

# **Business Marketing**

Text and Cases

Fourth Edition

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# Business Marketing

Text and Cases

Fourth Edition

**Krishna K Havaladar**

*Professor,  
Alliance School of Business  
Alliance University,  
Bangalore, India*



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*This Book is Dedicated*

*To*

*My beloved parents late Sushila and  
late Keshav Govind Havaladar,*

*And to my wife, Geeta,  
and children,*

*Kiran and Shilpa,  
for their love and support*



# Preface to the Fourth Edition

Welcome to the fourth edition of *Business Marketing: Text and Cases*. Let us recollect the journey of the book. The title of the first edition, which was published in 2002, was *Industrial Marketing*, and the same continued for the second edition, which came in the market in 2005. However, the third edition manifested a change in the name from *Industrial Marketing* to *Business Marketing* in 2010, indicating a more widely used contemporary title. The feedback received from the faculty and students has been positive in terms of simple and easy-to-understand language all through these editions. An analytical approach has been adopted in the text, with a large number of cases and examples to illustrate marketing concepts, strategies, and techniques.

## Features of this Edition

This edition has been expanded and streamlined to reflect emerging trends in business marketing academia and practices. Particularly, the following concepts and topics are added or expanded:

- Growth of B2B e-procurement, including online and reverse auctions
- Multi attribute decision making
- Supplementary service and basic customer service
- Estimating the company's current and future demands
- Use of the Internet in Business Marketing Research
- The nested approach to segmentation
- Core competencies
- Managing innovation
- Components and trends in supply chain management
- Key account management
- Integrating the marketing communications
- The Internet and new-age media
- Opportunity and threat matrix, and five competitive forces
- E-commerce and cloud computing

## New Cases

Ten new cases have been added at the end of different chapters thus making the total number of cases in this edition to be 55. This is perhaps the largest number of cases in a business marketing or business-to-business marketing book available in the market at present.

**Industry Examples**

Based on the feedback received from students many new examples from business organizations have been included in this edition, which are in addition to a large number of existing industry related examples. These examples, I believe, would help students to understand the theoretical concepts and techniques more easily.

**Teaching Support**

The important support features like summary, conceptual, objective-type and application questions, key terms and comprehensive glossary of key terms, reference notes, as well as chapter-end cases and integrated cases are included in the fourth edition.

**Teaching Supplements**

The existing “Instructor’s manual” is updated with inclusion of Power Point slides as well as solutions to chapter-end application and, objective-type questions, as well as case notes.

**Acknowledgements**

I would like to acknowledge all my friends and colleagues who have provided support and made contributions to help me complete the fourth edition. First, I would like to thank my colleagues at Alliance, Professors Rathanakar Acharya and Mihir Dash, and my long-standing friend, Professor B.S. Sachidanand, for reviewing and updating chapters.

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My overriding inspiration continues to be my wife, Geeta and my family, who provided me time and support needed to prepare this edition.

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# Preface to the First Edition

Industrial marketing has taken a long time to get some kind of recognition amongst academicians and industrial businesses of India. Increasing number of management institutes have added industrial or business-to-business marketing to their curricula. However, there are relatively few textbooks on industrial marketing and perhaps none that deals with Indian business situations. The aim of this book is to contribute in some small way to the knowledge and practices of industrial marketing with emphasis on Indian markets.

The forces of globalisation and technological changes have opened up new opportunities as well as challenges to the industrial marketer who intends to serve the needs of commercial enterprises, government organisations and institutions. Indian organisations have now started getting a feel of global competition. Today no country can remain isolated from the world economy. Today's markets are changing rapidly. These changes are throwing companies into a state of confusion, if they lack marketing know-how and appropriate marketing strategy. Vastly improved industrial marketing practices are needed for performing well in rapidly changing markets.

## **Organisation of the Book**

This book focuses on the needs and interests of an Indian reader. Its emphasis is on global thinking, but its plan is to act locally. The organisation of the book is based on the current marketing thinking and new ideas to meet the new challenges.

The book is organised into thirteen chapters. Each chapter provides learning objectives, examples of industrial marketing practices, key concepts, summary and questions for discussion. A special chapter is included on application of electronic commerce to business-to-business marketing, considering the growing emphasis on direct and online marketing. The book also includes Indian cases on business marketing problems and issues.

KRISHNA K. HAVALDAR



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# 1

## The Nature of Business Marketing

*After studying this chapter you should be able to:*

- Know what business marketing is.
- Understand customer value in business markets.
- Know the differences in the characteristics between business and consumer marketing.
- Learn about business marketing planning.
- Understand the concept of derived demand and other related concepts.

The basic concepts of marketing (in terms of exchange processes between buyers and sellers) remain the same for both the consumer marketing and business marketing. However, there are differences between consumer markets and business markets. These differences must be understood well by business marketers who want to reach and satisfy the customers better and faster than their competitors, in order to achieve the corporate objectives.

Business marketing is a dynamic and challenging area that presents opportunities for the application of marketing concepts and principles. To market effectively in a business market, we must understand the nature of business marketing which functions differently, in many respects, from consumer marketing. It is therefore necessary to study business marketing for those who are planning a career in business marketing.

### WHAT IS BUSINESS MARKETING?

Business marketing is also referred to as ‘business-to-business marketing’ (B2B), industrial marketing, or ‘organisational marketing’. **Business marketing** is the marketing of products and services to business organisations. Business organisations include manufacturing companies, government undertakings, private sector organisations, educational institutions, hospitals, distributors, and dealers. Business organisations buy products and services to satisfy many objectives like production of other goods and services, making profits, reducing costs, and so on. In contrast, **consumer marketing** is the marketing of products and services to individuals, families, and households. The consumers buy products and services for their own consumption or use.

The companies (selling organisations) that sell steel, machine tools, computers, courier services, and other goods and services to business firms (buying organisations) need to understand the buyers’ needs, resources, policies, and buying procedures. The important point in business marketing is to create value (benefit) for the buying organisations (customers) with products and services that focus on buying organisational needs and objectives. **For example**, a company manufacturing and marketing

precision steel tubes to bicycle manufacturers is doing business marketing. Business marketer of the precision steel tube company, must understand the needs of bicycle manufacturers such as Hero Cycle and Atlas Cycle, in terms of their quality requirements, applications of tubes, availability or delivery on daily or weekly basis, and so on.

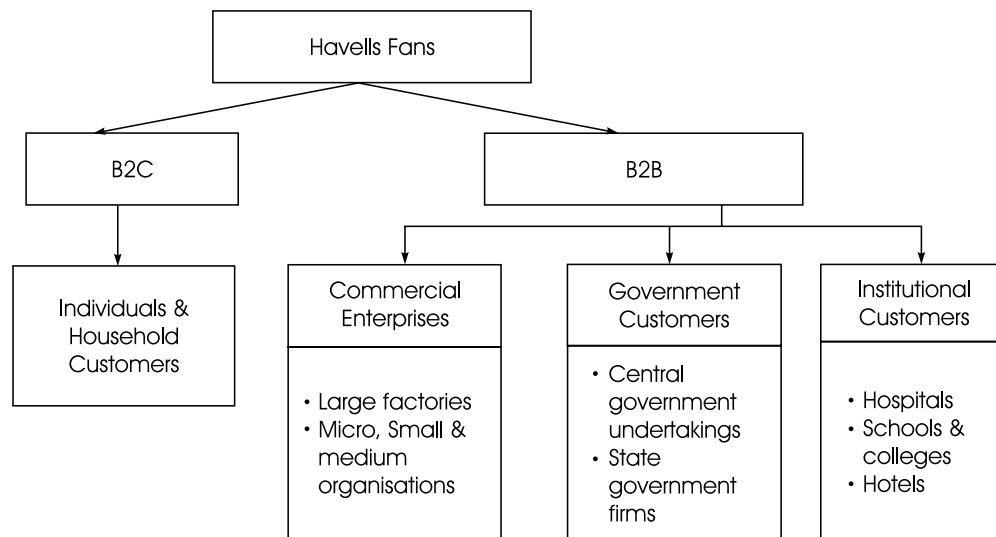
Similarly, a small and proprietary firm, giving technical advice (or service) to paint-manufacturers is also doing business marketing.

## Business Markets

Business Markets consist of firms, institutions and government organisations that purchase goods and services either for their own use, i.e. for use in the products and services that they produce, or for resale along with other products and services to other firms. Generally, business markets are composed of fewer but larger customers than consumer markets. **For example**, Lakshmi Machine Works (LMW) Limited, Coimbatore, India, is a leading textile machinery manufacturer, whose business markets consist of textile mills in India as well as in Asian and Ocean regions. These textile mills sell fabrics of cotton or wool to garment manufacturers, who are also the business customers. Finally, the garment manufacturers make items of clothing, such as shirts and trousers, which are sold in consumer markets to individuals. There are companies whose products and services are marketed to both business and consumer markets. One such example is Havells India Limited, described below:

### Example: Consumer Market (B2C) and Business Market (B2B)

Havells India Limited is a leading electrical and power distribution equipment manufacturer. Let us consider how Havells markets one of its products – viz. fans. Various types of fans, such as ceiling, table, wall mounting, pedestal and exhaust are sold to both consumer market (B2C) and business market (B2B).



**Figure 1.1** Consumer and Business Markets for Havells Fans

Havells fans are sold in larger quantity to consumer market, i.e. to households. However, fans are also required for business markets where the volume of business coming from a single customer like a new office building for a central government organisation can be very large. Havells may serve large government and private sector companies directly through its branch sales people. For household customers, fans are sold through Havells distribution network, consisting of the company showrooms, called “Havells Galaxy”, dealers, and retail outlets.

## CUSTOMER VALUE IN BUSINESS MARKETS

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Customer value or value is one of the widely used terms in business markets in recent years. However, most customer value propositions or offerings make claims of benefits to the customer, but do not express the value in monetary terms.

Value in business markets is defined as “the economic, technical, service, and social benefits received by a customer firm in exchange for the price paid for a product or service offering”<sup>1</sup>. There is another method of defining value, that is, “a ratio between what the customer gets (i.e. benefits) and what he gives (i.e. costs)”<sup>2</sup>. Here,  $\text{value} = \text{benefits/costs}$ . The benefits include functional and emotional benefits. The costs include monetary, time, energy, and psychic costs. The customer firm, which receives offerings V1 and V2 from the two supplier firms, chooses the offering which gives higher value, that is, higher ratio of benefits to costs.

### Estimating Customer Value

Accurately estimating value would help the supplier firm to create and deliver value to targeted market segments and customers. In business markets, customer value varies for different market segments and customers. Business market managers should estimate the worth of their offering in monetary terms for market segments and customer firms. Some of the methods used to assess or estimate customer value are: focus group, customer interview, internal test, and conjoint analysis.

**Focus Group** This consists of a group of knowledgeable individuals (or participants) from customer firms. The moderator from the supplier firm shows the product offering to the participants and then asks them to write down the value of the offering to their firms. The moderator then discusses the offering with the participants in detail for about one hour. At the end of the discussion, the participants are asked to write down their interest in the product, using a 10-point scale, and again, what benefits they expect and the price they would be willing to pay for these benefits.

**Customer Interview** In this method, the supplier firm people (and/or their consultants) seek customer firm’s cooperation to get detailed information about the benefits and costs associated with the supplier firm’s product or service. Based on the data collected, the supplier firm calculates the value estimate of its product for that specific application.

**Internal Test** Technical people in the supplier firm conduct laboratory tests on the product in order to get an estimate of its value. This method can be applied only if the supplier has a detailed knowledge of how the product is used by the customers.

**Conjoint Analysis** Here, the participants (or respondents), in a personal interview, are asked to evaluate a set of product offerings. The participants indicate a purchase preference rating for each product offering. The researcher then uses regression analysis to decompose the ratings into value estimates.

Most business marketing firms do not try to estimate the customer value in monetary terms. The few but growing number of firms who develop this capability have superior knowledge of the market and show superior performance.

### Customer Value Proposition

Business marketing firms (or supplier firms) use the term “customer value proposition” (or “value proposition”) for three types of benefits:

- (a) many benefits listed,
- (b) few benefits compared, and
- (c) few benefits meeting customer expectations.

**Many Benefits Listed** In a study conducted by the author, about 70 per cent of business marketing firms listed more than four benefits, which they believed their product or service would deliver to their target customers. They thought more number of benefits (or customer value propositions), the better it would be. However, when asked, some of their target customers were not aware of these benefits. Listing many benefits require little knowledge about customers and competitors. These marketing firms cannot answer the buying firm’s question, “Why should we buy your product?”

**Few Benefits Compared** In our study, about 20 per cent business marketing firms mentioned three or four benefits and compared some of these benefits to the competitors’ value propositions. They assumed that some of these superior benefits might be valuable to their target customers. Here, the marketing firms did not have detailed information about the customers’ needs or expectations. In other words, they did not estimate customer value.

Let us consider one **example** of Intel core processors supplied to its business customers, such as Dell and Lenovo, for desktop PCs. Intel has developed a customer value proposition, which includes as many as six benefits as follows:

- Superior quality
- Lower price
- Competitive service offerings
- Greater investment protection
- Partnering to deliver mission results
- Provide a complete range of highly scalable, flexible, and reliable products

Dell and Lenovo recall only three out of the six benefits listed by Intel—that is, product quality, lower prices and service offerings. It is interesting to know that Intel’s competitor AMD’s customer value proposition was similar, and consisted of two benefits—superior quality and lower price. When asked about the similarity of the customer value propositions of Intel and AMD, Dell and Lenovo responded that Intel’s offerings were greater than AMD’s offerings and that Intel’s customer value proposition (CVP) was closest to their expectations.

**Few Benefits Meeting Customer Expectations** Purchase managers prefer to do business with supplier firms who make their product or service offerings superior to the few benefits that matter most to their firms. These supplier (or marketing) firms demonstrate and communicate the superior value to the customer firms in a way that show their complete understanding of customer firms’ businesses. **For**

**instance,** Kewaunee Labway India Ltd. undertakes projects to set up scientific laboratories. Once the project is set up, they validate it by carrying out internal audit, which is not provided by any competitors. When we asked two of their customers—Hikal Limited and Biocon Limited, they confirmed that Kewaunee had a complete view of their businesses and met their expectations better than other players in the market.

**Another example:** Agritech Engineering Pvt. Ltd. developed the latest technology machines under the brand name AGT (Advanced Grain Technology) to manufacture rice mills used for threshing paddy to rice. Few benefits, in addition to the latest technology, provided by AGT to customers include superior presales service of planning, designing, building and installing rice mill machines as well as prompt after-sales technical service. These benefits are meeting the expectations of customers and hence, AGT branded rice mills have the highest market share not only in India but also in Bangladesh.

### Demonstrating and Documenting Customer Value<sup>3</sup>

Once a salesperson gets a complete understanding of the prospective customer's specific needs, he/she modifies the company's value propositions or benefits in line with the customer's requirements. Successful marketing firms use "value case histories" in order to demonstrate and document the cost savings and other benefits that customer firms have actually received by using their products and services.

**For instance,** IBM in their advertisement, headlined "special muffler", gives the example of how IBM's supply chain expertise helped a major European automotive parts manufacturer cut inventory by over 30 per cent, while keeping (delivery) service levels at 97 per cent. This illustration was based on IBM's value chain study.

**Another example** of how case studies are used in the company websites to demonstrate and document customer value can be seen for Wipro Technologies. In one case study on "quality consulting", Wipro has documented improvement in the product performance of a telecom application by 250 per cent using six sigma methodologies.

**Superior Performance** When the customer value proposition is developed and delivered properly, it would result in superior performance of the company. That is the responsibility of the senior management of the company.

Let us illustrate this concept with an **example** from a service provider. Quality Solutions for Information Technology Pvt. Ltd. (QSIT) is a service provider to many software companies in training and development, certification programmes, process consulting, and audit/assessment. QSIT's customer value proposition (CVP) for executive training is as follows:

- Providing high quality training in software testing and project management
- Providing certification after the training programme—the only company in Asia-Pacific region to give CSTP (Certified Software Test Professional) certification

The main competitors of QSIT are: QAI (Quality Assurance Institute), Binary Essentials Consulting, Management Professionals International (MPROI), and PMCC (India). Despite competition from national and international organisations, QSIT has a client base of about 600 companies including IBM, Microsoft, Motorola, Accenture, and Infosys, and has been growing rapidly, showing superior performance, since the company has not only developed customer value proposition, but also delivered the same properly.



## BUSINESS vs CONSUMER MARKETING

The basic tasks of marketing management apply to both consumer and business marketing. These tasks are: (a) deciding the target markets, (b) finding out the needs and wants of the target markets, (c) developing products and services to meet the needs of those markets, and (d) evolving marketing programme or strategy to reach and satisfy target customers, better and faster than competitors.

However, there are differences in the characteristics of business and consumer markets.

### Differences Between Business and Consumer Marketing

In business marketing, the markets are geographically concentrated; the customers are relatively fewer; the distribution channels are short; the buyers (or customers) are well informed; the buying organisations are highly organised and use sophisticated purchasing techniques; the purchasing decisions are based on observable stages.

In comparison to consumer marketing, business marketing is more a responsibility of general management. Sometimes, it is difficult to separate business marketing strategy from the corporate (company) strategy. In consumer marketing, the changes in marketing strategy are carried out many times within the marketing department through changes in advertising, sales promotion, and packaging. However, the changes in business marketing strategy generally have company-wide implications.

**For example**, in 1983, a newly-recruited marketing manager of a precision steel tubes company wanted to evolve a marketing plan. He initially carried out a market survey to understand the needs and the requirements of the existing and new customers. One of the major findings of the market survey was that out of seven different market segments, two segments—namely Bicycle and Automotive—required 70 per cent of the total market of precision steel tubes in India and that their future growth was much higher than the other segments. However, both the segments needed a higher volume of value added tubes (called “cold drawn welded tubes”), which were also giving a much higher contribution to fixed costs and profits. The marketing strategy of focusing (targeting) marketing efforts on Bicycle and Automotive segments could be achieved only when it became a part of the corporate strategy, by investing ₹ five crores (USD 0.83 million) for increasing the production of cold drawn welded (CDW) tubes from 80 metric tons per month to 400 metric tons per month. The company could, therefore, achieve its objective of becoming the market leader by 1986.

While generally it is true that the differences between business and consumer marketing are of degrees, the degrees of differences are substantial. These differences can be seen by comparing the two markets, as shown in Table 1.1.

**Table 1.1** Differences between Business and Consumer Marketing

<i>Areas</i>	<i>Business Markets</i>	<i>Consumer Markets</i>
1. Market characteristics	<ul style="list-style-type: none"> <li>Geographically concentrated</li> <li>Relatively fewer buyers</li> </ul>	<ul style="list-style-type: none"> <li>Geographically dispersed</li> <li>Mass markets</li> </ul>
2. Product characteristics	<ul style="list-style-type: none"> <li>Technical complexity</li> <li>Customised</li> </ul>	<ul style="list-style-type: none"> <li>Technically not complex.</li> <li>Standardised</li> </ul>
3. Service characteristics	<ul style="list-style-type: none"> <li>Timely delivery service and availability very important</li> </ul>	<ul style="list-style-type: none"> <li>Delivery service and availability somewhat important</li> </ul>

*Contd.*

4. Buyer behaviour	<ul style="list-style-type: none"> <li>▪ Involvement of various functional areas in both buyer and supplier firms</li> <li>▪ Purchase decisions are mainly made on rational/performance basis</li> <li>▪ Technical expertise required</li> <li>▪ Stable interpersonal relationship between buyers and sellers</li> </ul>	<ul style="list-style-type: none"> <li>▪ Involvement of family members</li> <li>▪ Purchase decisions are mostly made based on physiological/social/psychological needs</li> <li>▪ Less technical expertise required</li> <li>▪ Non-personal relationship between buyers and sellers.</li> </ul>
5. Channel characteristics	<ul style="list-style-type: none"> <li>▪ More direct</li> <li>▪ Fewer channel levels</li> </ul>	<ul style="list-style-type: none"> <li>▪ Indirect</li> <li>▪ Multiple levels of intermediaries</li> </ul>
6. Promotional characteristics	<ul style="list-style-type: none"> <li>▪ Emphasis on personal selling</li> </ul>	<ul style="list-style-type: none"> <li>▪ Emphasis on advertising</li> </ul>
7. Price characteristics	<ul style="list-style-type: none"> <li>▪ Competitive bidding and negotiated prices</li> <li>▪ List prices for standard products</li> </ul>	<ul style="list-style-type: none"> <li>▪ List prices or maximum retail price (MRP)</li> </ul>

### ***Market Characteristics***

A large number of households, geographically dispersed all over the country, are included in the mass market for consumer goods and services. But, in the case of business markets, it is common to find less than 1000 companies to represent the total market for an industrial product or service. **For example**, for a consumer product like toothpaste or soap, a mass market, consisting of all the households in India, exist. However, for industrial products, such as large power transformers or high tension switchgears, there are limited numbers of customers—mainly state electricity boards, large private and public sector organisations.

### ***Product Characteristics***

In business marketing, the products or services are generally technically complex. They are used for serving the operations of the organisations. Because of the importance given to the technical aspects of products, the purchases are made based on the specifications evolved by the buyers.

The real risk in “falling in love with the technical aspects of a product” in business marketing is to ignore the flexibility in responding to customer’s needs in a competitive market. Some companies, as a result, commit the serious mistake of trying to change the customer to fit the product.

**For example**, the quality control manager of a “cold rolled (CR) steelstrip” manufacturing company informed an important customer (who used C.R. steel strip for the manufacture of luggage bags) that the customer was not justified in rejecting his company product, as it was as per the relevant Indian standard specifications and that the customer’s product specifications were more stringent than the Indian standard specifications. However, the customer refused to accept the product, as it was failing at the shop floor operations. The customer, therefore, not only returned the entire rejections but also cancelled the balance orders. Subsequently, other suppliers supplied the product as per the needs and specifications of the customer, who placed orders with them.

As compared to consumer marketing, business customers place a greater importance on service, that is, timely delivery or availability of product, because any delay in supply will have a significant impact on the production or operations.

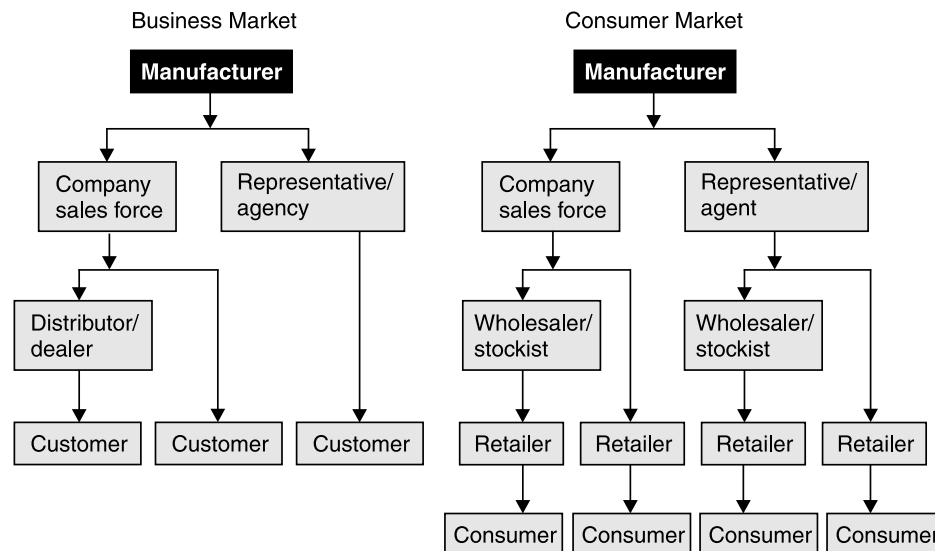
### Buyer Behaviour

In business marketing, the buying process is more complex as compared to consumer marketing. The purchase decisions in business marketing are based on many factors, such as compliance with product specifications, product quality, availability or timely supply, acceptable payment and other commercial terms, cost-effectiveness, after-sales service, and so on. The purchasing decisions generally take a longer time and involve many individuals from technical, commercial/materials, and finance departments. After the initial offer (or quotation) made by a seller (in response to a written or verbal enquiry from a buyer), there are negotiations and exchange of information between the specialists and representatives from each functional area, from both the buyer and the seller organisations. Thus, inter-organisational contacts take place and interpersonal relationships are developed. The relationships between the sellers and buyers are highly valued, and over a period of time, they become stable because of a high degree of interdependence.

In contrast, in consumer marketing, the relationship between a buyer and a seller is non-personal. The consumers change their purchasing habits frequently and the buying decisions are often based on physiological/social or psychological needs of the members of a family/household.

### Distribution Channel Characteristics

As shown in Fig. 1.2, there are fewer channel levels in business marketing as compared to consumer marketing.



**Figure 1.2** Channels of Distribution in Business and Consumer Markets

Because of the importance of inventory/stock control (i.e. minimisation of inventory carrying cost, without causing production stoppages due to non-availability of raw material components), the distribution channels are more direct from the manufacturer to the customer in business marketing. Often, the manufacturers use their own sales/marketing persons (i.e. company sales force) to sell directly to major customers. However, for selling to small-scale customers, many manufacturers use either distributors/dealers, or agents/representatives, which also helps in minimising the cost of marketing.

In case of consumer marketing, the channel of distribution is longer with multiple levels of intermediaries (also referred to as “middlemen”), since the household consumers are geographically dispersed all over the country/state.

### ***Promotional Characteristics***

While in consumer marketing the emphasis is on advertising, in business marketing, the importance is given to the personal selling through the company’s sales force. As a result, a much larger expenditure budget is provided for advertising in consumer marketing in comparison to business marketing.

In business marketing, apart from personal selling, the primary means of reaching the potential customers is through advertisements in trade journals and business magazines (e.g. *Business India*, *Business World*, etc.), as well as direct mailing of company leaflets/brochures to potential customers. The sales promotional activities (also referred to as business promotion activities) include participation in exhibitions or trade shows and conducting technical seminars.

### ***Price Characteristics***

In consumer marketing, the products are sold through the retailers to the consumers based on the “price list” of the manufacturer or the maximum retail price (MRP) for the packaged products. Sometimes, depending on the intensity of the competition, the retailer reduces the price by passing on to the consumer a part of his margin.

However, in business marketing, price is one of the factors considered in purchase decisions. Competitive bidding and price negotiations are very common in business marketing. When there are no price negotiations in certain government tenders, the competitive bidding (i.e. quoting a competitive price against a tender enquiry) becomes very important, as only the lowest bidders are considered for placement of orders. However, in almost all of the private sector and some government organisations, price negotiations are held to decide the prices and the volume of orders to be placed on various supplier firms. The payment and other commercial terms are also negotiated at the time of price negotiation.

Dealer (or trade) discounts, and volume (or quantity) discounts on the price list of standard industrial products are widely used in business marketing.

An **example** on price negotiation of a business marketing firm is as follows. A business organisation in the private sector had shortlisted two products for diversification. The corporate planning manager of the company sent the enquiries for carrying out marketing research on “coil winding machines” and “switch mode power supply” to the three marketing research agencies. The objectives and the information required from the market surveys were explained to the marketing research agencies, who were asked to submit their offers. After the receipt of the offers, the corporate planning manager called the three agencies for discussions as he found that while the delivery period and payment terms were similar, the fees for market survey (i.e. the prices) varied considerably between the three offers. After carrying out price negotiations separately with the three agencies, orders were

released for carrying out market surveys to two agencies for one product each, based on their market reputation, experience, methodology of research, and the negotiated prices.

From the above discussions, one can appreciate that many basic differences exist between consumer and business marketing. These differences in characteristics do not make a complete analysis. To understand better the differences between consumer and business markets, it is necessary to understand the economics of industrial demand as well as planning.

### **Business Marketing Planning**

Planning in business marketing requires a closer relationship to corporate strategy and more functional interdependence as compared to planning in consumer goods marketing. Changes in marketing strategy are more likely to involve capital investment in new equipment, or departure from traditional manufacturing approaches, which would have companywide implications. **For instance**, an engineering firm wanted to change its marketing strategy to superior quality product from average quality. For implementing this strategy, the company decided to go for backward integration by producing the raw material internally, since the quality of the raw material received from the only supplier was not good enough. The company had to make capital investment, resulting in the companywide implications. Hence, one may conclude that business marketing is much more a general management responsibility than it is in consumer-goods marketing. In a consumer-goods company, changes in marketing strategy can be made within marketing function through changes in advertising, sales promotion, or packaging.

**Functional Interdependence** Effectiveness of business marketing depends to a large extent on the support from other functions, particularly manufacturing, design, purchase, and logistics. **For instance**, if a major or key account like TVS wants flexibility in delivery due to frequent changes in the demand for various types or models of two-wheelers, the suppliers of components who meet this need get maximum share of business. The supplier firm can meet the key customer's needs only if other functions support the marketing efforts, keeping in mind the company objective of profits through customer satisfaction. In practice, it is seen that if the marketing person talks to other functional people informally with the intention to have good relationship, it results in greater cooperation for meeting customers' needs. In fact, cross-functional teams, with close and integrated relationship between marketing and other functions, have given good results to organisations like Hewlett-Packard and Wipro.

## **INDUSTRIAL DEMAND**

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The demand for industrial products and services does not exist by itself. It is derived from the ultimate demand for consumer goods and services. Industrial demand is, therefore, called derived demand. Sometimes the demand for industrial product is called joint demand, when the demand for a product depends upon its use along with the existence of other product or products. Cross elasticity of demand exists for some substitute products. Let us examine these concepts in more detail.

### ***Derived Demand***

Business customers buy goods and services often for use in producing other goods and services. Ultimately, whatever is finally produced will be sold to the consumers. Hence, the demand for industrial goods and services is derived from the demand from consumer goods and services.

**For example**, the demand for “precision steel tubes” does not exist in itself. It is demanded for the production of bicycles, motorcycles, scooters, and furniture (steel tables and chairs), which are used by the consumers. Thus, the demand for precision steel tubes is derived from the forecast of consumer demand for bicycles, motorcycles, scooters, and furniture.

In case of capital goods, such as machinery and equipment (e.g. machine tools, textile machinery, leather machinery, etc.) that are used to produce other goods, the purchases are made not only for the current requirements, but also in anticipation of profits from the future usage. If businessmen feel that there may be a recession in near future, their purchases will be drastically curtailed. On the other hand, if the attitude of businessmen is favourable (i.e. they feel the business is on the upswing) their investment in capital goods and other industrial products will increase. Thus, the attitude of businessmen is very important, as it reflects the optimism or pessimism about the future.

During the periods of recession, or reduced consumer demand, business firms reduce their inventories, or reduce the production, or do both. On the other hand, during the period of prosperity, there is an increased production and sales of consumer goods, which results in an increased demand for industrial goods. This may be the right time for price increases and building stocks as ready availability and shorter delivery period become very important to satisfy customers’ needs.

A business marketing firm should be in close touch with customers’ purchase, finance, quality, R&D and marketing departments, so as to get information on changes in customers’ sales, new product development, financial condition, and the quality of its products. This will help to understand the changes in the demand for industrial products.

### ***Fluctuating Demand***

It has been found that the demand for many industrial products fluctuate more than the demand for consumer products. **For instance**, if the demand for consumer durable products like refrigerators, washing machines, and mixers increase by 10 per cent during the period of prosperity in marketing environment, it can cause rise in demand for industrial products like paint, steel, and electrical motors by as much as 100 per cent. However, if there is a recession in the economy and fall in consumer demand by 10 per cent, it may cause a near collapse in the demand for industrial products. This is also referred to by economists as the **acceleration effect**, which indicates that the demand for industrial goods and services are generally more volatile than the demand for consumer goods and services. Consider the following **example**:

In 1986, due to recession in bicycle industry in domestic market, the demand for bicycles had fallen by about 40 per cent. This resulted in the drop in demand for precision steel tubes, which are used for production of bicycles, by as much as 70 per cent. The precision steel tube manufacturers who had targeted bicycle segment suffered substantial loss of sales and profits.

### ***Stimulating Demand***

As the demand for industrial products is derived from the ultimate demand for consumer products, it is logical that business marketers should carry out promotional programmes that directly reaches the ultimate consumers (i.e. individuals and household consumers), so as to stimulate the demand for industrial products. **For instance**, Steel Authority of India (SAIL) carried out an advertisement campaign in newspapers and television, targeting household consumers, to create a favourable environment for use of steel through household appliances like mixers, washing machines and refrigerators. Sometimes business marketers stimulate demand for their products by stimulating

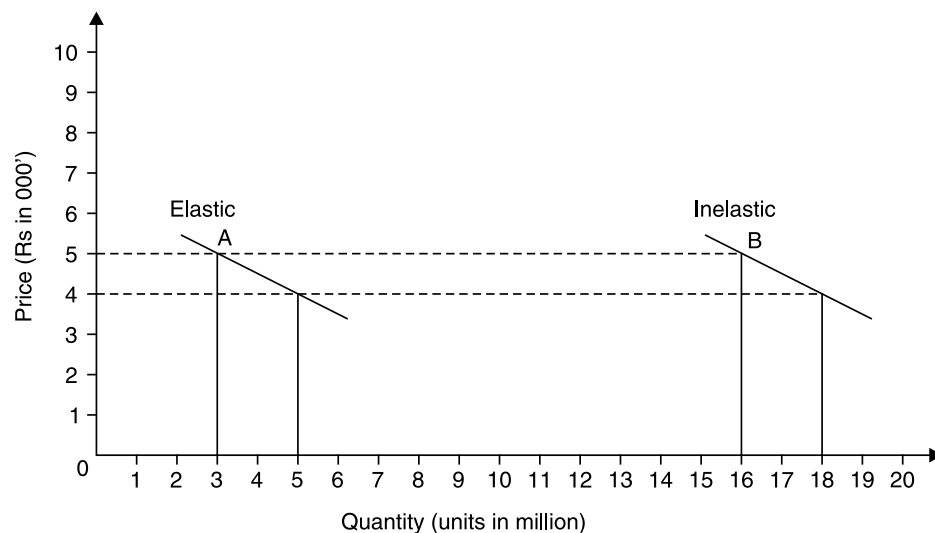
demand for their customers: products. **For example**, Intel, in their advertisements, were stimulating the demand for their microprocessors by making customers of Personal Computers (PCs) aware and more interested by mentioning “Intel inside”.

### ***Joint Demand***

Joint demand occurs when one industrial product is useful if other products also exist. **For example**, a pumpset cannot be used for pumping water, if the electric motor or diesel engine is not available. Similarly, the department of telecommunication (DoT), which requires a complete kit, consisting of 12 different items, for joining the underground telecom cables, cannot buy only some of the items from a supplier as it does not complete the kit. Thus, some industrial products do not have individual demand, but are demanded only if the “other” products are available from the business supplier.

### ***Cross-Elasticity of Demand***

Elasticity is simply the change in demand from a change in price. Percentages are used to measure the relative changes. Demand is “inelastic” if the percentage change in quantity demanded is less than the percentage change in price. Demand is “unitary” if the percentage change in price is matched by an equal percentage change in quantity. Demand is “elastic” if the percentage change in quantity demanded is more than the percentage change in price. This concept is useful as a starting point to understand the relationship between the price and the quantity sold (or demanded), as shown in Fig. 1.3.



**Figure 1.3** *Price Elasticity of Demand*

In Fig. 1.3, at position “A”, a 20 per cent price decrease is accompanied by a 66.67 per cent increase in quantity demanded, indicating that at this point, the demand is elastic. However, at position “B”, the same 20 per cent price decrease is accompanied by only 12.5 per cent increase in quantity demanded, that is, demand is inelastic. The demand for most of the industrial goods can be inelastic (i.e. insensitive to changes in prices) for a particular industry, but at the same time, highly elastic (i.e. sensitive to changes in prices) for individual suppliers. This is because, the total industry demand comes from

the collective needs of all the customers rather than price, and hence it is relatively inelastic. However, between the various suppliers, a slight change in the price by one firm may create a major change in the quantity and thereby, be highly elastic for any one firm.

Cross-elasticity of demand is the reaction of the sales of one product to a price change in another product. This concept is present in both consumer and business marketing, but it is far more important in business marketing as it can have a dramatic impact on the marketing strategy of a business firm. **For example**, the demand for aluminium is related to the prices of wood and steel for the doors and window frames, as they are close substitutes. Apart from other advantages of aluminium doors and windows, the cost comparison with steel and wooden door and window frames play an important role in the purchase decisions in the construction of houses, commercial offices, factories, hotels, hospitals, and so on. Aluminium extrusion companies regularly collect the information on cost of steel and wood, and advertise the advantages of use of aluminium in terms of negligible maintenance cost, elegant looks, environment friendly (in comparison to wood), and so on. Whenever there is a change in the price of aluminium due to changes in excise duty or other input costs, there is an impact on the sales of doors and window frames made out of wood or steel. The reverse is applicable for changes in the prices of steel or wood. Thus, the marketing persons working in the aluminium extrusion companies should recognise that the cross-elasticity of demand exists for their products.

If the cross-elasticity of substitute products is high, it indicates that these products compete in the same market. A business marketer must know how the demand for his products is likely to be affected by the changes in the prices of substitute products. Because of the unique characteristics of derived demand, the business marketing persons would anticipate an increase or decrease in the demand for their products, based on the changes in the demand for their customers' products. They must also find out if cross-elasticity of demand exists for their products so as to recognise both direct and indirect competition.

### ***Reverse-Elasticity of Demand***

This is an interesting characteristic of industrial demand. In this, a price increase can cause an increase in demand, and a price decrease would be followed by a decrease in demand—just opposite from what we would normally expect from business buyers. The reason is that business buyers regard initial price change as the first step in that direction with expectations of more to come. In order to minimise the costs, the business buyer increases the purchases immediately after a price increase in anticipation of further price increases in future. Similarly, for a price reduction, the business buyer decreases the purchases in anticipation of further price reductions. These short-term reactions are not common for all business buyers. Normally, when a manufacturer (or a supplier) lowers the price, it should result in higher level of demand, but in reverse-elasticity of demand, the opposite thing happens.

### ***Bull-Whip Effect***

Many firms, marketing industrial and consumer products, have observed the bull-whip effect, in which fluctuations increase in the orders as they move up the supply chain from dealers (or retailers) to distributors to manufacturers to suppliers. The bull-whip effect distorts demand information within the supply chain. For instance, H.P. found that demand for printers from customers showed some variability, but the orders from dealers (or resellers) to the printer division showed more variability, and the orders placed on the integrated circuit division (or supplier division) were highly variable. This made it difficult for supply to match demand, increasing the cost of filling the orders.



### Circumventing Influences of Some of the Concepts

Some organisations have managed to find a way around the obstacle created by the influence of joint demand and cross-elasticity of demand. Joint demand occurs when one product is useful if other product(s) also exist. **For instance**, a pumpset cannot be used for pumping water, if the electric motor is not available. Crompton Greaves Company, which manufactured both pumps and motors separately in two different manufacturing units, circumvented the influence of joint demand, by designing the monobloc pumpset, which had the motor as an integral part of the pumpset.

Cross-elasticity of demand, as discussed earlier, is the relationship between the price of one product and the demand of another substitute product. Extending the **example** we discussed earlier in cross-elasticity of demand, the marketing manager of aluminium extrusion manufacturer focused marketing efforts on the government organisations in coastal towns and cities, where door and window frames made from steel were not preferred (due to severe corrosion) and the wooden frames were not permitted considering its harmful effect on the environment. Any changes in the prices of steel and wood had no effect on the sales of aluminium frames used for doors, windows, and partitions in these geographic areas for government organisations, which was considered as a niche segment.

It should be clear after going through this chapter that business marketing is more complex than consumer marketing and the marketing success depends on understanding the complexities involved. Business marketing strategy has company-wide implications and is, therefore, more of a general management function, affecting the various departments or functions in an organisation.

### SUMMARY

In this chapter, we have understood business marketing (also referred to as Business-to-Business Marketing, industrial marketing, or Organisational Marketing) as marketing of goods and services to business organisations. The business organisations include manufacturing companies, service organisations, institutions and middlemen in private and public sector organisations, and government undertakings. The differences between business and consumer marketing exist in certain characteristics such as market, product, buyer behaviour, channel, promotional, and price.

Customer value is defined as the benefits received by a customer firm in exchange for the price paid or the cost incurred for a product or service. For estimating customer value, the supplier firms can use some methods, such as focus group, customer interview, internal test, and conjoint analysis. There are three types of value propositions developed by supplier firms—(a) many benefits listed, (b) few benefits compared, and (c) few benefits meeting customer expectations. Successful marketing firms use methods like “value case histories” to demonstrate and document the benefits to customer firms. This results in superior performance.

Planning in business marketing needs a closer relationship to corporate strategy and more interdependence between marketing and other functions, compared to planning in consumer marketing.

Unlike consumer products, the demand for industrial products is derived from the ultimate demand for consumer goods and services. It is, therefore, called as *derived demand*. *Joint demand* occurs when one industrial product is required, if other product also exists. *Cross-elasticity of demand* is the responsiveness of the sales of one product to a price change in another product.

Business marketers need to understand some relevant concepts like fluctuating demand, stimulating demand, reverse-elasticity of demand and bull-whip effect. A few business marketing firms have managed to circumvent influences of some of the concepts.

**KEY TERMS**

- Acceleration effect
- Bull-whip effect
- Business customer
- Business marketing
- Conjoint analysis
- Consumer marketing
- Cross-elasticity of demand
- Customer value proposition
- Derived demand
- Distribution channels
- Focus group
- Joint demand
- Price elasticity of demand
- Reverse-elasticity of demand
- Value

*Note:* Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. Explain the major differences between consumer and business marketing.
2. It is said that as compared to consumer marketing, business marketing is more of a general management responsibility. Do you agree with this statement? Explain your answer.
3. Define value in business markets. What methods are used to estimate customer value?
4. How are customer values proposed, demonstrated, and documented?
5. Explain with an example why industrial demand is called derived demand.
6. Describe the concept of cross-elasticity of demand. What is reverse-elasticity of demand?

**OBJECTIVE TYPE QUESTIONS**

1. Business marketing is marketing of goods and services to: (a) individuals, (b) households, (c) organisations, or (d) all of them.
2. In business marketing, buying decisions are mainly made on: (a) social, (b) rational, (c) psychological, or (d) physiological basis.
3. In business-to-business marketing special importance is given to: (a) personal selling, (b) sales promotion, (c) advertising, or (d) direct marketing.
4. Demand is elastic, if the percentage change in quantity demanded is: (a) less, (b) more, or (c) equal, as compared to the percentage change in price.
5. Cross-elasticity of demand is the reaction of the sales of one product to a change in: (a) distribution, (b) promotion, (c) publicity, or (d) price of another product.
6. Compared to consumer markets, business markets have: (a) less, (b) more, or (c) same number of buyers.
7. One of the definitions of customer value is the ratio between customer benefits and: (a) advantages, (b) costs, (c) features, or (d) none of them.
8. Developing and delivering superior customer value is the responsibility of: (a) junior executives, (b) middle-level executives, or (c) senior-level executives.

### APPLICATION QUESTIONS

1. Illustrate how a company can circumvent the influence of joint demand.
2. Out of the various differences between business and consumer marketing, which characteristics would have maximum impact on development of marketing strategy for a pump manufacturer? Give reasons.
3. Construct a customer value proposition for a company known to you. Explain how would you demonstrate and document the customer value.

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## CASE 1.1

### MB Ltd.: Nature of Demand for Special Purpose Machines\*

Suresh Kulkarni, General Manager of MB Ltd., was wondering on how to meet the demand for special purpose machines (SPMs) manufactured and marketed by the company in India. The products included metal cutting machines, grinding machines, honing machines, cleaning machines, and so on.

#### About the company

Special purpose machines and test equipment are made by “Equipment Division” of MB Ltd. The focus of the division is to provide total turnkey solutions, special purpose machines, and test equipment to customers with stringent processes and quality systems. The equipment division received ISO 9001:2008 certification for design, manufacture, sales, installation and servicing of SPMs as well as for test equipment. MB Ltd. is the market leader with the supply of over 2500 SPMs over the past 35 years. In addition to serving the domestic market in India, the company has exported machines worldwide. The product mix of the company depended on its role as the provider of appropriate and cost-effective solutions in precision manufacturing and quality assurance to all its customers.

The demand for these special purpose machines fluctuated due to changes in the external environmental factors like economic and technological. **For example**, the demand for these machines was less in 1996, 1997, and 2002 due to slowing down of demand in the Indian economy. However, the demand went up substantially, much above the production capacity, from 2003 to 2004. In June 2004, Suresh increased the prices of these machines by about 25 per cent in order to reduce the orders from business customers like Bajaj Auto, Maruti Suzuki, Ashok Leyland, and others. In spite of increase in prices, the demand for these machines went up by more than 30 per cent, which was in excess of production capacity. Suresh wondered how to improve the accuracy of demand forecasting. The company had been using sales force composite method, which has an advantage of giving the break-down of the sales forecast by product, customer, territory, and salesperson.

\* This case was prepared by Professor Krishna K. Havaladar based on the case data provided by Satya Natesh, Shivaputhra, Subrata, and Sriram, MBA students of Alliance Business Academy, Bangalore.

Suresh decided to call a meeting of sales and marketing persons to improve the accuracy of forecasting. He also thought of meeting all the functional managers to discuss and decide how to meet the fluctuating demand of the special purpose machines.

***Questions***

1. How would you describe the nature of demand for special purpose machines?
2. What guidelines should be followed to improve the accuracy of the sales forecast?
3. What alternatives are available to the company to meet the fluctuating demand of the special purpose machines?

# 2

## UNDERSTANDING BUSINESS MARKETS AND ENVIRONMENT

*After studying this chapter you should be able to:*

- Understand the types of business customers and classifications of industrial goods and services.
- Learn marketing implications of different types of customers and products.
- Know purchasing orientations and practices of business customers.
- Understand environmental analysis in business marketing, and also the strategies available for managing the external environment.

For developing an effective marketing plan, a business marketer needs to understand business markets and the external macro and micro environment.

### TYPES OF BUSINESS CUSTOMERS

Business marketing firms study different types of business customers because these groups of customers have different purchasing orientations and purchasing practices (discussed later in this chapter), which lead to sales and marketing strategies that differ for different types of customers.

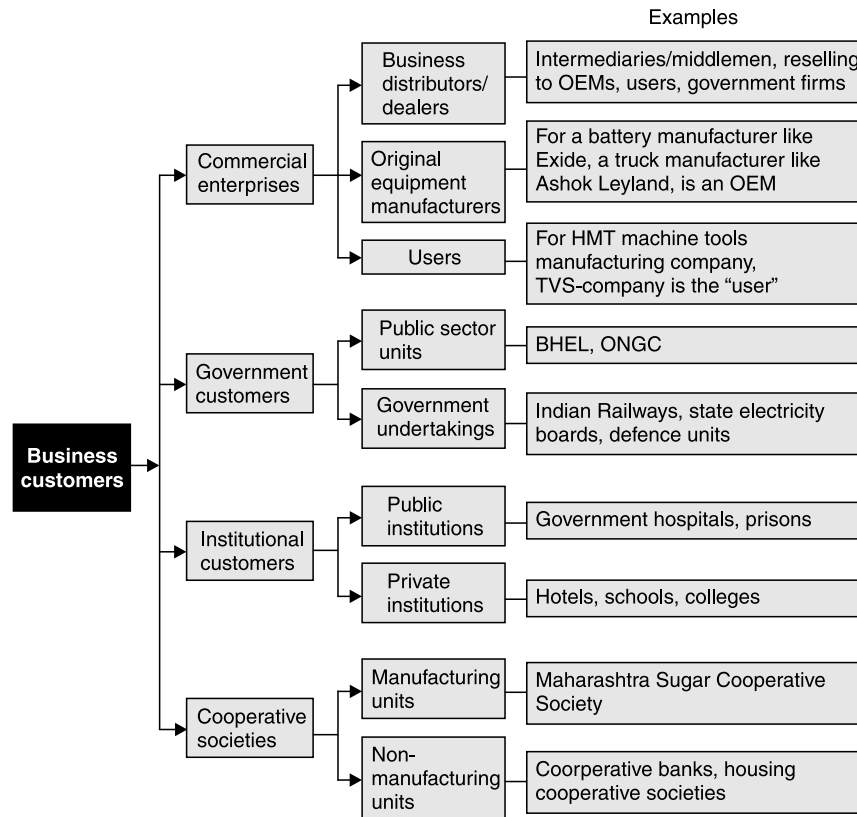
Business customers are generally classified into four groups, as shown in Fig. 2.1.

- (i) Commercial enterprises
- (ii) Government customers
- (iii) Institutional customers
- (iv) Cooperative societies

#### Commercial Enterprises

Commercial enterprises are private sector, profit-seeking organisations, consisting of (i) business distributors, or dealers, (ii) original equipment manufacturers (OEMs), and (iii) users. They include manufacturing firms (e.g. Hero Cycles, Bajaj Auto) and non-manufacturing firms (e.g. JWT advertising firm, IMRB marketing research firm). Sometimes these classifications overlap, but they are useful to the business marketer because they indicate how the products and services are used by buying organisations.

**Business Distributors and Dealers** They purchase industrial goods and resell them in the same form to other business customers such as commercial enterprises, governmental and institutional customers. They are intermediaries or middlemen of a business marketer. We shall discuss further about them in Chapter 8 on “Business Distribution Channels” and “Marketing Logistics”.



**Figure 2.1** *Types of Business Customers*

**Original Equipment Manufacturers (OEMs)** These business customers purchase industrial goods to incorporate them into the products they produce. **For instance**, a tyre manufacturer (say, MRF), who sells tyres to a truck manufacturer (say, Tata Motors) would consider the truck manufacturer as an OEM. Thus, the product of the business marketer (MRF) becomes a part of the customer's (Tata Motors) product. Usually requirements of OEM customers are large and continuous.

**Users** When a commercial enterprise (i.e. business customer) purchases industrial products or services to support its manufacturing process or to facilitate the business operations, we classify it as a user. The products which support manufacturing process are drilling machines, press, winding machines, and so on, whereas the products which facilitate the operations of business are computers, printers, telephones, and others.

### ***Overlapping of Categories***

Sometimes a manufacturer can be a user and also an OEM. **For example**, a car manufacturer buys a drilling machine to support the manufacturing operation and is referred to as a "user". The same car manufacturer also buys batteries which is incorporated into cars and hence, it can be also referred to as an OEM.

### Government Customers

The largest purchasers of industrial products in India are central and state government departments, undertakings, and agencies, such as railways, department of telecommunication, defence, Director General of Supplies and Disposal (DGS&D), state transport undertakings, state electricity boards, and so on. These government units purchase almost all kind of industrial products and services and they represent a huge market. We shall discuss the government purchasing orientations and practices later in this chapter.

### Institutions

Public and private institutions such as hospitals, schools, colleges, universities, and prisons, are classified as institutional customers. Some of these institutions have rigid purchasing rules and others have more flexible rules. A business marketing person needs to understand the purchasing orientations and practices of each institute so as to be effective in marketing the products or services.

### Cooperative Societies

This category is unique and was a part of the cooperative movement in India. An association of persons form a cooperative society. It can be manufacturing units (e.g. cooperative sugar mills) or non-manufacturing organisations (e.g. cooperative banks, cooperative housing societies).

## CLASSIFICATION OF INDUSTRIAL PRODUCTS AND SERVICES

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There are many methods by which industrial products and services are classified. The method that is most accepted classifies products and services based on how products or services enter the production process, and their relative costs. Based on this method, industrial products and services are classified into three broad groups: (i) materials and parts, (ii) capital items, (iii) supplies and services. Figure 2.2 indicates this method of classification.

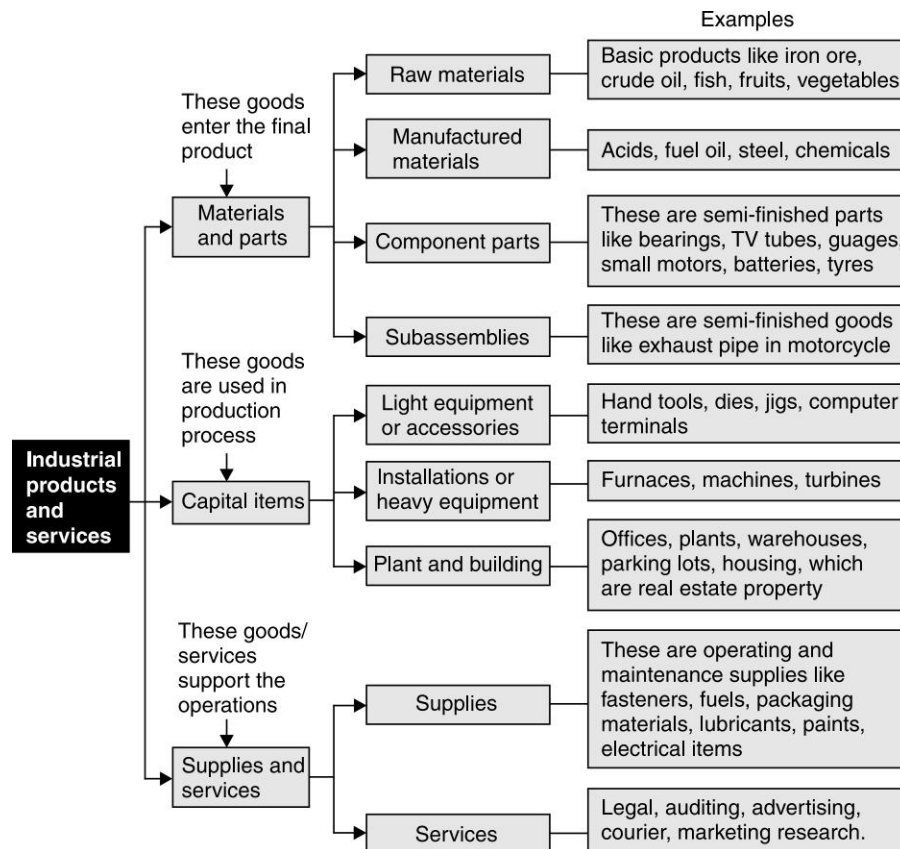
### Materials and Parts

Goods that enter the final (or finished) product consist of raw materials, manufactured materials, and component parts. The cost of these items are treated by the purchasing company as part of manufacturing cost.

**Raw Materials** These are the basic products that enter the production process with little or no alternations. They may be marketed to OEMs or user customers. **For instance**, when a large bakery purchases natural gas to fire the ovens which are used to produce cakes, it is a user customer. When the same firm purchases sugar for processing the cakes, it is an OEM, because sugar is a part of the final product, which is the cake in this case.

**Manufactured Materials and Component Parts** Manufactured materials include those raw materials that are subjected to some amount of processing before entering the manufacturing process. Acids, fuel oil, and steel are the examples of manufactured or processed materials that are the basic ingredients of many manufacturing activities. **For instance**, an aluminium extrusion unit buys aluminium billets to manufacture aluminium extruded products such as door and window frames, by using an extrusion press. Thus, aluminium billets are called manufactured materials.

Component parts such as electric motors, batteries and instruments can be installed directly into products with little or no additional changes. When these products are sold to customers who use them in their production processes, they are marketed as OEM goods. The component parts are also sold to the dealers or distributors (also called “Trade market”), who resell them to the replacement market. **For example**, MICO spark plugs are sold to a truck or car manufacturer (as an OEM), as well as to automotive dealers/distributors throughout India (for replacement market).



**Figure 2.2** Classification of Industrial Products and Services

Subassemblies are typically made and supplied by vendors. Typically in the automobile industry, exhaust pipe is a subassembly for motorcycles and passenger cars.

### Capital Items

Capital items are those which are used in the production processes. They wear out over certain time frame. They are normally treated as “user” customers. Capital items are classified into three groups: (i) Heavy equipment/installations, (ii) Accessories/Light equipment and (iii) Plant and building.

**Installations/Heavy Equipment** These are major and long-term investment items such as general purpose and special purpose machines, turbines, generators, furnaces, and earth moving equipment.



These items are shown in the balance sheet as plant and equipment, and are fixed assets to be depreciated over a period of years if they are purchased outright. However, if these are leased, the cost is treated for tax purpose as expenses by the purchaser. As the unit purchase price of capital items are high, these items are financed by borrowing money for a period of time, which is roughly equivalent to the expected life of the fixed assets.

**Accessories/Light Equipment** Light equipment and tools which have lower purchase prices and are not considered as part of heavy equipment, are power operated hand tools, small electric motors, dies, jigs, and computer terminals. Purchases of accessories are either considered as current expenses with purchase prices taken as operating expenses in the year purchased, or they may be considered as fixed assets and therefore, depreciated over a period of few years.

**Plant and Buildings** These are the real estate property of a company. It includes the firm's offices, plants (factories), warehouses, housing, parking lots, and so on.

### Supplies and Services

Supplies and services support the operation of the purchasing organisation. They do not become a part of the finished product. They are treated as operating expenses for the periods they are consumed.

**Supplies** Items such as paints, soaps, oils and greases, pencils, stationery and paper clips belong to this category. These items are generally standardised and are marketed to a wide cross-section of business users.

**Services** Companies need a wide range of services like building maintenance services, auditing services, legal services, courier services, marketing research services and others.

## MARKETING IMPLICATIONS FOR DIFFERENT CUSTOMER AND PRODUCT TYPES

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In case of **Materials and Parts products**, for large OEMs or users, selling is mostly done directly from a seller to a buyer organisation. However, for smaller volume OEMs and users, the standard raw materials or components are sold through industrial dealers or distributors as it is cost effective. In case the components are custom-made, considerable interaction takes place between technical and commercial persons from both buyer and seller organisations, and obviously selling is done directly. It is therefore, important for a business salesman to remain in close touch with not only purchase or materials department persons, but also with quality, production, R&D, marketing, and accounts/finance persons of buyer organisations as they influence buying or payment releasing decisions. Apart from personal contacts, product leaflets/brochures help a business marketer in communicating product and other information. In case of standard products, the factors which influence buying decisions, with differing share of business for various suppliers, are product quality and performance, delivery dependability, price, payment terms, customer service, and customer rapport. When component parts such as batteries and tyres are sold in the consumer replacement market, marketers either create a product differentiation through consumer advertising (e.g. JK tyre's TV advertisement for radial tyres) or sell on a competitive price basis. For this, advertising and distribution through multiple channels all over the country becomes an important part of marketing strategy.

**For example,** Crompton Greaves Ltd manufactures and markets a wide range of electrical motors ranging from fractional horse power (FHP) to large high tension (HT) motors. The company adopted a marketing strategy to sell its standard motors through a network of dealers to small-scale manufacturers, all over India. However, the special purpose motors to the original equipment manufacturers (OEMs) such as pump and compressor manufacturers, are sold directly through its sales persons located at various branches. The field sales persons are trained in both technical and commercial aspects of selling and are required to establish a close relationship with various departments such as purchase/materials, quality, R&D, marketing, and finance/accounts in the customers' organisations. The company could maintain a leadership position in the competitive market due to its strategy of customer satisfaction through superior product quality and performance, delivery dependability, competitive prices and excellent customer service.

### Marketing Strategy for Capital Items, Supplies and Services

**Capital Items** For capital items, consisting of heavy machinery and construction equipment for factories and office buildings, personal selling with extensive interactions, involving top executives in both buying and selling organisations are very common. Negotiations take considerable time on key factors such as price, return on investment, credit facilities, specifications, delivery period, installation time, third party certificate for previous jobs done, and so on. Personal selling is the primary promotional method used.

**For instance,** the marketing strategy for a large furnace manufacturer was to directly sell its furnaces to the business buyers. As the value of each furnace was running into millions of rupees, it was treated as a capital item by the buyers. Senior executives from marketing, engineering, and finance from the selling organisation not only decided the technical and commercial aspects at the time of submission of quotations/offers, but also visited as a team, for negotiations, with the senior technical and commercial persons from the buyers' organisations. Apart from price, payment terms, delivery and installation time, meeting the technical parameters required by the customers and the performance of similar furnaces supplied earlier to other business customers played important parts in securing high value orders.

**Supplies** For *marketing* supplies, like lubricants and paints, personal selling (i.e. marketing through company's sales persons) is used for large-volume buying firms, and distributors or dealers are used to market to diverse markets consisting of small and medium size companies. The purchase or materials department persons generally make buying decisions based on dependable delivery, price, quality, and locational convenience. Advertising in magazines, trade journals, local newspapers, and yellow pages are used to create an awareness of the company and its products to the potential users and distributors/dealers.

**Services** Marketing strategy for services is more subtle. Buying firms generally contact the selling firms who have reputation by way of word-of-mouth. The selling firm's efforts mostly are on consultative or advisory nature, and continuation of the service depends upon the quality, price, and timeliness of service to meet the customer's needs. **For example,** in 1994–95 a reputed Indian marketing research agency decided to establish a tie-up with an internationally recognised marketing research agency to get updated on the latest techniques, improve its quality of service, and get additional business by using the contacts of its international partner.

## BUSINESS CUSTOMERS' PURCHASING ORIENTATIONS

The concept of purchasing orientations in buying (or customer) firms is similar to the marketing orientations of selling firms (or suppliers). Marketing activities of selling organisations are guided by six competing concepts or philosophies, such as production concept, product concept, selling concept, marketing concept, customer concept, and societal marketing concept. The selling firm's marketing efforts are guided by one of the six marketing concepts or orientations. Similarly, the buying firm's purchasing efforts or decisions are guided by one of the three purchasing orientations or philosophies, as mentioned below.

Business buyers choose one of the three purchasing orientations—(a) Buying, (b) Procurement, or (c) Supply chain management.<sup>1</sup>

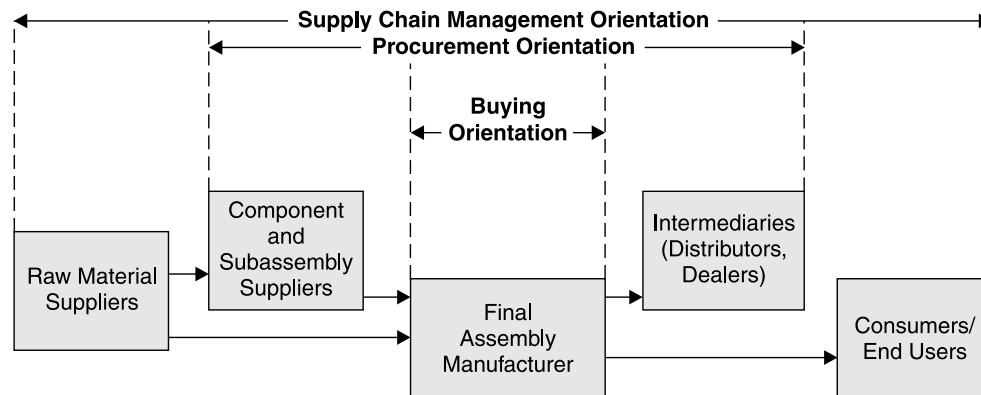
Figure 2.3 shows the three purchasing orientations.

### Buying Orientation

The purchasing firm with buying orientation has a narrow and short-term focus. The buyers, in these firms, follow the practices as under:

**Lowest Price** The buying firm usually selects the lowest price supplier. Quality and availability are the factors that are considered as qualifiers for a supplier to be considered. The buying firm gets the best deal, by inviting the short-listed (or qualified) suppliers for negotiations. The negotiation style used is “I win–you lose”, with buyer and supplier haggling over the price.

**Gain Power** The buying firm gains power over suppliers by using tactics like commodification and multisourcing.



**Figure 2.3** *Purchasing Orientations of Business Customers (or Business Buyers)*

In commodification, buyers argue that there are no differences between various suppliers' offers in terms of technical services, product quality, or product features. Buyers hint that the product is a commodity and price is the only thing to be negotiated.

In multisourcing, the buying firm asks quotations from several suppliers, and after negotiations, places orders with many suppliers, who compete to get more share of the buying firm's purchases.

**Risk** Buyers avoid risk altogether, in order to reduce the chance of criticism and penalisation for making a mistake. The tactics used for avoiding risk are: **(a)** follow the standard purchase procedure established by the company and **(b)** depend on suppliers who have proved their performance earlier. Thereby, the companies generally avoid the risk of buying from new suppliers.

### Procurement Orientation

Here, the purchasing firm has a strategic (i.e. long-term) focus and is proactive. The span of influence of purchasing is more with integration of other activities like order processing, material handling and logistics. The buyers, with procurement orientation, seek both *quality improvements* and *cost reductions*. To achieve these objectives, the company adopts the following practices: **(a)** collaborative relationship with major suppliers and **(b)** working closely with other functional areas.

**Collaborative Relationship with Major Suppliers** This results in quality improvements and cost reductions. For this, both supplier and buyer firms must trust one another to a greater extent, and should agree to share the rewards of working together. The customer (i.e. buyer) and supplier have inter-firm teams who implement “just-in-time” (JIT) delivery scheduling and quality assurance to attain zero defects level. They use “integrative negotiation”, in which it is assumed that resources can be expanded to benefit both buyer and supplier. The integrative negotiation includes focusing on common interests and goals, minimising differences, exchanging information, and seeking solutions to meet the goals and interests.

**Working Closely with Other Functional Areas** This is an important attribute of buyers with procurement orientation. Buyers are involved in describing the specifications of the products or services that the firm is looking for, ensuring quality of purchased goods, and timely availability of products and services. They work closely with their manufacturing group on “materials requirement planning” (MRP) to make sure that goods and services arrive on time.

### Supply Chain Management Orientation

Here, the role of purchasing is further expanded to become more value-adding, and strategic operations. It includes coordination and integration of purchasing function with other functions within the company and also with other organisations in the whole value chain, like customers, customers’ customers, intermediaries, suppliers, and suppliers’ suppliers. The company with supply chain management orientation focuses on how to improve the whole value chain from raw materials to end users. The supply chain management orientation has the three purchasing philosophies: **(a)** deliver value to end users; **(b)** outsource non-core activities; and **(c)** support collaborative relationships with major suppliers.

**Deliver Value to End Users** Using marketing research, the supply managers would understand the requirements of end users and direct the entire supply chain to deliver superior value to end users.

**Outsource Non-core Activities** The top management of the firm identifies the core competences of the company.<sup>2</sup> Thereafter the firm would group its products and services into strategic and nonstrategic systems and subsystems. The firm would outsource those systems or subsystems that have become non-competitive, are nonstrategic, involve mature technologies, and have many qualified suppliers.

**Support Collaborative Relationships with Major Suppliers** The supply managers work with major suppliers in partnering relationships that require cooperation, communication, trust, and commit-

ment between the supplier and customer persons. The objective is to lower total costs, and/or increase value in order to achieve mutual benefits.

One of the **examples** of supply chain management orientation is the automotive industry. Both two-wheeler and four-wheeler companies have collaborative relationships with their respective suppliers to whom they outsource non-core activities like sub-assemblies (e.g. exhaust pipes, handle bars) and component parts (e.g. batteries, instruments, and spark plugs). Both the supplier and buyer firms work together to deliver superior value (i.e. more benefits at lower costs than competitors) to end users.

### Applications of Purchasing Orientation

Through a proper understanding of a business customer's purchasing orientation, a business marketer could gain important insights. **For example**, most government organisations place orders on the suppliers who quote the lowest prices against government tenders. The purchasing orientations in such government firms are typical "buying orientation", asking quotations from suppliers against the product specifications, and placing orders on several suppliers on the basis of lowest prices.<sup>3</sup>

For an **illustration** of procurement orientation, let us consider the case of a Light Commercial Vehicle (LCV) manufacturer. The purchasing orientation followed by the company included identifying major suppliers, forming joint teams from both the buyer and suppliers, working together to improve quality and delivery performance, and to reduce costs. Agreements were made to share the rewards equally. This approach has contributed substantially to the success of the company, in a competitive LCV market.

## PURCHASING PRACTICES OF BUSINESS CUSTOMERS

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The business marketers market industrial goods or services to different types of customers—commercial enterprises, governmental customers, and institutional customers. For effective marketing of industrial products, it is important to know the purchasing practices generally adopted by the various types of industrial customers.

### Purchasing Practices in Commercial Enterprises

The purchasing practices depend upon the nature of business and the size of the commercial enterprise as well as the volume, variety, and technical complexity of the products purchased. In large and medium size organisations, the purchase decisions involve persons from departments like production, materials, quality, finance/cost accountant, engineering, and also senior management executives. Thus, there are many persons influencing purchase decisions in such organisations. Various techniques, such as material planning, supplier rating system, economic order quantity, value analysis, and so on are used by buyer organisations. Materials/purchase managers are professionals who are knowledgeable about price trends, commercial matters, and negotiating skills. They make use of in-house technical expertise when required.

A business marketer must understand a set of formal purchasing procedure and documentation followed in a commercial enterprise. These are illustrated in Fig. 2.4.

<i>Step</i>	<i>Activity</i>	<i>Responsibility</i>
1.	User department initiates the process by issuing purchase requisition (P.R.) or indent for the material required by it to the purchase (materials) department	User department (e.g. Production, Finance, Marketing, R&D, H.R.)
2.	Check if the material required is in stock. If yes, the material (against the P.R.) is issued to the user department and the P.R. is filed, indicating action taken	Purchase department
3.	If the material (required as per P.R.) is not in stock, then identify potential suppliers, get quotations, negotiate, select supplier(s), and issue purchase order (P.O.)	Purchase department (for negotiation and selection, technical and finance departments are also involved)
4.	The supplier (or vendor) acknowledges the P.O.	Supplier (or vendor)
5.	Follow-up with the supplier (if required) on delivery	Purchase department
6.	The supplier despatches the material and informs the despatch details (such as invoice and lorry receipt number and date, invoice value, transporter name) to purchase department	Supplier/Vendor.
7.	On receipt of the material, stores (or receiving department) checks the material against delivery challan and P.O. and issues material receipt report (M.R.R.)	Stores
8.	Quality control (or inspection) department inspects the material and issues inspection report (I.R.)	Quality or inspection department
9.	Purchase department issues supplier invoice along with P.O., M.R.R. and I.R. to accounts department for payment and closes the order if it is executed fully	Purchase department
10.	Accounts department checks all the above documents with P.O. and issues payments to supplier	Accounts (or finance) department

**Figure 2.4** Activity Chart for a Typical Purchasing Process in a Commercial Enterprise (Private Sector)

From the activity chart, it is seen that a typical purchasing process in a large or medium size commercial organisation involves various departments, like technical (R&D, production, quality, industrial engineering), finance or accounts, purchase, stores, and sometimes, for high value purchases and policy matters, senior level executives.

The major tasks (or activities) in the purchasing process are (i) identifying potential suppliers, (ii) negotiating and selecting suppliers, (iii) ensuring right quality and quantity of material at the right time, and (iv) a long-term business relationship with the suppliers.

Many commercial organisations have separated purchasing from manufacturing to form a distinct functional area, on the same level as marketing, production, finance and R&D, called materials or purchase function. The major reason for enhancing the status of purchasing in manufacturing organisations is that on an average 50 to 70 per cent of sales revenue is spent on purchase. Hence, purchasing can improve operational efficiency by saving in material cost, by making available good quality material at the right time, and thus contributing to the company's competitive advantage in the market.

### **E-Procurement/E-Purchasing.**

There is a remarkable growth of business-to-business e-procurement. It is estimated that B2B e-procurement will be 10–15 times larger in dollar rupee volume than B2C buying. Some companies use the term e-purchasing, which means firms purchase goods, services, and information from various online suppliers. These companies have old-fashioned purchasing departments who focus on buying at the lowest cost. However, new and more strategically oriented companies have renamed purchasing departments as “procurement departments” with the main objective of seeking the best value from better and fewer suppliers.

After studying procurement processes at 60 different organisations, including Motorola and American Express, Tim Minahan, a supply chain consultant found that e-procurement reduced material cost by 14 per cent and administrative costs of procurement by 60 per cent, minimised purchasing cycle time by 50 per cent, and increased the ability of procurement departments to identify new suppliers on a global scale.

Electronic markets can be either horizontal or vertical. Horizontal market places are used by buyers to buy indirect items (i.e. items or goods that do not contribute directly to the company's own product), such as MRO (maintenance, repair and operations) items as well as travel and entertainment services. Vertical market places are used by companies to buy direct materials, such as raw materials or component parts, that contribute directly to the company's own product. **For example**, firms that buy and supply components for use in the electronics industry can use [www.coverage.com](http://www.coverage.com), which has a network of over 6000 organisations including IBM, Apple, Intel and Cisco. These market places normally offer a range of exchange facilities, such as auctions, reverse auctions, catalogues, bulletin boards and commodity exchanges to participants. Online auctions, reverse auctions and electronic catalogues are discussed in Chapter 14. However, some more informations are given below:

**Online Auctions** There are a range of specialised auction sites through which buyers and sellers can transact. An auction is a form of exchange in which competitive bidding (i.e. offers at stated prices) drives a sale or purchase. In an auction (also called **forward auction** or **“English auction”**), the seller offers an item for sale to many interested buyers and the sale goes to the buyer who makes the highest bid. Online auctions operate under the same principles and can be conducted on a global scale with noteworthy reductions in transaction costs. Online auctions are particularly used by companies for high-value purchase items.

**Reverse Auctions** In many ways, the reverse auction is an electronic form of the competitive tendering process that is used in many business buying situations. Also called as **“Dutch auction”**, it involves one buyer who invites several prequalified suppliers to bid in a real-time competitive bidding process. Reverse auctions are widely used in aerospace, automobile, electronics, and pharmaceutical industries for high-value orders. Reverse auction can lower the cost of processing products and services by 20 to 30 per cent, but often it is found that the winning bidder provides lower quality of products and services than the existing supplier. Opportunities and risks offered by reverse auctions are shown in Table 2.1.

**Table 2.1:** Opportunities and Risks in Reverse Auctions

	<i>Opportunities/Reasons</i>	<i>Risks</i>
Suppliers	<ul style="list-style-type: none"> <li>• New business</li> <li>• Market penetration</li> <li>• Cycle time reduction</li> <li>• Inventory management</li> </ul>	<ul style="list-style-type: none"> <li>• Low price focus threatens long-term relationships</li> <li>• Competitive bargaining tool for buyers</li> <li>• Offering unrealistic prices</li> </ul>
Buyer's	<ul style="list-style-type: none"> <li>• Reduced purchase price</li> <li>• Lower administrative cost</li> </ul>	<ul style="list-style-type: none"> <li>• Undermine relationship trust</li> <li>• Suppliers less willing for relationship</li> <li>• Insufficient suppliers can cause non-competitive auction scenario</li> </ul>

**Source:** Adapted from Smeltzer and Carr, 2003: “Electronic reverse auctions”, *Industrial Marketing Management*, 32: 481–8.

