodities in buyer's responsibility

10. Providing timely responses to inquiries form suppliers and internal customers.

3.4 Motivations of the Business Buyer

Like consumers, business buyers are subject to a wide variety and complexity of buying motives, and it is rare for either group to buy for just one reason. In this section we first list some of the criteria that business buyers may apply in making their decisions. We then look at the different uncertainties that motivate businesses in making their purchases. Finally, we look at the different abilities a marketer needs to satisfy buyers' requirements.

3.4.1 Buyers' Criteria

The choice of supplier for a particular product could be influenced by any combination of such factors as convenience, specification, life cycle cost, delivery, reputation of the supplier, after-sales service, technology, reciprocity, product range, and expertise.

- **Convenience -** The convenience offered by a product refers to the extent to which it is compatible with the customer's existing products and procedures.
- **Specification -** The specification for a product includes its required performance and versatility: These requirements may be expressed in clear, quantitative terms, or more loosely as the need for "high quality." Assessments of the quality of a single product can vary between different applications and different customers.
- **Delivery -** For some customers, speed of delivery will be important. Other will be more concerned with reliability of delivery, and some will demand both.
- **Reputation** - Some companies will place great emphasis on the reputation of the supplier in making their decision, rather than concentrating on assessing the quality of the product itself. Reputation is often taken as a guarantee to reliable sources and performance. Reputation of the markets is more important where the product involves high risk.
- **After-Sales Service -** Some customers will question very closely the ability of a supplier to ensure the continuing effectiveness of the product in the use. The quality of this after-sales service and support by the supplier may outweigh the importance of initial price or product performance.

- **Technology** - Some products are based on entirely new technologies. It may be very important to a buyer to keep up with such technological changes. In this case the buyer may be prepared to trade off the new technology against a lower level of reliability from the product.
- **Reciprocity** - Many companies both buy from and sell to each other. This can mean that a company will agree to buy a particular product, even though the product may offer lower performance, just so that it can ensure a reciprocal sale of its own products. This reciprocity can influence the buying decision.
- **Product Range** - A customer may buy a particular product because it is from the same company that supplies a range of other products to the customer. Often the customer will be able to negotiate a favorable deal across the whole range.
- **Expertise -** When a buying company is purchasing a product for the first time, it may be unsure about which is the right product for its particular requirements. In this case it is likely to buy from a company that it believes has the expertise to advise it, even though that company may not offer the best prices.

3.4.2 Buyers' Uncertainties

Understanding the problems and uncertainties facing buyers is vital for marketers if they are to provide successful solutions and reduce these uncertainties. Buyer uncertainties can be grouped into three categories:

1. Need uncertainty
2. Market uncertainty
3. Transaction uncertainty.

1. Need Uncertainty. The purchase of goods and services is relatively straightforward when the company is sure of precisely what it wants. However, the company's needs may be difficult to determine, such as when buying a complex machining center, and this need uncertainty will strongly influence the way the company buys.

When buyers have high need uncertainty, they are more likely to look toward current suppliers or well-known brands. Only more experienced buyers would have low enough need uncertainty to feel confident about purchasing "brand less" generic products.

2. Market Uncertainty - Sometimes a market may consist of a wide diversity of types of products, or it may be changing rapidly with a succession of new and different offerings. In these cases buyers face market uncertainty. They will be concerned about keeping track of the rapid technological and product changes in the market and the different offerings of suppliers. A buyer with high market uncertainty will place great emphasis on market scanning and will be less concerned about establishing a close relationship with a single supplier than is the buyer with need uncertainty. A close relationship with a single supplier means that buyer may receive improved service or that the seller may modify a product to suit the buyer's requirements. But a close relationship with a single supplier in a time of high market uncertainty means that the buyer loses the advantage of access to the technology of alternative suppliers. Under conditions of high market uncertainty the buyer is more likely to favor two or more parallel suppliers.

3. Transaction Uncertainty - The buyer may also face problems with suppliers perhaps they are located overseas, or perhaps their reliability is in doubt. In such cases the buyer has high transaction uncertainty. To avoid transaction uncertainty buyers are likely to emphasize the importance of building contacts with potential suppliers and gathering information from them. (A well-known business adage is "No one ever buys from a stranger.") Buyers may also try o increase the likelihood of getting what they need by using such formal procedures as vendor rating.

3.4.3 Marketer's Abilities

The various uncertainties facing buyers result in ever-changing requirements. Marketers have two abilities to satisfy these requirements:

1. problem solving ability and
2. transfer ability.

1. Problem-Solving Ability - The seller's problem-solving ability is important when the technology in a product is new or changing very rapidly. At this time buyers will have great difficulty in choosing among alternatives, and the seller may be able to capitalize on its much greater knowledge of the product to solve the buyer's problems. This means that the customer is buying the seller's problem-solving skills as well as the product's characteristics, and his may mean that the seller can command a higher price.

2. Transfer Ability - Later, as buyers become familiar with a particular product, they will have a better understanding of the capability and imperfections of different suppliers. The buyer then will not need and will not be willing to pay for the seller's problem solving abilities. Instead, the buyer has transaction uncertainty, and questions of price and delivery are of major importance. The most important characteristic of the seller at this time is ***the ability to deliver an undifferentiated product to the buyer quickly, reliably, and cheaply***. This is the seller's transfer ability.

To succeed in today's market, a marketing company must develop the abilities that match the buyer's uncertainties at that particular time.

3.5 Characteristics of Buyer/Seller Relationships

One way to understand business marketing is to see it establishing and developing a portfolio of relationships with customers. This means that the business marketer has the task of managing these relationships. We first look at the process or relationship development in business markets and then at the implications of the buyer/seller relationship for the business marketer.

3.5.1 The Process of Relationship Development

Buyer/seller relationships evolve over time. This is particularly the case with relationships that center on important purchases, such as component parts or capital goods, rather than routine, off-the-shelf items, such as standard operating supplies. By looking at the stages in the relationship development process we can examine the problems of starting, developing and managing relationships. These tasks are faced by both buyer and seller companies, because both have an important stake in the success of their relationships. Sellers need to develop and retain business, and buyers need to ensure that they continue to obtain the products they want at the best value possible.

Exhibit 3-7 The Development Of Buyer/Seller Relationships In Business/Industrial Markets

1 **The Pre-relationship Stage**	2 **The Early Stage**	3 **The development Stage**	4 **The Long-Term Stage**	5 **The Final Stage**
Evaluation of New Potential Supplier	Negotiation or Sample Delivery	After Contract Signed or delivery Build-Up	After Several Major Purchases or Large-Scale Deliveries	In long. Established Markets
Evaluation initiated by: • Particular episode in existing relationship • General evaluation of existing supplier performance • Efforts of out-supplier • Other information sources • Overall policy decision **Evaluation conditioned by:** • Experience with previous supplier • Uncertainty about • Potential relationship • "Distance" from potential supplier	Experience Low Distance high commitment and adaptation low High investment of management time; few benefits	Experience increased Distance reduced Actual Commitment increased; Perceived commitment demonstrated by informal adaptation increasing formal and informal adaptations; benefits increase	Experience high Distance minimum Actual commitment maximum; perceived commitment reduced Extensive adaptations; benefits reduced by lack of attention	Business stable and based on historical ways of dealing with each other Vulnerable to competitive entry

Source: From H.Hakansson, ed. Industrial Marketing and Purchasing: An introduction Approach.

1. The Pre-relationship Stage - We have already noted how inertia affects business buying. Buying and selling companies may continue to deal with each other over a long period with relatively little attention to the alternative suppliers or customers available to them. A buyer's decision to consider a new potential supplier can be triggered for a number of reasons, such as a ***particular episode*** in a current relationship like a series of price increases.

Sometimes a company will carry out a general ***review of an existing supplier's performance***, perhaps as part of a continuing vendor-rating procedure. This review may lead to a decision to evaluate new potential suppliers. The sales or promotional efforts of an out-supplier or information received from others in the industry may also trigger a buyer to evaluate new suppliers. Finally, the customer may seek to evaluate new potential suppliers as a result of an overall policy decision.

For whatever reason, the buyer's decision to evaluate new suppliers will not be casual, and its evaluation of any new supplier will be strongly influenced by its ***experience with its current and other suppliers.*** Thus the customer may choose a new supplier mainly for its supposed consistency of product quality if the existing supplier has performed badly in that area.

The "***distance***" between the buyer and a new supplier is likely to be considerable and affects their ability to understand and cooperate with each other. The ***physical distance*** between them is likely to restrict communication. The ***social distance*** is the extent to which people from the buying and selling companies are unfamiliar with each other's ways of working and thinking. ***Cultural distance*** concerns differences in norms, values or practices between companies in different regions or counties. ***Technological distance*** refers to differences between the technological skills of the two companies. Obviously, contacts will be different between companies when they involve a product that both companies understand well, as opposed to a customer's first purchase of a particular piece of high technology. Technological distance is likely to be reinforced when the two companies are from different countries and hence the individuals involved are from different cultures. ***Time distance*** refers to the length of time between initial discussions and the likely time of product or service delivery. The longer this time is, the less the two companies are likely to feel committed to each other in the early stages of their dealings. They also tend to feel more uncertain about the potential cost and benefits of dealing with each other when the fruits of their relationship are a long way in the future. To build a successful relationship with a customer a marketer must be aware of which aspects of distance are important to the customer and take clear steps to reduce them.

2. The Early Stage - Stage 2 in the development of a buyer/seller relationship is when ***negotiations take place*** about what precisely is to be supplied or when ***samples of products are delivered***. If the relationship is successful at this stage, the distance between the firms will gradually decrease. They begin to know each other on a social as well as a professional level. The marketer also demonstrates commitment to the customer by devoting time to development of the relationship.

One way for the marketer to show commitment is by making adaptations to suit the buyer's requirements. In this way the marketer hopes to gain the benefits of increased commitment from the customer in return. It is common in some markets for a special product to be developed for a single customer. We refer to this as a ***formal adaptation***. Perhaps more significant in showing commitment are the informal, non-contractual adaptations that the supplier may make, such as altering a delivery schedule or making a minor product change.

The marketer must control the adaptations it makes for a buying company because they can involve considerable costs. The buying company may also show its commitment to the seller by making adaptations to its own products, production, or payment terms to accommodate the seller.

The early stages of a buyer/seller relationship involve investment of considerable management time in meetings, negotiations, and the discussion of design and delivery issues. At this early stage, both sides will see few benefits from their efforts. The buying company has not yet acquired a new, stable, quality product offering tailored more or less to its requirements, and the seller does not have the certainty of a new valuable customer.

3. The Development Stage - As their relationship develops in stage 3, the buyer and seller companies grow closer to each other. This stage is reached after a contract has been signed or the delivery of continuously purchased products has built up. The two companies become more used to each other's ways of living and working, rather like individuals do after they have been married for some time. They show important how they feel the other party is by making more ***informal adaptations*** to meet each other's requirements. In this way both their actual commitment and their perceived commitment increase.

4. The Long-Term Stage - There is a danger that as individuals or companies grow close to each other, they may start to take each other for granted. This is where the buyer/seller relationship moves into stage 4. After several major purchases or large-scale deliveries, both sides will know each other very well. As with a long-married couple, the distance between buying and selling companies may be at a minimum, and both will be strongly committed to each other.

5. The Final Stage - Stage 5 in the buyer/seller relationship is reached only in very long-established markets. Many suppliers drifted into complacency and operated in traditional, non-innovative ways. Of course, when an industry slides into this state, it is very vulnerable to the actions of new, foreign suppliers that may have inadequate knowledge of conventional methods of doing business. These new suppliers may offer levels of innovation and adaptation beyond the experience of the domestic buyers and sellers. The result is that many relationships break up, with buyers building new relationships with foreign partners. Thus from stage 4 or stage 5 the model cycles back to stage 1 and the evaluation of a new potential supplier.

This model of the development of the development of buyer/seller relationships does not mean that all long-established relationships must fail. Good management can ensure that the relationship carries on indefinitely, satisfying the requirements of both companies.

3.4.2 Implications of Buyer/Seller Relationship for the Industrial Marketer

1. Relationship Management - The complexity of the buyer/seller relationship means that for a successful relationship to develop, relationship management is needed. The marketer must develop and manage relationships with each customer company.

- As the out-supplier, the marketer must determine the nature of any inadequacies that a customer sees in its current supplier.
- The marketer must carefully measure and evaluate the sales effort, product, or production resources that it devotes to each of its customers so that it can

satisfy the customer's requirements while not allowing the customer to take these resources for granted.

- A seller must not let its relationship with a customer become fixed and unresponsive and hence provide the buyer with an incentive to seek another supplier.

Because of the importance of buyer/seller relationships to the business marketer, we need to reassess the role of ***the salesperson***, who is perhaps best thought of as a "***relationship manger***." It is the salesperson's task to coordinate the many different contacts between different people in the two companies, who are all performing different tasks. Many problems can arise if all parties are not working well together. For example, at the exact time that a salesperson from one company was visiting a customer and negotiating a new order, the seller's finance department called the customer and threatened to cut off supplies if an invoice was not paid immediately!

2. Relationship Audits - As well as the operational management of a single relationship, marketers have a strategic management task in dealing with all the company's portfolio of relationships. A salesperson involved in detailed interaction with customers may have difficulty in seeing each relationship in a wider perspective. An overall marketing view must be taken of how the company will allocate its resources and efforts among different customers, including such decisions as for which customers it should use its limited product development facilities, for which it should change its production schedules, and on which it should concentrate it sales and service efforts. The basis of this strategy is an audit of the company's relationships. A relationship audit must involve answers to at least the following questions:

- What is the likely sales and profit potential of this relationship?
- What resources are required to fulfill this potential?
- Does the likely return justify this investment when compared with the potential in other relationships?
- Where do the threats to the development of this relationship come form?
- What is the contribution of this relationship to the company's overall operations? Does it provide a strong cash flow, is it the source of joint product development that will enhance the company's general market position, and does it provide entry to other similar customers?
- Are the current efforts devoted to this relationship appropriate to the company's overall strategy?

- Are we too dependent on this customer?
- Are our ways of dealing with this customer appropriate both to its needs and our strategy, or are they dealings based on habit or history?

Summary

The business marketer must be able to analyze the many different environmental factors that may affect each single buying decision: physical, economic, technological, legal and political, and cultural. The marketer must also understand that business purchases vary widely, depending on the requirements of the buying company and its skills and experience. Additionally, business buying is carried out by a number of people, and the marketer must strive to identify each of these and the roles they are performing at different stages in the process of buying. Business buyers have a variety of motivations, and the marketing company must tailor its abilities to meet the real requirements of buyers at any one point in time.

As well as examining individual buying decisions, the marketer must be aware that these form part of an overall relationship between buying and selling companies. The marketer's task is to determine whether the buyer needs a close, complex relationship or a more distant one, and which is in the marketer's best interests. The marketing company must mange each relationship over the different stages of its life. It must also develop a strategy for all current and potential relationships as part of a portfolio, so as to maximize the contribution of each to the company's profitability.

Discussion Questions

1. Describe the type of sales activities that would be appropriate at different buy phases in the purchase process for (a) a new-task purchase, (b) a modified-rebuy purchase, and (c) a straight-rebuy. To what extent is the salesperson able to influence the purchase process after the initial sales presentation?
2. Assume that you are a salesperson with the task of developing sales to two groups of business customers. One group has long-established relationships with single suppliers, and the other changes frequently among different suppliers. Explain how you would assess the requirement of companies from the two groups. What would you expect these differences to be and how would your sales approach cope with them?

3. This chapter has separated the members of the buying center into a number of categories: users, deciders, buyers, and gatekeepers. Discuss the ways in which a marketing company can reach and influence these different groups and whether personal media are likely to be more or less successful.
4. This chapter has suggested that companies can compete on the bases of their problem solving ability and their transfer ability. How would the way in which marketing was organized be different between companies whose orientation was toward problem solving and those that concentrated on transfer ability?
5. From a marketer's perspective, what are the advantages and disadvantage of dealing with a modern, centralized purchasing function compared to a decentralized department?
6. "In selling to a committee, it is definitely more effective to make an initial presentation to the group as a whole and then handle objections and problems in separate, individual sessions." Agree or disagree with this statement and explain why.

CHAPTER 4 SEGMENTATION OF INDUSTRIAL MARKETS

Learning Objectives

Upon completion of this chapter a student should be able to:

- Appreciate the difficulty involved in successfully segmenting industrial markets.
- Distinguish among undifferentiated marketing, differentiated marketing, and concentrated marketing
- Differentiate between the micro/macro segmentation, the nested approach to segmentation, segmentation for maturing markets, segmentation by purchase responsibility, and other bases of industrial markets segmentation.
- Understand how to evaluate potential markets segments.
- Discuss the six approaches by which a firm can position its products.

Overview

Market segmentation has long been considered among the most fundamental concepts of marketing. Business market segmentation is the practice of dividing a business market into distinct groups of buyers with similar requirements and that will respond similarly to a specific set of marketing actions. It is the foundation of the marketing strategy process and the driver of resource allocation.

Segmenting business markets is difficult. Indeed, the segmentation of business markets is universally considered to be a more complex process than segmenting consumer markets. The goal of segmentation in an industrial setting is the same as that in a consumer product environment to divide larger markets into smaller components that are homogeneous with respect to their response to a market mix. To be successful, the business marketer must:

- identify, analyze, and evaluate potentially attractive market segments;
- target the segments to serve; and then
- develop and communicate a positioning strategy that will differentiate the firm's offerings from others.

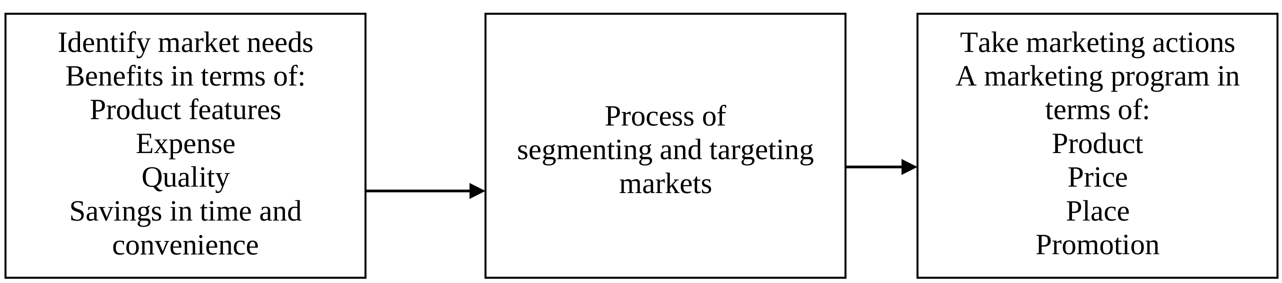
4.1 General Market Segmentation Strategy

Industrial market segmentation can assist firms in several areas:

- **Market analysis**-developing a better understanding of the total marketplace, including how and why customers buy.
- **Market selection**-making a rational choice of market segments that best fit the company's capabilities.
- **Marketing management** - developing strategies, policies, and programs to meet the needs of different market segments profitably and to give the company a distinct competitive advantage.

Business-to-business firms vary in needs and wants, size, economic activities, procurement structure, and location. Exhibit 4-1 shows how the process of segmenting a market and selecting specific segments as targets is the link between identifying various organizational buyers' needs and taking marketing actions.

Exhibit 4-1 Marketing Segmentation Links Market Needs to an Organization's Marketing Actions



4.2 Market Strategies for Business Segmentation

Business marketing managers must determine what strategy to use for different market segments. Three alternative market-selection strategies are:

1. undifferentiated strategy,
2. differentiated strategy, and
3. concentrated strategy.

1. Undifferentiated Marketing Strategy

An undifferentiated marketing strategy uses the concept of "market aggregation," wherein the total market is treated as if it were one homogeneous market segment.

Marketing management creates a single marketing mix to serve potential customers within this market. This approach focuses on common needs among buyers, rather than on how buyers' needs differ. Consider, for example, the marketing mix adopted by a business cleaning or business waste removal firm. The price per hour or per pickup would be the same for all potential users of the service, and the same promotional package would be aimed at buyers in several different industries. Undifferentiated marketing is appropriate due to cost economies, with the narrow product line keeping down production, inventory, and transportation costs. This particular strategy also lowers the cost of marketing research and product management. An undifferentiated marketing strategy might be employed by firms offering a homogenous, staple product, such as gasoline or industrial lubricants, for which product usage varies little by customer type.

2. Differentiated Marketing Strategy

A differentiated marketing strategy attempts to distinguish a product from competitive products offered to the same aggregate market. An example of a firm using a differentiated marketing strategy is IBM, which offers many hardware and software variations to different segments in the computer market. By differentiating its product or product line, the firm identifies several potential target markets. Each of these target markets may be attractive in demand but may differ form one another substantially in other important aspects (such as size, product application, and technical expertise). With this strategy, the firm hopes to engage in non-price competition and thus avoid, or at least minimize, the threat of severe price competition. Differentiated marketing strategy is justified when each segment is distinct, when there is very little cross-elasticity of demand (the effect that demand for one product has on the demand for another product), and when the potential size of each segment is large enough to provide a satisfactory return.

Although usually it can be shown that total sales may be increased with the marketing of a more diversified product line, such activity does increase the cost of doing business. The following costs are likely to be higher when a firm elects to pursue a differentiated marketing strategy:

1. **Product modification costs** - Modifying a product or product line to serve different segment requirements usually involves additional research and development, engineering, and/or special tooling costs.

2. **Production costs -** For each product, the longer the production setup time and the smaller the sales volume, the more expensive it becomes. For a product sold in large volume, however, the higher costs of setup time can be quite small per unit.
3. **Administrative costs** - The firm must develop separate marketing plans for different segments, usually necessitating additional effort in marketing research, forecasting, sales analysis, promotion planning, and channel management strategy.
4. **Inventory costs -** Managing inventories is more costly generally than managing an inventory of only one product.
5. **Promotion costs** - In trying to reach different market segments with variations of the promotional mix, each segment may require separate creative advertising planning, sales strategy, and so forth.

Exhibit 4-2 Three Alternative Market Segmentation Strategies

Company marketing mix → Market

a. Undifferentiated marketing

Company marketing mix → Segment 1

Company marketing mix → Segment 2

Company marketing mix → Segment 3

b. Differentiated marketing

Company marketing mix → Segment 1
Segment 2

c. Concentrated marketing

3. Concentrated Marketing Strategy

A firm using concentrated marketing strategy selects one or a relatively few segments on which to focus all its marketing effort. Through concentrated marketing, the firm achieves a strong market position in the segment because of its greater knowledge of the segment's needs. Furthermore, the firm enjoys many operating economies through specialization in its production, distribution, and promotion functions. Concentrated marketing is, however, not without risk. A particular market segment's demand can turn downward, or a competitor may decide to enter the same segment.

Exhibit 4-2 summarizes the key differences between undifferentiated marketing, differentiated marketing, and concentrated marketing.

4.3 Approaches to Market Segmentation

Fundamental means of segmenting business markets include:

1. Macro/micro segmentation,
2. The nested approach to segmentation,
3. Segmentation for maturing markets, and
4. Segmentation by purchase responsibilities of individuals within organizations.
5. Other Approaches to Market Segmentation

Each of these is discussed below.

1. Macro/Micro Segmentation

Macro segmentation involves dividing the market into subgroups based on over all characteristics of the prospect organization:

- The size of buying units
- Type of industry and
- location

Micro segmentation, on the other hand, involves dividing the market into subgroups based on specific characteristics of the decision-making process and the buying structure within the prospect organization:

- buying-center authority,
- attitudes toward vendors, and so on

In either case, the business marketer identifies subgroups that share common macro or micro characteristics and then selects target segments from among these subgroups.

2. Nested Approach

Thomas Bonoma and Benson Shapiro have developed a more detailed approach to market segmentation that they refer to as a nested approach. Their premise is that the distinction between macro segments and micro segments noted above leaves out a number of potentially valuable segmentation variables. In contrast, the nested approach stresses segmentation according to the amount of investigation required to identify and evaluate different criteria. Layers of the nest are arranged according to ease of assessment of the information, beginning with organization demographics. As diagrammed in Exhibit 4-3, they come increasingly complex criteria, including company variables (operating and purchasing), situational factors, and personal characteristics. The nested approach assumes a hierarchical structure that moves from broad, general bases for segmentation to very specific bases. As illustrated, macro layers, or characteristics, are outer most, and micro characteristics are innermost, in the exhibit. In other words, more specific customer characteristics are nested inside the broader organizational basis.

The Macro Bases for Segmentation

Exhibit 4-3 Major Potential Bases for Segmentation (Nesting)

General, observable
(Macro)

(Intermediate)

Specific, subtle
(Micro)

Emporographics (Organizational Demographics)
- Industry
- Company size
- Location

Operating variables
- Technology
- User-nonuser status
- Customer capabilities (financial)

Purchasing approaches
- Organization of DMU
- Purchasing policies
- Purchasing criteria

Situational factors
- Urgency
- Application
- Size of order

Personal characteristics
- Motivation
- Buyer-seller
  1 to 1
  relationship
- Risk
  perceptions

The Macro Bases for Segmentation

The broad objective or macro bases of segmentation shown at the top of Exhibit 6-3 are

- the size of buying units,
- the type of industry, and
- location.

A Note on Terminology

Demographics is the term used when segmenting consumer markets according to such variables as the size of population, location of residence, age, occupation, of level of education. (The term comes from demos, a Greek word meaning "people.") These demographic variables serve as the macro or objective bases for segmenting the market for consumer goods and services.

We shall use the word emporographics as the industrial equivalent of demographics. (The term comes from emporium, also a Greek word, meaning" A place of commerce" or "trading area."). Emporographics encompasses the macro or objective bases for segmenting business markets that is, the size of buying unit, type of industry, and location.

Size of Buying Unit

The giant companies are given much publicity because they command the resources. They understand well each other's practices and constraints. Small firms are often trendsetters in their activities, and they can thus serve as proving grounds without undue risk taking.

Type of Industry

SIC (Standard Industrial Classification) code, has received wide acceptance by both the public and private sectors. Its equivalent at the international level is the SIC (Standard Industrial Classification) code, which is also enjoying popularity. A company classifying its client base according to the SIC code can compare its sales data with existing statistics.

The Standard Industrial Classification (SIC) System

Division	Description of Major Industry
A	Agriculture, Forestry, Fishing
B	Mining
C	Construction
D	Manufacturing
E	Transport, Communication., Utilities
F&G	Wholesale & Retail Trade
H	Finance, Insurance, Real Estate
I	Services
J	Public Administration
K	Non classifiable

Geographic Location

Knowing the location of actual and potential customers assists greatly in sizing up and segmenting markets. Good decisions in this area have a major impact on planning distribution centers and promotional campaigns. The first step is to pinpoint the resources or facilities of a given industry.

The segmenting of markets by location has different implications in different industries. A resource-based industry such as lumber and a manufacturing industries have to consider the distances that their output must be shipped to reach buyers. This consideration must then be balanced against the desire to be close to their raw input and suppliers. Light manufacturers such as electronic component makers and service industry companies such as leasing offices have fewer problems in regard to being distant from their customers and suppliers. It is true, however, that being geographically close is reassuring to users. This applies especially for maintenance and repair firms.

Combining Size, Industry, and Location

Macro bases such as those just discussed can be used singly, but such emporographics prove to be more meaningful in combination. Knowing where clients are located, to which industries they belong, and how big they are can assist the marketing manager in the segmentation process. Few companies can serve all possible markets. Focusing on a limited set of actual and potential customers while knowing much about their characteristics and then adjusting the product or service line makes sense, whether we consider old-line or new industries.

The Intermediate Bases for Segmentation

The intermediate bases of segmentation are the middle three nests: operating variables, purchasing approaches, and situational factors.

Operating Variables

Operating variables include some important distinguishing characteristics:

- user status,
- technical features, and
- customer capabilities.

All of these descriptors may serve as ways of segmenting the existing and potential client base. As before, they may be used singly or in combination.

Usage Rate - Segmentation of clients on the basis of usage occurs usually along the following lines:

- heavy users,
- moderate users, and
- light users.

The challenge is to retain heavy users, at the same time remembering that light users can develop into significant clients. It is important to recognize also that related goods and follow-up services can be useful for approaching clients for further sales. For example, progressive chemical firms not only offer compounds in bulk or in small quantities, but carry out testing and monitoring to see if the chemicals perform and promised and to show that pollution does not occur.

An important division for business marketers is the one between original equipment makers (OEMs) and the replacement market. Quite frequently, the OEM field is dominated by large vendors and is difficult to penetrate. In such cases, the replacement market or after-market may look attractive. Examples include the sale of tires, batteries, and servicing for truck and car fleets; instruments for chemical, paper, and other process companies; computer peripheral equipment and consultancy for large and small offices; and architectural services for building renovation.

High usage rates may imply frequent repeat orders for small quantities or occasional sizable orders. The vendor is well advised to know what role its products and services play in the buyer's activities

Customer Capability - By understanding the nature of the customer's business (including knowing the client's clients), the relationship becomes one of trust, and the account may enjoy a steady increase. Loyalty bonds refer to both trust and longevity. Such bonds are based on the parties knowing and assisting each other.

Strong ties are often prevalent in the case of basic commodities, factory parts, and office supplies. The result is the straight-rebuy situation, described in Chapter 3. Even in such situations, it pays to know the manner in which the client operates. The modified-rebuy and new-tasks situations represent opportunities for vendors to become first-time suppliers and thereby make the "short list." Such lists, often disavowed or secret, are made up of preferred vendors that are solicited to bid or to approach with a proposal for a transaction that, of course, may then turn into a long-term commitment or relationship.

Purchasing Approaches

Why do some buyers place orders much in advance, whereas others wait until the last minute? Which departments get involved (and in what sequence) in surveying alternative makes, determining specifications, bid invitations, and supplier selection? Answers to these and similar questions are important to vendors for purposes of segmenting, for dealing with both policies and people, and for positioning the product or service offered to the target markets.

Purchasing Policies and Practices - Whenever feasible, vendors should obtain written documentation, beyond oral understanding, about the purchasing practices of their clients. Topics covered may include policies on reciprocity, gift giving, the way in which bids are sought, and special arrangements for minority contractors. Two key areas are worth investigating: (1) Is purchasing centralized, decentralized, or a combination of the two (for example, capital goods bought at headquarters, routine orders at branches)? (2) Does the client prefer a system solution or does it wish to buy separate components for assembly?

Purchasing Criteria - Traditional business buying occurs along the familiar lines of seeking quality products, prompt delivery, a fair price, and follow-up service.

Service Level - Although price is often cited as a key consideration (most often by large users), many clients focus on such service issues as reliability, ability to obtain emergency deliveries, and the quality of technical assistance. It may be useful, therefore, to segment customers according to common service requirements. As a general rule, the more service is required, the more localized must be the offerings by the vendor. There is no substitute for being near and readily available to clients.

Situational Variables

Situational Variables are the last of the intermediate bases of segmentation. Situational variables are closely related to operating and purchasing variables on the one hand and to the micro bases of team and individual buyer characteristics on the other. Situational considerations are aspects as urgency and the nature and size of the order placed by a client. Another factor that can be equally important here is whether clients are seeking standardized or customized solutions. Service level expectations, referred to above, can also come into play.

The Micro Bases for Segmentation

Beyond macro and intermediate segments lies the realm of micro bases of segmentation. At this juncture, we are looking at the groups and individuals in the buying center, their decision-making style, their technical sophistication, and their attitude toward risk taking. Such considerations are similar to organizational buying behavior and purchasing practices. We concluded that looking at the purchasing agent is hardly enough; we must study the individuals and groups who are influential or who have veto power over the procurement.

Buyer-Seller: One on One

It is clearly at the micro level that we can speak of strong ties or loyalty bonds between seller and buyer. There are cross-currents in all industrial sectors and in local or national economies. Some observers say that long-term commitments are on the rise because of a desire for stability, the complexity of transactions, and clients' preference for dealing with fewer vendors. Others contend that under the pressures of cost cutting, corporate downsizing, and outsourcing, loyalty bonds are bound to erode. In industries characterized by rapid change and keen competition, suppliers are often played off against each other. The ties between seller and buyer usually take years to build but can erode rather quickly.

Business customers as a rule are ready to switch vendors under the following circumstances: dissatisfaction with an existing vendor's price, quality, or service; the retirement, transfer, or death of a key contact, such as a sales force member who had called on the client for decades; and changes in requirements for example when a factory switches to a new materials. In times of turbulence such as inflation, shortages, or reorganization loyalty bonds become frayed. Such situations represent threats to present vendors and opportunities for would be suppliers that are on the outside looking in.

Once loyalty bonds are established, relationship selling should still be cultivated. No individual or company is sold forever even on the best product. Thus, once the relationship has evolved from a transaction to a relationship or commitment style of operation, a continuing dialog is still required. Such discussion can take a number of different formats, especially when it comes to selling add-ons, peripherals, or follow-up items.

Individual Characteristics

In this section we descend to the most specific level of segmentation: the demographic and psychographic characteristics of individuals. The more we know about them, the better we can execute the task of segmentation and the subsequent task of delivering value.

Background, Function, and Responsibility Level - Research has shown that the greater the similarity between the salesperson and the prospective client, the higher the probability of the sale. When the background, education, and corporate rank of individuals match each other, there is a sense of a partnership. This is enhanced when the selling organization designates an individual to be resident troubleshooter at the site of the customer. Common sense and protocol dictate that young salespersons should not call on upper-level managers with years of experience and expertise.

Preferences, Motivation, Sophistication - Whereas the background, title, and function of individuals can be ascertained with relative ease, it is much harder to learn about their attitudes, especially in regard to risk taking. Although findings in this regard are not plentiful, several insights are beginning to emerge. A few firms even commissioned research focusing on industrial psychographics that is, the study of personality traits and behavior of individuals in organizations.

3. Segmentation for maturing markets

Exhibit 4-4 Examples of Segmentation Variables for Organization Markets

Categories of Segmentation Variables

- Type of economic activity — Segmentation variables
  - Agriculture, forestry, fisheries
  - Mining
  - Construction
  - Manufacturing
  - Transportation
  - Communication
  - Wholesales trade
  - Retail trade
- Size of organization — Segmentation variables
  - Number of establishments
  - Number of employees
  - Volume of shipments
  - Annual sales
- Geographic location — Segmentation variables
  - Global regions
  - Nations
  - National regions
  - States
  - Counties
  - Cities
  - Neighborhoods
  - Climate
  - Terrain
  - Population density
  - Market density
- Product usage — Segmentation variables
  - How used
  - Usage rate
- Structure of the procurement function — Segmentation variables
  - Centralized
  - Decentralized
  - Buyer center
  - Buyer situation

In mature markets, some try to segment on size, industry, or products alone. However, segmenting on these variables alone, while often done, is rarely sufficient. Customer behavior in terms of trade-offs between price and service is an important additional criterion. Often, the nested approach (and others) do not capture the underlying dynamics of a maturing market. Considerable value can often be gained by attempting to move toward buying-behavior based segmentation.

4. Segmentation by purchase responsibilities of individuals within organizations.
Many marketers believe that the use of purchase responsibilities among individuals within organizations as a basis for segmenting business markets is a valid approach to segmentation. Knowledge that a firm's market may be segmented by purchase responsibilities may lead to more effective deployment of marketing resources. The use of purchase responsibilities to classify organizations represents an attempt to reduce some of the complexity involved in understanding the concept of the buying center. Different kinds of organizations may give rise to different kinds of buying centers, at least insofar as purchase responsibilities within the buying center are concerned.

5. Other Approaches to Market Segmentation
Many of the variables generally used by the marketer to segment the consumer market also can be used by the business marketer to segment the organizational market (for example, user status, degree of customer loyalty, and customer attitude toward the product). To expand upon the previous discussion of business market segmentation, some of the categories of variables for segmenting organizational markets are identified in **Exhibit 4-4** and are discussed in the following sections.

Type of Economic Activity
Industrial Classification System (ICS) is a useful starting place to segment business-to-business firms according to primary economic activity.

Size of Organization
Segmentation on the basis of size, using variables such as volume of shipments, number of employees, market share enjoyed, and so on, may be a useful technique for business market segmentation. However, a note of caution is in order. Segmentation based on size alone is rather risky, as the prospect may or may not be a viable target. Just because an organization is large does not necessarily mean that it will be a heavy user of the product.

Geographic Location

Segmentation on the basis of location is anther criterion for segmenting organizational markets, as some industries such as textile manufacturing and furniture manufacturing are concentrated geographically.
Additionally, segmentation is possible by product usage rate, that is, light, moderate, and heavy use.

Structure of the Procurement Function

Market segmentation strategy can be affected by the structure of the buying organization, as well. Consider, for example, the buying behavior of the firm that centralizes the buying function. In a centralized buying situation, the members of the buying center will be in a stronger position to buy in larger quantities and make quicker buying decisions and they will be attractive targets to many potential competitors. In a decentralized buying situation, in contrast, the potential order size will be smaller, the number of potential competitors will be limited geographically, and a final decision on the price and quality aspects of the purchase (especially in a modified-rebuy or new-task situation) may need central authorization. Also, the composition of the buying center can present considerable demographic and psychographic differences among members of the center that the business marketing manager must accommodate. Finally, buying situations will impact segmentation strategy. As noted, the effort necessary to appeal to buying center members in a new-task situation is very different from that needed to appeal to buyers in a straight-re-buy situation.

4.4 Evaluating Potential Market Segments

Market segmentation reveals the potential market opportunity faced by firms and what would appear to be the most attractive markets the business firm can serve. Before target markets can be chosen, however, the marketing manager has to decide which segments will provide the best return, given limited resources.

By examining the relationship between business marketing strategy and financial performance in a profitability analysis of a market segment, a product line, or an individual product within a product line the marketing manager can select those market segments that appear to be profitable and disregard those that do not appear so. Segments selected must be served at a reasonable cost to the firm, in order to provide the necessary or required return on investment. Additionally, it is important to undertake a competitive analysis to assess both the strengths and weaknesses of competitors within a segment and to identify other areas of opportunity. The two useful tools in the overall evaluation of potential segments are:

1. the profitability analysis and
2. the competitive analysis

Market Profitability Analysis

A market segment might have desirable size and growth characteristics, yet still not be attractive from a profitability point of view. (Many marketers would cite government defense procurements as an example of this phenomenon.) Michael Porter has identified five forces that determine the intrinsic long-run attractiveness of a whole market, or any segment within it. The firm must assess the impact on long-run profitability of five groups:

- industry competitors,
- potential entrants,
- substitutes,
- buyers and
- suppliers.

The collective strength of these five competitive forces determines the ability of firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital. The strength of these five forces varies from industry to industry and can change as an industry evolves. Further, the strength of each of the competitive forces is a function of industry structure, or the underlying economic and technical characteristics of an industry.

2. Market Competitive Analysis

Demand and profitability are not the only key variables in a marketing plan; the number and types of competitors must also be analyzed. This is accomplished through a competitive analysis, which answers such questions as How many competitors are there? What are their strengths and weaknesses? What is their market share?

Competition both within and between segments is stronger today than ever before, partly because of the increasing strength of both domestic and foreign markets. The strategic approach that is most likely to succeed is a comprehensive one that starts with market segment preferences, and considers competitors' capabilities and costs and the way in which competitive offerings are perceived. Foreign competitors are strong and are important factors to consider in the In response to market changes and unprecedented global competition, executives are revising their business and marketing strategic alliances. Competition cannot be avoided, and the actions of competitors cannot be controlled. Thus, profit potential depends to some degree on a careful analysis of the strengths and weaknesses of existing or potential competitors. In evaluating market segments, the marketing manager should ask who the target competitors are. What are the target competitors' strategic weaknesses? What are their strengths?