## Purchasing in Government Units

As mentioned earlier, government units (including central and state government undertakings and public sector units) are the largest purchasers of industrial goods and services. To compete successfully and to get business, a business marketer must understand the complexities involved in selling to government units.

There are many centres where state and central government units buy a variety of products required by railways, department of telecommunications, state electricity boards, state transport undertakings, defence units, and so on. The DGS&D is an agency which finalises the running contracts for various standard products on behalf of the central government. However, other large central and state government units have their own procurement departments with a set of standard terms and conditions to be fulfilled by the suppliers.

Generally, the first step is to get the name of the company and the products registered with the government units. Usually, the procedure of registration involves the submission of duly filled standard forms, product leaflets, and company details properly certified by a chartered accountant. Subsequently, some government units depute their inspectors to inspect the company's manufacturing facilities, and based on the favourable report from the government inspector, the company is registered as approved supplier for those products.

**Competitive Bidding** Government organisations are required to purchase goods and services through the bidding or tender system. There are two types of bidding (or tender) systems: (i) Closed, and (ii) Open.

### *Closed Bidding/Sealed Tender*

For standard products and services, tender notices are advertised in national newspapers, based on which suppliers procure tender papers from the specified government authority after paying a small amount of tender fees or the tender papers are downloaded from the website. The suppliers are then required to submit tender offers in sealed envelopes, duly signed by the person having signing authority, as per the instructions given in the tender papers, by certain specified time and date. After the tender offers are received in the "tender box", the sealed covers are opened at the specified date and time in the presence of the representatives of the suppliers and then the prices, delivery, and other relevant terms are read out for the benefit of those attending the "tender opening".

An illustration of closed or sealed tenders is seen in Fig. 2.5 of India Government Mint's notice of global tender.

<b>India Government Mint</b> (A unit of Security Printing and Minting Corporation of India Ltd.) Wholly owned by Govt. of India Shahid Bhagatsingh Road, Fort, Mumbai—400023. INDIA Tel.: 022-22661735 Mobile: 9969000766 Fax: 022-22661450, Email: mintmumbai@vsnl.net Website: www.mumbaimint.org <b>Notice of Global Tender</b>	
NO.IGM-M/GT/BMCC/2012	Date: 22-12-2007
<b>Global Tender Notice</b>	



India Government Mint. Shahid Bhagat Singh Road, Fort, Mumbai invites sealed tenders comprising Techno-commercial bid and price bid in separate sealed covers for supply of Bi-Metallic Composite Coin Blanks.

<i>Description</i>	<i>Quantity</i>	<i>EMD amount to accept tender</i>	<i>Time for completion of supply</i>	<i>Last date and time for receipt of duly filled and sealed Tenders</i>	<i>Due date and time for opening of Techno-commercial bids</i>
Bi-Metallic Composite Coin Blanks	300 Million Pieces approx. 2315 “MTs”	₹ 200,00,000/- (Rupees Two Crore only) (Twenty Million Rupees only)	52 weeks from the date of clearance of pre-production sample	01-02-2008 up to 14.00 Hrs	01-02-2008 at 15 Hrs

The detailed specification/general conditions contained in the tender document can be obtained from the Cashier, India Government Mint, MUMBAI on payment of ₹ 5625/- (Rupees Five Thousand Six Hundred & Twenty Five only) or USD 155/- (US Dollar One Hundred & Fifty Five only) for the cost of the tender document (including Sales Tax and Surcharge) in the form of Demand Draft drawn in favour of **“India Government Mint (unit of SPMCIL) collection A/C”** from any Nationalized Bank in India in acceptable form. The Tender Documents will be issued till 21.01.2008, up to 1500 hours.

### Tender Conditions

1. Tenders are invited from Manufacturers having minimum 5 (five) years overall experience in making of non-ferrous coin—blanks, having records of successful completion of delivery of non-ferrous coin-blanks worth not less than ₹ 75 crore (₹ 750 million) or 300 million pieces in last five years.
2. Quotations should be valid for 270 days from the date of opening of Techno-Commercial Bids and may have to be extended further if considered necessary by General Manager, India Government Mint, Mumbai. No reasons will be assigned for extension and no withdrawal shall be allowed.
3. The sale of tender documents will be done till 21-01-2008 up to 15.00 hrs. and Mint will not extend the date of opening to facilitate late buyers and it will be at their own risk.
4. No Telex/Fax/Telegram/E-mail of the Techno-Commercial and Price bids will be accepted. India Government Mint, Mumbai is not responsible for Postal/courier delays. The parties have to ensure the submission of completed bids well in time.
5. If the date of tender submission and opening happens to be unforeseen holiday, the same will be postponed to the next working day without any further intimation.
6. The tender document is non-transferable and only the firm to whom the tender is sold may submit quotations.
7. The General Manager, India Government Mint, Mumbai reserves the right to accept or reject any or all tenders wholly or in part or split without assigning any reason. The General Manager also reserves the right to increase or decrease the quantity proposed to be purchased.
8. Purchase and Price Preference, if applicable, shall be accorded to the Central Public Sector Undertakings in accordance with the guidelines issued by the Department of Public Enterprises,

Ministry of Heavy Industries and to SSI units registered with NSIC as admissible under the existing policies of Government of India.

9. Offers received from any bidder shall be summarily rejected on National Security considerations without any intimation to the bidder.
10. All rules, regulations, orders and instructions issued by the Government of India from time to time relating to procurement as intended by this tender shall be applicable.

sd/-  
General Manager

**Figure 2.5** Global Tender—India Government Mint

**Open Bidding/Open Tender** When government organisations require non-standard or complex technical products and services, they use open bidding (or tendering) method. The buying firm may invite offers or bids from limited suppliers who are capable of supplying complex or non-standard products and services. After receipt of bids, discussions are then held first on technical matters to ensure that supplier firms understand and meet the requirements of the buying firm. Thereafter, negotiations are held between the buying firm and the supplier firms on prices, payment terms, delivery period, warranty service, and other commercial terms.

**Reverse Bidding** Here, the buyers set the highest possible bidding price, beyond which the offers will not be accepted. Each supplier is encouraged to offer its price below the set price indicated by the buyer. The lowest price bidder may get the order, without compromising on quality of product and service. **For instance**, Lafarge India, a cement manufacturer, uses this bidding system.

Based on the lowest prices or the lowest landed costs (i.e. after adding to the basic price, excise duty, freight, sales tax, and octroi charges), the orders are released on the lowest bidder (i.e. the supplier who has quoted the lowest price or has the lowest landed cost) if other factors such as technical specifications, delivery period, and payment terms are the same as per tender enquiry. If the value of tender enquiry is small, the orders are placed on one or two suppliers. However, if the tender value is large, maximum share of the total value is decided on the lowest bidder (called L1) and the balance orders are distributed to more than one bidder after other bidders (called L2, L3, L4, etc.) agree to match the lowest price(L1).

There may be small variations in the purchase procedures described above in different government or public sector units, but whatever are the procedures or terms and conditions, the same are indicated in the tender papers.

**Government Contracts** Marketing to government organisations requires a selling firm to understand the types of contracts that may be applicable. These are (i) fixed-price contracts, and (ii) cost-reimbursement contracts. In a **fixed-price contract**, a firm price is agreed without any variation in the price, when negotiation is concluded between the government customer and the supplier firm. If the costs of raw materials and other production inputs go up substantially during the contract period, it may result in loss to the supplier. However, if the selling firm can reduce costs to a large extent, profits may go up more than when contract was negotiated. In a **Cost-reimbursement contract**, supplier firms are reimbursed for allowable costs that are incurred in performing the contract. These contracts are typically employed for government projects which involve a lot of developmental work for which it is difficult to estimate efforts and costs. Another method used for complex projects by government organisations is called negotiated contract.

In most countries, government organisations are major buyers of goods and services<sup>4</sup>. Typically government organisations ask suppliers to submit bids or proposals for goods and services and generally award the contract to the lowest price bidder. Suppliers often complain about excessive paperwork, regulations, corruption, and decision-making delays in government organisations, whose spending decisions are subject to public review. Then why would any supplier want to do business with government units? The reasons are that government organisations buy goods and services of large value (they are the largest customer), the payments of bills are assured (cheques are not bounced), and in a closed bidding, the purchasing system is transparent.

**Sales Strategy for Government Business** Suppliers who pursue government business follow specific strategies. These firms set up a separate team or department for marketing their products and services to government organisations. The sales and marketing persons in the government business team are trained to understand complex commercial terms like risk-purchase clause, liquidated damages (LD) clause, and special payment terms<sup>5</sup> (see Chapter 12). In addition, they monitor government needs and projects or tender notices, involve in product specification phase of new product buying process, obtain competitors' information, and prepare quotations or bids cautiously showing enough attention and thought. In short, these sales and marketing persons become experts or specialised in handling government customers.

### Institutional Purchasing

Institutional buyers are either the government or the private organisations. If it is a government hospital or college, it normally follows the government purchase procedures. However, in cases of privately-owned educational or other types of institutions, the purchase procedures are similar to those followed by commercial enterprises described earlier. A business marketer should study the purchasing practices of each institutional buyer so as to be effective in marketing the company's goods or services.

### Purchasing in the Reseller's Market

Reseller market (also called *replacement market*) consists of business dealers or distributors whose main goals are profits and sales volume. Hence, the dealers/distributors (called intermediaries, or middlemen or traders) select a supplier based not only on product quality but also on the policies of the supplier's products and services.

A business dealer/distributor could deal either exclusively with a supplier's (or manufacturer's) product or may deal with many competing firms of a product. However, the supplier related policies which affect competitiveness of traders in the market are: sharing of local advertising cost by the supplier, providing product leaflets or display materials, competitive prices and trade discounts, flexible payment terms with credit facility, and so on. Acceptance of some of these terms by a dealer would depend upon the relative strengths of the dealer and the supplier and also on the customers' acceptance level of the supplier's products.

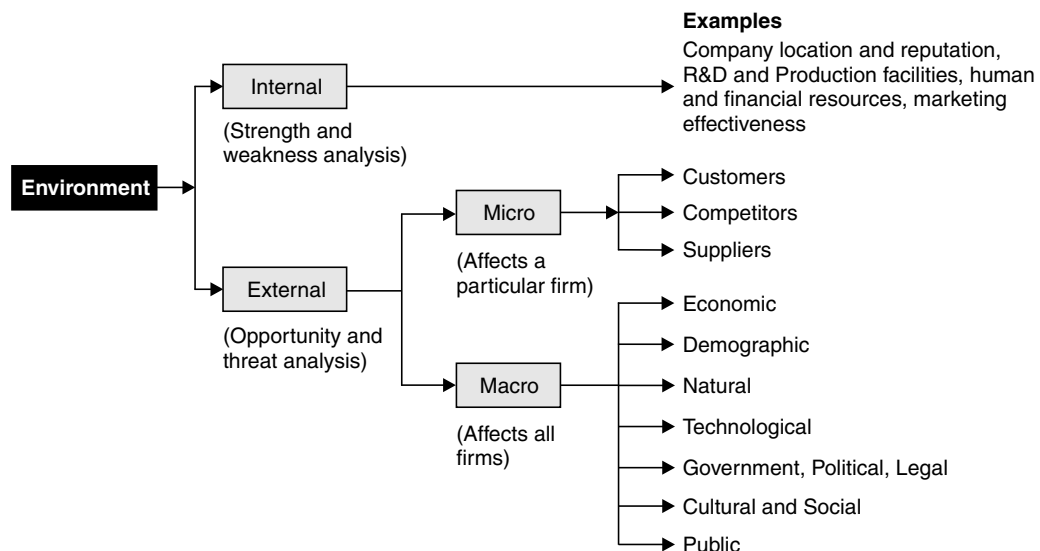
The reseller or the dealer/distributor has to ultimately abide by the policies of the supplier/manufacturer. In a competitive market, both the reseller and the supplier have to work harmoniously as a team so as to beat the competition, increase the business share, and make reasonable profits. If a reseller (or a trader) does not make a profit over a period of time from the products or services of a manufacturer/supplier, he would most probably change the supplier because the main goal of profitability is not achieved.

## Purchasing in Cooperative Societies

This is similar to institutional purchasing. Business marketers should study the purchasing practices of each cooperative society in order to be effective in marketing their goods and services. **For example**, the cooperative sugar factories in the states of Maharashtra and UP may adopt different buying practices while purchasing sugar machinery, pumpsets, compressors, etc. While making purchase decisions, their emphasis on factors such as quality, delivery, price, payment terms, service and long-term relationship with suppliers, may vary from each other.

## ENVIRONMENTAL ANALYSIS IN BUSINESS MARKETING

Environmental analysis is required as one of the important steps for developing strategic (or long-term) planning and also for short-term marketing plan.



**Figure 2.6** Types of Environment

All firms—buyers, suppliers, competitors, and marketing intermediaries—operate in macro-environmental factors (or forces). There are two types of environment: (i) internal, and (ii) external. These are shown in Fig. 2.6.

**Internal Environment** The purpose of carrying out the **internal environment analysis** (that is, internal company analysis) is to identify periodically the specific strengths and weaknesses of a company. This involves an analysis of all the factors of a firm, including marketing, finance, R&D, manufacturing, organisation structure, and human resources, as shown in Fig. 2.6.

**For instance**, an industrial firm manufacturing and marketing material handling equipment, recruited in February 1994, a senior marketing executive to head its marketing function. The first task given to the marketing head was to prepare a marketing plan for the following year (1994–95) and the time available to complete the task was one and a half months. As a part of marketing plan, the head of

marketing did the strengths and weaknesses analysis by looking at the important internal environment factors like marketing effectiveness (market share, product quality, customer service, pricing policy, sales-force capability, and geographic coverage), production facilities (technical ability, timely production, production capacity, and productivity), financial resources (liquidity, profitability, and cash flow), human resources (dedicated or motivated employees, flexible or responsive organisation structure, leadership at various levels, training needs, and team work). He talked to the employees of various departments, some of the branch sales persons, customers and suppliers; analysed the past performance and then came up with the company's strengths and weaknesses based on the internal environment (or company) analysis. Internal environment analysis (or internal company analysis) is also a part of strategic planning process which is covered in Chapter 13.

**External Environment in Business Marketing** Successful companies recognise the importance of continuously scanning (or monitoring) the external environmental factors. Both macro and micro external environmental factors change continuously. These changes spin out new opportunities and threats. Based on the analysis of the external environmental factors and the resulting opportunities and threats, business firms determine their objectives and strategies. It is important for a business firm to understand that all the environmental factors are not relevant and hence, each firm should identify the relevant environmental factors for its business and monitor the relevant environmental factors. It is not adequate to analyse and measure the current status of the relevant environmental factors. It is required that the future estimates or forecasts (or trends) of economy, technology, market demand, government regulations, etc. are made. These forecasts are used as the basis for strategic planning and short-term marketing plans.

The *time-horizon for environmental scanning* is approximately twice the duration of a company's planning period. **For example**, if a business firm is developing a short-term plan of one year, the environmental scanning period is two years. Similarly, if a firm has a strategic planning for five years, the environmental scanning period is ten years.

The *responsibility for environmental analysis*, including forecasting the future trends is generally shared by the corporate planning department and senior line managers. Some business firms seek help from management consultants to get expert opinions.

The *sources of information on environmental factors* are (i) business press, (ii) government publications, (iii) trade journals, (iv) professional publications, and (v) the internet. These publications are distributed among the line managers and corporate planning executives, who make brief notes on relevant environmental factors. These notes are discussed in a group of senior executives to identify the relevant environmental factors and the trends to be monitored in future. The other sources of information such as sales representatives, business customers, dealers, distributors, and trade associations are also considered for collecting information on environmental factors.

### The Micro Environmental Factors

The micro environmental factors (or forces) shown in Fig. 2.6 consists of customers, competitors, and suppliers. These forces affect individual firms differently since each firm has different set of customers, competitors, and suppliers. It is important for business marketers to understand the changes in their customers' needs and goals, competitive conditions in the customers' industries as well as changes taking place in the environmental factors of customers. This is particularly applicable when a business firm selects its target market segments.

**For instance**, in 1986 the marketing head of a precision tube manufacturer discussed with his regional and branch managers the draft marketing plan for the year 1986–87. After evaluating various market segments, they decided to focus their marketing efforts on two out of six segments. These were bicycle and automotive. However, within four months of finalisation of the marketing plan, the Ludhiana branch manager reported recessionary trends in bicycle market segment as the main reason for the decline in sales in Ludhiana. The marketing head rushed to Ludhiana to talk to major bicycle manufacturers such as Hero Cycles, Avon Cycles, and Atlas Cycles. The recessionary trends had been noticed in the domestic and export markets of bicycle industry for the previous six months, but the Ludhiana branch was not aware earlier of the changes taking place in the economic environment and the needs of the bicycle market. This happened because the branch sales people did not talk to customers' marketing, production, and finance department persons. By talking only to the purchase department persons, the branch sales people could not understand the changes taking place in the customers' needs and the environmental conditions. The marketing head had to make major changes in the marketing plan due to the unexpected drop in sales from bicycle segment, which was one of the target segments.

**Competitors** In today's markets, understanding competition is as important as understanding customers. A business marketer needs to gather information on competitors' strategies, objectives, strengths and weaknesses, and reaction patterns. The company marketing executives should be able to obtain a complete and reliable information about competitors. Competitors' information influence the decisions on the various elements of marketing strategy like target market segments, pricing, product mix, distribution, and so on. Consider the case of Crompton Greaves company, as an **example**:

Electric motor industry is a highly competitive industry. Crompton Greaves (CG) is one of the major players in the industry. The company has a wide variety of electric motors ranging from fractional horse power (FHP) to large high tension (HT) motors. The company faces severe competition from small-scale manufacturers in small range of motors up to 20 H.P. In the medium or large range of motors, the competition is mainly from large Indian firms like Kirloskar Electric Co., as well as from multinational companies such as Siemens and ABB. The marketing manager of CG was finding difficulty in getting relevant competitive information from the field sales engineers on regular basis. He, therefore, devised formats for field visit report (FVR) and monthly branch report (MBR) to ensure that the sales engineers and branch managers find out the information about competitors from customers, dealers, trade journals, newspapers, and report the same in FVR and MBR. In the divisional head office, the marketing manager gave the responsibility of collecting, monitoring, analysing, disseminating the information on external environment to a marketing services executive. The streamlining of the competitive information system along with information on customers, and other relevant macro environment factors, such as economic, technological, and legal, helped the marketing manager to take effective marketing decisions on pricing, product development or improvement, sales force, and target markets.

**Suppliers** Raw materials, component parts, and capital goods are supplied by supplier firms to buyer firms as inputs for the use in production of goods and services. The survival and success of both supplier and buyer firms depend on their (a) interdependent relationship, (b) commitment to quality of products and services, and (c) knowledge of external environmental factors. Any interruptions in the flow of inputs like raw materials affect the entire business chain.

**For example**, in 1970s and 80s, the labour unrest affected production and marketing in many business firms in India. One of the heavy commercial vehicle manufacturers did not get the supplies from the spark plug manufacturer for one week, which resulted in accumulation of unfinished trucks all over the factory. The distributors and the ultimate consumers, who had paid advance amount, started getting anxious and restive. The chief executive officer (CEO) of the truck manufacturer spoke to the director of the spark plug manufacturer. The director of the spark plug unit resolved the problems of the workers, who had gone on an indefinite strike. The production and supplies of spark plugs resumed, but the labour unrest resulted in the loss of production, sales, customer confidence, and profits.

## Macro Environmental Factors

These factors are as follows:

**Economic** Changes in economic environment needs to be monitored as it affects the willingness and ability of business organisations to buy and sell. If business marketers serve domestic and international markets, it would be necessary for them to examine the changes in the economic environment, both at home and overseas markets. The various *economic factors* that need to be monitored are business cycle, purchasing power, prices, interest rates, currency rates, fiscal policies, investment, industrial production, and so on.

It is interesting and sometimes confusing, when some of the predictions of world economy made by different international agencies are contradicting. **For instance**, in its report dated Jan 11, 2007, the United Nations predicted a deceleration (or slowing down) of the world economy in the year 2007, after three straight years of growth. However, International Monetary Fund (IMF) chief said on Jan 17, 2007 that global economy was in good health and predicted a strong performance of 5 per cent growth. One must go through these reports carefully and draw conclusions based on the analysis of various factors like oil prices, inflation and the US housing market.

If the economy shows recessionary trends, the consumers will have a lower purchasing power to buy consumer products. As a result, due to the derived nature of industrial demand, the demand for industrial raw materials, components, and capital goods will decrease. However, the demand for industrial goods and services does not get affected equally due to the change in economic conditions, and that there is a variation in the degree of impact among various industrial products and services.

**For example**, during the recessionary period in the Indian economy—from 1996 to 1998, the demand for capital goods, steel, and aluminium fell much more than other goods such as computer software, paper, chemicals, and pharmaceutical. Hence, business marketers, marketing their goods and services to many business market segments need to find out the degree of impact of demand recession in their market segments.

**Demographic** Business firms should not fail to consider changes in demographic environment. Because of the derived nature of industrial demand, changes in population can have an impact on the demand for industrial goods and services. **For instance**, the demand for steel will increase substantially, if population increases considerably in the emerging economies like India and China. Increased population will need more durable products like washing machines, refrigerators, and automobiles, which require steel for production. However, population growth is uneven, with slow rate of increase in some countries like Sweden, U.K., and Germany, and faster rate of growth in population in countries such as India, Mexico, and South Africa<sup>6</sup>. Business firms should collect the data on population, develop and monitor the trends, and use this information for short-term and long-term planning.

**Natural** Worsening of the natural environment like air and water is one of the major anxieties. There are major concerns about air and water pollution, depletion of ozone layer due to certain chemicals, and shortage of water and raw materials.

Air and water pollutions have reached dangerous levels in many world cities. Business organisations manufacturing chemicals and pesticides pose serious threats to environment due to discharge of untreated wastewater. Governments and courts in most countries have tightened safety and environmental regulations to force the defaulting firms to take corrective measures. **For example**, Delhi High Court, in its judgment in 1997, asked a number of factories to close down as they failed to treat the liquid waste discharged from their factories. According to the World Bank report<sup>7</sup>, India's small and medium enterprises (SMEs) contribute 70 per cent of the total industrial pollution. The report stated that aluminium, cement, copper and distilleries, iron and steel, leather and pesticides were the most polluting industries.

Shortage of water has already become a political issue. Limited renewable resources like food and forests should be used wisely, otherwise they can be a major problem. Companies making products that use scarce nonrenewable resources, such as coal, oil, zinc, silver, and platinum may face considerable cost increases. However, such firms have excellent opportunities to develop substitute materials by using their research and development activities. In the book “**Natural Capitalism: Creating the Next Industrial Revolution**”, authors<sup>8</sup> have asked the organizations to practice a new type of industrialism that will not only create jobs and profits, but also save the environment.

**Technological** Technological developments and changes have major impact on both business buyers and sellers. There are rapid technological changes in some of the industries such as telecommunication, computers, and semiconductors. Technological breakthrough can affect markets by starting new industries (e.g. computer software) and radically change (or virtually destroy) existing industries (**for example**, calculators destroyed slide-rule industry).

Rapid changes in technology are forcing business firms to (i) recognise limit to their existing technologies, (ii) know which new technologies are emerging, and (iii) decide when to incorporate new technologies in their products. There is also a need for working like a team among marketing, R&D, production engineering, and manufacturing for responding effectively to the technological changes.

**Governmental, Political and Legal** As the global competition increases, business marketers have to understand the actions of their governments as well as those of the governments around the world. The major functions of the governments are to protect the consumers, companies, and the society from unfair business practices and guide their industries towards growth. These functions are achieved by the governments through political and legal systems.

**For example**, the government of India had served notices to the domestic pharma company Cipla to pay ₹ 193 Crore (₹ 1930 million), for overcharging of five drugs between August 2003 and March 2006. The company had challenged the inclusion of these drugs within the ambit of price control. Supreme Court permitted the government to recover 50 per cent of the amount they claimed to have been overcharged.

**Another illustration** of protecting small and tiny enterprises from large companies is the bill passed by the Indian Parliament, called micro, small and medium enterprises development (MSMED), in June 2006. As per this act, large companies that source inputs from small and tiny enterprises will now have to pay up within 45 days of procurement, irrespective of any written agreement between the two. Large scale enterprises will have to pay an interest rate of about 18 per cent on delayed payments to micro, small, and medium enterprises.



Business marketers are benefited by anticipating and influencing government actions. Before governmental regulations and laws are enacted, the captains of industries can influence governmental actions by discussions with the concerned ministry through industry associations like Confederation of Indian Industries (CII) and Federation of Indian Chamber of Commerce and Industries (FICCI).

Political environment includes the stability of governments, their policies towards business and international trade. In many countries, protection against foreign imports is brought about through use of import tariffs or imposition of artificial barriers or enacting anti-dumping laws.

**For instance**, the US imposed unilaterally Super 301 sanctions against certain countries on the pretext of 'human rights violations'. In India, Competition Act, 2002 was passed by the parliament, replacing Monopolies and Restrictive Trade Practices (MRTP) Act. The Competition Commission of India (CCI) is implementing the competition law. CCI Chairman expressed in an interview that the enforcement of the provisions regarding anti-competitive agreements and abuse of dominance would promote competition in the market and would benefit companies as well as the ultimate consumer. On August 17, 2011, CCI has slapped a penalty of ₹ 630 crore (US \$115 million) on a real estate company for unfair practices, abuse of market dominance and a brutal disregard of consumer rights relating to a housing project. One more **example** is: Japan imposes 15–20 per cent commodity tax on sales in Japan, which is waived for exports from Japan.

**Public** It consists of various groups who help or hinder a business organisation's effort to serve its markets. Some of these groups are press, institutional investors (or financial institutions), shareholders, banks, public interest groups, and general public.

Press (mass media) is capable of publishing news that can help or hinder the reputation of a business firm. **For example**, Anubhav Plantation company received negative publicity in the press when the company's senior executives were arrested for not honouring the payment commitments to its customers. Similarly, in 1998, the Unit Trust of India (UTI) received negative publicity in the press and TV for its most popular "US-64" scheme.

Institutional investors like Life Insurance Corporation (LIC) and UTI who buy shares of a firm, exert influence on the management of the firm if they are not satisfied with certain policies of the firm. **For instance**, in January 1999, Tata group's proposal to enhance its shareholding in ACC (Asbestos Cement Company) through preferential issue was successfully opposed by domestic financial institutions led by Industrial Development Bank of India (IDBI) to protect the rights of minority shareholders.

Business firms consider the objections or interests of public interest groups while developing firms' long-term objectives and strategies. The public interest groups seek to protect the ecological environment (such as air and water), women's rights, or child labour and other such interests. **For example**, Cogentrix Power Project in Karnataka State had to face stiff resistance from the environment protection groups. Many tannery units in Kanpur faced protests against child labour from public interest groups.

The general public does react, when a large population gets affected. **For example**, when the industrial accident occurred at Union Carbide in Bhopal due to the leakage of deadly methyl isocyanate, the company had to wind up its operations in India and pay compensation to the victims of the gas tragedy.

**Cultural and Social** The impact of changes in cultural and social environment is felt more for consumer markets than business markets. However, if business firms decide to have joint ventures with foreign companies or decide to set up factories abroad, there is a need to study the cultural and social aspects of the societies in those countries to ensure better compatibility.

## Strategies for Managing External Environment

Effective use of marketing mix-variables such as product, place, price, and promotion are not adequate for the survival and success of business firms in a dynamic external environment. The first step is the continuous gathering and monitoring of information on the relevant external environmental factors. This is done by (a) collecting information on customers and competitors through marketing and field sales persons and use of the internet, (b) analysing trade and government publications, and (c) carrying out marketing research and economic forecasting within or through external market research agencies. These actions would help the company to (i) understand changes in customer needs, (ii) monitor competitors' actions and strategies, (iii) identify technological innovations, (iv) consider the changes taking place in governmental, political, and legal factors, (v) identify changes in demand of major customers and the total market, and (vi) consider the changes in any other relevant environmental factors. A continuous monitoring of the external environment will spin out new opportunities and threats which need to be identified. The following three strategies are available to respond proactively and creatively for managing the external environment.

**Independent Strategies** These are the independent efforts of a business firm by using its own resources (or strengths). There are several examples of independent strategies depending upon an organisation's initiative and strengths. To overcome a competitor's strategy of price cuts, a firm pursues an aggressive pricing by undercutting the competitor's prices, or differentiates its product superiority through product development. To meet the public concern for ecological environmental protection, a firm carries out environmental controls and creates awareness through corporate image advertising. To take care of political or legal regulation on protection to public sector firms or government undertakings, it uses the influence (lobbying) of local MLAs or MPs. If the demand for its products is too inadequate in a certain geographical area in relation to the cost of marketing, a firm may decide to demarket (not to market) in that area.

An **example** of an independent strategy can be given about the Aditya Birla group, which decided to set up viscose staple fibre (VSF) plant in China, when its group company Grasim's Nagda plant was faced with water scarcity. This strategy helped the group to cater to the huge demand for VSF from the Chinese market<sup>9</sup>.

**Another illustration** of independent strategies to overcome global competition is by Indian software service suppliers, who added consulting expertise to meet the changing needs of their clients<sup>10</sup>. Infosys set up a consulting subsidiary, called Infosys Consulting, and roped in senior professionals from leading consulting firms. Wipro acquired US-based, NerveWire, a mid-size business and IT consulting firm. Similarly, Cognizant acquired Fathom Solutions, a consulting company and Mphasis group acquired Princeton Consulting. Thus, Indian IT companies have also got on to the turf of IBM, Accenture, and others, who offer technology and business solutions to meet their clients' needs.

**Cooperative Strategies** In these strategies, a business firm cooperates with other firms, industries, or groups in the environment. **For example**, industry associations such as Confederation of Indian Industries (CII) and Federation of Indian Chamber of Commerce and Industries (FICCI) protect the Indian industries from unfair political or legal regulations of the government. **For instance**, in 1993/94, Bombay Club at Mumbai and Windsor Club at Bangalore were formed by certain leading business firms to protect Indian industries from unfair business practices, tariff differences, and to decide how to meet and survive international competition as a result of the liberalisation policies of the Indian Government. The Japanese firms, while competing fiercely in the domestic market, cooperate with the

same competing firms while exporting to foreign markets. Some Indian firms operate with implicit or explicit understanding on pricing with competing firms, and thus form price syndicates or cartels, which is illegal.

Both Yahoo and Microsoft's internet unit, MSN, compete and also follow cooperative strategies (i.e. co-opetition), in order to take advertising revenues away from more established media, including television. Both web portals have a common goal of increasing their online advertising share of the total advertising budgets of large advertisers.

**Strategic Planning** A business firm carries out strategic planning by identifying long-term product/markets, based on its forecasts of external environment, analysis of its strengths and weaknesses, and its long-term objectives and goals. This would help a business firm to take strategic decisions on diversifying through "backward", "forward" or "horizontal" integration or by expanding its markets from domestic to international markets.

In **backward integration**, a company seeks ownership or control of its supply system. **For instance**, Crompton Greaves went for backward integration by setting up its manufacturing plant for steel stampings, which were earlier supplied by GKW.

In **forward integration**, a company seeks ownership or increased control of its distribution systems. A material handling company, **for example**, opened its own branches with warehousing facilities, in place of its agents, in order to improve customer service.

In **horizontal integration**, a company seeks ownership or control of some of its competitors. **For instance**, VIP company reduced competition by acquiring the management control of some of its competing firms.

## SUMMARY

In this chapter, the business customers are classified into four groups—commercial enterprises, government customers, institutional customers and cooperative societies. The industrial goods and services are also classified into three broad types—materials and parts, capital items, and supplies and services. The various types of business customers and products have certain marketing implications. The purchasing practices of business customers vary for different types of customers and it is important that business marketers understand the purchasing practices followed by their major business customers.

Selling firms wanting to market products and services to government organisations should understand different types of contracts, such as fixed-price, cost-reimbursement, as well as complex commercial terms like risk-purchase clause, and liquidated damages (LD) clause.

Environmental analysis (or SWOT analysis) is required for developing strategic plan as well as marketing plan. All firms operate under macro environmental forces or factors, which include economic, demographic, natural, technological, government, political, legal, cultural, social, and public. There are two types of environment: (1) internal, and (2) external, which are further divided into microenvironment (consisting of customers, competitors, and suppliers), and macroenvironment. Business marketing firms need to identify the relevant macroenvironmental factors affecting their businesses. The major problem faced by all firms is that external environmental factors keep on changing and hence, difficult to manage. The three strategies available for managing the external environmental factors are independent, cooperative, and strategic planning.

**KEY TERMS**

- Buying orientation
- Closed/sealed tender
- Commercial enterprises
- Cooperative societies
- Dutch/Reverse auction
- E-Procurement/E-Purchasing
- Forward/English auction
- Institutional customers
- Macro and micro environment
- Open tender/bidding
- Original Equipment Manufacturer (OEM) customer
- Procurement orientation
- Reverse bidding
- Strategic planning
- Supply chain management orientation

**Note:** Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. Explain with an example an OEM (Original Equipment Manufacturer) customer and how an OEM customer is different than a user customer?
2. What are the major differences between supply chain management orientation and buying orientation?
3. How purchasing practices in private sector commercial enterprises differ from purchasing in government organisations?
4. Why companies carry out environmental analysis? Mention major micro and macro environmental factors or forces.
5. Explain the strategies used for managing external environment.
6. Explain the difference between forward and reverse auctions.

**OBJECTIVE TYPE QUESTIONS**

1. Business customers are classified into commercial, institutional, cooperative societies and one of the following: (a) household, (b) individual, (c) government, or (d) none of them.
2. A tyre manufacturer, who sells tyres to a truck (heavy commercial vehicle—HCV) manufacturer, would classify the truck manufacturer as a: (a) user, (b) OEM, (c) intermediary, or (d) institutional customer.
3. Components, such as bearings and batteries which enter the final products of customers are classified as: (a) materials and parts, (b) capital items, (c) supplies, or (d) none of them.
4. A buying firm with the characteristics of selecting the lowest bidder, trying to gain power over suppliers, avoiding risk, and having a short-term focus has one of the following purchasing orientations: (a) procurement orientation, (b) buying orientation, or (c) supply chain management orientation.
5. Purchase orders in government organisations are usually decided based on the suppliers' offerings of (a) superior quality product and service, (b) shortest delivery, (c) lowest prices, or (d) all of them.
6. Business firms carry out environmental analysis mainly for the purpose of: (a) strategy implementation, (b) performance control, (c) planning, or (d) none of them.

7. Micro environmental factors include customers, competitors, and one of the following: (a) government, (b) shareholders, (c) intermediaries, or (d) suppliers.
8. Macro environment factors affect: (a) all firms, (b) a particular firm, (c) a few firms, or (d) none of them.
9. Government contracts usually have commercial terms that are described as: (a) lenient, (b) easy, (c) complex, or (d) none of them.
10. Strategies available for managing external environment are independent, cooperative, and one of the following: (a) diversification, (b) strategic planning, (c) focus, or (d) differentiation.

### APPLICATION QUESTIONS

1. Can a customer be classified as an OEM as well as a user customer? Explain with an example.
2. What distribution strategy should be followed by a company, which is marketing tyres to OEM customers and replacement markets and why?
3. A major electrical equipment (like power transformers and switch-gear) manufacturer tried to have collaborative relationships with high business potential government organisations like state electricity boards. What are the possibility of success of this strategy? Explain the reasons.
4. How should India's small and medium enterprises (SMEs), which contribute 70 per cent of the total industrial pollution, not only create jobs and profits, but also protect natural environment?
5. What are the relevant macroenvironmental factors for a major information technology firm like Infosys? What would happen if the firm stops monitoring these macroenvironmental factors on a continuous basis?
6. Discuss: "Why should a business marketer classify industrial products and customers?"

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## CASE 2.1

### HK Electroplating Company Ltd: Environmental Issue<sup>\*</sup>

When HK Electroplating company started the electroplating operations in a residential location in Bangalore in 1989, it received a notice from the Pollution Control Board to instal the effluent treatment plant within 15 days, failing which they would seal the plant.

The director of the company, collected the information that it would cost about ₹ 5,00,000 to buy an effluent treatment plant, an area of about 600 sq. feet to instal it over a period of 2–3 months, and running cost of about ₹ 20,000 per month for the purchase of materials like caustic soda and others. The effluent contained nickel, cyanide, chromium, cadmium and zinc, which were to be treated separately using different chemicals. After effluent liquid of about 800 litres per day was treated, the sludge was to be dried, packed, stored, and dumped in a government notified place. The entire process would not only cost substantial amount, but also would need additional area of about 600–700 sq. feet.

The company gathered information that some of the competitors outsourced the effluent treatment to government approved agencies, who collected the effluent liquid from these chemical and electroplating factories, and treated (or neutralised) the chemicals at their effluent treatment plants. These agencies charged ₹ 5 to ₹ 10 per litre for treatment of effluent liquid, depending on the type of chemicals. The cost of outsourcing was considered much higher compared to in-house effluent treatment plant. However, HK Electroplating company, like many other chemical and electroplating factories did not have additional area for the installation of effluent treatment plant.

The director was aware that the liquid waste from the factory would have harmful effects on the surrounding residential area. He also could not violate the government regulation on environment control. The director had very little time—two weeks—to decide and act.

### Question

1. If you were the director of the company, what would you do and why?

## CASE 2.2

### Star Material Handling Company Ltd<sup>\*\*</sup>

In the first week of July 1997, Ashok Kumar, Marketing Manager of Star Material Handling Company Ltd (SMHC) was analysing the marketing performance of the first quarter (i.e. April 1997–June 1997) period. He was preparing himself for the performance review meeting with the Managing Director, scheduled in the second week of July 1997. Mr. Kumar was concerned to note that the orders received in the first quarter for a range of material handling equipment were ₹ 3.50 crore (i.e. ₹ 35 million) compared to the budgeted figure of ₹ 5 crore (₹ 50 million), that is, a drop of 30 per cent. When he compared the actual orders received during the same period for the previous year (i.e. April–June 1996), the

<sup>\*</sup> This case was prepared by Prof. Krishna K. Havaladar based on the case data provided by Rasheed Ahmed, Rajeev Samuel, Ranjana, and M. Rajkumar, MBA students of Alliance Business Academy, Bangalore.

<sup>\*\*</sup> This case was prepared by Prof. Krishna K. Havaladar for classroom discussion. It does not indicate an effective or an ineffective handling of business situation.

present order input was lower by 8 per cent. Besides, receivables (debtors) from customers had gone up to 65 days from the previous quarter figure of 35 days. Mr. Kumar wondered whether the unfavourable performance was due to the changes taking place in the external marketing environment, and if so, how to manage the same.

### The Company

SMHC was one of the major manufacturers of material handling equipment in India. The range of equipment manufactured were used for in-plant material handling by almost all industries. The product classification was “capital item”, with unit prices ranging from ₹ 20,000 to ₹ 9,00,000, depending on the type of equipment. The life of the equipment varied from five years to 15 years, depending on how the equipment was serviced and used. Most of the equipment were non-standard, and were made as per customers’ requirements. The application details of the in-plant equipment manufactured by SMHC, in technical collaborations with a Danish firm and a Canadian company, were as shown in Exhibit 1.

### Exhibit 1 Products or In-plant Equipment

<i>S.No.</i>	<i>Applications</i>	<i>Type of Equipment</i>	<i>Collaborations with</i>
1.	Loading and unloading raw-materials, components, and finished products into the lorries [i.e. light commercial vehicles (LCV) and heavy commercial vehicles (HCV)]	<ul style="list-style-type: none"> <li>▪ Dock levellers—mechanical and hydraulic types of different sizes</li> <li>▪ Hydraulic lift tables and elevating docks of various sizes</li> </ul>	Canadian firm
2.	Transportation of materials and components on the shopfloors and warehouses	<ul style="list-style-type: none"> <li>▪ Manual and electrical pallet trucks and platform trucks</li> </ul>	Danish firm
3.	Stacking raw materials and finished goods in warehouses	<ul style="list-style-type: none"> <li>▪ Manual, semi-electric, and electric stackers</li> </ul>	Danish firm

### Sales and Services

SMHC had its factory located near Hyderabad. The marketing head office and all other commercial and technical departments were located at the factory. The field sales and service operations were carried out through employee-controlled branches (at Delhi, Mumbai, Baroda, Bangalore, Coimbatore, and Hyderabad) and agent-controlled offices (at Chandigarh, Lucknow, Kolkata, Indore, Pune, Vizag, and Chennai). The responsibilities of the branch sales persons were to (i) give effective pre-sales and post-sales service to customers; (ii) generate enquiries, submit offers, negotiate, and book orders; (iii) collect payments and sales tax forms; (iv) collect and send market information to the head office. The sales and service engineers were given training at the time of induction at the factory, and thereafter, on-the-job training in the field. The customers needed technical information and guidance from the company’s sales engineers. For difficult problems, help from R&D department was sought to give solutions to material handling problems faced by the customers. The domestic sales contributed 90 per cent of ₹ 10 crore (₹ 100 million) sales in 1995–96 and the balance 10 per cent was exported to UK, US, New Zealand, Russia, and Gulf countries. The sales volume budgeted for the year 1996–97 was ₹ 20 crore (₹ 200 million), out of which exports were targeted at ₹ 2 crore (₹ 20 million).

### External Environment

Mr Kumar felt that the economic environment had changed in the past 6 months or so, after finalisation of the company’s budget, since there was a slowing down of investment in new projects. In the previous

two to three years, due to liberalisation and reforms introduced by the Government of India, many new projects came up for expansions/diversifications which helped the company to grow by about 100 per cent compound rate of growth per year. Mr Kumar wondered whether the change in political situation, with the installation of a new coalition government in mid-1996, had contributed to the political uncertainty and slowing down of the economic environment.

Mr Kumar also noticed that receivables from customers had gone up to 65 days from the previous quarter performance of 35 days. This, he thought, might be due to the tight money market as banks and financial institutions had become over-cautious. Many customers were facing financial stringency and were not paying even overdue bills. The standard payment terms of 30 per cent advance and the balance 70 per cent against the proforma invoice were relaxed to accommodate some customers.

### **Competition**

There were two major competitors out of 12 players. Both the competitors had higher market share than SMHC. The two major competitors also had foreign technical collaborations with a German, and a UK firm respectively. The strengths of the competitors were that they had a wider product range which enabled them to give complete solutions to material handling problems. Besides, they were in the industry for a longer duration of time in comparison to about 10 years of SMHC. Compared to the superior product features, and post-sales service of SMHC, the competitors had better product quality as their strengths. Mr. Kumar wondered whether the company had positioned its products correctly.

Mr. Kumar had a week to analyse the marketing environment and the performance of marketing department, and come up with his analysis and recommendations to the Managing Director during the performance review meeting.

### **Questions**

1. What were the major factors that contributed to the unfavourable performance of the company?
2. What strategy and actions would you suggest to the company's management to manage the environment and to improve the performance?



# 3

## Organisational Buying and Buying Behaviour

*After studying this chapter you should be able to:*

- Understand organisational buying objectives.
- Gain knowledge of organisational buying process, including different phases in the buying decision process and the types of buying situations.
- Identify the members of decision making units (or buying centres).
- Understand some of the models of organisational buying behaviour.
- Know how organisational buyers choose and evaluate suppliers.

For developing effective marketing strategy, business marketers need to understand not only the nature of business buying but also the business (or organisational) buying behaviour.

Buying (or purchasing) is the other side of the business marketing coin. Just as business marketers seek customers, so the business buyers seek suppliers or vendors. Purchase (or materials) function is an important function or department in an organisation. Purchase department of a firm develops organisational buying objectives and performs certain activities so as to maintain an adequate flow of goods and services into the operations.

### PURCHASING OBJECTIVES

Generally, the **purchase/materials management objective** is defined as buying the right items in the right quantity, at the right price, for delivery at the right time and place. It is the management's problem to define what is "right" for each dimension. The objectives of the purchasing function are briefly stated as follows:

**Delivery/Availability** One of the prime objectives is to ensure that purchased goods and services are available or delivered when and where needed. If not, the work will come to a grinding halt. This will reflect badly on the performance of the purchase function. The corollary to this is that the vendor/supplier reliability in delivery is the most important criterion while evaluating vendors in most of the cases.

**Product Quality** The product quality should be consistent with the specifications and use of the product. It can happen that a product may meet the Indian Standard (IS) or British Standard (BS) specifications, but may fail on the shop-floor when used on a machine. It is important to ensure consistency in product quality to reduce the cost of inspection, interruptions in production process due to rejections, and arranging replacements of rejected material. Hence, product quality is considered as one of the important objectives of purchasing.

**Lowest Price** The buyers would like to buy at the lowest price consistent with availability and quality of the product. The buyers consider price as an important objective if delivery and quality objectives are met, because low price is meaningless, if the product is not delivered when needed or if the quality of the product is unacceptable.

**Services** The business buyers need many types of services accompanying the purchase of goods. These services include (i) prompt and accurate information from suppliers, (ii) application or technical assistance, (iii) spare-parts availability, (iv) repairs and maintenance capability, and (v) training, if required.

**Supplier Relationship** To develop a good long-term supplier/vendor relationship and to develop new sources of supply.

The importance of achieving these purchasing objectives can be understood by the fact that manufacturing firms generally spend more than 50 per cent of their sales revenue on purchases.

Business marketers need to understand that purchasing objectives described above are based on the company objectives. However, the buying members of an organisation are influenced by both purchasing objectives of the firm and personal objectives.

**Personal objectives** of business buyers (or members of buying centres) include (a) higher status, (b) job security, (c) salary increments, (d) promotions, and (e) social considerations (that is, friendship, mutually beneficial relationships, and personal favours).

The business buyers try to achieve both organisational purchase objectives and personal objectives. The business marketers should realise that it is important to satisfy not only the purchasing objectives of a business firm but also the personal objectives of the buying members.

## THE ORGANISATIONAL BUYING PROCESS

The organisational purchasing (or buying) process consist of various phases (or stages) of buying-decision making process. The importance to be given to the various phases will depend upon the type of buying situations. The business marketers should understand both the phases of decision making process and the types of buying situations. Robinson, Faris, and Wind<sup>1</sup> developed eight phases of buying-decision process in business market in 1967, and called the process **Buyphases**.

### Buyphases in the Business Buying-decision Process

Buying is an organisational-decision making process. There are eight phases (or stages) in the buying-decision process, indicating the logical sequence of activities.

#### PHASES IN BUYING DECISION PROCESS

1. Recognition of a problem or need.
2. Determination of the application or characteristics and quantity of needed product.
3. Development of specifications or description of needed product.
4. Search for and qualifications of potential suppliers.
5. Obtaining and analysing supplier proposals.
6. Evaluation of proposals and selection of suppliers.
7. Selection of an order routine.
8. Performance feedback and post-purchase evaluation.

In consumer markets, consumers make buying decisions based on certain mental stages such as problem (or need) recognition, information search, evaluation, purchase decision, and post-purchase behaviour. However, in business markets the buying decision making process includes observable and sequential stages (or phases) involving many people in the buying organisation. Understanding the various phases of buying-decision making is useful to a business marketer as it helps in developing an appropriate selling strategy.

Some researches<sup>2</sup> have suggested that the eight phases of the buying process may not be sequential due to complexity of buying situations. Some phases may be completed in parallel, like determining characteristics and developing specifications. The organisational buying process is influenced by internal factors like changes in company priorities and external environmental factors, such as slowing down of the economic growth and substantial increase in competition.

One question that is often asked: “Is the organisational buying process for services the same as that for physical products?” According to research studies<sup>3</sup>, the buying processes of a product and service are moderately similar. The major differences are as follows: (1) Difficulty in writing specifications for services because of unclear nature of services; (2) Problems in forecasting when certain services will be needed. For instance, a company may not be able to predict accurately when some of the services, such as legal and medical, will be needed; (3) Lack of well developed planning systems, like ERP, for services.

**Phase 1: Recognition of a Problem (or Need)** The recognition of a problem or need may originate within the buying firm or may also be recognised by a smart marketer. When the quality of material supplied by the existing supplier is not satisfactory, or the material is not available when required, or the machine supplied by the existing supplier breaks down too often, the buying organisation recognises the problem. If a business marketer identifies a problem in the buying organisation and suggests how the problem could be solved, there will be a better possibility of it being selected as a supplier. Consider the case of a material handling equipment manufacturing company:

The sales executive of a material handling equipment company visited a car manufacturing company in India, and while taking a walk on the shop floor of the car manufacturer, he noticed a long queue of trucks waiting to unload the incoming components and parts. The operation of unloading was taking a long time, as it was done in semi-manual way. He studied the operation and then suggested that he could supply an automatic equipment (that is, Hydroelectric lift-table), which could reduce the time of unloading substantially.

**Phase 2: Determination of the Characteristics and Quantity of Needed Product** Once the problem is recognised within or outside the buying organisation, the next phase is how to resolve the problem. The buying firm will try to answer questions such as: What type of products or services to be considered? What quantity of the product needed? and so on. For technical products, the technical departments (R&D, industrial engineering, production, or quality control) will suggest general solutions of the needed product. For non-technical goods or services, either the user department or purchase department may suggest products or services, based on experience and also the quantity required to solve the problem. However, if the required information is not available internally within the buying organisation, the same can be obtained from the outside sources.

**Phase 3: Development of Specifications of Needed Product** Phases 2 and 3 are closely related. After the general solutions to the problem is determined in the second phase, the buying organisation,

in the third stage, develops a precise statement of the specifications or characteristics of the product or service needed. During this stage the purchase department takes the help of their technical personnel, or if required, outside sources such as suppliers or consultants. Business marketers have a great opportunity to get involved at this stage by helping the buyer organisation to develop product specifications and characteristics. It would give a definite advantage by ensuring that the needed product includes his or her company's product characteristics and specifications.

### ***Early Supplier Involvement (ESI) Programme***

Production (or operations) experts say that about 80 per cent of a product's total costs are decided before the commercial production. Once the commercial production starts, any change in the design or specification would become very costly. It is, therefore, important that suppliers are involved in the early stages to develop specifications. In addition, the purchasing persons of the company should also be included in the design process.

More companies are involving purchasing persons as active members of *cross-functional development teams*. This practice is also called as "*Early Purchasing Involvement (EPI) Programme*". The major contributions of purchasing to EPI programme includes (a) selecting right suppliers as partners; (b) recommending alternatives on sourcing; and (c) identifying core competencies of the company.

**Phase 4: Search for and Qualifications of Potential Suppliers** In this phase the buying organisation searches for acceptable suppliers or vendors. The first step taken by the buyer is to obtain information on all the available suppliers and then, in the second step, decide on the acceptable or qualifying suppliers. The search for potential suppliers is based on the various sources of information like trade journals, sales calls, word-of-mouth, catalogues, trade-shows, and industrial directories. Now-a-days, the internet is the most likely source of information, for searching potential suppliers. The amount of time and effort invested in the supplier search will depend on the importance of the proposed product or service and its effect on the company's performance.

The *qualifications of acceptable suppliers* will depend on (a) the type of buying organisation (i.e. government undertaking, private sector commercial organisation, or institutions), (b) the buying situation (described subsequently in this chapter), and (c) the decision making members (also described subsequently in this chapter). However, generally the factors such as quality of product or service, reliability in delivery, and service are considered in qualifications of suppliers.

**Phase 5: Obtaining and Analysing Supplier Proposals** Once the qualified suppliers are decided, the buying organisation obtains the proposals by sending enquiries to the qualified suppliers. A supplier's proposal can be in the form of a formal offer, quotation, or a formal bid, submitted by the supplier to the buying organisation. It should include (a) the product specification, (b) price, (c) delivery period, (d) payment terms, (e) taxes and duties applicable, (f) transportation cost (or freight), (g) cost of transit insurance, and (h) any other relevant cost or free service provided.

For purchases of routine products or services, phases four and five may occur simultaneously, as the buyer may contact the qualified suppliers to get the latest information on prices and delivery periods.

For technically complex products and services, a lot of time is spent on analysing proposals in terms of comparisons on products, services, deliveries, and the landed costs (which includes the price after discount plus excise duty, sales tax, freight, and insurance).

**Phase 6: Evaluation of Proposals and Selection of Suppliers** Before evaluation and selection of one or more vendors or suppliers, the buying centre should decide on the desired attributes and their

relative importance. It will then evaluate the performance of each supplier on these attributes and by using weightage (or importance) attached to each attribute, the most attractive suppliers are selected. Buying centres often use “**multiattribute model**” for supplier/vendor analysis, as shown in Table 3.1

**Table 3.1** A Vendor Analysis System

<i>Attributes (or Criteria)</i>	<i>Weightage (or Importance)</i>	<i>Supplier/Vendor Performance Rating</i>	<i>Total Score</i>
Product Quality	3	8	$3 \times 8 = 24$
Service Quality	3	7	$3 \times 7 = 21$
Price	2	6	$2 \times 6 = 12$
Reputation	1	8	$1 \times 8 = 08$
Flexibility	1	6	$1 \times 6 = 06$
Total	10		71

**Performance rating scale:** 1–10, with 10 being “excellent” and 1 being “poor”.

The choice of attributes and importance of different attributes vary with the type of buying situations, such as new task, modified rebuy and straight rebuy (described later in this chapter). **For example**, for a new purchase (or task) situation for a copying machine, supplier reputation, service quality and product quality may be most important attributes for the buying organisation. For a modified rebuy situation, **for instance**, for a two-wheeler manufacturer wanting to change an existing tyre manufacturer due to unsatisfactory delivery service, the most important attributes may be timely delivery service, product quality and price. It should be noted that in case of buying situation of straight rebuy, the question of evaluation and selection of a new supplier or vendor does not exit, as the buying centre places repeated orders on the existing suppliers in a routine or automatic decision making process.

The vendor analysis shown in Table 3.1 is for one particular vendor. The same form can be used for other suppliers. **Multiattribute decision making**, based on the vendor analysis system shown in Table 3.1, can be used not only for evaluating potential suppliers or vendors, but also for analysing the performance of current vendors. Buying centres or purchasing departments of most organisations use formal rating forms to rate performance of different suppliers and their offerings. One must understand that attributes and weightages shown in Table 3.1 would vary from one buying organisation to another. The attribute ‘flexibility’ means the extent to which the supplier firm is flexible to adjust its deliveries to the variations in the delivery schedules, due to changes in the demand for the buying organisation’s product. Service quality refers to the quality of core service (e.g. courier or legal service) as well as quality of supplementary service (i.e. additional service like obtaining stamp papers that is charged to the customer) and basic customer service, such as typing on the stamp paper that is not charged to the customer.

The buying centre or purchasing committee may negotiate with short-listed suppliers for better prices and payment terms before making the final selection. In a purchasing magazine survey, 92 per cent buyers said that negotiating price was one of their top responsibilities as well as a key criterion to select suppliers.

A salesperson would be benefited, if he obtains the information about the most important attributes decided by the buying centre for purchasing a product or service and uses this information when the proposal is made. If a competitor is rated higher on an important attribute, the sales person may work to change the importance of the attribute in the minds of key members of the buying centre. If the buyer asks for a lower price, the salesperson can counter the same by highlighting the value of superior quality of after-sales service as well as just-in-time delivery service. Another way of countering the request for a lower price is to show evidence that the “life-cycle cost” of using the product is lower than that of competitors’ products.

### ***Evaluating Supplier Performance by Using “Balanced Scorecards” Technique***

The Balanced Scorecard (BSC) is a new technique or framework that can be used to evaluate supplier performance in information age companies. It translates a company’s mission and strategy into a set of performance measurements. The framework is organised into four parts: (a) financial, (b) customer, (c) internal business process, and (d) learning and growth,<sup>1</sup> as shown in Fig. 3.1.

Out of the four parts shown in Fig. 3.1, the internal-business-process is relevant for evaluating supplier performance. In the internal-business-process, company executives should identify the key internal processes in which the company must excel, in order to (i) deliver superior customer value, and (ii) satisfy shareholders with excellent financial performance. The internal-business-process includes operations and innovation processes as shown in Fig. 3.2.

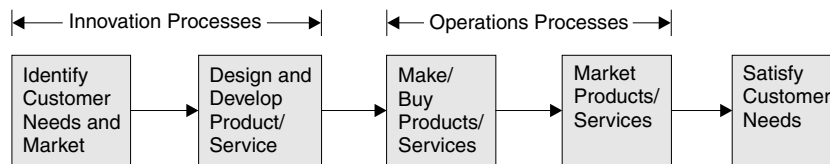
Buying products/services from suppliers is a part of operations processes, as shown in Fig. 3.2. In addition to the traditional measurement of cost (or price) for measuring the offers of various suppliers, the balanced scorecard approach is used to find additional measurements (or factors) that create superior value to customers and that are specific to a company. For instance, an electrical engineering company manufacturing and marketing electric motors to OEMs (original equipment manufacturers) of pumps and compressors identified shorter and timely delivery time as key customer needs, in addition to usual performance evaluation factors of cost and quality. The company informed their suppliers of components that performance evaluation factors will consist of quality, cost, as well as, shorter and timely delivery.

**Phase 7: Selection of an Order Routine** In this stage, the mechanics of exchange of goods and services between a buyer and a seller is worked out. The activities include (a) placement of orders (i.e. purchase orders) with the selected suppliers, (b) the quantity to be purchased from each supplier, (c) frequency of order placement by buyers and delivery schedules to be adhered to by the supplier, (d) levels of inventory needed, (e) follow up of actual delivery to ensure it to be as per delivery schedule, and (f) the payment terms to be adhered to by the buyer.

The user (or indenting) department would not be satisfied until the supplier delivers the required item as per delivery schedule, and with acceptable quality.



**Figure 3.1** *The Balanced Scorecard Framework*



**Figure 3.2** *Internal-Business-Process*

**Phase 8: Performance Feedback and Post-purchase Evaluation** In this final phase, a formal or informal review regarding the performance of each supplier (or vendor) takes place. The user department gives a feedback on whether the purchased item solved the problem or not. If not, the members of the decision making unit review their earlier decision and decide to give a chance to the previously rejected supplier, or a new supplier.

### Example: Organisational Buying Process

MTR Foods Private Limited follows the following steps or stages in the buying decision process.

- Recognition of a buying need, based on which an indent (i.e. a requisition or written demand) is sent from the production department (or any other department who needs a product or service) to the purchase department.
- The purchase department finds out from the store if the indented material is available in stock. If the material is in stock, the same is supplied to the indenting department. If not, the purchase department gets the specification and complete description of the material from indenting or engineering department.
- Search for potential suppliers is undertaken by the purchase officers through the internet, purchase journals, word-of-mouth and yellow pages of telephone directory.

- Potential suppliers are asked to submit their quotations or proposals, including their financial status, references of their existing customers, production capacity, and quality policy.
- Potential suppliers' background verification is done. In addition, a technical team from MTR foods visits the premises of prospective suppliers to examine production and quality processes, hygiene and cleanliness. Based on above, some of the potential suppliers are qualified or shortlisted.
- Negotiations are carried out with the qualified suppliers on prices and other commercial terms like payments terms, transportation cost, transit insurance, and so on.
- Purchase orders are issued to selected suppliers indicating product specification, price, delivery schedule, payment terms, and so on.

### Marketing Implications

While understanding the various phases in the buying-decision making process (or buyphases), the business salesperson should recognise that marketing effort is not over after the order is received. He or she must monitor the feedback and evaluation process in the customer (buyer) organisation. In particular, the user satisfaction levels or complaints must be monitored by the business marketer so that immediate corrective actions can be taken before a major damage is done. In fact, a quick response to customers' complaints can result in good buyer-seller relationship.

Before submitting the proposal in phase 5 of buying decision process, the sales person must get all the relevant information about the customer and competitors. It is usually important to understand clearly the customer firm's needs, specific benefits and costs based on which the customer will evaluate the suppliers' proposals, the buying situation, buying centre members, key influentials, and perceptions about various suppliers. The salesperson can make use of the information while preparing the proposal or quotation. In such a case, the probability of getting the business or the order for the salesperson is much higher than submitting the proposal, without collecting the relevant information, in a routine manner. The conversion ratio of order receipts to quotations submitted is much higher for the salesperson who collects the above information and builds relationship with the business customer.

If a selling firm fails to get the order, particularly from a high potential prospective or existing customer, the salesperson should be asked to keep in touch with the purchase executive of the buying firm on a regular basis. There is a possibility that the user department of the buying firm may not be satisfied with the performance of the supplier who had obtained the order. In such a case, the purchase executive may give a chance to the supplier who had lost the order earlier.

The *marketing strategy* to be adopted will depend on the (a) type of products, (b) phase of the buying-decision making process of customer firms, and (c) purchasing situations. To better understand the buying process, it is necessary to consider different types of purchases or buying situations.

## TYPES OF PURCHASES OR BUYING SITUATIONS

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There are three common types of buying situations, called **buyclasses**: (i) New purchase (or New task), (ii) Change in supplier (or Modified rebuy), and (iii) Repeat purchase (or Straight rebuy).

### New Task

In this situation, the company is buying the item for the first time. The need for a new purchase may be due to internal or external factors. **For instance**, when a firm decides to diversify into new products or



services, it necessitates the purchase of a new machine, materials, or parts. In the new purchase situations, the buyers have limited knowledge and lack of previous experience. Hence, they have to obtain a variety of information about the product, the suppliers, the prices, and so on. In the new task decisions, (a) the risks are more, (b) decisions may take longer time, and (c) more people are involved in decision making.

In the new task buying situation, the buying centre (or buying committee) members adopt extensive problem solving<sup>5</sup> approach, involving all the phases of buying decision process. They gather a large amount of information about alternative ways of solving the problem and different suppliers. They are more concerned about finding a suitable solution than getting the lowest price. The key people who influence the buying decision are usually the technical members of the buying centre. Consider the following **example**.

In 1993–94, when Information Technology (Infotech) park was set up at Bangalore, India, by Karnataka government in technical collaboration with a Singapore-based organisation, the purchase committee wanted to buy a number of equipment for loading and unloading of materials at various warehouses. They were not sure what kind of equipment could be used, who were the suppliers available locally, and the quality of equipment and service. In response to their advertisement, the purchase committee received a proposal from only one supplier. They waited for two months for other proposals to be received. When there was no response, they invited the technical members from Singapore to visit Bangalore to evaluate the potential supplier and to decide. The commercial and technical members visited the potential supplier's manufacturing plant, inspected the manufacturing and quality control processes. Thereafter, they asked the potential supplier to show their equipment working at one of the supplier's customer's place. The supplier took the buying centre members to Ashok Leyland's factory (unit 2), where five such equipment were working. The Infotech Park members made detailed enquiries with Ashok Leyland's shop floor supervisors and workers, and only after they were satisfied that the equipment's performance and service were good and it would solve their loading and unloading problems, they negotiated the commercial terms like price, payment terms, installation service, delivery period, warranty service, and thereafter placed a formal order on the supplier.

**Sales Strategy** The business marketing firm facing a new-task buying situation should ask its salespeople to get involved in the first three phases of buying process. The selling firm will gain a competitive advantage if their salespeople understand the buying firm's requirements completely and clearly, assist in developing specifications, and make the proposal or offer to meet the requirements better than competitors. The salespeople should be trained to respond promptly to technical and commercial queries and if needed, take the help of technical and industry (vertical) experts from the organisation during initial discussions for understanding customer firm's needs, preparation of the proposal or quotation, and later for sales presentation and negotiation with the customer firm, as a part of team selling efforts.

### Modified Rebuy

A modified rebuy situation occurs when the organisation is not satisfied with the performance of the existing suppliers, or the need arises for cost reduction or quality improvement. The change in supplier may also be necessary if technical people in the buying organisation ask for changes in the product specification, or marketing department asks for additional features in the product to gain some competitive advantage. As a result, search for information about an alternative source of supply becomes necessary. Although certain attributes or factors can be used to evaluate the suppliers, there may be uncertainty regarding which supplier can best meet the needs of the buying firm. However, the modified rebuy situation occurs mostly when the buying firms are not satisfied with the performance of the existing suppliers. Consider the following **example**:

A large multi-product, multi-location company took a decision to change the existing marketing research firm because the company was not satisfied with the quality of report submitted by the marketing research firm on a chemical product. The company was planning to diversify and was keen to get the information on competition, potential customers, long-term demand forecasting, and so on, from the market survey report. However, the information given in the report by the marketing research firm was vague and inaccurate. The senior executives of the company, therefore, took a decision to change the supplier.

An **illustration** of change in supplier (modified rebuy situation) due to change in product specifications can be given when Crompton Greaves Ltd. received an export order from the US based customer for ceiling fans with electronic speed regulators, instead of prevailing electrical speed regulators, since the fans were required to run at a very slow speed to compress hot air from heaters in conference rooms during very cold winter season. The existing suppliers of electrical speed regulators could not develop electronic speed regulators to meet the specifications of the export market. Crompton Greaves had to change the suppliers of speed regulators in the modified rebuy situation.

**Finding a new supplier** In a modified rebuy situation, an existing supplier is replaced by a new supplier. However, finding a new supplier is not an easy task for the most buying organisations. Let us consider an **example** of a multinational company manufacturing automobile components. The company wanted to replace the existing supplier of “battery charger”, since the supplier’s performance on quality and delivery became unsatisfactory and also the supplier’s attitude changed to a kind of arrogance. The company’s purchasing department went through the following steps, before finalising on the new supplier.

- They obtained detailed and relevant information, such as mission, objectives, products, production capacity, quality policy, market feedback, sales turnover and legal compliance from prospective suppliers.
- Thereafter, a technical team visited prospective suppliers’ plants to find out production and quality processes as well as safety measures taken.
- Prospective suppliers’ samples were field-tested, quotations were obtained, negotiations were held on commercial issues like prices, transportation, transit insurance and payment terms.
- Orders were placed on two new suppliers for the supply of “battery charger”.

**Sales Strategy** The salespersons from the “in” (or existing) supplier should be continuously in touch with the buying firm’s requirements. If the customer firm’s requirements change in terms of improvement in quality standards or just-in-time (JIT) delivery, the salesperson of the supplier firm can immediately take action by alerting his company well in time. In case of the “out” (or potential) supplier, the salesperson should find out why the buying firm wants to change the existing supplier and then make the proposal that gives the performance guarantees<sup>6</sup>. Understanding the buying firm’s purchase needs clearly, the buying orientation, the purchase practices, criteria used for supplier selection, and key buying influentials are important inputs to developing an effective sales strategy in modified rebuy situation.

### **Straight Rebuy**

This situation occurs when the buying organisation requires certain products or services continuously and when such products/services have been purchased in the past. In such a situation, the buying organisation reorders/places repeat orders with the suppliers who are currently supplying such items. This means that the product, the price, the delivery period, and the payment terms remain the same in the reorder, as per the original purchase order. This is a routine decision with low risk and less informa-

tion needs, taken by a junior executive in the purchase department. Generally, the buying firms do not change the existing suppliers if their performance (on the previously established performance criteria) is satisfactory.

A typical **example** of straight rebuy situation could be given for the purchase of precision steel tubes by Bajaj Auto's (BAL's) Pune factory, manufacturing two-wheelers. Once a year, negotiations were held with the existing three suppliers, who indicated special net prices (after discount on the list prices). BAL senior executives would review the performance with each supplier with respect to "perfect" delivery (i.e. on-time and ordered quantity delivery), consistency in quality, and flexibility (i.e. the supplier's response to the changes in the delivery schedules of steel tubes due to changes in demand for different models of two-wheelers). Based on the supplier's performance on the above three factors and the price, BAL's senior executives decided the percentage of share of business for the three suppliers for the following financial year. Thereafter, the junior purchase executive released the quarterly (tentative), and monthly (firm) delivery schedules, based on the percentage share decision taken by the senior executives for the different suppliers.

Electronic purchasing<sup>7</sup> should be possible in the straight rebuy situation, with automatic reordering systems that save the time and cost of purchase executives<sup>8</sup>. For supplier firms, an electronic market place offers a low-cost distribution channel to reach and efficiently serve customers.

**Sales Strategy** For existing or "in" suppliers the sales strategy should be to maintain product and service quality, good buyer-seller relationship, and be responsive to the changing needs of the customer organisation. However, it is a difficult task for an "out" supplier to get business in the straight rebuy situation. The strategy to be adopted by "out" suppliers include collecting information to exploit dissatisfaction with a current supplier, offer something new that gives large benefits to the buying firm, or get a small order initially and then increase the purchase share over a period of time.

## THE BUYGRID FRAMEWORK

Understanding organisational buying becomes easier if it is divided into different buying phases (called *buyphases*) and these phases are analysed under different buying situations (called *buyclasses*).

**Table 3.2** The Buygrid Framework for Organisational Buying Situations

<i>Buyphases (Phases in Buying Process)</i>	<i>Buy Classes (Buying Situations)</i>		
	<i>New Task</i>	<i>Modified Rebuy</i>	<i>Straight Rebuy</i>
1. Problem recognition	Yes	May be	No
2. Characteristics and quantity of needed item	Yes	May be	No
3. Description or specification of needed item	Yes	May be	No
4. Search for and qualifications of potential suppliers	Yes	Yes	No
5. Obtaining and analysing supplier proposals	Yes	Yes	May be
6. Evaluation of proposals and selection of suppliers	Yes	Yes	No
7. Selection of an order routine	Yes	Yes	May be
8. Performance feedback and evaluation	Yes	Yes	Yes

**Source:** Adapted from the Marketing Science Institute Series, *Industrial Buying and Creative Marketing*, by Patrick J. Robinson, Charles W. Faris, and Yoram Wind. Copyright 1967 by Allyn and Bacon, Inc., Boston.

Robinson *et al.* have formulated the buygrid framework, which combines three types of buying situations (buyclasses) with eight phases of buying decision process (buyphases). An analysis of the buyphases in relation to the buyclasses gave interesting results, which are summarised below:

1. All eight phases of the business buying process are applicable to a new-task buying situation. However, in case of modified rebuy and straight rebuy situations, only some of the buyphases are applicable.
2. The most difficult buying situation occurs for a new-task in buyphases of problem recognition, and determination of product characteristics and specification. This is because maximum number of decision making members and influencers are involved.
3. Modified rebuy situations are not very difficult to handle.
4. Straight rebuy situations are handled in a routine manner.

## MULTIPLE BUYING INFLUENCES

Salespeople selling products and services to business buyers must understand that the organisational buying process is typically influenced by many individuals. The degree of involvement of individuals in the buying process varies for different buying situations. If the business salesperson can answer the following questions correctly, he has a high probability of getting the business from a business customer.

- What type of buying situation the customer is in?
- Which individuals are involved in the purchase decision process (i.e. members of decision making unit) and who are the key influentials?
- What criteria would be used by the decision-making unit and if this is not decided, then what criteria are important to each member of the decision making unit?

### The Buying Centre

The decision-making unit, in business marketing, is called as the buying centre<sup>9</sup>. The buying centre consists of those individuals or members who participate in the buying decision and who share the common objectives and risks arising from the purchase decision. The size of the buying centre varies for different organisations<sup>10</sup>. It may be only one person, in case of a proprietary or partnership firm. The buying centre may have fifteen to twenty individuals. However, the average size of a buying centre will be four persons per purchase. The size of the buying centre may vary from one buying situation to another, because business buying is a process and not a single action<sup>11</sup>. A more formalised buying centre is referred to as purchase committee or buying committee in some organisations, when buying is centralised. Institutions like hospitals and colleges often have buying committees to make buying decisions. Usually, one or two individuals are most influential in the buying committee and other members go along.

**Example: Buying centre.** MTR Foods Private Limited, which manufactures and markets a range of food products, such as snacks, masala powder, pure spices, sweets, ready-to-eat curries, and so on, have members of buying centre consisting of production officer, quality officer, purchase officer, purchase manager and finance manager. In situations, where the purchase value is high, vice-president (finance) and vice-president (SCM) (i.e. Supply Chain Management) are involved in negotiations with suppliers.

Most important attributes or factors considered by the buying centre of MTR Foods Private Limited while making buying decisions are:

- Quality of the product
- Price of the product
- On-time delivery
- After-sales service

Other attributes of lesser importance, which are also considered, are:

- Financial position of suppliers
- Testimonials from the existing customers of suppliers
- Location of suppliers' premises

### The Buying Centre Roles

Members of the buying centre accept different roles during the buying process. These roles vary for different stages of the buying process depending on the buying situation, complexity of the purchase and the functions involved. Any one member of the buying centre may assume several roles, which are as follows: users, buyers, influentials, deciders, and gatekeepers<sup>12</sup>.

**Users** They actually use the product and service. Their influence on the purchase decision varies from minor to important. Sometimes users may initiate the purchase action and may develop the product specifications.

**Buyers** They implement purchase procedures. They are the purchase executives, who do administration and coordination of all purchase activities. They have, in many organisations, formal authority for negotiation and selection of suppliers.

**Influentials** Those individuals, inside or outside the firm, who influence the buying process by supplying information or decision criteria for evaluating purchasing alternatives. Generally, persons from technical departments, such as quality control, design, and industrial engineering, may have important influence in the buying decisions. Sometimes, individuals outside the buying firm, such as technical consultants, architects, and consulting engineers assume the role of influentials<sup>13</sup>.

**Deciders** These are the individuals or members who decide the supplier or the brand of a product. For salespeople, it is important to identify the deciders, although sometimes it may be a difficult task. Usually, for routine and small value purchases, buyers (or purchase executives) may be the deciders, and for complex and high value purchases senior managers and directors may be the deciders.

**Gatekeepers** They control information to members of the buying centre, by spreading or controlling printed information or regulating salespeople who want to speak to members of buying centre. Usually, the buyers or junior purchase executives may be performing this role.

### Recognising Key Influentials

Recognising or identifying key buying influentials is an important and difficult task of salespeople. Research shows that often key influentials are located outside the purchase department, and have great power or influence over other members. For purchasing a highly technical product like CNC (Comput-

erised Numerical Control) machine, design engineer and production manager may be the key influentials. In purchasing component parts, such as a spark plug and battery for an automobile manufacturer, again the technical department personnel, such as quality control and production, are often the key influentials. However, for straight rebuy situations, where repeat purchases are made, purchase executives are the important influentials<sup>14</sup>.

**Sales Strategy** Salespeople should sell their product characteristics or quality to technical people of the buying centre for product selection decisions, in which technical personnel like design (or Research and Development—R&D), and production are key influentials. For supplier selection decisions, salespeople should focus on purchase executives and managers, who are most influential<sup>15</sup>.