The Basic Criteria

Five criteria must be met for pinpointing a market and its subcategories. The market and its specific segments should be:

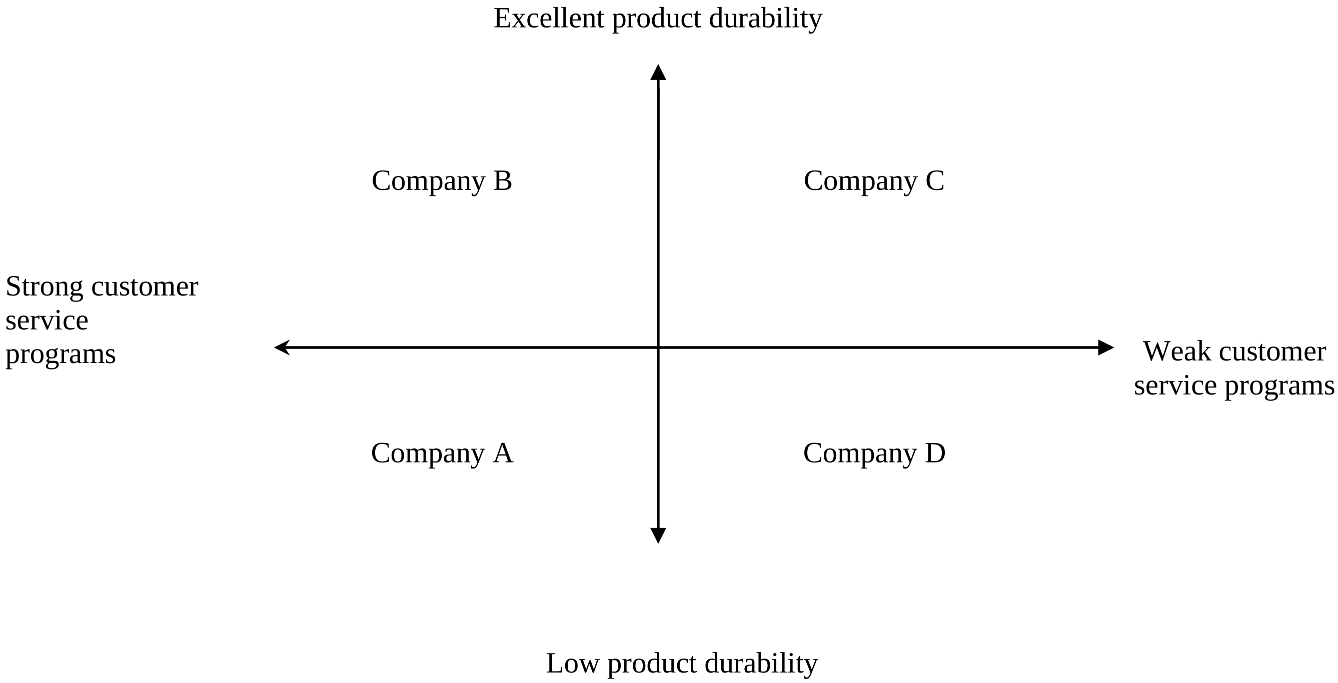
1. **Measurable** – Measurability means that information on location and other characteristics of buyers is available.
2. **Substantial –** A given market is substantial when it is sufficiently large in size and /or is likely to have future potential.
3. **Accessible –** Accessibility means that a supplier can retain old customers and pinpoint new ones.
4. **Stable –** Stability implies that customers have staying power and that a relationship can be established between supplier and clients.
5. **Compatible –** Compatibility is the degree of similarity between sellers and buyers in regard to risk taking, service standards, and corporate style.

4.5 Product Positioning Strategy

Once potential markets have been identified, analyzed, and properly segmented (if appropriate), business marketers must carve a position or niche for their respective products in the minds of prospective customers. Product position is the way the product is defined by customers on important attributes, or the place the product occupies in customers' minds relative to competing product. Positioning is one of the central ideas of the marketing discipline.

Positioning is placing a product in that part of the market at which it will have a favorable reception compared to competing products As a matter of strategy, a product should be matched with the segment of the market in which it is most likely to succeed. The product should be positioned so as to stand apart from competitive products, reflecting the firm's unique combination of marketing variables that differentiate the product from competitive offerings.

Exhibit 4-6 Two- Dimensional Perceptual Map of Vendor Attributes of Copier Suppliers

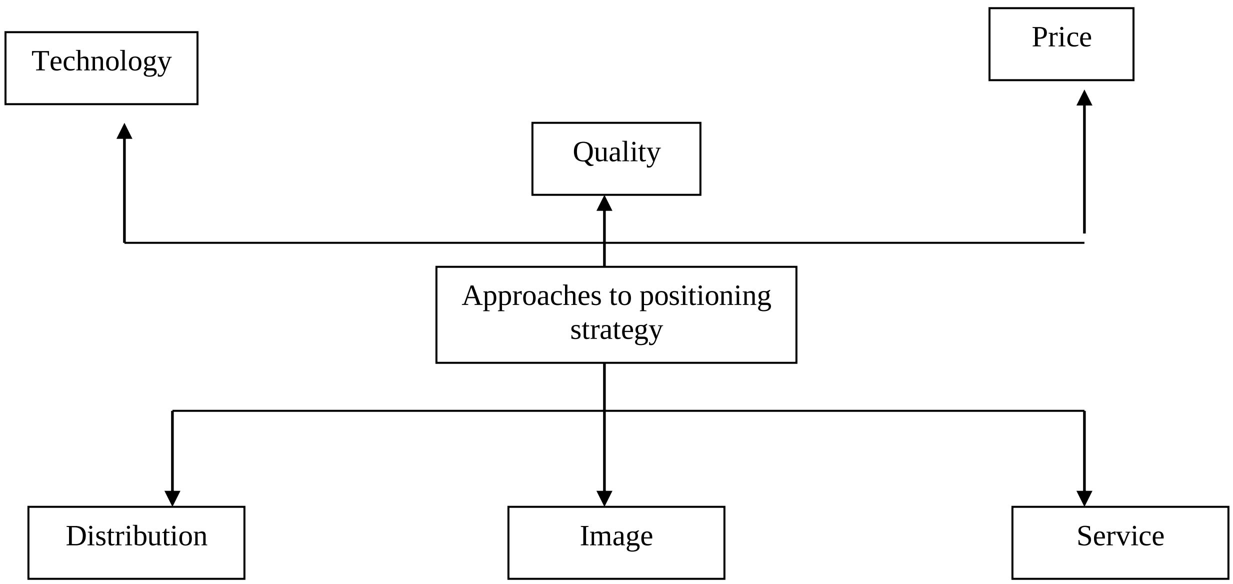


4.5.1 Perceptual Mapping

A technique for examining a product's position, relative to strengths and weaknesses of the product and compared to competitors, is called perceptual mapping. Perceptual mapping attempts to uncover how buyers evaluate a set of competing products by identifying the relative dimensions or features of each. As is evident in **exhibit 4-6**, this map has opposite levels of one attribute on the ends of the grid X and Y axes, such as strong/weak customer service and excellent/low product durability. Perceptual mapping can be accomplished using statistical tools, with the most popular being multidimensional scaling (MDS). Business buyers rate sellers' products or services on specified attributes, thereby evaluating the firm's position relative to the competition.

The perceptual map presented in **Exhibit 4-6** illustrates the positions of four manufactures of copiers. Product durability and customer service are the most important attributes in this market, business marketers within this industry try to position their respective products favorably on those attributes in relation to the competition. Organizational customers interviewed clearly perceive Company A as having a better service program than the other competitors rated. However, Company A's product-durability level is not rated highly. Company C, on the other hand, is perceived as having the best product durability, but its product service is rated poorly. Company B has the strongest combined performance on both attributes. Company D is perceived by business buyers as having low product durability and a weak customer service program. With such data, a seller is in a position at least to attempt to control as own destiny with regard to positioning its product favorably in elation to the competition.

Exhibit 4-7 Approaches to Positioning Strategy



4.5.2 Approaches to Positioning

Often, positioning business products is a more difficult and subtle process than positioning consumer goods. Positioning represents the place that a business product occupies in particular market and is determined by researching the organizational buyer's perceptions and preferences for the product in relation to the competition. While advertising is the primary tool used to position products and services in the consumer market, personal selling, advertising, and trade shows are used to position in organizational markets. Evaluating the position of individual products or product lines relative to the competition requires not only extensive knowledge of the competitor's offerings but also access to the various members of the buying center. Few business firms do not recognize their product's actual position, nor do they understand how their customers perceive the position of the firm's product. A lack of support from top management combined with managerial ignorance on the concept of positioning generally is responsible for this lack of awareness. Consequently, few business organizations purposely employ positioning strategy.

An initial step in understanding the opportunity of positioning alternatives is to study some of the ways in which a product positioning strategy can be conceived and implemented. As shown in **exhibit 4-7**, six possible approaches emphasized by the marketing strategist include positioning by technology, quality, price distribution, image, and service. We will discuss each of these approaches in turn. Several additional positioning strategies may apply in select situations, depending upon the particular industry (or segment), the competitive structure, the marketing expertise, and so on.

Technology - The high-technology business marketer must ascertain which industries or buying groups can use the firm's products and then array the industries in an ordered fashion. A high-tech firm should be able to determine which industries offer the greatest potential; which firms in these industries would benefit most from its products or processes; and which markets, in rank order, it will attempt to enter. Often, there is a multitude of possible applications for any technology the firm could employ. Rapid change puts tremendous pressure on the marketer and emphasizes the selection and the establishment of priorities for target markets.

Quality - Although organizational buyers resist paying for unnecessary high quality, generally they will not compromise quality for a lower price. Earlier explorations of the relationship between profitability and sales volume focused on the experience curve and the relationship between volume and cost. High product quality can have a positive impact on performance measurers, such as market share, profit, and return on investment. High market share means high volume, which leads to lower per-unit product costs. Given this phenomenon, high quality can lead to lower costs through a favorable influence on market position. Some firms will have the delicate task of retaining the image of low price while simultaneously trying to upgrade their quality image. In this situation, the firm runs the risk that the quality message will obscure the basic low price/value position. Quality positioning is a difficult but frequently a highly lucrative positioning strategy to employ.

Price - Astute business marketers know what their respective firms' total costs are (fixed, variable, and incremental) and will set prices accordingly. By achieving the lowest delivered-cost position relative to competition (including freight charges and installation expense), the firm can build a strong position, in that the lowest costs generally provide the highest margins. Higher margins, in turn, present additional opportunities for future cost, price, or promotional battles with the competition. Time and time again, higher market share and experience lead to lower cost. Thus, a new product should be priced to improve general competitive experience and market share.

Distribution - Many business-to-business firms think of distribution as a dilemma or, possible, as an unpleasant problem. Management's difficulties with distribution often can be traced to its indecision about whether distribution should be part of the marketing or sales organization, the manufacturing organization, or some other internal discipline. Too often, distribution is the neglected side of marketing. Some companies have outstripped their competition, however, using imaginative strategies for getting products to their customers. Indeed, other marketing executives can learn from such creativity. A business firm can employ efficient and innovative means for distribution positioning and gain a competitive edge.

Image - Image positioning emphasizes the importance of creating an exclusive image for a product by establishing a distinctive quality perception of the product's category that will place it in a class unique from all other products in the category. It should be noted, though, that image positioning is vulnerable to losing ground to more specific product-oriented concepts by the competition.

Service - Service positioning describes an attribute provided by the business market to assist the ongoing activities of the business buyer. This category can include technical assistance, repair services, information, delivery, parts availability, and financing, as well as advisory services such as tax or legal counsel. In addition, it can include adding services to the current offering or providing a higher level of quality of present services overall. Clearly, service positioning offers the business marketer an important means of differentiation.

4.5.3 Successful Positioning

When a firm establishes and maintains a distinctive place for itself and its offerings in the market, it is said to be successfully positioned. In the increasingly competitive business products sector, effective positioning is one of marketing's most critical tasks. The identification of an exclusive niche in the market, or the creation of a unique perception of the product or service that satisfies an unfulfilled customer need, can serve to distinguish the product or service from competitive offerings.

How does the firm develop a positioning strategy? To help with this process, six questions (simple to ask, but difficult to answer) should be posed.

1. What position does the firm presently own? Determining the firm's present position in the mind of the prospect allows the market to tie the product service or concept to current perceptions.
2. What position does the firm want to own? The business marketing manager must assess the firm's best position to hold from a long-term point of view. Head-on positioning should be avoided by all but the strongest of firms.
3. Whom must the firm outflank? Generally, the marketing manager will attempt to avoid the competitor's strengths while exploiting its weaknesses. the market will try to select a position that no one else has adopted.
4. Does the firm have enough resources? A big obstacle to successful positioning is attempting to establish a position with only limited resources to commit to the effort. A firm must dedicate substantial resources to establish a position and even more resources to maintain it.
5. Can the firm stick it out? The business marketing environment changes regularly and rapidly, so it is important for the marketer to develop a long-range point of view, determine the positioning strategy desired, and then stick to it.
6. Does the firm match its marketing mix with its stated market position? In determining a positioning strategy, the marketing manager must be able to match the elements of the marketing mix creatively with the stated position. Does the firm's advertising campaign, for example, match the firm's overall positioning strategy?

A business market must have a good understanding of the basic segments of the market that the firm's product or product line can satisfy. Some business marketing practitioners would argue that some of the positioning strategies cited above should be used but that others would serve no useful purpose. The validity of many of their arguments depends upon the firm's position within the industry. Is the firm a leader or a follower, an innovator or a laggard? Regardless of a firm's position, product positioning studies are useful for giving the marketing manager a clearer idea of customer perceptions of market offerings.

Concept Review

1. Why is it necessary to engage in business market segmentation?
2. What is the fundamental difference between a macro segmentation strategy and a micro segmentation strategy?
3. What is the basic premise of the nested approach to market segmentation?
4. Segmentation based on size alone can be risky. Why?
5. How can the structure of the procurement function affect market segmentation strategy?
6. What is the role of a competitive analysis?

CHAPTER 5 NEW PRODUCT DEVELOPMENT, MANAGEMENT AND STRATEGY

Learning Objectives

Upon completion of this chapter a student will be able to:

- Recognize the importance of product strategy in industrial marketing.
- Classify new products into four distinct types.
- Understand the important role of marketers in new product development.
- Discuss new product developments, including approaches, processes, and methods of organization.
- Understand the product lifecycle and the importance of effective marketing strategies over a product's projected lifecycle.
- Relate how experience and learning curves can determine what happens to a product as it matures.
- Describe the three options for product elimination.

5.1 Product Strategy in Industrial Marketing

Product development management and strategy are important components of industrial marketing. Measuring and predicting success and executing proper strategy over the life of the business product are of considerable importance. Indeed, a unique or superior product or service, knowledge of the market, and an effective marketing strategy are critical to a company's success.

Effective product management and strategy are, in fact, more important today than ever as the business-to-business sector positions itself to compete against competitors. In industrial marketing, it is critical to position products, the company, its distribution channels, and, often, the production technologies. Once the market is segmented and targets are chosen, the product or service that will give the company legitimate claims to the position it wants to occupy is developed and fine-tuned. New product development, a greater marketing orientation, more sophisticated marketing research, improved new product introduction efforts, better attention to service marketing, a closer linkage with customers, and an increased global marketing effort are among the keys to making good in the marketplace. Likewise, haphazard entry into the market, without considering all facets of product entry strategy, may help to explain why new products fail at a rate approaching 80 percent.

5.2 Product Lines Defined

Because industrial products differ, a classification of new products into four distinct types is useful for our discussion of product development, management, and strategy. The four types are:

1. **proprietary or Catalog Products**
   These include standard product offerings made and usually inventoried in anticipation of sales order. Marketing managers of proprietary or catalog products must be concerned with new product development, repositioning strategy, and product deletion strategy.
2. **Custom Built Products**
   These are different variations of accessories and option to complement the proprietary or catalog products offered. Management concerns here is to know what options and accessories will be demanded by customers, and when.
3. **Custom-designed Products**
   These products include one-of-a-kind units, customized for a particular user or small group of users.
4. **Industrial Services**
   With a service, the buyer is purchasing an intangible, such as maintenance, machine repair, or warranty.

5.3 New Industrial Product Development

Innovation is the fuel of corporate longevity. Heightened competition often forces firms to develop new products or find new markets for their existing products. "Without continuous innovation, organizations wither and die.

In many business-to-business firms, the design of new products and services (especially scientific and technical products) is the sole responsibility of people within the engineering discipline. However, much marketing literature argues that ***industrial marketing managers should play a major role in the design (development) of new products*** through the guidelines that marketing research can provide. It appears today that the important role of business marketers in the design and development of new products and services finally is being recognized. Marketing and sales personnel frequently are called on to work with and sometimes to lead specialists from other functional areas in the development of new products and services. Of necessity, a major concern of sales and marketing managers must be new product development.

Two important trends are facing mangers as we enter this century.

- First, ***world wide enterprises are creating new technology at an increasing rate***. In some segments of industry, technology is changing both how business is conducted and the nature of competition. It also is changing product development and introduction processes by shortening the time firms have to bring new products to market (time-to-market). New product introduction in today's technology-driven business sector is loaded with risk, yet it is something that must occur if a firm is to remain viable.

- In addition to technological change that is revolutionary rather than evolutionary, ***an unprecedented level of aggressive competition from across the globe resulting in unbelievably rapid market saturation is characteristic of many business markets today***. All too quickly a product line can be obsolete by a less expensive, or stronger, or longer-lasting, or more environmentally friendly alternative. A company must look to its marketing function to assure that its product lines are positioned optimally.

5.3.1 New Product Approaches

Most new product development processes can be classified as:

1. the technology-push process
2. the market-pull process.

Technology Push - When the perceived value of a particular technology is great, technology push usually results. Once the product or process has been developed, the marketing function becomes important. The marketing firm has some form of technology, only a vague notion of possible applications, and usually little else. Most telecom products and services start with a technology-push phase. A growing number of customers buy for reasons of availability, novelty and price, even if the benefits are not fully defined. With a great invention, it is difficult to estimate the ultimate size of the market. For example, who, at the outset, could have estimated the market for computers or xerography? This type of product, in effect, follows Say's Law in economics. Supply creates demand. Such momentous success inspires all technology push efforts, whether warranted or not.

Market Pull - Market pull is primarily the result of marketing research methodologies of interviewing potential users about their needs and then developing solutions to meet those perceived needs. This method carries the least business risk because there is less chance that the developed product cannot be sold. This approach is considered more difficult to manage than technology push, however, because it requires more input and coordination from both the internal and external environments. Exhibit 5-1 shows a comparison of these two processes. Note that the only differences between the two approaches are in the first and second steps. The market-pull approach identifies customer values and them creatively identifies solutions and approaches; the technology-push approach identifies technology and then creatively identifies possible customers and applications.

Note that there are more similarities than differences between these two new product processes. The key to success with either approach lies in pursuing each step of the process thoroughly, professionally, and objectively.

Exhibit 5-1 A Comparison of Two New Product Processes

Technology Push Processes	**Market Pull Processes**
1. Identify technology	1. Identify customer values.
2. Creatively identify possible customers and applications	2. Creatively identify possible customers and applications
3. Do homework.	3. Do homework.
4. Validate with market research	4. Validate with market research
5. Test	5. Test
6. Launch	6. Launch

5.3.2 The New Product Development Process

New product success is a vital goal for many firms. In the last two decades numerous studies have been conducted to try to determine what makes a new product succeed or fail. The research has been intensive because new product success has long been valued as essential to the economic health of a business unit and as a critical means for improving business performance. Five basic attributes are found to be of exceptional importance in new product success:

1. an open-minded, supportive and professional management,
2. good market knowledge and strategy,
3. a unique and superior product,
4. good communication and coordination, and

5. proficiency in technological activities.

As noted earlier in this chapter, about 80 percent of all commercialized new products fail. Clearly, an effective new product development process must be firmly in place and operational within the organization if the new product failure rate is to drop. The new product development process shown in exhibit 5-2 shows the six phases management must address to offer the best chance for the product's success. The following discussion will explore each of the six phases in this process.

Exhibit 5-2 The New Product Development Process

Idea and Concept Generation

↓

Screening and Evaluation

↓

Business Analysis

↓

Product Development

↓

Product Testing

↓

Product Commercialization and Introduction

1. Idea and Concept Generation - The idea and concept generation phase involves the ***search for product ideas*** or concepts that meet company objectives. These new ideas often will come from the customer, although the sales department's distributors, suppliers, other employees, and research and development play an important role in this effort. Many marketing analysts suggest that an open perspective is essential for generating new ideas.

2. Screening and Evaluation - The next phase is a screening and evaluation to determine which ideas submitted merit a detailed study as to potential feasibility and market acceptance. A screening process can focus company energies on creating and developing products that have greater likelihood of succeeding in the market place.

The nature of this part of the analysis can be indicated by a series of questions meant to be informative but not exhaustive.

1. Do we have or can we develop access to the necessary raw materials?
2. Is the project's scope feasible within our existing financial capability?
3. Is there some synergy within our existing product line?
4. Is it likely that our present customers represent a potential market, or must we develop entirely new markets?
5. Could the product be marketed through our existing sales force and distributor organization?
6. Does the idea appear to be within the capability of our product development organization?
7. What impact would the successful development of this product have on our existing products, markets, and marketing organization?
8. Can the new product be manufactured within our existing production facilities and with our existing skills?

Negative answers to several such questions, or the recognition that significant new financial, managerial, marketing, production, or supplier resources would be required, would reduce the attractiveness and feasibility of producing the new product.

3. Business Analysis - The business analysis phase, along with the remaining phases in the process, expands the idea or the concept through creative analysis into a "go" or "no go" recommendation. Management examines return-on-investment criteria as well as competition and the potential for profitable market entry. A more specific list of considerations during the business analysis stage includes:

- demand projections,
- cost projections,
- competition,
- required investment,
- profitability,
- break-even analysis,
- discounted cash flow,
- the Bayesian decision model, and
- simulation models to assess the likely profitability of promising new product ideas.

4. Product Development - The product development phase takes the product to a state of readiness for product and market testing. Activities during this particular stage are more difficult and time consuming than many would expect. Something that looks great on paper can fail miserably when engineers and production technicians try to create the physical product. Many new product ideas are either abandoned or sent back for more study at this point in the development process.

5. Product Testing - The firm conducts commercial experiments necessary to verify earlier business judgments during the product testing phase. Testing takes place both in the laboratory and in the field and usually involves **pilot production testing** as well as **market testing** for acceptance or rejection. More companies now are turning to market testing to indicate the product's performance under actual operating conditions, the key buying influencers, reactions to alternative price and sales approaches, the market potential, and the best market segments to pursue. Some market test methods commonly used by business marketers in the new product development process include product use tests and trade shows, along with distributor and dealer display rooms.

6. Product Commercialization and Introduction - The final phase of development involves launching the new product through full-scale production and sales and committing the company's reputation and resources to the product's success. The product commercialization and introduction phase is critical in any new product development process. The success of the product is likely to depend heavily on how well marketing managers' deal with the launch.

Although the new product development process is complex, difficult, interdisciplinary, challenging, and expensive, it is nonetheless vital to sustain the profitable growth of the firm. A primary purpose of this process is to eliminate new product ideas that do not seem feasible before extensive resources are expended on a potential product failure. New product ideas within the development process follow a characteristic decay curve, with a progressive elimination of product ideas during each stage of the process.

5.4 Organization of the New Product Effort

In most business-to-business firms, the new product development effort involves a complex structure of line and staff relationships, with several departments involved in the development of new product ideas. The problem of coordinating these individuals and groups in a manner that will bring maximum productivity for the new product and will not jeopardize their effectiveness in producing and marketing mature existing products is one of the most difficult problems that management faces. The following are alternate organizational approaches in the process of developing a new product.

1. Product Manager

Product management often is viewed as one of the more effective organizational forms for multi-product firms. A product manager is charged with the success of a product or product line. The overall responsibility of the product manager is to integrate the various segments of a business into a strategically focused whole, maximizing the value of a product by his/her knowledge of changing market needs and championing the processes involved in braining the product to the market.

Product managers plan, organize, implement, and control new product development; they also manage the product as it travels through its life cycle. The product management approach requires the product manager to move the new product from the idea generation stage to the product introduction stage- complete with service, technical assistance, and performance feedback.

The product manager is a tactician who orchestrates the new product effort, as do the advertising manager, the sales manager, the distribution manager, the sales promotion manager, and the marketing research manager. Product managers in the business market often are considered to play a role equivalent to that of brand managers in the consumer market. **Exhibit 5-3** lists typical responsibilities of business product managers. Notice the wide variety of tasks for which product managers are responsible and the technical nature of some of those tasks.

2. New Product Committee

The new product committee approach involves a top management committee, comprising representatives from marketing, production, accounting, engineering, and other areas, that review new product proposals. Though not necessarily involved in the actual development process, the committee is charged with evaluating new product proposals. This approach allows for a minimum of organizational disruption. Generally, new product committee participation is a part-time activity, secondary to the needs of a particular department within the firm. A disadvantage to this form of organizational structure is the possibility that demands of departmental priorities might supersede those of the committee. Nonetheless, most firms must feel that the advantages of using a new product committee outweigh the disadvantages because the new product committee is the most common form of organizational structure for managing new products.

3. New Product Department

The new product department generates and evaluates new product ideas, directs and coordinates development work, and implements field testing and pre-commercialization of the new product. This arrangement allows for a maximum effort in new product development but incurs major overhead costs in the process. The department head typically has substantial authority and relatively easy access to top management.

4. New Product Venture Team

The new product venture team represents various departments and gives responsibility for new product implementation to a full-time task force. Members in this team are charged with bringing a specific product to the market or a specific new business into being. This approach consolidates the communication between technical, marketing, and internal resource experts, resulting in sharing of information, an appreciation of other perspectives, and more rapid decision making. Marketing's role is to coordinate, integrate, and lead the process to implementation. The venture team normally is dissolved once a new product is established in the market.

5.5 Product Life-Cycle Analysis

The product life cycle (PLC) is a concept that explains how products go through four distinct stages from birth to death. As you will recall, these stages are:

1. introduction,
2. growth,
3. maturity, and
4. decline.

All new products will go through this cycle, so the management of new products throughout their useful lives is of paramount importance. The product life-cycle model and new product development have been emphasized frequently on the marketing literature in showing how sales of a product vary over time and how every product eventually becomes obsolete. While life cycles once were measured in years, more often they are measured today in months. For example, the average effective life span for commercial electronics is only two years.

Exhibit 5-4 How Sales and Profits of an Industrial Product Vary over Time

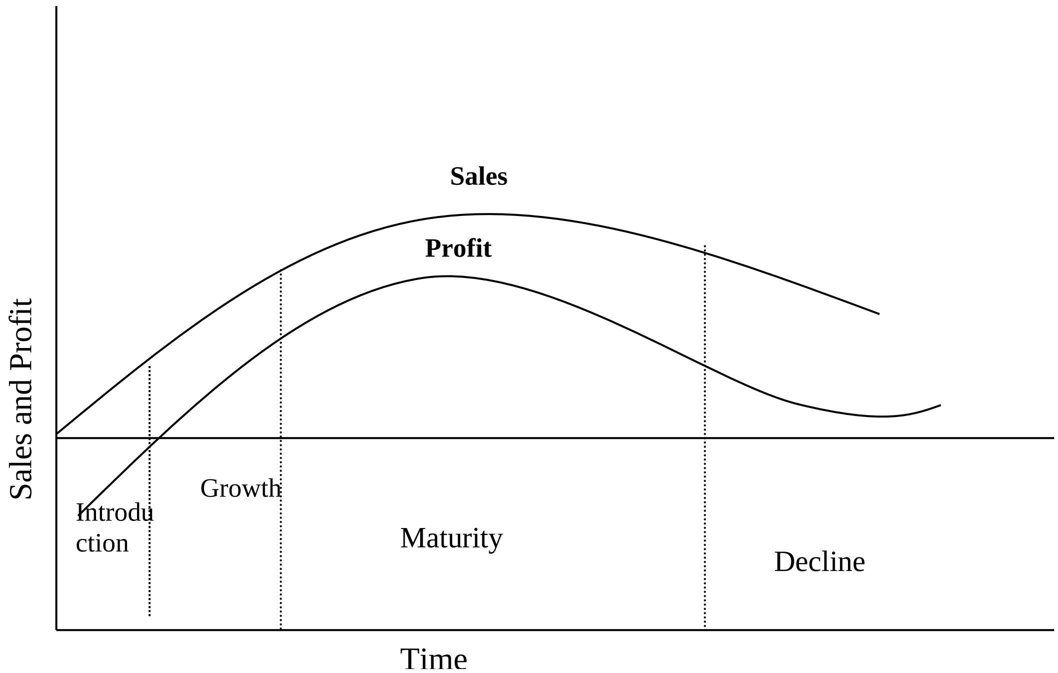


Exhibit 5-4 reflects that sales grow sharply during the growth stage but begin to flatten out during the maturity stage of the product life cycle. Sales reach their peak during the maturity stage, and then dramatically fall off during the decline stage. Information from the product life-cycle analysis has been used to suggest effective marketing strategies over a product's projected life span. While the shapes of the sales-volume and profit-margin curves will vary from product to product, the relationship between the curves is illustrated in exhibit 5-4. Note that profit peaks during the growth stage, whereas sales top out during the maturity stage.

It is important that management recognize a product's stage in the life cycle at any given time because the competitive environment and the resultant marketing strategies reflect that position. As a product moves through the PLC, some strategic elements that come into play in making industrial marketing decisions include competitor strategy, return on investment requirements, distribution coverage decisions, and advertising strategy. The product life cycle should be looked upon as a dynamic model, as opposed to a static one.

Learning Curve Analysis

Learning curve analysis, linked with the product life cycle, is another base for developing business product strategy. It has long been observed that ***manufacturing costs seem to fall with cumulative experience, and not just with scale of production***. The ***relationship between cumulative production and labor cost is known as the learning curve.***

In the 1960s, evidence began mounting that this phenomenon was broader than originally thought. The Boston Consulting Group (1970), in particular, showed that each time cumulative volume of production of a product doubled, marginal value-added costs including sales, administration, and so on fell by a constant percentage. This ***relationship between marginal costs and cumulative production became known as the experience curve***.

In a related concept, the term economies of scale (often confused with the experience curve) refer to the production efficiency attained as increased units are produced. It is a fixed-cost phenomenon because an increase in production seldom requires and equivalent increase in capital investment, size of the sales force, or overhead costs. In a stable environment, the firm will realize economies of scale by producing a uniform product, with perceivable demand, thereby guaranteeing efficiencies and higher profit levels. Learning, per se, helps the firm not only to increase profit levels but also to lower the break-even quality. The result is a reduction in fixed costs because these are being spread over many additional units.

The task at hand is to explore what happens to a product as it product as it proceeds from one stage of the product life cycle to the next. The following discussion of model relationships examines how the learning curve can help to clarify the product life cycle

Introduction

Product introduction, the initial phase of the learning curve, represents the highest-cost stage. Initial costs are high, but they drop rapidly with additional units produced. This phase of the learning curve is labeled stage 1 in order for it to coincide with the introductory stage of the product life cycle shown in **exhibit 5-4.** The slope of the learning curve reflects that sales are lowest here, as the innovative firm tries to drive its costs down. As cost and price decrease, the product appeals to more users, resulting in increased sales.

Market Growth

In the market growth stage of the product life cycle, rapid growth occurs, accompanied by dramatic cost decreases. During this stage, the innovative firm should be utilizing cost decreases, as described by the learning curve, to its advantage in keeping costs below those of the competition. If the firm manages to succeed in this effort, it can also expand its market share, use price as a competitive weapon, and still generate an adequate profit margin.

Market Maturity

During the market maturity stage, cumulative volume reaches the point at which costs are about as low as they are going to get. Because further significant cost decreases are difficult to achieve, market penetration into new user segments is very slow. What the learning curve adds to the understanding of the maturity stage of the life cycle is that lower costs are associated with market penetration, which means increased sales. In Stage 3 of the learning curve (see Exhibit 5-4), cost reductions are progressively harder to achieve; thus, maturity occurs.

Sales Decline

The sales decline stage is associated with Stage 4 in Exhibit 5-4. As the market becomes saturated, sales drop off. It then becomes impossible to achieve sufficient increases in cumulative production to lower costs significantly in an attempt to stimulate sales. As a result, marginal producers drop out of the market.

5.6 The Product Adopting-Diffusion Process

Business marketers must not only estimate the duration of a new product success but also evaluate the substitution "fit" for a proposed new product. In other words, if a company decides to expand its product mix, business marketers, must assess how quickly prospects will adopt a new product and to what extent it will be accepted as a replacement for the old.

The adoption process is the decision-making activity of the buying firm through which the new product or innovation is accepted. The diffusion process, in turn, is the process by which the product or service is accepted by an industry over time.

Stages in the Adoption Process

There are many similarities between the consumer in the consumer adoption process and the members of the business buying center, as both groups go through a five-step process in deciding whether to adopt something new.

1. Awareness. At this stage, the buyer first learns of the new product or service, but he or she knows little about it. The buyer might develop awareness by being exposed to sales promotion, talking with other buyers, or by casually conversing with another member of the buying center.

2. Interest. The buyer might seek out additional information about the product or service by requesting additional data from the potential seller or, perhaps, by requesting that a member of the potential supplier's sales team make a sales call.

3. Evaluation. At this stage, the buyer (or another member of the buying center) consider whether the new product or service would be useful. This deliberation might lead to a value analysis project or, quite possible, to a make-or-buy decision.

4. Trial. In this stage, the buyer adopts the innovation on a limited basis, making a trial purchase in order to evaluate carefully the correctness of the decision to buy. If the new product or service is very expensive, radically new, or quite complex, the prospect might perceive the risk of a trial purchase to be greater than its benefits. In contrast, less expensive and less complex products might be distributed as free samples, with the goal of inducing prospects to try the new offering by reducing their perceived risk.

5. Adoption. If the trial purchase works as expected, then the buyer might likely decide to use the product regularly. Likewise, if the trial falls short of buyer expectations, then the product or service probably will be rejected, at least for the time being.

Diffusion Process - The adoption process, then, is a series of stages that a member of the buying center goes through in deciding whether to buy and make regular use of a new product or service. The diffusion process goes beyond the adoption process, representing the spread of a new product, innovation, or service throughout an industry over time. The speed with which the industrial diffusion process takes place varies among industries, being very fast in the electronics industry and possibly quite slow in the domestic steel industry. At first, a few firms (**innovation**) adopt, and then the number of adopters increase rapidly (**early adopters** and **early majority**) as the value of the product innovation or service becomes apparent. The rate finally diminishes as fewer potential buyers (**late majority** and **laggards**) remain in the non-adopter category. By the time laggards adopt something new, it may already have been discarded by the innovator group in favor of a newer idea or technology.

Factors Influencing the Rate of Adoption-Diffusion

The acceptance of new products and the time a product spends in the introductory stage vary greatly among business-to-business firms. Some products diffuse very slowly into a particular market, while others may almost bypass the diffusion stage.

- **Perceived advantage and perceived risk** play a part along with common barriers to adoption such as marriage to an existing facility or incompatibility with existing products. Products that require major changes in manufacturing processes, or those that require a large outlay of capital, tend to diffuse slowly.

- Another factor affecting a product's acceptance is **technological uncertainty**. Will the technology function as expected when placed into volume production? How about the perceived likelihood of technological obsolescence? What about the unpredictable quality of a new product or innovation, or other emerging technologies that can provide similar advantages? These and other factors force some potential customers to take a wait-and-see attitude before committing to a new product adoption.

5.7 Product Portfolio Classification, Analysis, and Strategy

Today, the underlying principle guiding new product development combines external market needs with internal functional strength. This combination allows companies to develop a product portfolio that satisfies corporate strategic objectives. Portfolio classification models often are used to give a visual display of the present and prospective positions of business products according to the attractiveness of the market and the ability to compete within the market. The business marketer must regularly review the product portfolio, developing strategic alternatives for each of the company's current product, businesses, and prospects for new customers. The concept of the product portfolio emphasizes viewing products not individually, but as parts of a total system. This perspective invites management's regular review of strategic alternatives and corresponding resource allocation decisions.

What Is a Product Portfolio?

A product portfolio is the firm's offering of products or divisions, each of which can be identified as a strategic business unit (SBU), and most of which operate as a separate profit center that may or may to have its own management, it s own set of identifiable markets and competitors, and its own marketing strategies. The industrial firms' product portfolio typically consists of related businesses and/or products grouped into SBUs that are homogeneous enough to control most factors affecting their performance. Resources are allocated to SBUs in proportion to their contribution to the corporate objectives of growth and profitability. The challenge is to identify the SBUs in the firm's product portfolio that enhance the overall corporate mission, while withdrawing support for those that do not.

The concept of the product portfolio was first put forth by the founder of the Boston Consulting Group, Bruce Henderson, in a booklet published in 1970. Henderson looked at a firm's products or divisions as a mix of businesses that strategically interact and influence one another, principally in terms of their use of resources and the development of these resources against opportunities in a competitive marketplace. He described and evaluated products and divisions in terms of three dimensions:

1. The attractiveness of the market, especially in light of the SBU's stage in the product life cycle.
2. The business-to-business firm's position in the market in terms of market share
3. The firm's acknowledged or perceived strengths and weaknesses, relative to competitors.

Diagnosing the Product Portfolio

Business units can be classified into four categories. Businesses in each category exhibit different financial characteristics and offer different strategic choices. The four types of SBU's include:

1. stars,
2. cash cows,
3. question marks, and
4. dogs.

Product Portfolio Strategies

An appropriate strategy for products in each category is given briefly in Exhibit 5-5. First, a primary goal of an industrial company should be to secure a position with cash cows but also to guard against the frequent temptation to reinvest in them excessively. The cash generated from cash cows can be used to support start that are not self-sustaining. Surplus cash might be used to finance selected question marks toward a dominant market position. Question marks that cannot be funded might be divested. A dog could be restored to a position of viability by shrewdly segmenting the market that is, by rationalizing and specializing the business into a small niche that the product can dominate. If that approach is not feasible, the firm will weigh harvesting the SBU by cutting off all investment in the business, giving consideration to liquidating the unit when and if the opportunity develops (see discussion on next page).

This concept provides the business marketer with a useful synthesis of the analysis and judgments necessary as an SBU moves through the product life cycle, presenting a provocative source of strategic alternatives. The business marketer must remember that a strategy is a decision about what must be done; likewise, a tactic is a decision about how to do it. Marketing planners must plot the projected positions of each SBU under both present and alternative strategies, enabling them to decide on strategies for each SBU, the tactics to use in carrying out those strategies, and the resources to assign each SBU.

Exhibit 5-5 Strategy Implications of Products in the Product Portfolio Quadrants

Quadrant	Investment Characteristics	Earning Characteristics	Chas-Flow Characteristics	Strategy Implication
Stars	Continual expenditures for capacity expansion Pipeline filling with cash	Low to high	Negative cash flow (net cash user)	Continue to increase market share, if necessary, at the expense of short-term earnings
Cash cows	Capacity maintenance expenditures	High	Positive cash flow (new cash contributor)	Maintain share and cost leadership until further investment

				becomes marginal
Question marks	Heavy initial capacity expenditures High R&D costs	Negative to low	Negative cash flow (net cash user)	Assess changes of dominating segment: if good, go after share; if bad, redefine business or withdraw
Dogs	Gradually deplete capacity	High to low	Positive cash flow (net cash contributor)	Plan an orderly withdrawal so as to maximize cash flow

5.8 Product Deletion Strategy

Any discussion of product development, management and strategy would not be complete without a brief review of a very difficult industrial marketing decision: when to drop a product, product line, or division. In identifying and analyzing product performance deviations from established norms, management often discovers that seldom is weak product performance the result of one factor only. Often, **poor sales, inadequate profit, and decline in market potential**, among other factors, play roles in poor performance. Generally, a variety of factors are interrelated. In addition, **noncompetitive price, production problems, inferior technology, and uneconomic production batches** are other reasons cited for unsatisfactory product performance.

The idea that some products entering the decline stage of the product life cycle must be eliminated reflects the strategic thinking that every SBU plays an important part in making the product portfolio viable. When the SBU becomes a drain on the financial and managerial resources of an organization, management has three alternatives in the strategy for product deletion:

1. harvesting,
2. line simplification, and
3. total line divestment.

Harvesting

Harvesting is a strategy applied to a product or business with slowly declining sales volume and/or market share. It is an effort to cut the costs associated with the SBU in order to help improve the cash flow. Harvesting leads to a slow decline in sales; when the business ceases to provide positive cash flow, it is divested. The implementation of harvesting strategy requires where appropriate, reducing maintenance of facilities, cutting advertising and research budgets, curtailing the number and scope of channel intermediaries used, eliminating small-order customers, and reducing service levels in terms of delivery time, sales assistance, and so on.

Line Simplification

Line simplification is a product deletion strategy that trims a product line to a manageable size by pruning the number and variety of products and services offered. This can lead to a variety of benefits, such as potential cost saving from longer production runs, reduced inventories, and a more focused concentration of marketing, research and development, and other efforts on fewer products. The decision to drop an SBU from the product line is a difficult one to make. Despite the emotional aspects of this decision, the need for objectivity in this market cannot be overemphasized.

Divestment

Divestment is a situation of reverse acquisition and is also a key dimension of marketing strategy. Divestment decisions are principally economic or psychological in nature; they may allow the firm to restore a balanced product portfolio. If the firm has too many high-growth businesses, its resources might be inadequate to fund such growth. In contrast, if the firm has too many low-growth businesses, frequently it will generate more cash than is required for investment purposes. For the firm to grow evenly over time, while showing regular earning increments, a portfolio of both fast- and slow-growing businesses is necessary. Divestment can help to achieve this type of balance.

Summary

1. Product development, management, and strategy are important parts of the business marketing process, with the major concerns being both to measure and predict success and to execute proper strategy over the life of the business product.

2. Business marketers are now beginning to take their place along with engineers as having the most important role in the development of new product ideas. Technology push and market pull are the two major approaches to new product development. Technology push results when the driving force of a

new product's development is the perceived potential of the technology itself, market pull is primarily the result of marketing research methodologies of interviewing prospective users about their needs and then developing solutions to those perceived needs. The new product development process includes six stages: idea and concept generation, screening and evaluation, business analysis, product development, product testing, and product commercialization and introduction.