### Identifying Key Members of Buying Centre (or Decision Making Unit) in Buying Organisation

**Top Management Persons** The top management in a business organisation consists of managing director, director, president, vice-president or general manager. They are generally involved in (a) purchase policy decisions such as diversification into a new product/project, (b) approval of purchase or materials department annual budgets and objectives, and (c) deciding the guidelines for purchase decisions. For purchases of high value capital equipment, the top management in most firms get involved in the supplier selection, as it may have a major impact on the firm's operations.

**Technical Persons (or Functions)** The technical persons are design engineers, production manager, maintenance manager, quality control manager, R&D manager, and industrial engineers. They are generally involved in product specification or description, technical evaluation of offers received from suppliers, negotiations with suppliers, performance feedback on products supplied, and so on. They also visit the factories of potential suppliers to gain more information and assurance of manufacturing capability.

**Buyers/Purchasers (or Purchase/Materials Department)** Buyers are the persons in the purchase or materials department. They may be senior executives or managers, and also, at junior levels, purchase officers or assistants. They are generally involved in most of the phases or steps of the purchase activities. They coordinate with technical persons, top management, accounts or finance persons within an organisation, as well as, with suppliers or vendors externally. Buyer's influence on selection of suppliers is considerable. They are conscious of keeping good relations with other decision making members within the organisation and also with the suppliers.

**Accounts/Finance Persons (or Department)** The contribution of finance/accounts persons are seen while finalising commercial terms such as modes of payment, issuance of bank guarantees, financial approval of capital purchases, issuing payments to suppliers, and so on.

**Marketing Function** When a purchase decision has an impact on the marketability of a firm's product, marketing people become influencers in the buying decision process. **For example**, a firm manufacturing and marketing electric motors had to change its packing due to damages caused to the product in transportation. This in turn affected the satisfaction level of the customers. The marketing manager insisted that suppliers should use good quality and thicker wood for packing the motors to minimise damage in transit.

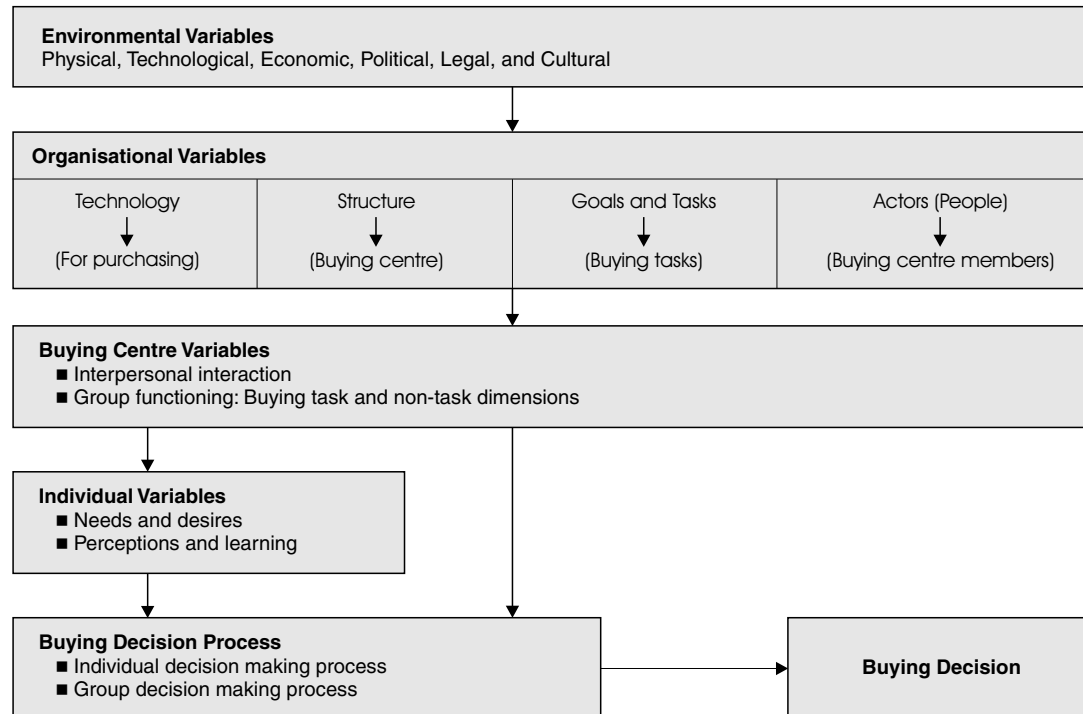
## MODELS OF ORGANISATIONAL BUYING BEHAVIOUR

Business buyers are influenced by many factors when they make buying decisions. Generally, business buyers are influenced by *organisational factors* or task-oriented objectives (like best product quality, or dependable delivery, or lowest price) and *personal factors* or non-task objectives (like promotion, increments, job security, personal treatment, or favour). When the suppliers' proposals are substantially similar, organisational buyers can satisfy organisational objectives with any supplier, and hence personal factors become more important. When suppliers' offers differ substantially, business buyers pay more attention to organisational factors in order to satisfy the organisational objectives.

There are two models (or framework) available to provide a comprehensive and integrated picture of the major factors that combine to explain the organisational buying behaviour. These are: (i) The Webster and Wind model, (ii) The Sheth model, shown in Figs. 3.3 and 3.4.

### The Webster and Wind Model of Organisational Buying Behaviour

A comprehensive model of the organisational buying behaviour is developed by Webster and Wind, as shown in Fig. 3.3. This model considers four sets of variables: environmental, organisational, buying centre (or group forces), and individual.



**Source:** Adapted from F.E. Webster, Jr. and Y. Wind, "A General Model of Organisational Buying Behaviour", *Journal of Marketing*, 36, 2 (April, 1972), 12-19. Reprinted with permission from the American Marketing Association.

**Figure 3.3** The Webster and Wind Model of Organisational Buying Behaviour

**Environmental variables** These variables include physical, technological, economic, political, legal, and cultural factors. The environmental variables can change organisational buying plans. For instance, political conflict in a nation can affect the growth rate of the economy which may influence purchasing plans of companies. The economic environment influences a firm's willingness and ability to buy. **For example**, the recession in Bicycle industry in 1985 in India resulted in substantial reduction in the purchase of steel components required for the manufacture of bicycles.

Technological changes influence buying decisions. One illustration is the change in technology from jelly-filled telecommunication cables to fibre-optics cables. The department of telecommunications (DOT) in India reduced the volume of purchase of jelly-filled cables and increased buying of fibre-optics cables, which have many benefits. Similarly, World Wide Web (WWW) has changed the way business buyers and suppliers buy and sell to each other. Recent research<sup>16</sup> also suggests that buyers, who understand the rapid rate of technological change, will conduct more serious research efforts. Marketing consequences of technological changes include changing product life-cycles, new sources of competition and increased globalisation of markets<sup>17</sup>.

**Organisational variables** The Webster and Wind model gives importance to four sets of organisational variables. These are: technology relevant to purchase, organisational structure, organisational goals and tasks, and members of buying centre. These four variables (or subsystems) interact with one another to determine organisational functioning and buying centre individuals' attitudes, goals, and assumptions used in buying decision making. The business marketing firms need to be aware of the following organisational trends in the purchasing area.

- Some multi-divisional companies identify materials purchased by several divisions and buy them centrally, resulting in substantial savings. Centralised purchasing units place more weight on long-term (strategic) supply availability and partnering relationships with key suppliers. At the same time, buying firms are decentralising small-value items. Decentralised buyers may give importance to short-term issues like costs and profits. Thus, centralised and decentralised procurement differ substantially<sup>18</sup>.
- Recent competitive pressures have resulted in upgradation of purchasing departments to "strategic supply departments" with responsibility for global sourcing and partnering, instead of old-fashioned purchase departments' concentration of buying at the lowest cost. Some buying firms have changed the purchasing departments' name to "procurement departments" with focus on seeking the best value from better and fewer suppliers<sup>19</sup>.
- Buying tasks are increasingly getting focused on accepting long-term purchase contracts with reliable suppliers. Besides, business marketing firms are using the internet with key buying firms to minimise the cost and time of transactions. In fact, some suppliers manage their customers' inventory through a system, called "Vendor-managed inventory", and replenish inventory levels through "continuous replenishment programs".

**Buying Centre Variables** The functioning of buying centre is analysed by interpersonal or social interactions of participants and group functioning. The interpersonal or social interactions depend on the role of each participant or individual member of the buying centre. The group functioning is influenced by

1. individual member's goals and personal characteristics,
2. the nature of leadership in the group,



3. the group tasks and structure, and
4. external influences, which include organisational and environmental variables.

The group functioning or process relate to buying tasks like best product quality, dependable delivery, or lowest price and also non-task dimensions, such as promotion, job security, good increment, or personal favour.

Johnston and Bonoma<sup>20</sup> found that complexity of buying tasks and uncertainty about product attributes lead to vertical involvement (particularly, higher level executives) and lateral involvement (i.e. other functions and departments) in the buying decision process. In another study by McCabe<sup>21</sup>, it was found that high levels of uncertainty lead to narrowing of the structure of the buying centre. The concept of the buying centre, one of the findings of this research, is useful in analysing business buying situations and planning sales and marketing strategies. The structure of buying centre varies from company to company. It also varies from one buying situation to another<sup>22</sup>.

**Individual Variables** The Webster and Wind model mentions that individuals make buying decisions in the organisational and interactional settings. Only individuals can define problems, make buying decisions, and act accordingly. The individual buying behaviour is motivated by individual needs, desires, perceptions, learning, in complex interaction with organisational objectives. One study<sup>23</sup> confirms that individuals who perceive that they have an important personal stake in the buying decision will participate more powerfully than other members of the buying centre.

Individuals join companies for getting rewards for achieving organisational objectives and tasks. Hence, there is a key interaction between individual member's needs and his or her perceptions about the performance, evaluation, and rewards.

Individual decision making merges into a group decision-making process, which includes bargaining, negotiation, and persuasion. The Webster and Wind model does not present in detail these group decision processes. The strengths of the model are that it is comprehensive, analytical, generally applicable, and identifies many key variables which could be considered for developing sales and marketing strategies. However, the model is weak in explaining the specific influence of the key variables.

### The Sheth Model of Business Buyer Behaviour

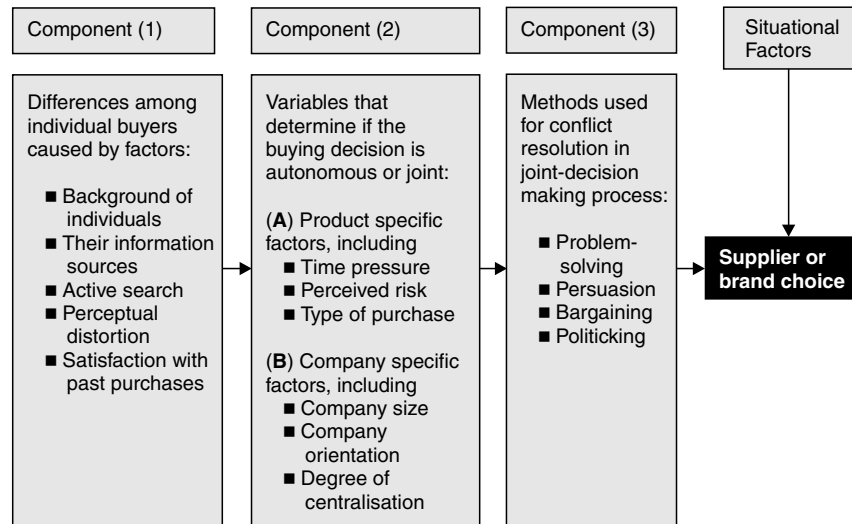
Professor Jagdish N Sheth developed the Sheth model in 1973. This model, shown in Fig. 3.4, emphasises the joint decision-making by two or more individuals, and the psychological aspects of the decision making by individuals in the business buying behaviour.

The model includes three components and situational factors, which determine the choice of a supplier or a brand in the buying decision making process in an organisation. The differences among the individual buyers expectations (Component 1) are caused by the factors, such as (a) the background of individuals, (b) their information sources, (c) active search, (d) perceptual distortion, and (e) satisfaction with past purchases.

The background of individuals depend upon their education, role in the organisation, and life style. The factor **perceptual distortion** means the extent to which each individual participant modifies his perceptions to make it consistent with his existing beliefs and previous experiences. It is difficult to measure perceptual distortion, although techniques such as factor analysis and perceptual mapping are available for this purpose.

In Component (2), shown in Fig. 3.4, there are six variables which determine whether the buying decisions are autonomous (i.e. single individual) or joint (i.e. two or more individuals). According to

the Sheth Model, larger the size of the organisation and higher the degree of decentralisation, more will be the possibilities of joint-decision making.



**Source:** Adapted from Jagdish N. Sheth, “A Model of Industrial Buyer Behaviour”, *Journal of Marketing*, 37, pp. 50–56, October, 1973. Reprinted with permission of the American Marketing Association.

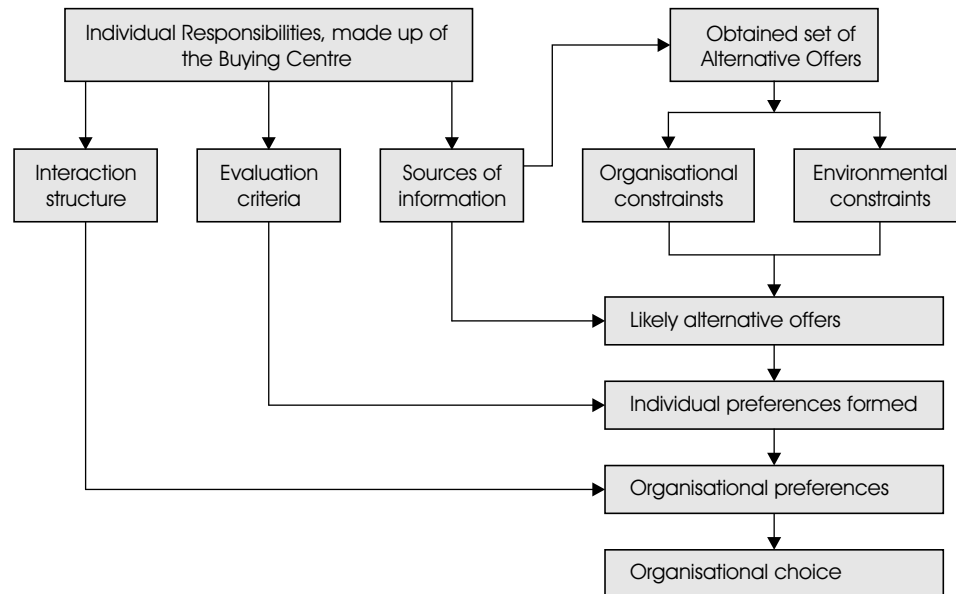
**Figure 3.4** The Sheth Model of Industrial Buyer Behaviour

The Component (3) in the model indicates the methods used for conflict resolution in joint-decision making process. Problem-solving and persuasion methods are used when there is an agreement about the organisational objectives. If there is no such agreement, bargaining takes place. Conflict about the style of decision making is resolved by politicking.

Situation factors can be varied like economic conditions, labour disputes, mergers and acquisitions. The model does not explain their influence on the buying process.

### The Choffray and Lilien Model<sup>24</sup>

We have discussed earlier in the Webster and Wind model that the organisational buying behaviour is influenced by four major elements or factors, such as environmental, organisational, buying centre or group, and individual. The Choffray and Lilien model helps to conceptualise the group decision process and also integrates the important aspects of the organisational buying process. The Choffray and Lilien model is presented in Fig. 3.5. In this model, environmental factors (like technological and economic) and organisational factors (such as technical, financial) are seen as constraints. These factors influence the buying process by limiting the number of product alternatives, which satisfy organisational needs. **For instance**, capital equipment like a material handling equipment has several alternative product offers and those offers which exceed a particular initial cost may be excluded from further consideration. The remaining product offers from suppliers become likely alternative offers for the buying firm. Individual members of the buying centre form their preferences from the likely alternative offers. These individual members have their own sources of information and evaluation criteria, which are used to form their preferences. The interaction structure of the individual members of the buying centre, which includes negotiation and group problem solving, leads to the formation of organisational preferences and finally to organisational choice.



**Source:** Jean-Marie Choffray and Gary L. Lilien, “Assessing Response to Industrial Marketing Strategy”, *Journal of Marketing* 42 (April 1978), p. 22. Reprinted by permission of the American Marketing Association.

**Figure 3.5** The Choffray and Lilien Model of Organisational Buying Behaviour

Choffray and Lilien have developed four models<sup>25</sup> of multiperson decision making process, which make organisational decisions. In brief, these models are: (i) a weighted probability model, where weights show individual member’s power or authority in the buying centre; (ii) a proportionality model, where all members of the buying centre have equal weight; (iii) a unanimity model, where the negotiation process is continued until all the members of the buying centre come to an agreement; and (iv) an acceptability model, where the final choice or the decision is such that it has least problems to the individual member’s preferences.

**Marketing Implications** Understanding the organisational buying process and buying behaviour are very important aspects of business marketing. It helps business marketers to make effective decisions on selling, pricing, product design, and promotion.

#### CONTEMPORARY PURCHASING ACTIVITIES

**Just-in-Time (JIT) Delivery** It means that the materials arrive at the buyer’s factory exactly when needed by the buyer. It minimises the inventory and increases the quality and productivity. The goal of JIT delivery is zero inventory and excellent quality of the material delivered by the supplier. This ensures nil rejection at the buyer’s factory. The JIT delivery means that the buying and selling organisations work together closely to reduce costs.

A good **example** of just-in-time delivery was seen at Hero Cycles factory at Ludhiana, India. Precision steel tubes suppliers used to cut the steel tubes in the required lengths, keeping in mind the specifications of the product at their warehouses at Ludhiana and supply to Hero Cycles just before the start of each shift of production. The suppliers also ensured good quality supplies, so that the steel tubes could be sent to production lines without any inspection by Hero Cycles. This process improved the production and productivity as well as reduced costs of bicycles produced by Hero Cycles, which helped Hero Cycles to become number one in the world in terms of production and market share of bicycles.

**Outsourcing** More companies are willing to buy more goods and services from outside suppliers (or vendors), if they are cheaper and better. In other words, outsourcing implies purchasing a part of the company's operations, instead of producing (or making) internally.

Business firms develop and implement **sourcing strategy**. The company should identify its core competencies, which are skills or knowledge, and not products or functions. The company should *insource*, or produce itself, those parts or subsystems where it has core competencies or superior expertise. The company outsources those systems or subsystems where it has become non-competitive. **For example**, Dupont Textiles Fibers department focused its resources on its core competencies of R&D and manufacturing and outsourced maintenance repairs, and purchasing. This has resulted in a large amount of cost savings over a number of years.

In **multisourcing** strategy, the buyer (or customer) firm requests quotations from a number of supplier firms, and places orders with two or three suppliers. By pitting one against the other, the customer firm gains a lower price.

In a **sole sourcing** situation, only one supplier firm produces a product or service required by the buyer firm. The **examples** may include a new technology, patented product, or a rare raw material. There is no competition for some time and the customer firm may wait until competitors come out.

KPMG International in its survey<sup>26</sup>, covering over 659 companies with half of the respondents having an annual turnover of more than \$1 billion, said that 89 per cent respondents were expected to maintain or increase current level of sourcing (or outsourcing). The majority of respondents, the report indicated, believed that outsourcing improves their financial performance, shareholder value and competitiveness. In another survey, carried out by A.T. Kearney<sup>27</sup>, it was indicated that offshore locations for services, such as Information Technology (IT), business processes and call centres, would remain cheaper for another 20 years. India, closely followed by China, would lead the outsourcing pack by a wide margin, with relative decline in cost advantage being offset by improvements in talent supply and business environment. The Economic Times, India, survey<sup>28</sup> of 2390 listed manufacturing companies in India showed that outsourced labour charges had jumped a whopping 456 per cent in just two years, from ₹ 13.56 billion in fiscal 2004 to ₹ 75.41 billion in fiscal 2006. The report further said that this trend in manufacturing sector would expand further as cost-cutting and higher value addition became important. Apart from autocomponent and pharma sectors, which led the outsourcing drive, the other sectors like non-renewable energy and non-ferrous metals would also grow, stated the survey report.

A business firm may outsource the warehousing function to a "third party", a company which specializes in carrying out warehousing services for its customers. The benefits of third-party (i.e. outsourcing) warehousing are reduced assets, professional work, and flexibility. In the chemical

industry, **for instance**, the work of distributors is changing because they are offering to their customers logistics solutions, such as inventory management, just-in-time delivery, and repackaging<sup>29</sup>.

Many new application service providers have emerged to meet the outsourcing needs of all types of organisations. These service providers can be accessed through the Internet to outsource various functions and services, such as accounting, payroll, and even selling<sup>30</sup>. External marketing resources have emerged as a strong new category in outsourced sales and marketing practices. **For example**, Motorola, India, decided to fight back losing marketshare by outsourcing a substantial part of its retail marketing effort<sup>31</sup>. Pepsi, India, wanted to introduce trolley based vending system as an alternative distribution channel. This was outsourced to Multiplier company for appointing distributors and to set up sales teams.

**Worldsourcing** William J. Amelio, CEO of Lenovo PCs, argues about crucial differences between outsourcing and worldsourcing<sup>32</sup>. According to him outsourcing is a centralised, and top-down strategy that is designed to save money on non-core operations. Worldsourcing, by contrast, is a global, decentralised strategy that is designed to drive greater value and quality by distributing a firm's core functions across multiple global hubs of excellence. **For example**, Lenovo has a global marketing hub in India, a global operations hub in Paris, fulfilling hub in North America, and factories in China, India, Latin America, and a new plant planned in Poland. The true flag of each global company, according to Mr Amelio, is its brand. "The more a company reaches out to the entire world for the best ideas, people, and processes, the more it becomes the refined essence of its brand. Its attributes are the quality of its goods, services, governance, transparency, and degree of corporate social responsibility. It is evaluated by the level of value it delivers to customers worldwide", concludes Mr Amelio in this thought-provoking article.

**Single Sourcing** Some of the business customers place orders with only one supplier, even though alternative suppliers exist. This may sound against the old concept of placing orders with two or three suppliers, so that "all the eggs are not in one basket". However, single-sourcing practice makes it possible for the buying and selling organisations to work closely together, involve the supplier from the design stage, and utilise the supplier's expertise.

**Value Analysis** The objective of value analysis is to reduce cost while maintaining product reliability. It involves analysing a product item by the (a) function it performs, (b) value of the function, and alternate methods of performing the same function. It uses creative technique like brainstorming and includes members of various departments such as production, quality control, design, industrial engineering, marketing, and purchase. The group uses some of the following questions during the brainstorming session for value analysis. There can be many more questions.

- Can the weight or thickness of the item be reduced?
- Does the item have greater capacity than required?
- Is unnecessary machining performed on the item?
- If the item is non-standard, can a standard item be used?

Value analysis, which is also called as value engineering, is defined as follows:

A thorough assessment of all the elements like design, manufacture, and maintenance of an item and its parts in order to achieve the needed performance of the item at lowest cost<sup>33</sup>.

*Basic steps in Value Analysis* derived from a study<sup>34</sup> are as follows:

- Item (or product) selection for value analysis is important because the value analysis process is time consuming and requires hard work. Hence, typically the products or items which have substantial cost or used in large volumes are used. For instance, in one electrical engineering company the product which was bulky in design with much more material content, resulting in higher cost, was selected for value analysis.
- Cross-functional team, consisting of representatives from various functions or departments, is formed with a team coordinator. Often the team includes purchase executives, design and production engineers, finance and marketing executives.
- The team has regular meetings, in which each activity or function of the product is discussed, the cost is estimated, and relevant information is collected.
- Brainstorming sessions are held so that the team members can suggest creative ideas to see new ways of performing a product function, or reduction in costs. These ideas are recorded and later the ideas are evaluated in terms of cost and feasibility.
- The selected ideas are implemented, after approval from the management.

The main purpose of value in analysis is to find ways of improving products, lowering costs, or both. For example, Ferro Corporation developed a new coating process that allowed its customer to paint a refrigerator cabinet in ten minutes compared to the old process that took three hours. The new process helped to reduce the cost substantially<sup>35</sup>.

Buying (or customer) firms may carry out value analysis to assess the value of proposals or offers submitted by different suppliers. The use of value analysis (or value engineering) is increasing with major applications in product modifications, including improving product quality, features, or design to meet customer needs, cost reductions, and pricing flexibility.

**Supplier Evaluation** Many buying firms use some kind of supplier (or vendor) evaluation system. The objectives of evaluating supplier performance are: (1) qualifying the potential suppliers (i.e. phase 4 of the buying decision process, (2) selecting the suppliers for future supplies (i.e. phase 6 of the buying decision process), and (3) reviewing the performance of present suppliers.

*Weighted-Point Technique* A typical example of a technique used for supplier evaluation was shown earlier in Table 3.1, which gives weights to each performance attribute or factor. Attributes and weights vary from organisation to organisation. Hence, it is important for a salesperson to understand the evaluation factors or criteria for each customer firm, particularly for those buying firms who have high sales potential. Some of the best practiced buying organisations, use balanced scorecards technique as shown in Fig. 3.1, to assess supplier performance.

The supplier rating, shown in Table 3.1, can provide an information to purchase executives of the buying firms to discuss with present suppliers about their performance and how to improve the same. Purchase executives should back-up the supplier performance score with factual data, such as how many lots were received on-time with required quality and quantity.

Sales and marketing persons from supplier organisations must visit customer organisations to better understand the supplier evaluation system followed. This information would help the selling firm to make their offer or quotation in line with the factors or attributes that are important to the customer organisation, resulting in a high probability of getting that business.

In addition, production and quality control personnel should also make visits to key customer firms to understand how their products are used and evaluated. These steps would help to make the business marketer a customer-oriented organisation.

To illustrate how a supplier (or vendor) evaluation is done, let us consider the process followed by Bajaj Auto Ltd., Pune, for evaluating three suppliers, who were supplying precision steel tubes (product classification: materials and parts) for two-wheelers produced at Pune and Aurangabad factories. These three suppliers were selected out of about seven manufacturers of steel tubes, based on the three major factors: quality, delivery, and price. The three suppliers were evaluated again on the basis of the three criteria mentioned earlier, plus one more criterion—viz. flexibility, which meant how well the suppliers responded to the sudden changes in the delivery schedules, due to fluctuations in the market demand for the various models of motor cycles and scooters. The weightages given to the four factors were not informed to the suppliers, but the suppliers were told about their overall ranking at the end of the financial year, during negotiations, when the percentage share of business for the three suppliers were finalised.

It is interesting to know that for capital goods like material handling equipment, purchased by Ashok Leyland, Chennai, for its three factories located at Chennai and Hosur, the buying criteria used were different—viz: presales and postsales service, price, and performance of the equipment. By combining the requirements of the three factories for material handling equipment, Ashok Leyland used to take advantage of the large value of the order, and negotiate hard with suppliers to get the benefit of large discount (or low net price after discount). The order would be placed on one supplier, out of the three suppliers, after negotiations, based on the criteria mentioned earlier. Again the weightages given to the three factors were not disclosed to the suppliers. Thus, the evaluation factors and weightages may vary from company to company, type of product category, and the buying firm's purchase policies.

**Buying Committee** A formalised buying centre (or decision making unit) is the buying committee. It is used in many business organisations including institutions (such as universities and hospitals) and Government companies. Generally, in a typical buying committee, one or two individuals dominate in the decision making. The salesperson must provide information to all the members of the buying committee, and should target the real sales efforts to those dominant members who influence the buying decisions. Identifying buying committee individuals, their technical and commercial expertise, their individual needs, buying decision process, and the organisation structure are the important tasks to be performed by the effective business marketer.

## SUMMARY

The business marketers need to understand the purchasing objectives and purchasing activities of the business buyers. The business buyers are influenced by both purchasing objectives of the firm and personal objectives. The business purchasing activities include eight phases of buying-decision making process, which are referred to as *buyphases*. There are three common types of buying situations (called *buyclasses*) in business buying. Understanding business buying becomes easier by combining buy-phases and buyclasses, and developing a conceptual model, called *buygrid framework*. The individuals involved in buying-decision process (referred to as buying centre members, or decision making unit

members) have certain roles. The business marketers should identify the key members of buying centre in each buying organisation. The business buyers are influenced by many factors when they make buying decisions. The major factors are organisational and personal, but there are other factors such as environmental and buying centre variables. There are two models of organisational buying behaviour. These are *The Webster and Wind Model* and *The Sheth Model*.

The Choffray and Lilien model is another useful and simple model that helps to understand the group decision process and to integrate major factors of organisational buying process. The business marketers should also be aware of some of the contemporary purchasing activities, such as just-in-time delivery, outsourcing and world-sourcing, single sourcing, value analysis, supplier evaluation, and buying committee.

### KEY TERMS

- Balanced scorecard
- Buy classes
- Buygrid framework
- Buying centre
- Buyphases
- Gatekeepers
- Multiattribute decision making
- Modified Rebuy
- New task
- Single sourcing
- Straight Rebuy
- World sourcing

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. At what phase(s) of the business buying process the business marketer should get involved and why?
2. Is the organisational buying process for services the same as that for physical products? Explain.
3. Describe any one of the techniques used by customer organisations for evaluating performance of suppliers? Why is it important for the sales person of the supplier firm to understand clearly the supplier evaluation system followed by the customer organisation?
4. What is a buygrid framework? What are the major results or conclusions one can draw from the analysis of buygrid framework?
5. What is a buying centre? Explain the major roles assumed by the members of a buying centre.
6. Describe any one of the models of the organisational buying behaviour.

### OBJECTIVE TYPE QUESTIONS

1. Buying situations (or type of purchases) are called: (a) buyphases, (b) buyclasses, (c) buygrid, or (d) buying centre.
2. The buying situation which involves the purchase of something not purchased before is called: (a) straight rebuy, (b) modified rebuy, (c) new task, or (d) none of the above.
3. The pathbreaking study by Robinson, Faris, and Wind found that the number of phases in the buying decision process of business buying organisations are: (a) seven, (b) eight, (c) nine, or (d) ten.
4. The objective(s) of evaluating supplier performance may be to: (a) qualify the potential suppliers, (b) select the future suppliers, (c) review the performance of present suppliers, or (d) achieve all the above.



5. Research indicates that in business buying organisations, the key buying influentials are most often located: (a) inside the purchase department, (b) outside the purchase department, (c) in both of them, or (d) in none of them.
6. The Webster and Wind model of organisational buying behaviour specifically considers four sets of variables—environmental, organisational, individual, and one of the following: (a) the buying centre, (b) situational variable, (c) cultural variable, or (d) technological variable.
7. The Sheth model of business buyer behaviour mentions four methods used for conflict resolution in joint-decision making process: problem-solving, persuasion, bargaining and one of the following: (a) negotiation, (b) mediation, (c) arbitration, or (d) politicking.
8. One of the techniques used in value analysis is: (a) bargaining, (b) persuasion, (c) brainstorming, or (d) none of the above.
9. Outsourcing is designed to save money on: (a) core functions, (b) non-core activities, (c) both of them, or (d) none of them.
10. The structure of buying centre: (a) remains same, (b) varies, or (c) becomes uncertain for different buying situations.

### APPLICATION QUESTIONS

1. A business marketer (who is 'out' or potential supplier) is keen to supply cold-rolled (CR) steel coils to a major passenger car manufacturer, who has been buying the same material from three other suppliers on regular basis for the past few years. As per the purchase policy, the car manufacturer cannot buy any material from more than three suppliers. What should the business marketer do to supply CR steel coils to the major passenger car manufacturer?
2. Large numbers of personal computers (PCs) are purchased by educational institutions in India for use of their students. Identify the factors or criteria that may be used for evaluation and selection of a supplier. Which technique of supplier evaluation would you suggest and why?
3. An international paint manufacturing company is setting up a new plant near Mumbai, India. The company wants to buy a material handling system for handling raw material, work-in-process, and finished goods for the first time. The company has appointed a technical consultant. The total value of business is estimated at about ₹5 million. Assume that you are the branch sales manager of one of the three major suppliers of material handling equipment. You are keen to get this business, and you want to apply the concepts and techniques that you had learnt at the management institute, where you studied three years ago. What would you do and why? (Make suitable assumptions, if need be).

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### CASE 3.1

#### India Textiles Ltd.: Fulfilling Purchasing Objectives\*

Mahindra Parikh, Senior Manager—Commercial, India Textiles Ltd., felt doubtful on bringing down the delivery time from 60 days to 45 days, demanded by some international buyers of garments. The company’s manufacturing unit at Bangalore produced garments like shirts, trousers, skirts and blouses for domestic as well as international customers, including Walmart, J.C. Penny, and Gap.

The production process included various operations like dyeing of yarn, weaving, and processing. The production was organised on three shift basis. The company had outsourced some of the operations like processing because it did not have facility to do the processing, although it had adequate space.

Mahindra asked the market research manager to get the information about the competitors’ delivery time for the garments. The market research manager informed him that only four out of about 100 garment (or apparel) manufacturing units were in a position to fulfil the important purchasing objectives of 45 days delivery time and consistent product quality.

Mahindra applied a lot of pressure on the existing processing firms to bring down the delivery time. However, he did not receive any positive commitments from them. Mahindra felt that it was very important to satisfy the delivery and quality objectives of the garment buying firms, in order to achieve the company’s sales and profitability goals.

#### Question

1. If you were Mahindra Parikh, what would you do?

\* This case was prepared by Professor Krishna K. Havaladar, based on the case data provided by Pooja Jain, Prakash Inani, Prithvi Hegde, and Sangeetha, MBA students of Alliance Business Academy, Bangalore.

**CASE 3.2****JET India Company: Organisational Buying<sup>1\*</sup>**

Shabbir, proprietor of JET India Company, sat in his chair contemplating about the challenges and hardships he would have to face in the coming months for procuring raw materials. He reflected upon the increasing costs and stagnating profits which made him worried.

**BACKGROUND**

As an inquisitive child, Shabbir started to work at the age of 14 accompanying his father who had a business in hydraulic pipes and valves. Capitalising on the knowledge he gained about carrying out a business, he later started a business of his own, trading in support systems for construction industry like M.S. (Mild Steel) rods, clamps, bolts and fasteners which are primarily used for construction of buildings.

The boom of information technology (IT) industry in India resulted in growing opportunities in the construction business. Hence, Shabbir vigilantly seized it by starting a small scale manufacturing firm called 'JET India' for producing construction support system equipment.

**ABOUT THE COMPANY**

JET India is a small scale manufacturing company located in Bangalore, India. The company started its operations in the year 2003 with a capital of ₹ 5 lakh (US \$10,000). The capital was raised from the profits earned from the earlier trading business. Shabbir did not take loan from banks or financial institutions as per his religious beliefs. The firm produces standardized products and its product-mix includes:

- Support system for the construction line
- Pipe supports
- Fan supports
- Air Conditioner supports

Based on the knowledge of the construction industry, the target market segments identified by the company are construction companies, builders, plumbing contractors, electrical contractors and air conditioning contractors.

JET India has competition from many other small scale units manufacturing similar equipment. However, the attributes of superior quality, timely delivery and competitive prices have created a strong brand name for JET India which is reflected in good demand for its products in the market.

**PURCHASING PRACTICES**

The prime raw material used in manufacturing the company's products is steel comprising the following components:

- GI (Galvanized Iron) sheets of sizes .8 mm, 1 mm, 1.5 mm and 2 mm
- Wire rods of sizes 7 mm, 8 mm, and 10 mm
- CR (Cold Rolled) sheets of sizes 1.5 mm and 2 mm

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<sup>1</sup> \* This case was prepared by Maryam Ezzy, an MBA student of Alliance Business Academy, Bangalore, under the guidance of Prof. Krishna K. Havaladar for classroom discussion.

JET India company's total monthly requirement of steel varies between 50 and 75 tons. The firm primarily sources its raw materials from SAIL (Steel Authority of India Limited), JINDAL Steel and TATA Steel. Under unavoidable circumstances, the company procures the same from the distributors or dealers of steel in the open market.

The purchasing objectives of the company are to procure raw materials of good quality at low cost and most importantly in a timely manner. However, these objectives are presented with challenges which make it difficult to achieve the same.

The government policy with regard to steel industry is often inconsistent. The prices of steel vary or fluctuate from time to time. Also, due to government regulations, the suppliers (SAIL and TATA Steel) provide steel on the basis of 'quota' (a fixed quantity) which is, in turn, determined on the basis of the production capacity of the manufacturing unit. However, due to limited availability of steel and huge requirements from numerous manufacturers, the suppliers supply only about 40–50 per cent of the manufacturers' requirements. **For example**, if the company requires 75 tons to meet its monthly production capacity, the quota given to it is only about 30–35 tons. JET India's production capacity is 75 tons and it can store inventory up to 100 tons. Once the quota is fixed, the firm cannot obtain the steel from the steel suppliers beyond the allocated quota. The larger the production capacity, the higher is the quota given to them. Thus, small scale manufacturers like JET India are given a very small 'quota'. Due to this reason, only about 50 per cent of the steel can be procured from the steel manufacturers and the remaining from the open market. Purchasing from dealers/distributors in the open market costs them an additional 10 to 15 per cent.

The difficulties of JET India Company seem to increase when the steel suppliers propose a rise in the prices of steel. They hold back supply of steel to sell at higher prices later. Large manufacturers are given preference and a large quantity of steel is supplied to them, leaving the small-scale companies like JET India in distress with a meagre quantity. In a situation like this, JET India has no choice but to purchase a large quantity of raw material from the open market (i.e. dealers or distributors) at much higher prices.

These hurdles have increased the cost of production and the company's profits have started to decline. At times, JET India sells below the cost of the product. Shabbir is looking for methods of reducing the cost and finding a solution to increase the company's profits.

### Question

What suggestions would you make to Shabbir to reduce costs and increase profits?

## CASE 3.3

### ABC India Limited: Purchasing Steel<sup>2\*</sup>

The Indian bearing industry has been estimated to be above ₹ 50 billion (i.e. about US \$1 billion) in the year 2008. While the organised bearing sector in India comprises 12 leading manufacturers who contribute to over 55 per cent of the total turnover, the unorganised sector contributes to almost 15 per cent of the total industry turnover. The remaining demand to the tune of 30 per cent is being imported, essentially for industrial applications and special purposes.

<sup>2\*</sup> This case was prepared by Manasa P, an MBA student of Alliance Business Academy, under the guidance of Prof. Krishna. K. Havaladar for classroom discussion.

ABC was founded in the early 1900's and it grew at a rapid rate to become a global company. ABC groups its technologies in five platforms: Bearings and units, seals, mechatronics, services and lubrication systems. By utilising capabilities from all or some of the platforms, ABC develops tailor-made offers for each customer segment, helping customers improve performance, reduce energy use and lower total costs.

ABC does business mainly through the following divisions:

- Industrial Division: serving industrial original equipment manufacturers (OEMs)
- Automotive Division: serving automotive OEMs and aftermarket customers
- Service Division: aftermarket customers
- Electrical & Two-wheeler Division

The OEM market for bearing represents the demand arising out of the original vehicles and industrial manufacturers. The demand for the OEM market directly depends upon the growth in the user industry. OEM market accounts for 40% of total demand of bearing industry. This market is characterized by requirements of high quality, stringent delivery norms and lower margins. OEM's have been facing price competition in their own markets, and they continue to exert price pressure on the local bearing suppliers.

The replacement market represents the demand arising on account of replacing the used and worn-out bearings. The size of replacement market is dependent on equipment population and frequency of maintenance. The margins in this market are relatively higher placed as compared to OEM market. The replacement market is highly price sensitive. It has a higher number of unorganised players and cheaper imported bearings. In 2008–09, Indian automobile and industrial sectors were facing a slowdown. This had led to lower growth in OEM segment and higher growth in replacement demand. The organised players were concentrating on improving share in the replacement market.

Since 2008, steel prices have appreciated significantly riding on the shortage of iron ore, one of the principal raw materials for steel. The significant increase in steel prices has resulted in pricing and margin pressures on bearing manufacturers.

ABC is facing procurement problems in recent times due to the ban in iron ore mining in Karnataka. Karnataka had to suspend operations in about 50 mines affecting supplies to a host of steelmakers and prompting large players such as JSW Steel and Tata Metaliks to consider a stoppage in production. Karnataka has 9 billion tonnes of reserves accounting for nearly 38 per cent of India's iron ore deposits. The crackdown on illegal mining has come at a time when Karnataka has emerged as a much sought-after location for major global steel sector companies planning to make inroads into India.

The tight supplies of iron ore have already led to a steep rise in the prices of iron ore. This has put a pressure on ABC's purchases. Steel and alloy steel form the basic material for the manufacturing of bearings and accounts for almost 45 per cent of the total cost. Steel prices have, therefore, significant impact on margins. To add on to this, the duty rates for steel have come down over the last few years and a few countries like China, Russia, Eastern Europe dump their excess production of steel at a very low price. This has led to huge price differentials between the domestic and imported bearings (almost 40–50%), encouraging the inflow of imported bearings into India. ABC is now in the quest of other alternatives to combat the current problem. Its purchase department is now engaged in a modified rebuy situation to identify low cost sources. ABC has now resorted to importing steel. This seems to be an immediate resort, but yet fluctuations in key raw material (steel) prices cannot be evaded in the long run.

The purchase manager of ABC India Ltd. was thinking about the various issues involved in the purchase of steel and wondered how to achieve the purchasing objectives of getting good quality steel at low prices with assured availability for the production of bearings.

***Question***

If you were the purchasing manager, what would you do and why?

# 4

## Buyer-Seller Relationship

*After studying this chapter you should be able to:*

- Understand the roles and relationship of business buyer and salesperson.
- Know the types of relationships between buying and selling firms.
- Study the steps involved in developing effective relationship marketing strategies.
- Learn the concepts of relationship marketing (RM), customer relationship management (CRM), and customer lifetime value (CLV).
- Understand the methods used by business marketers to influence business customers, as well as, special kinds of dealings between business buyers and suppliers.

The nature of buyer-seller relationship is an important factor which differentiates business marketing from consumer marketing. The focus of business marketing should be on buyer-seller relationship.

Development of mutually satisfying, profitable, long-term relationships with customers is a major business asset of a business marketer. We shall examine the various dimensions of buyer-seller relationship in this chapter.

### BUYER AND SALES REPRESENTATIVE INTERACTION

The most important part of buyer-seller relationship is the interaction between a representative of the buying organisation (buyer) and a representative of the selling organisation (sales representative or sales rep). There are many other persons from both the organisations involved in the relationship, but the basic building block of the relationship is based on buyer and sales rep's interactions.

When the buyer and the sales rep meet, the nature of their interactions depend upon their roles, behaviour, and perceptions.

#### Buyer's Perception of Sales Representative

There are two major perceptions held by buyers of sales representatives. One is the stereotypical description of the sales reps, as "talkative", "easy going", "manipulative", "competitive", "optimistic", and "excitable". A business buyer, who does not have previous experience with a particular sales representative, may respond to the sales representative in terms of the stereotype which he has of sales reps in general. The second major perception of the buyer depends on the reputation of the company which a sales representative represents. Generally, the sales representative of a company with better reputation always gets a more favourable initial response from the business purchasers. **For example**, a sales



engineer, working with a reputed company like Larsen & Toubro (L&T), often got a positive response from the business customers. However, when the same sales engineer changed the job to a less reputed company, as a sales executive, the response was not encouraging, as he had to wait for a long time before he was called in for discussions.

### The Role Played by Business Buyer

An analysis of business buyer behaviour indicates that personal needs, interaction in the buying centre, and organisational objectives (or needs) determine the response of a buyer to the selling efforts by a sales rep. **For example**, a business buyer may be motivated by a personal need for salary increment and promotion in his job, and also by a social or organisational need to satisfy the user department. A buying decision may allow the buyer to satisfy both the sets of needs. The specific personal and social needs will decide: (i) whether a buyer meets with a sales representative (rep), (ii) which parts of sales representative (rep) presentation he listens; (iii) the influence of sales presentation on his decision to buy.

How a buyer behaves also depends on his self-confidence, which, in turn, depends on how much risk a buyer thinks he is taking in a buying decision. A study reveals, that in large organisations, buyers holding key positions but without senior management status normally tend to be risk avoiders in making decisions. Often, it is seen that a buyer reduces the risk of buying from a new supplier at a lower price by (i) contacting other buyers in the trade to learn their experiences of the new supplier; and/or (ii) placing orders for only small percentage (say, 10 per cent) of his total requirements, so that if the new supplier fails on deliveries, production or operations are not seriously hampered.

Another study findings<sup>1</sup> state that the buyer's peers (such as colleagues and friends) have the most favourable influence on the buyer's attitude towards a sales rep's products. This is followed by the sales rep's interaction with the buyer, which is more effective than advertisement of the sales rep's products. However, it was found in a study<sup>2</sup> that for becoming aware of new products, 90 per cent of business buyers reported that advertisement was useful to them, as compared to 84 per cent mentioning sales rep's interaction.

### Is the Business Buyer Rational or Irrational?

From the various studies conducted, it is clear that business purchasing decisions are not always governed by a rational or logical review. Here, the word "rational" is defined as a long-term and fully considered view of all possible alternatives, in order to obtain maximum company profitability. In another major study,<sup>3</sup> based on interviews with 137 managers in 70 companies, Shoaf brought out two behaviour patterns of business buyer:

- (i) The business buyer is likely to be a *conformist*, that is, an organisation man. This produces a conflict, because although he wants to grow and help his company to grow, he is also (job) security minded, wishing to play safe and impress the boss.
- (ii) As products and services offered by various suppliers become more objectively alike, a buyer's final decision on buying is more and more based on subjective factors (or personal factors), such as personal treatment or favours from suppliers. **For example**, a chief engineer of a large public sector steel plant recommended 80 per cent share to the supplier **A** and 20 per cent to supplier **B** for an electrical circuit breaker although the offers of both suppliers were almost similar. Supplier **A** agreed to meet certain personal favours of the chief engineer.

In business buying, the organisational culture demands analysis of supplier proposals and justification for the selection of suppliers. Even when the decisions are based on subjective factors, the buyers rationalise their decisions by giving formal (i.e. written) analysis and justification.

### The Role Played by Business Sales Representative

Many of the observations made earlier regarding the role of the buyer also apply to the sales rep. The sales rep's behaviour is determined by his personal needs (e.g. his desire to earn a commission or a reward) and his social needs. The sales rep's behaviour is influenced by his desire to meet the expectations of his boss, his peers, and the customer. The sales rep's confidence in his own ability depends on his knowledge, training, personality, and previous experience.

The effectiveness of a sales rep would depend upon (i) his ability to sense how a buyer is reacting to what he says; (ii) his ability to understand the buying decision-makers in the buying organisation and to resolve, if there is any, conflict between decision making persons, (iii) clarity of the manager's (or superior's) expectations of the sales rep. If the buyers' expectations of a sales representative are not in line with the expectations of sales rep's superiors, there will be conflict, anxiety, and frustration. **For example**, if a customer asks for 45 or 60 days credit, and the sales rep's superior does not agree to give any credit, sales rep may lose a large-value order, after putting in a lot of efforts.

### Buyer–Seller Relationships/Interactions

Based on the research carried out by Dr Jagdish N Sheth, two major factors have been identified as the basis of the buyer–seller interactions or relationships. These two factors are: the *content* of information, and the *style* in which that information is exchanged. The successful interaction between the buyer and the seller takes place only when the buyer and seller are compatible in both content and style.

The content of information (or communication) includes product features, prices, services, as well as, individual needs of a buyer and a seller. The style of interaction includes mannerisms and the format used by a buyer and a seller in their communication (or interaction). There are three styles of interactions: (i) Task Oriented, (ii) Interaction Oriented (social and personal interactions), (iii) Self-oriented (pre-occupied with one's self-interest). Figure 4.1 shows the various types of interactions, based on style and content.

		Style of Interaction	
		Compatible Style	Incompatible Style
Content of Information	Compatible Content	Ideal Interaction	Inefficient Interaction
	Incompatible Content	Inefficient Interaction	No Interaction

**Source:** Jagdish N. Sheth, "Buyer-Seller Interaction: A Conceptual Framework," *Advances in Consumer Research*, Vol. III, pp. 133–144. Reprinted with the permission of Association for Consumer Research.

**Figure 4.1** Buyer–Seller Interaction—A Conceptual Framework

The buyer–seller interaction is a *dyadic* (two persons) *interaction*, consisting of transaction between a buyer and a seller. The transaction oriented buyer–seller interaction focuses on pre-sales activities and during-sales activities, and not on post-sales activities. Both the sales person and the buyer have personal needs, and organisational needs to satisfy. These needs become the starting point of their interaction.

### Need for Relationship Focus in Business Marketing

A major factor that recognises the difference between business marketing and consumer marketing is the relationship between buyers and sellers. We have described in Chapter 1 that the relationship between a buyer and a seller in business marketing is stable and interdependent, as against non-personal relationship in consumer marketing. Another aspect of buyer–seller relationship is that selling and marketing strategies in business marketing are generally directed towards either individual customer firms or a small group of customers (i.e. a market segment). Whereas in consumer marketing these strategies are directed towards mass markets.

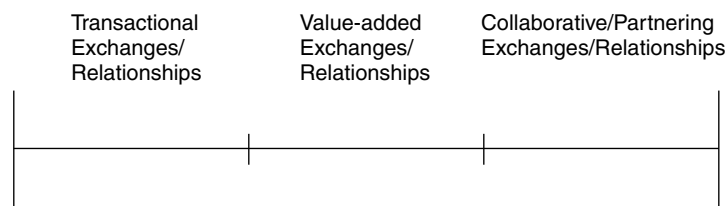
The distinctive feature of business marketing is the buyer–seller relationships. These relationships are strategically important to both parties. The buyer–seller relationships provide continuity, security, and predictability. They also create unique challenges in sustaining relationships.

Relationship between a customer firm and a supplier firm in business marketing starts from pre-sales activities like RFI (request for information), RFQ (request for quotation), negotiations, to purchase order placement and order execution, and further to post-sales service (if required), and repeat orders. Many of these activities are absent in consumer marketing, and hence, the importance of relationship between a buyer and seller in consumer marketing is much less.

Developing strong relationships with business customers is a major business asset for a supplier firm that is very difficult for competing firms to copy. The relationship between a customer firm and supplier firm depends upon their mutual interest in working together. We, therefore, will first discuss the types of relationships, and then how to develop effective relationship marketing strategies, and the concepts of relationship marketing (R.M.), customer relationship management (CRM), and customer lifetime value (CLV).

### TYPES OF RELATIONSHIPS

Buyer and seller firms (or customer and supplier organisations), who do business together have some types of business (or working) relationships. These relationships have a range or spectrum, as shown in Fig. 4.2.



**Figure 4.2** The Relationship Range/Spectrum

At one end of the relationship range is the *transactional exchange* or relationship, and at the other end, the relationship is called *collaborative exchange* or *partnering*. Every business relationship is an exchange, which is the process of obtaining a desired product or service from someone by offering something in return.

In practice, the attitude and culture of the organisation are reflected in the attitude and behaviour of individual buyers and sellers. In some instances, the business buyers want only transactional relationships and selling organisations must accept this view.

### Transactional Exchanges or Relationships

It focuses on timely exchange of a basic product for a competitive price between the customer and the supplier. Transactional exchanges include one-time-only exchanges with economy and necessity as the main motivational factors. There is little interest by either the buyer or the seller to extend the relationship. Negotiations are held by the buyer in transactional exchanges to get the best terms, mainly the lowest prices, from the suppliers.

Business marketers must understand that some customers may prefer transactional relationships and others may choose value-added exchanges or collaborative relationships depending on differing needs and orientations of customers. Customers are likely to prefer a transactional relationship, when (a) many suppliers are available, (b) the supply market is stable, (c) the purchase decision is not complex, and (d) the purchase is considered as less important to the achievement of the firm's objectives. Buyers of office supplies like stationery materials, and cleaning services are some of the **examples**, which fit the above characteristics.

Transaction-oriented customers show less loyalty to a particular supplier. They may switch purchases from one supplier to another. Such customers are called “switchers”. A business marketer has a good chance of getting business from a transactional customer, if the company makes a timely offer of attractive combination of product, price and technical support (if needed). The salesperson has a *dyadic relationship* with purchase staff of a buyer organisation. Business marketers need not make any specialised investment in transactional relationships.

Business marketers must understand the customer needs, costs of serving business customers, as well as sales and profit potentials of different customers. The least profitable customers may be the right customers for the transactional exchanges (or relationships).

### Value-added Exchanges/Relationships

Between the transactional exchanges and collaborative exchanges are the value-added exchanges. The selling firm groups these customers in “B” category, who are between the least profit potential customers of, say, “C” category, and the most profit potential customers of, say, “A” category.

The focus in value-added exchanges is on complete understanding of the present and future needs of the customer, and meeting those needs better than competitors, so as to obtain a maximum share of the customer's business. **To illustrate**, a precision tube manufacturing company had built adequate stocks in its warehouse located near a two-wheeler manufacturer to meet the fluctuating requirements of superior quality tubes of different sizes. The two-wheeler manufacturer needed flexibility in delivery schedules, since there were wide variations in the demand for different models of two-wheelers. This need of flexibility was met completely by the tube supplier.

This category of customers are called “split loyals”, as they are loyal to two or three suppliers.

### **Collaborative/Partnering Exchanges (or Relationships)**

Moving across the relationship range, as shown in Fig. 4.2, is the collaborative (or partnering) relationship between the customer and the supplier.

The focus of collaborative exchange or relationship here is between a customer firm and a supplier firm, and it is the process of building strong social, economic, service, and technical ties over a long period of time. The purpose of partnering is to lower the total costs or increase value, in order to achieve mutual benefits. This is achieved by giving importance to joint problem solving and multiple connections, in order to integrate the processes of the two companies. Both the firms work toward bringing their capabilities together and thereby provide value for each company. Such customers are called “hard-core loyals”, as they may buy from one supplier.

The foundation for collaborative relationship are *commitment* and *trust*. *Commitment* includes acceptance by both partners that the relationship is so important that it deserves maximum efforts to continue with it. *Trust* is found when one organisation has confidence in the other firm’s honesty and dependability.

### **Examples of Transactional, Value-added and Collaborative Relationships**

There are several instances when companies did not understand the business customers:

- An electrical equipment manufacturer in India, named AEC, was asked to give a proposal by Patrat Power Station, a state government owned electrical sub-station unit for replacing 20-year-old Russian motors. After inspecting the motors, the equipment manufacturer quoted equivalent motors with relevant Indian Standards. However, being a government unit, the sub-station management had sent the similar tender notices to three other large equipment manufacturers for submission of their offers. The large value order for replacement of Russian motors went to the lowest bidder and not to AEC, which had quoted high prices. AEC failed to understand that the sub-station was a government unit that followed transactional relationship with the lowest price policy.
- Hero cycles, a large manufacturer of bicycles, was buying precision steel tubes, which was the major component for the production of bicycles, from three suppliers of precision tubes. Based on the value of just-in-time delivery of good quality of precision tubes at competitive prices, the bicycle manufacture placed orders for precision tubes on three companies, viz. TI with 50 per cent share, STI with 30 per cent share and Tata Tubes with 20 per cent share of the total requirement. TI company, which provided superior value, understood the customer’s needs clearly and satisfied those needs better than the other two suppliers.
- Maruti Suzuki, having the highest market share of passenger cars in India, developed collaborative or partnering relationship with many vendors or ancillary manufacturing units, supplying a large number components. Maruti Suzuki provided technical support to vendors with joint problem solving approach, and integrated production planning of vendors with that of the company. Vendors are treated like business partners by Maruti Suzuki company.

## **DEVELOPING EFFECTIVE RELATIONSHIP MARKETING STRATEGIES**

Business marketers have a set of customers with whom they have a range of relationship—transactional, value-added, and collaborative—as described earlier. It is important that the business marketing firm

develops effective relationship marketing strategies by going through the following steps: (1) Linking CRM system with customer databases, (2) selecting customers, (3) developing relationship marketing objectives and strategies, (4) implementing relationship strategies, (5) evaluating relationship objectives & strategies.

### Linking CRM System with Customer Databases

For effective relationship marketing strategies, the business marketing firm should build databases of each customer firm by using customer relationship management (CRM) software. The database should have a profile of each customer firm including customer lifetime value, key decision influentials, specific needs of goods and services, past purchases of various products and services, relationship, purchasing orientations and practices, and so on.

In the above mentioned customer database, **the lifetime value of a customer firm** is the net present value of the total current and future revenues a given customer generates for a marketing company minus all costs associated with getting and attending the customer. In other words, it calculates the potential profitability of each customer.

In general, the following information may be included in customer databases:

- Basic information: name, address, mail ID, telephone—land and mobile numbers.
- Company information: buying centre members, products and services purchased, type of customer (government, private sector, institution, cooperative sector), financial position, and so on.
- Psychographic information: values, personality, lifestyle of buying centre members.
- Transaction history: transactions carried out by customers, frequency of purchases, payments made.
- Other relevant information: satisfaction, loyalty, inquiries sent, orders received, type of service required, and so on.

The increasing use of information technology and the internet has made it possible for firms to collect and analyse large amounts of data on their present and potential customers. This is how customer databases are developed. CRM takes database marketing to individual customers, and develops company-to-customer relationships. CRM is defined in different ways, and one of the accepted definitions is as follows:

**Customer relationship management (CRM)** is the process that identifies customers, develops, and analyses customer and marketing databases, builds customer relationships, influences customer perceptions of the company and its products, and maximizes the lifetime value of each customer to the firm.<sup>5</sup>

Web-based CRM softwares are available to business marketers. Siebel Systems, which is the world's leading provider of customer relationship management (CRM) solutions, introduced web-based CRM software in September 2005<sup>6</sup>. The Siebel Call Centre application software enabled its client, CNT to manage, synchronize, and distribute all customer contact information to all three service and sales channels. Customer relationship management (CRM) systems are often enterprise software applications that integrate sales, marketing and customer service functions<sup>7</sup>.

We shall discuss more about CRM later in this chapter.

## Selecting Customers

Business marketers first segment the total market, as discussed in Chapter 6, for a product into several segments (i.e. distinct group of buying firms), by using different bases or variables. They then estimate the value of their offerings (which can be a combination of products, services, information, and experiences) to these segments. The **value in business markets** is the worth in monetary terms of the economic, technical, service and social benefits received by a customer firm in exchange for the price paid for a product offering<sup>8</sup>. Business marketers, therefore, target one or more market segments, where the company's offering has superior value in relation to its competitors. Such segments are meant for collaborative or partnering relationships. Those segments where the firm's offering does not provide superior value, transactional relationships are given importance.

After deciding the target market segments, business marketers look into individual customer firms. Individual customer (or account) selection process should consider profit potential of customer firms. For estimating profit potential, the business marketer should have an accurate knowledge of the customer needs, sales potential, and costs of serving the customer.

To illustrate selection of customers, let us look at the **example** of an electrical engineering company, manufacturing and marketing electrical motors. This company had three market segments: **(1) original equipment manufacturers** (OEMs) such as industrial pump manufacturers, and air compressor manufacturers who needed electric motors for their finished products on regular basis, **(2) user industries** like steel plants and electrical sub-stations, who needed electrical motors as replacements, not on regular basis, and **(3) small-scale industries** whose requirements were of small volume, such as flour-mills and juice-makers. The company decided to target OEM customers with high sales and profit potential for partnering or collaborative relationships who valued such relationships and supporting services. User industries typically were price sensitive as well as looked for immediate availability, and hence, the company decided to have transactional relationships with them. The third segment, viz—small scale industries, were passed on to the company's dealers to look after.

## Developing Relationship Marketing Objectives and Strategies

In Fig. 4.2 we discussed earlier a range or spectrum of relationships between buying and selling organisations. Before developing marketing strategies, the business marketing firm should study the nature of buyer–seller relationships in its industry, and the relationship strategies followed by its competitors. The business marketer should then satisfy the specific customer needs better than its competitors by tailoring the objectives and strategies to customers, who may require collaborative, value-added, or transactional relationships.

**Collaborative relationship strategy** This should be developed for those customer firms who value partnering or collaborative relationships with supplier firms with the objective of mutual benefits or joint value. As discussed earlier in Chapter 2, these customer firms have overall purchasing philosophy or orientation of “supply chain management”. These buying organisations support collaborative relationships with major suppliers to achieve the objective of delivering superior value to their customers or end users. The business marketer identifies the customer firm for collaborative relationship strategy which includes coordinated teams from the buying and selling firms working together effectively in order to reduce costs substantially, resolve technical problems, and ensuring superior delivery

performance to the customer's customers. **For instance**, this strategy is visible in automotive industry (including two- and four-wheeler manufacturers) in India, where they mostly show “hard-core loyalty” by buying from one vendor.

**Transactional relationship strategy** Many buying firms prefer to have transactional relationships with supplier firms. As explained earlier in Chapter 2, these customer firms have purchasing philosophy or orientation of “buying”, which means they want to gain power over supplier firms by using tactics like multisourcing and commodification, and typically selecting the lowest price suppliers. Business marketers should respond to such “buying oriented” customer firms with transactional relationship strategy by offering a generic product with basic properties, which give fundamental benefits, at lower price, and meet the availability requirements of the customer. If these customers want augmented services, such as technical assistance, maintenance and repair services, and training, each of these services should be offered on an incremental and additional price basis. These incremental prices for the total set of augmented services should be higher than those offered to collaborative relationship customer firms. Typical **example** of transactional relationship strategy is seen with government customers, who usually place orders on lowest price bidders.

**Value-added relationship strategy** Typically these buying firms are between the two ends of the relationship spectrum, shown in Fig. 4.2. These customer firms have “procurement orientation” (see Fig. 2.3 in Chapter 2), with strategic focus. They seek quality improvements and cost reductions. These objectives are achieved through collaborative relationships with key suppliers. Business marketers should respond positively with value-added relationship strategy by understanding completely the needs of the customer firm and satisfying those needs (e.g. product quality and delivery service) better than competitors. Typically, these customer firms are “split loyals”, as they are loyal to two or three supplier firms. Hence, the business marketer should try to get maximum share of business from the customer firm by offering superior quality of product and service, or superior value.

## Implementing Relationship Strategies

Relationship strategies can be successfully implemented with a proper organisation structure and effective use of salespeople along with support staff from technical service and logistics departments. In some business marketing organisations the salesforce is divided into different groups. Each sales group serves a special class of customers, such as key accounts, transactional accounts, and trade accounts.

**Key accounts** (i.e., major or national customers) are served by a team consisting of key accounts executive, technical support engineer, logistics executive (if the key account wants the product to be delivered at several locations), and an inside salesperson to coordinate and communicate with the key account. In some marketing firms, key accounts team is headed by a branch or regional sales manager, or a national accounts manager. The objective to be achieved by the key accounts team is to be the sole or preferred supplier to the key account. This can be achieved by implementing the collaborative relationship strategy discussed earlier through the key accounts teams. Key account executives are also assigned to value-added relationship accounts, and depending on the needs they are allowed to take the help of technical and logistics persons. In fact, sometimes these value-added accounts' business grows over a period of time to the level of key or major accounts.

**Transactional accounts** are usually served by individual salespersons who are assigned a geographical area and are responsible for all selling activities to all customers, except those served by



key accounts executives, within the assigned area. They perform traditional selling activities, such as visiting prospective and current customers as per sales plan, understanding customers' requirements, submitting quotations or offers, giving sales presentations, negotiating, getting the customer orders, collecting payments after the orders are executed, and giving service as required by customers.

**Trade or dealer** salesforce of the company contact the dealers or distributors on regular basis, help them to stock and sell the manufacturer's (or the company's) products, train the dealer's salespeople, and provide required service. Telemarketing people contact the prospective customers on telephone and assign them to individual salespeople or dealers depending on their business potential.

### Evaluating Relationship Objectives and Strategies

Both the buyer and seller firms should evaluate the objectives and strategies of their relationship on a regular basis. The objective of mutual benefits or joint value that was defined in the beginning need to be reviewed in terms actual results obtained. **For instance**, one shock-absorber manufacturer agreed to give 100 per cent business (as a sole supplier) to a precision steel tube supplier, if the supplier achieves the objective of reduction in the rejection level of the steel tubes from 0.5 per cent to 0.2 per cent with superior quality and perfect delivery (i.e. on-time and required quantity). When the evaluation was done after six months, both the buyer and supplier were satisfied that the objective was achieved and therefore, extended the partnering relationship by another year.

Sometimes customer requirements change due to various reasons, such as pressures for cost reduction from competitors, change in technology, or changes in the customer's markets. **For example**, Ford Company asked suppliers to cut costs by five per cent per year through early 2000s. Business marketing firms should continuously monitor the changing needs of key customers. The customer's definition of value may change over the period of collaborative relationship. It is, therefore, important that the business marketer adopts continuous improvement policy in order to succeed in the customer relationship strategy.

After evaluating relationship objectives and strategies, if the customer and supplier firms come to a conclusion that the collaborative relationship strategy has not achieved the objectives, then the collaborative relationship strategy is downgraded to transactional relationship strategy. Similarly, there may be upgradation from transactional to value-added relationship and value-added to collaborative relationship strategies. It is, therefore, necessary to review or evaluate relationship objectives and strategies between the buyer and seller after an appropriate period.

## RELATIONSHIP MARKETING (R.M.)

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All customer and supplier firms that do business together have some kind of working relationships, which has a range, as shown in Fig. 4.2. Relationship marketing focuses on collaborative or partnering relationships between customer and supplier firms. The aim of relationship marketing is to build mutually satisfying long-term relationships between key parties—customers, suppliers, distributors—in order to gain and retain business<sup>9</sup>. Relationship marketing builds strong economic, social, and technical (or structural) ties for developing strong customer bond or loyalty.

Berry and Parasuraman<sup>10</sup> have identified three approaches—(1) **financial** and (2) **social benefits**, (3) **structural ties**—for forming strong customer bonds. The first approach is to add financial benefits to the key customer by offering special prices, or volume discounts. However, these benefits can be

copied by competitors and cannot be used to differentiate in the long-term. The second approach is to give social benefits, in addition to financial benefits. This is done by individualising and personalising customer relationships. Business customers can be served on an individual basis by the professionals from the supplier firm. The third approach is adding structural ties to financial and social benefits. **For example**, supplying a special software programme, or technical training to the customer's maintenance staff.

Today's key or major customers are large and sometimes global. They prefer suppliers who can deliver products and services to many locations. They expect suppliers to solve problems quickly and work with customer teams to improve products, services, and processes. Key sales executives who are assigned to these key accounts are expected to be in close contact with them, understand their problems, make useful suggestions, and develop a long-term partnering relationship.

Barbara Jackson argues<sup>11</sup> that relationship marketing is not effective in all situations, but is extremely effective in the right situations. Relationship marketing pays off handsomely with customers who have a long-term focus with major suppliers, support collaborative relationships, have high sales and profit potential, and expect suppliers to deliver superior value. The **example** of relationship marketing for the suppliers of tyres and automotive batteries are the automobile manufacturers like Tata Motors, Ford, Maruti Suzuki, who are OEM (Original Equipment Manufacturer) customers. Transaction marketing is suitable (and not relationship marketing) for customers who have a short-term approach, have a low sales and profit potential and want to reduce costs by switching or changing suppliers. Business marketers should deal with such customers on transaction basis and not on relationship building basis. Business marketing firms should analyse and decide which market segments and which specific customer firms would respond profitably to relationship marketing.

The relationship marketing concept builds mutually satisfying long-term (i.e. strategic) relationships not only with customers, intermediaries and suppliers, but also with other broader sets of stakeholders, such as employees, the surrounding community, and the society as a whole. However, as per the current concept of “360 degree view of serving customers”, relationship marketing focuses increasingly on sustaining long-term relationships with the organisation's most profitable customers. **For example**, Hewlett Packard (HP), which practices relationship marketing, has built a unique company asset called a **marketing network** that includes the company and its supporting stakeholders, such as Intel (the highly respected manufacturer of microprocessor), Nokia (the Finnish wireless technology innovator), Agilent Technologies (which specialises in testing and measurement products and standards) and Celestica (the manufacturer of printed circuit boards). In addition, HP has built relationships with universities that supply its talented employees. Companies have recognised that competition is not between organisations, but between marketing networks. Successful companies will be those that have built better marketing network of relationships with key stakeholders.

Organisations engaged in relationship marketing activities are also often involved in the practice of “**customer relationship management (CRM)**”, which is a process of identifying, attracting, differentiating, and retaining customers.

## CUSTOMER RELATIONSHIP MANAGEMENT (CRM)

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The buzz for CRM began seriously in late 1990s. The definition of CRM varies, as can be seen below the opinions of some of the people who are from the industry:

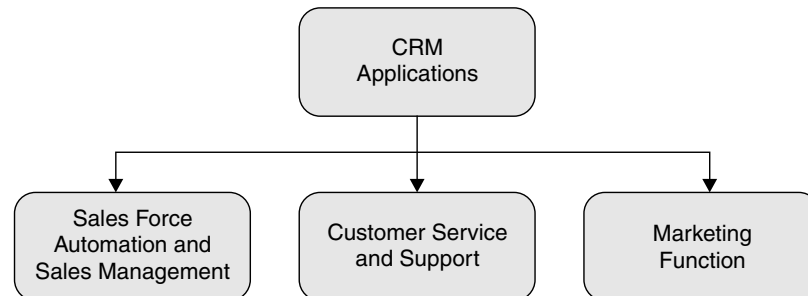
## How do we define CRM?

- **Brent Frei, President and CEO, Onyx Software:** “It is a comprehensive set of processes and technologies for managing the relationships with potential and current customers and business partners across marketing, sales, and service regardless of the communication channel. The goal of CRM is to optimise customer and partner satisfaction, revenue, and business efficiency by building the strongest possible relationships at an organisational level. Successful CRM requires a holistic approach to every relationship with the entire organisation sharing and contributing to that view.”
- **Peter Keen, Chairman, Keen Innovations:** “Customer Relationship Management (CRM) is the commitment of the company to place the customer experience at the centre of its priorities and to ensure that incentive systems, processes, and information resources leverage the relationship by enhancing the experience.”
- **Robert Thompson, President, Front Line Solutions, Inc.:** “CRM is a business strategy to select and manage customers to optimise long-term value. CRM requires a customer-centric business philosophy and culture to support effective marketing, sales, and service processes. CRM applications can enable effective customer relationship management, provided that an enterprise has the right leadership, strategy, and culture.”
- **Darrell K. Rigby, Frederick F. Reichheld, and Phil Schefter, Consultants:** “CRM is the bundling of customer strategy and processes, supported by relevant software, for the purpose of improving customer loyalty and eventually, corporate profitability. The imperatives of CRM are acquiring the right customer, crafting the right value proposition, instituting the best processes, motivating employees, and learning to retain customers.”

From the above-mentioned some of the general definitions of CRM, we understand that CRM is not only getting a software, but also developing customer strategy, business processes, and customer-centric culture of the employees of the organisation. In many cases, CRM systems are software applications that integrate sales, marketing, and customer service functions<sup>12</sup>. The **main objective** of CRM system is to give to all customer interacting persons and departments access to shared customer data in real time. Salespersons, customer service people, sales and marketing managers, accounts department staff, and any other employee of the organisation—all have the same real-time information on each customer. **For example**, if the marketing manager of a material handling equipment company wants to visit a key customer firm, as a part of building a long-term partnering relationship, before meeting the senior executives of the customer firm, he gets all the information about the firm through the CRM system, so that he is well-prepared to discuss various issues to create a favourable impact. We shall now look at some of the applications of a CRM system.

## CRM Applications

Some of the CRM applications that we shall discuss briefly are: (1) Salesforce automation and sales management, (2) customer service and support, (3) marketing function, as shown in Fig. 4.3.



**Figure 4.3** *Components of CRM Applications*<sup>13</sup>

**Sales Force Automation (SFA) and Sales Management (SM)** The objectives of sales force automation and sales management applications are to help salespeople acquire and retain customers, minimise time spent on administrative work, get competitive information, use sales process and sales forecasting methods. The CRM system is useful for both salespeople and sales managers. **For example**, Compaq Computer<sup>14</sup> has got excellent results from SFA and SM modules in the CRM system, which include the database where Compaq people from different departments record their contact with present and prospective customers. The CRM system includes marketing material, technical reports, application stories, and e-mails. Salespeople, customer service personnel, and field sales managers can scan the network to get the latest information. All of them can make use of the updates from the database. Some salespeople say that SFA is more useful in nonselling activities like sales report preparation, sales forecasting, and getting customer information. However, for some of the activities of the selling process, such as identifying customer needs or problems, overcoming customer objections, and closing sales, sales force automation are less useful.<sup>15</sup> Some of the major players who include SFA and sales management modules in CRM packages are Siebel, PeopleSoft, SAP and Oracle. In a competitive marketplace, sales force automation and sales management applications of CRM have become necessity and hence, marketing and sales managers must introduce the technology to salespeople, with needed training so as to improve the performance of the sales force substantially.

**Customer Service and Support (CSS)** This mainly consists of after-sales service activities, such as help desks, contact and call centres, and field service support. In the Internet age, we have customer interaction centre (CIC), which is also known as customer contact centre or multimedia call centre. CIC allows a customer to call on his/her phone and go through a website that will handle most common problems easily with online information. In this CRM application, the customer directly interacts with the company through a customer service person and a number of communication channels like e-mails, faxes, and the Internet. The Gartner Group has predicted that increasing number of call centres will have integrated live Web contact points or somekind of automated e-mail response. Some of the players who offer customer interaction centre or customer contact centre as a part of CRM multifunctional solutions are People Soft (including Support, Field Service, and Help Desk), Amdocs Clarify (consisting of Clear Call Centre, Clear Support, Clear Contracts, Clear Help Desk, and so on), Genesys (SUITE 6 Version 6.5, GPLUS ADAPTERS), and Siebel (Call Centre and Service).

**Customer interaction management (CIM)** has emerged as a sub-segment of customer relationship management (CRM) as a post-sales or after-sales effort for a company. CIM can help collect and

manage the information to measure and optimise customer experience. CIM software market was expected to cross 1 billion in 2008, according to Gartner's research. In mature markets like North America and Europe, CRM and CIM software products are sold separately, but in India, they are sold as a package. CIM is essentially targeted at business markets.