3. New product development, evaluation, and management must follow good management practice if effectiveness, efficiency, and a reasonable likelihood of success are to be achieved. The major options available to the business marketer in organizing the new product development process include a product manager system, a new product committee, a new product department, and a new product venture team.

4. The information derived from product life-cycle analysis generally is used to suggest appropriate marketing strategies over a particular product's life span. Experience and learning curves can be used in conjunction with product life-cycle analysis to determine more specifically what is happening to a product as it moves from one stage in its life cycle to the next. Stages in the product life cycle include product introduction, market growth, market maturity, and sales decline.

5. Business marketers have the responsibility of deciding how quickly prospects will adopt a new product and to what extent they will replace the old one. To perform such a task, marketers frequently rely on the adoption-diffusion process. The adoption process is the decision-making activity of the buying firm through which the new product or innovation is accepted. The diffusion process shows how a product is accepted by an industry over time.

6. The business-to-business firm should regularly review its product portfolio, developing strategic alternatives for each of the company's current products, businesses, and new business possibilities. The Boston Consulting Group categorizes each product or business division in a company according to four types of strategic business units (SBUs): stars, cash cows, question marks, and dogs. Strategies have been formulated for use with each of these four categories.

7. Determining when to drop a product, product lie, or company division is a very difficult task for the business marketer. Common product-elimination options include harvesting, line simplification, and total-line divestment.

Review Questions

1. Why are effective product management and strategies so important today? What are the major concerns of product management and strategy?
2. Why was there reluctance in the past to give marketing personnel a major role in the design and development of new products? Discuss three major styles in organizing the new product development process. Identify two approaches to new product development. Describe each of the six stages in the new product development process.
3. Identify and discuss the four distinct types of product lines useful in a discussion of product development, management, and strategy.
4. Discuss the fundamental difference between technology push and market pull.
5. What are the five basic attributes found to be of importance in new service development?
6. In business-to-business firms, several departments usually are involved in the development of new product ideas. With this in mind, what are some of the options available to management to actively involve appropriate management personnel in this important activity?
7. What is the fundamental value of product life-cycle analysis? How are learning curve analysis and experience curves used in product life-cycle analysis? Identify and describe each of the four stages involved in the product life-cycle.
8. How do technology, competition, change in the level of business activity, and the utilization of plant capacity impact possible changes in business-to-business firm's product mix?
9. What are the adoption and diffusion processes? How can they be utilized together? Identify and describe the stages in the adoption process. What factors influence the rate of adoption? The rate of diffusion?
10. Define product portfolio analysis. According to the Boston Consulting Group approach to product management, what is a strategic business unit? Identify four categories into which each strategic business unit within a business-to-business firm can be placed and indicate appropriate strategies for use with each of the four categories.

CHAPTER 6 PRICING OF INDUSTRIAL PRODUCTS

Learning Objectives

Upon completion of this chapter a student will be able to:

- Appreciate the theoretical approaches to pricing
- Explain the basic pricing objectives
- Become familiar with the pricing strategies used by industrial marketers
- Distinguish between a market skimming and market penetration strategy.
- Identify the different types of pricing

Overview

The price of a product or service is crucially important to the seller. ***It determines whether a product will gain market acceptance, maintain its market position in the face of growing competition, and realize an optimum profit level.*** In establishing a price, one must estimate the costs involved. To estimate the cost, the demand for the product must be known. But even more important to marketers is determining the value of the product or service to the customer, since prices should be market oriented.

We begin this chapter with the market classification and theoretical foundations of price. We then present the "real world" considerations used to establish prices in business marketing.

6.1 Market Classification and Pricing

From the perspective of management, one of the most important factors in pricing is the market in which the firm operates. The type of product and the number and size of competitors must be considered when setting prices. Pricing behavior that is rational and consistent with "scientific" principles in one type of market may be irrational and unscientific in another market. ***The appropriate starting point in pricing is to ascertain what type of market the business marketer is attempting to sell into***.

Five theoretical forms of market structure are described here:

1. perfect competition,
2. monopolistic competition,
3. pure and differentiated oligopoly,
4. pure and differentiated oligopsony, and

5. monopoly.

Although there are many differences among these five types of market structure, the major criteria used to distinguish them are:

- the numbers of buyers and sellers, and
- the similarity of products sold by the sellers in the market.

Exhibit 6-1 Market Structure

Market Configuration	Identical Product	Differentiated Product
Many buyers and sellers	Perfect competition	Monopolistic competition
Many buyers, few sellers	Pure oligopoly	Differentiated Oligopoly
Few buyers, many sellers	Pure oligopsony	Differentiated Oligopsony
Many buyers, one seller	Monopoly	

In **perfect competition** no single firm has control over price. This lack of control results from the large number of sellers, each producing exactly the same product. If a firm should raise its price above the prevailing market price, its product would be non salable. On the other hand, a perfectly competitive firm would not reduce its price below the prevailing market price because its offering is so small relative to the total supply that it can market its total output at the going market price. Commodities markets and widely held shares in the stock market are examples of perfect completion.

In a **monopoly market** there is only one seller. This firm has complete control of the market. It can formulate its pricing policy with little fear of losing sales to other firms, since there are none. Public utilities are an example of monopoly markets.

In other three forms of market structure-monopolistic competition, oligopoly and oligopsony - each industrial firm has some control over the price of its products and can alter its sales performance through non-price competition such as advertising, sales promotion, product-service variation, channel of distribution changes, logistics strategies, and corporate imagery. However, a firm's freedom to change price is tempered by the possibility of competitive repercussions.

Monopolistic competitors have the greatest price-selling freedom. Since there are many firms in a monopolistic competitive industry, limited action taken by one firm is unlikely to make large inroads in the sales of any one firm rival. Hence, there is less fear of retaliation.

In an **oligopoly structure** there are only a few sellers. Thus, price changes initiated by one firm are likely to invite price retaliation. Marketers of cellular telephone service fit this category, as do petroleum refiners, and manufacturers of automobiles, steel, and tobacco. Unless it is acknowledged price leader, an oligopolistic firm has limited pricing flexibility

In an **oligopsonistic industries** have pricing opportunities similar to those of monopolistic competitors. For example, a packaged food manufacturer selling to the central buying units of major corporate chain supermarkets is not very concerned about competitor's reactions to its pricing.

6.2 Major Factors Influencing Price Strategy

Important factors that influence price strategy include:

- Competition
- Cost
- Demand
- Pricing objectives
- Legal considerations

1. Competition

In most highly competitive markets, the use of certain strategic critical and tactical pricing practices is a key factor in determining profitability. There are two kinds of competitive factors that influence price.

- One factor is the competitive effect on demand for the marketers' product. This includes competition from directly comparable products – Pepsi against Coke, for example.
- The second competitive factor influencing price is the reaction of competitors to any price move the business marketer may make. If the marketer raises the price, will the competition hold its price level and hope to pick up customers? If the price is lowered, will the competition ignore the change, move in aggressively, and possible retaliate with a lower price? A firm may target a particular brand to exploit its vulnerability or to avoid direct competition with other brands.

2. Cost

Fixed and variable costs are of major concern to the industrial marketer charged with establishing price levels. If a manufacturer is a low-cost producer relative to competition, the firm will earn additional profits by maintaining prices at competitive levels. On the other hand if fixed and variable costs are relatively higher than the competition, the marketer may be in no position to reduce its price because such action can lead to a price war that it will probably lose. ***Costs set the floor for the price*** that the company can charge for its product. The company wants to charge a price that both covers all its costs for producing, distributing, and selling the product and delivers a fair rate of return for its effort and risk. A company's costs may be an important element in its pricing strategy. Companies with lower cost can set lower prices that result in greater sales and profits.

3. Demand

Whereas cost set the lower limit of prices, the market and demand set the upper limit. Industrial buyers balance the price of a product or service against the benefits of owning it. Thus, before setting prices, the marketer must understand the relationship between price and demand for its product. As discussed in the above section price-demand relationship varies for different types of markets and buyers perceptions of price affect the pricing decision.

4. Pricing Objectives

An important step in pricing strategy is to determine goals and objectives prior to setting price points or levels. Pricing objectives must be established by top management to ensure not only that the company's profitability is adequate, but also that pricing is complementary to the total strategy of the organization. Among the many pricing objectives that a firm may adopt are pricing to:

- Maximize profit
- Expand and maintain market share
- Achieve a target return on investment (ROI)
- achieve rapid cost recovery:
- Support corporate imagery.
- match, lead, or follow competitors.
- discourage entry of competitors.
- achieve or complement product differentiation.

Whatever long-rang pricing objectives are established by top management, they set the framework within which more specific shorter-run pricing policies can be built.

5. Legal Considerations

Industrial marketers should justify price levels along with quantity and other practices. From legal point of view industrial marketers should avoid:

- **Price Fixing –** price fixing is also known as **collusion.** It is the illegal practice of setting a price. Price fixing is more likely to happen when the number of firms in a particular industry is small and the product is relatively homogeneous (as in the case of oligopolies). Where there are many firms, or when heterogeneous products are involved, competitors will find it difficult to agree on what the fixed price will be.

- **Exchanging Price Information –** this activity occurs when competitors exchange information regarding prices, inventory levels, and the like. It becomes illegal when it leads to price agreements, however, as this is tantamount to price fixing.

- **Predatory Pricing –** predatory pricing involves the cutting of prices (usually by a larger producer) to a point that is at or below cost for the purpose of eliminating competition. It is an attempt to monopolize the market and, in most cases, is illegal. Once the competition is eliminated, then the firm generally will raise its prices to monopoly lvels.

6.3 Price-Setting Theory

Several methods of pricing are practiced by business marketers. The three pricing methods discussed here are:

(1) supply-demand pricing,
(2) cost plus or markup pricing, and
(3) break-even pricing.

Profit considerations are of paramount importance in all those methods. The methods differ in the emphasis placed on profit and in the importance of the role played by demand conditions.

1. Supply-Demand Pricing

Supply-demand pricing places similar emphasis on both supply and demand factors. In this pricing method, it is assumed that firms are attempting to maximize profits. They accomplish this goal by determining a price where the extra revenue received from selling the last unit of product is equal to the cost of producing it (**marginal revenue = marginal cost**).

This method of pricing is an "ideal" that should be aimed for, but it is difficult to use in practice. The cost of producing and selling additional units of a good or taking on a special job is difficult to ascertain. A more important reason for the difficulty that firms have in implementing this method of pricing is due to the uncertainty surrounding the demand for the firm's product.

2. Cost-Plus Pricing

In cost-plus pricing, firms set prices on the basis of cost plus a "fair" profit percentage. Cost refers to average or per unit cost and may be based on actual, expected, or standard costs. The level of output (expected demand) use in computing cost is usually based on the quantity that is or could be sold at the current price. The profit markup is often set quite arbitrarily.

The major objection to cost-plus pricing is that it is based primarily on supply conditions and pays little attention to the demand side of the market. This method of pricing does not attempt to measure the number of units that could be sold at different prices, precluding any possibility of increasing or reducing prices to increase profits. In addition, cost-plus pricing disregards the actions of competitors and places inordinate attention on a firm's historic costs.

The major advantage of this form of pricing is that it is simple. It appeals especially to firms that do very little market research. Many firms believe that cost-plus pricing is the safest method to follow, because attempts to estimate demand are frustrated by volatile buyer's preferences and unpredictable reactions by competitors.

3. Break-Even Pricing

Break-even analysis is used by the industrial marketer to determine the level of sales required to cover all relevant fixed and variable costs. This analysis indicates that different pricing strategies will have an impact on profit margins; it also identifies the minimum price below which losses will occur. Industrial marketers should not set price without first determining what will happen to profits at various price levels.

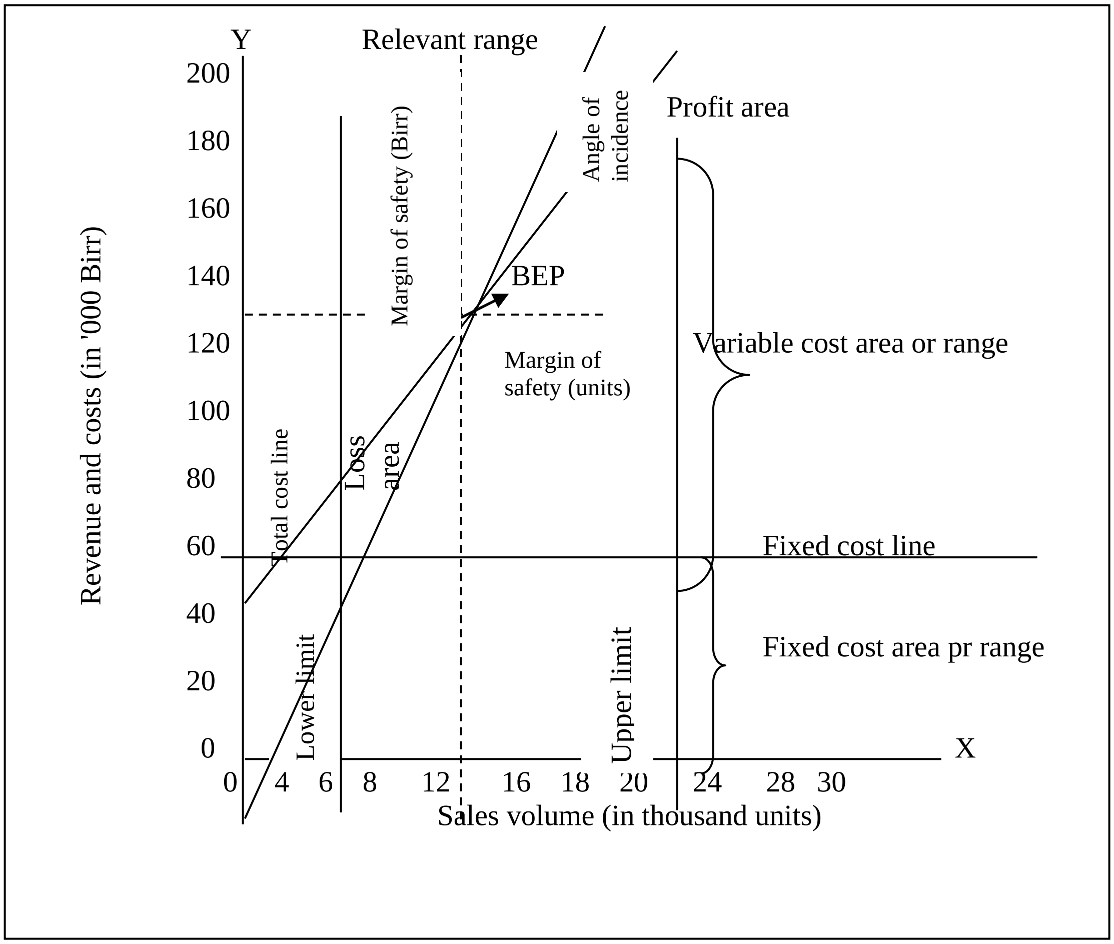
Break-even analysis is often used to illustrate the relationship of costs and revenues to output, but it also can be used as a method of pricing. Break-even pricing is similar to cost-plus pricing in that it is **primarily supply oriented**; however, it does give some weight to demand conditions, break-even pricing involves estimating a relationship between cost and output, and computing relationships between revenue and output at various prices. The points where the various revenues are equal to the cost are examined, and the firm selects the point that is determined to be the most readily attainable.

The break-even point (BEP) may be defined as a point at which the firm's total revenues are exactly equal to total costs, yielding zero income. The "no-profit, no-loss" point is a break-even point or a point at which losses cease and profits begin.

Break-even analysis shows:

a) The relationship between the costs and profits with sales volume.
b) The break-even point which equates total revenue with related costs and results in neither profit nor loss.

Graphic Presentation



Determination of the Break-Even-point (BEP)

Assume that unit variable cost is Birr 20 and total fixed cost is Birr 200,000. The actual sales units have been 50,000 units. The expected return or profit margin is 40% and the investment of the company is Birr 1,000,000.

Required:

a) Determine the break even quantity
b) Ensure that total revenue and total cost are equal at the break even point.
c) Compute the safety margin
d) Determine the total revenue, total cost, and profit from sales of 50,000 units.

Algebraic Method

Contribution Margin Approach

In order to determine the break-even point, the following three information must be available.

1. Total fixed cost (TFC)
2. Unit selling price (P) and
3. Unit variable cost (V)

Contribution margin is the difference between unit selling price (P) and unit variable cost (V). Therefore, break-even point (BEP) can be computed as follows.

$$\boxed{\mathbf{BEP} = \frac{\mathbf{TFC}}{\mathbf{P - C}}}$$

Illustration 1:

Consider a company that manufactures a water sealer used to stop leaks in cement retainer wall. In 2006 the company sold 1,600,000 gallons of the sealer at a price for Birr 3 pr gallon with a variable cost of Birr 1.50 per gallon. The fixed manufacturing costs were Birr 1,550,000. In 2007 more automated equipment will be used in production. This will increase the fixed manufacturing cost forth year to Birr 1,785,000. The variable production cost per gallon, and sales volume has a forecasted increase of 12.5%.

In 2006 the break-even point would be:

$$\text{BEP (units)} = \frac{\text{Fixed cost}}{\text{Contributing margin (CM) per unit}}$$

$$\text{BEP (units)} = \frac{\text{Fixed cost (Entry fees +Stall expenses)}}{\text{(Sales price-Unit variable cost)}}$$

$$\text{BEP (units)} = \frac{\text{Birr 1,550,000}}{\text{Birr 3 – Birr 1.50}}$$

$$= 1{,}033{,}333 \text{ units}$$

In 2007, the breakeven point will be:

$$\text{BEP (units)} = \frac{\text{Birr } 1{,}785{,}000}{\text{Birr } 3 - \text{Birr } 1.30} = 1{,}050{,}000 \text{ units}$$

Break Even Point (BEP) Amount and Break Even Sales Revenue (BESR) Amount

BEP (amount) & BEP (Sales revenue) BESR = BEP (units) X Selling price (SP) per unit. Referring to the above illustration determine the break even point amount and the break-even point sales revenue in 2007. (You can use the space left below to compute the answer.)

BEP or BESR amount =1,050,000xBirr 3 = Birr 3,150,000.

Or

$$\text{BEP (amount)} = \frac{\text{Fixed cost}}{\text{Profit volume ratio (p/v ratio)}}$$

$$\text{(P/V ratio)} = \frac{\text{Contributing margin Per unit}}{\text{Selling price per unit}}$$

Contribution margin per unit = selling price per unit – variable cost per unit

Contribution margin = Birr 3 – Birr 1.30 = Birr 1.70

$$\frac{\text{Birr } 1.70}{\text{Birr } 3} = \text{or } 56.66\ \%$$

BEP (amount) = Birr 1,785,000÷0.5666 = Birr 3,150,000

Margin of Safety

The excess of the actual sales from the break even point is known as safety margin. Margin of safety can be computed in units or amount. The excess of the actual sales revenue (ASR) over the break even sales revenue (BESR) is known as the margin of safety amount. Symbolically,

Margin of safety amount = (ASR-BESR)

The excess of the actual sales in units over the break-even point is known as the margin of safety unit. Symbolically,

Margin of safety in units = sales units – breakeven point

Assume that sales is 1,500,000 units in 2007. Determine the margin of safety and the profit to be made.

a) Margin of safety amount
   Margin of safety amount = ASR – BESR
   ASR = 1,500,000 units X Birr 3 = Birr 4,500,000
   BESR = 1,050,000 units X Birr 3 = Birr 3,150,000
   Margin of safety amount = Birr 4,500,000– Birr 3,150,000= Birr **1,350,000**

b) Margin of safety in units
   Sales volume – Break-even point
   1,500,000 units – 1,050,000 units = **450,000** units

c) The amount of profit can be directly determined with reference to the margin of safety and P/V ratio. Symbolically,
   450,000 X Birr 1.70 = Birr **765,000**

Illustration 2:

Assume that the following costs represent the cost and sales information of a company.

- Total fixed cost = Birr 300,000
- Unit variable cost = Birr 10
- Sales units = 50,000 units
- Profit margin = 20%

Required:

a. Determine the break even quantity
b. Find the margin of safety

Solution

a) Break even quantity

To compute the break even quantity, there is a need to compute first the unit cost and price.

Unit cost = unit fixed cost + unit variable cost

Unit fixed cost = Total fixed cost / sales units

Birr 300,000 / 50,000

Birr 6

Unit cost = Birr 6 + Birr 10

= Birr 16

Price = unit cost +

$$\text{Price} = \frac{\text{unit cost}}{1 - \text{profit margin}}$$

$$\text{Price} = \frac{\text{Birr } 16}{1 - 0.20}$$

Birr 16 /0.80 = Birr 20.

$$\text{Break Even Quantity} = \frac{\text{Total fixed cost}}{\text{Price} - \text{unit variable cost}}$$

$$= \frac{\text{Birr } 300{,}000}{\text{Birr } 20 - \text{Birr } 10}$$

= 30,000 units

b) The margin of safety

Margin of safety = actual sales – break even quantity

= 50,000 – 30,000 = 20,000 units

Contribution margin = price – unit variable cost

= 20 – 10 = 10

Profit = 20,000 X Birr 10 = Birr 200,000

6.4 Pricing Strategies

Environmental factors, including the prevailing levels of technology in the industry, customer perceptions, intensity of competition, and barriers to competitive entry, as well as internal factors such as efficiency of production and the need to recapture research expenditures expeditiously, affect pricing. Three pricing strategies-experience curve pricing; new product pricing, which includes price skimming and market penetration pricing; and product-line pricing-reflect the interplay of these various influences.

1. New Product Pricing

It is difficult to price new products because of the uncertainty associated with their potential for success. Will customers really consider the new product of value? Will customers be willing to experience the disturbance to and possible interruption of their manufacturing operation in order to install a new piece of equipment? Will the prospect be willing to risk new equipment when things are going just fine with the old equipment?

These types of questions make new product pricing especially precarious. Thus, it is helpful to know that there are some conditions surrounding the adoption of new products that favor higher introductory prices, whereas other circumstances suggest choosing lower introductory price. These circumstances or conditions are best illustrated by describing the extreme pricing strategies of **price skimming (a very high introductory price)** and **market penetration (a very low introductory price).**

i) Price skimming - In price skimming the new product is priced close to the upper limit of value of utility as perceive by the industrial customer. To use such an approach, the following conditions should be present.

1. The buyer is an innovator or early adopter, a risk taker who welcomes new products. The buying company is probably known for its innovative
2. The supplier has a patent or hard-to-copy innovation, such as software that is too difficult or time consuming to reverse-engineer.
3. Variable costs are a high proportion of total costs. Thus, there are no economies of scale to be achieved.
4. Barriers to competitive entry are high-whether they be financial, marketing, or other types.
5. The usage of the market is limited.

Because of higher initial per unit profit potential, price skimming permits the business marketer to charge very high prices at the outset to recover heavy R&D and marketing investment costs quickly. But price skimming also acts as an invitation to competitors, so that eventually the marketer will have to reduce price to the experience curve norm. With careful monitoring of competitors' activities, this strategy can maximize profits over the product life cycle through price reductions that anticipate and may effectively prevent competitors' market entry.

ii) Market Penetration - In market penetrating pricing, the business marketer recognizes the following conditions.

1. With heavy fixed costs and low variable costs, the key to profitability is building sales volume and economies of scale quickly.
2. Many close substitutes are available; thus, a low price discourages competitive entry.
3. In this market, the customers are very conservatives and traditional, and are unwilling to take risks.
4. The product is easy to copy and there are few barriers to entry by the company's competitors.
5. The market exhibits a high price elasticity of demand.
6. The size of the potential market justifies the risk of an extended period during which fixed costs must be recaptured.

A market penetration pricing strategy helps a company build a large share of the market quickly, with the resulting experience effect providing substantial costs advantages compared to competitors.

2. Product Line Pricing

Most firms sell a range of products within each product line. These products are related to one another, marketed together, used together, and provide variations on the same general benefits required by the customer. Thus, product line pricing takes into account, on the demand side, the segments to which these products and services appeal and their impact on each other (complementarily and substitutability) and, on the cost side, their interactions with one another (joint costs, bundling possibilities, cannibalization).

The price of the entire line can support the image the company wishes to project. Alternatively, the low-end price in the product line might be used to attract marginal buyers and build total volume. When pricing product lines, the business marketing manager must be aware that the sale of one item in the line may be influenced by and may influence the sale of other items in the line.

6.5 Type of Prices

There are many ways that prices can be stated. The following are some of the most common pricing approaches and the tactics associated with them.

List Prices

The prices in a price list are rarely those paid by customers. Rather, list prices form the starting point for calculation of a net price**. Net price is a list price minus one or more discounts**. Such discounts can be changed as frequently as required without the expense of printing a new set of list prices. The list prices can help a supplier camouflage price changes from competitors. List prices are also a useful guide to engineers and buyers who are estimating "ballpark" figures for proposals and in preparation of tenders.

Net Prices

The net is, of course, the key price in the decision whether or not to buy. In arriving at the net price many types of discounts can be applied to the list price.

Trade Discounts - Trade discounts are reductions from list price that are given to different groups of intermediaries or customers according to the range of functions they perform (stocking, advertising), the type of market to which they sell (OEM, retailers), and the volumes in which they purchase. Trade discounts can be used as a competitive weapon. In most industries there is an accepted norm for the discounts offered to intermediaries. A business marketer selling through a distributor must recognize that competition includes not only similar products offered by other manufacturers but also quite dissimilar lines of items that are competing for the distributor's time and attention. Thus, the marketer may increase discounts to motivate the distributor to devote more effort on behalf of the manufacturer's product.

Cash Discounts - Cash discounts offer the buyer an incentive to pay a slightly lower price within a short period of being invoiced.

Quantity Discounts - Quantity discounts encourage the customer to order in larger quantities. Volume price breads are established, such as those in Exhibit 6-1. The break point might represent savings the supplier can achieve in order processing, palletizing, or transportation.

Exhibit 6-1 A Typical Quantity Discount Structure

Volume Purchased	Quantity Discount
Less than 100 units	0
101-300 units	2%
301-500 units	3.5%
501-1, 000 units	4.5%
More than 1, 000 units	5.25%

Geographic Pricing

The geographical location at which a price is applied can be a competitive pricing technique. Geographic pricing means that the price may be quoted at the factory door, at the customer's receiving dock, or at some other location. The choice of which location to specify depends on the location of the competitors' plants, the bulk and density of the product, location of key customer accounts, industry norms, general competitive conditions, and the proportion of total price that transportation costs contribute.

FOB Factory - FOB stands for "free on board". When goods are shipped FOB factory, the buyer pays the invoice price plus the cost of freight. This form of pricing is customer oriented in that the customer can choose which carrier will handle transportation of the goods. The choice may allow the purchaser to obtain a better freight cost than the supplier by consolidating shipments or by negotiating freight rates. The buyer may also choose among various transport modes to obtain the lowest freight charge (for example, rail may be cheaper than truck) or to obtain faster delivery (for example, courier or air freight).

FOB Destination - The FOB destination pricing technique means that the supplier assumes the cost of freight and charges only the remaining portion to the customer. The amount absorbed by the supplier depends on the distance between the seller's factory and the location at which freight is equalized. Hence, they calculate delivered prices based on the transportation costs from the supplier's factory location nearest to the customer, whether it is their own or a competitor's.

CIF - CIF stands for "customs, insurance, and freight" and is the most commonly used pricing format for international shipments. The CIF price includes FOB factory price plus all domestic inland charges and all ocean (or air) transportation and ancillary costs. The total of these costs is called the C&F (cost and freight) value. To the C&F value is added an all-risk insurance premium to arrive at the CIF price. This price is always quoted at the port of destination (for example, CIF Djibouti). Shipment from the dock or airport to the customer's plant is the buyer's responsibility.

CHAPTER 7 DISTRIBUTION AND CHANNEL RELATIONS IN INDUSTRIAL MARKETS

Learning Objectives

Upon completion of this chapter, you will be able to:

- To explain the reasons for using intermediaries in the distribution channel.
- To identify the various intermediaries that are used in business marketing.
- To discuss typical practices and policies governing manufacture-industrial distributor relations.
- To explain why manufactures' agents are used and discuss their advantages and disadvantages

Overview

Distribution is the term applied to the process of moving goods from producer to the ultimate customer. Distribution is usually thought of in terms of physical goods only. In marketing goods and services, however, much more than the simple movement of physical objects is necessary. Knowledge of who has the correct item, credit service, and technical information are a few of the ingredients that are also important. Thus, people and institutions are frequently involved in distribution without ever physically coming into contact with the product. Yet their contribution to distribution can be just as vital as the physical movement of the product.

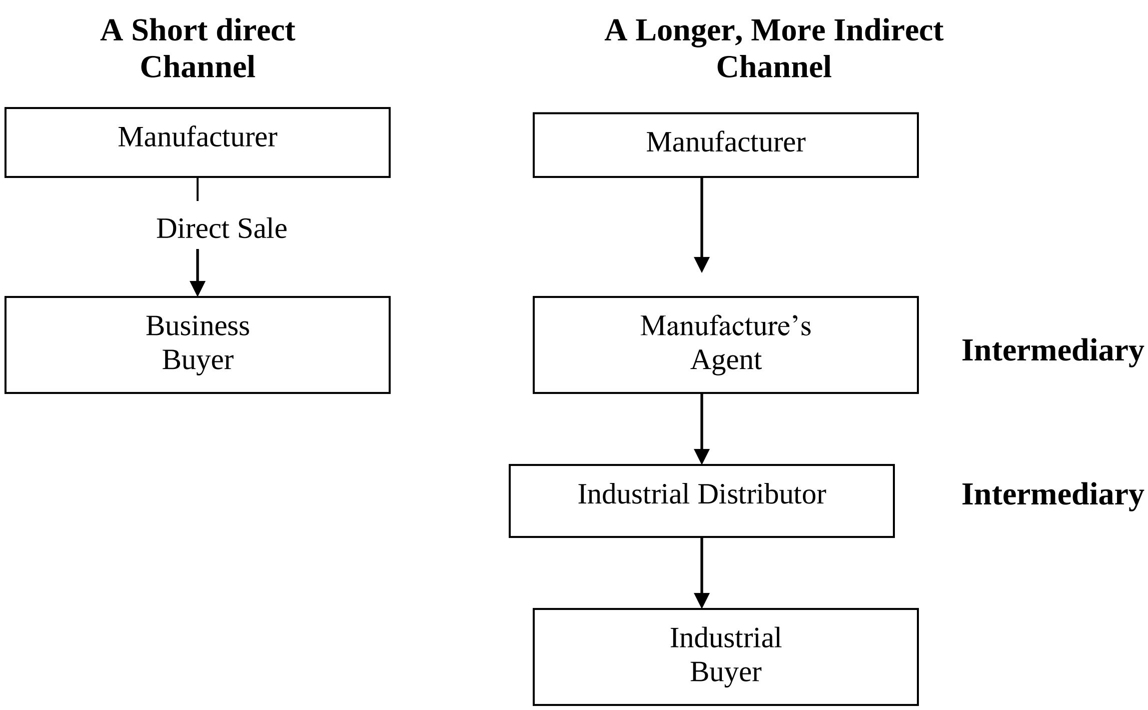
7.1 The Distribution Channel

A channel of distribution may be defined as a sequence of marketing institutions, including intermediaries, that facilitates transactions between producers and final users. The member or facilitating institutions can be very small when the producer sells directly to user (no intermediaries), or quite large when several types of intermediaries perform successive operations in the product's distribution. The first scenario is called a **direct** (or **short**) **cannel**; the second is an **indirect** (or **long**) **channel**. (see Exhibit 7-1).

In the shortest direct channel, the manufacturer's employees deal face-to-face or directly by mail or telephone, with the end users. Another fairly direct channel is created when the manufacturer operates sales branches and company-owned dealerships. In all these cases the manufacturer assumes total responsibility for all of the functions (maintaining inventory, delivering goods, providing information to customers, promotion, and credit) necessary to satisfy customer needs. The manufacturer has greatest control over the quality of customer relationships. Selling prices, service, and availability of product. But all this comes from a high investment in facilities, inventories, and personnel, which perhaps could be spent more profitably in the manufacturer' principal expertise: manufacturing.

Although well-established and large companies may have used a particular business channel arrangement for many years, it is advisable to conduct a periodic channel audit and, if need, restructure the channel. The channel audit is a comprehensive reappraisal of a company's approach to distribution. It identifies shifting customer emporographics and market behavior, reassesses cost of using different types of intermediaries, and evaluates changes in corporate distribution goals.

Exhibit 7-1 Channel Length



7.2 Why Use Intermediaries

Business marketers may choose to sell through intermediaries for a number of reasons, including the following.

Transaction Costs - Every order incurs costs-contact costs, order-filling costs, expediting costs and lots of paperwork. By selling larger quantities to intermediaries, the manufacturer can reduce the proportion of transaction cost per sales dollar.

Inventory Costs - When an intermediary carries inventory, the manufacturer can reduce its own levels of inventory. By reducing its inventory levels, the manufacturer reduces inventory carrying costs, which include storage costs, property taxes, insurance, cost of money invested in the inventory, and so on.

Limited Finances - Even large corporations can have a difficult time raising enough money to operate a nationwide network of wholly owned local distribution outlets. Despite the high cost, some industries sell direct because customers demand personalized attention from the manufacturer, or their equipment is too sophisticated to risk less than optimal installation by intermediaries.

Narrow Product Line- Few industrial manufacturers have a wide enough product line to generate a high ratio of sales to direct calls by their sales force. Excessive selling costs suggest turning the job over to intermediaries, whose broader range of products (because they handle distribution functions for a large number of manufacturers) generates higher returns per sales call.

Proximity- Intermediaries offer much more immediate and local representation. Because they are closer to their customers, they are better able to ascertain their customers' needs and wants, assess their credit rating, and offer speedy delivery, service, and individual attention than an industrial manufacturer whose plant may be thousands of miles away.

Opportunity Costs- manufacturers often have begun operation on the basis of their technological and production expertise rather than on their marketing and distribution skills. Their return on manufacturing investment, then, tends to be much higher than on investment in distribution. Thus, it makes sense to let more efficient distribution specialists act as their intermediaries and then to invest more in the manufacturing side of the operation. Doing so reduces the manufacturers, opportunity costs-that is, the incremental gain foregone by not pursuing a higher-yielding alternative.

7.3 Type of Intermediaries

Each channel system is designed to provide certain specific functions or services. Channel length or complexity depends on the number of functions or services required and the manner in which they will be accomplished. Over the years, specialists have developed within channels when certain functions or services required greater attention than others. To develop and an efficient channel of distribution, one should be familiar with the various types of intermediaries available. The following section describes the most common categories of intermediaries.

7.3.1 Merchant Intermediaries -Merchant intermediaries are wholesale industrial distributors who buy and own the goods they handle. The majority of these distributors provide the broadest range of services and are consequently called full service wholesalers. They generally carry a broad line of staple, nonperishable items, accessories, and supplies and sell to retailers or industrial users. Their functions or services include stocking, delivery, credit, and promotion.

The single-line wholesaler restricts its offering to a certain type of product, such as industrial chemicals, and provides more specialized service to industrial buyers.

The specialty wholesaler provides a great deal of technical information and selling functions along with the product. Distributors of industrial coating materials are an example.

Limited-function wholesalers do not provide as wide a range of services as the **full-service wholesalers**. This is because the customer does not require as extensive an array of functions or services and is unwilling to pay for unnecessary extras. **The cash-and-carry wholesaler,** for example, does not provide credit or delivery. The **drop shipper** (or **desk jobber**) does not physically stock products but orders goods to be shipped directly from manufacturer to user. **The truck (or wagon) jobber** caries all its stock in a truck and provides quick, regular deliveries, usually of perishable goods, such as cutting tools. **The mail order distributor** depends on a catalog to obtain sales.

7.3.2 Agent Intermediaries - In contrast to merchant intermediaries, agent intermediaries do not buy or own the goods they sell. Agent intermediaries also fall into several categories, characterized by the extent of their services. **Commission merchants** generally handle commodities that are valuable to distant suppliers because of their wealth of local market information. **Manufacturers' agents** act as the sales force for several manufacturers who cannot afford their own sales forces. Brokers bring buyers and sellers together through their knowledge of market availability and requirements. Used machinery is often handled by industrial brokers. Auction companies provide display area and facilitate negotiation among sellers and buyers.

7.4 Major Industrial Channels

Although many different business channel structures may be employed, the most popular involves the manufacturer selling through an industrial distributor to the end user. Since industrial distributors and manufacturers' agents account for the majority of all business transactions, the remainder of this chapter will focus on them.

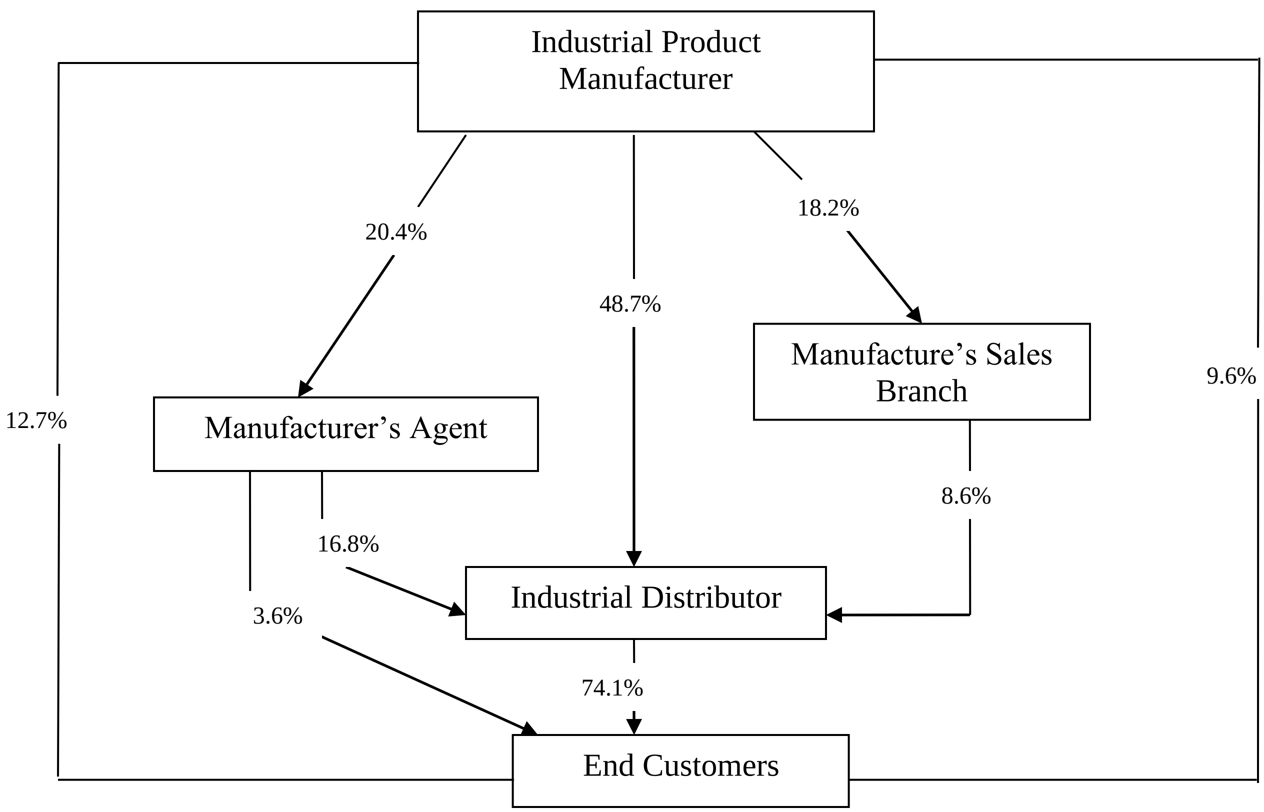
7.4.1 Industrial Distributors

Industrial distributors contact customers, provide delivery, may do some assembly or finishing of products, offer repair service, handle credit, and provide a wide product assortment to industrial buyers generally. Distributors take title (ownership) to the goods they sell. Hence they can set their own selling prices (and margins) for the goods; usually maintain adequate inventories, and every carry competing products. Distributors range from single location owner-managed companies to multi branch corporations.

The distributor's **outside salespeople** act as "**order getters**", calling on customer accounts and prospecting for new customers, solving technical problems, and maintaining customer service. Although the distributor may be small in comparison with national marketers, the firm is likely to be a large, independently owned business in its own local community, providing a full range of service to its customers.

The distributor's **inside salespeople**, who have a high level of product expertise and stock availability knowledge, act as "**order takers**" by telephone. They also process orders, schedule deliveries, and answer customer queries. A growing percentage of women are now functioning as inside telephone and counter sales people.