**Marketing Function** The CRM system should integrate important marketing activities, such as lead generation and follow-up, web-based information, market segmentation and targeting, multi-channel operations. Individualised marketing is becoming expected norm of conducting business. If the frequency of contacts of a supplier's web site by customers goes up, buying through the internet channel is likely to go up. A good **example** of integrating main activities of marketing is seen in Capital One Company, in which the CRM system integrates segmentation, customer data analysis, competition and marketing strategies.

### CRM Application to SMEs

Small and medium enterprises (SMEs) have realised the importance of customer relationship management (CRM). A modern CRM solution enables the SME to manage the entire lifecycle of a customer – from generating sales leads to closing sales, and providing superior customer service support that results in additional business. Ajit A. Kamath, CMD, Arch Pharma Labs Ltd, winner of Emerging India Award 2006, says "CRM continuously assesses performance with systematic feedback from customers, thus constantly reviewing the organisation's adaptability in the changing business environment." Another winner of Emerging India Award 2007, Mamta Apparao, chairperson, Kama Jewellery (India) Pvt. Ltd., says "CRM is a very successful module and for us it has been very beneficial. Our customers can just log in through the system which is integrated to our backend. So with just a click of a button, our customers can get online information on pricing, design and so on."

Daniells, Regional Sales Director, Epicor Software Corporation, feels that for most companies, responding to customers in a timely and meaningful manner can be the difference between keeping their business and losing them to a competitor. A world-class CRM solution can help the SME deliver first-rate service to its customers while controlling costs.

**An important note** It should be understood that simply installing a CRM software does not ensure a successful customer relationship. To achieve this, business processes and the company culture both have to be redesigned to focus on the customer. In short, customer centric company culture, customer focused business processes, and CRM software have to be integrated to ensure successful customer relationship.

### Development of CRM

We shall examine the stages of development of CRM from 1990s up to now. As shown in Table 4.1, CRM has changed its position (or approach) from an operational (or functional) purpose to a strategic purpose.

**First Stage of CRM development** In early 1990s, the major activities or applications of CRM were in the areas of sales force automation, sales management, and customer service and support. These activities achieved the objectives of improvements in sales and service. However, there was no proper integration of these applications with the back office operations like manufacturing and distribution. Besides, the market for these applications was also not large enough.

**Table 4.1** Stages of Development of CRM

<i>Particulars</i>	<i>First Stage</i>	<i>Second Stage</i>	<i>Third Stage</i>
Objectives	<ul style="list-style-type: none"> <li>▪ Improve sales and sales management</li> <li>▪ Improve customer service</li> </ul>	<ul style="list-style-type: none"> <li>▪ Integrate major marketing activities</li> <li>▪ Increase customer retention</li> <li>▪ Reduce cost</li> </ul>	<ul style="list-style-type: none"> <li>▪ Integrate entire organisation</li> <li>▪ Improve profitability</li> </ul>
Approach	Functional	Customer oriented	Strategic
Activity	<ul style="list-style-type: none"> <li>▪ Sales force automation</li> <li>▪ Sales Management</li> <li>▪ Customer Service and Support</li> </ul>	<ul style="list-style-type: none"> <li>▪ Integrate customer-facing activities like sales, customer service, and marketing</li> </ul>	<ul style="list-style-type: none"> <li>▪ Integrate customer-facing front-end systems with back-end systems</li> </ul>
Approximate Period	1990–1996	1997–2002	2003 onwards

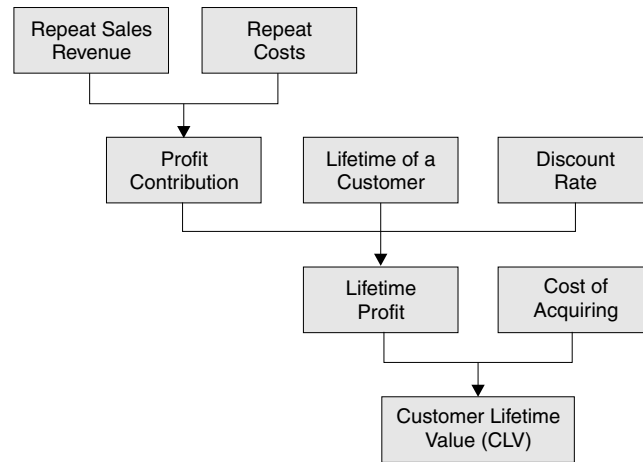
**Second stage of CRM development** In late 1990s and early part of 2000, the objective to be achieved was to integrate all the activities or interactions with customers, so as to develop one view of a customer. This means that an organisation may have different reasons for contacting customers, such as selling, pre-sales service and post-sales service. It may contact customers in different ways like letters sent through postal mails or e-mails, and on phones. Whatever may be the reasons and ways of contacting a customer, the company must evolve a CRM system, which should achieve the objective of one view of the customer. However, this laudable objective could not be achieved during the period of the second stage and hence there was a widespread disappointment with CRM implementation. Many firms talked about the failure of CRM technology as well as implementation process.

**Third stage of CRM development** In the early part of 2003, many firms realised (based on their experience of implementing CRM systems) that they had to adopt a strategic approach to CRM implementation process, as well as, integrate customer-facing front end systems like sales, marketing and customer service with back end systems like distribution and manufacturing. The strategic approach to CRM implementation process included important areas like customer-centric culture of employees, redesigning business processes, and of course, investing in the CRM software technology. **For example**, some banks used CRM technology in mid-1990s<sup>16</sup>. Unfortunately, the banks did not get suitable returns from their large investment in CRM technology. In the early part of this century, CRM gained a bad name in the banking industry. Neither the suppliers of CRM technology nor the banks realised that CRM goes much beyond technology into the areas of people (i.e. customer-centric culture of employees) and business processes. It was only after adopting the strategic approach to CRM implementation process, and integrating with banking applications like core banking system, the banks started getting the benefits of 360-degree view of customers in real-time. This included a customer's entire relationship details, such as multiple product holdings, sales opportunities, marketing campaigns, support and service incidents, and the history of all interactions with the bank. The objectives of integration and profitability in terms of growth in the revenue and control of cost were achieved in the third stage of CRM after 2003.

## LINKING CRM TO CUSTOMER LIFETIME VALUE (CLV)

The concepts of customer value and customer lifetime value are used to link CRM to profits. We earlier (in Chapter 1) defined customer value (or value) as the ratio between what the customer gets (i.e. benefits) and what he gives (i.e. costs). There is another definition of customer value—that is, the economic value of the customer relationship to the organisation. This is expressed as ‘profit contribution’ or ‘net profit’. One of the definitions of CRM, quoted earlier in this chapter, by Rigby, Reichheld, and Schefter, was: “CRM is the bundling of customer strategy and processes, supported by relevant software (and customer databases), for the purpose of improving customer loyalty and eventually, corporate profitability.” This definition establishes a linkage between CRM and profitability. Since the concept of CRM is relatively new, consulting firms and organisations have developed their own definitions of CRM.

The general term used to describe the long-term economic value of a customer is referred to as **“Customer Lifetime Value” (CLV)**. Typically, CLV models calculate the net present value of a customer’s profit margin accounting for firm-level retention rate. Conceptually, the process of calculating CLV is shown in Fig. 4.4.



**Figure 4.4** Process of Calculating Customer Lifetime Value (CLV)

After understanding the process of calculating CLV, we can calculate CLV based on the available data and the basic formula (or model). The basic formula for the lifetime of a customer is:

$$CLV = \sum_{t=1}^n PC_t \left( \frac{1}{1+d} \right)^t,$$

where

- $CLV$  = Customer lifetime value of a customer
- $PC$  = Profit contribution
- $d$  = Discount rate (or interest rate)
- $t$  = Time unit
- $n$  = Duration over years
- $\Sigma$  = Summation of profit contributions across time periods

The profit contribution may vary from customer to customer and also across time periods. The above formula is typically based on past customer behaviour. The information on profit contribution and the duration ‘ $n$ ’ are obtained from actual purchase data or managerial opinion. The discount or interest rate is a function of (or relationship with) a company’s cost of capital, which can be established from finance department.

The above formula, can be broken down as follows:

$$CLV = \sum_{t=1}^n PC_t (S_{xt} - PC_{xt}) - MC_{xt} + \left( \frac{1}{1+d} \right)^t,$$

where

$CLV$  = Lifetime value of a customer in \$ or ₹

$S$  = Sales to customer ‘ $x$ ’

$PC$  = Cost of Products purchased by customer ‘ $x$ ’

$MC$  = Marketing Cost of customer ‘ $x$ ’

The cost is broken down to direct products-related costs and marketing cost. If data is available, one can include other relevant costs like delivery cost and customer service cost. The information on sales, cost of products, and marketing cost are generally available internally in the company. Activity-based costing (ABC) method is used by increasing number of companies to determine these costs, instead of converting from traditional or natural accounting expenses to functional and product expenses.<sup>17</sup>

## Benefit and Cost Analysis of CRM

The business marketer can benefit by implementing a customer relationship management (CRM) system. The most important benefit of the CRM system is to identify attractive accounts (i.e. customers) and to retain them. The costs of CRM system in dollars or rupees, personnel, and time can be high.

### Benefits of CRM

- **Unified customer database** In CRM system, the company maintains a reliable customer database about past, present, and potential customers. For each customer, it includes all relevant information, like sales potential, prices, the supplier’s share of the customer’s business, buying team members, buying orientations and practices, products and services purchased, and so on. This database can be used by salespeople, sales and marketing managers, customer service engineers, and all those persons and departments who are in touch with customers. The CRM system helps sales people to save time, improve customer service, increase sales revenue, and reduce cost. Here is an **illustration**:

Dell South Africa’s CRM system provided a single integrated view of its customers. Dell obtained detailed information about their customers. It changed the functioning of the salespeople by taking away the need to maintain customer information in any other format like spreadsheets and outlook. The marketing team tracked customer activity, used available segmentation data, and developed marketing campaigns. There was an overall improvement in Dell’s performance in South Africa due to adoption of CRM system tailored to its needs.<sup>18</sup>

- **Retaining customers** Business marketers recognise that keeping or retaining existing customers can improve a company’s profitability substantially. For getting this benefit, business market managers develop customer retention plan<sup>19</sup>, which includes the following tasks.



Business marketers should track customer retention on continuous basis by measuring, each customer's total business potential, the supplier's share of the business, cost of serving the customer and the customer's contribution to profitability. Business market managers also track customer defections, contact lost customers, analyse customer complaints, and use the important information to improve the company's products and services. For customers with whom the company has collaborative relationships, marketing managers use appropriate strategy to ensure superior value, and for transactional customers, they lower the price by deleting unnecessary services. Let us consider the following **example**:

Travelers<sup>20</sup>, an insurance company, was faced with the problem of building profitable relationships with customers through many independent agents. The company implemented a CRM system (or programme), which was built from their customer database, to interact with customers in a systematic and low cost way. These interactions were having five touches: an annual review, a thank you card, a cross-sell post card, a newsletter, and a seasonal greeting. Independent agents carried out these communications during a year. The CRM system was used also to calculate customer profitability, to help determine customers for collaborative relationships. This programme reduced the lost customers by five per cent and, therefore, increased the customer retention rate.

- **Acquiring customers** It concentrates on finding new customers and delivering value to them. The process of acquiring customers includes prospecting, qualifying, making the sale, and fulfilling the initial customer order to the customer's complete satisfaction. This can be called as going through the entire selling process. Increasingly business marketers rely on a customer relationship management (CRM) system to carry out the various activities described above. Within the CRM system, companies maintain a customer database, which is a place for all relevant information about customers.

We shall look at the **example** of Amazon<sup>21</sup>, which is one of the leaders in implementing CRM system on the Web. These systems or programmes have helped Amazon for both customer acquisition and retention. In 1999, Amazon acquired 11 million new customers, which was almost three times its number of customers acquired in 1998. In addition, the company was successful in retaining the customers it already had. Repeat customers during 1999 accounted for 71 per cent of the total sales. The major reasons for such a high rate of acquisition and retention of customers are: (1) Striving to learn about its customers and their needs, and (2) using this information to offer them value-added features.

### Cost and Success of CRM Implementation

Companies can select any one or combination of three different ways to implement a CRM system. (1) developing software in house, (2) buying licensed software, and (3) outsourcing creation of software.

For all the three alternatives mentioned earlier, the costs of CRM in dollars (or rupees), personnel, and time can be high. CAP Gemini recently released a study that found that the average total investment in a CRM implementation was \$ 3.1 million. The payback period was 28 months. Integrating the new CRM software with existing applications is usually a tough and expensive task, which may take one to three years to implement. The industry rule of thumb is that the implementation services would cost double to triple the price of the CRM software.

It is important to get the approval from the top management for a major project like CRM, after analysing the benefits and costs. Scott Fletcher, vice-president of i2 said: "CRM systems have great

promise, but no system, CRM or ERP, is good unless it provides better information or improved business processes. Hopefully, both”. The drivers are business considerations, not technical.

Forrester report (2003) indicated that the success rate of CRM implementation worldwide since 2001 was only 50 per cent. The main reason for such a mediocre rate of success was poor implementation. A **good example** of proper implementation of CRM system can be given of a USA-based multinational distributor of office and technology products to business customers. The company spent US \$25 million in adopting a CRM system in order to improve the customer service levels and to further strengthen its relationship with customers. The process of implementation of CRM system began with the company management informing all the department heads about the new initiative, customer needs, and the company’s objectives and strategies. A team, consisting of business managers and IT department personnel, was formed to look after the deployment of the CRM system. They decided on a suitable software. The company CEO constantly monitored the process and ensured that all the departments understood the importance and basic characteristics of CRM implementation. He particularly emphasised that customers were not caused any inconvenience during the transition from the traditional operating system to the new CRM system. This was ensured by performing the task of centralising the databases during non-operating hours. Every department and employee of the company adopted a customer-centric approach, which was one of the important factors of success in implementation of CRM system. The other essential success parameters were installation of proper processes and the CRM software. The successful implementation of the CRM system resulted in higher levels of customer service, satisfaction, and retention. It boosted the company’s sales and reduced the operating expenses.

### Connecting RM and CRM

Academia and business practitioners have written and talked about relationship marketing (RM), and customer relationship management (CRM), but not much has been written about connecting RM and CRM. An attempt has been made here to link the two. Let us first recall how we have defined RM and CRM, and thereafter, connect RM and CRM.

Relationship marketing (RM) focuses on collaborative or partnering relationships between customer and supplier firms. The aim of RM is to build mutually satisfying long-term relationships between key parties—customers, suppliers, and distributors—in order to gain and retain business. Relationship marketing builds strong economic, social, and structural (or technical) ties for forming strong customer bonds or loyalty. RM is not effective in all situations and is effective with customers who support collaborative relationships, have a long-term focus, have a high sales and profit potential, and expect suppliers to deliver superior value.

Customer relationship management (CRM) has been defined in several ways, but one of the acceptable definitions is that CRM is the bundling of customer strategy and processes, supported by relevant software, for the purpose of improving customer loyalty, and corporate profitability<sup>22</sup>. It is also defined as a system of tools and processes a firm uses to identify, attract, and retain customers and to leverage its relationships with customers<sup>23</sup>. Within the CRM system, supplier firms commonly maintain a reliable customer database and an additional market database.

Both relationship marketing (RM) and customer relationship management (CRM) aim at improving profitability of the supplier firm by selecting and retaining key customers, with whom the firm builds long-term partnering or collaborative relationships. The strategies and activities (or tools) used by RM and CRM may be different. As mentioned earlier, RM uses financial and social benefits as well

as structural ties to build long-term relationships with key customers. CRM tries to integrate customer facing front-end activities (like sales, customer service, and marketing) with back-end activities (such as production, accounts, finance, research and development), with the help of people, processes, and relevant software. Thus, we may conclude that both RM and CRM try to achieve the same objective of improving profitability by attracting and retaining key customers. However, the methods or approaches used to achieve the objective are different.

As mentioned earlier, organisations engaged in the activities of relationship marketing (RM) are also often involved in the practice of customer relationship management.

## METHODS USED TO INFLUENCE BUSINESS CUSTOMERS

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The business marketer should develop a distinct value proposition, as described in Chapter 1 earlier. The question asked by a customer firm (and need to be answered by the supplier firm) is: “why should our firm want to purchase the supplier’s product or service (or the market offering), instead of a competitor’s offering?”. After getting the feedback from target customers, the business market manager develops a customer value proposition promising superior benefits that matter most to prospective target customers. At the same time, the marketer should provide proof or a reason to believe those promises. Thus, the customer value proposition is useful in influencing business customers.

Business marketers can use a number of methods to influence the existing customers to increase the share of their business, or to influence potential customers (or prospects) to buy their products or services. The major methods are sales presentation and negotiation.

### Sales Presentation

Before a sales presentation is made, a sales rep must plan, to (i) find out or identify potential customer firms, (ii) get information about the buying centre members in these firms, (iii) identify the needs or problems of the potential customer firms. This planning is necessary for getting orders from new customers. The sources of information about new/potential customers are company sources, industry directory, exhibitions or trade shows, direct mailing, telemarketing, and so on.

A good quality of sales presentation is an important factor in getting favourable first hearing and in influencing buying decision. A sales presentation should be tailored to fit the needs and expectations of the potential customer. A sales rep should first raise the interest and identify the needs of the buyer. He should then show how his products or services can satisfy those needs. Thus, the key to a successful sales presentation is based on the ability of the sales person to identify and respond to customer’s needs.

Another important point in a good sales presentation is that a sales rep should first present positive points about his product, service, and the company, and keep the difficult or negative points (e.g. price or payment terms, etc.) towards the end. A “two-sided” discussion (between a buyer and sales rep) can be effective in anticipating and negating the effects of counter-arguments.

In a competitive situation, a sales rep should show the buyer why his product or service has greater value, as against competitor’s claims. Sales people should know various methods of sales presentation, such as stimulus response method, formula method, need satisfaction method, team selling method and consultative selling method. These methods are described in detail in Chapter 10.

At the end of the sales presentation, a sales rep should conclude by pointing out the advantages of using his product or service and how it would satisfy the needs of the buyer. This would help the buyer in making up his/her mind, if the important points are missed earlier. While selling to business

customers, numerous sales calls are required to be made over a long period of time, before customers are convinced to buy from a supplier.

Salespeople should consider using the latest technology to make effective sales presentations. Overhead transparencies, 35 mm slides, and black-and-white handouts are being replaced by dynamic software packages and multimedia projectors that bring computer images to life.

## **Negotiation**

Negotiation is a process that tries to maximise benefits to both buyer and seller, and takes a long-term view of their relationship. The different methods of negotiation and how to negotiate effectively are given below.

**Negotiating with Business Customers** The basic marketing concept focuses on customer satisfaction or customer service, which is one of the key factors for the success of a business unit. For giving effective customer service, it is necessary to have interaction with customers.

We know that business customers are different from household consumers. The buying decisions for business customers are made by professionals, who are knowledgeable on technical and commercial aspects of buying. However, the decisions are made by human beings, with certain degrees of egos, likes, and dislikes. Hence, many times, the buying decisions are partly subjective and partly objective. It is, therefore, necessary that the sales/marketing persons should possess the skills of negotiations in addition to commercial and technical knowledge.

### ***Purpose***

The purpose for which the negotiations are held with business customers are several. It could be for an increase in the prices due to an increase in the cost of inputs such as raw material, excise duty, consumables, freight, and others; it may be for getting higher share of business, for introducing new products, or for getting payments against old/disputed bills. Whatever may be the purpose of the negotiation, it helps sales/marketing persons to succeed if they have the right kind of approach or style of negotiation that is described in the following pages.

### ***Information***

Before the final or formal negotiations are held with a business customer, it is important to collect the necessary information about the customer needs; key decision-making people; customer perceptions of company's as well as competitors quality, service, prices, payment terms; customer's products/services and their markets; customer's approach or style of negotiation, and so on.

Sales/marketing persons should ask intelligent questions (even when they think they know the answers) and find out whether they are getting accurate responses. One gets more information by probing, observing, asking questions and listening more than talking.

### ***Customer Trust and Confidence***

Much before the final negotiations, sales/marketing persons should use the 'lead time' to build an environment of trust, understanding, and rapport with a business customer, at various levels of the customer's organisation. Without the rapport or good relationship, it would be difficult to collect the required information. Hence, a lot of formal and informal meetings are needed by sales/marketing persons, not only for building the trust and confidence, but also for collecting the required information.

### **Styles of Negotiation**

Theoretically, there are four different styles of negotiation. These are: (i) I win, you lose; (ii) Both of us win; (iii) You win, I lose; (iv) Both of us lose. However, in practice, styles (i) and (ii) are used predominantly, style (iii) is used sometimes and, (iv) is rarely used.

**“I Win, You Lose” (Winning at all Costs) Style** This is a competitive approach. It may use methods from intimidation to subtle forms of manipulation. This style is generally used when strong competition prevails, **for example** litigation, beating competition, or during elections. However, it is not recommended, while negotiating with customers, but one should recognise, based on the tips given below, whether the other side uses this style.

- They start with tough demands or ridiculous offers.
- The negotiators have little or no authority to make any concessions.
- They raise their voices or make emotional outbursts.
- If you make a concession, they do not reciprocate, or are stingy in making concessions.
- They ignore deadlines and act as if time is of no significance to them.

**How to Defend against “I Win, You Lose” Style** You have recognised (based on the tips given earlier) that your customer is using this style against you. In such a case, you defend your position, as follows:

- Take up an equally tough or strong position by presenting a clear but unemotional opposition to their demand.
- Seek information from the customer why he holds that position. Explain why you hold your position.
- Stress the consequences to the customer of a failure to resolve the issue.

The objective of the above procedure is to increase mutual respect. Thereafter, try “problem-solving approach” (given subsequently in win-win style), with the purpose of moving the other party from ‘win-lose’ situation to ‘win-win’ situation.

**“Both of us Win” or “Win-Win” Style** This style is generally used for customers, suppliers, employees, relatives, and so on, where long-term healthy relationships and mutual satisfaction are important. Here, the negotiations are held for mutual satisfaction, with emphasis on development of genuine relationships based upon trust and understanding, where both sides win. This is achieved through the following guidelines:

- Build an environment of trust and confidence, much before the final negotiation. Be polite and humble, which would help the customer to communicate in an easy manner.
- The initial focus, during the final negotiation, should be on getting the agreement to the general statement of the problems. In other words, initially, the focus should be on identifying the problems rather than solutions.
- The emphasis during negotiation should be on “end results” or needs, rather than on the “means”.
- Both sides should then work together, pooling their resources, ideas and sharing information to solve the problems stated earlier.
- Regular frequency of concessions (and not the size of concessions) that is conducive to this style.

- Avoid defensive posture; be amenable (i.e. responsive to correction) if negotiation climate is favourable.
- If possible, avoid legalistic or contractual approach.

**“You Win, I lose” Style** This style is sometimes used by sales/marketing persons with demanding and highly cost-conscious business customers, who feel satisfied if they have driven the buyer to lose in the bargain. Once a sales person knows such an approach of the business customer, he creates an environment, at the final stage of negotiation, that he has lost in the deal (although actually he has gained), but he is accepting the terms in view of long-term business relationship. Thus, although the sales person gives the impression to the business customer of “you win, I lose”, the actual situation is “both of us win”.

**“Both of us lose” (or I Lose, You Lose) Style** This style is adopted by people who are either unskilled negotiators or have philosophy of war. **For example**, in an industrial relation dispute, if both workers’ union and management become unrealistic, it results in strike. In such situation, both workers and management may lose in some respect.

To avoid the possibility of lose-lose situation, we should maintain an “adult” mental attitude, which (in “transactional analysis”) means a well-balanced, unemotional, and factual attitude towards the other party, if the other party provokes you with “child-like” emotional and immature behaviour, or “parental” judgemental and bossy behaviour.

### **Time Factor**

It is important to know the business customer’s deadline on time, particularly the delivery time from the date of placement of order. It may involve risk or penalty if a company goes beyond the delivery time. It is a good strategy to indicate the realistic delivery time at the time of negotiations, to maintain the customer trust and confidence and for getting repeat orders in future.

To be successful, a sales/marketing person should not only possess the technical and commercial knowledge, but also the negotiating skills with “both sides win” approach, while marketing products and services to business customers. While negotiating, if one remains cool and unruffled, it gives tremendous advantage. At the same time, one should remember not to criticise the customer in public, even if the negotiations fail.

### **IMPORTANT POINTS ON NEGOTIATIONS**

**Prepare and Plan for Negotiation** Decide what you have to offer, its cost or limit beyond which you will not make concessions. What is its value (or benefits) to the customer. Gather information about the real needs of the customers, who are the negotiators and their ‘power’ or authority to make decisions. If you are having a negotiating team, nominate a leader, members with technical or commercial skills and a note-taker. Decide your style or approach will be win-win or win-lose.

**Opening** Be warm and positive in your opening remarks. State what you hope to achieve, and introduce your team members. Signal your intentions of win-win style. Listen and observe the signals of the customers. If the customer’s approach is cordial, continue to be polite and courteous.

**Exploring** Identify the customer’s decision maker. If the person with authority to take decisions is not present, ask if the person can join you. Ask the customer what is the agenda and try to find what they want most. If your win-win approach is adequately responded, try to get agreement to the general statement of the problems, or explore the areas of common ground, where you both agree.

**Bidding** Remember, only proposals can be negotiated. If you are in strong position, aim high with your proposals. If you are going to argue against the customer's proposals, do so logically and calmly. Make concessions slowly and in small amounts. Listen carefully. Remember, the weakest party will usually make the first concession. If in doubt, use the power of 'recess'. Search as many variables as you can and use these to get more concessions. When you conclude, check what you have both agreed to, and ratify (confirm by signing) it. If you want the deal to be legally binding, check with your advocate.

**Conclusion** It may be difficult to remember the above points and how to use them. The solution to this difficulty is to practise. By practising these points in role-playing exercises, negotiating skills can be improved.

## SPECIAL DEALINGS BETWEEN BUYER AND SELLER

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There are two kinds of special dealings between a buyer and a seller: (i) Reciprocity and (ii) Dealing with customer's customer.

### Reciprocity

Reciprocity means reciprocal dealings between a buyer and a seller. It is the practice of buying from one's own customers and also using purchasing power to sell to one's suppliers. When products are homogeneous or products have little differentiation and price competition is less, reciprocal dealings are likely to occur. **For example**, it may occur in petroleum products and chemicals.

However, in practice, the procedure involved becomes very complex. Studies conducted indicate that purchase managers dislike reciprocity as it reduces the chances of obtaining competitive prices, and also, sales managers oppose the reciprocal dealings.

Reciprocal dealings have reduced recently. However, large business firms may not avoid buying small volume from their customers. Reciprocity is a special case of buyer and seller relationship and caution must be exercised to keep it at minimum level.

### Dealing with Customer's Customers

One of the complexities of business marketing is the need to deal with a customer's customers and therefore, become a competitor of such a customer. This is a sensitive matter, as it may be viewed as interference in the customer's relationship with his customers. However, it can become effective if it is done with coordination and planning with the customer. The nature of these cooperative efforts are based on negotiations with such customers.

**For instance**, aircraft engine manufacturers direct their marketing efforts to the aircraft buyers (i.e. airlines) and not to aircraft manufacturers. This is done so that the airlines specify the particular aircraft engines while placing orders on the aircraft manufacturers.

In **another instance**, a leading manufacturer of electrical engineering products was marketing one of its products, viz. alternators, to diesel generating (DG) set assemblers. The company later started assembling and marketing DG sets by buying the diesel engines. Due to this strategy, the company's customers of alternators (i.e. DG set assemblers) became competitors. The company realised the problem and stopped marketing DG sets subsequently.

## CUSTOMER SERVICE

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In business marketing, the customer service is sometimes more important than the physical product. The customer service supplements the sales of physical product and creates a total value for a customer. The nature of customer service varies based on the *type of product* and the *stage of “product life cycle”*.

In case of mature markets and similar industrial products (i.e. with no major product differentiation), the major part of customer service, is “timely delivery”, and a minor part is the technical support service to the customers. When an industrial product is available from several suppliers at competitive prices, then delivery, product quality, and technical service are important differences for deciding major share of business among various suppliers.

**For example**, in case of “precision steel tubes” product that was available from 14 different suppliers for a large bicycle manufacturer, the most important factor was just-in-time delivery which helped the bicycle manufacturer to hold minimum inventory and reduce the cost of inventory carrying. The next important factor was product quality which would reduce the rejection on the shop-floor and improve the productivity of the workers. The price became the third most important factor while deciding how much business share to be given to the three suppliers among the 14 suppliers.

For large equipment or machines, the important elements of customer service are installation, maintenance and repair, including availability of spare parts and replacement units.

**For instance**, for diesel generating sets, the important elements of customer service to be considered by a business marketer are the installation and maintenance service, as well as, repairs and availability of spare parts. The business marketing organisation for diesel generating sets must provide these services through the service centres which should be located close to the customers. It would then be effective and successful in marketing diesel generating sets in a competitive market.

For a large business customer, the components and materials suppliers (vendors) build their production or distribution facilities close to the customer. Such arrangements require contractual obligations and long-term buyer-seller relationships.

**For example**, Bajaj Auto has developed a large number of ancillary units very near to their factory. These ancillary units (or vendors) manufacture a large number of components which are required for the manufacture of motor cycles. Bajaj were one of the first units in India to develop ancillary units with long-term business relationships and contractual obligations.

Thus, in business marketing, customer service is many times a key factor in differentiating suppliers having similar products to offer. We, therefore, find many articles written on the subject of “customer service”, practised by many successful organisations.

### Supplementary and Basic Customer Service

Philip Kotler has defined service as “an act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything.” We need to distinguish the term ‘service’ (singular) and ‘services’ (plural) which are not synonymous. Although service and services share common characteristics, such as intangibility and perishability, yet they do differ in a fundamental way. The term ‘services’ (e.g. courier, legal, and software services) is used for ‘intangible activities’ which suppliers provide to their customers. Both ‘tangible goods’ (e.g. furniture, ceiling fan and personal computer) and ‘intangible services’ (e.g. insurance, banking and healthcare) are considered as ‘core offerings’ or ‘core goods or services.’ These goods and services require traditional marketing strategies, such as 4Ps for marketing of products and 8Ps for marketing of services.



On the other hand, a ‘service’ (or a customer service) accompanies the core offering (i.e. core product or service) and includes basic customer service and supplementary service. **The basic customer service** is defined as a service that accompanies the core product or service offering and is provided free of charge to customers. The **supplementary service** is an additional service that also accompanies the core product or service for which a supplier may charge an extra amount to the customer.

To understand the difference between core service or product, basic customer service and supplementary service, let us consider three different industries, as illustrated in Table 4.2.

**Table 4.2** Examples of Supplementary and Basic Customer Services

<i>Industry</i>	<i>Product/Service</i>	<i>Examples of Core Service/Product</i>	<i>Examples of Basic Customer Service</i>	<i>Examples of Supplementary Service</i>
Banking	Service	<ul style="list-style-type: none"> <li>• Cash deposits and withdrawal</li> <li>• Internet banking</li> <li>• ATM</li> </ul>	<ul style="list-style-type: none"> <li>• Information about payments/deposits</li> <li>• Formalities for opening an account</li> <li>• Customer support helpdesk</li> </ul>	<ul style="list-style-type: none"> <li>• Credit cards</li> <li>• House/vehicle loans</li> <li>• Demand drafts &amp; locker facility</li> </ul>
Automobile	Product	<ul style="list-style-type: none"> <li>• Four wheelers</li> <li>• Two wheelers</li> </ul>	<ul style="list-style-type: none"> <li>• Information on prices and availability of specific models</li> <li>• Billing after repair/maintenance</li> <li>• Information about cost and delivery after repair</li> </ul>	<ul style="list-style-type: none"> <li>• Maintenance and repair</li> <li>• On-road service</li> </ul>
Telecommunications	Service	<ul style="list-style-type: none"> <li>• Quality of a call (i.e. Clarity of voice)</li> <li>• Coverage of the calling area</li> </ul>	<ul style="list-style-type: none"> <li>• Inquiry system (or information on) balance amount of money in the account</li> <li>• Complaint handling</li> </ul>	<ul style="list-style-type: none"> <li>• SMS</li> <li>• Mobile internet</li> </ul>

## SUMMARY

In this chapter, the buyer and sales representative interaction is considered as an important part of buyer–seller relationship. Business buyers have certain perceptions of sales representatives. A buyer behaviour depends on various factors, and studies on business buyer behaviour have revealed that business purchasing decisions are not always rational. The behaviour of the sales representative depends upon his personal needs as well as the social or organisational needs. The conceptual model developed by Dr. Jagdish N. Sheth describes the two factors (viz. the content of information and the style in which that information is exchanged) that determine dyadic interaction between the buyer and the seller. Many companies have now realised the importance of retaining the current customers, by investing on selective basis, in relationship marketing.

Companies have recognised that competition is not between organisations, but between marketing networks, which include the company and its supporting stakeholders like intermediaries, suppliers, employees and the surrounding community.

Business marketing firms develop effective relationship marketing strategies by (1) linking CRM systems with customer databases, (2) selecting customers, (3) developing relationship marketing objectives and strategies, (4) implementing relationship strategies, and (5) evaluating the objectives and strategies. The concepts and applications of relationship marketing (RM) and customer relationship management (CRM) should be understood. The concept of customer lifetime value (CLV) is used to link CRM to profits. Connecting RM and CRM is done by understanding that both try to achieve the objective of improving business marketers' profitability by attracting and retaining key customers, using different approaches or strategies.

Business marketers influence the customers by using methods, such as sales presentation and negotiation. It is important for business marketers to develop the skills of negotiation with business customers.

Reciprocity and dealing with customer's customer are the kinds of special dealings which business marketers sometimes come across. Customer service is sometimes more important than the product because it creates value for target customers. Business marketers must give due priority to customer service and customer relationship.

Customer service accompanies a core product or service and includes two parts – the basic customer service (that is provided free of charge to a customer) and the supplementary service (that is an additional service which may be charged extra by a supplier to a customer).

### KEY TERMS

- |  |                               |
|--|-------------------------------|
| • Basic Customer Service                 | • Marketing Network           |
| • Collaborative/Partnering relationship  | • Reciprocity                 |
| • Customer interaction management (CIM)  | • Relationship marketing (RM) |
| • Customer lifetime value (CLV)          | • Supplementary service       |
| • Customer relationship management (CRM) | • Transactional accounts      |
| • Customer service                       | • Transactional relationship  |
| • Key accounts                           | • Value-added relationship    |

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. Explain different dimensions of a business buyer and a salesperson's interactions.
2. Are business buyers always rational? Give reasons.
3. Describe different types of relationships between buying and selling firms.
4. Explain the steps involved in developing effective relationship marketing strategies.
5. Describe the concepts of relationship marketing (RM), customer relationship management (CRM), and customer lifetime value (CLV).
6. Which important points a salesperson should keep in mind to ensure a good sales presentation?
7. Which style of negotiation is recommended for negotiating with customers and why? What should a salesperson do if the customer uses some other style of negotiation?
8. Explain what are the meanings of reciprocity and dealing with customer's customers.
9. Describe importance and nature of customer service in business marketing.

**OBJECTIVE TYPE QUESTIONS**

1. When proposals from supplier firms are almost similar, the buying decision of the buying firm is likely to be based on: (a) objective factors, (b) subjective factors, or (c) none of the above factors.
2. As per Dr. Jagdish N. Sheth's conceptual framework on buyer-seller interaction, successful transaction between a buyer and a seller depends on the compatible content of information and the compatible: (a) need, (b) urgency, (c) accuracy, or (d) style of information.
3. Types of relationships between a buying firm and a selling company are broadly categorised as transactional, value-added, and one of the following: (a) successful, (b) compatible, (c) collaborative, or (d) efficient.
4. Customer lifetime value (CLV) calculates a customer's potential: (a) revenues, (b) costs, (c) benefits, or (d) profitability.
5. Relationship marketing (RM) focuses on collaborative relationships between a selling firm and: (i) all customers, (ii) a few key customers, or (iii) none of the customers.
6. The similarity between the concepts of relationship marketing (RM) and customer relationship management (CRM) is in terms of: (a) objectives, (b) strategies, (c) tactics, or (d) none of the above.
7. The major difference between the concepts of relationship marketing (RM) and customer relationship management (CRM) is in terms of: (a) techniques, (b) objectives, (c) results, or (d) none of the above.
8. The key to a successful sales presentation is based on the ability of the salesperson to identify and respond to: (a) the customer's needs, (b) competitive strategies and tactics, (c) the company's objectives, (d) all of the above, or (e) none of the above.
9. For negotiating with customers, a selling firm should use one of the following styles of negotiations: (a) You win, I lose, (b) I win, you lose, (c) I win, you win, or (d) Both of us lose.
10. In practice, the procedure involved in reciprocal dealings between a buyer and seller becomes: (a) simple, (b) complex, (c) normal, or (d) none of the above.

**APPLICATION QUESTIONS**

1. In a highly competitive market, a tyre manufacturer wants to increase the share of business from the current level of 20 per cent to at least 50 per cent with Tata Motors, which is a major OEM customer. What should the tyre manufacturer do? (make suitable assumptions, if needed).
2. You are negotiating a price increase of 10 per cent for steel components with a major two-wheeler manufacturer, due to substantial increase in steel prices. The customer refuses to give you any increase in the prices. If you continue supplies, your company will incur losses, and if you discontinue supplying to this major customer, your sales would suffer. How would you handle the negotiations?
3. The mid-1990s saw several banks going in for large-scale deployments of CRM technology. Unfortunately, a majority of these initiatives turned out to be costly and banks did not get adequate returns from their massive investments. What might have gone wrong with the CRM system, in those early days of CRM solutions?

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### CASE 4.1

#### Vani Agencies: Buyer-Seller Relationship\*

Suresh babu, the proprietor of Vani Agencies was confused on the issue of maintaining good relationships with his business customers at the cost of strained relationships with the suppliers of machines and equipment.

Vani agencies were the authorised dealers of various industrial products such as wood working machines; grinding, drilling and welding machines; power tools; air-compressors; and so on. These products were supplied by reputed manufacturers (suppliers) like Bosch, Hitachi, AEG-Atlas, Ral-liwolf, etc. These suppliers gave a credit of 15 days to Vani Agencies. However, Vani agencies offered the products to its customers at credit periods of 30 days to 160 days, in order to attract and retain customers. Suresh Babu, who started the agency in 2001 in Bangalore, had 165 business customers in 5 years period, including some large firms like Bharat Heavy Engineering Limited (BHEL), Hindustan Aeronautics Ltd. (HAL), Bharat Electronics Ltd (BEL), and Ashok Leyland. These major customers accounted for 65 per cent of total sales of Vani Agencies. The balance 35 per cent sales were from small-scale customers. Some of the small-scale customers, to whom credit was extended by the sales-persons of Vani Agencies, closed their factories and went out of business. This resulted in write-off of bad debts of ₹ 2,00,000 to ₹ 3,00,000 every year from 2004 to 2006.

Sometimes customers asked for replacements of equipment and machines, which were malfunctioning as the customers did not follow the operating instructions. In order to maintain good relationship with customers, Vani Agencies took back such products for replacement, but the suppliers (or manufacturers) expressed their dissatisfaction for such frequent replacements. In a few cases, when the suppliers refused free replacements, the agency had to replace the goods at its cost.

Suresh Babu was not sure whether he should take a tough stand with his customers. He thought for getting business from his customers, he should maintain good customer relationships by giving more credit as well as good customer service. However, this policy had resulted in strained relationships with the suppliers.

#### Question

If you were the consultant for Suresh Babu, what would you advise him and why?

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Manasa, Mohan Babu, Narendra Babu, and Megha Havaladar, MBA students of Alliance Business Academy, Bangalore.

## CASE 4.2

### Rainbow Paints Ltd: Customer Service\*

Rahul Sharma, sales supervisor, Rainbow Paints Ltd., was concerned to receive two complaints within two hours from two key business customers. He was considering carefully how to handle these customer complaints, and ensure prompt and effective customer service.

Rahul received the first call from the purchase executive of C.G. Ltd., a rough and low pitch voice, “We are terribly upset about your product. Why should your paint peel off within three weeks of application on our machines? I want to know how soon you would take care of this problem.” Rahul expressed his sincere regrets, took the details of the address of the customer’s premises, and promised to send somebody immediately. By the time he made arrangements to send the customer support person to C.G. Ltd., the second client, Voltas Ltd., rang up.

“Mr Sharma, my paint applicator is having health problems like allergy, coughing and sneezing because of your paint. Can you send somebody immediately to resolve the health related complaints?”

“Yes Sir, I will do the needful soon” said Rahul and took the details from the client.

Rahul was thinking what could be the possible causes of these two customer complaints. The problem of peel off of paint might be due to wrong specification of the paint, which did not match with the customer requirements. Would it be the company’s (Rainbow Paint’s) responsibility, if the customer employed unskilled, untrained, low-cost, local paint applicants? The second customer, Voltas Ltd., might have asked the same kind of local paint applicant, who perhaps was negligent on the safety matters.

Rahul wondered why their clients did not ask for skilled and trained paint applicants, which the company recommended. What steps should be taken so that such complaints are minimised or eliminated. If not, the word-of-mouth publicity would affect the company’s reputation as well as sales and profitability.

### Question

If you were Rahul, what would you do and why?

## CASE 4.3

### Indo Tele Services Company: Retaining Customers\*\*

Marketing manager of Indo Tele Services (ITS) company was worried because the company was unable to retain its customers. He was wondering whether he should develop a formal “customer retention plan” (CRP).

ITS company was a private sector provider of telecom and internet services in India. The company had segmented the total business market based on the extent of usage of the internet. Firms with more than 15 hours a day internet usage were categorised as ‘high potential’ or ‘A’ class customers. Compa-

\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Rohini Ramachandran, Roopa, Sarika Saini, and Sathya Kalpesh, MBA students of Alliance Business Academy, Bangalore.

\*\* This case was prepared by Prof. Krishna K. Havaladar based on the case data provided by Devraj Hazarika and Dwarka Nath, MBA students of Alliance Business Academy, Bangalore.

nies with 10 to 15 hours a day internet usage were classified as ‘medium potential’ or ‘B’ class customers, and organisations with less than 10 hours a day internet usage were called ‘low potential’ or ‘C’ class customers.

ITS had used indirect channel, termed as “channel partners”, for sales and service of its internet services to business customers. Each channel partner had sales representatives who carried out all the activities of the selling process, such as prospecting, presentation, negotiation, and closing the sales. Sales reps. felt that many customers focused more on getting lower prices rather than the quality of services.

The marketing manager noticed that the company was not retaining its existing customers. He wondered whether this was due to increase in competition, changing technology, or ineffective channel partners.

### Question

What should the marketing manager do to retain the company’s existing customers?

## CASE 4.4

### BF Garments: Buyer-Seller Relationship\*

Suresh Kumar, marketing executive of BF Garments was very upset with the supplier, Parel Textile Mills for not supplying 50 per cent of the balance ordered quantity of the fabric. Due to the non-supply of the fabric, he had to listen to the verbal outbursts from his customer, Ahmedabad Tubes for the balance 10,000 shirts.

Ahmedabad Tubes Ltd had placed an order on BF Garments for the supply of 20,000 shirts of specific design and quality over a period of 6-months from May 2006 to October 2006. Ahmedabad Tubes paid 50 per cent of the ordered value in advance and had agreed to pay the balance amount against the delivery of shirts. The advance was paid because the order was for a specific design and quality of shirts and not for standard, branded shirts which were made by BF Garments for consumer markets. BF Garments supplied 10,000 shirts to Ahmedabad Tubes as per the order in three months. However, after 3-months, they could not supply the balance shirts due to non-receipt of the fabric from Parel Textile Mills.

Suresh spoke to the executive of Parel Textile Mills who were supplying fabrics for over 10 years, and explained to him that this was the first order received by BF Garments from Ahmedabad Tubes, who had also paid the advance amount along with the purchase order. The executive responded by saying that the delay in supplying the fabric was due to the overbooking of the orders by his sales team and that after the peak season of May to August 2006, the balance 50 per cent quantity of the fabric would be delivered to BF Garments. This would mean a delay of three months.

Suresh immediately contacted Ahmedabad Tubes and explained the situation arising out of the delay in getting the fabric. He asked for an extension in delivery of balance quantity of shirts (after accounting for processing of the fabric) by about 6–7 months. Rohit Parekh of Ahmedabad Tubes refused to extend the delivery and asked Suresh to make alternative arrangement for getting the fabric.

Suresh tried other textile mills, who were all booked with the peak season orders. He could persuade one of their regular suppliers to supply, but the quality of the fabric was inferior and the prices much

\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Meena Sundari S. and Lanna Lalithan, SBS-ABA MBA students of Alliance Business Academy, Bangalore.

higher compared to the earlier order on Parel Textile Mills. Before placing the order on the new supplier, Suresh contacted Rohit and asked for a slightly inferior quality of the fabric. Rohit refused to accept any change in the quality of fabric and asked Suresh to supply the balance 50 per cent shirts as per the purchase order or face the consequences, including penalty for late delivery.

### Question

What would you do if you were Suresh?

## CASE 4.5

### Cyberwatch Solutions: Retaining Customers\*

Kumar, marketing head of Cyberwatch Solutions, is very much concerned as the company has not been able to retain its customers notwithstanding the support of cybercrime police, the state police, and government of India.

Cyberwatch Solutions is an internet media company creating value in spaces where there are usages of personal computers (PCs) like cyber cafes. Cyber cafés contribute to a growing e-commerce market with about 37 per cent share of the total internet access. However, cyber cafés are highly unorganised and unrecognised.

The company's brand 'Cyberwatch' caters to the 360 degree needs of a cyber café. Its three products help cyber cafés in accounting, security and efficient operations. It meets the security norms laid down by the law enforcement agencies. Cyberwatch also offers a desktop portal that provides ease of surfing, search, quick links and brand communication. It has grown into a well-recognised advertising platform in India. The desktop application of Cyberwatch is installed on cyber café systems for no additional cost. This application works as a monitoring agent, capturing all details of a user from the duration of usage to the visited sites and this usage is endorsed by cybercrime police, the state police and government of India. By using the application, the cyber café manager does not have any headache on monitoring user activities.

To better understand the internet usage and habits of cyber café users, the company carried out a sample survey, using online interview method. The major findings are as follows:

- There are 16875 cyber cafés in India, covering 342 cities
- 52 per cent cyber café users have purchased financial investment products.
- 51 per cent cyber café users carry out online shopping and 45 per cent do online banking.
- More than 80 per cent users of cyber café have affluent background.

During the survey, some of the cyber café owners, who do not want to be named said that as most of the PCs are run on pirated operating systems, they are afraid of getting into legal issues, if they instal cyberwatch applications. These cyber café owners mention slowing down and crashing of computers as the reasons for not using the cyberwatch applications, which are termed as untrue by Cyberwatch Solutions.

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\* This case is prepared by Manoj Kumar Shetty, an MBA student of Alliance Business Academy, Bangalore, under the guidance of Prof. Krishna K. Havaladar, for classroom discussion.



The marketing head wondered how to use the survey findings to resolve the issue of retaining its customers.

***Question***

If you were the marketing manager, what would you do to retain the customers?

# 5

## Business Marketing Intelligence and Marketing Research

*After studying this chapter you should be able to:*

- Know the nature and scope of marketing research in business marketing environment.
- Examine the marketing research process with focus on business marketing.
- Learn estimating company's current and future demand including forecasting approaches and sales forecasting methods.
- Know the use of secondary sources of information including use of internet in business marketing research.
- Become familiar with the standard industrial classification (SIC).
- Learn different statistical techniques available for data analysis in business marketing research, particularly elasticity estimation and sales forecasting.
- Understand the Chofray–Lilien model for estimating potential market share for industrial products/services.
- Understand business marketing intelligence system and decision support system.

Effective marketing decisions are based on information in marketplace rather than intuitions or hunches. In a changing marketplace, the business marketer must continuously gather information on customers, competitors, and environment to support decision making. This results in superior marketing performance. In this chapter, we will study the methods or systems used by business organisations to gather and analyse the necessary marketing information.

### THE NATURE OF RESEARCH IN BUSINESS MARKETING ENVIRONMENT

**Marketing research** is defined as the objective and systematic process of obtaining, analysing, and reporting of data (or information) for decision making in marketing. The reason for emphasising the importance of “objective and systematic process” is that marketing research should not be influenced by personal views and considerations.

Business marketing research is one of the parts or components of business marketing intelligence. **Marketing intelligence** is an on-going activity to provide *continuous information* on various issues in marketing for decision making. Marketing research undertakes periodic projects or studies (not on continuous basis) to collect and analyse data with specific objectives. Some of the projects or studies on business marketing research are forecasting sales and market potential, competitive analysis, and new product research.

### Differences between Consumer and Business Marketing Research

The basic elements of marketing research apply to both consumer and business marketing. However, because of the environment of business markets and the nature of business buying, major differences exist between consumer and business marketing research. They are as follows:

1. More reliance on secondary data, exploratory research, and expert opinion in business research. This is because the market information is concentrated among a few knowledgeable people and the number of business buyers are smaller. The secondary data is also available from the government and non-government publications, trade and business associations, and computerised online databases, which can be useful for business marketing decisions.
2. Understanding of technical factors is important for business marketing researcher because of technical nature of many industrial products. The researcher has to obtain information from design engineers, production managers and materials executives. Sometimes highly technical factors are to be studied and hence, the business marketing researcher should have technical orientation.
3. Managers of industrial products companies generally perform less marketing research studies than the marketing managers of consumer product companies.
4. More emphasis is given to exploratory and descriptive research approaches for primary data collection in business markets.
5. Differences in certain areas of survey method are shown in Table 5.1.

### Major Guidelines for Performing Marketing Research in Business Markets

1. Because the demand for industrial goods is derived, as we have explained in Chapter 1, business marketing firms cannot only focus on their immediate customers but may need to be also aware of factors affecting demand in downstream markets. **For example**, a manufacturer of copper coated steel tubes that are used in the automobile and refrigeration industries will try to keep updated with consumer and business demand for four-wheelers and refrigerators, rather than simply looking at immediate demand for tubes from automobiles and refrigerator manufacturers. The need to be aware of downstream market demand is even more important where an acceleration effect is present, as explained in Chapter 1, since a small shift in downstream demand will have a multiplied effect on the demand for industrial goods. Generally, business marketing firms are dependent on secondary sources for keeping themselves updated with the trends in downstream markets of their customers.
2. When conducting a primary research project with small number of buyers who represent a high proportion of industry demand, it is important to obtain information from these “vital few” buying firms. The marketer or researcher must gain cooperation from respondents of these few and important buying organisations by developing contacts either directly or through friends and relatives. Another approach is to provide incentives to key respondents for participation and cooperation. The incentives could be monetary or small gift items that are useful. Wherever possible, respondents should be offered a summary of the study’s findings or results. This is another incentive to improve the response rate in business marketing surveys.

3. Another important issue is about who is to be surveyed among the buying centre members in an organisation. Logically, the person who has most of the commercial information in an organisation is purchase, commercial or administration executive. If the researcher needs technical information, such as the product's specifications and maintenance, then he/she should ask the purchase executive's help to approach the right technical person. Obtaining information from all the buying centre members may not be required as this will result in duplication and wastage of time.
4. Time compression, which means an increase in the speed of doing business, has also an impact on the marketing research process. The researcher is asked to compress the time period of the research. Information technology can make data collection (through email surveys) and analysis (e.g. SPSS, SAS statistical packages) less time consuming. However, response rate from respondents is affected, as they have less time to participate in personal interviews, focus groups, or surveys. The response rate will be higher where the topic of research is of interest to the respondents, the questionnaire is shorter, or the value of incentives offered is higher. A polite covering letter to the questionnaire or a telephonic request may also improve the response rate.

### Scope of Business Marketing Research

Business marketers mainly conduct or use marketing research in the areas of market potential, market share analysis, sales analysis, forecasting, competitor analysis, new product acceptance and potential, business trends, and sales quotas determination.

**Development of Market Potential** Business marketers need information on sales and profit potential of various product-markets at present and in future. This information is useful in deciding how much resources should be allocated to the existing product-markets, which products should be dropped, and which new product-markets to enter. **For example**, marketing manager of electric motors need information on sales and profit potential of its various product-markets: (i) Fractional house power motors—used by consumer durable product manufacturers, (ii) Smaller range AC motors—used mainly by rural market (by farmers) for pumping water, (iii) Medium range AC motors—used by business customers for various applications, and (iv) Higher horsepower motors—used by large steel, cement, paper, and power generation plants. The information on sales and profit potential would be used to allocate resources, such as sales people, advertising budget, capital expenditure for future growth, and so on.

**Market Share Analysis** Market share of a product for a firm changes due to the changes in competitive strategies and actions, changes in customer requirements, and changes in external environment such as economic and political conditions. Market share is an important performance parameter that determines if the business firm is the leader or the follower in that industry. Based on market share information, a firm can set its future goals.

**Sales Analysis** Sales, costs (or expenses), and contribution are broken-down by each product line, territory (i.e. branch or region), sales person, market segment, and customer. The actual performance is compared with the goals (or targets) on regular (monthly, quarterly, and yearly) basis with respect to the above parameters. This analysis is useful for a marketing manager to identify the problem areas and to take corrective actions.

**Table 5.1** Difference in Certain Areas of Survey Method between Consumer and Business Marketing Research

<i>Areas of survey methods</i>	<i>Business Research</i>	<i>Consumers Research</i>
1. Sample size	Small sample due to small universe (or population) and concentration of buyers	Large sample due to large universe, and individual or household buyers are geographically dispersed
2. Respondent cooperation and accessibility	More difficult due to time constraint; accessibility is limited to working time	Less difficult to obtain data; accessibility is easier
3. Defining respondent	More difficult, as buying decisions are made by several members of buying committee and not by purchase executives	Simple, as individuals or household users are generally the buyers

**Forecasting** The short-term (up to one year) and long-term (beyond one year) forecasts are important inputs for preparing annual marketing plans and strategic planning, respectively. Forecasting the trends in external environment such as economic, technological and international business, are important in determining business opportunities and threats. The forecasts on sales, costs, and profits, keeping in mind the changes in external environment, and analysis of internal environment (i.e. strengths and weaknesses), would help the company take decisions on existing products (to continue, drop, or modify), diversify into new products/markets, changes in distribution channels, and so on.

**Competitor Analysis** A marketing research is undertaken to understand customers' perceptions to competitors' product features and quality, service, pricing, and promotion as compared to that of the company. This information is useful in knowing competitors' strengths, weaknesses, strategies and tactics. A more detailed study of major competitors' objectives, culture, mind-set, and product-costs, helps the company to anticipate competitors' reaction to the changes in company's decisions on pricing, product, or promotion. In a highly competitive market, in order to survive and succeed, the business marketer would have to satisfy the target customers' needs in a better and faster manner than its competitors. Competitors' analysis will be useful in deciding effective marketing strategy.

**Benchmarking** This is a relatively new form of marketing research. It is used to find out how and why some competitors perform certain marketing tasks better than other firms. The aim of benchmarking is to improve the company's performance by comparing and measuring the company against business leaders anywhere in the world. The focus of benchmarking studies can be on almost anything, but must include key success factors for the industry in which the company operates. It may include customer service, on-time delivery, or effective sales force. **For example**, Hewlett-Packard (HP) has applied benchmarking to improve inventory management. Xerox learned how to improve reliability and reduce costs of its copiers through benchmarking. The process of benchmarking involves the following steps: (i) determining which functions or tasks to benchmark, (ii) identifying the critical performance factors for measurement, (iii) finding out the best company for the given functions/tasks, (iv) measuring the performance of the best company and also of the company, (v) collecting the information on the processes followed by the best company through surveys, site visits, and/or consultants, (vi) analysing the data and determining which processes or methods of the best company may work for the company, (vii) implementing and monitoring results.

**New Product Acceptance and Potential** Business marketing research must find out, when the new product is at concept testing in prototype form, initial reactions from the customers regarding probability of purchasing, which aspects they like or dislike, potential usage problems, and so on. Based on the customers' opinion survey, the initial sales potential and acceptance level of customers could be assessed. This information is useful in deciding whether the company should make substantial investment in production and marketing for the new product. Marketing research, therefore, reduces the financial risk, as the failure rate in new products is high.

**Business Trend Studies** As discussed earlier in Chapter 1, industrial demand is derived from the demand of other industries. **For example**, the demand for "precision steel tubes" is derived from (or depends upon) the demand for motorcycles, scooters, mopeds, bicycles, low-pressure boilers, and furniture, where the precision steel tubes are used. The manufacturer and marketer of precision steel tubes should study the future business trends (i.e. growth in sales, profitability, and competition) of those industries on which the demand (or sales) of its products depends. This can also be called the analysis of market segments, based on which the business marketer decides the target market segments.

**Sales Quota Determination** For evaluating the performance of sales people and territories (i.e. branches or regions), and for setting sales goals (or quotas), it is necessary for a business marketer to determine the sales quotas. The objective approach for deciding sales quotas is to break-down the estimated national market potential and market share into various geographical areas, as per a company's requirement. By multiplying the area market potential with expected market share, under the expected market conditions, a manager can determine sales quotas for individual sales people and territories.

It can be seen from the brief description of the major areas of use of business marketing research that the main tasks of the researcher are the collection and analysis of the data (or information) on marketing environment. In this respect, one can say that the marketing research process remains the same for both industrial and consumer markets.

## Use of Marketing Research Agencies

Business marketing managers collect, analyse and use marketing information for decision making. The marketing information comes from sales reports (from sales representatives or sales executives), journals, business magazines, industry-specific sites on the internet, and so on. In addition, primary information gathering may be done through various methods discussed in this chapter. This research may be done in-house in large organisations, but in small and medium enterprises (SMEs) often primary data gathering is carried out by a professional marketing research agency.

The marketing head of a SME prepares a research brief that includes definition of the problem and the research objectives. He will then select a research agency with the help of his colleagues. The research brief is given to the research agencies which also indicate the time and cost estimates in their proposals. Peterson and Kerin (1980) have, in their study, offered three most important tips on the management of client–agency relationship in business markets:

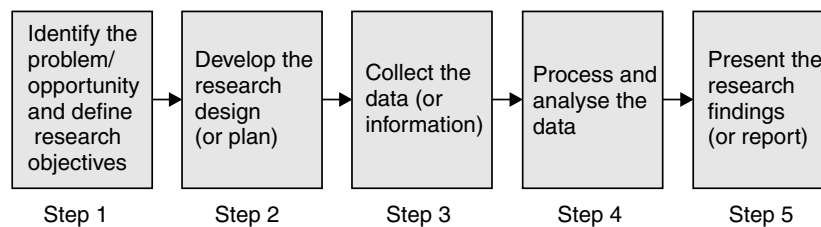
- Have a clear understanding of the problem to be studied prior to contacting research agencies.
- Get closely involved at an early stage of the research process, and
- Check past clients of research agencies, evaluate their prior experience and industry familiarity.

The authors of the study concluded that effective management of the client-agency relationship required the client to open frank and honest communication with the agency early in the research process

and maintain them throughout project implementation. In another study by Cater and Zabkar (2009), it is suggested that a research firm that has developed a close relationship with a client is in a better position to know the client's needs and preferences and provide more efficient service.

## MARKETING RESEARCH PROCESS

Business marketers, after identifying the areas of marketing research, face the question—how to conduct marketing research? Or in other words, what are the tasks involved in business marketing research? The answers to these questions are to follow the logical steps involved in the marketing research process, shown in Fig. 5.1. Each step is briefly described with the focus on the business marketing research.



**Figure 5.1** *The Marketing Research Process*

### Identifying the Problem (or Opportunity) and Defining Research Objectives

The first step in the marketing research process is to identify the marketing problem or opportunity accurately, and define the objectives of marketing research. The problem identification is very important and to avoid any controversy at a later stage, the marketing manager should prepare a written statement, referred as “research brief”, giving the background information about the problem and how the findings of marketing research will be useful for making decisions to solve the problem. There should be an agreement between the marketing manager and the researcher about the problem and the research objectives. Let us consider the following **example** to illustrate the steps involved in the marketing research process.

**Research Brief** A German manufacturer of sophisticated knitting machines was considering the possibility of entering Indian market. The prices of German machines were between ₹ one million to ₹ 1.20 million, compared to the local Indian manufacturers’ prices of ₹ 1,00,000 to ₹ 1,50,000. The German machine’s productivity was about three to four times that of Indian machines, and the quality of knitted garment was also superior due to less breakage of yarn. The German manufacturer commissioned an Indian marketing research agency to find out the long-term market potential for its machines, which market segments it should target, what range of prices target customers are prepared to pay for its superior machines, and business trends for textile industry in India.

The problem in the above business situation was identified as follows: Will the German knitting machines have enough market potential, customer acceptance, and capability to earn profits to justify the investments in Indian market that the German manufacturer might make? The following marketing research objectives were agreed between the manufacturer and the research agency:

1. To find the major reasons for the textile units to buy the German-make knitting machines.
2. To understand which groups of textile units (market segments) are most likely to buy the German-make machines and how many numbers.
3. Considering the large difference in the prices, to find how many number of machines are likely to be purchased by the Indian textile units in the next five years.
4. To understand the business trends for textile industry in India.
5. To find the likely competitive situation for knitting machines in the next five years in India.

After identifying the problem and defining the research objectives, the researcher goes to the second step of developing the research design or the research plan.

### Develop the Research Design/Plan

The business marketing researcher or the marketing research agency develops the research design, which basically indicates the procedure and the cost of conducting the research study. The research design includes the decision areas, as shown in Table 5.2.

### Decision Areas in Research Design

#### Information Type

Based on research objectives, prepare a list of information required. **For instance**, if one of the research objectives is to obtain *competitors' information*, the list of information should include: (i) the list of competitors, (ii) their market share, (iii) whether they are local, national, or multinational companies (MNCs), (iv) whether there will be any new competitors in future, (v) major competitors' strength, weaknesses, objectives, marketing strategies and tactics, pricing policies and prices.

#### Sources of Data

**Primary data** consists of original information gathered for specific purpose. Survey (or descriptive) method is extensively used in business marketing research to collect information from those business buyers who are believed to possess the desired information. **For instance**, in the example described earlier, purchase executives and technical people in textile mills were interviewed to obtain the required information.

**Table 5.2** Decision Areas in Research Design

<i>Decision Areas</i>	<i>Particulars</i>
1. Information type	Prepare a list of information required from research objectives, indicating sources—primary, secondary, or both.
2. Sources of data	Primary, secondary, commercial, or combination.
3. Research methods	Observational, exploratory, descriptive (or survey), experimental.
4. Sampling Plan	Sampling unit, sample size, sampling procedure.
5. Method of contacts	Mail, telephone, or personal interview.
6. Data collection methods (i.e. Research Instruments)	Questionnaire, mechanical devices.



**Table 5.3** Sources of Secondary Data

<i>Publications</i>	<i>Data Coverage</i>
<b>Government publications</b>	
1. <i>Statistical Abstract of India</i> , by Central Statistical Organisation (CSO), New Delhi.	▪ Indian economy, covering macro and micro parameters.
2. <i>Annual Survey of Industries</i> , by CSO, New Delhi.	▪ Industrial statistics, performance of industries in India.
3. Census Report, by Registrar General of India	▪ Demographic information such as break-up of population by age, sex, education, urban/rural, general economic tables, district census.
4. Planning Commission, New Delhi	▪ Basic statistics relating to Indian economy.
5. National Sample Survey (NSS)	▪ Socio-economic surveys.
6. Reserve Bank of India (RBI) Bulletin	▪ Economy, currency, and finance in India.
<b>Non-government publications</b>	
7. Thapar's Indian Industrial Directory of the World; Mumbai.	▪ List of Indian manufacturers of pharmaceuticals, chemicals, pesticides, fertilisers, etc. ▪ Global information, import-export of various countries.
8. Kothari's Industrial and Economic Guide of India, Chennai.	▪ Banks, cements, chemicals, electricity, etc. ▪ Indian economy, industrial policy, taxation.
9. <i>Handbook and Directory of Indian Industries</i> , Mumbai.	▪ Foreign collaborations, government undertakings, trade associations, services, and manufacturers.
10. Newspapers and periodicals (e.g. <i>Economic and Political Weekly</i> , <i>The Economic Times</i> , <i>Business India</i> , etc.)	▪ Articles and information on many industries.

**Secondary data** consists of data or information that exist somewhere and was collected earlier for some purpose. Its advantages are ready availability and low cost. However, its disadvantages are that the data may be outdated, inaccurate, or incomplete.

In business marketing research, many secondary data sources are used as important sources of information. Some of these sources available in India are indicated in Table 5.3. Business marketing researchers start their projects or studies by obtaining the secondary data. If the secondary data solves the problem, either partly or wholly, the high cost of collecting the primary data is minimised or eliminated completely.

Computerised secondary sources of data, like on-line databases, CD-ROM (Compact disk/read-only memory) data, and data on diskette and magnetic tape, make great amount of data readily available. Computerised data sources are available at relatively low cost and only relevant data can be searched. It is, therefore, not surprising that more and more business firms and researchers are using computerised data sources. Some of the on-line information sources are included in Table 5.4.

**Table 5.4** Some of the On-line Portals

<i>On-line Portals</i>	<i>Type of Information Provided</i>
1. Indiainfoline.com	▪ This is a vertical portal, to get on-line information on: stock markets, corporates, database on industry sectors, macro economic database, money and forex markets, global stock markets and currency markets. It offers research and financial services.
2. Indiamarkets.com	▪ This also is a vertical portal. It is a forum for interaction between small and medium enterprises (SMEs) and large buyers. Hence, it is referred to as business-to-business portal. It provides information on industry sectors such as auto ancillary, chemicals, computers, construction, drugs and pharmaceuticals, engineering, iron and steel, telecom, textiles, and so on.
3. Matexnet.com	▪ This is a “Material Stock Exchange” online auction portal. It helps to dispose surplus inventory, sell finished products, and give technology inputs. Its members include manufacturing companies, suppliers, buyers, consultants, etc. who register with them.
4. Seekandsource.com	▪ This is another business to business portal that helps to buy and sell industrial goods. It provides up-to-date source for business needs.

*Commercial data* includes the marketing information offered by some marketing research organisations (referred to as *syndicated research*) to selected clients on payment basis. Some of these **syndicated research** studies are: *Retail stores audit*, *Prescription audit* by ORG/MARG; Market Pulse, Businessmen’s readership survey, and TV rating point by Indian Market Research Bureau (IMRB). These are mainly consumer research studies.

### The Standard Industrial Classification (SIC)

One of the most important secondary data sources for business marketing research is the Standard Industrial Classification (SIC). The SIC categorises the economy into different divisions, denoted by a letter code; within each division into major industry groups, denoted by a two-digit code; within each industry group into industry subgroups, denoted by a three-digit code; and so forth. The SIC system enables the identification of groups of businesses that produce the same type of product. It is particularly important because several secondary data sources used in business marketing research have their data arranged in accordance with SIC codes.

The most up-to-date industrial classification system is the International Standard Industrial Classification (ISIC) of All Economic Activities, the United Nations system, for classifying economic data. The United Nations Statistics Division describes it in the following terms:

“Wide use has been made of ISIC, both nationally and internationally, in classifying data according to kind of economic activity in the fields of production, employment, gross domestic product and other statistical areas. ISIC is a basic tool for studying economic phenomena, fostering international comparability of data, providing guidance for the development of national classifications and for promoting the development of sound national statistical systems.”.

The list below gives the detailed structure of ISIC Rev.4 (Draft):

- A – Agriculture, forestry and fishing
  - 01 – Crop and animal production, hunting and related service activities
  - 02 – Forestry and logging
  - 03 – Fishing and aquaculture
- B – Mining and quarrying
  - 05 – Mining of coal and lignite
  - 06 – Extraction of crude petroleum and natural gas
  - 07 – Mining of metal ores
  - 08 – Other mining and quarrying
  - 09 – Mining support service activities
- C – Manufacturing
  - 10 – Manufacture of food products
  - 11 – Manufacture of beverages
  - 12 – Manufacture of tobacco products
  - 13 – Manufacture of textiles
  - 14 – Manufacture of wearing apparel
  - 15 – Manufacture of leather and related products
  - 16 – Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
  - 17 – Manufacture of paper and paper products
  - 18 – Printing and reproduction of recorded media
  - 19 – Manufacture of coke and refined petroleum products
  - 20 – Manufacture of chemicals and chemical products
  - 21 – Manufacture of basic pharmaceutical products and pharmaceutical preparations
  - 22 – Manufacture of rubber and plastics products
  - 23 – Manufacture of other non-metallic mineral products
  - 24 – Manufacture of basic metals
  - 25 – Manufacture of fabricated metal products, except machinery and equipment
  - 26 – Manufacture of computer, electronic and optical products
  - 27 – Manufacture of electrical equipment
  - 28 – Manufacture of machinery and equipment n.e.c.
  - 29 – Manufacture of motor vehicles, trailers and semi-trailers
  - 30 – Manufacture of other transport equipment
  - 31 – Manufacture of furniture
  - 32 – Other manufacturing
  - 33 – Repair and installation of machinery and equipment
- D – Electricity, gas, steam and air conditioning supply
  - 35 – Electricity, gas, steam and air conditioning supply

- E – Water supply; sewerage, waste management and remediation activities
  - 36 – Water collection, treatment and supply
  - 37 – Sewerage
  - 38 – Waste collection, treatment and disposal activities; materials recovery
  - 39 – Remediation activities and other waste management services
- F – Construction
  - 41 – Construction of buildings
  - 42 – Civil engineering
  - 43 – Specialised construction activities
- G – Wholesale and retail trade; repair of motor vehicles and motorcycles
  - 45 – Wholesale and retail trade and repair of motor vehicles and motorcycles
  - 46 – Wholesale trade, except of motor vehicles and motorcycles
  - 47 – Retail trade, except of motor vehicles and motorcycles
- H – Transportation and storage
  - 49 – Land transport and transport via pipelines
  - 50 – Water transport
  - 51 – Air transport
  - 52 – Warehousing and support activities for transportation
  - 53 – Postal and courier activities
- I – Accommodation and food service activities
  - 55 – Accommodation
  - 56 – Food and beverage service activities
- J – Information and communication
  - 58 – Publishing activities
  - 59 – Motion picture, video and television programme production, sound recording and music publishing activities
  - 60 – Programming and broadcasting activities
  - 61 – Telecommunications
  - 62 – Computer programming, consultancy and related activities
  - 63 – Information service activities
- K – Financial and insurance activities
  - 64 – Financial service activities, except insurance and pension funding
  - 65 – Insurance, reinsurance and pension funding, except compulsory social security
  - 66 – Activities auxiliary to financial service and insurance activities
- L – Real estate activities
  - 68 – Real estate activities

- M – Professional, scientific and technical activities
  - 69 – Legal and accounting activities
  - 70 – Activities of head offices; management consultancy activities
  - 71 – Architectural and engineering activities; technical testing and analysis
  - 72 – Scientific research and development
  - 73 – Advertising and market research
  - 74 – Other professional, scientific and technical activities
  - 75 – Veterinary activities
- N – Administrative and support service activities
  - 77 – Rental and leasing activities
  - 78 – Employment activities
  - 79 – Travel agency, tour operator, reservation service and related activities
  - 80 – Security and investigation activities
  - 81 – Services to buildings and landscape activities
  - 82 – Office administrative, office support and other business support activities
- O – Public administration and defence; compulsory social security
  - 84 – Public administration and defence; compulsory social security
- P – Education
  - 85 – Education
- Q – Human health and social work activities
  - 86 – Human health activities
  - 87 – Residential care activities
  - 88 – Social work activities without accommodation
- R – Arts, entertainment and recreation
  - 90 – Creative arts and entertainment activities
  - 91 – Libraries, archives, museums and other cultural activities
  - 92 – Gambling and betting activities
  - 93 – Sports activities and amusement and recreation activities
- S – Other service activities
  - 94 – Activities of membership organisations
  - 95 – Repair of computers and personal and household goods
  - 96 – Other personal service activities
- T – Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
  - 97 – Activities of households as employers of domestic personnel
  - 98 – Undifferentiated goods- and services-producing activities of private households for own use

- U – Activities of extraterritorial organisations and bodies
  - 99 – Activities of extraterritorial organisations and bodies

Each division in the hierarchy is further subdivided into subclasses of activities. **For example,**

**Section:** A – Agriculture, forestry and fishing

**Division:** 01 – Crop and animal production, hunting and related service activities is further subdivided into the following groups:

- 011 – Growing of non-perennial crops
- 012 – Growing of perennial crops
- 013 – Plant propagation
- 014 – Animal production
- 015 – Mixed farming
- 016 – Support activities to agriculture and post-harvest crop activities
- 017 – Hunting, trapping and related service activities

These groups are further subdivided into classes, which are further divided into elementary activities. **For example,**

**Group:** 011 – Growing of non-perennial crops is further divided into

- 0111 – Growing of cereals (except rice), leguminous crops and oil seeds
- 0112 – Growing of rice
- 0113 – Growing of vegetables and melons, roots and tubers
- 0114 – Growing of sugar cane
- 0115 – Growing of tobacco
- 0116 – Growing of fibre crops
- 0119 – Growing of other non-perennial crops

**Class:** 0111 – Growing of cereals (except rice), leguminous crops and oil seeds

This class includes all forms of growing of cereals, leguminous crops and oil seeds in open fields, including those considered organic farming and the growing of genetically modified crops. The growing of these crops is often combined within agricultural units.

This class includes:

- growing of cereals such as: wheat, grain maize, sorghum, barley, rye, oats, millets, other cereals n.e.c.
- growing of leguminous crops such as: beans, broad beans, chick peas, cow peas, lentils, lupins, peas, pigeon peas, other leguminous crops
- growing of oil seeds such as: soya beans, groundnuts, cottonseed, castor bean, linseed, mustard seed, niger seed, rapeseed, safflower seed, sesame seed, sunflower seed, other oil seeds

This class excludes:

- growing of maize for fodder, see 0119

## Benefits and Limitations of SIC

The Standard Industrial Classification is a useful classification scheme, allowing for proper identification of business activities. It is frequently used by businesses to identify potential vendors and business customers, and to specify nature of business processes. In particular, it can be used to identify market opportunities, both in existing markets and in new markets. The key point is that, by understanding the needs and requirements of a few firms within a SIC category, the business marketer can project these requirements for all firms in that category, as their requirements would be likely to be similar. Thus, the business marketer can evaluate the total market through a detailed analysis of just a few firms. **For example**, a leading IT company uses the SIC as described above to identify and locate new business prospects.