Products Carried - Distributors handle maintenance, repair, and operating supplies (MRO items) such as lubricants, paint, and machine parts to create immediate availability when required. They also stock original equipment supplies for OEM, including such items as power transmission components, fasteners, and electronic memory chips, which become part of the manufacturer's finished product. Distributors also handle accessory equipment used in the operation of the customer's business, such as power tools and hoists, as well as machines such as lathes and presses that are used to machine meal and covert raw materials. Exhibit 12-8 lists some of the product line carried by different distributors.



Broad Categories of Distributors

There are three broad categories of merchant distributors: general line, specialty, and combination house.

1. **General Line Distributors -** General line distributors maintain inventories of a broad range of industrial items. To the trade, they are often referred to as "mill supply houses" and are known as the" supermarkets of industry" because of their

extensive assortments. When customers have large annual requirements made up of small, frequent purchases, the general line distributors also establish specialist departments in some product line. These specialist departments can provide customers with better service.

2. Specialists - A limited-line distributor specializes in a narrow line of relate products such as abrasives, cutting tools, or power transmission equipment. Surveys suggest that specialty distributors are growing in numbers relative to other distribution types. The specialist offers customers a high degree of technical expertise, problem-solving capability, and application know-how. Some specialists perform special services such as assembly or sub manufacturing to better serve customers and differentiate themselves from competitors.

3. Combination House - The combination house sells to other customers in addition to industrial manufacturers. It operates in both industrial and consumer markets. An electrical distributor may sell lighting fixtures to retailers and institutions in addition to the construction industry and manufacturers.

7.4.2 Manufacturers' Agents

The manufacturers' agent is an independent business establishment that, on a continuous contractual basis in a limited or exclusive geographic territory, sells part of the output of two or more client manufacturers. The products handled are complementary or related to one another but are non-competing. The agency:

- does not take title (or ownership) to the goods in which it deals,
- has little control over prices, credit, or other terms of sale, and
- is paid on commission.

The main different between a manufacturers' agent and a distributor lies in the "**title**." Because manufacturers' agents do not take title to the goods, they can not set price and usually don't maintain inventories. The items they sell usually are shipped directly from the manufacturer's factory to the customer.

Manufacturers' agents are known by a variety of names, including manufacturers' representative, "rep", M/A, sales agent, and agent. Typically the "rep" has had many years of experience in a well-established company before becoming a manufacturers' agent. Indeed, the majority have been successful direct salespeople for large firms who escaped the bureaucracy of a corporate environment to go it alone.

Trend toward Manufacturers' Agents

Sales Costs - Industrial sales call costs have increased dramatically and makes agents important partners.

Specialized Market Segments - Industrial manufacturers are finding new sales opportunities in narrow market segments outside their traditional markets which can best be served by agents.

Opening New Territories - As industrial development expands into new geographical regions, industrial manufacturers have difficulty justifying the use of their direct sales force. Adolescent markets have insufficient sales potential to support direct selling. However, manufacturers' reps, who offer a much broader product assortment than any of their manufacturers can, provide industrial manufacturers a fixed cost of sales entry to such sparse markets.

Increasing Travel Costs - When potential customers are widely separated or distant from the company's head office, the use of manufacturers' agents over direct selling has increased because of rapidly growing costs of travel.

Advantages Offered by Manufacturers' Agents

Manufacturers' agents as a distribution channel offer the manufacturer a number of potential advantages, particularly when compared with the manufacturing firm using its own direct sales force.

Predictable, Stable Sales Cost - Manufacturers' agents are paid a straight commission on sales. Thus, the manufacturer knows exactly how much its sales expense will be. Manufacturers' reps can be less expensive because they are paid only if they bring in orders. The manufacturer does not pay a regular salary plus benefits for orders that are not coming in, as would be the case with its own sales people.

More Aggressive Representation - Few corporate salespeople are paid on straight commission, but the manufacturers' agent is. This is a strong incentive for highly motivated agents.

Synergy in Complementary Lines - Because a rep handles compatible products from several manufacturers, the sale of one product is likely to lead to the sale of others. Consider the example of a customer buying a signal lamp: the manufacturers' agent for the electrical instrument firm may also describe his or her related lines and often secures orders for sockets, panels, meters, or switches from the same customer during the same sales call.

Minimal Training - The rep is an experienced professional salesperson, with an in-depth knowledge of a particular industry and territory. At most, the manufacturers' agent needs familiarization with a new principal's product line.

Instant Marketing - The manufacturers' agent has an established market or regular customers with whom the firm has built rapport. For a manufacturer who is either introducing a new product (especially one that does not fit its traditional markets) or wishing to exploit sparse markets with mature products, the M/A is an "in-supplier" whose built-in customers offer immediate coverage in his or her territory.

Nurture for Small Customers - Both manufacturers and distributors prefer to deal with larger-volume accounts. Thus, their smaller buyers often receive short shrift. Manufacturers' agents aggressively cultivate small accounts and develop new markets.

Reduced Sales Management - Although reps are extremely beneficial for smaller companies, some quite large industrial manufacturers employ them.

Permanence of Representation- All too frequently the young direct salesperson may cost the industrial manufacturer a couple of hundred thousand dollars to train, only to be lost to another firm just as he or she is about to become productive. On the other hand, the manufacturers' rep firm has its roots in its local territory, and its major asset is customer base.

Disadvantages of Using Manufacturers' Agents

From the perspective of the business principal, the use of manufacturers' agents is not without some limitations, including the following:

Loss of Control - As with direct sale people who operate on a full commission basis, manufacturers' agents avoid any administrative or reporting functions that are not directly related to generating sales. There is no guarantee the agent will use the principal's promotional materials properly. The agent may exploit immediately profitable sales rather than maximizing long-run potential. The agent may devote more time to its other principals' products than the industrial manufacturer would wish. Solution: The principal should outline expectations clearly in its contract with the agent. Control needs are obviated if the manufacturer's products yield better than average profit potential.

Partial Attention - Since the manufacturers' agent represents several manufacturers, it cannot give full attention to any one product line all the time. Indeed, the agent may devote more time to the other firms it represents that the industrial agent may devote more time to the other firms it represents than the industrial manufacturer would wish. This becomes particularly annoying when the manufacturer expects detailed call reports, extensive missionary selling, or extra pre/post sale service. Solution: Such extra attention should be specified in the contract with the agent, specific fees for services should be negotiated, or higher commission rates should be established.

Customer Patronage Preferences - Some customers want to deal directly with the industrial manufacturer's own sales force; others have strong loyalty to a particular manufacturers' agent. Solution: Assess prospects' preferences before establishing a new representative.

Administrative Procedures - Each rep has its own internal procedures. Thus, the proliferation or policies and procedures faced by a manufacturer may be equal to the number of reps the manufacturer deals with. Solution: Offer consulting assistance and be adaptable.

Government Contract - Different government agencies have varying policies toward manufacturers' representatives. Solution: Investigate government agency policies and specify which government departments or agencies will be retained by the manufacturer as "house accounts." These house accounts should be clearly specified in the contract signed with the rep.

Circumventing the Agent - The great fear of the manufacturers' agent is that the agency will build a substantial account from nothing only to have the manufacturer take it away from the rep and sell direct. This leads to secrecy by the rep about the agency's accounts. Alternatively, some industrial manufacturers who terminate a manufacturers' agent find that they also lose their customers because strong personal relationships keep customers loyal to their agent and their loyalty is transferred to the agent's new supplier. Solution: maintenance of open communication between manufacturer and agent, together with clear conditions surrounding terminations, can reduce these potential conflicts.

SUMMARY

A channel of distribution is a sequence of institutions that facilitate transactions between producers and final users. Business marketers have a choice of selling directly to their customers or using intermediaries. Channel members may reduce total transaction costs, assume inventory responsibilities, reduce the manufacturer's financing requirements, provide more cost-effective market coverage, be better tuned in to local markets, and permit the manufacturer to invest in higher return activities.

Channel length or complexity depends on the range of function required and how they will be accomplished. Typically, the result is multi channel marketing. Direction and coordination of channels is assumed by a channel leader, whose activities may reduce potential conflict among channel members.

CHAPTER 8 INDUSTRIAL MARKETING COMMUNICATION

Learning Objectives

Upon completion of this chapter a student will be able to:

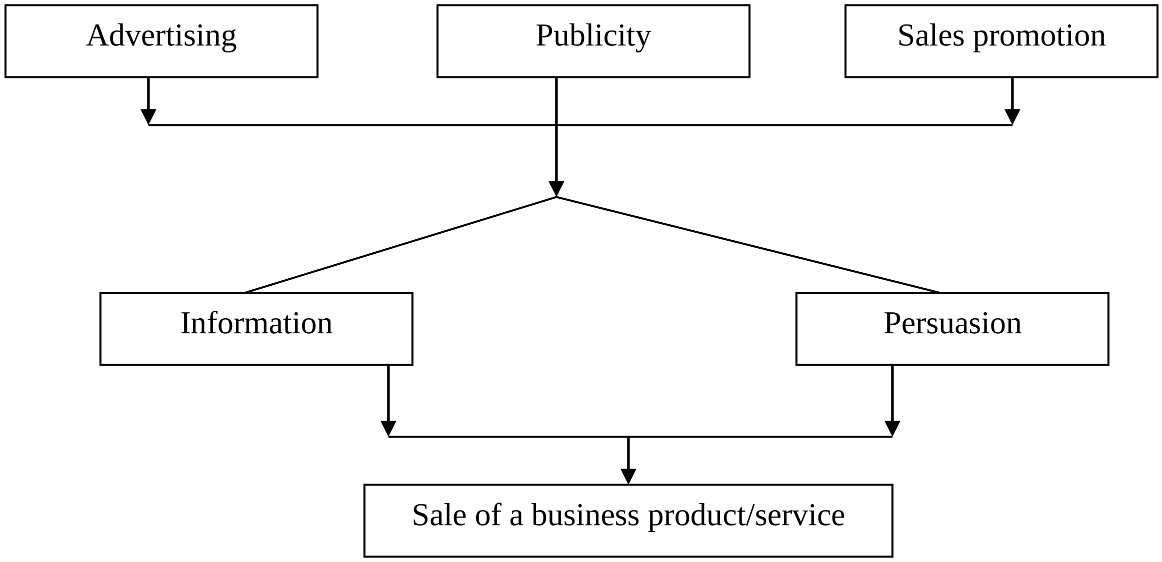
- Appreciate the role of promotion in industrial marketing and how it differs from the role of consumer promotion.
- Identify the steps involved in creating a business promotion plan.
- Explain how objectives are set for an industrial promotion campaign.
- Discuss how promotional budgets are developed
- Differentiate among the various promotional tools available to the business marketer.
- Recall two primary methods by which effectiveness of business promotion campaign can be measured.

8.1 The Role of Promotion in Industrial Marketing

Advertising, publicity, and sales promotion are communication methods used by marketers to remind or persuade current and potential customers that a particular product or service exists. In the business market, advertising, publicity, and sales promotion ***pave the way for the sales call***. As Exhibit 11-1 shows, business promotion refers to the use of the seller-generated promotional tools of advertising, publicity, and sales promotion in delivering both information and persuasive messages to business markets. The cost of using these promotional methods is relatively inexpensive when compared to that of personal selling.

Business markets tend to be geographically concentrated, with relatively few companies purchasing large amounts. Due to the geographic concentration of these markets and the substantial purchasing volume of such firms, ***personal selling dominates the promotional mix***. Consequently, the role of business promotion traditionally has been to support the personal selling function.

Exhibit 11- Business Promotion and the Flows of Information and Persuasion



Organizational buyers tend to be part of a larger buying center or decision-making unit, tend to purchase in large quantities, and tend to base their purchases on relatively exact specifications. Therefore, some consider ***purchasing managers to be less susceptible to promotional appeals that emphasize brand names***. Nonetheless, business buyers are human and are subject to the same appeals found to be effective in consumer advertising. Likewise, not all business markets are concentrated geographically, nor do all purchase in large volume. The cost of sending salespeople to many scattered business accounts can be prohibitive. Thus, promotion must assume the "selling" function for small orders or low-margin products.

Differences between Industrial and Consumer Advertising

Business advertising	***Consumer Advertising***
Rational appeals	Emotional appeals
Views profit motive as a primary purchasing criterion	Recognizes personal gratification as a primary buying motive
Smaller part of the entire selling function	Larger part of the entire selling function
Utilizes smaller percentage of the sales dollar	Utilizes larger percentage of the sales dollar
Addresses a somewhat limited market	Speaks to a very large and diverse market
Places greater emphasis on direct mail	Places less emphasis on direct mail

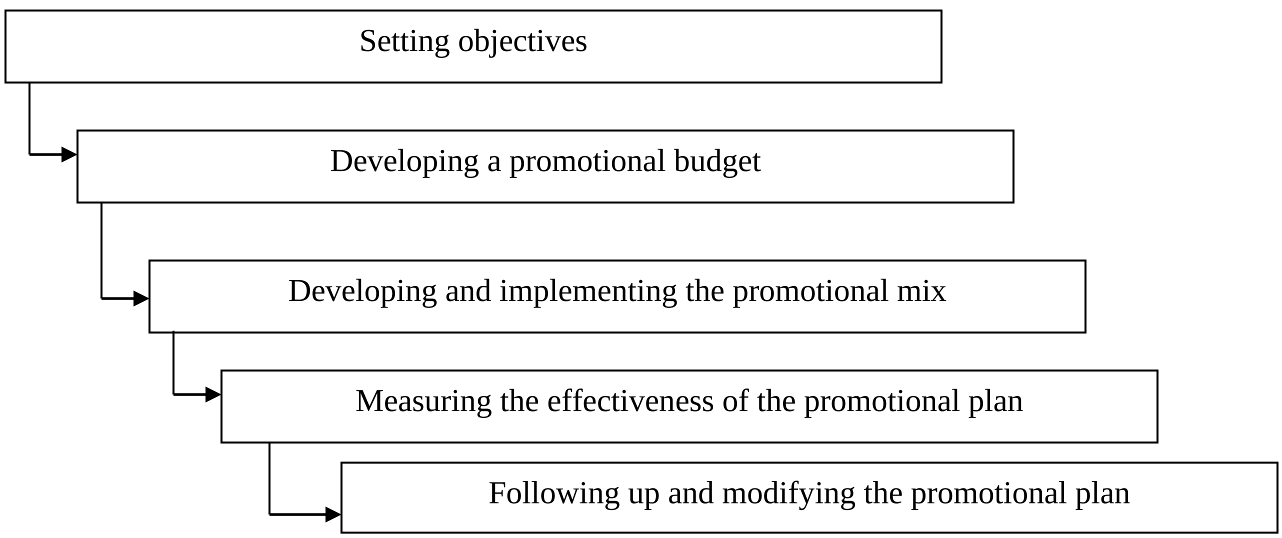
8.2 The Process of Business Promotion

If promotion is going to stimulate sales, it must be carefully tailored to the product or product line and convey an appropriate message. Effective promotion can increase sales, but ineffective promotion can waste millions of dollars and even damage company image. Exhibit 11-2 demonstrates that creating a promotional campaign for business markets involves the following five steps.

(1) setting objectives,
(2) developing a promotional budget,
(3) developing and implementing the promotional mix,
(4) measuring the effectiveness of the promotional plan, and
(5) following up and modifying the promotional plan, if necessary.

This process results in a promotional campaign a sequence of promotions reflecting a common theme and geared to specific objectives. Developing such a campaign is the focus of this chapter.

Exhibit 11-2 Steps in a Business Promotion Campaign



Setting Objectives for a Promotional Plan

Establishing specific, realistic objectives should be the starting point for every promotional campaign. It is difficult and probably even imprudent to plan a promotional program unless marketers have first established the objectives they are trying to attain. Business advertising campaigns should not necessarily be based on sales goals. Measuring their effectiveness begins with a set of specific objectives that are attainable, timely, and measurable. Common advertising objectives include:

1. building product awareness,

2. inducing trail and retrial of new market entries,
3. increasing market share,
4. stimulating short-term sales,
5. countering competitor's offerings,
6. buying space with distributors,
7. building product-line acceptance,
8. intensifying usage,
9. sustaining product preference,
10. aiding the sales staff by introducing buyers to product offerings,
11. reviving a brand that is in the decline stage of its product life cycle, and
12. confirming buyers' purchase decisions.

Industrial advertising generally has one or more of four specific goals.

1. ***It makes the advertiser favorably known to its current and potential customers***.

   Business advertising can have a significant beneficial effect in making potential customers aware of potential suppliers and in reinforcing satisfaction among existing customers. An enormous challenge to business executives is to select an image that will attract the eyes of readers. Theodore Levitt makes the following point.

   A company's (good) reputation improves the chances of getting a favorable first bearing and an early adoption of the product. Thus, corporate advertising that can build upon the company' reputation (other factors also shape its reputation) will help the company's sales representatives.

2. ***It conveys specific and technical information about the characteristics of a particular product or products manufactured by the advertiser.***

   Advertising should provide specific information about a firm's products and/or services to members of a buying center so they can appraise that advertiser's offerings properly. There are two important assumptions being made here: first, that organizational buyers are looking for detailed information about the products and/or services they buy; second, that advertisers know what information is relevant to their customers. It appears that knowledge of buying motives is no less important among business purchasers than among the consuming public. If advertisers do not know how customers perceive their firms or their products, they should find out, in order to avoid sending advertising messages that could be irrelevant and possibly ignored.

3. ***Making the advertiser favorably known and/or conveying specific and technical product information tend to ease the salesperson's job.*** The company the salesperson represents and the products be or she bindles become better known as a result of advertising.

   Over time, one fundamental justification for advertising has been the belief that it paves the salesperson's entry into both established and prospective customer's firms. Making his or her selling efforts more productive. Increases in business advertising should lead to greater sales and profits. Although it might be difficult to prove in specific situations, there is growing support that real and substantial positive interaction exists between advertising and sales efforts, justifying advertising investments.

4. ***Due to improved sales performance as a result of advertising, business advertising helps to reduce overall selling costs***.

   It is one thing to conclude that advertising helps a salesperson's performance and yet another to quantify just how much savings advertising helps to generate. No one seems to know quite how the advertising salesperson relationship operates, or the exact economics of the relationship. Indeed, both academics and practitioners perceive much uncertainty in advertising effectiveness.

Developing the promotional Budget

After the marketing manager establishes promotional goals and identifies appropriate market segments, a solid, cost-effective promotional budget must be developed. This is neither a simple nor an enviable task, as there are no concrete budgeting guidelines or techniques to ensure maximum success. Ideally, the budget needs to be set at a point where the last dollar spent on promotion equals the profit from the sales that promotional dollar produced. Economists advise that the first dollar spent on promotion yields the greatest return, with a diminishing ratio of return from additional expenditures. However, in the real world, this **marginal utility concept** is all but impossible to apply. More realistic methods commonly used for setting budgets include:

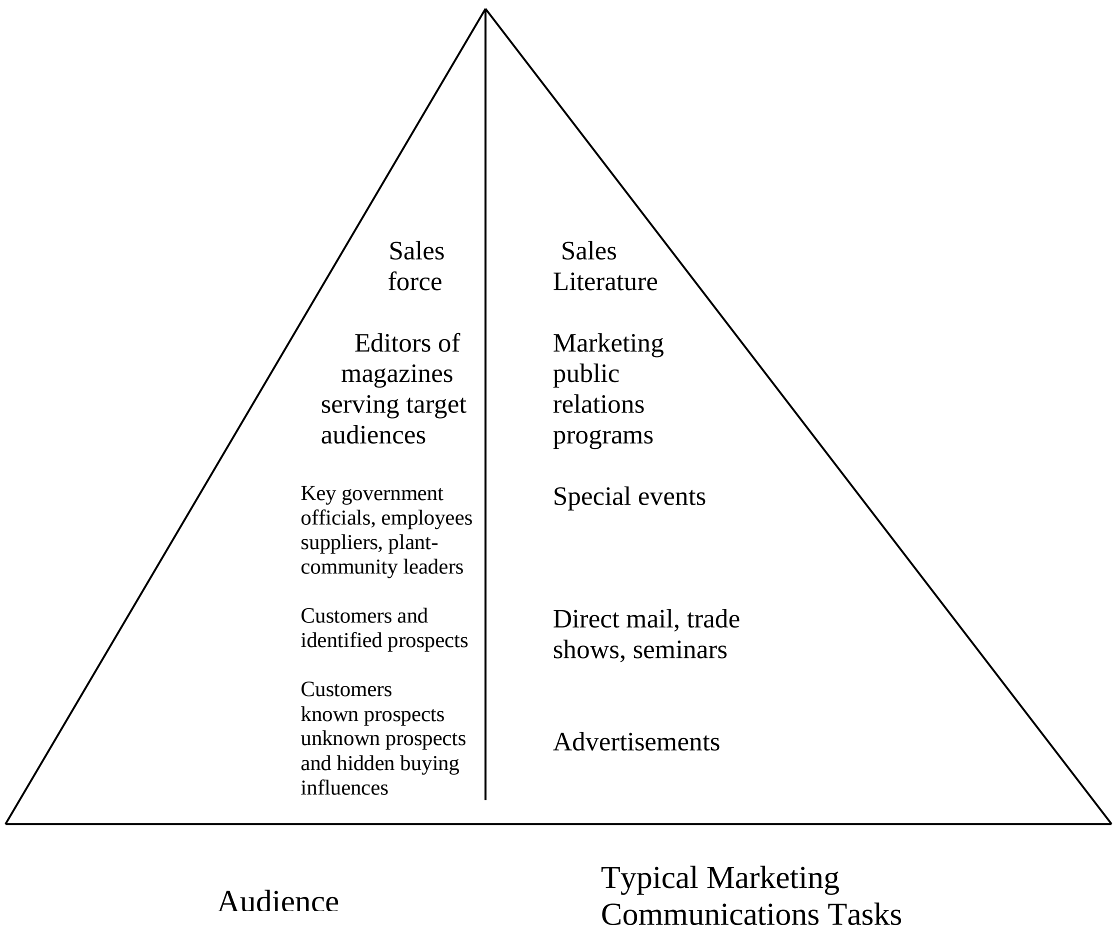
- percentage of anticipated sales,
- affordable/arbitrary,
- competitive parity/market share, and
- objective-and-task methods.