Another related use of the SIC is in the estimation of market potential using statistical series methods. The first step to this end is to identify specific industries/segments that either use or could use the firm's product. The next step is to estimate the demand for the product in each segment: the basic underlying assumption is that there is a close correlation between the level of product demand and a small set of variables describing the level of activity in different segments. Thus, for each segment, a suitable set of variables is chosen to represent the level of economic activity, and the demand for the product in that segment is estimated based on this. Finally, the estimate of the total market potential is arrived at by aggregating the segment-wise estimates.

As an **illustration** of this process, consider the computation of market potential for trimmer and router bits, which are used for carving designs on wooden furniture. The market segments for the product are furniture manufacturers, interior decorators, door/window frame manufacturers, carvers/designers, and others. Furniture manufacturers are grouped under the class 3100 of the ISIC, which includes the manufacture of furniture of any kind, except stone, concrete, or ceramics, for any place and for various purposes. In Bangalore, about three hundred establishments were found to come under this industry class. Further, based on a market survey, it was found that trimmer and router machines were feasible for only about 50 per cent of furniture manufacturers, and 37 per cent of them used the machines every day, 47 per cent used the machines once or twice a week, 12 per cent of them used the machines once or twice a month, and the remaining 4 per cent hardly used the machines at all. The average monthly requirements for bits for daily users were found to be as follows: three edge-forming bits, three laminate-trim bits, two rounding-over bits, and one (guided) staff bead bit. Combining this information together, the expected market potential for trimmer/router bits annually in the furniture segment in Bangalore was found to be 291 edge-forming bits, 291 laminate-trim bits, 194 rounding-over bits, and 97 (guided) staff bead bits, totalling to 873 bits annually. A similar calculation can be performed in other segments to arrive at the total market potential.

SIC does have some major limitations. First of all, SIC codes are rarely up-to-date, so that newer industries are often difficult to locate in the classification. Secondly, SIC codes are based on the major/primary product produced or operation performed by the establishment. Two ratios indicate the degree of error involved: the *specialisation ratio*, which indicates the percentage of total shipments for a given four-digit industry that is accounted for by its primary product or operation, and the *coverage ratio*, which indicates the extent to which the primary product is produced by other industries. When specialisation and coverage ratios are high, the industry tends to be more homogeneous, while when they are low, the industry tends to be more heterogeneous. Finally, SIC often tends to aggregate several different types of firms into one code, so they are not as differentiating as they should be.

### Research Methods for Primary Data Collection

Although business marketers depend substantially on the secondary data, primary data is often collected if the research objectives are not achieved by secondary data. For both consumer and business marketing research, the basic methods of gathering primary data are shown in Table 5.5.

**Table 5.5** Research Methods used for Primary Data Collection

<i>Research Methods</i>	<i>Brief Description</i>
1. Observational	<ul style="list-style-type: none"> <li>People and their behaviour are observed and the information is recorded, without asking questions.</li> </ul>
2. Exploratory	<ul style="list-style-type: none"> <li>When the problem is not clearly defined or little information is available about the problem, exploratory research methods such as focus-groups and depth-interviews are used to gain insight into the problem.</li> </ul>
3. Survey	<ul style="list-style-type: none"> <li>Descriptive study (i.e. describing the way things are) or survey method is used by interviewing or asking questions to people who are believed to possess the desired information. It measures the magnitude of people's knowledge, attitudes, and buying behaviour.</li> </ul>
4. Experimental	<ul style="list-style-type: none"> <li>The purpose of experimental research is to measure cause and effect relationship (causal relationship) by setting up a controlled situation.</li> </ul>

**Survey Research Method** In business marketing research, the most common primary data collection method is survey research. This is because surveys can provide the information required by business marketers. **For example**, to evolve an effective marketing strategy, the business marketer obtains the information on the buying behaviour of existing and potential customers by undertaking the market survey. The information on awareness, attitudes, and buying behaviour of customers is usually not available in secondary data sources. Survey is the best method to get this information for business marketers.

In survey method, the data collection is either structured or unstructured, depending upon whether a formal schedule of information is formulated or not. An interview is either direct or indirect depending on whether the purpose of questions asked are intentionally disguised or non-disguised. Cross classifying the above, there are four different possibilities of data collection: **(i)** structured and direct way of interview, **(ii)** unstructured and direct form of interview, **(iii)** structured and indirect form of interview, **(iv)** unstructured and indirect mode of interview.

**Structured Direct Interview** This is a formal questionnaire (i.e. a set of questions) that is structured and direct, and the interviewer is instructed to ask the persons those questions only in the order given in the questionnaire. This type of interview is referred to as “structured survey”. Its advantage is that less skilled interviewers can be used, resulting in lower cost per interview. It gives standardised information, and hence, editing, tabulating, and analysing of the data are more easily done. This form of data collection is generally preferred when the sample size is relatively large and the market is geographically dispersed. However, care should be taken in wording questions properly. There may be difficulties in getting unbiased and complete answers to questions regarding personal and motivational factors.



**Unstructured Direct Interview** This form of interview also known as “**depth interview**”, and it is often used for exploratory research. Depth interviews are useful in obtaining clearer understanding of problems and to discover information on hidden motives (**for example**, in consumer research—Why did a person purchase a particular brand of motorcycle?). Here, the interviewer is given general instructions on the type of information required and he/she is given the freedom to ask the necessary direct questions. The interviewer asks probing questions like: Why did you feel this way? What do you mean by that statement? This goes on until he/she is satisfied that the required information is obtained. Depth interviews are often conducted in informal or casual manner. This is done to build the rapport that is required to obtain information on hidden motives. The advantages of this form of interview are that it encourages the respondents to express any ideas, and also gives flexibility to the interviewers. However, the disadvantages are that it takes longer time (approximately 30 to 60 minutes), there is difficulty in quantifying or analysing the data, competent interviewers are required, and the cost per interview is higher.

**Delphi Technique** This is another useful method to obtain information from a group of experts from within or outside the company. Senior executives from the firm or external experts (such as industry consultants, editors of trade journals, professors) form Delphi panel members. Each panel member is asked to respond separately to the same problem (e.g. forecasting the economic trend is next 2–3 years). A coordinator collects the responses, summarises, and gives the groups average score to the individual experts, who are again asked to respond to the same problem. This process is repeated (3 to 4 rounds) till some consensus opinion is reached. Delphi technique is useful in getting answers to difficult problems of forecasting future trends on external environmental factors, such as economic, technological and political. However, care should be taken in the selection of experts.

**Indirect Interviews** This includes one of the most widely-used unstructured indirect interview technique called “**focus-group interview**”. In this method, a group of six to 10 persons are invited to spend a few hours with a skilled moderator to discuss a given problem. The meeting is held in a pleasant surrounding and the discussion is held in a relaxed and informal manner. The skilled moderator focuses the discussion on the problem and hence the name focus-group technique. The discussion is recorded through note taking or on audio or video tape, which are subsequently examined to understand attitudes, opinions, and buying behaviour of present or potential customers. Focus group technique is used for: (i) obtaining preliminary information (exploratory) before undertaking a large-scale market survey, (ii) generating hypothesis, (iii) examining new product concepts, (iv) generating ideas for improving existing products, and (v) getting insight into consumers’ perceptions, attitudes, and behaviour. Its advantages are saving of cost and time, compared to depth-interview method. However, one should not generalise the findings of focus-group research, because sample size is small and sample is not drawn randomly. This technique is used more in consumer research but increasing number of business researchers are finding it useful for exploratory research.

### ***Sampling Plan***

The **sample** is a part of population (or universe) which is selected to obtain the necessary information. A **universe** consists of all the items (or objects) under consideration in a research project, and depends on the research objective. **For example**, if the research objective is to estimate the demand for steel in India, the universe will consist of all the business units in India which consume or use steel. The

sample selected should represent various types of customers and their geographic locations. It should also economise on the cost of survey.

Sampling plan consists of three decisions: (i) sampling unit, (ii) sample size, (iii) sampling procedure (or scheme).

**Sampling Units** The researcher should determine the target population. In other words, the researcher answers the question like: Who is to be surveyed? In the **example** given earlier, the marketing researcher makes a list of steel customers by type of industry (e.g. automotive, engineering, furniture), their geographic locations, and current purchases. The elements of target population available for selection during the sampling process are called sampling units.

**Sample Size** The researcher decides how many firms (or people) should be selected from the population for survey. This is a difficult decision. The sample size should neither be too large nor too small. If the population is more homogeneous in terms of characteristics, the sample size is smaller. Although for sample size determination, some researchers use mathematical formulas based on statistical analysis to be adopted, ultimately, the decision on sample size depends on the researcher's judgement. In the above **example**, considering customer groups, geographic spread, and the cost, the sample size of 600 is considered appropriate.

**Sampling Procedure/Sampling Scheme** The decision on how study objects (or respondents) are to be selected is known as sampling scheme or procedure. The characteristics of a good sample scheme are: (i) it should be truly representative sample, (ii) it should result in a small sampling error, (iii) it should consider the cost and time available for the research, (iv) it should enable results of the sample study to be applicable for the population with a reasonable level of confidence. Sampling schemes are classified into two types: (a) probability based sampling scheme (probability or random sampling), and (b) non-probability based sampling scheme (non-probability sampling).

### ***Probability or Random Sampling***

It is based on the concept of random selection, that is, each object or item in the population has equal chance of being included in the sample. Its advantage is that it is a superior design because it can measure the errors of estimation statistically. However, its disadvantage is that the cost and time involved are too high.

### ***Non-probability Sampling***

It is non-random sampling, and hence the sampling error cannot be estimated and research findings cannot be generalised. There is also a possibility of personal biases of the researcher while selecting the sample. However, its advantage is that the cost and time involved are less.

Table 5.6 shows the various techniques of sampling, under the probability and non-probability types of sampling schemes.

### ***Methods of Contact***

Three methods of contact with respondents (or study objects) are used in business marketing research: (i) personal interviews; (ii) telephone interviewing; and (iii) mail surveys.

**Personal Interviews** In business marketing research, personal interviewing method is most widely used because sample size is relatively small and the interviewer can ask more questions. However, the disadvantages are that personal interviewing is most expensive, time consuming, needs more planning and supervision, and is subject to interviewer biases. When the product is highly technical or the information sought is complex, personal interviewing is most effective. In business marketing research, interviews are arranged by contacting the respondents on telephone or personally for fixing the interviews at a suitable time in the office.

**Telephone Interviewing** This method is useful if interviews are short and not too personal, such as measuring corporate awareness and evaluating advertising recall. The advantages of telephone interviewing are that information gathering is quicker, response rate is higher, and the expenses are less than personal interviews. The major drawbacks are that limited information can be gathered, interviewer biases cannot be detected and controlled, and difficulty in gaining access to those respondents in business firms whose secretaries screen telephone calls.

**Mail Surveys** The wording and structure of the questionnaire used for collecting the data by mail are important in mail surveys. This is because the contact is impersonal and there are possibilities of ambiguous or omitted replies. Another major problem with business mail surveys is the low response rate (lower than consumer surveys). Its advantages are low cost, free from interviewer biases, and reaching the respondents who are not easily approachable.

**Table 5.6** Sampling Techniques under Probability and Non-probability Sampling Schemes

<i>Scheme</i>	<i>Sampling Technique</i>	<i>Brief Description</i>
1. Probability or Random Sampling	▪ Simple random sampling	All study objects (or sampling units) of population have equal chance of selection in the sample.
	▪ Stratified random sampling	Population is segmented into several homogeneous groups (or stratas) and then a sample is selected from each group at random.
	▪ Cluster sampling	Large population is divided into small clusters (or geographic areas). Thereafter a random selection of a sample of few areas (or clusters) is done and again a few sampling units from each area are chosen at random or census conducted.
	▪ Systematic random sampling	First, study object is selected randomly and then remaining units (or objects) are selected at a fixed interval, which is calculated by formula: <b>Population ÷ Sample size</b>
2. Non-Probability Sampling	▪ Convenience sampling	Sample is selected based on convenience of the researcher regarding location or cooperation of study objects.
	▪ Judgement sampling	Based on past studies (or experience), the researcher uses judgement in selecting a sample.
	▪ Quota sampling	Based on prior knowledge of population, the researcher first defines categories or groups, and then interviews a fixed number (or quota) of people in each category, based on convenience or judgement.

### **Data Collection Methods (Research Instruments)**

For collecting primary data two methods (or research instruments) are mainly used: (i) Questionnaire, and (ii) Mechanical instruments.

**Questionnaire** It is the most popular method used in business marketing research when the population and sample size are large. A questionnaire includes a number of questions, printed or typed in proper sequence, for presenting to respondents for their answers. Each question should contribute to research objectives. Questions should be simple, easy to understand, direct, and unbiased. The form of questions can be closed-end or open-end. The *closed-end questions* can be dichotomous (i.e. *yes* or *no* answers), or multiple choice (i.e. selecting one from three or more alternative answers). *Open-end questions* allow respondents to answer freely in their own words. The sequencing of questions should be logical. The first few questions should be easy to answer and create respondents' interest. Difficult and personal questions (e.g. income, age, etc.) should be included at the end of the questionnaire. *Pre-testing* of the draft questionnaire (also referred as *pilot survey*) is advisable because it brings out weaknesses in wording or sequencing of questions. This is done on a small sample size by "convenience sampling" method.

**Mechanical Instruments** These devices are used more in consumer research to collect information directly. The instruments used are eye cameras, psycho-galvanometer, audiometer, and motion picture cameras.

### **Collecting the Data**

This phase is referred to as **field work**. It is expensive and problem oriented phase. In survey method of research, the types of problems are: (i) *not available* respondents are to be contacted again or replaced, (ii) some respondents may not cooperate as they may say they are too busy (sometimes a small gift item is presented to respondents for their cooperation and sparing their valuable time), (iii) some respondents may give biased or dishonest replies, and (iv) some interviewers may be dishonest or biased. The business researcher is, therefore, required to set up a system of supervising the interviewers.

**Processing and Analysing the Data** Processing of data includes editing, coding, classification, and tabulation.

**Editing** Editing consists of checking the completed questionnaires for any errors and omissions, and correcting, wherever required. This can be done during field work immediately after the interviews as well as after the receipt of all the forms at the office—referred to as "central editing". This ensures consistency and accuracy.

**Coding** Coding includes assigning symbols or numerals to answers so that the answers can be put into limited categories. This is needed for efficient data analysis. If coding is done at the questionnaire preparation stage, it will be useful for computer aided tabulation. Even for manual tabulation, the data can be transferred to a coding sheet. The researcher should ensure that coding errors are minimised or eliminated.

**Classification** Classification of data consists of arranging the data in groups or classes, based on common characteristics. Classifications are of two types: (i) descriptive (or qualitative) classification (e.g. product quality or customer service), (ii) numerical (or quantitative) classification (e.g. business customers whose sales potential is between ₹ 1 million and ₹ 5 million can form one group or class and the customer with sales potential of over ₹ 5 million can form another group, etc.).

**Tabulation** This is an ordinary arrangement of data into columns and rows so that further data analysis can be done. It can be done by computers, mechanical machines, or manually. Tabulation can be simple (one-way tables consisting of one characteristic of data), or complex (two-way or three-way tables). Cross-tabulation involves two-way or three-way tables with two or more variables (or characteristics).

**Data Analysis** Data analysis can be categorised into: (1) Descriptive analysis, (2) Inferential analysis, (3) Differences analysis, (4) Associative analysis, and (5) Predictive analysis.

**Descriptive analysis** Descriptive analysis is used to describe or summarise the distribution of the variables in the data set. It tends to be essentially univariate in nature, i.e. it involves a single variable at a time.

Descriptive analysis of qualitative variables (which can only be grouped into categories) and quantitative variables (which can be measured) tend to be quite different from each other.

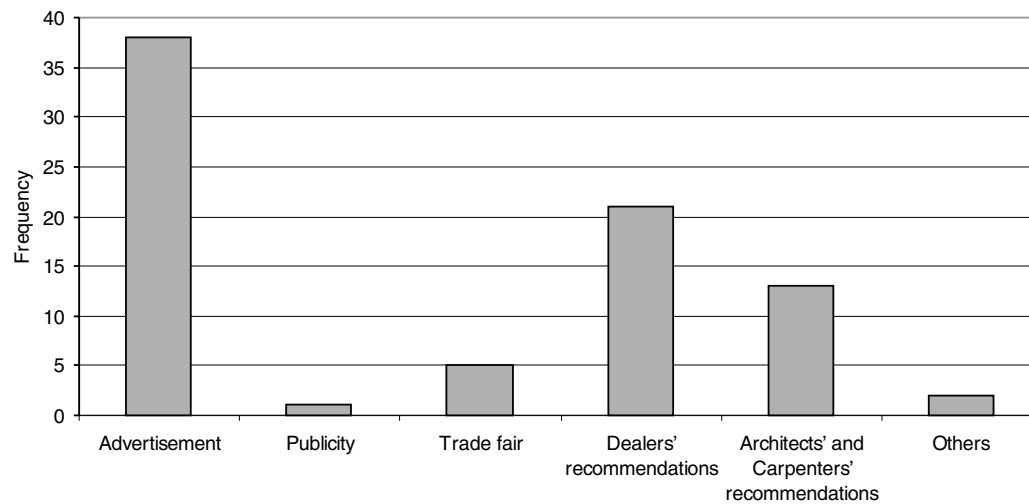
The distribution of qualitative variables is presented in terms of the frequency or percentage distribution of the data across the categories, in the form of frequency tables or charts, such as bar charts or Pareto charts, and is often summarised in terms of a modal category, which is interpreted as a “most frequent” or “most likely” outcome, or in terms of a few categories which together account for a majority of observations. **For example**, awareness of products/brands is summarised simply as the percentage of customers who are aware of the product/brand. On the other hand, **for example**, choice of distribution channel may be summarised in terms of the two or three distribution channels that together are chosen by say 90 per cent of the customers, allowing the business marketer to focus on these particular channels for further analysis.

**For example**, Table 5.7 shows the frequency distribution and bar chart of sources of awareness of plywood in a sample of building contractors. Clearly, the most influential source of awareness was advertisements, accounting for about 50 per cent of the responses. Furthermore, advertisements, dealers, and architects & carpenters put together account for about 90 per cent of the responses, suggesting that these would be the channels that should be focused on to maximise reach.

The distribution of quantitative variables is presented in terms of the frequency or percentage distribution across conveniently-chosen class intervals of values, in the form of frequency tables or graphs, such as histograms or frequency curves, and is summarised by sets of descriptive measures. Two fundamental sets of descriptive measures are the measures of central tendency, which are interpreted as “average” or typical values of the variables, and measures of dispersion or variability, which are interpreted as the typical “spread” or difference between the values of the variables. **For example**, the average level of sales in particular segments or geographical regions would be of interest to the business marketer in market segmentation and targeting, while the variation in the level of sales in particular segments or geographical regions would enable the business marketer to assess the risk involved in concentrating on particular segments or geographical regions. Alternatively, **for example**, the average level of performance and variation in the level of performance for different performance factors can be used in establishing benchmarks and in determining an acceptable range of performance.

**Table 5.7** An Example of Distribution of Qualitative Variables*Frequency distribution of sources of awareness of plywood in the sample*

	<i>Frequency</i>	<i>Per cent</i>
Advertisement	38	47.5%
Publicity	1	1.3%
Trade fair	5	6.3%
Dealers' recommendations	21	26.3%
Architects' and Carpenters' recommendations	13	16.3%
Others	2	2.5%
Total	80	100.0%

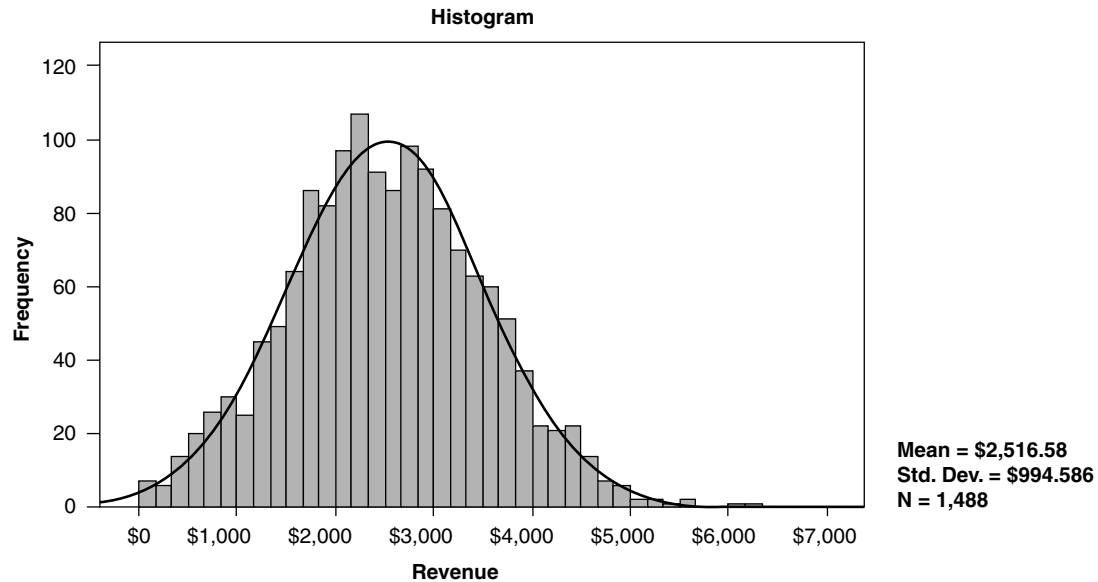
*Bar chart of sources of awareness of plywood in the sample*

**For instance,** Table 5.8 shows the descriptive statistics and histogram of the distribution of monthly revenue from different customers:

The sample mean monthly revenue from customers was found to be \$2,516.58, with a standard deviation of \$994.586. The histogram indicates that the distribution of monthly revenue was approximately normally distributed, with slightly positive skewness.

**Table 5.8** An Example of Distribution of Quantitative Variables

	Mean Statistic	Std. Statistic	Skewness Statistic	Kurtosis Statistic
Revenue	\$2,516.56	\$994.586	.124	-.099



**Inferential analysis** Inferential analysis is used to generate conclusions about the population's characteristics based on the sample data. The main techniques of inferential analysis are estimation, distribution-fitting, and hypothesis testing.

*Estimation* involves the use of sample statistics, i.e. measures based on the sample observations, in the place of unknown population parameters, for the purpose of decision-making relating to the unknown population parameters. **For example**, the sample mean, proportion, and standard deviation are used as estimates for the population mean, proportion and standard deviation, respectively. In the preceding **example**, the sample mean monthly revenue of \$2,516.58 can be taken as an estimate for the population mean monthly revenue. On the other hand, sometimes, rather than considering a single value estimate (i.e. a point estimate) for a population parameter, the business marketer may be interested in considering a range of possible values which the population parameter is likely to take (i.e. an interval estimate). In the preceding **example**, the marketer may want to consider a 95 per cent confidence interval for the population mean monthly revenue, constructed via the formula  $\bar{x} \pm t_{n-1, \frac{\alpha}{2}}^* \cdot \frac{s}{\sqrt{n}}$ , so that with 95 per cent probability the population mean monthly revenue would be in the range \$2,466.23–\$2566.93.

*Distribution-fitting* involves the use of probability models or distributions to understand observed patterns in data, depending upon the mechanisms or processes underlying the data. As in descriptive analysis, the probability models used to describe the frequency distributions of qualitative variables and quantitative variables tend to be quite different.

The probability models used to describe the frequency distributions of qualitative variables assign a theoretical probability with each of the categories of the variable, reflecting the proportions of observations expected from each category. The simplest probability model for a qualitative variable is the equi-probable model, which specifies equal probabilities across all of the categories of the variable. In the preceding **example**, an equi-probable model would specify equal probabilities to each of the sources of awareness of plywood, suggesting that all of the sources are equally important, and, as there are six different categories of sources, each would have a probability of 16.67 per cent. The fact that the observed frequency distribution is quite different from this suggests that this model does not correctly describe the importance of the sources, i.e. some of the sources are more important than others. Other probability models specify differing probabilities across categories. In the same example as above, advertisements may be assumed to be twice as important as dealers' recommendations, which in turn may be assumed to be 50 per cent more important than architects' and carpenters' recommendations, and which in turn may be assumed to be five times as important as the remaining sources (which can all be assumed to be equally important). The resulting probability model for the sources of awareness specifies 49.18 per cent probability for advertisements, 24.59 per cent probability of dealers' recommendations, 16.39 per cent probability for architects' and carpenters' recommendations, and 3.28 per cent probability for each of the remaining sources. Note that this reflects the observed distribution much better than the equi-probable model.

On the other hand, the probability models used to describe quantitative variables are in the form of probability distributions. The probability distributions used to describe the frequency distributions of discrete variables and continuous variables tend to be quite different.

The probability distributions used to describe the frequency distributions of discrete variables specify probability mass functions, i.e. the probabilities associated with particular values of the variable expressed as a function of the values of the variable. Some of the most common probability distributions used for discrete variables are the uniform, binomial, hypergeometric, and Poisson distributions. The uniform distribution is the quantitative analogue of the equi-probable model, specifying equal probabilities to each of the values of the variable. **For example**, the last digit of a phone number could be any digit, and since there is no logical reason for any particular digit to be more likely to arise as a last digit than any other, it would be expected that the last digit of a phone number would be a random digit, i.e. any of the digits 0, 1, 2, 3, 4, 5, 6, 7, 8, or 9, with equal probability (10 per cent). The binomial distribution is typically used to model the number of "successes" in a fixed number of trials of an experiment which in each trial results either in "success" or "failure" (i.e. a dichotomous experiment), in which the trials are independent of each other, and the probability of obtaining "success" is the same in each trial. **For example**, the number of defective units in a sample of a fixed size taken randomly with replacement from a batch of items containing a known percentage of defective units can be modelled using a binomial distribution. The hypergeometric distribution is a variant of the binomial distribution, used for finite populations, under sampling without replacement. The Poisson distribution is a limiting case of the binomial distribution, used when the number of trials is relatively large, while the probability of success is relatively small, i.e. for rare events.

The probability distributions used to describe the frequency distributions of continuous variables specify probability density functions, i.e. functions of values of the variable which when integrated over different intervals of values of the variable yield the probabilities of the intervals. The most common probability distributions used for continuous variables are the continuous uniform, exponential, and normal distributions. The continuous uniform distribution is a generalisation of the (discrete) uni-



form distribution to continuous variables, specifying that the probability of a subinterval is proportional to its length (this abstracts the common-sense notion that the probability of any subset is proportional to the measure of the subset relative to the measure of the universal set). The exponential distribution is commonly used to describe times between the occurrences of events, and is closely related to the Poisson distribution. The normal distribution is the most important of all probability distributions, and is used to describe almost any continuous frequency distribution (approximately). **For example**, the distribution of monthly revenue in the preceding **example** can be seen to be approximately normally distributed with a mean value of \$2,516.58, and a standard deviation of \$994.586.

*Hypothesis testing* involves the use of sample statistics to ascertain the validity of statistical hypothesis, i.e. assumptions regarding the population distribution of the variable of interest. Statistical hypotheses are classified either as parametric hypotheses, which assume an underlying normal population distribution and make assertions about population parameters, usually the population mean, population proportion, or population variance, or nonparametric hypothesis, which asserts about the nature of the population distribution itself and which do not usually assume normality of the underlying population. Statistical hypotheses are usually constructed in pairs, viz. a null hypothesis ( $H_0$ ), representing a conservative assumption (typically of “no difference,” “no change,” or “no effect”), as against an alternative hypothesis ( $H_1$ ), which asserts some form of difference or change. Once the null and alternative hypotheses are specified, a test statistic, which distinguishes between the null and alternative hypothesis, and a critical region, which represents the range of values of the test statistic for which the null hypothesis would be rejected, are constructed. Most hypothesis tests are constructed as significance tests: the critical region is constructed so that the probability of type I error (i.e. that of rejecting the null hypothesis even though it is true) is fixed at a value  $\alpha$ , called the level of significance. Once the test statistic and the critical region are constructed, a random sample is taken from the population. The “calculated value” of the test statistic is computed, and the decision to reject the null hypothesis or not is taken by comparing the calculated value of the test statistic with the critical value.

The most common parametric tests involve testing for the population mean, the population proportion, or the population variance.

The  $t$ -test for a single population mean  $\mu$ , which is used to test the hypothesis  $H_0: \mu = \mu_0$  against  $H_1:$

$\mu \neq \mu_0$ , is given by  $t_{\text{cal}} = \frac{\bar{x} - \mu_0}{s/\sqrt{n}}$ , and results in rejection of  $H_0$  if  $|t_{\text{cal}}| > t_{n-1, \frac{\alpha}{2}}^*$ . On the other hand, the

corresponding one-sided test, for  $H_0: \mu \leq \mu_0$  against  $H_0: \mu < \mu_0$ , results in rejection of  $H_0$  if  $t_{\text{cal}} > t_{n-1, \alpha}^*$ .

In the preceding example, if it were hypothesised that the mean monthly revenue from customers in the whole population is at most \$2000, applying the  $t$ -test for a single population mean:

$$t_{\text{cal}} = \frac{\bar{x} - \mu_0}{s/\sqrt{n}} = \frac{(2516.58 - 2000)}{994.586/\sqrt{1488}} = 20.035$$

The results show that  $t_{\text{cal}} = 20.035$ , while the critical value is  $t_{1487, 0.05}^* = 1.9616$ , so that  $t_{\text{cal}} > t_{n-1, \alpha}^*$ . It follows that the null hypothesis would be rejected, i.e. it can be concluded that the mean monthly revenue from customers in the whole population is significantly higher than \$2000. Alternatively, this can be inferred by looking at the significance value ( $p$ -value): if the  $p$ -value is less than the level of significance  $\alpha$ , the null hypothesis would be rejected at level of significance  $\alpha$ .

**Table 5.9** An Example of a t-test for a Single Population Mean

One-Sample Test					
	Test Value = 2000				
				95 per cent Confidence Interval of the Difference	
	<i>t</i>	<i>df</i>	<i>Sig. (2-tailed)</i>	<i>Lower</i>	<i>Upper</i>
Revenue	20.035	1487	.0000	\$466.00	\$567.15

The z-test for a single population proportion  $p$ , which is used to test  $H_0: p = p_0$  against the alternative  $H_1: p \neq p_0$ , is given by  $z_{\text{cal}} = \frac{\hat{p} - p_0}{\sqrt{p_0(1 - p_0)/n}}$ , and results in rejection of  $H_0$  if  $|z_{\text{cal}}| > \frac{z_{\alpha}^*}{2}$ . On the other hand, the corresponding one-sided test, for  $H_0: p \leq p_0$ , against the alternative  $H_1: p > p_0$ , results in rejection of  $H_0$  if  $z_{\text{cal}} > z_{\alpha}^*$ . In the preceding **example**, if it were hypothesised that dealers contributed to at most 20 per cent of the awareness of plywood, applying the z-test would yield

$$z_{\text{cal}} = \frac{\hat{p} - p_0}{\sqrt{p_0(1 - p_0)/n}} = \frac{(0.263 - 0.20)}{\sqrt{(0.20 \times 0.80/80)}} = 5.881,$$

while the critical value is  $z_{0.05}^* = 1.645$ , so that  $z_{\text{cal}} > z_{\alpha}^*$ . It follows that the null hypothesis would be rejected, i.e. it can be inferred that dealers contribute by significantly more than 20 per cent to the overall awareness of plywood.

There are several nonparametric tests available for a variety of statistical analyses. The most common nonparametric test is the  $\chi^2$ -test for goodness of fit, used in distribution-fitting. The null hypothesis for the  $\chi^2$ -test for goodness of fit is simply that the population distribution follows a specified theoretical model or probability distribution. If the observed frequencies in the different categories of the variable are denoted as  $f_1, f_2 \dots f_k$  and the expected frequencies (obtained under the assumption that the theoretical model or probability distribution holds) are denoted by  $ef_1, ef_2 \dots ef_k$ , then the  $\chi^2$ -test statistic is given by  $\chi_{\text{cal}}^2 = \sum_{j=1}^k (f_j - ef_j)^2 / ef_j$ . The null hypothesis is rejected if  $\chi_{\text{cal}}^2 > \chi_{k-r, \alpha}^2$ , where  $r$  is the

number of restrictions imposed when fitting the model to the observed data. In the preceding **example**, if it were hypothesised that the different sources of awareness of plywood are equally influential, then, under the null hypothesis of equi-probability, the expected frequencies for each of the sources would be 13.33, as shown in Table 5.10. So that  $\chi_{\text{cal}}^2 = 76.3$ , while the critical value is  $\chi_{5,0.05}^2 = 11.0705$ . The resulting value of the test statistic is  $\chi_{\text{cal}}^2 > \chi_{k-r, \alpha}^2$ . It follows that the null hypothesis would be rejected, i.e. it can be inferred that the different sources of awareness of plywood are not equally influential—that is, some are more influential than others: from the frequency distribution, it can be concluded that advertisements, dealers, and architects and carpenters would together be the most influential sources of awareness of plywood.

**Table 5.10** An Example of a  $\chi^2$ -test for Goodness-of-fit

	<i>Observed Frequency</i>	<i>Expected Frequency</i>	
Advertisement	38	13.33	45.6333
Publicity	1	13.33	11.4083
Trade fair	5	13.33	5.2083
Dealers' recommendations	21	13.33	4.4083
Architects' and Carpenters' recommendations	13	13.33	0.0083
Others	2	13.33	9.6333
<i>Total</i>	<i>80</i>	<i>80</i>	<i>76.3</i>

**Differences analysis** Differences analysis is used to compare the distribution of responses of one group to that of another group or of other groups. The comparison could be in terms of any population parameter, but is usually performed for means, proportions, and variances.

The  $t$ -test for equality of two population means, which is used to test the null hypothesis  $H_0: \mu_1 = \mu_2$

against  $H_1: \mu_1 \neq \mu_2$ , is given by  $t_{\text{cal}} = \frac{\bar{x}_1 - \bar{x}_2}{\sqrt{\left( \frac{(n_1 - 1)s_1^2 + (n_2 - 1)s_2^2}{(n_1 - 1) + (n_2 - 1)} \right) \left( \frac{n_1 + n_2}{n_1 n_2} \right)}}$ , and results in rejection

of  $H_0$  if  $|t_{\text{cal}}| > t_{n_1 + n_2 - 2, \frac{\alpha}{2}}^*$ . On the other hand, the corresponding one-sided test, for  $H_0: \mu_1 \leq \mu_2$ , against

$H_1: \mu_1 > \mu_2$ , results in rejection of  $H_0$  if  $t_{\text{cal}} > t_{n_1 + n_2 - 2, \alpha}^*$ . In the preceding example, comparing the mean monthly revenue from regular customers and from preferred customers:

**Table 5.11** An Example of Descriptive Statistics for Two Independent Groups

<b>Report</b>			
<i>Revenue</i>			
<i>Customer Status</i>	<i>Mean</i>	<i>Std. Deviation</i>	<i>N</i>
Regular customer	\$2,583.63	\$947.593	635
Preferred customer	\$2,466.66	\$1,025.882	853
<i>Total</i>	<i>\$2,516.58</i>	<i>\$994.586</i>	<i>1488</i>

The mean monthly revenue from the sample regular customers was found to be higher than the mean monthly revenue from the sample preferred customers. Applying the  $t$ -test for equality of two population means:

$$\begin{aligned}
 t_{\text{cal}} &= \frac{\bar{x}_1 - \bar{x}_2}{\sqrt{\left( \frac{(n_1 - 1)s_1^2 + (n_2 - 1)s_2^2}{(n_1 - 1) + (n_2 - 1)} \right) \left( \frac{n_1 + n_2}{n_1 n_2} \right)}} \\
 &= \frac{(2583.63 - 2466.66)}{\sqrt{\left( \frac{634 * 947.593^2 + 852 * 1025.882^2}{634 + 852} \right) \left( \frac{1}{635} + \frac{1}{853} \right)}} = 2.247
 \end{aligned}$$

**Table 5.12** An Example of a *t*-test for Equality of Two Population Means

Independent Samples Test										
		Levene's Test for Equality of Variances		<i>t</i> -test for Equality of Means						
		<i>F</i>	<i>Sig.</i>	<i>t</i>	<i>df</i>	<i>Sig.</i> (2-tailed)	Mean Difference	Std. Error Difference	95 per cent Confidence Interval of the Difference	
									Lower	Upper
Revenue	Equal variances assume	2.816	0.094	2.247	1486	0.025	\$116.971	\$52.059	\$14.855	\$219.087
	Equal variances not assumed			2.273	1419.096	0.023	\$116.971	\$51.457	\$16.030	\$217.912

The results show that  $t_{\text{cal}} = 2.247$ , while the critical value is  $t_{1486, 0.05}^* = 1.9616$ , so that  $t_{\text{cal}} > t_{n-1, \alpha}^*$ . It follows that the null hypothesis would be rejected, i.e. it can be concluded that the mean monthly revenue from regular customers in the whole population is significantly higher than the mean monthly revenue from preferred customers.

The *z*-test for equality of two population proportions, which is used to test  $H_0: p_1 = p_2$  against the al-

ternative  $H_1: p_1 \neq p_2$ , is given by  $z_{\text{cal}} = \frac{\hat{p}_1 - \hat{p}_2}{\sqrt{\hat{p}(1 - \hat{p})((n_1 + n_2)/n_1 n_2)}}$ , where  $\hat{p} = \frac{n_1 \hat{p}_1 + n_2 \hat{p}_2}{n_1 + n_2}$ , and results

in rejection of  $H_0$  if  $|z_{\text{cal}}| > \frac{z_{\alpha}^*}{2}$ . On the other hand, the corresponding one-sided test, for the null hy-

pothesis  $H_0: p_1 \leq p_2$  against the alternative hypothesis  $H_1: p_1 > p_2$ , results in rejection of  $H_0$  if  $z_{\text{cal}} > z_{\alpha}^*$ .

The ANOVA test for equality of several population means is a generalisation of the *t*-test for equality of two population means. The null hypothesis for the ANOVA test is that the population (group) means are equal, against an alternative hypothesis of difference between group means. The test statistic for the

ANOVA test is given by  $F_{\text{cal}} = \frac{TrSS/(k-1)}{ESS/(N-k)}$ , where  $N$  is the combined sample size,  $k$  is the number

of groups,  $TrSS = \sum_{i=1}^k n_i (\bar{x}_i - \hat{x})^2$  (the treatment sum of squares, or the sum of squares of differences

between groups), and  $ESS = \sum_{i=1}^k \sum_{j=1}^{n_i} (x_{ij} - \hat{x})^2$  (the residual sum of squares), where  $\hat{x}$  denotes the com-

bined sample mean. The null hypothesis is rejected if  $F_{\text{cal}} > F_{k-1, N-k, \alpha}^*$ .

In the preceding example, applying the ANOVA test:

**Table 5.13** An Example of an ANOVA Test for Equality of Means

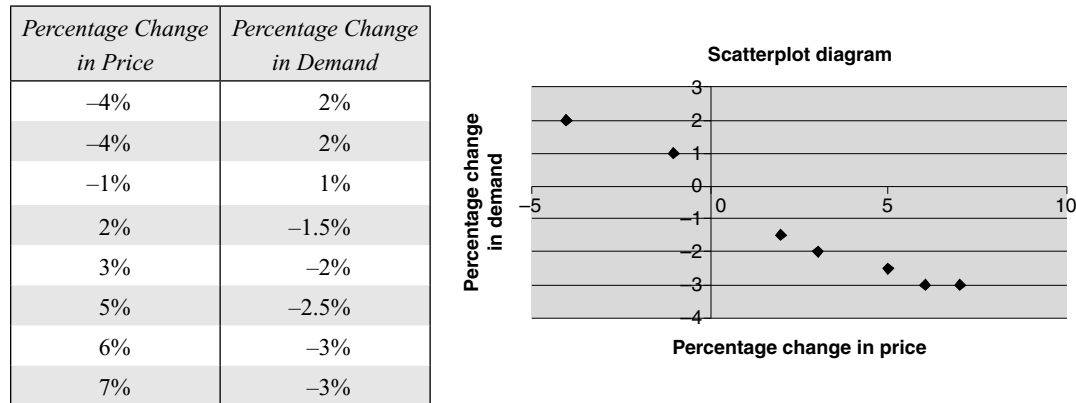
ANOVA Table							
			<i>Sum of Squares</i>	<i>df</i>	<i>Means Square</i>	<i>F</i>	<i>Sig.</i>
Revenue*	Between Groups	(Combined)	4980526	1	4980525.988	5.049	.025
Customer Status	Within Groups		1.5E + 009	1486	986515.267		
	<i>Total</i>		1.5E + 009	1487			

The results show that  $F_{\text{cal}} = 5.049$ , while the critical value is  $F_{1,1486,0.05}^* = 3.8477$ , so that  $F_{\text{cal}} > F_{1, n-1, \alpha}^*$ . It follows that the null hypothesis would be rejected, i.e. as before, it can be concluded that the mean monthly revenue from regular customers in the whole population is significantly higher than the mean monthly revenue from preferred customers.

**Associative analysis** Associative analysis studies the strength, form, and direction of relationships between two or more variables. If only two variables are involved, associative analysis is referred to as bivariate analysis; if there are more than two variables involved, associative analysis is referred to as multivariate analysis.

Associative analysis addresses three distinct sets of questions: (1) to what extent the variables are related to each other, (2) how the variables are related to each other (or the form of the relationship between the variables), and (3) which variables cause changes in other variables. The first question is addressed by correlation, the second by regression, and the third is a question of causality.

**Correlation analysis** studies the extent to which two or more variables are related to each other. The simplest form of correlation is bivariate correlation, which considers only two variables at a time. The first step in a bivariate analysis involves plotting a scatterplot diagram, i.e. a diagram showing the paired values of the two variables. Table 5.14 shows a scatterplot of the percentage change in demand for rolled aluminium against the percentage change in its price.

**Table 5.14** An Example of a Scatterplot Diagram**Scatterplot Diagram for Percentage Change in Demand against Percentage Change in Price**

It may be observed that the points in the scatterplot diagram seem to fall almost in line. More generally, if the points in the scatterplot diagram lie on some curve (usually as determined by theoretical considerations), then the two variables can be interpreted to be related in terms of the curve. On the other hand, if the points in the scatterplot diagram are all scattered, without any apparent pattern, then the two variables can be interpreted to be unrelated. In the example above, assuming that all other things remain unchanged, one would infer that there seems a linear relationship between the percentage change in price and the percentage change in demand.

Correlation is a measure of the extent to which two variables are linearly related. Pearson's product-moment coefficient of (linear) correlation is computed using the formula

$$\rho = \frac{\sum_{i=1}^n ((x_i - \bar{x})(y_i - \bar{y}))}{\sqrt{\left( \sum_{i=1}^n (x_i - \bar{x})^2 \right) \left( \sum_{i=1}^n (y_i - \bar{y})^2 \right)}}$$

The coefficient of correlation always lies between  $-1$  and  $+1$ . A coefficient of correlation close to  $+1$  indicates that the two variables are likely to be linearly related and tend to move in the same direction (i.e. they tend to either increase together or decrease together). A coefficient of correlation close to  $-1$  indicates that the two variables are likely to be linearly related and tend to move in opposite directions (i.e. as one of them increases, the other tends to decrease, and vice versa). A coefficient of correlation close to  $0$  indicates that the two variables are not likely to be linearly related and tend to move independently of each other (i.e. sometimes together, sometimes in opposite directions, without any pattern). In the preceding example, the coefficient of correlation between the percentage change in price and the percentage change in demand is found to be as follows.

The coefficient of correlation was found to be  $-0.985$ , indicating a strong negative correlation between the percentage change in price and the percentage change in demand, i.e. that the percentage change in price and the percentage change in demand are linearly related, and that the percentage

change in demand tends to decrease with an increase in the percentage change in price, and tends to increase with a decrease in the percentage change in price. In economic terms, this is interpreted as a constant price elasticity of demand.

**Table 5.15** An Example of Pearson's Correlation Coefficient

Correlations			
		% Change in Price (rolled aluminium)	% Change in Demand (rolled aluminium)
% Change in Price (rolled aluminium)	Pearson Correlation	1	-.985**
	Sig. (1-tailed)		.000
	N	8	8
% Change in Demand (rolled aluminium)	Pearson Correlation	-.985**	1
	Sig. (1-tailed)	.000	
	N	8	8

\*\*Correlation is significant at the 0.01 level (1-tailed).

Bivariate correlation is, however, a very limited statistical technique. In practice, there would be several variables involved in any situation, and bivariate correlation could misrepresent the extent to which variables are related in the case. In the preceding **example**, consider a simplistic situation in which the price of another product, ready aluminium, influences both the price and demand for rolled aluminium. The bivariate correlations between the percentage change in price of ready aluminium, the percentage change in price of rolled aluminium, and the percentage change in demand of rolled aluminium would then be as below.

**Table 5.16** An Example of Pearson's Correlation Coefficient

Correlations				
		% Change in Price (ready aluminium)	% Change in Price (rolled aluminium)	% Change in Demand (rolled aluminium)
% Change in Price (ready aluminium)	Pearson Correlation	1	.992**	-.985**
	Sig. (1-tailed)		.000	.000
	N	8	8	8
% Change in Price (rolled aluminium)	Pearson Correlation	.992**	1	-.985**
	Sig. (1-tailed)	.000		.000
	N	8	8	8
% Change in Demand (rolled aluminium)	Pearson Correlation	-.985**	-.985**	1
	Sig. (1-tailed)	.000	.000	
	N	8	8	8

\*\*Correlation is significant at the 0.01 level (1-tailed).

The bivariate correlation between the percentage change in price of rolled aluminium and the percentage change in demand for rolled aluminium is still found to be  $-0.985$ , but this could be due to

the variation in the percentage change in price of ready aluminium. In order to study the correlation between the percentage change in price and the percentage change in demand of rolled aluminium without the effect of the percentage change in price of ready aluminium, partial correlation is a more appropriate technique. In partial correlation, the correlation between two variables is examined, controlling for any mediating variables. The partial correlation of the percentage change in price and the percentage change in demand for rolled aluminium, controlling for the effect of the percentage change in price of ready aluminium is shown in Table 5.17.

**Table 5.17** An Example of Partial Correlation Coefficient

Correlations				
Control Variable			% Change in Price (rolled aluminium)	% Change in Demand (rolled aluminium)
% Change in Price (ready aluminium)	% Change in Price (rolled aluminium)	Correlation	1.000	-.352
		Significance (1-tailed)		.220
		df	0	5
	% Change in Demand (rolled aluminium)	Correlation	-.352	1.000
		Significance (1-tailed)	.220	
		df	5	0

The coefficient of partial correlation was found to be  $-0.352$ , indicating a mild negative correlation between the percentage change in price and the percentage change in demand of rolled aluminium.

Correlation analysis for categorical variables takes the form of the  $\chi$ -test for independence of attributes. The null hypothesis is that the two variables  $A$  and  $B$  are independent of each other. The test statistic is given by  $\chi^2_{\text{cal}} = \sum_{i=1}^m \sum_{j=1}^n (f_{ij} - ef_{ij})^2 / ef_{ij}$ , where  $f_{ij}$  represents the observed joint frequency of  $A_i$  and  $B_j$ , while the expected joint frequency  $ef_{ij}$  is given by  $ef_{ij} = \frac{f_{i\cdot} f_{\cdot j}}{f_{\cdot\cdot}}$ , where  $f_{i\cdot}$  is the marginal frequency of  $A_i$ ,  $f_{\cdot j}$  is the marginal frequency of  $B_j$ , and  $f_{\cdot\cdot}$  is the total frequency (sample size). The null hypothesis is rejected if  $\chi^2_{\text{cal}} > \chi^2_{(m-1)(n-1), \alpha}$ .

**Regression analysis** goes one step further than correlation analysis in that it tries to find the relationship between two or more variables. Unlike correlation, however, regression analysis is a dependency technique, which means that one of the variables is treated as a dependent variable, while the other variables are treated as independent variables, and regression analysis expresses the dependent variable as a function of the independent variables. The nature or functional form of the relationship is usually determined by theoretical considerations.

The simplest form of regression is that of simple linear regression. In simple linear regression, the dependent variable  $y$  is expressed as a linear function of the independent variable  $x$ , i.e. using the model  $y = \alpha + \beta x + \varepsilon$ , where  $\alpha$  and  $\beta$  are fixed parameters, and  $\varepsilon$  represents the error term. The least squares



estimators for the parameters  $\alpha$  and  $\beta$  are given by  $\hat{b}_{yx} = \frac{\sum_{i=1}^n ((x_i - \bar{x})(y_i - \bar{y}))}{\sum_{i=1}^n (x_i - \bar{x})^2}$ , and  $\hat{a}_{yx} = \bar{y} - \hat{b}_{yx}\bar{x}$ .

The regression equation is then given by  $\hat{y} = \hat{a}_{yx} + \hat{b}_{yx}x$ , and is used to linearly estimate the value of  $y$  when the value of  $x$  is given (i.e. the conditional expectation of  $y$  given  $x$ ). The standard error (of estimate) measures the standard deviation of the value of  $y$  around this conditional mean, and is used to construct confidence intervals for the value of  $y$  for a given value of  $x$ . The coefficient of determination  $R^2$  measures the percentage of variation in  $y$  which is explained by variation in  $x$ , and gives an indication of how well the linear regression fits the data. In the preceding example, the linear regression of the percentage change in demand for rolled aluminium on the percentage change in price of rolled aluminium is shown in Table 5.18.

**Table 5.18** An Example of Simple Linear Regression

Coefficients <sup>a, b</sup>					
	Unstandardised Coefficients		Standardised Coefficients		
Model	<i>B</i>	<i>Std. Error</i>	<i>Beta</i>	<i>t</i>	<i>Sig.</i>
1 % Change in Price (rolled aluminium)	-.497	.030	-.987	-16.430	.000

a. Dependent Variable: % Change in Demand (rolled aluminium).

b. Linear Regression through the Origin.

It was found that linear regression of the percentage change in demand for rolled aluminium on the percentage change in price of rolled aluminium was statistically significant, explaining 97.5 per cent of the variation in the percentage change in demand for rolled aluminium. The regression coefficient was found to be  $-0.497$ , so that a 1 per cent increase in the price of rolled aluminium would on average result in a 0.497 per cent decrease in the demand for rolled aluminium. In economic terms, this quantity can be interpreted as the coefficient of price elasticity of demand for rolled aluminium. Note that the regression above was performed with the restriction of  $\alpha = 0$ , i.e. regression through the origin.

Apart from simple linear regression, there are several other common forms of bivariate regression, depending upon the functional form used in the regression model. **For instance**, when estimating cost functions, quadratic or cubic regression may be more appropriate than linear regression. Quadratic regression is also used in time series analysis, when the trend is expected to be quadratic in nature. The least-squares method is extended more generally to polynomial regression to any degree. Two other common forms of regression are power regression and exponential regression, which are used especially in growth/decay models (such as population models). These are estimated by reducing them to linear regression models by taking natural logarithms. Especially when no theoretical models relating two variables are available, different regression models may be estimated and compared. Generally, models are compared on the basis of their adjusted  $R^2$  value. Often, such model-building is useful in theoretical development.

Multiple linear regression involves the regression of a dependent variable  $y$  on several independent variables  $x_1, x_2, \dots, x_k$ . The multiple linear regression model is of the form  $y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \dots +$

$\beta_k x_k + \varepsilon$ , where  $\alpha, \beta_1, \beta_2, \dots, \beta_k$  are parameters, and  $\varepsilon$  represents the error term. Again the least-squares method is used to estimate the parameters. In the preceding **example**, the linear regression of the percentage change in demand for rolled aluminium on the percentage change in price of ready aluminium and on the percentage change in price rolled aluminium is shown in Table 5.19.

**Table 5.19** An Example of Multiple Linear Regression

Coefficients <sup>a, b</sup>					
		Unstandardised Coefficients		Standardised Coefficients	
Model		<i>B</i>	<i>Std. Error</i>	<i>Beta</i>	<i>t</i>
1	% Change in Price (ready aluminium)	-.109	.282	-.100	-.387
	% Change in Price (rolled aluminium)	-.448	.130	-.890	-3.451
					.712
					.014

a. Dependent Variable: % Change in Demand (rolled aluminium).

b. Linear Regression through the Origin.

It was found that linear regression of the percentage change in demand for rolled aluminium on the percentage change in price of ready aluminium and on the percentage change in price of rolled aluminium was statistically significant, explaining 97.5 per cent of the variation in the percentage change in demand for rolled aluminium. The partial regression coefficients were found to be  $-0.109$  with respect to the percentage change in price of ready aluminium and  $-0.448$  with respect to the percentage change in price of rolled aluminium. Once again, these can be interpreted as price elasticities: a 1 per cent increase in the price of ready aluminium would result in a 0.109 per cent decrease in the demand for rolled aluminium if there were no change in the price of rolled aluminium, while a 1 per cent increase in the price of rolled aluminium would result in a 0.448 per cent decrease in the demand for rolled aluminium if there were no change in the price of ready aluminium. In economic terms, the first quantity represents the cross-elasticity of demand, while the second quantity represents the price elasticity of demand. In fact, to properly estimate price elasticity of demand and cross-elasticities of demand, all prices that may affect the demand for the particular product must be considered together in the multiple regression model. This once again echoes the concept of statistical control, as in the case of partial correlation.

Apart from multiple regression, there are several very useful multivariate analytic techniques. Factor analysis is a multivariate method used to identify underlying factors from a given set of variables, obtained by combining correlated sets of variables and interpreting them accordingly. **For example**, the five dimensions of service quality arise as factors from the overall set of variables that look at different aspects of service quality. Multi-dimensional scaling is a multivariate method that is used to create perceptual maps from a given set of variables, obtained by defining “distances” between different units in terms of the variables and combining variables together so that when the units are plotted in a coordinate plane, the distance between the plotted points corresponds as closely to the “distance” as defined by the variables. If the dimensions along which the perceptual mapping is made are readily interpretable, a positioning analysis is enabled. Discriminant analysis is a multivariate method used to identify the set of variables that maximally distinguish between two or more classes of units. **For example**, in order to identify critical performance parameters in the operation of systems, one would take performance measurements of systems that are operating well, as well of systems that are not operating well; discriminant analysis would be able to identify the performance parameters that distinguish these

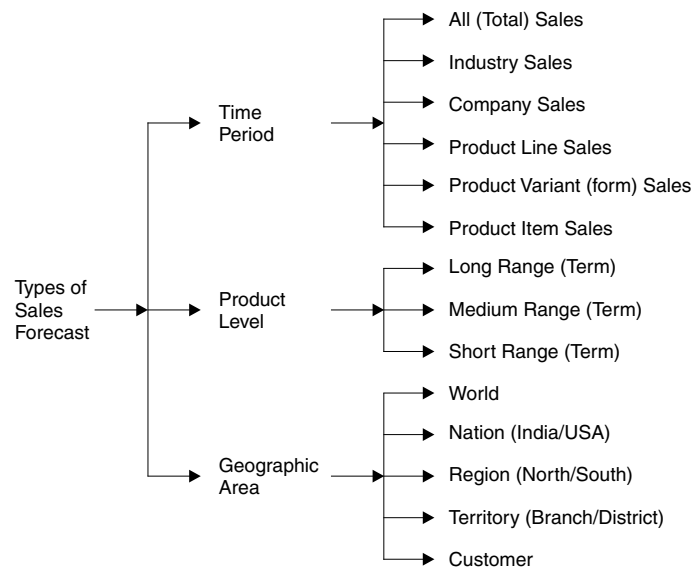
two classes, which would be interpreted as the critical performance parameters. Finally, cluster analysis is a multivariate method used to classify units in terms of similarity in perception or behaviour, by defining distances between units in terms of the variables, and grouping units that are close together into clusters. The clusters can then be analysed so as to identify behavioural profiles. In particular, cluster analysis is a common technique used in customer profiling.

**Predictive analysis** Predictive analysis (or forecasting) allows one to make forecasts or projections for future events. It involves a study of past and present data to estimate/predict/project future values of variables of interest. The process of sales forecasting is discussed in this context.

### Sales Forecasting

The purpose of a sales forecast is to enable effective planning of business processes. The sales forecast is used by several other functional departments: (i) the manufacturing or production department: for setting up production capacity and planning production; (ii) the finance department: for raising cash for investment and operations as well as for profit planning; (iii) the purchase department: for planning their purchases; and (iv) the human resource department: for manpower planning. Thus, the sales forecast has a role as a forerunner to all planning activities in an organisation. Accuracy of the sales forecast is important because all functions base their plans on such forecast. It is the responsibility of sales and marketing managers to prepare the sales forecast.

**Types of Sales Forecast** The term 'forecast' is generally used to describe a prediction for a future period, such as a weather forecast. A sales forecast for a product is the estimated number of units or monetary value of sales for a specific future time period based on an assumed marketing environment and a proposed marketing plan. Firms refer to sales forecast by defining three factors: (i) product level, (ii) geographic area, and (iii) time period. These factors are further subdivided into subfactors as shown in Fig. 5.2. Thus, a total of  $6 \times 3 \times 5 = 90$  different types of sales (or demand) forecast can be made, one for each combination of product level, time period, and geographic area.



**Figure 5.2** Types of Sales Forecasting

### ***Basic Terms Used in Forecasting***

Before discussing approaches and methods of forecasting, it is necessary to define and understand some of the basic terms used in forecasting sales or demand. These terms are closely related, and are often used loosely, and can therefore cause misunderstanding among academicians and managers.

**Market Potential** is the best possible (or maximum) estimated sales of a given product or service for the entire industry in a given market for a specific period of time. **For example**, the market potential for personal computers (PCs) in India for the year 2005–06 is estimated to be four million units. Market potential is also called as industry sales forecast. The following four details must be included for a complete definition of market potential (or for any form of forecast):

1. The item marketed, such as a product or service.
2. The sales estimated in units or monetary value.
3. A description of the market by a geographical area, or type of customer, or both.
4. A specific time period, such as a particular year.

**Market forecast** is the expected industry sales of a given product or service at one specific level of industry marketing expenditure, in a given market, for a specific period of time. Market forecast is also called market size. **For instance**, market size of talcum powder in the organised sector in India is expected to be ₹ 700 crore (₹ 7000 million or about US \$140 million) for the year 2008.

**Sales potential (or company sales potential)** is the best possible (or maximum) estimated sales of a given product or service for a company in a given geographic area for a specific period of time. Sales potential is also defined as the maximum share (or percentage) of market potential that is expected to be achieved by a company. **For instance**, the sales potential of ICICI-Prudential is expected to be close to five per cent of the gross premium collection of life insurance industry in India in coming years.

**Sales forecast (or company sales forecast)** is the estimated company sales of a given product or service, under a proposed marketing plan, in a given market, for a specific period of time. There is a relationship between the company's sales forecast and proposed marketing expenditure (or marketing plan). A company may make a sales forecast for an entire product line (such as detergent from Hindustan Lever) or a product item (such as a particular brand). Sales potential and sales forecast are usually not the same. Sales potential is what a company would achieve under ideal conditions. Typically, the sales forecast is less than the sales potential, for different reasons, such as limited production facilities, and inadequate financial resources.

**Sales budget** is the estimate of expected sales volume in units or revenues from the company's products and services and the selling expenses. Sales budgets are generally set slightly lower than the sales forecast, in order to avoid excessive risk. Sales budget is used for making purchasing, production, manpower and cash flow decisions. The sales budget goes into complete details of expected sales of each product item.

**Sales quota** is a sales goal (or a performance goal) set for a marketing unit for a specific period of time. The marketing unit may be a salesperson, a branch, a region, a dealer, or a distributor. A company management sets sales quotas on the basis of the company sales forecast.

### **Estimating Company's Current Demand**

After understanding various terms used in forecasting or demand measurement, let us examine practical methods for estimating current **organisational demand** in business marketing. First, the company

should estimate total market potential, which is the maximum amount of sales that may be available to all firms in an industry during a given period, under a given level of industry marketing effort and environmental conditions. The method often used to estimate **total market potential** = estimated potential number of buyers  $\times$  the average quantity purchased by each buyer  $\times$  the average price.

Methods commonly used for estimating potential number of buyers, the average quantity of the product purchased by each buyer during certain period of time, and average price of the product are buyers' survey and standard industrial classification (SIC) system. Both the methods are described in this chapter.

For estimating **area market potential** of different cities, states, and geographical areas, market-buildup method is mainly used by business marketing firms. This method is also described in the subsequent pages in this chapter. In this case also, the estimation on number of buyers, quantity purchased by each buyer and the average price can be obtained by conducting a survey of buyers in the specified area or by using SIC system.

The second step, after estimating market potential, is the **company's sales forecast**, or in other words, estimating **the company's current demand**. This is calculated by multiplying the market potential (estimated earlier) by the company's estimated market share. The company's estimated share of market potential mainly depends on the company's marketing expenditure relative to that of competitors and its marketing effectiveness.

**For example**, a new company manufacturing and marketing overhead LCD projectors required by educational institutions and training centres wants to find out the area market potential for western region for the current year and also the company's sales forecast. It carries out a market survey to know how many number of educational institutions and training centres are expected to buy LCD projectors, average number of purchases per buyer and the average price. This works out to 8000 buyers  $\times$  average 3 projectors per buyer  $\times$  ₹ 50,000/- average price of a projector = ₹ 1200 million as the market potential of the projector in the current year in western region. Based on the estimated marketing expenditure, competitors' strengths and weaknesses, and the company's marketing effectiveness, the company estimated its market share in the first year to be three per cent. Hence, the company's sales forecast for LCD projector in the current year is equal to ₹ 36 million (i.e. ₹ 1200 million  $\times$  0.03).

### Estimating Company's Future Demand

For estimating the future demand, companies often use a three-stage process. They prepare a macroeconomic forecast first, followed by an industry forecast, and thereafter a company sales forecast. The macroeconomic forecast includes government expenditures, inflation, business investment, net exports, and so on, resulting in a forecast of gross domestic product (GDP). This is used, along with other environmental indicators, to forecast industry sales. The company's sales forecast is based on the estimated share of the total industry's estimated sales. Sales forecasting methods are described in detail subsequently in this chapter. Companies may carry out sales or demand forecasting internally or buy forecasts from outside sources like marketing research firms.

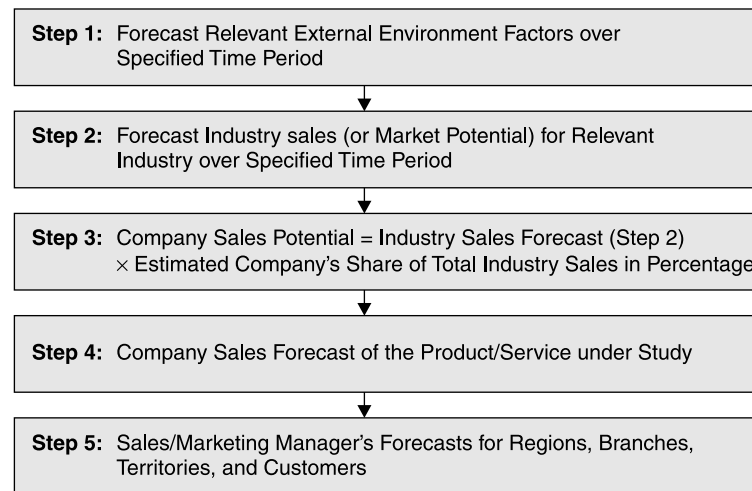
## FORECASTING APPROACHES

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Two basic approaches of forecasting, as shown in Figs 5.3 and 5.4, are: (1) Top-down (or Break-down) approach, and (2) Bottom-up (or Build-up) approach.

### Top-down/Break-down Approach

In this approach, typically the company sales forecast is developed at the business unit (or SBU) level, by using suitable forecasting methods. The head of sales/marketing then breaks down the company sales forecast into region, district, territory, salesperson, and individual customer sales quotas. The steps followed in this approach are shown in Fig. 5.3.



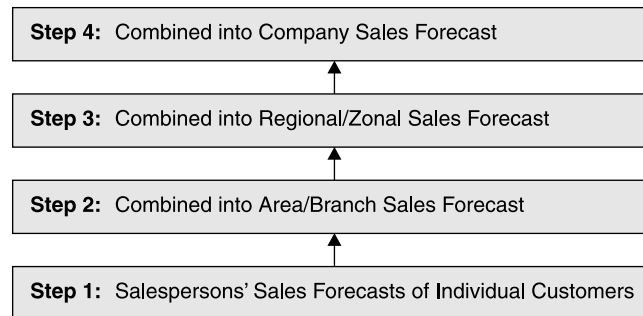
**Figure 5.3** Development of Top-down Forecasting Approach

The key steps are Step 2 and Step 3. In Step 2, some of the methods used for forecasting industry sales (or market potential) are: (i) Delphi method, and (ii) regression analysis, which will be described subsequently in this chapter. In Step 3, for estimating the company's share of the total industry sales, a number of factors must be considered, including the company's current market share, target customers and their perceptions about the company's performance on key factors like quality, service, and price in comparison with major competitors, and the company's relationship with major customers. With respect to Step 4, the company sales forecast is usually lower than the company sales potential due to insufficient funds, increase in competition, or shortage of raw material. The last step of breaking down the company sales forecast to different regions and territories is done based on market potential of different geographical areas. For this, two major methods are available: (1) market build-up method, primarily used by business marketers, and (2) multiple-factor index method, mainly used by consumer marketers.

**Market-Buildup Method** The first step in this method is to identify existing and potential business buyers in the geographical territory. The second step is to find out their potential purchases of the product under study. The final step is to add-up the business potential of all the buying firms to obtain a fairly accurate estimate of market potential for the product or service for a specific geographic territory.

### Bottom-up/Build-up Approach

This approach starts with the company's area or branch managers asking its salespersons to estimate or forecast the sales in their respective territories, as shown in Fig. 5.4.



**Figure 5.4** *Development of Bottom-up Forecasting Approach*

Salespersons are given guidance by their respective area/branch sales managers on how to get information from the existing and potential customers on the estimated purchases of the company's products services for the specified future time period. Each area or branch manager then adds the sales forecasts received from the salespersons, modifies the same wherever needed, and sends the combined sales forecast figure for each product in units and value to his superior, that is, regional or zonal sales manager. Each regional/zonal manager adds the sales forecast received from the area or branch managers, modifies the same, if needed, and sends the regional sales forecast to the sales/marketing head. The head of sales/marketing repeats the process and presents his proposal of the company's sales forecast to the CEO for discussion, modification and approval.

Some companies use both top-down and bottom-up approaches, in order so increase their confidence in the sales forecast. However, comparison of the two approaches indicate that top-down approach needs less time and cost, as it uses data from secondary sources like Planning Commission Report, or market forecasts and indicators by Centre for Industrial and Economic Research, New Delhi. The bottom-up approach is very accurate for short-term forecast (up to one year), as it is based on primary data collection, which means more cost and time. Firms may develop sales forecast internally or buy forecast from outside sources such as marketing research companies or specialised forecasting firms like Centre for Industrial and Economic Research.

## Sales Forecasting Methods

As shown below, sales forecasting methods or techniques can be classified as: (1) qualitative methods, and (2) quantitative methods.

Qualitative methods can be further classified into (1) executive opinion method, (2) Delphi method, (3) sales-force composite method, (4) survey of buyers' intentions method, and (5) test marketing method.

Quantitative methods can be further classified into (1) moving average method, (2) exponential smoothing method, (3) decomposition method, (4) naïve/ratio method, (5) regression analysis, and (6) econometric analysis.

### *Executive Opinion Method*

This is the oldest, simplest, and the most widely used method. A study of one hundred and fifty companies found that 86 per cent used executive opinion method to forecast sales. The method involves

getting the views of top executives of the company regarding future sales. The sales forecasts are made either by taking the average of all the executives individual opinions or through discussions among the executives. Some executives' opinion may be supported by the use of forecasting methods, and other executives may form their opinion based on experience, judgement, and intuition.

The **advantages** of this method are: (i) forecasting can be done quickly and easily, (ii) less expensive than other methods, and (iii) very popular, particularly among small and medium-sized companies. However, there are some **disadvantages**: (a) unscientific, (b) subjective, and (c) difficult to break-down the forecast into subunits (like regions, branches) of the organisation.

### ***Delphi Method***

This method is similar to the executive opinion method, and was developed by Rand Corporation during the late 1940s. The difference is that the members of expert panel do not meet or discuss in a committee. The procedure includes selection of panel of experts from within and outside the organisation. A coordinator asks each expert separately to make a forecast on some matter. Each member of the expert panel submits in writing his/her forecast anonymously. The coordinator summarises these forecasts into a report that is sent to each panel member. The experts are then asked to make another prediction separately on the same matter, with the knowledge of the forecasts of the other experts on the panel. This process is repeated until the panel of experts arrives at some consensus. The basic belief in this method is that experts, without any pressure or influence will develop a more accurate prediction of the future.

The **advantages** of this method are: (i) objective forecast that is accurate, (ii) useful for technology, new product, and industry sales forecast, and (iii) both long and short-term forecasting possible. However, the **disadvantages** are: (a) difficulty getting a panel of experts, (b) longer time for getting consensus, and (c) break-down of forecast into products or territories is not possible.

### ***Sales-force Composite Method***

This method involves salespeople to estimate their future sales. It is an example of bottom-up approach and is also called a "grass-roots" approach. Each salesperson estimates in his/her territory how much quantity or value existing and potential customers will buy of each of the company's products and/or services. This method is often used by business marketing companies. Sales representatives make the sales estimate in consultation with customers and sales supervisors and/or based on their experience and intuition. The company sales forecast is made up (composite) of all the salespersons' sales forecast.

The **advantages** of this method are: (i) forecasting is done by salespeople who are closest to the market and have better insight into sales trends than any other group in the company, (ii) detailed sales estimate broken down by customer, product, sales representative and territory are possible, and (iii) involvement of sales people.

The **disadvantages** include: (a) sales forecasts are often pessimistic or optimistic, as salespeople are not trained in forecasting, (b) if sales forecasts are used to set sales quotas, which are linked to incentive schemes, salespeople may deliberately underestimate the demand, and (c) many salespersons are not interested in sales forecasting, and prefer to spend time in the field meeting customers.

To encourage better forecasting, companies are adopting some of the following modifications to the earlier practices:



1. Salespeople are given information on their past forecast with actual sales; the company assumptions on the business outlook during the forecasting period, major competitors' strategies, tactics, strengths, and weaknesses, and the company's proposed marketing plan.
2. The salesperson and the immediate sales supervisor work out the sales estimates independently. Then they meet and reconcile any differences in the figures. The same process is carried out between the sales supervisors and the territory manager, and later on, between the territory managers and the sales manager.
3. Conducting training programmes for salespeople on the process and methods used for forecasting sales.

### ***Survey of Buyers' Intentions Method***

This method is sometimes called as market research (or market survey). It includes asking existing and potential customers about their likely purchases of the company's product and services for the forecast period. **For instance**, a question like the following is asked:

Do you intend to buy a compressor within the next six months?

- |     |                      |
|-----|----------------------|
| 0.0 | (not at all)         |
| 0.2 | (slight possibility) |
| 0.4 | (fair possibility)   |
| 0.6 | (good possibility)   |
| 0.8 | (high possibility)   |
| 1.0 | (certainty)          |

The above is called a purchase probability scale. The customers are also asked other questions, such as product quality, features, price and service, which are all a part of the questionnaire. The information collected from buyers helps the company to make effective decisions not only in sales and marketing areas, but also on production, research and development.

Even though this method is grouped under qualitative methods, it can be classified as a quantitative method, when the respondents are selected based on probability sampling techniques, and analysis is done with multivariate statistical tools.

The **advantages** of this method are: (i) useful in forecasting sales for industrial products, consumer durables, and new products, (ii) it also gives customers' reasons for buying or not buying; (iii) relatively inexpensive and fast, when only a few customers are involved (for example business buyers' survey). The **disadvantages** are: (a) sometimes buyers are unwilling to reveal their plans, (b) buyers are sometimes overoptimistic.

### ***Test Marketing Method***

This method is useful for forecasting sales for a new product, which has no historical (or previous) sales figures. It can also be used for estimating sales for an established product in a new territory.

For industrial-product market testing, the methods used are alpha testing (testing within the company), and beta testing (with outside customers) for high cost and new technology products and services. **For example**, Infosys sent its banking software product, Finnacl, to the experts for a thorough check-up to see if it was fit for the multi-billion dollar US market. The supplier of the new product/service will ask the customers about their purchase intentions and other information after the beta testing. Another method used for introducing a new industrial product is participating in the industry trade-shows.

The main **advantages** of these methods are: (a) their usefulness for forecasting the sales of new or modified products, and (b) in deciding whether a company should go ahead for a national launch of a new product, without spending a huge amount.

### ***Moving Average Method***

This is a relatively simple method that develops a company forecast by calculating the average company sales for previous years. As shown below, a company's sales forecast was worked out by calculating moving averages for three to six-year time periods. The formula used is:

$$F_t = \frac{Y_{t-1} + Y_{t-2} + \dots + Y_{t-n}}{n}$$

Where,  $F_t$  = Sales forecast for next year,  
 $Y_{t-1}$  = Actual sales of this year,  
 $Y_{t-2}$  = Actual sales of previous year,  
 $n$  = Number of years.

**Table 5.20** An Example of Moving Average (MA) Method

Year	Actual Sales	3-point MA	4-point MA	5-point MA	6-point MA
2001	840				
2002	880				
2003	864				
2004	832	861.33			
2005	862	858.67	854.00		
2006	948	852.67	859.50	855.60	
2007	956	880.67	876.50	877.20	871.00
(forecast) 2008		922.00	899.50	892.40	890.33

(Figures of sales are in ₹ Million)

When a forecast is developed for the next period, the sales in the oldest period is dropped from the average and is replaced by sales in the newest period; hence the name “moving averages”. If the company operates in a stable environment a short two or three year moving average may be most useful. Moreover, if a firm is in an industry which exhibits cyclical variations, the moving average should use data, equal to the length of a cycle or a longer averaging period. The **advantages** of this method are: (a) relatively simple method, (b) easy to calculate, and (c) widely used for short-term and medium-term sales forecasts. The **disadvantages** are: (a) unable to predict a downturn or upturn in the market, (b) cannot predict long-term sales forecast accurately, and (c) historical data is needed.

### ***Exponential Smoothing Method***

This method is closely related to the moving average method for sales forecasting. Using the exponential smoothing equation, the forecaster can allow sales in certain periods to influence the sales forecast more than sales in other periods. The formula for the exponential smoothing method is as follows:

$$F_t = \lambda Y_{t-1} + (1 - \lambda)F_{t-1}$$

The forecaster decides the value of the smoothing constant  $\lambda$  based on: (a) review of sales data (b) knowledge and observation about the conditions in the forecasted period and conditions in previous period, and (c) intuition. **For instance**, a smoothing constant  $\lambda$  with a high value of 0.7 or 0.8 allows most recent periods of actual sales to influence sales forecast more than sales in earlier periods. Whereas a smoothing constant with a low value of 0.2 or 0.3 allows earlier periods of actual sales to influence forecasted sales more than sales in recent periods. The smoothing constant  $\lambda$  can range between 0 and 1.

In the **example** of Table 5.21, the forecasted sales for the year 2008 can be calculated by using the exponential smoothing method, with smoothing constant  $\lambda = 0.2$ . The sales forecast for the year 2008 would be  $0.2(956) + 0.8(869.83) = ₹ 887.06$ .

The **advantages** of this method are: (a) simple to operate, (b) forecaster's knowledge or intuition can be used in forecasting, (c) useful method when sales data have a trend or a seasonal pattern, (d) immediate response to an upturn or downturn in sales, and (e) used by many firms. The **disadvantages** are: (a) smoothing constant is somewhat arbitrary, and (b) long-term and new product forecasting are not possible.

**Table 5.21** An Example of Exponential Smoothing Method

<i>Year (t)</i>	<i>Actual Sales (Yt)</i>	<i>Forecast (Ft)</i>
2001	840	840.00
2002	880	840.00
2003	864	848.00
2004	832	851.20
2005	862	847.36
2006	948	850.29
2007	956	869.83
(forecast) 2008		887.06

(Figures of sales are in ₹ Million)

Exponential smoothing can be improved by including a trend component. This method is known as double exponential smoothing.

### **Decomposition Method**

In this method the company's previous periods' sales data is broken down (or decomposed) into four major components, such as trend, cycle, seasonal, and erratic events. These components are then re-combined to produce the sales forecast. Let us consider this method continuing the **example** above. Assume that various analyses have broken down (or decomposed) the previous sales data into the following components: a growth of 3 per cent in sales due to the development in technology, capital formation and population (trend component), increased terrorist activities are expected so reduce sales by 5 per cent (erratic events component), a 10 per cent reduction in sales is expected due to a recession in demand (cyclic component), and the sales in the third quarter of the year are expected to go up by 15 per cent due to festive season, as compared to other three quarters (seasonal component).

The forecaster would combine the different components, as follows, in order to forecast sales for 2008. Suppose that the total sales in 2007 was ₹ 956 million. The trend component shows that 2008 sales would be ₹ 985 million ( $= 1.03(956)$ ). The sales are reduced due to introduction of erratic event component to ₹ 936 million ( $= 0.95(985)$ ). The sales forecast changes further due to cyclic component of recession to ₹ 842 million ( $= 0.9(936)$ ). Thus, the annual sales forecast for 2008 is ₹ 842 million. The quarterly sales forecast would be ₹ 210 million ( $= 0.25(842)$ ), if the seasonal component is not considered. The seasonal component (due to, for instance, festive season) in third quarter would suggest 15 per cent increase in sales forecast, that is ₹ 242 million ( $= 1.15(210)$ ) for the third quarter and consistent sales forecast of ₹ 200 million ( $= (842 - 242)/3$ ) each for the other three quarters.

From the above **example**, we notice that trend, cyclic and erratic events are included in the calculation of annual sales forecast, while the seasonal component is used for forecasting sales for less than a year, like quarterly or monthly sales forecast. The major **advantage** of this method is that it is conceptually a sound method. However, the **disadvantages** of this method are: (a) difficult and complex statistical methods are needed to breakdown sales data into various components, and (b) historical data is needed.

### ***Naïve/Ratio Method***

Naïve or ratio method is a time series method of forecasting, which is based on the assumption that what happened in the immediate past will continue to happen in the immediate future. The simple formula used is as follows:

$$F_t = \left( \frac{Y_{t-1}}{Y_{t-2}} \right) Y_{t-1},$$

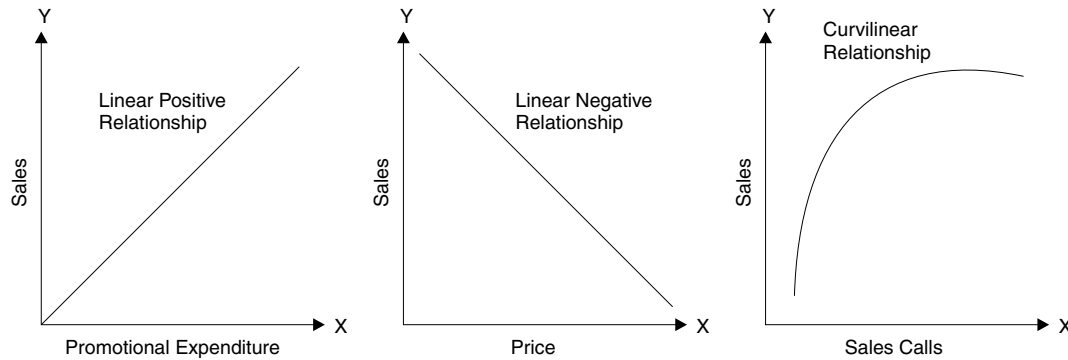
Where,  $F_t$  = Sales forecast for next year,  
 $Y_{t-1}$  = Actual sales of this year,  
 $Y_{t-2}$  = Actual sales of last year,

Let us continue with the above **example**, and forecast the sales for the year 2008. The actual sales of the current year (2007) is ₹ 956 million and that actual sales of last year (2006) was ₹ 948 million. The next year (2008) sales forecast would be ₹ 964 million ( $= (956)(956)/948$ ).

The **advantages** of the method are: (a) simple to calculate, (b) requires less data, and (c) accuracy is good for short-term forecast. However, the method also has certain **disadvantages** such as: (a) it cannot be used for forecasting sales for long-term periods and new products, and (b) accuracy of sales forecast would be less, if past sales fluctuate considerably.

### ***Regression Analysis***

This is a statistical forecasting method that is used to predict sales, treated as a dependent variable ( $Y$ ), based on some independent variables (or factors) which influence the sales. If there is only one independent variable ( $X$ ), say promotional expenditure, affecting sales, the relationship can be identified using a scatterplot diagram, described earlier. The scatterplot may show one of several possible different patterns of relationships, as shown in Fig. 5.5.



**Figure 5.5** Relationships in Regression Analysis

Once all of the relevant independent variables affecting sales are identified, regression analysis is performed to identify the functional relationship between sales and the independent variables, which in turn is used to forecast sales in subsequent periods, given forecasted levels of the independent variables.

**For example,** suppose that it is determined that the sales of trimmer and router bits depend on the sales of wooden furniture, interior decoration, doors and window frames, and wooden artifacts. The sales data for the same is shown in Table 5.22.

**Table 5.22** An Example of Regression Method

<i>Year</i>	<i>Trimmer and router bits</i>	<i>Wooden furniture</i>	<i>Interior decoration</i>	<i>Door/window frames</i>	<i>Wooden artifacts</i>
<b>2002</b>	123	23674	14564	2356	5345
<b>2003</b>	130	24532	17453	2541	5728
<b>2004</b>	138	26784	1824	2853	6024
<b>2005</b>	147	29342	21432	2914	6158
<b>2006</b>	155	31692	23127	3146	6324
<b>2007</b>	162	33457	25276	3256	6519
(forecast) 2008	169.37	35320.30	27624.69	3369.85	6720.01

(Figures of sales are in ₹ Million)

Using multiple linear regression, the sales of trimmer and router bits is expressed as a function of the sales of wooden furniture, interior decoration, doors and window frames, and wooden artifacts, as shown in Table 5.23.

**Table 5.23** Regression Coefficients in the Example

Coefficients <sup>a</sup>					
Model	Unstandardised Coefficients		Standardised Coefficients		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	23.633	1.882		12.559	.051
Sales of wooden furniture (FWF)	.002	.000	.549	37.074	.017
Sales of interior decoration (FID)	.001	.000	.228	16.825	.038
Sales of doors and window frames (FDWF)	.003	.001	.069	3.841	.162
Sales of wooden artifacts (FWA)	.006	.001	.162	9.739	.065

a. Dependent Variable: sales of trimmer and router bits.

The sales of trimmer and router bits (FTRB) can then be projected using projections for the sales of wooden furniture, interior decoration, doors and window frames, and wooden artifacts, which can be obtained by any method. Suppose the projections of sales of wooden furniture, interior decoration, doors and window frames, and wooden artifacts are found using the ratio method, as given in the last line in Table 5.22. These figures are then used in the regression equation

$$F_{TRB} = 23.633 + 0.002 * F_{WF} + 0.001 * F_{ID} + 0.003 * F_{DWF} + 0.006 * F_{WA}$$

to obtain a projection for the sales of trimmer and router bits, as shown in the last line of Table 5.22.

The **advantages** of regression analysis are: (a) high forecasting accuracy if relationships between variables are stable, (b) objective method, and (c) can predict turning points of the company's sales. The **disadvantages** are: (a) technically complex, (b) can be expensive and time consuming, and (c) use of computer and software packages is essential.

### ***Econometric Analysis***

In this method, many regression equations are built to forecast industry sales, general economic conditions, or future events. To find out which factors or variables influence sales, and the relationships between sales and these factors, as well as the interrelationships between the factors, a number of regression equations representing these relationships are developed. A forecast is prepared by solving these equations on computer. The major **advantage** of this method is that accurate forecast of economic conditions and industry sales are possible. The **disadvantage** is that a large volume of data is required representing the various factors.

## **HOW TO IMPROVE FORECASTING ACCURACY?**

Sales forecasting is an important and difficult task. It is therefore necessary to understand some guidelines that help in improving the accuracy of the sales forecast. These are: (a) use multiple forecasting methods, (b) identify suitable methods, (c) develop a few factors, (d) obtain a range of forecasts, and (e) use computer hardware and software tools.

### Use Multiple Forecasting Methods

Companies use two or three forecasting methods to ensure high level of accuracy and to gain confidence. **For example**, an electrical equipment manufacturing company uses regression analysis and sales-force composite methods to find if the sales forecasts developed by the two methods are similar to each other. Regression analysis method has the top-down approach that is used at sales and marketing headquarter. The sales-force composite method has the bottom-up approach, involving all the sales-people and field sales managers. In case the sales estimates of the two methods differ considerably, the company uses survey of buyer's intentions or moving averages method. The final forecast is approved by the senior executives (i.e. executive opinion method).

### Identify Suitable Methods

Suitability of the forecasting method depends on the application, cost and time available for forecasting. The forecaster should also keep in mind the advantages and disadvantages of each forecasting method, as mentioned earlier. Table 5.24 will give guidelines to sales and marketing executives in selecting suitable forecasting methods.

### Develop a Few Factors

When the forecaster uses regression analysis or econometric analysis, he/she should keep the number of independent variables or factors as few as possible because the use of too many factors result in duplication of a few basic factors like population and income. A good practice is for the forecaster or marketer to discuss the factors that affect the sales of the company's products with sales executives, salespersons, and customers, and thereafter use these few factors as independent variables for multiple regression analysis.

### Obtain a Range of Forecasts

Most forecasting firms prepare a range of sales forecasts, including minimum, intermediate, and maximum estimates. The minimum sales estimates are based on the lowest probable potential market for the product or service. The company also estimates the sales potential (maximum possible sales estimates), assuming all favourable things to happen. Between the two extremes of minimum and maximum estimates, the forecaster makes suitable assumptions to calculate the intermediate sales forecast.

Table 5.24 summarises the different forecasting methods and discusses the conditions under which each of them are appropriate.

### Use Computer Hardware and Software Tools

Computers are playing an important role in sales forecasting. Personal computers (PCs) are used widely for sales forecasting, because they are fast and capable of storing and processing large amount of data. There are several software packages, such as SAS (Statistical Analysis System) and SPSS (Statistical Package for the Social Sciences), that are marketed for use in sales forecasting. Sales managers are increasingly using these software packages, as they are user-friendly and helpful in avoiding manual calculation. Sales managers are realising that they must overcome their computer-phobia as they find computer an essential tool for sales forecasting.

**Table 5.24** Guidelines in Selecting Suitable Forecasting Method

<i>Forecasting Method</i>	<i>Time Required to Develop</i>	<i>Cost</i>	<i>Accuracy</i>	<i>Application</i>	<i>Strengths (Advantages)</i>	<i>Weaknesses (Disadvantages)</i>
Executive Opinion	Short (1 week) to Medium (3/4 weeks)	Low	Fair	Short/Medium range and new products	Quick forecast, less expensive	Subjective, no break-down *
Delphi	Medium (3/4 weeks) to long (2/3 months)	Low to medium	Good	Long-term, technology, new product, industry sales forecast	Objective, e-mail facility helps quick exchanges	Getting real experts, Break-down is difficult *
Salesforce Composite	Medium	Medium	Fair to good (if trained)	Annual sales forecast, for existing and new products/ services	Break-down * possible, involvement of sales people	Less knowledge, Optimistic or pessimistic estimates
Survey of Buyers' Intentions	Long (3–6 months)	Medium	Good	New products/ services, industrial/ consumer durable products	Gives more information on customers, Less cost and time, if customers are few	Intentions may not result in buying; some buyers unwilling to reveal their intentions
Test marketing	Low	Low	Good	New or modified products	Minimises cost or risk of launch	Competitors may disturb
Moving Averages	Short (Hours)	Low	Good for short-term and stable conditions	Short and medium term sales and inventory	Simple and easy to calculate	Cannot predict downturn/upturn, historical data needed
Exponential Smoothing	Short (Hours)	Low	–Do–	–Do–	Simple, forecasters' knowledge used	–Do– Smoothing constant arbitrary
Decomposition	Short to Medium (1–3 weeks)	Low to medium	Fair to good	Short-term Forecasting; software packages available	Conceptually sound	Complex, historical data needed, cannot predict upturn/ downturn
Naive/Ratio	Short (Hours)	Low	Good for short-term	Short-term forecasting	Simple to calculate	Less accurate if past sales fluctuate
Regression Analysis	Short (Hours) to Medium (2–4 weeks)	Low to medium	Good	Company sales forecast, Software packages available and essential	Objective, can predict upturn/ down-turn	Technically complex, Large historical data needed
Econometric Analysis	Medium to long	Medium to high	Good	Economic conditions, Industry sales, Computer hardware and software essential	Simulation of economy, accuracy of causal relationships	Need expertise, large historical data needed

\*Broak-down means detailed sales estimates by territory, product, and salespersons.



### The Chofray–Lilien Model

The Chofray–Lilien model is a refinement of the Sheth model of organisational buying. The model analyses the buying decision for an industrial product/service in different target segments, depending on their relative sizes, and on the feasibility of the product/service for each target segment. It also incorporates the involvement of different groups of decision makers in the buying decision in different segments, the awareness level about the product of the different groups of decision makers, and their preference for the product/service. All these factors are combined together in the model in order to arrive at an estimate of potential market share of the product/service.

The framework for the Chofray–Lilien model may be developed as follows. Suppose that the product/service is expected to have potential demand in  $m$  target segments, indexed as  $i = 1, 2, \dots, m$ . Let

the relative size of the  $i^{\text{th}}$  target segment be denoted by  $x_i$  (as a percentage of the total market, so that  $\sum_{i=1}^m x_i = 1$ ). Let  $f_i$  represent the feasibility level of the product/service in the  $i^{\text{th}}$  target segment, i.e. the

percentage of customers in the  $i^{\text{th}}$  target segment who would find the product/service technically and economically suitable for their purposes. Further, suppose that there are  $n$  groups of decision makers involved in the organisational buying decision, indexed as  $j = 1, 2, \dots, n$ . Let  $w_{ij}$  represent the involvement index of the  $j^{\text{th}}$  group of decision makers in the  $i^{\text{th}}$  target segment, measuring the extent to which the  $j^{\text{th}}$  group of decision makers influence the purchase decision of the product/service in the  $i^{\text{th}}$  target

segment (with a restriction that  $\sum_{j=1}^n w_{ij} = 1$ ). Let  $q_j$  represent the awareness level of the product/service

for the  $j^{\text{th}}$  group of decision makers, i.e. the percentage of decision makers in the  $j^{\text{th}}$  group who are aware of the product/service. Finally, let  $p_j$  represent the preference level of the product/service for the  $j^{\text{th}}$  group of decision makers, i.e. the percentage of decision makers who are aware of the product/service in the  $j^{\text{th}}$  group who will prefer to buy the product/service.

The overall potential market share of the product/service can then be expressed as

$$\pi = \sum_{i=1}^m \sum_{j=1}^n x_i f_i w_{ij} q_j p_j$$

**For example,** consider the computation of the potential market share of trimmers and routers, as given in the Table 5.25.

**Table 5.25** An Example of the Chofray–Lilien Model

Involvement Intensity Matrix						
	<i>Owners</i>	<i>Workers</i>	<i>Dealers</i>	<i>Agents</i>	<i>Size</i>	<i>Feasibility</i>
Furniture manufacturers	35.00%	15.00%	30.00%	20.00%	25.00%	50.00%
Interior decorators	25.00%	30.00%	30.00%	15.00%	10.00%	70.00%
Door/window frame mfrs.	20.00%	35.00%	30.00%	15.00%	30.00%	50.00%
Carvers/designers	45.00%	30.00%	15.00%	10.00%	25.00%	35.00%
Others	40.00%	10.00%	30.00%	20.00%	10.00%	25.00%
Choice/Awareness	60.00%	25.00%	65.00%	45.00%		
Awareness	65.00%	35.00%	100.00%	100.00%		

There are five target segments for the product, viz., furniture manufacturers, interior decorators, door/window frame manufacturers, carvers/designers, and others, representing 25 per cent, 10 per cent, 30 per cent, 25 per cent, and 10 per cent, respectively of the total market for the product. The decision makers in each of the target segments include owners, workers, dealers, and agents. The feasibility of the product for each target segment, the involvement of different groups of decision makers in the buying decision in different segments, the awareness level about the product of the different groups of decision makers, and their preference for the product are detailed in the table, as obtained from a market survey. The potential market share using this data is found to be 17.84 per cent.

### **Presenting the Research Findings/Report**

The final stage of a business marketing research study is report preparation, including communication of the research findings. Although the research findings are communicated by means of a written report, often a user company asks for presentation to a select group of executives. While making written or oral presentations, the researcher should keep the following points in mind.

1. The researcher should collect the information about the profile (or background) of the executives who would be interested in the research report from the user company. Generally, there would be a wide diversity of interests and preferences among the executives. The researcher should, therefore, not use too many technical terms or jargons.
2. The major research findings should be relevant to the marketing research objectives.
3. The researcher should logically justify the choice of research method, data collection method, data analysis techniques, etc. under the heading “Research Methodology”, so that the interested reader is convinced about the authenticity of the report.
4. The researcher must not try to satisfy the personal likes or dislikes of the executives in the user company.
5. The research report should have clarity of thought and expression. Although there is no standard format for all types of marketing research reports, the following sequence or format may be used: (i) Title Page, (ii) Table of Contents, (iii) Executive Summary, (iv) Introduction (or Research Brief), (v) Problem Formulation and Research Objectives, (vi) Research Methodology, (vii) Results (or Findings) of the Research, (viii) Recommendations and conclusion, (ix) Appendix, (x) Bibliography.

The above format is self-explanatory and does not need further discussion.

### **Use of Internet in Business Marketing Research**

Internet is a tool that is available for gathering information for business marketing research. Internet and particularly the World Wide Web (www) have made available many sources of information on a wide range of topic of marketing research, such as economic information, technological trends, political and legal information, customer and competitive information, and so on. This information is inexpensive, easy to use, and quick to access. However, one has to be careful to examine the information critically, and ask how relevant it is to a specific marketing problem, how recent it is, and whether the information is biased in some way. Some information providers give or sell us information of unreliable quality. One way to protect ourselves from making decisions based on incorrect data is by relying on the credibility of a trusted information provider. But it is always better to exercise our own critical ability to question the quality of the data through analysis, and interpretation. Internet is used not only to collect secondary information, but also to gather primary data through e-mails and Web pages.

**Internet as a Growing Source of Secondary Data** The main thing about the internet is probably its advantages in researching secondary information. The speed and amount of useful published data available through the internet is amazing. Company management, financial, and marketing information are necessary components for any business intelligence programme and most of the information can be found easily on the internet. There is a speciality website known as “Corporate information” ([www.corporateinformation.com](http://www.corporateinformation.com)), which contains links to public and private sector companies in more than 100 countries. The internet competes with several other online sources to satisfy the information needs of business firms and consumers. Generally, business organisations rely on professional databases such as Lexis/Nexis. Finding out information about competitors’ activities is an important task and internet is the main tool for this task. To monitor current press releases, news stores, products and services of competitors two sources are available: Excite’s News-tracker Clipping Service ([www.news.excite.com](http://www.news.excite.com)) and Company Sleuth ([www.companysleuth.com](http://www.companysleuth.com)).

**Online Survey Methods** The various ways of collecting primary information through the internet are: e-mail surveys, online panels, internet surveys and online focus groups.

**Email Surveys** This technique uses e-mail for the entire process of receiving, completing, and returning questionnaires. The researcher creates a standardized e-mail message, in the format of a cover letter, and adds the online survey (or questionnaire) as an attachment. These are then electronically transmitted as a ‘mass mailing’ to a large number of prospective respondents, who are given opt-in or opt-out approval options. Respondents who select the opt-in option continue to complete the survey and return it via e-mails. The advantages of e-mail surveys over regular postal mail surveys are that data collection is done at lightning speed and at a very low cost. In addition, errors like interviewer interaction bias and data entry are eliminated. The disadvantage is that access to the internet is not with everyone, although it is growing rapidly.

**Internet Surveys** These are similar to e-mail surveys, but there are some distinct differences. An internet survey is a self-administered questionnaire that is placed on a website for prospective respondents to read and complete. Another difference is that respondents have the option of accessing the results of the survey in real time.

**Online Panels** In online panels groups of people agree to participate in surveys and exchange their views. The information collected from these panel members is used for developing business and marketing solutions. Online panels provide high-quality data, in addition to being cost effective and fast. Other advantages include wide audience coverage, international research from one place, and electronic monitoring of respondents.

**Online Focus Groups** This method allows the researcher to reach target segments more effectively, compared to traditional offline focus group research. Everything from recruitment and screening (via e-mail) to moderation of discussion is conducted online. The processes, guidelines and decisions that are required in the planning and execution stages of an online focus group session are mostly the same as that for conducting offline focus group session. The differences are that the technology used during the focus group session is much more sophisticated for online than offline methods and that online focus groups provide greater flexibility to client participation before, during, and after the session. The major difference between the two methods is that online focus group method allows analysing and reporting of the results in real time, whereas offline method takes many days to manipulate and report the findings to decision makers.

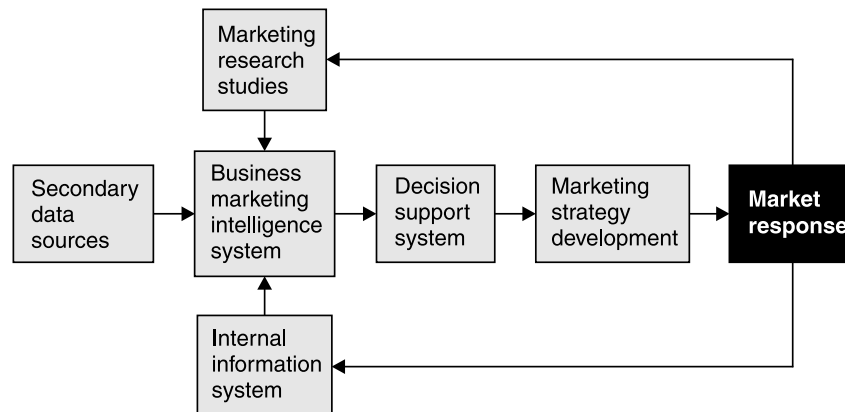
## BUSINESS MARKETING INTELLIGENCE SYSTEM

Business marketing research studies are carried out periodically to address specific problems. However, business marketing managers need continuous flow of information in developing strategies and tactics. Marketing intelligence system provides relevant, accurate, and timely information on continuous basis to the business marketing manager to make decisions. Thus, business marketing research is a part of business marketing intelligence system. The other components or parts are shown in Fig. 5.6.

### The Concept and Components

Business marketing intelligence system is defined as a broad spectrum of information that is required on continuous basis to make decisions. The system gathers, stores, analyses, interprets, and disseminates relevant marketing information. As shown in Fig. 5.6, it includes the following components:

**Marketing Research Studies** The marketing research studies, as described earlier in this chapter, may include development of market potential, market share analysis, forecasting, competitive analysis, business trends, and so on. Dedicated files could be set up for each marketing research project undertaken. The sources of data from marketing research projects are sometimes labelled “data providers” and are stored in the computer’s data storage devices.



**Figure 5.6** Business Marketing Intelligence System

**Internal Information System** This generates periodic reports on sales, costs, and profits by product, territory, market segment, and customer. These reports evaluate the actual performance with the goals or targets for the relevant periods. The same information may be required by other functions or executives such as finance, accounts, and senior management. The system coordinates the requirements of all functions and key executives. Internal information is also stored in the data storage devices.

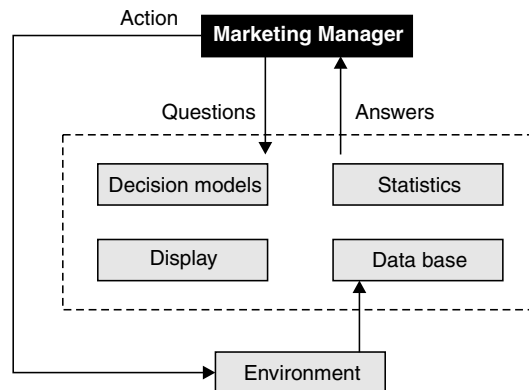
**Secondary Data Sources** These, as discussed earlier, are available from on-line databases, CD-ROMs and diskettes and magnetic tapes. The secondary data available is enormous and hence, care should be taken to determine which data is relevant and then such relevant secondary data should be collected and stored. This can be retrieved by the decision makers.

Marketing intelligence system (MIS) provides a systematic approach for collecting, storing, and disseminating marketing information. Its outputs are reports that are used for routine marketing decisions. As marketing decisions become more complex and business marketing managers develop their knowledge and skills, information needs exceed the capabilities of an MIS. The logical extension of MIS is the decision support system (DSS), which helps the business marketing manager to make more effective decisions in complex marketing situations.

**Decision Support System (DSS)** An increasing number of business marketing firms are adding decision support system (DSS) to marketing intelligence system (MIS) to help in solving unstructured problems and for making better decisions in complex market situations. John D.C. Little defines **DSS** as “a coordinated collection of data, systems, tools, and techniques with the necessary software and computer hardware through which an organisation gathers and interprets relevant information from business and environment and turns it into information that can be acted upon.”

The components of a decision support system, as shown in Fig. 5.7, are: (a) Database, (b) Statistics, (c) Decision models, and (d) Display.

**Data Base** It is same as that provided through marketing intelligence system. Data base captures the data from the various external and internal sources. The important task of data base is to store all the data in proper form so that it is accessible for decision making.



**Source:** \* Adapted from “Decision Support System for Marketing Managers”, J.D.C. Little, *Journal of Marketing*, 43, Summer 1979, 10. Reprinted with permission from American Marketing Association.

**Figure 5.7** Components of Decision Support System\*

### Decision Models

A decision model examines the relationships between the variables. Decision models may be complicated computer-based mathematical equations or simple hypothesis of the marketing manager. **For example**, a model may be developed to find out the effect of price change on the product sales.

### Statistics

These are the statistical tools used for manipulating the data. These tools may be complex multivariate statistical tools, or more often-used frequency distributions, averages, and standard deviations. This

component of DSS produces meaningful information by relating the data base to the decision models. It involves, **for example**, segregating the data into groups, totalling, taking ratios, making tables, and so on.

### **Display**

This component develops a set of decision rules for deciding the best alternative by using the available data base. It is also the place where interaction takes place between the marketing manager and the DSS. The information flows back and forth between the marketing manager and the computer so that different alternatives are examined before selecting the best alternative.

**Requirements of an Effective Decision Support System** The main requirement of an effective DSS is linking of PC and mainframe DSS so that the flexibility of the PC can be coupled to the power of large data base. The other requirements are the user-friendly system, need-based reports rather than standardised reports, analysis of data, evaluation of alternatives (**for example**, “what would happen if...”), flexibility and speed of operations. The capability of DSS in business marketing will increase substantially if *expert systems* (i.e. computer programmes that copy the behaviour of an expert in the area of problem solving) and *artificial intelligence technology* (i.e. combining human learning process with computer’s speed to extract useable knowledge from a large data base) are adopted into DSS framework.

## **SUMMARY**

Business marketing research supports business marketers in decision making by providing market information. However, business marketing research obtains the market information periodically and not on continuous basis. There are differences between consumer and business marketing research, although the elements or process remain the same. Major guidelines for performing market research in business markets are explained. The main areas of conduct of business marketing research are market potential development, market share analysis, sales analysis, forecasting, competitive analysis, new product acceptance and potential, business trend studies, and sales quota determination. To conduct these marketing research studies, one has to follow certain steps that are involved in the marketing research process, like: (i) identifying the problem and define research objectives, (ii) developing the research design, (iii) collecting the data, (iv) processing and analysing the data, and (v) presenting the research findings. The most important step is the research design which includes type of information required, sources of data (primary, secondary, commercial, or combination), research methods (observational, exploratory, descriptive, and experimental), sampling plan (sampling unit, sample size, and sampling procedure), method of contacts (mail, telephone, or personal interview), and data collection methods (or research instruments), such as questionnaire and mechanical devices.

Data analysis plays an important role in business marketing research. The type of data analysis to be used depends on the objectives of the research. Data analysis can be classified into descriptive analysis, inferential analysis, differences analysis, associative analysis, and predictive analysis. Predictive analysis is perhaps one of the most important forms of analysis used in business marketing, especially in sales forecasting and in market potential measurement.

Estimating a company's current and future demand are important issues that are discussed. We have also examined forecasting approaches and sales forecasting methods. Use of the Internet as a source of secondary data as well as collecting primary information are explained. Small and medium enterprises (SMEs) often use marketing research agencies to conduct marketing research studies.

Business marketing research obtains market information periodically and not continuously. To meet the needs of the business marketer for timely and continuous information for effective decision making, *business marketing intelligence system* was developed. The components or parts of business marketing intelligence system are: (a) marketing research studies, (b) internal information system, and (c) secondary data sources. Increasing number of business marketers are extending business marketing intelligence to *decision support system* (DSS), so as to help in making effective decisions in complex marketing situations. The components of DSS are: data base, statistics, decision models, and display. Decision support system enables the business marketing manager to (a) interact with the computer, (b) develop various alternatives, and (c) select the best alternative.

### KEY TERMS

- |                            |   |
|----------------------------|---|
| • Bivariate analysis       | • Multi-dimensional scaling                             |
| • Causality                | • Multivariate analysis                                 |
| • Cluster analysis         | • Partial correlation                                   |
| • Company's sales forecast | • Perceptual mapping                                    |
| • Confidence interval      | • Population/population parameters                      |
| • Correlation              | • Price elasticity of demand/cross-elasticity of demand |
| • Descriptive measures     | • Sample/sample statistics                              |
| • Discriminant analysis    | • Sampling distribution                                 |
| • Distribution-fitting     | • Scatterplot diagram                                   |
| • Factor analysis          | • Simple linear regression/multiple regression          |
| • Forecasting              | • Standard industrial classification                    |
| • Frequency distribution   | • Statistical inference                                 |
| • Hypothesis testing       | • Univariate analysis                                   |
| • Market potential         |   |

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. For what types of marketing decisions, conducting business marketing research studies would be useful and why?
2. Illustrate by an example, problem identification, the research objectives, and the list of information required, in a marketing research study.
3. Do you agree with the statement: "Secondary data is an important source of information in business marketing." Explain reasons. Mention some of the sources of secondary data.
4. A computer training institute finds that the intake of students has been dwindling. What type of research method would you recommend and why?

5. When are focus-group interview, Delphi technique, and in-depth interview used? Which method would you use to forecast business trends and why?
6. Why probability sampling is superior to non-probability sampling? Which sampling technique would you use for finding the market demand for a new textile machine with much higher productivity and quality compared to the existing machines? Justify your reply.
7. Describe how business marketing research is a part of business marketing intelligence system and how it helps the business marketers in decision making.
8. Why increasing number of business marketers are adding decision support system (DSS) to marketing intelligence system? Describe a typical decision support system (DSS).

### OBJECTIVE TYPE QUESTIONS

1. Primary data is usually collected: (a) through literature review, (b) from data bases, (c) from textbooks, or (d) by sample surveys.
2. Secondary data is usually: (a) taken from one source only, (b) always available up-to-date, (c) very costly to procure, or (d) incomplete and contradictory.
3. A business marketer would like to understand why customers are not buying the company's product. The research method that should be used is: (a) observational, (b) exploratory, (c) descriptive, or (d) experimental.
4. A sampling plan should include: (a) a description of the sampling unit, (b) a statement of the sample size, (c) a description of the sampling technique, or (d) all of the above.

### APPLICATION QUESTIONS

1. A manufacturer claims that at most 5 per cent of the company's products are defective. In a random sample of 160 units, 10 are found to be defective. Is the manufacturer's claim valid?
2. A lecturer claims that 85 per cent of students feel that mathematics is difficult. In a random sample of 250 students polled, 185 students felt that mathematics was difficult. Is the lecturer's claim valid?
3. In random samples of sizes 100 and 200 from two warehouses, the number of defectives is found to be 12 and 25, respectively. Is there a significant difference in the defect rates in the two warehouses?
4. Measurements of the weights (in grammes) of a sample of ten eggs of a particular species of birds were found to be as follows: 16, 20, 18, 18, 22, 18, 16, 18, 20, 20. Can it be said that the mean weight of the eggs of the bird is more than 20 g?
5. A salesman is set a weekly sales target of 100 units. In a random sample of ten weeks, his mean sale is found to be 97 units, with standard deviation 2.5 units. Is this significantly lower than the target?
6. A random sample of 20 shoppers revealed that the average time they spent shopping was 1 hr 10 min, with standard deviation 10 min. Can it be argued that shoppers spend significantly more than 1 hr shopping?
7. A sensitive instrument is calibrated to measure weights to within 0.5 g. A random sample of twenty measurements is found to have standard deviation 1.1 g. Is the variation in the measurements taken by the instrument within its calibrated limits?



8. The following contingency table shows the results of cross-tabulation of gender with income in a random sample:

		Income		
		low	medium	high
Gender	male	20	65	40
	female	40	65	20

From the sample data, can one conclude that income and gender are related?

9. In a random sample of 100 households, 35 households were found to have at most two children, and 25 households were found to have both working parents. Further, only 15 households were found to have more than two children and both working parents. From the sample data, can it be concluded that the number of children in the household is related to whether both parents are working or not?
10. The heights of a sample of 15 athletes from China had a mean value of 1.4 m, with standard deviation 0.3 m. The heights of a sample of 12 athletes from Japan had a mean value of 1.6 m, with standard deviation 0.2 m. From the sample data, can one conclude that there is a significant difference in the mean heights of Chinese and Japanese athletes?
11. Random samples of batting averages of players from three cricket teams were as follows:
- team A: 24.3, 22.5, 25.7, 27.4  
team B: 26.4, 27.5, 29.0, 29.3, 29.7  
team C: 25.4, 25.8, 26.5, 27.7

Can it be concluded that there is a significant difference in batting average of players in the three teams?

12. Four varieties of rice are tested, and the yields (in kg) obtained were as follows:

		Variety			
		A	B	C	D
	1	54.5	45.1	35.2	45.7
	2	43.3	39.8	34.3	34.1
	3	47.2	40.1	30.5	30.2
	4				

Is there a significant difference in the yield of the four varieties of rice?

13. Four salesmen were sent to each of three areas, and their sales figures were as follows:

		Salesmen			
		A	B	C	D
Areas	X	45	35	38	47
	Y	35	28	29	32
	Z	28	25	27	31

Is there a significant difference in the average sales of the salesmen?

## REFERENCE NOTES

1. For further details about the ISIC refer to the website:  
<http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=27>
2. For further details and examples of application of statistical techniques, please refer to the following textbooks:  
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## CASE 5.1

### LeafCo Pvt. Ltd.: Demand Forecasting

LeafCo Pvt. Ltd. is a medium-scale agro-business unit situated just outside Jamshedpur, Jharkhand, India. It produces three special grades of leaf pulp, all of which are sold to local small-scale manufacturers, who produce leaf-paper food containers, leaf-paper bags, and leaf-paper packaging materials for the nearby markets in Jamshedpur and Ranchi. Grade A is primarily used in the production of leaf-paper food containers, grade B is used in the production of leaf-paper bags and of leaf-paper packaging materials, and grade C is primarily used in the production of leaf-paper packaging materials. The by-products of its pulp production processes are sold to local small farmers as fertilizer.

The quarterly sales figures of LeafCo of the different grades of leaf-pulp and the quarterly sales figures of different leaf-paper products are given in the accompanying Table C.1.

The Jharkhand government has recently announced a policy promoting eco-friendly products. For this reason, the marketing manager of LeafCo expects the market for leaf-paper products to grow at twice or even thrice the current growth rate, and expects that LeafCo’s customers will expand their marketing operations to other nearby markets, such as Bokaro and Dhanbad. On the other hand, the operations-cum-finance manager is less enthusiastic about the growth potential of the market, pointing out that their customers are small-scale units, so that they would face serious capacity constraints and logistic difficulties if they tried to expand into other markets, and suggests a more cautious approach to forecast demand.

### Question

1. Use appropriate assumptions and techniques to forecast the quarterly demand of the three grades of leaf pulp for the next two years, and justify the same.

**Table C.1** Sales Figures of the Leaf-Paper Pulp and Leaf-Paper Products

<i>Quarter/ year</i>	<i>Grade A sales (1000 metric tonnes)</i>	<i>Grade B sales (1000 metric tonnes)</i>	<i>Grade C sales (1000 metric tonnes)</i>	<i>Leaf-paper food containers (1000 units)</i>	<i>Leaf-paper packaging materials (1000 units)</i>	<i>Leaf-paper bags (1000 units)</i>
Q1_2001	9.021	8.005	4.085	25773	27234	105642
Q2_2001	8.944	8.162	4.041	25554	26939	109356
Q3_2001	9.072	8.419	4.218	25920	28121	112132
Q4_2001	8.964	8.880	4.411	25612	29405	118797
Q1_2002	9.034	8.755	4.330	25811	28864	117379
Q2_2002	9.171	9.193	4.500	26204	29998	123861
Q3_2002	9.255	9.435	4.734	26444	31563	125576
Q4_2002	9.191	9.832	5.044	26261	33627	129395
Q1_2003	9.031	10.056	5.258	25803	35052	131018
Q2_2003	8.940	10.226	5.242	25544	34949	134626
Q3_2003	8.938	10.455	5.427	25538	36183	136740
Q4_2003	8.904	10.803	5.482	25440	36547	142967
Q1_2004	9.013	10.791	5.585	25752	37233	141359
Q2_2004	9.052	10.826	5.497	25864	36647	143230
Q3_2004	9.209	10.677	5.474	26312	36492	140550
Q4_2004	9.149	11.011	5.596	26141	37306	145617
Q1_2005	9.247	11.116	5.692	26419	37948	146419
Q2_2005	9.368	11.280	5.686	26767	37904	149787
Q3_2005	9.524	11.651	5.572	27213	37148	158721
Q4_2005	9.809	11.816	5.839	28027	38925	158476
Q1_2006	9.678	12.355	6.209	27650	41394	164321
Q2_2006	9.582	12.434	6.502	27377	43345	161990
Q3_2006	9.749	12.880	6.954	27855	46363	164864
Q4_2006	9.626	13.279	7.192	27502	47945	169698
Q1_2007	9.790	13.552	7.593	27972	50621	169796
Q2_2007	9.817	13.699	7.588	28785	50584	172809
Q3_2007	9.918	14.539	8.105	28337	54036	182718

# 6

## Segmenting, Targeting and Positioning in Business Marketing

*After studying this chapter you should be able to:*

- Know market segmentation, its benefits and limitations, and requirements of effective segmentation.
- Know the procedure followed for segmenting business markets.
- Identify the bases (or variables) used for segmenting business markets.
- Evaluate the potential segments.
- Learn to select the target market segments and target-market strategies.
- Learn to develop effective positioning strategies.

The decision of the business marketer on segmenting, targeting, and positioning (STP) is considered as an important strategic (i.e. long-term) marketing decision. This is also an important part of marketing strategy which the business marketer develops to achieve the organisational objectives.

### MARKET SEGMENTATION

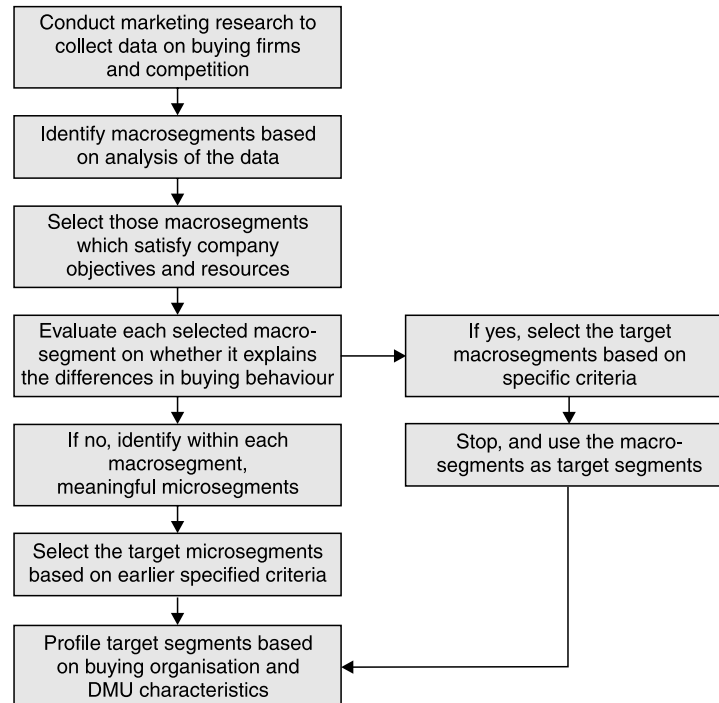
One of the most important decisions a business organisation makes is to select its customers (or markets) which it can serve effectively. A firm should decide whether it can effectively serve the entire market (against tough competitors). If it does not have the adequate resources, it can select those segments of the market which it can serve better than or at least equal to its competitors.

**Market segmentation** is the process of dividing a market into groups of customers who have similar requirements for a product or service offering. Business marketers' task is to identify the segments (i.e. customer groups) and decide which segment(s) to target. Before we discuss the details of market segmentation, let us look at the framework of segmenting and targeting in order to understand the same clearly.

### Process of Segmenting and Targeting Business Markets

The process of segmenting business markets is more difficult than segmenting consumer markets. Business customers differ greatly and it is difficult to perceive which differences are more important. Besides, the same industrial products have often multiple applications – **for example**, the same precision steel tube can be used for manufacturing bicycle, furniture and bus-body building. One of the ways to segment business markets is a **two-staged hierarchical approach**, where first macro-segmentation variables and then micro-segmentation variables are examined. This is shown in Fig. 6.1, which out-

lines a framework for carrying out the process of segmenting and targeting business markets. The process includes four steps: (1) carrying out a marketing research, (2) identifying and selecting macro-segments, (3) if needed, go for micro-segmentation, and (4) profiling target segments.



**Figure 6.1** *Segmenting and Targeting Framework*<sup>1</sup>

**Marketing Research** The process of segmenting and targeting in business marketing is shown in Fig. 6.1. The starting point is carrying out marketing research to collect information on characteristics of buying firms (i.e. macro variables), such as type of buyer or customer, customer's industry type, size (or sales potential), geographical location, product application or end-use. Information on competitors like major players, their strengths and weaknesses, strategies and tactics, will be useful later for selecting target segments. Most information may be available through secondary data sources like the internet, industry association, journals, and magazines. If the secondary data is inadequate or unreliable, primary data should be collected through market survey.

**Identify and Select Macro-segments** By analysing the data on buying organisations' characteristics from the marketing research findings, macro-segments can be identified. Out of the various macro-segments, only those macro-segments are selected which are in line with the company's long-term objectives and resources (see Table 6.2 and read "Target Marketing" in this chapter). The company should have adequate resources to serve the macro-segment. **For example**, for a small-sized capital equipment manufacturing company located near Bengaluru, financial and manpower resources were not adequate to give pre- and post-sales services to large customers located in northern and eastern regions. The next step is to evaluate each selected macro-segment on whether the segment explains the

differences in buying behaviour of buying organisations. **For instance**, there was no difference in the buying behaviour of the major two-wheeler manufacturers like Hero Honda, Bajaj Auto and TVS, for buying steel components. The difference in buying behaviour could be seen through a micro-variable, such as personal characteristics of buying centre members, in terms of risk taking ability for a new vendor. The new supplier of steel components used micro-segmentation for selecting the buying firms in two-wheeler auto segment. If the answer to the above question is “yes”, then select each of these macro-segments for another evaluation based on specific criteria, such as (1) size (market potential) and growth, (2) profitability analysis, (3) competitive analysis, and (4) costs of serving the segment. These criteria are subsequently explained, except the costs of serving the segment. The costs of serving the segment include any modification of the product, special service support, changes in the channels of distribution and promotion. Basically, the segment should be attractive in terms of sales, profitability, and growth.

**Micro-segmentation** If, in the earlier step, the selected macro-segment does not explain the differences in the buying behaviour of buying firms, then it is necessary to go for micro-segmentation, by using micro variables, such as (1) buying situations, (2) purchasing criteria, (3) buying organisations’ capability, and (4) personal characteristics of buying centre members. The cost and complexity of data collection are more for micro-segments than that for macro-segments. Target micro-segments are selected based on the earlier specified criteria of market size and growth, profitability, competition, and costs of serving the segment.

**Profiling** Each selected target segment is profiled by its specific characteristics of buying organisations and decision making units (DMUs) or buying centres. It may be the particular application or use of the product, geographic location of buying firms, purchasing criteria, and personal characteristics of buying centre members.

Business marketers should follow the above process for segmenting and targeting, keeping in mind that targeting a specific market segment involves long-term resource commitments. Marketing managers should, thereafter, decide and implement the target market strategies, which will be discussed subsequently in this chapter.

### An Illustration

The above described market segmentation process can be illustrated with an **example** of a precision steel tube manufacturing company. The company wanted to decide its marketing strategy, which was a part of the marketing plan, for precision steel tubes, for the domestic market in India. The first step was to carry out a market survey to get information required not only for developing segmenting, targeting, and positioning (STP) strategies, but also for product promotion, pricing, and distribution strategies. The company prepared a list of research objectives and the details of information or data to be collected. After the market survey, the collected data was analysed by using statistical tools, like SPSS (Statistical Package for Social Science which is now called as ‘Statistical Product and Service Solutions’), to identify different segments, such as bicycle, automotive, low-pressure boilers, furniture, and general engineering. The company’s long-term objective was to achieve number one position, in terms of market share, from number three position among 14 players in precision steel tubes industry. Hence, selling the product to all market segments would help to achieve the company objective. However, the company did not have the resources (or strengths) for getting boiler quality steel, for which it had to depend on its competitor—Tata Steel (Tubes Division). The company, therefore, did not consider the

segment of low-pressure boiler manufacturers. For furniture and general engineering segments, the company did not have the strength to match the low prices of small-scale players. Hence, these two segments were also not selected. The remaining two segments—viz. bicycle and automotive satisfied the company objectives and strengths (or resources). For each of these segments, the buying behaviour of buying units was different based on product application, usage rate, and geographic location of customers. Hence, the macro-segmentation was good enough, and micro-segmentation was not needed. Both bicycle and automotive were selected as target segments, based on specific criteria of size, growth, profitability, and competition, which are explained later in this chapter. Profile of each target segment was prepared in terms of type of industry, application or use of steel tubes, volume required, buying behaviour, and so on.

### Benefits, Limitations and Requirements of Market Segmentation

Market segmentation in business marketing has not been practised as effectively as in consumer marketing because of the difficulty involved in segmenting business markets. The difficulty is in grouping business customers into market segments whose responses to the company marketing programs may not be similar because of the involvement of many individuals with different background in the decision process. Despite this difficulty, there are distinct benefits or advantages in market segmentation.

**Benefits** (i) It enables the business marketer to compare marketing opportunities of different market segments by studying the customer needs and sales potential, competition and satisfaction levels of customers in each market segment. Thus, the business marketer can do a more effective marketing strategy. (ii) Business firms with availability of adequate resources can develop separate marketing programs or plans to meet the needs of different market segments. Smaller firms with inadequate resources can also survive and succeed by concentrating on a few or niche market segments. (iii) The budgeted allocation of resources can be done effectively to various segments, and hence, marketing resources can be used more efficiently.

**Limitations** Market segmentation is not always beneficial or practical, particularly when the market consists of a few customers, or a single large customer, or when the market is so small that marketing to a portion of it is not profitable. **For example**, a company supplying underground telecommunication jointing kits did not carry out market segmentation because it had only two customers—department of telecommunication (DOT) and Indian Railways.

The limitations of market segmentation are: (i) increase in marketing expenses such as inventory carrying cost, advertising cost, transportation, and so on; (ii) difficulty in segmenting due to the existence of great differences in buying practices, customer characteristics, product applications, and benefits sought by different members of buying centres.

**Requirements of effective segmentation** In order to ensure the usefulness of segmentation, marketers should apply the following criteria to evaluate the potential market segments.

1. **Measurable** Can the size, growth, and buyer characteristics of the segment be measured?
2. **Substantial** Is the segment large enough in terms of sales and profit potential to serve? A segment should have a substantially large customer group worth going after with a specific marketing programme.
3. **Accessible** Can the segment be identified, reached, and served effectively with the firm's marketing efforts?

- 4. Differentiable** Are the segments distinguishable and responding differently to different marketing-mix strategies? **For instance**, if scooter and motorcycle manufacturers respond similarly (to product requirements, pricing, and channel strategies) while buying steel, they are not differentiable and hence, do not form separate segments. They are combined to become a two-wheeler segment.

The purpose of segmenting the business market is to enable the business firms to allocate its resources effectively so as to maximise the return on investment. Thus, the market segments should not only be large and profitable (and the customers within each segment to be homogeneous), but also, the segments should be different enough to enable separate marketing plans or strategies.

## IDENTIFYING BASES (VARIABLES) USED FOR SEGMENTING BUSINESS MARKETS

Consumer markets are segmented on the basis of *demographic* variables (e.g. age, gender, income, occupation), or *psychographic* variables (e.g. lifestyle, personality). As business buying behaviour is fundamentally different from consumer buying behaviour, the variables used for segmentation are different (except for geographic, benefits sought, and usage rate). Business market segmentation is approached on the basis of: (i) Macro-variables, and (ii) Micro-variables. While carrying out the task of segmentation, the business marketer will have to try different segmentation variables—either one variable (if sufficient, in some cases), or a combination of several variables. In some instances, after using one variable it may be necessary to further subdivide the market by using another segmentation variable in order to obtain a more detailed segmentation scheme. This is called **sequential segmentation process**. The examples of some of the methods followed in practice, by using more than one variable, are given subsequently in this chapter. Table 6.1 shows the major variables (both macro and micro) used for segmenting business markets.

**Table 6.1** Major Variables used for Segmenting Business Markets

<i>Variables/Bases</i>	<i>Examples</i>
	<b>Macro-variables</b>
<b>1.</b> Type of industry, type of customer	<ul style="list-style-type: none"> <li>Which industries should we market our products or services? Mining, chemical, rubber, textile, etc. which are classified by Standard Industries Classification (SIC).</li> <li>Types of customer includes government, commercial, cooperative, and institutional.</li> </ul>
<b>2.</b> Company size, usage rate	<ul style="list-style-type: none"> <li>What size of companies should we focus on? Based on sales potential (or usage), market is segmented by large, medium, and small (or A, B, and C) size customers.</li> </ul>
<b>3.</b> Customer location, geographic area	<ul style="list-style-type: none"> <li>What geographical areas should we concentrate on? Customers located nearer to factory, or clusters of customers located in various urban areas like Mumbai, Chennai, Bangalore, Kolkata, Faridabad, Ludhiana, and so on.</li> </ul>
<b>4.</b> End-use or application, benefits of products	<ul style="list-style-type: none"> <li>Should we focus on certain specific end-uses or applications of our product instead of all the uses or applications? Each product or service has different benefits, uses or applications. Aluminium extrusions are used for door and window frames, electrical control panels, electronic equipment as heat sink, bus-body building, and so on.</li> </ul>

*Contd.*



	Micro-variables
1. Buying situations: new task, modified rebuy, straight rebuy	▪ Should we serve customers who need more information, help, or discussions in decision making process from the suppliers, because it is a new task (i.e., newpurchase)?
2. Organisational capabilities	▪ Should we concentrate on customers who need financial support (more credit), more services (prompt or quick deliveries), or technical support?
3. Purchasing policies	▪ Should we focus on customers who prefer competitive bidding, market based negotiated prices, turn-key contracts, or service contracts?
4. Purchasing criteria	▪ Should we serve the customers who seek quality, service, or price?
5. Personal characteristics	▪ Should we focus on customers based on the personal characteristics of buying-centre members such as risk-takers, risk-avoiders, or personal motives.

## Macro-segmentation

Macro-segmentation approach consists of identifying the macro-variables on the basis of industry characteristics or organisational characteristics such as type, size, geographic location, or product application. Most of the macro-segmentation variables are easy to identify. The information on macro-variables can be obtained through secondary sources of information such as the Internet, trade directories, business magazines, government publications, and company sources. Some of the macro-variables used for business-market segmentation are classified into (a) industry characteristics and (b) organisational characteristics as discussed below.

**Industry Characteristics** Many business firms market their products or services to different “types of industries”. These industries are classified by Standard Industries Classification (SIC) by government publications.

**Example: Industry type segmentation variable** A marketing research firm decided to segment its market based on “industry type” so as to develop special industry-wise knowledge and information for giving better value to its customers in a competitive market. The company used the SIC codes to club different industries into homogenous groups such as engineering industries; chemical, petrochemicals and fertilisers industries; agricultural and food processing industries; service organisations such as banks, hotels, trade associates and tourism. Each industrial group was looked after by a separate team to achieve the objective stated earlier.

Significant differences such as product or service requirements may also be present within an industry. In such instances, further subdividing of individual industries may be necessary to obtain a more detailed segmentation scheme.

**Organisational Characteristics** The “size” of the customer organisation is an important macro-variable used to segment the market. Larger organisations have different purchasing requirements (e.g. large volume purchases are used to obtain volume discounts) and will respond differently to marketing strategies or programmes as compared to smaller firms that purchase in smaller quantities. Similarly, larger firms may avoid buying from small-scale organisations as their large-volume needs may not be met by the small firms.

Another important segmentation variable is “customer location”. In business marketing, the geographical location of customers is an important factor in serving the needs of on-time delivery due to

factors like transportation time, inventory control, availability of warehouse facilities, or prompt after sales services. Some business marketers may avoid those customers or markets which are too far away or too dispersed, considering the high cost of marketing efforts such as deployment of sales force, ware-housing facility or service centres.

**Example: Geographical segmentation variable** Cadence, a software supplier firm, felt that Indian market required a special focus as it had a distinct set of characteristics. While design in most Asia Pacific region was still on 250 and 180 nanometre technology, Indian design engineers were working on the latest 130 and 90 nanometre technology. This needed more support from Electronic Design Automation (EDA) tool suppliers. Cadence, which made software for use in designing chips and other integrated circuits, used geographical segmentation variable (or basis) for market segmentation. The company considered India as the fifth market segment. The other four segments were North America, Europe, Japan and rest of Asia.

### **Micro-segmentation**

Micro-segments are homogenous groups of customers within the macro-segments. Thus, business marketers subdivide macro-segments into micro-segments only if necessary. Micro-segment variables (or micro variables) are based on the purchasing decisions. The data or information required for developing micro-segmentation is more difficult and costly as it has to be obtained through company sales persons or by conducting market surveys.

**Micro-variables in Micro-segmentation** The micro-variables used in micro-segmentation are as follows:

#### ***Buying Situations***

As discussed in Chapter 3, the type of buying situations, in terms of new-task, modified rebuy, and straight rebuy, are used to segment the customer firms further. The information needs of first-time buyers (i.e. new-task buying situations) are different from buyers who want to change the existing suppliers (i.e. modified rebuy).

#### ***Organisational Capabilities***

Micro-segmentation is also based on organisational capabilities, such as financial, technical, or operational. **For example**, companies that are financially weak may be attracted by longer credit terms or volume discounts as compared to product quality or delivery factors. Companies that are technically not strong depend on technical information and support from suppliers. Organisations that operate on tight inventories may look for suppliers who give prompt and quick deliveries.

#### ***Purchasing Policies***

Purchasing policies is another micro-segment variable used to segment customers based on their purchasing policies or practices. The government organisations have a standard purchase policy of tender bidding and orders are placed based on lowest price bids. Large and small organisations in the private sector have different purchasing policies, as discussed in Chapter 2.

### ***Purchasing Criteria***

The markets can also be segmented on the basis of purchasing criteria used by buyer organisations. **For example**, if products are standard, economic criteria such as price, payment terms, inventory carrying costs, inspection and rejection costs, dominate in purchase decisions. For non-standard, complex or new products, performance, application or quality criteria dominate in purchase decisions.

### ***Personal Characteristics***

The personal characteristics of individual buyers within an organisation is an important variable, as ultimately the decisions are made by individuals. Information on personal characteristics such as willingness to take risk, need for social relationships, education, age, personal motives of buyers and key decision making persons, is quite useful in developing segmentation strategies along the personal factors. Such information may be difficult but still possible to obtain from company sales persons in a formal information system formats.

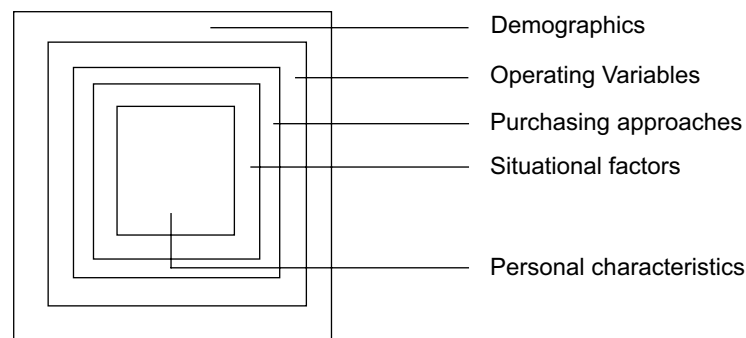
Thus, the degree of market segmentation (i.e. going from macro- to micro-segmentation) depends on how detailed the required customer knowledge is for effective utilisation. A business marketer should remember that the more a market is segmented the more it becomes costly and time consuming. Therefore, business market segmentation should begin with macro-segmentation, and only if necessary, move towards micro-segmentation. In other words, once it is clear that macro-segmentation is good enough, further segmentation with micro-variations should not be undertaken.

**For example**, in 1975 a large electrical engineering company with several industrial and consumer durable products decided to restructure its marketing and field sales organisation, based on a study undertaken by a consultant. It had 15 branch offices and four regional headquarters located in northern, eastern, western, and southern parts of India. The geographical segmentation was not adequate to increase its marketing effectiveness in a competitive market. The company used the macro-segmentation variables such as customer type and customer size as a two-step market-segmentation process. In the first step, the company used the customer type as the macro-segmentation variable to segment (or divide) the domestic market. Based on this segmentation, the customers were grouped into four distinct groups: (i) Government organisations; (ii) Private sector companies; (iii) Dealers; and (iv) The customers needing engineering projects/contracts services. These four customer groups were looked after in each of the four geographical regions by separate teams of field sales persons. In the second step, the company used the customer size as the macro-management variable to subdivide the market into sub-groups of large, medium, and small size customers. It was decided that the company would look after large and medium-size customers, and small-scale industries would be looked after by the company dealers, as it was not economical for the company to cater to quantitatively small purchases of small-scale business customers. The government customers such as state electricity boards, had different kinds of purchase policies as compared to private sector organisations. The team which undertook turn-key contracts or projects was required to purchase non-company products or services and also ensure installation and commissioning operations at customers' sites.

The above example illustrates how **sequential segmentation process** was carried out by using three different segmentation variables, such as geographic locations of customers, type of customers, and customer size (based on the volume of products used or purchased).

### The Nested Approach to Segmentation

Shapiro and Bonoma have suggested a nested approach to segmentation of business markets, as shown in Fig. 6.2. In this approach, five general segmentation criteria are identified and arranged as a nested hierarchy – like a set of boxes that fit one into the other. Moving from the outer nest toward the inner, these criteria are: demographics, operating variables, customer's purchasing approaches, situational factors and personal characteristics of the buyer. Figure 6.2 shows how the criteria relate to each other as nests.



**Source:** Shapiro and Bonoma, "How to Segment Industrial Markets," *Harvard Business Review*, May–June 1984, pp.103–110.

**Figure 6.2** Nested Approach

The business marketer moves from the more general and easily observable segmentation criteria of the outer nests to the more specific and subtle segmentation characteristics of inner nests. However, it may not be necessary for every business marketer to use every stage of the nested approach for every product. One may skip irrelevant criteria, but only after understanding the nested approach and the following segmentation criteria completely.

**Demographics** The outermost nest contains the most general segmentation criteria – i.e. demographics. They include variables, such as the type of **industry**, **company size** and **customer location**, which can be determined easily without visiting the customer. Marketers get a broad understanding from the knowledge of the industry about customer needs and purchase situations. It may be, **for instance**, a small manufacturer of auto components, after segmenting its prospective customers on the basis of the company size, will choose not to approach large automobile manufacturers whose volume requirements exceed its own manufacturing capacity. Similarly, a medium size manufacturer of material handling equipment used customer location variable when nearness of customers was a requirement for giving prompt pre-sales and post-sales technical services at a low cost.

**Operating Variables** The segmentation nest includes operating variables, such as **technology**, **user/non-user status** and **customer capabilities**. These variables help more accurate identification of current and potential customers within demographic categories. A buying firm's technology determines its buying needs. **For example**, Soda ash can be produced by two technologies which require differ-

ent capital equipment and supplies. Segmenting a market by uses of a product or brand is a easy way of segmentation. **For instance**, a supplier of aluminium extruded products may identify builders who use aluminium door and window frames for building houses, rather than using wooden or steel frames. Customers can also be identified based on their technical, financial and operational capabilities. **For example**, in the chemical industry, some suppliers provide effective technical support to customers who depend on suppliers for formulation assistance and technical support.

**Purchasing Approaches** The variables or factors in this middle segmentation nest include **the organisation of the purchasing function, the power structure, buyer-seller relationships, the general purchasing policies, and the purchasing criteria**. The business marketer deals with centralised purchasing approach of a buying firm's purchasing function through its major or key accounts program. However, if another buying organisation has a decentralised purchasing approach, then a field sales person can serve the customer. A supplier may have an approach to quote a low price for a buyer whose purchases are influenced by a powerful finance function and use another approach for a customer who has a strong technical team influencing buying centre. Some suppliers may prefer to deal with buyers whose purchasing policies emphasise quality of products and services and not only the prices. Other marketers may prefer to compete on price and hence, participate in bidding process, which is the normal purchasing policy of government undertakings.

General purchasing policies, power structure and buyer-seller relationships all have an effect on purchasing criteria, which indicate reasons (or benefits) why buying firms buy.

**Situational Factors** These factors are based on purchase situation of a buying firm and require detailed information about the buyer. Situational factors include **the urgency of order fulfilment, product application, and size of order**.

Urgent replacement of existing parts is different from routine replacement of products or parts. Some suppliers focus on fulfilling urgent or emergency requirements of customers. **For example**, a manufacturer of parts of generating sets supplies urgent orders of parts or components to large industrial generating sets of factories when generating sets are under break-down situation. These factories are willing to pay a higher price to minimise production loss. Product application can influence the choice of a supplier. **For instance**, reliability of flame-proof motors used in underground coal mines for pumping water out during rainy season is very important for the safety of workers. It can cause explosion and loss of life when inflammable gases present in some underground mines come in contact with a spark from electric motor used for pumping water out of the mines. The choice of the manufacturer or supplier would be based on the quality and reliability of the flame-proof motor. Size of orders can be a factor in selecting customers. **For example**, a small scale manufacturer of precision steel tubes would like to supply steel tubes to bus-body builders and furniture manufacturers whose orders are of small quantity. But a large manufacturer of steel tubes would be happy to have large quantity of orders from Hero Cycles.

**Personal Characteristics of Buyers** As mentioned earlier under microsegmentation, business marketers can segment markets based on personal characteristics, such as **risk takers, buyer motivation, and perceptions, of buyers** (i.e. purchase executives) and other buying centre members. **For instance**, the marketing manager of a new Aluminium extrusion manufacturing company asked its sales people to identify and get initial small quantity orders from buyers of electrical control panel manufac-

turers who are willing to take risk of buying from a new supplier. Generally, buyers who are unwilling to take risk of buying from a new supplier are not good prospective customers for a new product. It is expensive and difficult to get information on personal characteristics of key buying centre members. However, if a company develops an effective sales information system and asks its sales people to collect the relevant information on personal characteristics of buying centre members, then it would help the marketing head to come up with an effective segmentation strategy.

As we move from the outer nests to inner nests, the information in outer nests can be collected with less cost and time. But data collection on situational factors and personal characteristics require extensive research, higher cost and time. In nested approach, business marketers can work systematically from the outer to the inner nests, go through the whole set of segmentation criteria, and select important criteria. Marketers can balance between easily acquired data of the outer nests and the detailed analysis of inner nests.

### Views on Segmentation

Wind and Cardozo<sup>1</sup> found in their research that in practice, business marketers use macrosegmentation (with variables such as customer size, end use of the product, and geographic location of customer) much more than micro-segmentation variables, which are based on characteristics of buying organisations' buying centres (or decision-making units). The authors concluded that many business marketers were losing profit opportunities by not developing careful segmentation strategies.

Doyle and Saunders<sup>2</sup> made a study of a speciality chemicals market and concluded that the company used statistical procedure of factor analysis and clustering tools, along with managerial judgement. Based on this analysis, the company targeted four attractive segments. Marketing strategies were developed for each of these four segments. The company achieved its objectives of market share and profitability, as a result of this approach.

## TARGET MARKETING

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After segmenting the market into various (potential) segments, the company should then evaluate these segments. Thereafter, it should select the target segments (called, target marketing) and decide which market strategy it will adopt. These steps are shown in Fig. 6.1.

### Evaluating Market Segments

A business marketing firm should evaluate the different market segments (which were identified and profiled in the previous task of market segmentation). This is done by using the following four factors (or criteria). **(i)** Size and growth, **(ii)** Profitability analysis, **(iii)** Competitive analysis, and **(iv)** Company objectives and resources.

**Size and Growth** A company should find out what is the size (or market potential) of each market segment. The current and future market potential can be obtained by using one or more demand forecasting methods, such as **(a)** time-series analysis, **(b)** regression analysis, **(c)** econometric models, **(d)** sales force estimates, and **(e)** expert opinion. The growth characteristics of the market segment can be easily worked out once a long-term market demand (or market potential) is forecasted. This analysis will indicate what is the size and the estimated market growth of each segment.

**Profitability Analysis** There are three elements involved in analysing profitability of each potential segment. These are: (i) Market potential, which is the estimate of the quantity and value of a product that the entire/total market will purchase (as indicated in the previous step) in a specified time period; (ii) Sales forecast, which is the estimate of company's sales based on the company's share out of the market potential, in a specified time period; (iii) Profitability, which refers to the difference between the estimated sales revenue (or the sales forecast) and the marketing cost of servicing and maintaining the customers in the same time period.

For estimating the market potential for a product, the company can use some of the sales forecasting methods, such as executive opinion, Delphi, survey of buyers' intentions, moving averages, exponential smoothing, and regression analysis which are described in chapter 5. The company's sales forecast can be estimated by multiplying the market potential by the estimated market share of the company for a specific period under consideration. The company's estimated market share is usually determined based on the target customers' perceptions of the strengths and weaknesses of the company and its major competitors. The firm's sales budget (or estimated sales revenue) is generally equal to or slightly less than the sales forecast.

The steps involved in estimating profitability of each potential market segment are as follows: (1) identify major activities (or functions) that are relevant to sales and distribution costs, like personal selling, sales promotion, order processing, warehousing, and inventory carrying, for a market segment; (2) convert the natural (or traditional) expenses into functional (or activity) expenses; (some firms use activity-based costing (ABC) method for this); (3) allocate functional expenses to market segments, based on certain criteria; (4) prepare profitability of each market segment, based on one of the two approaches, viz. (a) full-cost (or net profit), or (b) direct-cost (or profit-contribution) approach. In other words, estimated marketing (or sales and distribution) costs are subtracted from the estimated sales revenue of each market segment to arrive at estimated profitability of each segment. Either full-cost (direct and indirect costs) or direct costs approach is used to estimate net profit or profit-contribution respectively. More details of profitability analysis can be obtained from *sales and distribution management* (book written by the author).

**Competitive Analysis** Profit potential and the ability of a business marketer to penetrate a particular market segment depends on a careful analysis of the strengths and weaknesses of existing and/or potential competitors, both domestic and foreign. The strengths and weaknesses of major competitors (if it is not possible to consider all the competitors) must be assessed in each market segment with respect to areas of manufacturing, R&D, finance, technical service, product quality, delivery performance, sales force, advertising, distribution, technology, and organisation/management reputation.

**Company Objectives and Resources** A business firm should ask itself whether each potential segment is in line with the firm's long-term objectives. If not, such segment(s) should be eliminated. Besides, a company will succeed in a segment if it has certain resources (or strengths) which are superior to competitors. These strengths should be in line with the success factors for each segment. **For example**, success factors for automotive industry are quality and after-sales-service, for bicycle industry it is cost, for hotel/restaurant industry it is service, and so on.

## Selecting the Target Segments

After evaluating several market segments based on the various factors (or criteria), the company must now decide which and how many segments it should select as its target (market) segments. This decision can be made by using either advanced computerised systems, called decision support systems

(DSS), or a simple matrix system (SMS). To understand the simple matrix system better, let us consider **an example** of a company manufacturing and marketing precision steel tubes in the domestic market of India. The company recruited a new marketing manager to improve its marketing effectiveness. The marketing manager carried out a marketing research study to get information on customers and competitors, which helped in deciding marketing strategies, including selection of target markets. Based on the analysis of the marketing research data and by using end-use macro-variable, the company identified several potential segments like automotive, bicycle, boiler, furniture, bus-body building, and general engineering. After evaluating these market segments, the marketing manager used a simple matrix system, shown in Table 6.2, to take a decision on target segments.

**Table 6.2** Simple Matrix System for Selecting Target Segments

<i>Segments Factor</i>	<i>Automotive</i>	<i>Bicycle</i>	<i>Boiler</i>	<i>Furniture</i>	<i>Bus body Building</i>	<i>General Engineering</i>
1. Size (₹ million)	600	500	300	250	200	150
2. Growth (in %)	20	10	10	7	10	8
3. Profitability	Good	Good	Good	Low	Low	Average
4. Degree of competition (No. of competitors)	3	4	3	10	8	7
5. Major competitors' strengths	Product quality and timely delivery	Product quality and timely delivery	Availability of special raw material with 2 competitors	Low prices from small-scale manufacturers	Low prices from small-scale manufacturers	Innovative product development
6. Major competitors' weaknesses	Customer service	Customer relationship	Except 2, other competitors did not have raw material	Mainly supplied by small-scale manufacturers	Mainly supplied by small-scale manufacturers	No specific information available
7. Company strengths	Customer service and relationship	Customer service and relationship	—	—	—	Product development
8. Success factors	Large volume production and technically complex product	Large volume production and technically complex product	Availability of special quality raw material	Simple product, low price	Simple product, low price	Customised product
9. Compatibility with company's long-term objectives	High	Average	Low	Low	Low	Average

By using the simple matrix system, the marketing manager decided to select two segments, viz. automotive (consisting of 2-, 3-, and 4-wheelers), and bicycle manufacturers. These two segments had



a large size (or market potential), average to high growth rate, good profitability, less competition, and compatibility with the company's long-term product-market strategy.

### Target-Market Strategies

Once the decision is made on target segments (i.e. the segments that will be served by a business organisation), the next step is to decide which strategy the firm will adopt out of the three broad strategies available. These are: (i) Concentrated marketing; (ii) Differentiated marketing, and (iii) Undifferentiated marketing.

#### Concentrated Marketing

It means focusing all the marketing efforts on a single or relatively few, carefully-defined segment(s). The result is likely to be a somewhat narrow range of product/service accompanied by high quality, high price, and highly selective promotional and distribution strategies. It may be done by a company whose resources are limited. As the company increases its knowledge and tailors its strategy to service a particular segment far better than its competitors, its reputation and share of business increases in the segment(s).

**Example: Concentrated Marketing** A small scale company manufacturing and marketing material handling equipment decided to concentrate or focus its marketing efforts on those customers who were located near its manufacturing unit. By using "customer location" as the single segmentation variable for market segmentation, the company could give superior quality of pre-sales and post-sales technical service compared to that of its competitors at lower costs. By targeting manufacturing firms and warehouses located near its factory, the company earned good profits.