As illustrated in Exhibit 11-3, business-to-business organizations typically employ the objective-and-task and affordable methods to set a promotional budget.

Developing and implementing the promotional mix of Business Advertising

As Exhibit 11-3 indicates, business advertising is considerably different from consumer advertising.

Exhibit 8-3 Identifying Target Audiences and the Most Effective Ways to Reach Them



Business advertising feature product-oriented appeals and addresses a somewhat limited market. Because of the nature of business industrial buying, the specific content of advertising is vastly more important than its creative package. Conversely, ***consumer***

advertising emphasizes people-oriented appeals, recognizes personal gratification as a primary buying motive, shoulders a greater burden in the total selling effort, spends a large share of the sales dollar, speaks to a very large and diverse market, and places less emphasis on direct mail.

Although remarks on advertising effectiveness research have largely been directed at the consumer market, the comments are no less relevant to the business-to-business market. Given the relative lack of research in this area, the need for additional research on industrial print advertising is even greater than for the consumer sector.

8.3 Media Selection

Business advertising now is viewed much like consumer advertising and this fact has stimulated broader media selections, indeed, a business advertisement may run on prime-time specials, on business cable television networks, in consumer magazines, and via electronic media. When advertising is used, management must select the media mix to be used. The media mix is some combination of the following types of advertising media:

- print media,
- broadcast media,
- direct marketing, and
- electronic media.

Print Media - Print media includes business publications, professional publications, general business publications, trade directories, and general consumer publications such as Time, and Newsweek. Business publications are of two basic types:

- horizontal publications and
- vertical publications

Horizontal publications - are intended for buyers who have similar functions in their companies, regardless of their specific industry, such as Industrial Maintenance and Plant Operation, published for those maintaining and operating industrial plants and Purchasing, a news magazine for purchasing executives.
Vertical publications - are those discussing current issues and problems of a single industry, such as food industry, edited for management personnel in the food industry.

Professional publications include research journals and trade and professional association journals. Their editorial range varies from reporting new technical developments to discussing how to run offices more efficiently and profitably. Much advertising is directed at professionals, as these experts are an important influence in recommending or specifying the products their clients will need.

Industrial trade directories have long been used as an important promotion medium in business advertising. Most industries have their own directories and buyer's guide, with descriptions of products and product lines and lists of various firms marketing and selling them. Trade directories are a highly effective way to get particular advertisers' names before their respective target audiences. The greatest advantages of industrial trade directories are their high credibility and acceptance rate by both large and small advertisers and buyers.

Broadcast Media - Broadcast media, that is, radio and television, once thought to be only for consumer advertising, are receiving increasing attention from advertisers who serve highly geographically concentrated markets and who want to get around the intense business advertising competition in older, more traditional business media. Both large and small firms have used radio advertising through the years.

The use of **direct marketing** is widely integrated throughout all advertising media- direct mail, telephone, newspaper, magazine, television, radio, and the Internet. **Telephone marketing** now represents the largest category of direct marketing sales, followed by direct mail and more distantly, by newspaper space advertising.

Direct mail is especially important where the market for a business product or service is concentrated because direct-mail pieces can be targeted specifically to key individuals and can focus on his or her unique buying motives. Direct mail does not attempt to dot the entire selling job; instead, it usually suggests some sort of action perhaps only passively as in urging willingness to listen to a salesperson when he or she calls, or merely to plant an idea in the recipient's and mind. Direct mail also is a great promotional tool for the business marketer because it is simple to compile lists of prospects from responses to trade and professional advertisements and intra company telemarketing operations (house lists).

Most direct marketers are turning to telemarketing as a cost-efficient, productive addition to direct mail. While telemarketing is more expensive than direct mail on a cost-per-contract basis, the response rate is greater. Companies are using telephone systems for promotion, order processing, sales support, and customer service. Telemarketing is not a substitute or replacement for a regular sales force; however, it should supplement other elements of the promotional mix so that overall promotional efficiently can be improved.

Their handicap of a comparatively short life notwithstanding, newspapers offer many opportunities for successful direct marketing. Newspapers also offer the impact of illustration size can make a difference. For example, a full newspaper page has tremendous attention-getting impact that is hard to match with direct mail.

Magazine copy is "tell-all" copy. This means that the marketer imagines all the ways the product or service can answer the prospect's wants and includes as many as possible in the message. However, tell-all copy sometimes requires considerable space; it relies on a willingness on the part of the reader to read a ling copy message. The writing typically is factual and no-nonsense writing that avoids the gimmicks, cute phrases, and personal writing style that characterize consumer advertising.

Any steady television viewer is aware that he or she is seeing an increasing number of **business-to-business commercials with direct response offers**. Television is the almost-perfect medium because viewers can see the product, watch it demonstrated, and be influenced by the enthusiasm conveyed by the announcer. Also, a vast audience may be exposed to the appeal.

On the negative side is the cost, which is so high that disaster may loom if the product and the direct response ad aren't interesting enough to draw heavy responses. Also, in contrast to print media, the message, once given, is gone; there is no page to reread and no coupon to fill out.

Radio has produced good somet6imes outstanding direct response success stories. Radio has other pleasing qualities as well, such as low cost and the fact that it can be produced far more quickly and simply than almost any other medium. However, it takes little perception to see that radio has serious handicaps when used in a marketing campaign. One of the most significant weaknesses of radio is that prospects cannot see the product. Except for cost, radio suffers from the same shortcomings as television and adds some of its own.

Electronic Media - The Internet has become a major sales channel and will continue to grow. The emergence of electronic commerce will continue to significantly impact advertising and sale promotion strategy in business markets. On-line sales catalogs will transform themselves from product listings to global sourcing tools. Buyers will be able to buy anything needed anywhere in the world at competitive prices. The impact of the Internet on business has barely begun.

Business advertising Content - The effective business product or service advertisement will start with a **short headline** presenting an interesting or intriguing idea of enough significance to readers that they will wish to see or hear more. The copy will describe the ***distinctive features*** of the product or service, offering ***evidence of its desirability*** and ***proof of claims*** made for it. The reader is urged to take some action. Where feasible, specific courses of action are suggested.

Excellent photography and ***clear illustrations*** increase readership while strengthening or elaborating on headlines. Art, however, should not be used for its own sake. Generic images do not convey messages. It is better to use testimonials, case histories, and other copy-heavy advertisements than to be burdened with weak pictures. Lebhar-Friedman Research and Information Services found that frequently run, colorful advertisements are best for business advertising. Eight out of 10 respondents said they are more favorably impressed and influenced by four-color than by black-and white advertisements.

8.4 Use of advertising Agencies

Advertising agencies work on advertising strategy and campaigns, prepare copy and layouts, study markets, select media, and carry out the actual physical production of the advertisement, including its placement in selected media. During the past decade, the advertising management responsibility among small-to moderate-size corporations has gradually been turned over to the well-integrated, total communications types of agency.

Contrary to these advantages, advertising agencies are not as universally used by business-to-business concerns as they are by consumer goods firms. Some firms believe that they can save money by avoiding hiring an agency; some may believe their own business and customer base. Advertising agencies, on the other hand, think, and sacrifice creative independence. There is little question that the advertising agency has an important place in the marketing of business products. Although there are some types of activities it cannot perform as well as in-house departments, there are others it can do more efficiently or more economically. If an advertising agency is used, the challenge for marketers is to achieve an effective partnership between the company and the agency.

8.5 Business Publicity

Business publicity can be a powerful mass-promotion tool for the business advertiser. Publicity, a communication in news story form about an organization, its products, or both, that is transmitted through a mass medium at no charge, can serve to help build or add to a firm's prestige; to introduce a new product or service, a product or service improvement, or a product or service application; to provide the salesperson with easier entry into the offices of current and prospective customers; and to increase the company's visibility and the desirability of its product mix.

The public relations or advertising department usually is charged with the responsibility for developing favorable publicity that comes to the attention of not only customers but also the company suppliers, distributors, employees, creditors, stockholders and investors, and the general public. As **Exhibit 8-4** shows, four techniques for getting in the news are the press release, the exclusive feature, the press conference, and the press kit. Management activities that are good source for publicity include personnel changes and promotions; speeches and special appearances at banquets, graduations, and professional meetings; and stories about the company's history and future. The private lives and interesting activities hobbies and charitable and volunteer activities of managerial personnel show a different side to those who work for what are frequently perceived as " insensitive corporate giants."

Exhibit 8-4 Four Techniques for Getting in the News

1. **Press Release**. An announcement to the news media of significant changes in a firm or product or to introduce a new product. It is the most popular technique for obtaining publicity.

2. **Exclusive Feature**. An in-depth article or broadcast message about something of interest to a particular public. An exclusive feature could highlight a new concept, an industry trend, a special technique, and so on. The feature usually

does not focus solely on a company's products but will use them as examples to illustrate points. An exclusive feature usually requires extensive coordination between public relations personnel and editors or broadcast managers.

3. **Press Conference**. A meeting for the media sponsored by the firm. Press conferences can be overdone and used too often. They should be used to announce major news items such as the introduction of a product or the appointment of a new president.

4. **Press Kits**. Sometimes used in connection with a press conference, a press kit may include press releases, pictures, tapes and firms, product samples, and complimentary passes.

One of the real advantages of publicity is that the media time or space used is free of charge for the company, but it must be remembered that publicity car be negative, too.

8.6 Business Sales Promotion

Business sales promotion was formerly considered by marketers as only a set of short-term inducements to create interest among salespeople, intermediaries, and customers. In many firms today, sales promotion venture well beyond creating short-term value for various prospects. It has become the driving force that links personal selling, advertising, and publicity into a meaningful, integrated promotional program. There are many forms of sales promotion activities

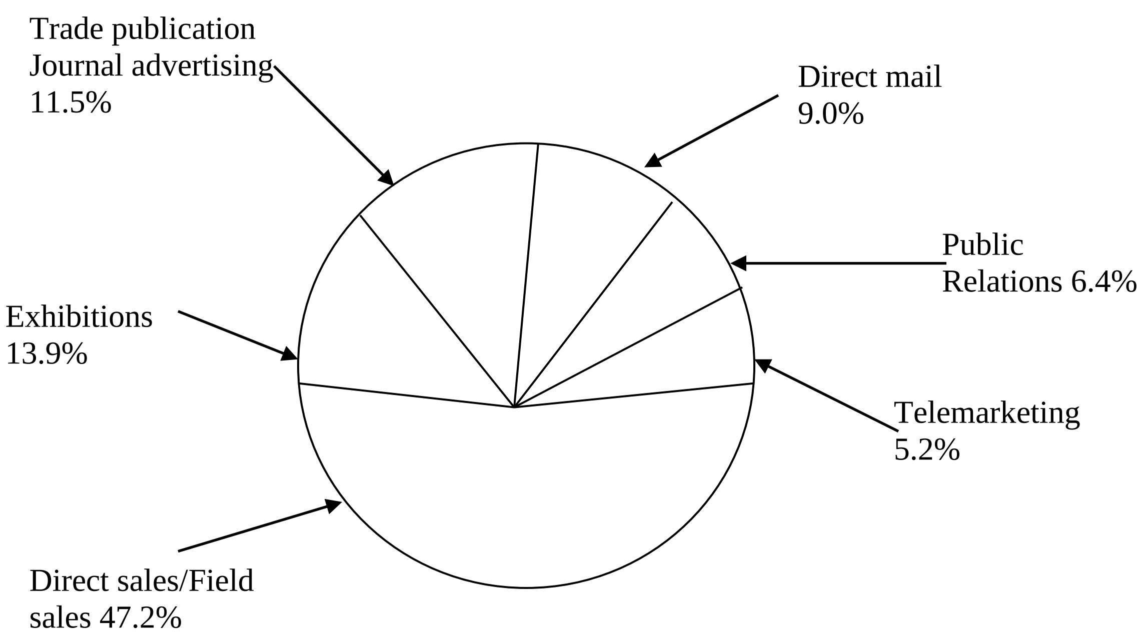
- trade shows and exhibits;
- contests, sweepstakes, and games; and
- Advertising specialties.

Trade Shows and Exhibits - Trade shows, trade fairs, expositions, scientific/technical conferences, conventions- the names may very, but the basic function of the activity represents a major industry marketing event. They have emerged as a significant component in companies' total marketing and selling strategies and budgets, as well as being places where information is exchanged and major buying demands are made within a given industry. Under carefully controlled conditions, the return from trade show investments can indeed be measured and quantified.

Why participate? Trade shows and exhibitions have been reported as the second-largest component of the total advertising budget allocation in firms marketing business products

Exhibit 8-5 The Role of Exhibitions in the Marketing Mix

Where the Marketing Dollars Go



Types of Trade Shows - Trade show managers classify shows as either horizontal or vertical.

- Vertical shows promotion products and services to a single industry or specific progression.
- A horizontal show, on the other hand, promotes a product or service to a variety of industries.

Finally, a firm should consider several factors in choosing shows in which to participate. These include:

- Expected attendance
- Total cost to participate

- Industry expectations
- Measurable results
- Staffing capability

Contests, Sweepstakes, and Games - Contests, sweepstakes, and games are used by many business marketers to stimulate buyer interest. These tools provide customers with a chance to win something such as cash, trips, or goods as a result of either luck or extra effort. A contest calls for customers to submit an entry a jingle. A sweepstakes calls for customers to submit their names for a drawing. A game presents customers with something every time they buy, which may or may not help them win a prize. A sales contest induces dealers or distributors to redouble their sales efforts over a specific time period, with prizes going to the top performers.

Advertising Specialties: An advertising specialty is a useful item with a message on it, such as a pen, or a calendar. Advertising specialties bear the company name, logo, or advertising message and are given away to present and potential customers. Marketers find advertising specialties to be one of the most effective means for reaching a target audience and holding its attention.

Advertising specialties offer great versatility when used in a planned campaign. Trade show exhibitors can specifically target their audience with an item the visitors will remember.

The Total Market Demand (1)

The total market demand for a given product category is composed of domestic production, imports, and exports (see box 1 in Exhibit 2-7). The export component carries a negative sign in the evaluation scheme to avoid overestimation of the total market size in the trading area of interest. The N/A designation should be applied to innovative products since prior data regarding the product class will be nonexistent.

Derived Demand (2)

Considerations of derived demand effects are important for both long-term planning and short-time forecasting. Long-term planning for major additions to capital plant and equipment is contingent upon determining the health of key markets overtime. The condition of business marketers is very often dependent on consumer markets. Thus the business product planner must be aware of market trends in the consumer sector that may exert an impact on demand for the business product. The importance of derived demand to the firm is a function of the degree of impact exerted by such demand and the number of alternative markets available. Firms that are dependent on a single end-use market should be especially concerned with derived-demand issues. The plus, minus, and N/A designations for the derived-demand category indicate the range of influence this factor can exert on the business market.

Two of the most commonly used methods of measuring the effectiveness of a promotion campaign are pre-and post testing and responses to advertisements.

Pre-testing and Post-testing

- Pre-testing of promotional print ads measures subjects' awareness of or reaction to a product or service. Respondents answer a series of questions or indicate their reactions to a number of situations, thereby conveying their degree of understanding of the product or service.
- In post-testing, those who have been exposed to advertisements, publicity pieces, or sales promotion devices are questioned to determine the extent of their aided recall, unaided recall, recognition, comprehension, acceptance, and brand awareness where applicable in regard to the promotion. If respondents purchased a product or service as a result of the promotional piece or activity under study, usually they will be asked also to indicate their satisfaction and frequency of usage.

Responses to business Advertising

Traditionally, one of the most popular models of measuring the effectiveness of business advertising has been through response to print and broadcast advertisements and direct marketing efforts. For print media, coupons or tear-away sheets usually are included in advertisements placed in various forms of business publications and direct marketing pieces. Advertisers generally assume that if a particular advertisement or direct marketing effort receives a large mail or phone response, it is an effective promotional piece. Likewise, if an advertisement using a broadcast medium receives a considerable number of inquiries, it is felt to be successful.

Business marketers seeking to determine the value of advertising can use scaled-down versions of the ad-weight study developed for the Advertising Research Foundation (ARF). Marketers can learn the following.

- Whether they should advertise
- How much of the advertising they do will be profitable
- Whether advertising cuts will hurt or help profit.

Summary

1. Promotion in business marketing refers to the use of the promotional tools of advertising, publicity, and sales promotion. Business promotional tools generally serve to strengthen the personal selling effort and can be very effective in paving the way for sales representatives, in introducing new products and product lines to both established and prospective customers, and in creating good will between the selling and purchasing firms.

2. Creating a promotional campaign involves five steps: setting objectives, developing the promotional budget, determining the promotional mix, measuring the effectiveness of the promotional plan, and making any necessary changes in the campaign.

3. There is a great need for specific, realistic objectives for any promotional campaign. The establishment of appropriate objectives should be the starting point for every promotional campaign. Whenever possible, it is preferable to state objectives in quantitative terms so they can be more easily measured.

4. Ideally, the promotional budget should be set at a point where the last dollar spent ion promotion equals profits from the sales produced by that dollar. This is possible, however, only if the money is spent in an optimal fashion. Therefore, there must be a prioritization of all promotional efforts in terms of their potential contribution to the firm.

5. A firm can use advertising, publicity, and sales promotion in its promotional mix. Business advertising has very specific goals and generally employs printed media, broadcast media, and direct marketing to deliver its message to selected target markets. The advertising agency provides the client with a wide breadth and depth of experience that can seldom be duplicated a singe firm; yet, a number of firms prefer to sue their own in-house advertising departments. Business publicity can be generated from the five major areas of management activities, product promotions, sales activities, manufacturing and engineering, and personnel activities. Business sales promotion has become the driving force that links personal selling, advertising, and publicity

into a meaningful, integrated promotional program; it includes trade shows and exhibits, contests, sweepstakes, games and advertising specialties.

6. Two of the most commonly used methods of measuring the effectiveness of promotional campaigns are pre-testing and post-testing, and determining responses to print media advertisements. Pre-testing and post-testing methods reveal how much respondents knew about the product or service before the advertisement and how much they learned about the product from the advertisement. If a business advertisement is successful, usually there will be strong mail or telephone response.

7. In order for marketing managers to determine the degree of success of promotional campaigns, they must first determine whether the campaign has met its initial objectives. If the objectives were not met, each stage of the campaign should be analyzed and modified as needed.

Review Questions

1. What three promotional tools are commonly used in business promotion campaigns? When does promotion play a primary role in selling business products and services? Why is promotion usually only a support effort for personal selling activities in business marketing?
2. What are the five stages in the development of a business promotion plan? What is a promotional campaign?
3. Ideally, at what point should the promotional budget be set? Identify the four major methods by which business promotion budgets are determined.
4. Discuss four major goals of business advertising. How is business advertising different from consumer advertising?
5. What should the typical effective business advertisement contain? How can advertising agencies be of great value to the firm? Why are many firms reluctant to use advertising agencies? How do advertising agencies counter this reluctance?
6. What role does publicity play in the business-to-business firm? From what five major areas does the firm generally derive its publicity? How can business publicity be negative? Provide a recent example of this phenomenon.