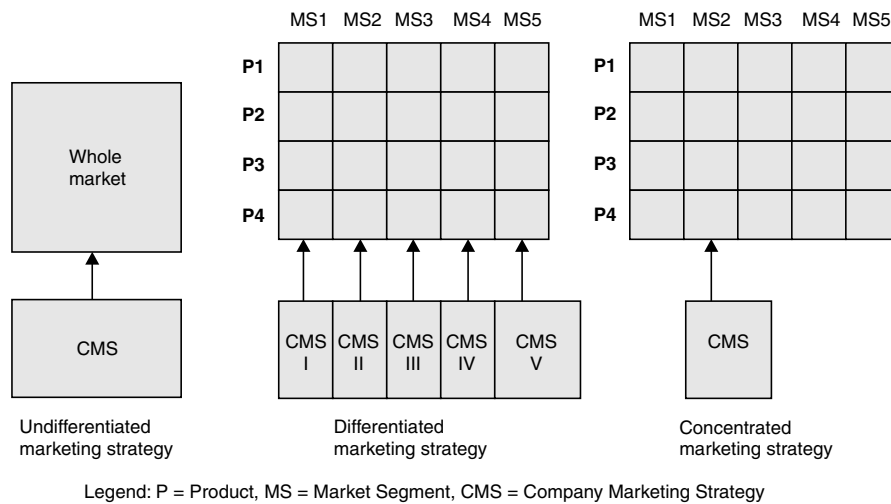
Concentrated marketing strategy involves more risks, since the market potential in the chosen segment(s) can decline, or a large competitor may invade the selected segment(s). Hence, many companies would concentrate on more than one market segment.

#### Differentiated Marketing

In this strategy, a firm decides to target several market segments whose needs, product usages, or market responses are appreciably different. In other words, a business organisation decides to serve some segments and avoids other segments within a market. It develops a separate marketing strategy/plan for each of its chosen segments. Although this increases overall costs in such areas as product development/modifications, promotion, production and administration, its objectives of higher sales volume and a stronger position in the chosen market segments are achieved. Thus, differentiated strategy leads to higher sales and higher costs. It is difficult to say whether firms adopting this strategy would generally make higher profits or not. Business firms should, therefore, avoid over-segmentation.

**Example: Differentiated Marketing** Faced with the problem of stagnating market share for its product Uninterruptible Power Supply (UPS), Emerson Network Power Company changed its marketing strategy from undifferentiated to differentiated. It started offering different products to different market segments. **For instance**, for Information Technology (IT) companies like Infosys, Wipro and HP, Emerson supplied 'Online Network UPS' and 'Desktop UPS' to take care of network servers, storage devices and critical workstations. For large hospitals like Fortis, the company offered and supplied 'Large Facility UPS' for large data centres and sensitive electronics, and for offices, it supplied 'Power Inverters'. The differentiated marketing strategy with different products and prices for different segments helped Emerson to improve its market share to 30 per cent in Indian market.

In order to understand the three alternative strategies for target markets more clearly, let us see Fig.6.3.



**Figure 6.3** Alternative Company Marketing Strategies for Target Markets Segments

### Undifferentiated Marketing

This means a lack of effective market segmentation. It refers to a situation when a business firm ignores segment differences and develops a single marketing plan or strategy that will be common to all segments or customers. This strategy is used either because of lack of management analysis and planning or it may be a conscious strategic decision due to standardised products or services sold to a market where there is a lack of meaningful differentiation among customers. **For example**, while marketing compressors (used for supplying compressed air for industrial production) a compressor manufacturer did not differentiate business customers. The company had one marketing plan for the whole market, thinking it was a standard (commodity) product. However, there is no such thing as “commodity” and that all products and services are differentiable, as considered by successful marketers.

**Example: Undifferentiated Marketing** Wipro Infotech’s V.P., Personal Computing division, once said, “Every segment is a robust market for us and we believe in delivering robust products with superior quality”. He further said that Wipro would target all segments for PC (Personal Computer) business (which included laptops, desktops and servers), with the highest level of quality and service that would make the difference at the market place<sup>4</sup>. However, out of the total unit shipment of the Indian PC market of 4.6 million for the financial year 2006, HP retained the top slot with a market share of 18 per cent, followed by HCL at 14 per cent, and Lenovo at 9 per cent.

The advantage of undifferentiated strategy is that it keeps down the total costs, including advertising, marketing research, inventory, and production. However, in a competitive market the company which follows undifferentiated marketing strategy will face decline in its sales if the competitors follow differentiated marketing strategy. Hence, even if the products are similar or standardised, business marketers should use other elements of marketing mix (such as price, promotion, and distribution) to differentiate them from competitors.

### Guidelines in Choosing Target-Market Strategy

The following are the general rules that are useful to business marketers in selecting a target-market strategy.

- If the company resources are limited, choose concentrated marketing strategy.
- If a new product is in the “introduction” stage of the product life-cycle, a firm can follow either concentrated or undifferentiated marketing strategy. For “mature stage” of the product life-cycle, differentiated marketing is sensible.
- If major competitors follow differentiated marketing strategy, a business marketer must also follow the same strategy. If competitors use undifferentiated marketing strategy, a company will gain by using either differentiated or concentrated marketing strategy.

### Niche Marketing

Market segments are large customer groups in a market. A niche is a more narrowly defined customer group, that seeks products or services tailored specially to the individual needs and preferences. Its objective is to reach potentially unsatisfied markets more effectively and profitably than competitors. The result is a selective approach to the market, and finding a market niche where company’s capabilities or strengths are best matched with customers’ needs.

Niche marketing helps an organisation to provide such products or services that are specially tailored to the customers’ individual preferences and desires. It is a strategic approach to marketing that is gaining increasing acceptance in business marketing because it enables a company to succeed in a competitive market.

There are **several examples** of niche marketing, one being an advertising firm which decided to concentrate its expertise, knowledge, and efforts on advertisement campaign for public issues. It secured maximum business in advertising for public issues and succeeded in its objective of profitability in a competitive advertising industry.

Another good **example** of niche marketing can be of a company which focusses its services on training field sales and service persons working in business marketing firms, by tailoring its training programmes to suit the needs of each of its business customers.

Business marketers who would like to follow niche marketing approach should understand the following:

- The customers in the niche have a different and somewhat complex set of needs which should be first identified by getting information from customers with the help of marketing research. The company should then develop a new product (or service) or promote an existing product (or service) in a new way so as to tailor to the special needs or benefits of such customers.
- Generally, the customers in the niche are willing to pay a higher price to the company which best satisfies their special needs. Niching strategy, therefore, achieves high profits.
- It is difficult for competitors to gain by attacking the company which is a niche leader.
- In a “mature” market, either a company should be in “top three” in the industry (with high volume and low cost) or should follow niche marketing strategy in order to achieve profits.
- The key idea in niche marketing is of *specialisation*, which can be achieved in several ways:

### WAYS OF ACHIEVING SPECIALISATION

**Geographic Specialisation** The firm sells only in a certain geographic area, as done by some of the UPS manufacturers, who market their products locally.

**End-user Specialisation** The organisation decides to specialise in one type of end-use customer (or market). **For example**, educational institutions like IIMs (Indian Institute of Management) have specialised in giving high quality education in management to the students interested in doing post graduate programme in management.

**Customer-size Specialisation** Many small-scale firms prefer to market their products or services to small-size customer organisations. Similarly, large firms prefer to serve large or medium-sized customers.

**Product-line Specialisation** A company produces only one product-line (or product). **For example**, in the lighting industry, there are many products such as fluorescent tube, bulb, mercury vapour lamps, sodium vapour lamps, luminaires (i.e. fittings to hold these different type of lamps), decorative lamps, and so on. A small-scale firm specialises in producing fittings for fluorescent tube required by commercial firms.

**Customer Specialisation** Companies specialise in marketing their products or services to one or a few major customers. **For instance**, automobile component suppliers (or vendors) sell their entire production to either TVS Suzuki, or Hero Honda, or Bajaj Auto two-wheeler manufacturer.

- The major advantage of niche marketing strategy is high profits. However, the major disadvantage is that the demand of niche market may decline or a large competitor may attack the niche market. To overcome the disadvantage, the firm creates new niche markets and concentrates its marketing efforts in two or more niche markets instead of single niche market. Generally, smaller firms follow niche (small) market strategy. However, larger and new firms have increasingly started adopting niching strategy by concentrating on multiple niche markets.

## POSITIONING

After selecting the target markets, the business marketer should decide positioning strategy for each target market. The positioning strategy should clearly differentiate the company and its products (or services) from that of the competitor's.

**Positioning** is defined as the distinct place a product (or service) occupies in the minds of the target customers relative to competing products (or services). In other words, positioning is how the firm wants its products (or services) to be perceived by the target customers on important attributes or benefits. The same definition of positioning is applicable when a company wants to position itself as an organisation. **For instance**, Infosys Technologies is positioned as a leading computer software company in India. L&T is positioned as the leading engineering company in India. Tata is associated with quality in the minds of customers.

**Positioning Statement** Positioning is important for success of a business marketing firm. It has a great strategic value. However, some business marketers do not understand its importance. Ries and Trout<sup>5</sup> call positioning as the battle for the customer's mind. In business marketing, positioning may

be defined as the process of setting up and continuing a planned meaning for a market offering in the minds of targeted customers. In writing positioning statements, Anderson and Narus suggest three critical components—*target, offering concept, and value proposition*<sup>6</sup>. The target component, mentions the characteristics of the target customers, in which the supplier is interested. The offering concept component states the absolutely necessary attributes of the market offering for the target customers. The value proposition element indicates the difference of the market offering compared to the next-best-alternative offering that are valuable to the target customer. **The value proposition** should answer the target customer's question: "Why should I buy the product/service from you, instead of from your competitor?" This means, the value proposition should give sound reasons on how target customers will be more benefited by using the supplier's brand, instead of the competitors' next-best alternative. Sometimes the target customers are doubtful about the supplier's ability to deliver on the value proposition. In such cases, claim support is needed, such as ISO certification, as shown in Fig. 6.4, to differentiate the superior product quality from that of competitors.

George Dovel<sup>7</sup> has suggested the following criteria to select the positioning statement from a number of alternative position statements: (1) It should be meaningful. Both target customers and the supplier firm people should understand the meaning of the positioning statement correctly. **For instance**, Oracle's positioning statement—"we offer better solutions", and Gati transport company's earlier positioning statement—"On time, every time"—show how the language is simple and meaningful. (2) The positioning statement should convey the value proposition that is accurate, real, and convincing for target customers. (3) The positioning statement should be consistent with what the organisation is trying to achieve. All concerned people in the organisation should be committed to deliver the value proposition to the target customers. (4) The positioning statement should be the basis of communication message that is communicated through advertising, sales promotion, and sales presentations.

### Procedure for Developing a Positioning Strategy

A business marketer should follow the following steps while developing a positioning strategy: (i) Identify the target customers' needs in terms of major attributes or benefits, while buying a product (or service). This is done by conducting marketing research to find out differentiating attributes; (ii) Select one or more major attributes (or benefits) for differentiation, based on the company's strengths or distinctive competencies; (iii) Communicate the company's positioning to the target market.

**Identifying Major Attributes for Differentiation** The purpose of doing marketing research is to understand which are the major factors (or attributes) the target customer organisations consider important while making buying decisions for a product. The business firm should also understand the customers' perceptions regarding the various competing products with respect to the major (or important) attributes. A business marketer can use several variables to differentiate its products from competing products. These are: (i) product variables, (ii) service variables, (iii) personnel variables, and (iv) image variables.

### Product Variables

For standard industrial products, the variation in product features may be little, but the product quality or performance can be used for differentiation. Many Indian firms have started getting ISO 9000 certification to differentiate their superior product quality from that of competitor's. For instance, in Fig. 6.4, Cerebra Integrated Technologies Ltd have differentiated and positioned their computers, accessories, and software as having "world-class quality" with authentic proof of ISO 9002 certification.

For products that can be offered with various extra features, a business firm should decide which features to make standard and which to make optional. **For instance**, the manufacturer of material handling equipment making standard pallet trucks can be pointed out as a case in point. This firm offers optional extra attachment for staking material up to 8 to 10 feet. This attachment is a special design not offered by any other pallet truck manufacturer, and hence it is used to differentiate the product.

### Service Variables

Some business firms offer superior pre-sales services (e.g. giving required information), during-sales services (e.g. on-time delivery), and after-sales service (e.g. repair service). The importance of these




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The Cerebra Server, launched just a few months ago has evoked exceptional response. And this success is being followed up with the launch of a series of high-end machines.

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**Cerebra Integrated Technologies Ltd.**

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Support centres all over the country.

Figure 6.4 Positioning Strategy using Quality for Differentiation

services depend upon the type of products. **For instance**, business buyers give importance to better and faster after-sales service when they buy diesel generating sets. When buyers purchase raw materials and components such as steel and spark plug for manufacturing cars, on-time delivery and quality are the important attributes. Pre-sales service is considered as an important variable to differentiate one supplier from others when a business buyer obtains the solution to the problem of excessive wastage of raw material by a specially designed machine by the supplier. Service variable becomes the key competitive advantage when products offered by the various suppliers are similar.

### ***Personnel Variable***

Business firms differentiate from their competitors (or in other words, gain competitive advantage) by recruiting better people and arranging training programmes at all levels. **For example**, a senior executive of Tata Iron and Steel Company Ltd (TISCO) once remarked that one of the key success factors of the company was its emphasis on training each employee for minimum of 14 days a year. Infosys Technologies Ltd. a highly successful company in IT industry, recruits better people by implementing a strict recruitment policy.

### ***Image Variables***

Image is the way buyers perceive a company. The company designs its identity-building programmes to shape the buyers' (or customers') image. This process takes a long time. The message is conveyed in a distinctive manner through all the available promotional tools. When competing offers from various suppliers are more or less similar, the buying firm responds favourably to the supplier firm which has a good image. Like, Tata group of companies have a favourable image in the minds of consumers. This gives them a competitive advantage in India.

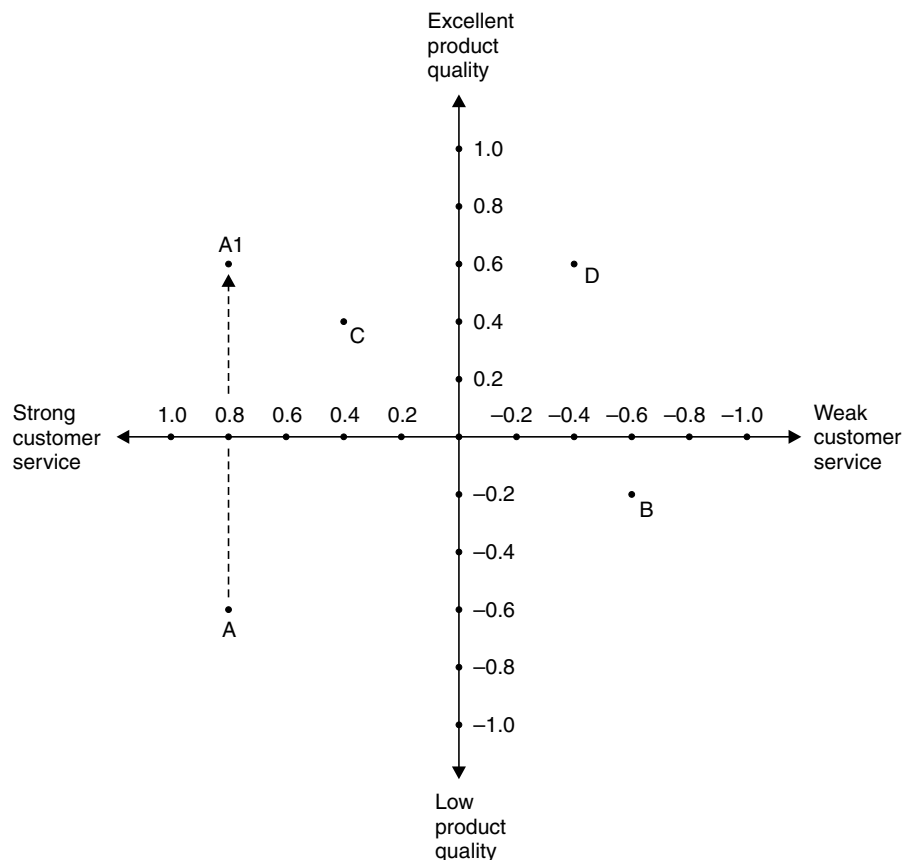
**Selecting the Differentiating Attributes** The business marketer has to decide how many and which attributes (or benefits or variables) should be selected in order to differentiate the company or the product from its competitors. Many companies select one benefit or attribute, like, "best quality" or "best service", or "most advanced technology". However, some companies believe in double-benefit positioning, and there are few companies who promote three benefits. **For instance**, JK Tyre had positioned itself by promoting multiple-variables, such as "No. 1 in Car Radial Tyres", "No. 1 in Quality", "No. 1 in R&D", "No. 1 in Technology", "No. 1 in Rallies", and "No. 1 in Exports". Oracle had promoted single-benefit positioning, viz. "We offer better solutions". The company has positioned that it can deliver better solutions to business problems than any other company and gave several examples of the business problems that it had answered (or solved) as a proof of its claim.

In deciding the positioning strategy the business marketer should consider three important factors after conducting marketing research. *First*, which are the most important attributes (in the order of priority) that target customers consider while deciding to place orders for a product or service; *Second*, how the target customers perceive the company's product or service with respect to the important attributes; *Third*, how the target customers perceive the competitors' products or services with respect to the same attributes. After getting the customers' perceptions based on marketing research, a statistical analysis is carried out. This leads to a technique called **perceptual map**, which helps the business marketer to decide on the positioning strategy.

In Fig. 6.5, company A wanted to decide its positioning strategy in relation to the three other major competitors. The market survey indicated that the target customers considered product quality and

customer service (or on-time delivery) as the two most important attributes while making buying decisions. The target customers' perceptions of the four major suppliers (viz. A, B, C, and D) with respect to the two attributes were put on the perceptual map, as shown in Fig. 6.5. Company A wanted to improve its ranking of number 3 in terms of market share. It therefore decided to reposition from position A to position A1. The company decided to improve its product quality by taking a number of steps including going for ISO 9000 certification which none of the three competitors had obtained. Company A decided to communicate its repositioning to the target customers only after implementing the various steps involved in improving the product quality.

**Communicating the Company's Positioning** Business marketers not only decide the positioning strategy, but also endeavour to communicate the same effectively to the target markets. In consumer markets the positioning strategy is mainly communicated through advertising. In business markets the communication of positioning strategy is done through personal selling (by the sales force), sales promotion (e.g. exhibitions or trade shows), and advertising (in technical or trade journals). If a business firm chooses "best quality" or "world class quality" as the positioning strategy, all the elements of



**Figure 6.5** Two-dimensional Perceptual Map



marketing should communicate quality. The implementation of the total quality management (TQM) is important for the company so that all the activities (e.g. submission of quotations, sales presentations, negotiations, packing, despatch, installations, and after-sales-service) display a superior quality in comparison to that of the competitors. Generally, business buyers perceive that high quality has a direct co-relation to high price. However, the business marketer should find out customers' perceptions through an independent marketing research agency before deciding on the positioning strategy. This aspect is, many times, ignored by the practising managers resulting in ineffective decisions.

## SUMMARY

One of the most important strategic marketing decisions a business marketer makes is with respect to market segmentation, target marketing, and positioning (STP).

In market segmentation a business firm decides whether it can serve the entire market or a part (or segment) of the whole market more effectively than the competitors. The procedure to be followed for segmentation includes carrying out marketing research, analysing the data to identify potential segments, and profiling of each segment (or the customer group) in terms of its specific characteristics. The major criteria used for the selection of variables for segmentation are: *measurable* (i.e. the variable used should measure sales potential and other market information); *differentiable* (i.e. the segments should be different and respond differently to separate marketing strategies); *substantial* (i.e. the segments should be large enough with respect to sales potential and profits); and *accessible* (i.e. the segments should be identified, reached, and served).

Major variables used for segmenting business markets are *macro-variables* (consisting of type of industry/customer, company size, customer location, and end-use/application of the product), and *micro-variables* (including buying situations, organisational capabilities, purchasing policies, purchasing criteria, and personal characteristics). Business marketers subdivide macro-segments into micro-segments only if necessary.

Shapiro and Bonoma have suggested an approach to market segmentation in which five segmentation criteria are arranged as a nested hierarchy, moving from the outer nest to the inner nest. These criteria are: demographics, operating variables, customer purchasing approaches, situational factors, and personal characteristics of buyers.

After segmenting the market the business marketer should evaluate the resulting (potential) segments by using four factors, viz. size and growth, profitability analysis, competitive analysis, and company objectives and resources.

The decision on selecting the target segments is taken by employing computerised *decision support system* or *simple matrix system*. After selecting the target segment(s) a business firm decides target market strategies out of the three available strategies: *concentrated marketing*, *differentiated marketing*, and *undifferentiated marketing*. *Niche marketing* strategy is gaining increasing acceptance in a competitive market. A niche is a more narrowly defined customer group that seeks specialised products or services.

For each selected target segment, a firm decides the positioning strategy by clearly differentiating its products or services in relation to the competitors. The procedure followed for developing a positioning strategy includes identifying major attributes (or benefits) needed by the target segment and selecting one or more attribute(s) that differentiates the company from its competitors. *Perceptual map technique* is useful for deciding the positioning strategy. The positioning strategy should then be communicated

effectively to the target market through promotional elements such as sales force, advertising, and sales promotion.

While writing positioning statement, marketers should consider three critical components—target, offering concept, and value proposition. A number of criteria are considered for selecting a positioning statement from alternative position statements.

### KEY TERMS

- |                            |  |
|----------------------------|--|
| • Concentrated marketing   | • Perceptual map/mapping                       |
| • Differentiated marketing | • Positioning                                  |
| • Market segmentation      | • Target marketing                             |
| • Nested approach          | • Value proposition/Customer value proposition |
| • Niche marketing          |  |

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. What is market segmentation? What are its benefits and limitations?
2. Describe the procedure to be followed for segmenting and targeting.
3. Explain sequential segmentation process, as well as macro and micro variables.
4. What criteria are used to evaluate different market segments? What is the difference between differentiated and undifferentiated marketing strategies?
5. What is the meaning of positioning? How a company should develop a positioning strategy?
6. How should an organisation write a positioning statement?
7. Describe the nested approach to segmentation.

### OBJECTIVE TYPE QUESTIONS

1. Market segmentation is the process of dividing total: (a) market, (b) products, (c) services, or (d) all of them.
2. The decision on segmenting, targeting, and positioning (STP) is considered as: (a) short-term, (b) medium-term, (c) long-term, or (d) none of the above, decision.
3. The criteria used for evaluating potential market segments include measurable, differentiable, substantial, and one of the following: (a) questionable, (b) accessible, (c) eligible, or (d) available.
4. Sequential segmentation process includes use of: (a) one variable, (b) more than one variable, (c) less than five variables, or (d) nil variable.
5. Business marketers subdivide macro-segments into micro-segments: (a) in all cases, (b) if necessary, (c) in a few cases, or (d) in no case.
6. Criteria used for evaluating different market segments include (1) size and growth, (2) competitive analysis, (3) company objectives and resources, and one of the following: (a) company analysis, (b) environmental analysis, (c) profitability analysis, (d) all the above, or (e) none of the above.
7. If major competitors follow differentiated marketing strategy, a business marketer should follow: (a) undifferentiated, (b) differentiated, (c) concentrated, or (d) none of the above marketing strategy.

8. The key idea in niche marketing is: (a) globalisation, (b) generalisation, (c) specialisation, or (d) none of the above.
9. Positioning is how a firm wants its products or services to be: (a) received, (b) perceived, (c) used, or (d) quantified by target customers.

### APPLICATION QUESTIONS

1. Assume you have joined a new company manufacturing and marketing aluminium extrusion products as a head of marketing. The company could market its products to household customers for door and window frames, and also to business customers for various applications like control panels in electrical industry, water purification equipment, heat sinks for electronic equipment, as well as, door and window frames in building construction industry. Develop a market segmentation plan for the company.
2. Steel Authority of India Limited (SAIL) is a large public sector company, manufacturing and marketing steel products to domestic market in India, and also to International markets. Which macro- and micro-segmentation variables and target market segments would you suggest to SAIL?
3. Describe how a positioning strategy should be developed for a small-scale electric motor manufacturing company, in a highly competitive market, marketing to business users and OEM (original equipment manufacturer) customers and how to communicate the same to target customers (make suitable assumptions, if needed).

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## CASE 6.1

### Govind Doors Pvt. Ltd.: STP Strategies \*

Arun Kumar, Director, Govind Doors Pvt. Ltd., was not sure what kind of target market and positioning strategies he should use in order to achieve the company goals on sales and profitability.

\* This case was prepared by Prof. Krishna K. Havaladar based on the case data provided by S. Seshu Sai, Dhananjay, Shashirekha and Aparna, MBA students of Alliance Business Academy, Bangalore.

Arun Kumar joined the family business in 2006, after completing graduation in Electronic Engineering and MBA from a reputed management institute in India. The company manufactured and marketed GTEX brand PVC (Poly Vinyl Chloride) and FRP (Fibre Reinforced Plastics) doors suitable for bed rooms, bath rooms, office rooms, balcony, etc. These non-wood based doors can be used for residential houses, institutions like hospitals and schools, as well as commercial establishments like shopping malls and multiplexes.

The company had segmented its market into the following segments: **(a)** government organisations like CPWD (Central Public Works Department), MES (Military Engineering Services), and Railways; **(b)** residential complexes built by builders; **(c)** commercial organisations and institutions; **(d)** individual house owners, replacement market, and **(e)** fabricators.

“We have targeted all the above market segments for PVC and FRP doors, excepting those customers who want wooden and special (or customised) doors” said Arun Kumar. He further added, “Our sales people regularly contact contractors who get business from government organisations, where lowest prices and good after-sales-service are the key buying factors. However, when our sales people call on builders for residential and commercial complexes for getting orders, superior product quality and service are the important factors they have to keep in mind. For a large number of individual house owners, small volume replacement market, and fabricators, we use indirect channel of dealers, who mostly look for low prices and delivery service (or availability).”

The company had established three sub-brands under GTEX brand. Solidex brand was suitable for government firms, institutions, individual houses with medium quality and medium to low prices. Fibrex brand with high quality and high price was appropriate for builders and a few individual house owners. Lightex brand offered lower quality and low prices for replacement market and a few individual house owners. Fabricators were offered the required raw material from all the three sub-brands. There were three major players, including Govind Doors, with almost equal market share of 20–25 per cent. The balance market was shared by many small players and also by fabricators.

The company had not considered which target market strategy it should use. Arun Kumar was also not sure what should be the positioning strategy for its brand GTEX. It was important to decide these strategies, since the market for PVC and FRP doors was growing extremely well at 34 to 64 per cent per year between 2002 and 2006. And the competition from small players was slowly catching up with the three major players.

### Questions

1. Do you think it was a right decision of the company to target all the segments?
2. What target market strategy would you suggest and why?
3. How would you develop a positioning strategy for GTEX brand of the company including its subbrands?

# 7

## Product and Brand Strategy

*After studying this chapter you should be able to:*

- Understand the meaning of an industrial product.
- Know the factors influencing changes in product strategy.
- Learn product life-cycle theory and its applications.
- Understand steps involved in developing product strategies.
- Learn branding in business markets, including branding process.

It is the product or service offer from a business firm that must ultimately satisfy customers' needs. Product decisions are both important and complex, and bind together various departments such as R&D, engineering, materials, manufacturing, and marketing.

A business organisation must consider two major objectives while developing product strategies. These are: **(i)** To ensure that the product-mix (i.e. various products marketed by the company) is in line with overall company and marketing objectives, and **(ii)** To evolve guidelines for reviewing the performance of the existing products, by using factors such as sales, profits, competition, and customer acceptance.

Based on these objectives, the product strategies are decided. Which of the existing products should be continued, modified, or dropped, and which new products need to be developed are included in the product strategies. Before we go into the details of the product strategy, it is necessary to define an industrial product.

### DEFINITION OF AN INDUSTRIAL PRODUCT

The industrial product is defined<sup>1</sup> not only as a physical entity, but also as a complex set of economic, technical, legal, and personal relationship between the buyer and the seller. **For instance**, a company, as a buyer of an industrial product—MCCB (moulded case circuit breakers) can consider economic (i.e. price), technical (i.e. specifications of the product), legal (if the supplier delays delivery), and personal relationships between itself and the suppliers as relevant factors.

From a customer's point of view, a product is a combination of **(a)** basic, **(b)** enhanced, and **(c)** augmented properties. *Basic* properties are included in the generic product, with fundamental benefits sought by customers. *Generic* products are made differentiable by adding tangible benefits or enhanced properties such as product features, styling and quality. The augmented properties include intangible benefits such as technical assistance, availability of spare parts, maintenance and repair services, warranties, training, timely delivery, and attractive commercial/payment terms.

In a competitive market, customers value these additional benefits—both tangible and intangible. A business marketer should be aware of what constitutes a total product package in the minds of prospective customers. To illustrate, diesel engines manufactured and marketed by Cummins Ltd have a good reputation. The company has been a leader in the market because of its excellent product quality. In addition, the company gives to its customers intangible benefits like availability of spare parts, technical assistance, training, and so on. A diesel engine's reliable operation depends on the product quality, which is a tangible (enhanced) property expected by customers. It may include additional product features such as less noise level and simple or easy operation. Apart from this, customers value other intangible benefits that constitute a total product package. Cummins Ltd has a successful product strategy because it has understood the customers' perceptions and offered both tangible and intangible benefits (or enhanced and augmented properties) to the target industrial customers, far superior than the competitors.

### Core Competencies

One of the reasons of successful industrial products is the core competencies developed by organisations, such as Canon, Honda, and 3M. **For example**, Canon has developed technologies in precision mechanics, fine optics, and micro-electronics, which enabled the company to bring out successful products, such as electronic camera, colour copier, and laser beam printer. Recently, Canon has developed display technology for flat-panel TVs. **Another example** can be given on core competence of Honda in designing and developing small engines and motors, which produced successful products like motorcycles, automobiles and lawn mowers. 3M company developed three related technologies – viz. adhesives, abrasives and coating – using its R&D skills and innovative system to bring out successful products, such as photographic film, coated abrasives, magnetic tape, post-it notes, and many more products on a continuous basis.

C.K. Prahalad and Garry Hamel, in their article on “The core Competencies of the Corporation” have given this analogy: “The diversified corporation is a large tree. The trunk and major limbs are core products, the smaller branches are business units; the leaves, flowers and fruits are end products. The root system that provides nourishment, sustenance, and stability is the core competence.” The successful organisations, such as Intel, Nike, and Cisco Systems have developed their unique set of competencies. Here, a question arises: how can a firm find out its core competencies? Three tests or characteristics can be applied to identify core competencies of a company: (1) a core competence should make a significant contribution to the benefits that customers perceive in the company's end-product, (2) a core competence has a breadth of applications to a wide variety of markets, and (3) a core competence is difficult for competitors to imitate. Prahalad and Hamel have defined a core competence as “a complex harmonisation of individual technologies and production skills” that would make competitors difficult to imitate. In simple words, a core competence means a combination of most important skills and knowledge to do something successfully.

### CHANGES IN PRODUCT STRATEGY

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Business marketers must understand that a product strategy is flexible and dynamic. In business marketing a product is variable. Business firms are required to make changes in the product strategy because of changes in (i) customer needs, (ii) technology, (iii) government policies or laws, and (iv) product life-cycle.

## Factors Demanding Change in Product Strategy

**Customer Needs** Products are made to satisfy certain needs and wants of target customers. To survive and succeed in a competitive market, a business firm must continuously monitor changes in the needs of its target customers and continue to satisfy the customers by making changes in its product in line with the changes in the needs.

Customer needs change because of changes in their environment. **For instance**, because of a substantial increase in the cost of land (environmental change) used for storing raw material and finished products, the business firm's needs have changed for vertical stacking of material in their warehouse from two metres height to six metres in order to save space and money.

**Technology** The changes in technology can require either product modification or make existing products obsolete. **For example**, the jelly filled telecom cables are getting replaced by fibre optic telecom cables. Similarly, many firms have changed over to personal computers (PCs) from main frame computers.

**Government Policies/Laws** The changes in government policies and the laws enacted by Indian Parliament requires change in the product strategy. **For instance**, after adopting the policy of liberalisation of the Indian economy in 1991, major changes have been initiated. This enabled Indian firms to decide without government intervention, which products to manufacture and market. A few specific areas such as defence, insurance and tele-communication sectors, which were earlier monopolised by government units, are now being liberalised for the entry of the private sector firms.

Another **example** can be given about the state and central governments issuing orders for banning the use of wood for window, door, and partition frames and recommending the use of steel and aluminium frames, in government buildings, in order to save natural environment.

**Product Life-Cycle (PLC)** In order to maintain growth in sales and profits, business firms decide to drop, or modify, or develop new (substitute) products when the existing products reach "maturity", or "decline" stages, in product life-cycles.

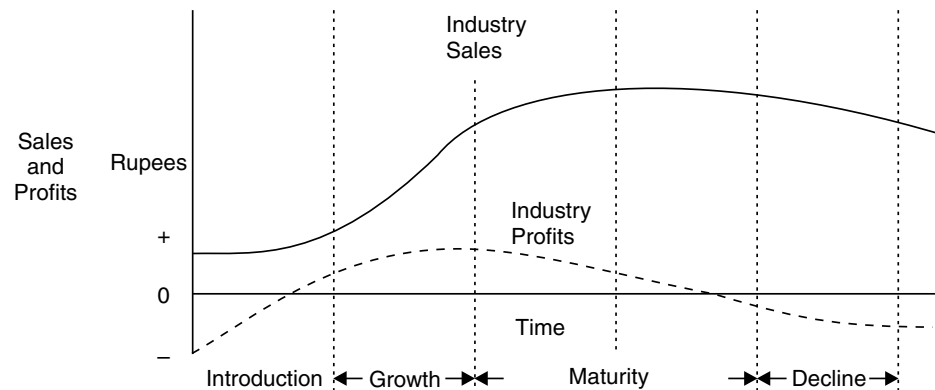
A **good example** of how a company has changed its product strategies and product offerings to meet the changing needs of customers and external environment can be given of Castrol India Limited, a part of BP Group. The company carries out marketing research to understand the requirements of modern engines from Original Engine Manufacturers (OEMs) and motor vehicle users and then develops high quality automotive lubricants. Indian government regulations require automotive engines to minimise harmful emission and to create a cleaner environment. Castrol India invests heavily on research and with new technological development provides lubricants that give solutions to environmental issues. The company has developed different products to meet the needs of different segments, such as passenger car engine oils, premium 2-stroke and 4-stroke oils and multi-grade diesel engine oils.

## INDUSTRIAL PRODUCT LIFE-CYCLE AND STRATEGIES

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The product life-cycle (PLC) theory or concept, used to determine marketing strategies, is an important subject in marketing textbooks. Figure 7.1 shows a general product life-cycle model with sales and profits history of a typical product. According to the theory, products tend to go through different cycles or stages that begin when they are launched in the market (introduction stage) and end when they are

eliminated from the market (decline stage). At the dividing line between the growth and the maturity stages, the profit curve is at its peak. In the maturity stage, sales volume continues to increase (although at a decreasing rate) but the profits fall.



**Figure 7.1** A General Model of the Product Life-Cycle

The behaviour of the product life-cycle depends on three factors over which management has little or no control. These are: (i) Changing needs of customers, (ii) Changes in technology, and (iii) Changing competition.

The Product life-cycle concept is criticised on the ground that it has little relevance in practice. Many studies on PLC concept are carried out in consumer marketing. However, a study<sup>2</sup> conducted on 1148 industrial businesses confirmed that industrial products typically follow the pattern of sales and profits as shown in Fig. 7.1.

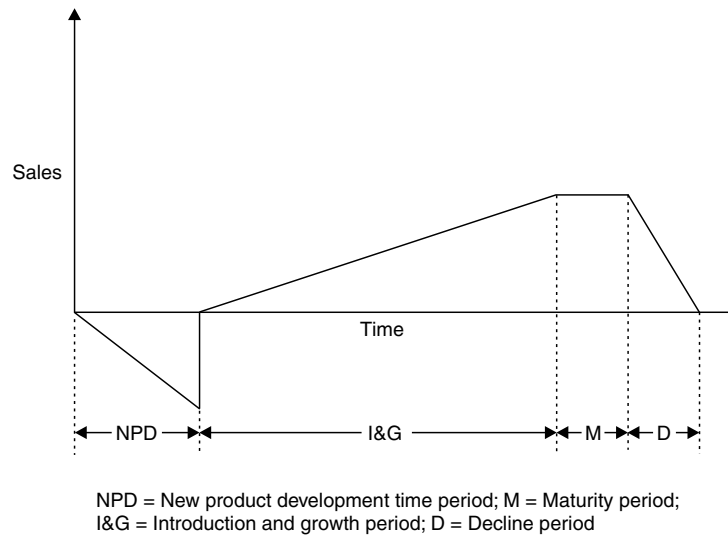
The product life-cycle concept suggests that different marketing strategies are needed at different stages of the PLC. This will be discussed subsequently in this chapter. The PLC concept also highlights the importance of long-term planning for a new product, including realisation of competition and its impact on profits at later stages. This should be understood well while estimating the profit potential or return on investment (ROI) during the business analysis (or feasibility analysis) stage of new product development processes.

### Other Shapes of the PLC for Industrial Products

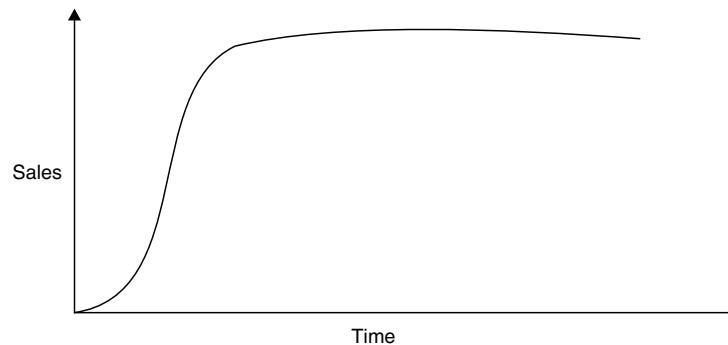
Generally most products follow an established S-shaped curve, as shown in Fig. 7.1, when their sales and profits are plotted against time. However, there are exceptions when the product may not follow this path. There are two such patterns as shown in Figs. 7.2 and 7.3.

As shown in Fig. 7.2, in high-tech products like computer and telecommunication, new product development cost and time are high. Introduction and growth stages are long but maturity and decline periods are short. This happens due to a rapid change in technology. However, as shown in Fig. 7.3, for commodity products, such as steel and cement in a monopolistic market, the demand remains relatively inelastic. The sales does not experience a decline due to less competition. However, the situation would change and sales would show a decline as soon as competition becomes intense.





**Figure 7.2** *Product Life-Cycle for High-tech Product*



**Figure 7.3** *Product Life-Cycle for Commodity Product*

Another important point to be understood in the product life-cycle concept is that profits from a product reaches a peak level before sales reach its peak. Generally, growth stage brings profits. In the early part of maturity stage profits reach peak level, and thereafter, sales reach peak level in the later part of maturity stage. This happens due to the competition, as competing firms offer low prices, better services, or do aggressive promotions. A company which launches a new product for the first time in the market fights back the competition in maturity stage by lowering the price to match the competition, spends more money on advertising and sales promotion, builds more intensive distribution, or develops new models by major modifications to the existing product. Thus, the marketing costs go up and profits start declining.

### International Product Life-Cycle

According to Louis Well<sup>3</sup> the products that go through international trade cycle pass through four stages, as follows:

- Exporting products to other countries takes place after a new product is launched in the home (domestic) market with successful results.
- Foreign manufacturers start production under licence, joint-venture arrangements, or start copying the product.
- Foreign manufacturers become competitive due to lower costs and start exporting the product to other countries.
- Foreign manufacturer's lower costs and high volumes enable them to export the product to the country where the product was originally innovated and launched in the present operations in international marketing. Many large manufacturers have become global marketers, having production and distribution facilities in the countries like India and China which have large markets and lower costs. The multinational companies, which operate globally, innovate new products anywhere in the world (where they have R&D facilities) and market the new products in many countries. Thus, the four stages of international product life-cycle may not be followed in the same sequence.

### Application of Product Life-Cycle Theory to Marketing Strategies

**Introduction Stage** Some industrial products get accepted rapidly after introduction and others are accepted slowly. This depends upon changes in the user's habits. For instance, hand-held electronic calculators replaced mechanical calculators in a very short time because the use of electronic calculator required neither new skills nor learning for users. While, electric typewriters took two decades after introduction to achieve market acceptance as a replacement for manual typewriters, since typists had to change the habit of keeping all the fingers on the keyboard of the manual typewriter to keeping the fingers off the electric typewriter keys. Thus, a new habit had to be developed for the use of electric typewriter.

For slowly accepted products (i.e. products that require high level of learning), marketing strategy should concentrate on market development efforts. However, for products that are accepted fast or have a potential of rapid acceptance (due to a low level of learning), the marketing strategy should be evolved to meet intense competition.

**Growth Stage** As the product enters the growth stage (i.e. high rate of growth of sales and profits), a business marketer should focus the marketing strategy on three key areas: **(i)** Improve product design to offer more benefits or product features to cover wider segments of the market; **(ii)** Improve distribution so that product availability to customers is strong; **(iii)** Reduce the price as increased volume of production (i.e. economies of large-scale production) lowers the cost. If these strategies are ignored by a business marketer, competitors are encouraged to enter the market because of weak availability of product and good profitability due to high prices.

LCD (or Multimedia) projector can be considered here as a good example. In India, it is in the growth stage, with additional product features like camera, and increased number of dealers for carrying out sales and service functions, required by educational institutions that are scattered all over the nation. The prices of the projector were reduced from about ₹ 2,00,000 in 2003 to less than ₹ 1,00,000 in 2007, perhaps due to increase in sales volume.

To illustrate the point that firms overlook the need to lower the price during growth stage, let us take the example of telecom cable jointing industry in which there were only two competitors in mid-1980s. In the introduction stage, the two suppliers had to convince only one customer, viz. Department of Telecommunication (DOT), which had complete monopoly in the purchase of telecom products and

services. Requirements of DOT for the “jointing kits” were large and the technical and quality/inspection wing of DOT gave the approval to adopt the new technology. The year from 1988 to 1992 were the high growth period in terms of sales and profits. Both suppliers did not reduce the prices although the costs had come down due to substantial increases in the volume. This attracted competitors who saw many advantages in entering this industry. It was a low technology, low investment, high sales and profit potential industry. By 1992, there were six suppliers, and in 1993, 18 suppliers had quoted for ₹ 60 crore tender from the DOT for the supply of jointing kits.

**Maturity Stage** As the product enters the maturity stage, the number of competitors entering the market increase, resulting in the decline in the growth of profits (i.e. profit as a percentage of sales). The marketing strategy when a product is in maturity or saturation stage should be: **(i)** Enter new markets (e.g. if a product matures in domestic market it may have a good export market); **(ii)** Keep the existing customers satisfied; and **(iii)** Cut marketing, production and other costs to maintain profit margins.

To illustrate, the electric motor industry was in stable maturity stage in early 1980s in India as the industry sales had stagnated due to saturation of market. There was over capacity in the industry and the competition was intense with three major firms having 65 per cent market share and striving for the total domestic market through high volumes, high quality, and competitive pricing. They tried to defend their respective market share by offering volume discount and liberal credit terms, giving customers technical assistance, ensuring on-time delivery, increasing the quality and quantity of sales engineers, matching the prices of competitors. There was not much scope in the product modifications as the electric motors were made as per Indian and international standard specifications. Although the product quality as perceived by the domestic customers was high, to enter international markets, all the three firms went for ISO 9000 certification for quality.

**Decline Stage** In this stage, price competition is more severe, and concurrently the sales and profits decline. The strategy adopted by a business marketer is to either withdraw the product from the market or develop a substitute product for replacement, or reduce marketing and other expenses substantially to make some profits. For industrial products, the decline tends to proceed rapidly since new technologies make established products obsolete like transistors replacing vacuum tubes, fibre optic telecom cables replacing jelly filled cables, and personal computers preferred by industrial customers over main-frame computers.

### Locating Industrial Products in their Life-Cycle

The product life-cycles are not caused by time. Where a particular product is in its life-cycle depends on a number of factors like industry profits (as a percentage of sales), rate of change in industry sales growth, and the information about competitors. The steps involved in locating a product in its life are as follows:

1. Develop a trend analysis for the past three to five years based on information to be collected for a business firm for a product, on quantity and value of sales, profits as a percentage of sales, market share, number of competitors and prices.
2. Analyse competitors’ market share, product performance, new product introduction, diversification or expansion plans.
3. Estimate and project sales and profits of the product over next three to five years.
4. From the above analysis, fix the product’s position on its life-cycle curve.

## DEVELOPING PRODUCT STRATEGIES FOR EXISTING PRODUCTS

Developing product strategies for existing (or established) individual products (or product items) and product lines (a group of related product items) is an important part of a business marketer's marketing plan. For this, the following steps should be taken by business marketing firms.

1. Evaluate the performance of all the existing products or product lines by using *product evaluation matrix* (see Table 7.1).
2. By using *perceptual mapping* technique, examine the relative strengths and weaknesses of the company's products in comparison to competitors' products.
3. Based on the above analysis, decide the product strategies for the existing products, that is, which products should be continued (or maintained), which products should be modified, which products or product lines should be dropped, and which new product items or product lines are to be added.

### Steps Involved in Developing Product Strategies

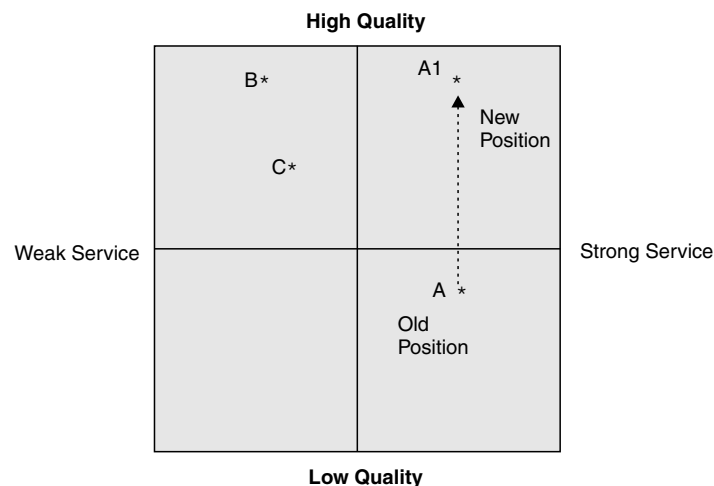
**Product Evaluation Matrix** A product performance is evaluated by using a technique called product evaluation matrix, developed by Yoram Wind and Henry Claycamp. The matrix combines four performance parameters of a product—industry sales growth, company sales growth, market share, and profitability. Industry sales growth are represented on vertical axis and are categorised as growth, stable, or decline, as shown in Table 7.1. Company sales growth is evaluated on horizontal axis and is classified as growth, stable, or decline. Similarly, profitability is classified as below target or above target, and market share as dominant, average, or marginal. These categories need to be defined by the marketing manager, depending on the situations prevailing in the industry. **For example**, if the market share is less than 10 per cent, it is evaluated as marginal, market share between 10 and 30 per cent is considered as average, and more than 30 per cent as dominant.

**Table 7.1** Product Evaluation Matrix

Company Sales Growth			Decline			Stable			Growth		
			Below Target	Target	Above Target	Below Target	Target	Above Target	Below Target	Target	Above Target
Industry Sales Growth	Market Share	Dominant									
		Average									
		Marginal									
Stable		Dominant									
		Average									
		Marginal									
Decline		Dominant									
		Average									
		Marginal									

Let us take an **example** of a material handling company having two product lines. Product P has a dominant market share of 40 per cent. The average growth of company sales in the past three years is 30 per cent. Industry sales have grown at the rate of 25 per cent per year for the past three years, and profitability is as per target. The marketing strategy for product P is to continue or maintain the leadership position by expanding the total market demand, protect (or defend) the current market share, and try to increase its market share, if the industry sales remain stable (or stagnant). Product S has an average market share of 12 per cent, the growth of company sales by 15 per cent in the past three years is considered stable compared to industry sales growth of 16 per cent, and profitability is below the target. The company's sales, market share, and profitability of product S needs to be improved to position S1, as shown in Table 7.1. For this, the business marketer should use the perceptual mapping technique (described below) to compare the relative strengths and weaknesses of the product line S with that of the competitors' products. Macro environmental factors such as economy, technology, political, and legal should also be considered at the time of deciding a suitable market-challenger strategies.

**Perceptual Mapping Technique** Perceptual mapping technique is used to study the strengths and weaknesses of a firm's product in comparison to that of competitors'. Figure 7.4 illustrates the position of three manufacturers of product Z. Based on marketing research study conducted by the firm A, product quality and customer service are the two purchase attributes considered most important by the business customers. The customers' perceptions of the three leading supplier firms' rating on these two attributes are shown in Fig. 7.4.



**Figure 7.4** Perceptual Mapping Technique

Firm A's product quality is perceived inferior to its competitors B and C. However, firm A's after-sales-service is perceived far superior to its two major competitors. Firm A can reposition itself from position A (old position) to A1 (new position) by improving its product quality substantially and maintaining its superior service. After improving its product quality firm A can set its price slightly higher than its competitors'. This would improve the profitability of the product.

**Deciding Product Strategies** Based on the two techniques—product evaluation matrix and perceptual mapping, the business marketer can now decide one of the strategy options mentioned below.

1. Maintain (or continue) the product and its marketing strategy.
2. Modify the product and/or change the marketing strategy.
3. Eliminate (or drop) the product or the product line.
4. Add new products or product lines.

It is important to identify the causes of unsatisfactory product performance. The quantitative performance parameters such as sales, market share, and profitability cannot indicate the causes of poor product performance. It will be useful to understand the customers' perceptions, particularly the opinions of sales, design, R&D, production, finance, and marketing people. The business firm will come up with number of factors (or causes) for the unsatisfactory performance of a product. The firm can then take corrective actions such as product modifications (or improvements), cost reductions, changing marketing strategy on price or promotion or market coverage, improve product quality, increase product features and range and so forth.

#### Product Elimination

Dropping the product or product line is perhaps one of the most controversial decisions because many stakeholders are threatened by this decision. A firm should, therefore, consider the following factors which should be discussed with the representatives of finance, production, marketing, purchase, and human resources.

1. Will the customer relationships be affected?
2. Will the profitability be affected due to change in overhead (fixed costs) allocation?
3. What will be the reaction of employees?
4. Will the sales of other products get affected?
5. Is there a new product to replace the eliminated product?
6. Will the company's image be affected?
7. What will be the possible competitive reactions?

## BRANDING IN BUSINESS MARKETS

Increasing number of business market managers recognise that they are benefited by setting up and building their brands. Business marketers understand that similar to consumer-goods marketing, a strong brand is also a valuable asset in business marketing. Similar to well-known consumer goods companies like Proctor and Gamble (P&G), Hindustan Unilever (HUL), and Colgate, there are valuable brands like IBM, Infosys, and Intel in business markets. Business marketers believe that they can build brand equity. Before we discuss about business-to-business (B2B) branding, let us go through some of the concepts used in brand decisions.

A **brand** is defined as a name, symbol, term, sign, design, or a combination of them, intended to identify the goods or services of one seller and differentiate them from those of competitors. In other words, a brand identifies the seller.

**Brand equity** is the value of a brand. It has a positive differential effect on customer response to a product or service. Brand equity results in customers showing a preference for one product over another when they are fundamentally similar. Brand equity can be measured by degree or extent to which customers are willing to pay more for the particular brand. For instance, Amazon.com charges 10 to 12

per cent more than other online book suppliers<sup>4</sup>. However, it should be understood that brand equity is different than **brand valuation**, which is the task of estimating the total financial value of the brand. For example, Microsoft's brand value was \$65 billion and that of IBM was \$53 billion in 2001<sup>5</sup>.

High brand equity results in the following preferential actions from customers.

- Customers are willing to pay a higher price.
- Customers give higher share of their purchase requirements.
- Customers take less time to decide the orders.
- Less likelihood of customers switching to competitors' offerings.

### Building a Strong Brand

In established markets, it is a disadvantage for the young companies having no brand recognition or reputation to compete against companies with strong brands. Like in consumer markets, a strong brand is valuable in business markets too. In general, except for a company that wants to be low-cost and low-price supplier, a strong brand reputation will result into a competitive advantage.

David Aaker in his book *Building Strong Brands* mentions that generally **Brand strength** is made up of brand recognition or **awareness**, quality of the product or service, and the customers' positive beliefs or **associations** that are linked to the brand. Building brand strength is a long-term process, which includes first building the company's value from which comes positive association about the product and company, and then building broader awareness.

**Building Associations** The most powerful associations come from customers' direct experience. In business marketing, if each member of the buying centre has a few positive experiences, with the company and its products or services, it would be an ideal situation. However, if the experiences of buying centre members are not uniformly positive, then politicking within the buying centre can be harmful. Hence, sales and service people of the company have a major role to play not only on getting short-term orders, but also on long-term results. Impressions are formed when the customer sees an advertisement, interact with the supplier's sales and service people and use the supplier's product. The supplier's messages communicated through sales people, advertisements, and other communication tools should be consistent. Similarly, customers' usage experiences should be made as positive as possible by the supplier. The supplier (or the business marketer) must determine what combination of customer experiences and communication messages is likely to be effective in creating a desired change in the customers' mind.

The fundamentals of building strong brands include creating strong products and communicating this to the target market segments.

## BRANDING DECISIONS IN B2B

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In business-to-consumer (B2C) branding, almost all companies recognise the importance of brands. But in business-to-business (B2B) marketing, not all companies understand the importance of brands. In a recent study carried out by the author, 14 per cent of B2B marketing companies gave a relatively low rating of 4 on a 10-point scale to the question, "how important branding is to the company?" Their argument was that branding was taken care by their customers, who subcontract the work to them. They felt their customers know about the quality of their work and that the customers take "rational"

(or logical) decisions while giving orders to them. Such firms do not realise that business buying decisions are not always rational. However, the study found that the average rating given by B2B marketing companies on the importance of branding was 8.2 on a 10-point scale. This shows that many B2B organisations recognise the importance of branding, particularly in a competitive market.

### Purpose of Branding

The purpose of branding in B2B or business markets is the same as that in consumer markets. The general purpose of branding is that brands make identification of products, services, and businesses easy. In addition, brands differentiate the products, services, and businesses from the competitors<sup>6</sup>. Brands are also an effective way to communicate the value or benefits a product or service can provide<sup>7</sup>. They are a guarantee of quality, performance, and origin, thereby increasing the performance value to the customer and reducing the risk and complexity involved in the buying decision<sup>8</sup>.

One more important point about B2B branding is that brands not only reach a company's business customers, but also to other stakeholders, such as employees, investors, suppliers, intermediaries, and general public. If a company manages its brand effectively, it receives a positive coverage and opinion of all its stakeholders.

It is understood that **"a brand is a promise"** to the company's customers. However, the brand can come to life if the company consistently delivers on that promise. The brand promise should be relevant, clear, and meaningful. For example, the IBM brand promise is "helping clients succeed through business and technology innovation". It offers to its customers superior service, improved solutions, and on-time delivery.

Brands and brand equity are recognised as the organisation's strategic assets, and the basis of **competitive advantage and long-term profitability**. It is difficult to evaluate and measure return on investment for brands. There are only a few research projects dealing with this subject. BBDO Consulting Germany have published the results of a study<sup>9</sup> in which companies with strong brands have recovered significantly faster from the stock market "slump" in the wake of the 9/11 terrorist attacks than weaker brands.

### Branding Process

We shall now discuss what process a B2B marketing company should follow in order to achieve brand success. The process starts with the first task of deciding "to brand or not to brand". If the decision is to go for branding, then "how to do it" is the next logical task. For this, a company has to go through a number of steps, as shown in Fig. 7.5. We shall discuss each of these steps.

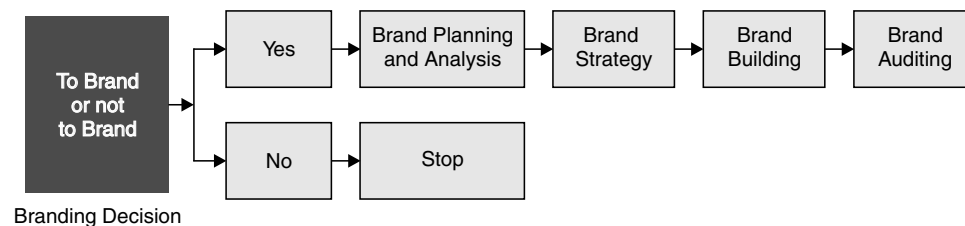


Figure 7.5 Branding Process



**To Brand or Not to Brand** Business marketers recognise that in an increasingly competitive environment, it is not enough to just offer quality products and services. Business organisations can successfully set themselves apart from competition, if they establish a brand and gain a competitive advantage in the market place. The main factors that should be considered by B2B marketing companies, when they make the decision whether to brand or not to brand, are: (1) high pressure on prices, (2) complexity in market offerings, and (3) availability of a large number of similar products and services.

Business marketers face increased competition and continuous changes in the external environment like economic, technological, and legal. These market conditions put pressure on the prices of products and services, which can be overcome by branding. Today, many business marketing firms sell solutions, which need a set of products and services. Thus, solution oriented market offerings make buying complex and difficult. Branding can assist in reducing the complexity. Now-a-days customers get many choices while buying not only consumer products and services, but also industrial and business offerings. Many of these offerings are similar and hence, the supplier can differentiate its product or service from those of competitors with a strong brand. **For example**, it is difficult to imagine how steel products like steel rods can be differentiated, but **Tata Steel** gets more than 27 per cent of its domestic steel volumes from branded steel products<sup>10</sup>. Tata Steel has branded “Cold Rolled Steel” product as “Tata Steelum”, “Galvanised Corrugated Steel Sheets” as “Tata Shaktee”, and “Galvanised wire products” as “Tata Wiron”.

Research studies conducted by McKinsey and MCM highlight the relevance and importance of brands in B2B markets<sup>11</sup>. These studies found that the most important brand functions, with respect to their importance and relevance in B2B markets, are as follows:

- **Risk Reduction** Business buyers (or customers) reduce the risk of incorrect buying decisions by choosing branded products and services. This is particularly important when buying high-value, technically complex products and services.
- **Easy Information** B2B customers find that collecting and processing information about branded products is much easier than those from non-branded products. Besides, branded products can be easily recognised and found by customers for repeat use.
- **Image Creation** Well-known brands create positive image about the customers, and hence, most customers prefer to buy products and services of reputed brands. For instance, a business management institute placed the order for construction of buildings for the new campus on Larsen and Tubro (L&T), which created a positive image about the institute on various stakeholders, including the students.

## Brand Planning and Analysis

Many business organisations develop strategic plans and marketing plans, but not brand plans. If brand plans are not developed, brands cannot reach their full potential. Key factors in brand planning are: (1) involvement of all, and (2) brand continuity.

**Involvement of all** It is important that business marketing organisations involve all people to get information or suggestions about the brand identity (i.e. brand’s name, logo, colours, and symbol), strengths and weaknesses of the brand. However, what is more important is the business marketer’s **promise to deliver a specific set of benefits consistently to the customer firms**. The customer’s contacts with the company employees and the company’s communications should be positive. Everyone in the company should live the brand. Many companies make brand promises but fail to train employees

to understand and deliver on the brand promise<sup>12</sup>. Companies should carry on internal branding with their employees to understand and deliver on the brand promise.

**Brand continuity** It means a company should not change its brand for the sake of change. In fact, strong brands are managed continuously over a long period. The customer's trust is built based on long-term association of the customer with the brand.

**Brand analysis** The first step towards creating a brand should be a detailed brand analysis, which should include customer analysis, competitor analysis, the company analysis, and the environmental analysis. For this, the company should carry out an effective marketing research. The research should find out the brand share, which is equal to "Brand Sales/Product Category Sales". **For example**, General Electric (GE) Healthcare was focusing on innovation and technology to gain market share of its brand in India. The domestic diagnostic imaging product category size was estimated to be around \$350 million in 2005, of which GE brand claimed to have a market share of 35 per cent<sup>13</sup>.

The company should carry out the marketing research to answer some of the following key questions:

- What is important to the company's target customers?
- How the company's target customers differentiate the company and its products/services from those of competitors?
- What is important to the company?
- What the company would like to be in 5–7 years from now?

How to conduct marketing research, to get all the relevant information about the brand, is covered in Chapter 5.

## Brand Strategy

A business marketing firm develops a brand strategy after interpreting the findings of the brand analysis carried out earlier. A branding strategy developed by a business marketing firm depends on the brand elements (such as name, logo, symbol, design, slogan, or some combination of these) a firm chooses to apply to the products and services it markets.

**Brand Hierarchy** The more important part of brand strategy for a business marketing firm is the decision on the brand hierarchy to be followed. A brand hierarchy has four levels or options in B2B marketing: (1) corporate brand, (2) family brand, (3) individual (product) brand, (4) a combination of above. Some companies, such as 3M, BHEL (Bharat Heavy Electricals Ltd), and General Electric (G.E.), have developed corporate brands (sometimes called "blanket family names") for all its products and services. The advantage is that brand development cost is less and brand recognition is good. Another brand strategy followed by some firms is to follow separate family brands for different product lines. **For instance**, Sears company uses brand "Kenmore" for appliances, brand "Craftman" for tools, and brand "Homart" for major home installations. The third alternative brand strategy available is to follow on individual brand strategy. The advantage in this strategy is that the company's reputation is not tied to the individual product's reputation. If a new product fails, the company's image is not badly affected. The last alternative is to use a combination of corporate name, family name, and individual product name.

In a study carried out by the author on branding decisions of B2B organisations, it was found that 55 per cent of the business firms preferred only corporate brands, individual product and family branding were decided by 17 per cent companies, and balance 28 per cent marketing firms combined corporate names with individual product names. Thus, corporate branding strategy was followed by 83 per cent of business marketing firms.

**For example,** India's largest information technology (IT) company, TCS launched its first global branding campaign in 2007 to build its corporate brand. The brand-building campaign's punch line was "Experience Certainty" in the minds of thousands of its customers and own employees. Similarly, IBM's brand campaign focuses on innovation, while Accenture, the other global IT services company, talks about improving business performance.

**Choosing Brand names** In business markets, brand names become meaningful over a period of time, based on the performance of the supplier firm and its products and services. The alternatives available for choosing a brand name are as follows:

- **Name of a person** Many great companies and brands are named after their founders, such as Honda, Tata, Siemens, and Boeing.
- **Nature of the business** Names that describe the names of business like International Business Machines (IBM), General Electric (GE) and British Airways may be easy to decide, but may have constraints when the company wants to diversify its business.
- **Use of Acronyms** Many business marketing firms use their initials as names. The examples are: IBM, HP, DHL, and SAP. Such firms need large amount of promotional budget to convey who they are and what they stand for, because many people don't know what the letters stand for and find difficult to remember and relate the names.
- **Artificial Names** Abstract or artificial names are different and easy to remember. Some of the examples are: Xerox, Accenture, and Kodak.
- **Metaphorical Names** When brand names are based on locations, animals, mythological names, or foreign words to make indirect reference to a certain quality of a company or its product, such brands have metaphorical names, like Oracle and Apple.

Some companies like GE and IBM use combinations of above alternatives. For instance, GE Medical Systems, or IBM Think Pad. Today considering the growth of global market place, organisations should choose brand names that can be used globally. Many firms hire marketing research agencies to develop and test names. One important point to remember for a global brand is that it should not carry poor meanings in other countries and languages. **For instance,** American company Enteron had to change its name to Enron, because the Greek origin of the word "enteron" meant male anus!

**Brand Positioning** Developing positioning strategy is very important in brand management. However, positioning strategy is often not properly understood or ignored by business marketers. Brand positioning means establishing and sustaining an intended meaning for a brand in the minds of targeted customers. A strong brand should create a unique and clear position, which should be different than competing brands, in the target markets. Positioning strategy always comes after segmenting and targeting, because the company should first decide who their target customers (or markets) are and thereafter decide the brand positioning strategy. We have already discussed segmenting, targeting, and

positioning (STP) earlier in Chapter 6. What we discuss here is brand positioning strategy. The important components of brand positioning are target market, marketing offer, and value proposition. The target market is the specific groups of customers that the marketing firm is interested in. The marketing offer of the supplier firm specifies the major attribute(s) or benefit(s) for the targeted market. The value proposition mentions the points of difference relative to the other alternative market offerings of competing firms. In the study carried out by the author, the value propositions used by most companies were: (1) quality of product and service, followed by (2) ontime delivery. The value proposition should answer the target customer's question: "Why should my organisation do business with your firm and not with your competitors?" It is necessary that business market managers involve other managers from relevant functional areas in the positioning process, so that there is a proper understanding of brand positioning within the firm. It also gives a shared understanding of what the supplier firm can be best at.

**Brand Extensions** Some companies have brand extension strategy of using their existing, well-established brand names to introduce new products or services in other product categories. One well-known **example** in consumer markets is that of Honda, which uses its company name (i.e. corporate brand) to cover different product categories, such as motorcycles, automobiles, lawn movers and marine engines. The advantages of this strategy are: (1) chances of survival for a new product is more with brand extension strategy than individual brand strategy with its own distinctive brand name; (2) minimising marketing costs of brand building. **For instance**, Sony puts its name on most of its new products and services, and thus establishes high quality reputation for the new products and services. However, there is a risk of brand dilution, if there is an overextension of the brand or the brand name may not be suitable for the new product.

**Multibrand Strategy** A few companies use this strategy to protect its major brand by setting up other brands. **For instance**, a company has different brand names for higher-priced, higher-quality products, and lower-priced, lower-quality products. Some companies have multibrands as a result of acquiring competitors' brands, like Hindalco acquired Pennar Aluminium, which increased the capacity of high-priced, value added products, substantially to more than 60 per cent of the total aluminium capacity of the company. A major drawback with multibrand strategy is that each brand may not be profitable, and that the company's limited resources are used for several brands.

**Co-Branding** There are increasing situations of co-branding (also called, "**dual branding**") in which, two or more well-known brands are combined in a product or service. Co-branding strategy is mainly used for consumer products and services. One of the forms of co-branding, that is often used in business marketing is **ingredient branding** (or ingredient co-branding) strategy. Manufacturers of materials or parts that enter into final branded products use ingredient branding strategy. These materials and parts (i.e. components or ingredients) lose their individual identity as they enter the finished (or final) products of their customers. These manufacturers try to establish ingredient brands that increase awareness and preference for their materials or parts. The important point is that the ingredient (i.e. the material or component) should be an essential part of the final product. **For instance**, Intel processors are considered as the "heart" of every personal computer. The "Intel Inside<sup>®</sup>" branding strategy for its processors in personal computers is a well-known example of ingredient branding. The "Intel Inside<sup>®</sup>" logo is used by about 2700 PC manufacturers around the world, and consumer awareness is about 90 per cent<sup>14</sup>. Within a few years, Intel went from an unknown component manufacturer to one of the most

recognised and valuable brands in the world. However, it is interesting to know that Intel has launched a new corporate brand to market itself less as a chip maker and more as a provider of platforms. Another company which has followed ingredient branding strategy successfully is DuPont with its Stainmaster® brand of carpet protector. DuPont sells this brand along with fibres to carpet mills, which produce Stainmaster carpets. In ingredient branding strategy, brand-building activities are concentrated on the customers' customers. The ingredient (or the component) should be perceived as important by the customers' customers (i.e. usually household or individual consumers), and hence, it contributes to the performance and success of the final product of the customer firm. The ingredient supplier should clearly mark the brand with a distinct logo or symbol on the final product of the customer, so that customers' customers (or consumers) are aware that the final product has this ingredient<sup>15</sup>.

**Global Brand Strategy** The main factors business buyers consider while buying industrial products and services are functions (or activities) performed and how well (i.e. performance of) the functions are carried out. In other words, functions and performance are the two factors that are mainly considered by business buyers not only in domestic markets but also in international markets. Business customers in Asia, Europe, and America seek the same functionality and performance from industrial products and services, such as chemicals, steel, computer software, and courier services. Companies in consumer markets have difficulties in marketing their products and services across different countries because of variation in tastes and aesthetics. Hence, market offerings (i.e. products and services) for business markets need very few changes in order to sell them across borders. Another critical point we discussed earlier was the importance of corporate branding like IBM, Infosys, and Bosch in business markets. Thus, it is clear that organisations in business markets should follow global brand strategy for their market offerings. Global branding is beneficial for companies, because it can reduce marketing costs, obtain higher volumes, and provide a long-term growth. The objective in global brand strategy should be to achieve standardisation and consistency as much as possible.

## BRAND BUILDING

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Increasing numbers of business market managers are establishing and building their brands. The value proposition for an industrial product or service is a vital part of brand building process in business markets. Business marketers should focus on one or two value propositions that are most important to target customer organisations. They should then allocate sufficient resources to improve functional and performance aspects of the product or service. **For instance**, if the value proposition of an electrical component (e.g. moulded case circuit breaker) is higher breaking capacity, as conveyed by the target customers (i.e. the state electricity boards), then the supplier firm allocates adequate resources to design and develop a superior product—superior to competing products. The superior function and performance of the product should be documented, demonstrated, and communicated effectively. For effective communication of the value proposition, business marketers use brand-building tools, which are as follows:

### Brand-Building Tools

In Business marketing, the major brand-building tools are: Personal selling, direct marketing, advertising, trade shows and exhibitions, public relations, and sponsorships.

**Personal Selling** It is the face-to-face interaction with potential and present customers for the purpose of getting business. It is particularly effective in B2B selling. Personal selling through the company's salespeople is the major tool used to build long-term mutually beneficial relationships with key customers (i.e. key accounts). The business marketer trains their salespeople to ensure effective communication of the value proposition of the brand. Personal selling builds the buying firm's preference, conviction, and the buying action of the brand.

**Direct Marketing** This includes internet (or online) marketing, telemarketing and direct mail as the major tools used by business market managers to communicate directly to prospective and current customers. The distinctive characteristics of direct marketing are: (1) interactive (i.e. allowing a two way flow of information, where the message can be changed depending on the customer's response), (2) the message can be prepared quickly, (3) the message is generally addressed to a particular person, and (4) the message can be customised to the specific individual. The main advantages of direct marketing tools for brand building are that it reduces wasteful communication costs, and establishes continuous customer relationships<sup>16</sup>.

**Advertising** To build up a long-term brand image, advertising can be used. In B2B marketing, trade (or industry) journals and business magazines are often used to ensure cost-effective and target market oriented advertising. Some of the benefits of advertising as brand building tools are: (1) advertising can be pervasive through magazines, journals, and newspapers in B2B marketing. It also permits the business marketer to repeat the message many times, (2) advertising can reach those senior or key executives of target customer firms whom salespeople either find difficult to reach (due to "gatekeepers") or are not aware of, (3) advertising can be cost-effective to reach geographically dispersed buyers.

**Trade-Shows and Exhibitions** In business marketing, trade-shows and exhibitions are used to build brand awareness, knowledge, and interest. They provide a great opportunity to introduce new products to a large audience in a short duration. Business marketing firms display and demonstrate their products at the trade shows and establish contacts with prospective and current customers. The challenge is to decide the trade-show budget and which trade-shows to participate. Marketers can collect information on trade-shows and decide which trade-shows to attend.

**Public Relations (PR)** Corporate brands can gain good attention from newspaper and magazine articles or stories. PR includes many programmes that are designed to promote or protect the corporate brand. High-tech companies like Microsoft, Oracle, and SAP built their initial identities via PR and thereafter spend large money on advertising<sup>17</sup>. The reason why PR is so effective in brand building is because of its credibility. An interesting story, picked up by media can be worth millions of dollars in equivalent advertising. PR builds brands by building positive word-of-mouth communications.

**Sponsorships** It is common for B2B brands to sponsor public events for brand promotion. Many business firms try to increase brand awareness by sponsoring famous events like world-cup cricket matches. Some companies like FedEx, Bearing Point and UBS use sponsorships seriously, by integrating it with the marketing mix. Some of the objectives of sponsoring, apart from brand promotion are, to increase sales revenue, relationship development, and entertaining customers.

In the study carried out by the author, business firms were found to be using the following brand building tools in the order of importance: (1) advertisement in magazines, journals, and newspapers;

(2) trade-shows and exhibitions; (3) online advertising; (4) technical seminars and workshops; and (5) sponsorships of events.

## BRAND AUDITING

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Business organisations should periodically audit the performance of their brands. The purpose of the audit is to find periodically the brand's strengths and weaknesses.

The process of brand auditing includes (1) deciding the objectives of the audit, (2) internal description of how the brand has been marketed, (3) external investigation through research methods, such as questionnaires, interviews, and data collection, (4) analysis and interpretation of the data, and (5) findings and report preparation, which includes the "brand score card".

The **brand score card** measures the performance of the brand in relation to the target customers' expectations. There are four components of the brand score card<sup>18</sup>, which are as follows:

- The functional performance of the brand.
- The ease and convenience of accessing the brand.
- The personality of the brand (i.e. it describes the brand as if it was a human being. **For instance**, SAP defines its brand personality as enjoyable, friendly, honest, responsive, listening, responding, and constantly improving).
- The brand value, including pricing.

Generally, companies do brand auditing every six or twelve months. However, some highly successful companies like IBM, GE, and Accenture are moving towards continuous brand monitoring by carrying out field researches every alternate month. Kevin Keller has suggested the following attributes, based on his review of the world's strongest brands<sup>19</sup>:

- The brand should deliver the benefits customers truly desire.
- The brand should stay relevant, by being in touch with current market conditions, market trends, and customer needs.
- The pricing strategy of the brand should be based on customers' perceptions of value, to meet or exceed customers' expectations.
- The brand should be properly positioned, after considering points of parity and difference with competitors.
- The brand should have consistent messages sent through various promotional media and marketing programmes.
- The brand should have a proper brand hierarchy and portfolio.
- The brand equity should be built by ensuring that the meaning of the brand is consistently represented through proper communication.
- The brand managers should know profile, likes and dislikes of target customers, based on market research data.
- The brand should be given adequate support from various functions, including R&D.
- The brand equity should be monitored, against a written description of the meaning and equity of the brand.

## SUMMARY

Before we discuss product strategy it is necessary to define an industrial product not only as a physical entity but also a complex set of economic, technical, legal, and personal relationships between the buyer and the seller.

For successful industrial products firms must know their core competencies, which is defined as a complex harmonisation of individual technologies and production skills.

In business marketing, product strategies are required to be changed due to changes in customer needs, technology, government regulations, and product life-cycle.

The product life-cycle (PLC) concept is used to determine different marketing strategies at different stages of the PLC. The shapes of the PLC may vary for certain industrial products, and the location of a particular product on its life-cycle will depend on industry sales-growth, industry profits, and competition.

Product strategies for existing products are developed after evaluating the performance of existing products (by using *product evaluation matrix*) and examining strengths and weaknesses of the existing products relative to competing products (by using *perceptual mapping technique*). The *alternative product strategies* available for existing products are: continue (or maintain) the existing products and its strategy, modify the product and its strategy, eliminate the product, or add new products.

A strong brand is a valuable strategic asset in business marketing. A brand is a promise to the company's customers. A business marketing firm first makes the branding decision—viz. to brand or not to brand. If the company decides to go ahead with branding, it has to follow the branding process, consisting of brand planning and analysis, brand strategy, brand building, and brand auditing. Some successful B2B companies carry out continuous brand monitoring or auditing.

## KEY TERMS

- Brand equity
- Brand hierarchy
- Branding/Brand
- Cobranding/dual branding
- Competitive advantage
- Core Competencies
- Ingredient branding
- Perceptual mapping
- Product Life-Cycle (PLC)

**Note:** Glossary of the key terms is given at the end of the text.

## CONCEPTUAL QUESTIONS

1. What do you understand by enhanced and augmented product properties? Why are they required?
2. Explain the factors that influence changes in the product strategy?
3. What changes are needed in the marketing strategy when a product enters the maturity stage from the growth stage of product life-cycle?
4. What are the alternatives available to a business marketer while deciding on product strategies? Briefly describe the steps to be followed for developing product strategies for existing products.
5. Should business marketing firms do branding? Explain with reasons.
6. Describe briefly the steps involved in the branding process.



**OBJECTIVE TYPE QUESTIONS**

1. In business marketing, a product is: (a) variable, (b) fixed, (c) both variable and fixed, or (d) neither variable nor fixed.
2. Augmented properties in a product include: (a) tangible benefits, (b) intangible benefits, (c) both tangible and intangible benefits, or (d) neither tangible nor intangible benefits.
3. The product life-cycle (PLC) theory is useful for determining: (a) strengths and weaknesses, (b) opportunities and threats, (c) marketing strategies, or (d) marketing objectives.
4. As the product enters the maturity stage, the number of competitors: (a) remain same, (b) increase, or (c) decrease, as compared to growth stage.
5. The technique used for studying the strengths and weaknesses of a firm's product in comparison to that of competitors is called: (a) BCG model, (b) GE model, (c) perceptual mapping, or (d) ABC analysis.
6. Brand equity of a brand means: (a) brand valuation, (b) value of a brand, (c) brand name, or (d) brand design.
7. In B2B branding, brands reach: (a) suppliers, (b) customers, (c) intermediaries, (d) all of the above, or (e) none of the above.
8. Brand positioning means: (a) starting, (b) keep going, or (c) establishing and sustaining an intended meaning for a brand in the minds of targeted customers.

**APPLICATION QUESTIONS**

1. Assume you are the regional marketing head of eastern region, located at Kolkata, in India. Your company manufactures and markets a large range of electrical engineering products. One of the products you are selling to diesel generating set (D.G. Set) assemblers is "Alternator", which is the electrical part of the D.G. Set. Subsequently, after many years, your company decides to assemble, sell, and service D.G. Sets, by combining Alternators (manufactured by the company) with diesel engines purchased from suppliers. You find the sales and profit performance of D.G. Sets over a period of three years unsatisfactory. What product strategy would you recommend for D.G. Set and Alternators and why?
2. Crompton Greaves Ltd. is the leader in Indian domestic market for electric motors, which conform to Indian and International standards. The company faces a severe competition from small-scale motor manufacturers as well as large global players like Siemens and ABB. What suggestions would you like to give to the company to maintain its leadership position in this product category?
3. Assume you are starting a new business as an entrepreneur. How would you choose a brand name for your company? How would you do brand building? What benefits of branding would you expect?

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## CASE 7.1

### Vastu Cement Blocks Pvt. Ltd.: Changes in Product Strategy

L.C. Goyal, Director, Vastu Cement Blocks (VCB) Pvt. Ltd., was seriously considering the proposal made by the company's marketing head, Pradeep Chatterjee, to make a change in the product strategy, in order to solve the problem of declining profitability.

VCB was one of the largest manufacturers of cement blocks, which were used by the construction industry. VCB was started in 2004, as a part of vertical integration, to support their businesses in the construction industry and the dealership of cement from Asbestos Cement Company (ACC) Ltd.

VCB was known for its superior quality, compared to its competitors. The raw materials required for the production of cement blocks included gravel, sand, cement, and dust. VCB had three production units with the objective of minimizing transportation costs. The production cycle was 5 days from the date of purchase of raw materials, and included the processes of mixing, moulding, and drying.

The company's profitability was affected due to rising cement prices as well as price war on cement blocks, with increase in competition. According to Pradeep Chatterjee, cement block was considered as a commodity and customers purchased the product based on two key factors—price and relationship. Pradeep recommended to L.C. Goyal that the company should change the product and pricing

strategies from “high quality and high price” to “medium quality and competitive prices”. Goyal was reluctant to change the “high-quality image” of the company, due to the company’s use of ‘A’ grade cement instead of low-priced ‘B’ and ‘C’ grade cements used by competitors. Goyal was also considering production of bricks using ash, with a new technology.

### Question

1. What changes in the product strategy would you recommend to L.C. Goyal?

## CASE 7.2

### Station 12 (currently Xantic)—Branding in B2B Services\*

As the satellite communications division of Dutch telecommunications company KPN, Station 12 traditionally offered various Inmarsat services, mainly to the maritime sector, the military (or peacekeeping) sector, aid organisations and governments. These services included analogue and digital voice, telex and data services. With its own Land Earth Station (LES) at Burum in the Netherlands, and a partnership with KDD of Japan for the use of its LES, Station 12 was able to provide worldwide access through geo-stationary satellites, which retain a fixed position in relation to a place on earth. These satellites orbit a few hundred kilometres over the Equator. Station 12 was primarily known for the reliability of its LES, which is a function of operational dependability, speed of connections, voice quality and few interruptions. The name, Station 12, was derived from the numerical position of its LES on the dial of Inmarsat satellite terminals: 12.

Gaining increased independence from KPN in the mid-1990s, Station 12 decided to strike out on a route of innovative services. In the beginning these innovations concentrated on bringing in new, or enhancing existing, Inmarsat services. In the maritime sector this meant offering Inmarsat-based services such as high-speed data links for large-volume data, light and cost-effective terminals for smaller ships, and e-mail and messaging solutions. In the (newer) land market, innovations included Inmarsat mobile satphones, and tracking and tracing services for truck fleets.

Shifting the brand perception from what was essentially one based on reputation to one that was domain-driven proved to be difficult and dependent on local circumstances. Station 12’s brand perception was especially entrenched in the maritime sector, where it had a long and successful history of dependability. This brand perception was not as prevailing in the land-based market, because of a limited exposure to the brand. It was Station 12’s explicit aspiration to gain ground in the land-based market, as this segment was largely untapped for satellite services.

Studies were conducted into the potential of the various innovative products and services. In the maritime sector these studies focused mainly on offering new value-added services, such as online billing, fleet-wide e-mail and various ways of reducing satellite communications costs. One piece of research was a so-called two-stage access service for shore to ship communications. This service works roughly like the callback services for fixed line telephones which sprang up in the 1990s as a way of reducing international calling costs. As Inmarsat satellite communications can be prohibitively expensive, the idea seemed appropriate. The study consisted of interviewing decision makers in a number of countries, among them were Germany, Singapore and the United States.

\* Taken from Xantic press release, March 19, 2001.

In Germany, decision makers wondered whether Deutsche Telecom would allow them to use the service. They worried that, by circumventing the national telecoms company, they would risk being denied service altogether.

German respect for authority was getting in the way of innovation. In Singapore, decision makers were delighted with the prospect of saving money on their satellite communications. The practical materialist attitude of Singaporeans was conducive to service acceptance. In the United States, a fair number of the decision makers' interview revealed that they were using regional satellite services rather than Inmarsat. This was in part because many US merchant and cruise ships never stray far from the continental United States. The regional satellite operators were offering continuous online services at a fixed cost irrespective of traffic, rather than the Inmarsat dial-up services with a connect and time charge. From a perspective of cost control, this made a lot of sense to the decision makers. The conventions of service experience were therefore totally different from what Station 12 had to offer.

In the land-based market, the studies concentrated mainly on new products and services such as tracking and tracing, remote measurement, messaging and various means of communications from remote sites, such as construction sites, oil exploration rigs and manufacturing sites in developing countries. One such study was into the potential for Station 12's Altus satphone. This phone was small and light by the standards of the time, being the size and weight of a laptop computer. This made it possible for the first time to carry a satphone rather than being consigned to a vehicle. The cost of the terminal (approx US \$2000) and the traffic charges (approx US \$2 per minute) were low compared with other satellite services.

Again the study was conducted through personal interviews with business decision makers in a number of countries, including the Ukraine and Indonesia. In the Ukraine, the decision makers were impressed, or to be more precise overawed, by the Altus. This was because fixed-line services were largely unavailable and unreliable, even in the capital Kiev. The gap between shoddy communist-era telecommunications services and the Altus satphone was simply too wide to be crossed in one go. The Ukraine decision makers decided they would first await the advent of mobile phone networks in their country. The challenge by Station 12's Altus to the conventions of service experience was too much for the Ukrainians.

In Indonesia, the businesspeople interviewed felt little need for such an expensive and unwieldy contraption as the Altus. This was because they had the impression that their mobile phones already offered complete worldwide coverage. They meant that they spent almost all their time in urban areas in Indonesia or other Asian countries, and had excellent mobile phone coverage there. These wealthy Indonesian urbanites did not feel the least inclination to venture into the countryside if they could help it. Indonesia's hierarchic society proved to be one obstacle on Station 12's path.

These few examples show that Station 12 had a struggle on its hands when trying to introduce innovations around the world. Even in such a relatively young and fast-changing industry as satellite communications it was faced with various local beliefs, customs and conventions of service experience which hindered the development of brand's desired perception into that of a specialist service provider. By widening its offer of satellite services to include non-Inmarsat services, as well as concentrating more on providing solutions (such as private networks and content distribution) and satellite broadband Internet access, Station 12 did manage to become recognised as one of the most innovative players in its industry.

In 2001 Station 12 merged with the satellite division of Australian telecoms company Telstra and with SpecTec, an enterprise resource planning (ERP) software developer for the maritime industry, to

form a new entity called Xantic. On the announcement of the merger Knut Reed, the company's then CEO, commented, 'Today sees the birth of the world's leading provider of satellite-based business solutions of connection, content, consultancy, applications and transactions, one that brings more of our customer's worlds into range. Through providing innovative and reliable services to customers across the world, we expect Xantic will be the number one choice for organisations across the globe.'

***Questions***

1. What changes in brand strategy should have been done by the management of Station 12 to develop into a specialist service provider for both maritime sector and land-based market?
2. What kind of branding process should be followed for the new brand Xantic?

# 8

## New Product Development and Marketing of Business Services

*After studying this chapter you should be able to:*

- Know new product development, innovation, impact of technology, and high-tech marketing with reference to business markets.
- Learn about product and service quality.
- Understand marketing of business services.

### NEW PRODUCT DEVELOPMENT

One of the challenging tasks faced by a business firm is the development and marketing of new industrial products. Though new product development is complex and difficult, it is a necessary task for a profitable growth of a firm. It tests a firm's market knowledge, technical competence, financial strength, and ability to compete. Unless products that have entered the decline stage (of product life-cycle) are replaced by new products a firm cannot expect to maintain its profitability and growth.

#### Classification of New Products

A product that is new to the company and to the market is called a new product. New products are classified as: (i) Products that are innovative and *new to the world*; (ii) Products that are new to the company, but not new to the market; (iii) Revisions or improvements to the existing products in the existing markets; (iv) Additions to the existing product lines with additional markets; (v) Repositioning existing products to new market segments; (vi) Products with substantial cost reductions without reduction in performance.

Research shows that about 10 per cent of all new products are truly innovative and new to the world (i.e. serial number (i) of above-mentioned classification of new products). These new products have the greatest risk and cost, because they are new to both the market and the company. Most companies follow a mix of above-mentioned classification of new products, with focus on improving existing products. There are a few companies, such as 3M, Oracle, and Microsoft, who recognise that in a rapidly changing economy, continuous innovation is necessary. These companies build innovation into their businesses and have routinised the innovation process. That has helped them to be leaders in their respective industries<sup>1</sup>.

#### ***Examples on Classification of New Products and Services***

Let us examine a few **examples** on how organisations have developed new products and services in business marketing arena.

- Indian software service vendors have added new service lines, such as testing, package implementation, technology infrastructure support, and business process outsourcing (BPO). These new services, which could be classified as services new to the company but not new to the market, have definitely helped to boost the sales revenues and profits of these organisations.
- Polaris Software Lab launched its new banking software product, called “Intellect Court”, to target large banking organisations worldwide. This new product was a fine-tuned version (i.e. improvement) of the company’s earlier product, called “OrbiOne”. Arun Jain, Chairman, Polaris, said that they were aiming to position Intellect Court in the top league of international products.
- ICICI Infotech launched a new product, “Orion Advantage”, in the ERP (enterprise resource planning) market for small and medium enterprises (SMEs). This product was appropriate for SMEs with its price of ₹ 9.9 lakh (i.e. about ₹ 1 million, compared to ₹ 2.5 to ₹ 3.5 million ERP offers of competitors), and short implementation cycle, instead of long implementation cycle of about one year of other ERP offers. The company estimated 6,30,000 potential buying firms in this market. This product could be classified as addition to the existing product lines with additional SME market segment.
- Specialised software solutions provider Manthan Systems had developed two products for retail and consumer product goods (CPG) business customers. These new products—(1) Advanced Strategic Analysis (AstraA), and (2) Analytical Reporting Capability (ARC)—were a part of Enterprise Performance Management (EPM) solution to provide planning managers a mechanism to link strategy with operations, and also to monitor and measure the effectiveness of the strategy. Atul Jalan, CEO, Manthan Systems, said the global market size for these products and services was \$35 billion, and that they were targeting retail and CPG companies in North America, Europe, Australia, New Zealand, and China.

### Factors Responsible for Success and Failure of New Industrial Products

Many studies have been conducted to determine the success or failure rate of new products. We define success or failure of a new product based on whether the product achieves the management’s performance objectives. Studies have found that 30 to 55 per cent of new industrial products fail, while the failure rate for consumer products is about 75 per cent.

Let us first look at the **factors responsible for failure** of new products.

- New products do not satisfy the needs of many potential customers. The failure results from an inadequate coordination between R&D (or product development group) and marketing (or marketing research) functions. **For example**, IBM overtook Univac in the computer market in the 1950s because Univac’s marketing research department informed the company that there was no scope for application market, whereas IBM went after business markets. The main reason for failure of Univac was its lack of understanding the needs of business customers.
- New products are not significantly different from the existing products. They are similar and perhaps imitations of the existing products. **For example** in 2009, an international drug ‘Axura’ (for Alzheimer’s disease) was launched in India. Axura was priced at ₹ 79 per tablet as against similar drugs from competing firms at a price range of ₹ 18 to ₹ 34. After six months of rigorous and continuous promotion, doctors’ acceptance of Axura was not adequate, and hence Axura was withdrawn from the market.
- New products do not deliver the expected performance. The companies understand the market (or customer) expectations, but fail to meet those expectations due to poor product design.

**For instance**, poor product design was the main reason for failure of a unique looking table fan, with a brand name 'Swishflow'. This table fan was expected to give air to more persons through an oscillation mechanism, which failed to work due to wrong design.

- The companies with weak new product development process are beaten by competitors who copy their products but have superior product quality and marketing effectiveness.
- Prices of the new products are much higher than the value perceived by the customers. This might be because the companies want to recover the cost of design, product development, and market introduction too quickly.
- In one study, 56 per cent of CEOs surveyed stated that inadequate marketing research was associated with higher rate of new product failures. **For instance**, in one company making products used for building construction industry, marketing research was not done during the concept testing, resulting in wrong selection of equipment which could not produce products required by 80 per cent of customers.

The important **success factors for new products** were studied by Cooper and Kleinschmidt and summarised as follows:

- Product superiority and uniqueness is the most important success factor. It means superior quality and new product features that give the product substantial competitive advantage in the market place. **For example**, when Crompton Greaves Ltd. (CGL) introduced a new electrical equipment, called Moulded Case Circuit Breaker (MCCB) in Indian market in technical collaboration with Hitachi company, Japan, it was a great success in the Indian market because it had a superior product feature, viz. higher breaking capacity, than its competitor's MCCB.
- Market knowledge (or marketing effectiveness) is considered important because the company understands the needs and wants of target markets, defines the same at the product concept stage of new product development process, and translates this knowledge into marketing strategies and action plans. **For instance**, before signing an agreement with a German firm for manufacturing a patented product, called Biplus Tubes, in India, the Indian company, Steel Tubes of India Ltd. (STI), carried out a market survey to get information on the needs of target markets, viz. refrigerator and automobile manufacturers. The detailed technical and application information was subsequently used in the process of new product development, including development of marketing strategies, such as target market segments, positioning, and pricing.
- Technical and production capabilities are important because they are required to translate the product concept into product development and commercial production. Cross-functional teamwork is needed to achieve synergy between technical and commercial functions. **For example**, when Crompton Greaves Ltd. (CGL) decided to go for backward integration with the product 'steel stampings' because of uncertain deliveries and frequent price increases by its sole supplier, Guest Keen Williams (GKW), it had complete confidence in its R&D and production teams. Steel stampings being an important component in the manufacture of the company's major products, like electric motors and transformers, the technical capability helped the company to develop and produce a good quality of steel stampings.

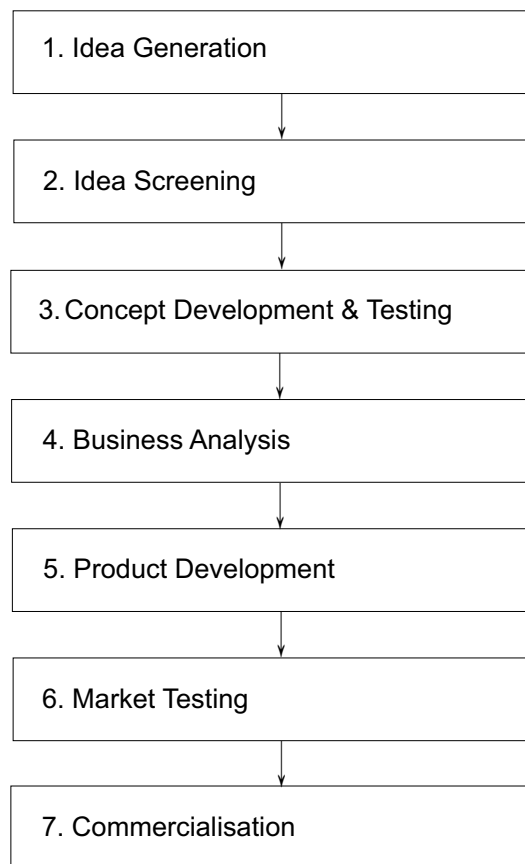
Successful new product development requires an effective process of new product development.



### The New Product Development Process

The process by which potential product ideas are generated, evaluated, directed, and turned into products is called the **new-product development process**. We shall consider seven stages in the new-product development process, although it can be described in a variety of other ways with more or less number of stages. The seven stages of new-product development process are: **(i)** Idea generation, **(ii)** Idea screening, **(iii)** Concept development and testing, **(iv)** Business analysis, **(v)** Product development, **(vi)** Market testing, and **(vii)** Commercialisation. These are shown in Fig. 8.1.

An addition of “**new product strategy**” step to the new product development process has improved the performance of new product ideas. It has set new product performance goals, such as a certain percentage of company sales and profits from new products, maintaining technological leadership, and defending a market share position. In a study, Cooper and Kleinschmidt found that successful firms focused new product development efforts on clearly defined areas of activities such as specific products, markets, and technology domains<sup>2</sup>.



**Figure 8.1** Seven Stages of New Product Development Process

**Idea Generation** The sales persons, customers, distributors, suppliers, design engineers, managers often conceive of new product ideas. Business customers are a very important source of these ideas.

Some of the characteristics of business marketing are the buyer-seller relationship and interdependence. The buyer has a specific problem which needs to be solved by the supplier. **For example**, a company which wanted to increase the production of transformer coil to meet the increasing demand, asked one of its suppliers to develop coil winding machines to solve its problem. Apart from solving customer problems, the new product idea should be in line with the company's strategic plan.

A business organisation can attract good ideas by using techniques such as brainstorming and attribute listing. In *attribute listing* technique, major attributes of an existing product are listed. Ideas are invited by conducting a brainstorming session from a group of employees to search for an improved product by modifying each attribute. Further, a business firm should motivate employees to submit innovative and novel ideas in writing by offering recognition and/or rewards to the employees submitting the best ideas.

**Idea Screening** The primary purpose of screening new product ideas is to select those ideas which are likely to succeed. There should be carefully specified criteria and procedures for screening new product ideas.

In some of the companies, the screening of ideas is done in two stages. In the first stage, the new-product committee asks certain questions or apply certain checks to the new product ideas, as suggested below.

- Is the new product idea in-line with the company's long-term objectives and strategies?
- Do we have adequate resources (like money, people, skills) to make it successful?
- Is it really useful to customers by providing certain benefits, or solving a specific problem?
- Does it deliver more value to customers than competing products?
- What is future growth, market size, and competition in the new product industry?

The new idea with positive answers to above questions will be screened further in the second stage by using a rating formula as shown in Table 8.1.

In Table 8.1, the first column indicates the significant factors considered for the success of new product ideas. In column (A) the relative importance of these factors are indicated by giving weights out of the total weights of 1. The relative importance may vary from company to company depending upon the products or services and the management thinking. In column (B) the management rates how well the new-product idea is in-line with the company's profile on each factor on a scale of 0 to 100. In the last column the scores in columns A and B are multiplied to get a total score for a new-product idea. In the **example** taken in Table 8.1 the total score is 62, which is below the minimum acceptance score of 70. This means that the specific new-product idea has failed to pass the rating formula.

Care must be taken to ensure that the persons involved in the new-product committee do not stop thinking and should not apply the rating formula mechanically. There could be some unusual ideas that need to be discussed from various angles before rejecting the idea.

**Table 8.1** New Product Idea Rating Formula

<i>New-Product Idea Significant Factors</i>	<i>(A) Importance (Weights)</i>	<i>(B) Company Capabilities for the Product Idea</i>	<i>(A × B) New-Product Idea Rating</i>
1. Company objectives and strategies	0.20	70	14
2. Marketing experience and effectiveness	0.20	50	10

*Contd.*

3. Production capabilities and facilities	0.15	40	6
4. Research and development know-how	0.15	60	9
5. Availability of raw materials and supplies	0.10	70	7
6. Financial resources and profitability	0.20	80	16
	1.00		62

**Rating scale:** Less than 40 = poor, 40–70 = fair, above 70 = good, minimum acceptance = 70.

**Concept Development and Testing** After a new-product idea passes the idea screening stage, the idea should be developed into a product concept. A **product concept** is a detailed version of the product idea that is stated in a meaningful customers' terms. Often, the firm develops the new-product into different versions or alternative product concepts. Then each product concept is tested by getting reactions from the customers. The concept that has the strongest appeal from the customers is chosen.

Let us consider an **example** of a company which wants to develop a pallet truck for carrying materials in factory shopfloors and warehouses. The company creates the following product concepts for the pallet trucks.

- Concept 1—A manual pallet truck, compact and light-weight, can carry materials weighing up to 20 kg, and low cost.
- Concept 2—An electric pallet truck, can carry materials weighing up to 30 kg, medium duty and medium cost, at two speeds.
- Concept 3—An electric pallet truck, can carry materials weighing up to 50 kg, heavy duty and high cost, at three speeds.

**Concept Testing** In concept testing, the new-product concepts are tested in prospective customer organisations. The concepts can be presented by developing three-dimensional models (called *stereolithography*) or physical products. The physical presentation of the product can increase the reliability of the concept testing. Stereolithography technique creates computer-generated three-dimensional plastic prototypes which take very short time (2–3 weeks) to get ready. However, this technique is used for small-size products. For large-size products, concept testing can be done by using a technique called *virtual reality*. In this technique, a software package is used to design the product on a computer. Prospective customers can operate the simulated product in a simulated situation.

After completing the experience of using the physical products, plastic models, or simulated products, the users and the key decision-makers in prospective organisations are interviewed and asked questions as suggested below, for the **example** mentioned above:

- Do you understand the concept of a pallet truck?
- What are the major benefits of manual and electric pallet trucks?
- Which of the three product concepts you liked most? Why?
- Are the pallet trucks similar or different to the products currently used by you?
- What improvements do you suggest in the pallet truck's features?
- For what uses would you prefer the manual and the electric pallet trucks?
- What would be the reasonable prices to charge for the pallet trucks?
- Would you buy the pallet truck?  
(▪ definitely buy, ▪ probably buy, ▪ not sure ▪ probably not buy, ▪ definitely not buy)

The answers to the questions will help the company decide which product concept has the strongest appeal from the prospective customers. It will help the company's management to generate a lot of information for taking decisions.

**Business Analysis** The purpose of business analysis is to develop an estimated projection of the sales, costs, and profitability of the proposed new product over 5–7 years. It is a detailed analysis in terms of (a) required investment in plant, equipment, working capital, and market development; (b) market potential, sales forecast, customer and competitive analysis; (c) costs of product development, manufacturing and marketing the product; (d) likely price levels, profitability and return on investment, and so on.

It is not a right decision to assign the task of business analysis to those persons who have either proposed the new product idea or who are advocating its acceptance, because of their excessive optimism or having vested interest. Either management consultants or the corporate planning staff, who have experience and skills in strategic planning, marketing, finance, engineering and production, could be given the task of business analysis. If the projected sales and profits satisfy the company's long-term objectives or goals, then the new product concept moves to the next stage of product development. It should be noted that the projections made in business analysis may be revised if new information comes in.

**Product Development** Product development is a process in which engineers and technicians create the desired product. The R&D department develops one or more prototypes of the product concept. The development of a prototype will confirm or negate its ability to produce the product within the cost estimates and the performance parameters previously established. The marketing department must inform the R&D department about the needs of the customers in terms of product performance and the cost estimates, based on the customers' reactions on the concept testing carried out earlier. The R&D department's challenge is to achieve both the performance and the cost objectives.

In today's fiercely competitive market, developing a new product or a new technology is not enough. How fast the new product is developed and launched in the market is very critical. Conventional development engineering cycle consists of:

Design → Process Engineering → Tooling → Manufacturing → Testing → Final product  
(if there is no failure during testing).

The possibility of reducing this cycle to half and for speeding up the development, a concept of *concurrent engineering* is practised. It uses hi-tech computer hardware and software tools, in conjunction with high speed satellite communication to design, test, process engineer, manufacture toolings, and so forth, simultaneously instead of in a long sequence. All this is done to ensure that new products are developed and launched in the market before the competitors'.

**Market Testing** In business marketing, market testing is done by using different methods. These are: (a) alpha and beta testing, (b) introduction of the new product at trade shows, (c) testing in distributor/dealer showrooms, and (d) test marketing. The choice of the method of testing depends on (i) the size and cost of the product, (ii) need for maintaining confidentiality during market testing, and (iii) the readiness to launch the product in a short span of time.

### ***Alfa and Beta Testing***

Alfa testing consists of testing the products which are high priced or having new technologies, internally in the company. The product testing is done to evaluate the performance parameters and operating costs. If the results of an in-company testing are satisfactory, the company will go for the second stage of *beta testing* at the potential users' sites. The sales/marketing people should identify the user firms who would permit confidential testing of the new product at their factories. The marketing and technical people should observe how the user firms use the product, if any problems are faced while using the new product, and interact with the user firm's technical and other members. If the number of users of the new product are small, product testing at relatively few users' sites may suffice. However, in case of large number of business users, the results of product testing at few users' site may be difficult to generalise.

**Trade Shows** Another method commonly used is to introduce the new product at trade shows, where large number of prospective buyers are exposed to the new product. The company can find out potential customers' reactions, purchase intentions, or placement of orders. The disadvantage is that the new product gets exposed to the competitors. The company should be ready to launch the new product within a short duration of time after the trade show.

**Dealer Show-Rooms** If the new industrial product is sold through the distribution channel, it can be tested at distributors' or dealers' show-rooms or display rooms. This method uses the normal selling situations and hence, can give useful information on customers' attitudes, preferences, and actual sales. However, the company should be ready to execute the orders within a reasonable time.

**Test Marketing** The test marketing method is used by some business marketers to test the product in a limited geographical area through their sales force, in normal marketing situations. Product catalogues, price-list, and sales training are given to the sales people. The market information received from test marketing help the company management to take effective decisions when the product is launched on full-scale basis. However, the company should produce a limited quantity of the new product that could be sold by the sales force.

If market testing of the new product gives adequate and positive information to decide on launching the new product, the company management decides to go ahead with commercialisation.

**Commercialisation** A product is commercialised or launched when it is introduced to a target market. It involves implementation of the various activities developed in an action plan as a part of the marketing plan. The activities include recruiting or hiring, training of sales force, product catalogues, price lists, introductory advertisements, adequate stocks at the company warehouses and/or with dealers/distributors, customer service, and so on. In order to ensure proper coordination and timely completion of many activities involved in launching a new product, business marketers can use *critical path method* (CPM) network technique. The marketing activities have to be synchronised with production to ensure market-entry timing.

The strategy for launching a new product depends on two factors: (1) the degree of novelty of the new product to the market, and (2) the extent of service support required by customers for the new product. If a product represents a new technology, potential customers must be educated about the new product and shown how it will satisfy their needs. On the contrary, If the product is new to the company but not new to the market, like aluminium extruded products manufactured by Sangam Aluminium Company, customer education is not required. Service needs of the new product determine the extent of training to be given to support personnel. **For example**, IBM cannot launch a line of servers until there

are enough trained technicians to support the new product. Hence, some technology-based as well as smaller companies launch the new product sequentially, often on a geographical basis. **For instance**, Sangam Aluminium Company launched its new aluminium extruded products in south Indian states of Karnataka, Tamil Nadu, Andhra Pradesh, and Kerala initially for ten months and thereafter, rolling to western regional states of Maharashtra and Gujarat.

The new product marketing plan should clearly define **(a)** the timing of market launch, **(b)** marketing objectives and goals, **(c)** geographical strategy (whether to launch the new product in local, regional, national, or international markets), **(d)** the target market segments, and positioning strategy, and **(e)** the marketing mix strategies. An effective feedback system from the market is needed to take timely corrective actions.

### Product Lifecycle Management for New Product Development

In many industries, suppliers contribute more than 70 per cent of the final product design, and in some cases the manufacturer is just a systems integrator. This has resulted in a new category of software solutions, known as Product Lifecycle Management (PLM)<sup>3</sup>. It is about managing a product all the way across its lifecycle. PLM describes a comprehensive framework of technology and services that permits manufacturing firms, their suppliers, and customers to collaboratively conceptualise, design, build, and manage products throughout their entire lifecycle. Modern product development system should have the following:

- The ability to create digital products.
- Cross-functional collaboration within the firm and throughout the value chain of the product.
- Controlling and managing product information and product development processes throughout the product's lifecycle.
- Deploying, collecting, retrieving, and updating digital data to all the people involved in the product development process.

The change from product development management (PDM) to product lifecycle management (PLM) has begun. A recent survey of 200 companies by Boston-based AMR research showed that 90 per cent firms had PDM systems in place and many were moving towards PLM. Software vendors are responding with a variety of PLM systems aimed at delivering fast and quantifiable results. The benefits of using an enterprise PLM solution are as follows:

- Reduction in product development time by 40 per cent.
- Minimisation of process errors by 50 per cent.
- Reduction in product development travel expenses by 65 per cent.
- Minimisation of time to market by 40 per cent.

PLM software can be integrated with ERP and supply-chain management systems. Industries that have been using product lifecycle management (PLM) software and services for new product development are pharmaceutical, retail, consumer products, and medical devices.

**Innovation in Design** By adopting PLM, companies can improve product design innovation, product development, and engineering processes. Manufacturing companies can visualise not only how a new product idea will look, but also how it will work in the real world. Firms can do this with an advanced 3D (three dimensions) design technology, such as digital prototyping. Digital prototyping allows companies to visualise, simulate, and analyse the real-world performance of new product ideas and concepts<sup>4</sup>.

Design innovation is the way for business organisations to stay ahead of competition, and digital prototyping is the most important point of design innovation. Most of the companies in the past (and some companies even today), created physical prototypes and tested them in the market (this is what we described earlier in the new product development process!). This not only consumed too much time, but also used large resources. For any modifications or corrections to the prototype, the whole process had to be repeated. Today, 3D tools have made innovation in design a reality. Now, new products can be visualised, tested, redesigned repeatedly, and improved even before products are actually created. This saves both time and resources. It is necessary that manufacturing firms take advantage of PLM software and services and design their own success.

## INNOVATION, COMPETITIVENESS, AND TECHNOLOGY

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Innovation implies not only “creating new products”, but also introducing new methods to improve any operations. The concept also includes using new methods to improve manufacturing. **For instance**, some manufacturers use computer software programs to reduce assembly time and number of parts at design stage, resulting in substantial reduction in manufacturing costs. In the new economy, companies can improve operations with substantial cost savings by using the internet, which provides a more accurate, cheaper and faster way to send and receive information, orders, and payments between companies, their business partners, and their customers. Companies can establish websites, which can be used as distribution channels as well as information channels. **Innovation** is, therefore, broadly **defined** as “any product, process, method, service, or idea that is perceived as new by someone”. Innovation must have commercial use. It is the creation of something new, or improvement of something to make it more useful.

### Innovation and Competitiveness

Direct relationship exists between innovation and competitiveness. A company can increase or maintain a degree of differentiation from competitors through continuous innovation. Here, the company should not only consider innovation as creating new products, but also improving manufacturing process, making distribution channel structure more effective, or improving customer service.

Citibank, **for instance**, offers a large number of financial products to customers, some of which could even be copied by other banks. However, since Citibank invests in continuous innovation, it still stays ahead of its competitors. 3M also has a similar strategy of continuous innovation that gives the company a competitive advantage.

Many organisations rarely innovate, while some firms innovate in an occasional manner. A few companies innovate continuously. There are companies like Citibank, 3M, Sony, and Microsoft, who innovate continuously, and have even developed a regular process of innovation. They have understood that in a rapidly changing marketing environment, continuous innovation helps them not only to gain a leadership position in their respective industries, but also competitiveness. Before we discuss the impact of technology, let us understand the word “technology”. Technology has been defined as “practical knowledge, skills, and know-how that can be used to develop a new product or service, and/or a new production or delivery system. Technology can be included in people, materials, processes, plant, equipment, and tools.”<sup>5</sup>

## Impact of Technology

**Technological innovations** (i.e. inventions in commercial use) create new products and services that are new to both the company and the market. Less than 10 per cent of all new products come under this category. These innovations are also called '**breakthrough technology**' or **innovations**. For example, the technological inventions in 1940s of vacuum tube and amplifier circuit created new products and services like radio, wireless telegraphy, and long-distance telephone service. Subsequently, between 1948 and 1973, there was a dramatic change in electronics (or microelectronic) industry due to some more technological inventions such as transistor, integrated circuit (IC), and microprocessors (or semiconductors). These technological inventions in microelectronics have applications in a variety of products, like TV sets, movie cameras, computers, computer aided design (CAD), heart pacemakers, watches, calculators, mobile phones, printers, and so on.

## Digital Revolution

The new economy is based on digital revolution in terms of adoption of information technology (IT), and the internet. It has placed a new set of capabilities with companies as well as consumers.<sup>6</sup>

### *Company Capabilities*

This includes the company's capability in (a) promoting their business through websites to customers and prospects from anywhere in the world; (b) collecting more information about markets, customers, prospects and competitors by using the Internet; (c) facilitating internal communication among the company employees by using the internet as a private intranet; (d) improving operations (e.g. purchasing, recruiting, and training) with substantial cost savings by using the internet to send and receive information, orders, and payments between companies, their business partners, and their customers.

### *Consumer Capabilities*

The consumer capabilities have improved due to adoption of information technology and internet. Today, an individual consumer can order almost anything over the internet from anywhere in the world. The consumer can compare the prices and products of various suppliers on the internet. The consumer can access online medical information, movie ratings, and several other information.

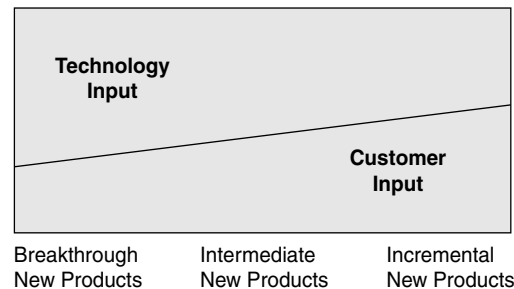
The new set of capabilities of consumers and companies due to digital revolution will lead to more accurate volumes of production, communication, inventory levels, and marketing. It will change the way business is done and will transform every organisation.

## Breakthrough and Incremental Innovations

Breakthrough innovations, also called **radical innovations**, are "big" innovations that require intensive technology and/or applications development. Breakthrough invention uses a new technology and creates a new market. Breakthrough products are less than 10 per cent of all new products, and some of the **examples** of breakthrough products are Penicillin, birth control pills, transistors and microprocessors.

For simplicity, we divide all the innovations into 'breakthrough' and 'incremental' innovations. The innovations as applicable to new products are shown in Fig. 8.2. However, we must understand that many intermediate positions are also possible.





**Figure 8.2** *Classifications of Innovations/New Products*

**Incremental innovations** are improvements to the existing products, methods, or designs. Customers have a major role in incremental innovations, as they give information on specific improvements needed in the existing product, based on the product usage. Hence, the customer input is a major moving force for improvement in design or product features. **For instance**, in a leading electrical engineering company, sales and marketing persons informed senior executives, design and production engineers that business customers, who have used their product “direct-online starter” for starting an electric motor, have found it too bulky and costly. The major competitors’—Siemens and L&T—products were sleek and less costly. Based on the inputs received from customers, the technical inputs were added to improve the design and to reduce the costs, by using the value engineering technique.

In case of breakthrough products, which require a higher degree of technical inputs, it may be possible that a small number of customers (who may be called “opinion-leaders”) may understand the technical vision of the company. A large number of customers may not understand the breakthrough product’s concept, usage pattern, and the market development aspects. As shown in Fig. 8.2, customer inputs are required for breakthrough products also, although the degree of technical inputs (like research and development, industrial engineering, and manufacturing) may be higher than customer inputs.

**Disruptive Technology** The disruptive technology or innovation is created by a new company by introducing a new product which is based on a technology that is substantially different from the dominant technology in use in a market. The dominant technology is developed by an established company through breakthrough or incremental innovation. Disruptive innovation in a product or service should be followed by a small business unit or a separate project, from the existing company with its established customers. The small or new business unit pursues an uncertain opportunity, called disruptive innovation, by finding new customers who want the new product.

By contrast, **sustaining innovation** is the innovation that supports the existing dominant technology and the resulting new products. A company must follow sustaining innovations, which are improvements to existing technology.

### Managing Innovation

A company’s value creating potential cannot only come from technological innovations, but also from production innovations, marketing innovations and management innovations. **For example**, Honda’s technological innovations in small engines created the basis for a core competency that was difficult to be copied and Pilkington’s innovation in production process created a superior quality of sheet glass. The important question is how should a business marketing organisation manage and encourage innovation. To answer this question, a company should take three major steps, as follows:

**Adopt Decentralised Structure** Companies should adopt decentralised organisational structures with less hierarchical and formal control. This would make the organisation more adaptable and flexible so that creative individuals can work as a team. However, a balance should be ensured by combining flexibility with a few controls. These controls include setting priorities for new projects or products, determining time schedules for key milestones, and assigning responsibilities for results. **For example**, GE has changed its rigid and top-heavy organisation structure to allow its regional units to respond to local opportunities faster.

**Develop Collaborative Teams** Innovation is always a team game. Companies need to create an environment where creative individuals can work together across functions and divisions within an organisation as well as externally with other organisations. **For example**, Sun Microsystems launched “iForce” to provide business customers with a single entity to go for e-business or other network systems, by developing a collaborative team, including software developers, value-added resellers, systems integrators and peripheral equipment vendors. Much of the revenues and margins produced on sales generated by iForce go to the partners. Sun Microsystems makes money on sales of equipment, operating systems software and consulting. **Another example** can be given of Cisco Systems, which involves many small companies that are working on new technologies. The small companies that create breakthroughs will be acquired and the companies that are less successful may be directed in other areas or cut loose. This means, Cisco is outsourcing its R&D. Similarly some other companies like TCS, HCL and IBM regularly conduct brainstorming sessions with their employees and partners in order to develop collaborative teams.

**Get Right People** Two common traits or characteristics that should be used while recruiting for the company’s R&D team or project teams are people who are creative and team players. However, special characteristics of people are required for different types of innovations. **For instance**, for disruptive or radical innovations, the company should look for people who have patience to work in situations with a lot of uncertainties, and for incremental innovations, a person should have a short-term approach. The focus of these people should be benefits or value to target customer groups. These creative people should also be given technological and socio-economic challenges by the company’s CEO. **For example**, Ratan Tata, Chairman of Tata Motors, came up with an idea of ₹ 1 lakh (less than US \$2000) car.

## HIGH-TECH MARKETING

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There are many articles on high technology (hi-tech) marketing that explain the point that hi-tech marketing is different from other product or service marketing. Hi-tech includes a wide range of industries such as telecommunications, computers, software, biotech, and consumer electronics.

In this section, we shall focus on the following three key aspects of high-tech marketing:

- Differentiating characteristics of high-tech marketing
- Impact of technology adoption life cycle
- Unique nature of high-tech marketing strategy

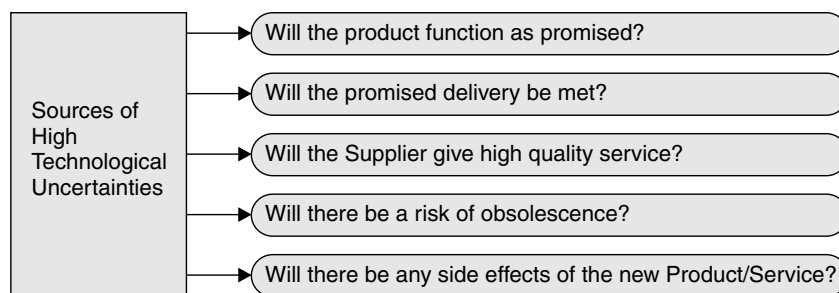
### Differentiating Characteristics of High-tech Marketing

It is understood that technology includes product technology, process technology, and management technology (i.e. knowledge of how to manage the business and market the product). The two major

characteristics that distinguish hi-tech marketing are high technological uncertainty and high market uncertainty.

**High Technological Uncertainties** The high technological uncertainties are due to the following problematic sources, shown in Fig. 8.3, and described below:

- Will the product or service function as promised by the seller? **For example**, when computer time-sharing system was introduced for the first time, both buyers and sellers faced the uncertainty when trying to establish the response time.
- Will the promised delivery time be met? **For instance**, many computer hardware and software marketers find it difficult to adhere to the promised delivery dates for new products or services.
- Will the supplier give high quality service? Mature technologies like automobiles and generators have several years of experience with after-sales-service problems and solutions that reduce uncertainty about resolving breakdown problems. But new technologies have no track record, and hence there is uncertainty about repairing the breakdown.



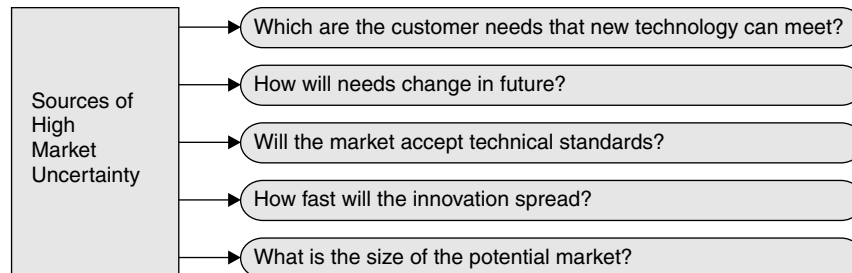
**Figure 8.3** Sources of High Technological Uncertainty

- Will there be a risk of obsolescence? Uncertainty can occur because of technological obsolescence. **For instance**, when compact disc (CD) audio system was introduced, and the sales of CD players was going up, digital tape players promised the same quality of sound at a much lower cost. Hence, there was uncertainty in the market, whether digital tape technology would make compact disc technology obsolete.
- Will there be any side effects of the product or service that is based on the new technology? **For example**, the emerging electronic payment technology for electronic payment system has major risks or side effects of fraud, mistakes, and violations of privacy. These problems can be resolved through an improved technology and more experience.

### High Market Uncertainty

The sources of high market uncertainty are shown in Fig. 8.4.

- Which are the customer needs that the new technology can meet? **For instance**, it is difficult to say how customers' needs of risk-free (i.e. privacy and fraud issues of) electronic payment system can be met at present.

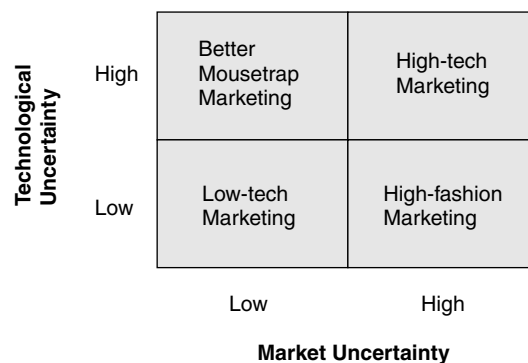


**Figure 8.4** Sources of High Market Uncertainty

- How will the needs, once known, change in future? As the environment changes, customers needs may change in an unpredictable manner.
- Will the market accept technical standards? **For example**, the uncertainty that had prevailed in the market regarding the acceptability of WAP standards for wireless phones in the early years of wireless phones is also a type of market uncertainty.
- How fast will the hi-tech innovation spread? This is difficult to predict. Market researches find it very difficult to estimate the sales of hi-tech innovations such as videocassette records (VCRs), new micro-chip, and office automation systems.

Lastly, considering the above-mentioned questions, marketers will find it extremely difficult to forecast the size of the potential market for a hi-tech innovation. **For example**, when xerographic technology was invented, a consulting firm estimated the total market size for the model Xerox 914 as only 5000 numbers. Later on, Xerox corporation had sold 2,00,000 numbers of model 914 and went on to become a billion-dollar company.

The marketing situations could be classified into four types on the basis of the degree of technological and market uncertainties, as shown in Fig. 8.5. The first situation is “low-tech marketing”, which includes known technology applications to meet clear and well-known market (customer) needs, such as a generating set and a pump set. The second situation is “hi-fashion marketing”, which consists of known and slow changing technology applications to meet difficult to predict consumer needs or wants, like motion pictures and fashion (designer) clothes. The third situation is “hi-tech marketing”, where both technology application and customer (market) needs are difficult to predict, such as biotechnology



**Figure 8.5** Classification of Marketing Situations based on Technological and Market Uncertainty<sup>7</sup>

products (e.g. genetically engineered seeds, and faster computers). The fourth situation is called “better mousetrap marketing”, which includes a new technology to meet well-established customer needs, such as a new technology to have pure drinking water.

**Other Differentiating Characteristics of High-tech Marketing** Apart from the two major characteristics of hi-tech marketing, there are some other common characteristics, which are as follows.

### ***High Competitive Volatility***

Will the major competitors come from within the industry or from outside? Will the marketing tactics or policies used by competitors be same or different? These are some of the uncertainties in relation to competitors.

### ***Short life of High-tech Products***

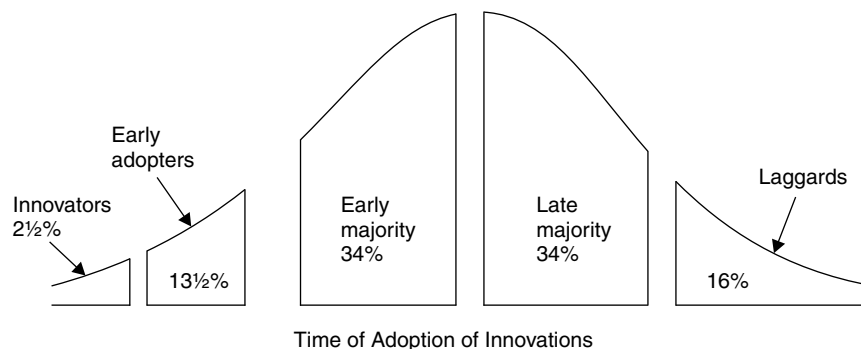
Most of the hi-tech products have relatively short life. The original product needs to be improved or upgraded before competitors do.

### ***High Development Cost***

Many hi-tech products have high investment or initial development cost, but low variable costs on additional units. **For example**, the cost of developing a new software is high, but the cost of distributing it in CD-ROM is relatively low.

## **IMPACT OF TECHNOLOGY ADOPTION LIFE CYCLE**

Everett Rogers proposed in 1983 that individuals differ in adopting new ideas, technologies, or products. He propounded a model, called “diffusion of innovations”, or “adoption of innovations”, to understand the acceptance of new products. This model is slightly modified, as shown in Fig. 8.6. The modified technology adoption life cycle, is suited to high-tech marketing.



**Figure 8.6** *The Modified Technology Adoption Life Cycle<sup>8</sup>*

The model in Fig. 8.6 shows a bell curve with five new technology adopter groups. It describes the market penetration of any new high-tech product through its useful life. Each adopter group has a different psychographic and demographic profile, which results in different marketing responses as

compared to other groups. It is important to understand and research psychographic characteristics (i.e., inner core values) of these groups.

**Innovators** These are the first people to adopt any new technology. They take risks (**i.e., venture-some**) and follow new technology products forcefully. They have high interest in technology and they purchase new technology products for the pleasure of exploring the properties of the new product. These **technology enthusiasts** (or just “techies”) are the ones who buy digital cameras, DVD players, interactive multimedia systems when they each cost high. These innovators are small in numbers (about 2.5 per cent of total population), but winning them over reassures the other people in the market that the new product with new technology does work.

**Early Adopters** Like innovators, they buy new high-tech products very early, but they are not technologists. They are **visionaries**, who are driven by a dream that is linked to their business. They want to buy new high-tech products in order to achieve business objectives and to remain ahead of competitors. They are outgoing and ambitious, and are highly visible references to other prospects. They are “opinion leaders”, or “change agents” in their communities. They give first big break to high-tech companies, but they are highly demanding customers.

**Early Majority** These are **pragmatists**, who evaluate the new products based on practical considerations. They want to see the references of other people, who have already purchased the new product, before buying themselves. They represent about one-third of the whole adoption life cycle, and hence winning them is very important in achieving the sales and profit goals. However, pragmatists are difficult to win over, as they buy a good product from a proven market leader. They are loyal once won. Their focus is productivity improvement and standardisation. They are price-sensitive.

**Late Majority** These people are **skeptical** and are called “**conservative**”. They often fear high-tech and hence, adopt new ideas at the end of a technology life cycle. They do not support high price margins. Conservatives want high quality, low price, and are reluctant purchasers of technology products.

**Laggards** These persons are **tradition-bound and suspicious** of change. They do not want new technology products for economic and personal reasons. The only time they buy a technology product is when the new technology product is buried inside another product, they don’t even know it is there. **For example**, a microprocessor is designed into the braking system of a new car. Laggards are considered as not worth persuading for accepting the new technology product.

**Crossing the deep gap** between “early adopters” and “early majority” in the modified technology adoption life cycle, shown in Fig. 8.6, is the most difficult and dangerous transition, which goes on without notice often. The deep gap is seen because selling to “early majority” group of prospective customers is radically different from selling to “early adopters” group. As mentioned earlier, the early adopter buys a new high-tech product as a change agent and does not mind initial defects in a new product. By contrast, the early majority wants to buy the new product for productivity improvement purpose and wants references to say that the new product is good, without any defects.

Because of the differences in their psychographic profiles, early adopters do not make good references for selling to the early majority. And good references are important to the buying decisions of early majority. Hence, we have a catch-22 situation here. This is the deep gap, into which many new ventures have fallen. In order to avoid the dangers of the “deep gap”, we need to develop and implement a unique high-tech marketing strategy.

## Unique Nature of High-tech Marketing Strategy

**1. Target a Niche Market** The high-tech company should select a niche market, and achieve a dominant leadership position, by concentrating its marketing efforts in it. This group of prospective customers should have compelling reasons to buy the new high-tech product and they should be completely satisfied after the purchase of the new product. The company can then create a base of “early majority” customers, who can be used as references for selling the new product to other early majority prospective customers. The new high-tech company should establish a strong word-of-mouth reputation among buyers. Consider, **for example**, marketing an electronic book. The target niche market was maintenance application in aerospace. In a situation of diagnosing and fixing a technical problem for Boeing 737, the e-book contains all documentation and revisions that help to improve maintenance technician’s productivity, avoids cost of printing and revisions of technical data, and minimises delays.

**2. Plan Whole Product Properties** As mentioned earlier in the beginning of seventh chapter, an industrial product is a combination of basic, enhanced, and augmented properties. Basic properties are included in the generic product, with fundamental benefits sought by innovators and early adopters. However, early majority, or pragmatists, prefer to buy the whole product, with enhanced properties like additional product features and good quality, as well as with augmented properties like effective technical and after sales-services, wherever required. While planning the relevant properties of the whole product, the new company should carry out a marketing research task to understand the main or compelling reasons of target customers for buying the new high-tech product and then incorporate those product properties to make a whole product.

**3. Develop Partnerships** The new high-tech company should develop relationships slowly with suppliers to make sure that the customers are completely satisfied with the codeveloped new product and services. It should be ensured that the suppliers or vendors get equal share of the benefits. Trust and commitment are important in developing partnering relationships with key suppliers of goods and services.

**4. Unique Positioning Strategy** In high-tech marketing, it is important to understand that initially while developing early markets by selling to innovators, the new company should position its product as having a strong technology advantage. This would be converted into product-oriented benefits required by early adopters (or visionaries) for achieving their business objectives. Thereafter, the positioning strategy should focus on the needs of early majority (or pragmatists), who want to buy from the market leader for achieving productivity improvements and standardisation. The company’s dominant position in the niche market ensures the market leadership position. The company should convert the market leadership of the niche market into company belief. The positioning, as we know, exists in the minds of prospective customers. As the target customers keep on changing from innovators (technology enthusiasts), to early adopters (visionaries, or change agents), to early majority (pragmatists), to late majority (conservatives), the high-tech company should keep on changing its positioning and communication strategies.

**5. Integrated Marketing Communication Strategy** If the new product is sold to business buyers, the effective media would be business newspapers and magazines, as well as technical journals. In high-tech marketing, word-of-mouth communication is the most effective tool to promote a new product, as the buying behaviour suggests extensive use of references. It is, therefore, important to develop relationships during and after new product launching.

**6. Multi-channel Distribution Strategy** There are many alternative channels, such as direct sales (manufacturer selling directly to customers), distributors, value-added resellers (VARs), the internet, and telemarketing. The right choice of distribution channel initially for high-tech marketers is direct sales force (or direct sales), because it creates control, gives maximum demand, and builds long-term relationship. Once the market segments are aware of the company's new product, intermediaries (i.e. dealers, or distributors) can be used to fulfil the demand. Value-added resellers (VARs) can be used as technical problem solvers, or for giving technical support service. The internet is the excellent channel for targeting technology enthusiasts (or innovators), and also to coordinate the whole product team members. This means, a high-tech company should use multi-channel distribution strategy, as the new product gets acceptance from innovators, to early adopters, to early majority, to late majority prospects.

**7. Skimming Pricing Strategy** As innovators and early adopters are not price-sensitive for a new high-tech product, the company can adopt initially a high-price strategy for the new product. This also would support the company's claim to market leadership. As the product gets established and competition increases over a period of time, for marketing to price-sensitive late majority group of potential customers, the price may have to be brought down.

The above-mentioned marketing strategy would assist companies in meeting challenges of the high-tech marketing. It emphasises understanding of the technology adoption life cycle and its modification, and its relationship to the development of effective marketing strategy.

## PRODUCT AND SERVICE QUALITY

Due to increasing customer expectations and greater global competition, product and service quality have strategic importance to business marketers. Many buying firms want their suppliers to meet the quality standards set out by International Standards Organisation (i.e. ISO—9000 standards), which was developed for European Community<sup>9</sup>, but has a global following. Some firms adopt **total quality management (TQM)**, developed by Japan, as an organisation wide approach to continuously improve the quality of all the firm's processes, products, and services. The United States established the Malcolm Baldrige National Quality Award, which has seven criteria: customer focus and satisfaction, quality and operational results, management of process quality, human resource development and management, strategic quality planning, information and analysis, and senior executive leadership. According to General Electric's (GE's) former chairman, John F. Welch, Jr., "Quality is our best assurance of customer alliance, our strongest defence against foreign competition, and the only path to sustained growth and earnings".<sup>10</sup> **For instance**, General Electric (GE) has a company-wide goal of achieving Six Sigma quality, which means a product would have a defect level of not more than 3.4 parts per million<sup>11</sup>. G.E. also assists its suppliers in using the Six Sigma approach. This has helped the company not only in huge cost savings, but also in improvements in product and service quality.

**PIMS** (Profit Impact of Marketing Strategy) data-base, consisting of a sample of 2124 industrial and consumer businesses, found that product quality had both direct and indirect influence on profitability.<sup>12</sup> The direct effect was seen as higher quality led to higher prices, with a positive influence on profitability. Product quality also had a positive impact on the company's market share. High market share means high sales volume, which leads to lower per unit product cost, and higher profitability.



**Meaning of Quality** Experts have defined quality in various ways: fitness for use, freedom from variation, conformance to requirements, and so on. One of the most accepted definitions, from American Society for Quality Control, is: “Quality is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.”<sup>13</sup> This definition is customer-focused. Quality movement has gone through three stages. In the first stage, the focus was on meeting specifications or standards. In stage two, the importance was given to total quality management and to measuring customer satisfaction. Stage three concentrates on customers’ perceptions of a company’s quality performance and value of products in relation to that of competitors. Value is defined in terms of customer choice in a competitive context.<sup>14</sup> According to Gale, value is simply quality offered at the right price.<sup>15</sup> In other words, value is equal to quality relative to price. Thomas Hogue of Intel Corporation has appropriately described the linkage between quality and value. He said that **total quality** includes product quality and level of service to the customer—delivery service, response to the customer questions, after-sales-service—all these things define the supplier’s worth (i.e. value) in the mind of the customer.<sup>16</sup>

**Measuring Service Quality** Product quality standards, such as conformance to design specifications, or number of defective parts produced, do not apply to service quality. Service providers face greater difficulty in evaluating quality of services when compared to product providers. This difficulty is due to intangible and customised nature of business services. A research by Parasuraman and others<sup>17</sup> indicates how customers measure (or evaluate) service quality. Table 8.2 shows that customers use five dimensions in measuring or evaluating service quality. These are: reliability (or dependability), responsiveness to customers, assurance (or confidence), empathy with customers, and tangibles.

**Table 8.2** Dimensions Used for Measuring Service Quality

<i>Service Dimension</i>	<i>Brief Description</i>	<i>Examples</i>
▪ Reliability	Satisfying a promise	Promised delivery schedule met
▪ Tangibles	Appearance of physical facilities and personnel	Brochures, experienced and qualified service providers
▪ Responsiveness	Willingness and ability to provide prompt service	Quick response to customers’ complaints
▪ Assurance	Trust and confidence	Capable staff
▪ Empathy	Treating customers as individuals	Adapting to the needs of individual customer

**Source:** Adapted from Parasuraman, Zeithaml, and Berry: Servqual: A Multiple-Item Scale for Measuring Customer Perceptions of Service Quality (Cambridge, MA: Marketing Science Institute, 1986), pp. 6–7.

If a marketing services firm wants to know the quality rating of its services, it should ask its customers to indicate the degree to which the customers agree or disagree (on a 5-point Likert scale) with a series of statements relating to each service dimension mentioned in Table 8.2. Thereafter, the customers are asked about their expectations in each area of the firm’s service operations, and also the customers’

actual perception of the firm's service quality in each of these areas. The outcome is a rating of overall quality on each service dimension and also a summary quality rating for the entire firm.

A company's service quality is determined by its employees who provide service to its customers. **For instance**, if a customer firm complains to a PC (Personal Computer) manufacturer about a problem on the recently serviced PCs, and the service provider employee promptly accepts the mistake and quickly solves the problem, the relationship with the customer firm would improve further.

**Marketers' roles** in defining and delivering their companies' high-quality goods and services to target customers are as follows:

- Identify the customer's needs or expectations correctly and completely.
- Communicate the customer needs internally within the organisation to all concerned departments and people.
- Give prompt and accurate information to customers about the company's products and services.
- Book orders for products and services that meet with the customer's needs.
- Give proper information, instructions and training to the customer in the use of the product and service.
- Follow-up with the customer after the product or service is delivered to ensure complete satisfaction of the customer.
- Convey customer suggestions for improvements to the concerned departments and people within the organisation.

## MARKETING OF BUSINESS SERVICES

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We have discussed earlier in this chapter about the strategies for physical products. However, one of the major trends has been the remarkable growth of services in both the consumer and the business markets. Marketing of business services has many unique characteristics that are different from the marketing of industrial products. We shall define these unique characteristics of business services after understanding their classifications.

### Classification of Business Services

The services in business markets can be classified into two groups: (i) products supported by services, and (ii) pure services.

**Products Supported by Services** Here, a wide range of service elements accompany the physical product. The **examples** of this category include maintenance and repairs of material handling equipment, sales and services of computers, supply and maintenance of diesel generating sets. The service component can be a major, an equal, or a minor part of the total offer from a company.

**Pure Services** These are marketed without any association with physical products. The **examples** are marketing research, courier, audit, legal, security, travel booking, and recruitment services. These services make up a substantial per cent of the purchases made by business organisations.

Figure 8.7 shows the range from a pure tangible product at one end to a pure intangible service at the other end. This helps to understand the classification of business services more clearly.

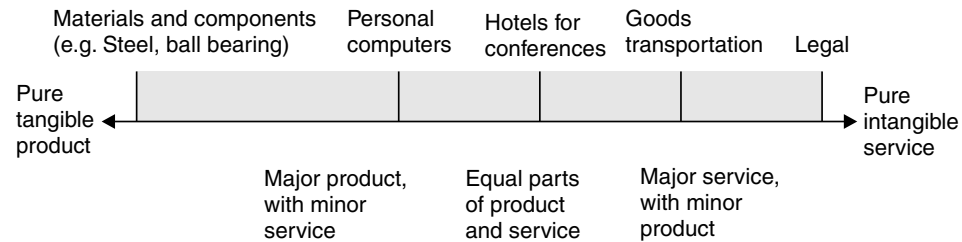


Figure 8.7 Industrial Product-Service Classification

### Unique Characteristics of Services and the Marketing Implications

Services have some unique characteristics that makes them distinct from a product. These include: (i) Services are *intangible*, but products are tangible (ii) Services are generally consumed at the time of production (i.e. *inseparable*), but in case of products there is a time gap between production and consumption (iii) Normally, services cannot be stored (i.e. *perishability*), but products can be stored (iv) Services are highly variable (i.e. variability), but many products are highly standardised. The unique characteristics of services have their own marketing implications, as shown in Table 8.3.

**Intangibility** The most important characteristic that makes the difference between a service and a product is tangibility. Services are intangible, whereas physical products are tangible. Many business firms offer combinations of products and services. In such situations if the business buyers perceive that service elements dominate, then the business sellers should concentrate on those strategies that are appropriate for service instead of using product strategies.

Due to the intangible (i.e. cannot be seen, felt or tasted before purchase) nature of services, buyers are uncertain about the quality of service provided by the service firm. To reduce the uncertainty, business buyers look for evidence or experience in determining the service quality. It is the task of the service marketer to manage the evidence or “to tangibilise the intangible.” Some of the methods or tools used by service marketers to tangibilise the intangible are as follows:

#### People

Indicating the qualifications and experience of people who conduct management development programmes, or the courteous behaviour of people working in the hotel or the airlines.

#### Place

The exterior and interior of the financial institution or of the bank including the layout of furniture, indicating clean and efficient working environment.

#### Equipment or Infrastructure

The state-of-the-art audio-visual equipment in the hotel seminar hall including the type of furniture, and the effective air-conditioning and lighting system will help the business buyer to take favourable decision of hiring the conference hall.

**Table 8.3** Unique Characteristics of Services and the Marketing Implications

<i>Characteristics</i>	<i>Examples</i>	<i>Marketing Implications</i>
<b>1.</b> Intangibility (Services cannot be seen or felt before they are purchased)	<ul style="list-style-type: none"> <li>Management consultancy</li> <li>Executive development programmes</li> </ul>	<ul style="list-style-type: none"> <li>Buyers look for evidence of the service quality</li> <li>Service providers try to tangibilise the intangible</li> </ul>
<b>2.</b> Inseparability (Services are generally produced and consumed simultaneously)	<ul style="list-style-type: none"> <li>Machinery or equipment repairs</li> <li>Courier service</li> </ul>	<ul style="list-style-type: none"> <li>Effective buyer-seller interaction depends on the service provider</li> <li>Requires effective recruitment and training of service providers</li> </ul>
<b>3.</b> Variability (Quality of services are highly variable depending on who provides, when, and where they are provided)	<ul style="list-style-type: none"> <li>Marketing research</li> <li>Management education</li> </ul>	<ul style="list-style-type: none"> <li>Standardisation of output and uniformity in quality are difficult to achieve</li> <li>Service providers should emphasise on quality standards, develop systems to minimise errors, and try to automate</li> </ul>
<b>4.</b> Perishability (Generally services cannot be stored)	<ul style="list-style-type: none"> <li>Airlines empty seats</li> <li>Unused warehouse space</li> </ul>	<ul style="list-style-type: none"> <li>When demand fluctuates service firms have difficult problems</li> <li>Plan capacity around peak demand</li> <li>Use pricing, reservation system, and other methods to achieve closer match between demand and capacity</li> </ul>
<b>5.</b> Non-ownership (Service buyer uses but does not own the service purchased)	<ul style="list-style-type: none"> <li>Use of hotel services</li> <li>Use of car rental service</li> </ul>	<ul style="list-style-type: none"> <li>Service marketer should communicate advantages of non-ownership—reduction in labour and overheads, and flexibility</li> </ul>

**Inseparability** Generally, the production and consumption of services take place simultaneously, that is, they are inseparable. Hence, the relationship between the buyer and the seller depends on the person who provides the service. The effective interaction between the client and the service provider is very important for building an effective buyer-seller relationship. It is, therefore, important for the business service firm to give special attention to recruitment, training, and developing the people who provide services to the client organisations.

**Variability** Quality of the services is highly variable because services are provided by different individuals within a service firm. The quality of services may vary each time it is provided, depending on who provides them, and where and when they are provided.

To ensure an effective quality control, business marketers in service firms can take the following steps:

1. A good system of recruitment, training, and development of service providers.
2. Preparation of a service blueprint (or a service-performance process) which should indicate the service events and processes in a flow chart. This would standardise the service-performance process in the service firm, highlighting the possible areas of service failures.
3. Regularly collecting information on customer satisfaction through consumer research studies and installing a system of receiving and correcting customer complaints.

**Perishability** Generally, services cannot be mass produced and stored. If services are not provided when they are required, the revenue lost cannot be recaptured. When the demand for services is steady, it is not difficult to manage the services. But if the demand fluctuates, it is difficult for a service firm to cope with the problem. The service marketer should forecast the demand as accurately as possible and then develop capacity for peak demand. In a service business, additional capacity becomes the substitute for stocks (or inventory). No doubt setting capacity for peak demand is costly, and hence, the service marketer must carry out cost versus benefit analysis by considering the factors such as customer satisfaction, sales revenue, and cost of maintaining high or low capacity.

Some of the methods used by service firms to achieve a closer match between demand and supply (i.e. capacity) are:

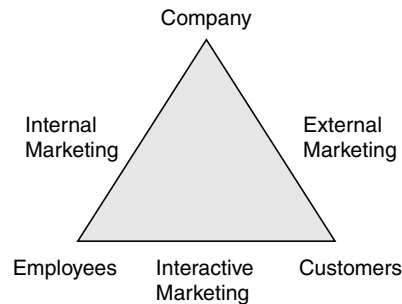
1. Shift some demand from peak to off-peak periods by adopting differential pricing. **For example,** telephone tariffs for domestic STD (Subscriber Trunk Dialing) service in India are lower at night and early morning calls.
2. Reservation systems are used to manage the demand by some service firms like airlines, hotels, and railways.
3. Part-time employees are hired to serve the peak demand. Large marketing research firms hire the services of small firms, and leading computer software companies hire the services of small software firms to serve the peak demand.

**Non-ownership** Unlike physical products, when the service buyer purchases the service, the buying organisation uses the service but does not own the service. Like, when a buying organisation hires a hotel conference hall for conducting a marketing conference, it uses the conference hall but does not own the hotel conference hall. A service marketer should communicate the benefits of non-ownership to the target market. The benefits are reduction in labour cost and overheads, and the flexibility of using the service when required.

### Marketing Strategies for Business Service Firms

Christian Gronroos<sup>18</sup> has argued that service marketing requires not only external marketing but also internal and interactive marketing, as shown in Fig. 8.8. External marketing deals with the company's normal marketing work such as pricing, distribution, and promotion of the service to target customers.

Internal marketing deals with the work done by the company in training, developing, and motivating the employees to ensure that the customers are served well. This may be called customer orientation, whereby all the employees of the company are motivated and trained to achieve a high level of customer satisfaction.



**Figure 8.8** Three Types of Marketing in Business Service Firms

**Source:** Reprinted with permission from MCB University Press.

Interactive marketing describes the employees' skills in serving the customer. The customer perceives the quality of service by its *technical* quality (i.e. technical content of service) and the *functional* quality (i.e. how the service was provided). **For example**, the buying organisation for the marketing research service looks for not only the research methodology and the findings of the marketing research (i.e. technical quality), but also the presentation of the report (i.e. functional quality). Technical quality is subjected to the application of systems and techniques, which assures its quality. **For instance**, a courier service firm can develop computer based programmes for routing shipments so as to achieve on-time delivery objective. But how the courier persons interact with customers is difficult to standardise but it is possible to train them to be courteous to customers.

**Segmenting and Targeting Business Services** The process of segmentation and target marketing described in Chapter 6 is also applicable in the business service markets. However, service market segments differ from product market segments in certain aspects.<sup>19</sup> These are: (i) Service customer organisations expect services to be customised. Such expectations cannot be met with standardised services. Customised services may result in narrow niche marketing strategies. (ii) Service market segmentation concentrates on what the business customers expect instead of what they need. Selection of target market segments and development of an appropriate service package will mainly depend on the understanding of the buying organisations' expectations of the services. (iii) The forecasting of total demand for the service market may consist of many niche (narrow) market segments. The knowledge of the total market demand will help the service firm to target its market share and set its service capacity accordingly.

**To illustrate**, Gati cargo management services has segmented its market geographically and has targeted to deliver cargo to 980 locations from 290 branches. The company has estimated the demand for the cargo services from each of its branches. The service capacity is then worked out, depending on the company's objectives and resources.

**Service Differentiation** Compared to the marketers of products, marketers of services have a more difficult task in differentiating their services. How do business buyers differentiate a management consultant or a courier service firm from their competitors?

One of the most common methods used by business marketers of services is to undertake a marketing research study to determine from the business buyers as to what are the most important attributes

or benefits they expect while selecting a service supplier from the competing service suppliers. The service firm should then develop its service package to incorporate these important attributes. The important (or determinant) attributes may vary depending on the type of service industry. However, some of the major ways of differentiation are:

1. Business customers choose those service firms whose perceived quality of service meet or exceed the expected quality of service. Customers' expectations are formed by their past experiences, service-firm advertising, or word-of-mouth. A continuous improvement in the quality of service will have a significant impact on the increase in repeat purchase and reduction in customer "defections" (i.e. customers who will not come back).
2. The service package can include innovative features to differentiate it from the competing offers. **For example**, some airlines introducing frequent-flyer award programmes, movies, and advanced seating. The problem is that most service innovations are easily copied. Still, the service firm that introduces service innovations based on the research studies, will earn the reputation of a lead innovator and may retain customers.
3. Service delivery can be a differentiating factor. Delivery schedule can be achieved better than the competitors by the service firm through more able and reliable people or by superior delivery system (e.g. state-of-the art computerised systems). The service firm can develop a more comfortable and efficient physical environment in which the service is delivered (e.g. a bank delivering its services in air-conditioned, clean and efficient environment).
4. Specialisation and experience are considered to assess the service provider's capabilities over the competitors. **For instance**, a business buyer selected a marketing research firm which it believed had specialised and was more experienced in studies on chemical industry, since the marketing research assignment pertained to a chemical industry.

**Service Packages** The service package is the product tool of services marketing. A service firm develops the service package (or service offer) based on certain procedure or steps. They are:

**Step 1** In developing a new service or evaluating an existing service, the service firm must find out (through marketing research) the core benefits the customers will derive from the service.

**Step 2** To decide what benefits (or attributes) the business service firm will focus.

**Step 3** To spell out the details of the benefits the service firm will offer. The detailed service offer (or service package) includes the tangible and intangible elements.

**Step 4** To decide how the service will be provided to the customer (i.e. service delivery system), which consists of people, facilities and systems.

To elaborate the above, let's take an **example** of a group of young MBAs who wish to start a new marketing research service firm. The firm first carries out a marketing research study to find out what core benefits the business buyers expect. The findings of the study indicate the core benefits (or attributes) as accurate and timely information about the market that is well presented in a report, for business and consumer markets. The firm decides to focus on business markets. The tangible benefits offered are excellent presentation of the firm's quotations, preliminary, and final reports. The intangible benefits are the positive attitudes, knowledge and skills of the firm's personnel who provide service to the customers. The service delivery system consists of well-qualified and experienced service personnel who create a professional image. The facilities include a clean and efficient looking office, well-

stocked library, modern computers and other equipment. The carefully prepared system of operations indicate how the enquiries are generated, the quotations are prepared, the presentations are made to the clients, the negotiations are conducted, the order receipts, and the various stages of executions of the marketing research assignments, with special emphasis on the number and quality of interactions with the client, the quality of report presentation, and timely completion of the assignment.

**Service Pricing** Generally, pricing strategies and policies have common approaches in product and service pricing. However, there are some special pricing situations in service pricing. Differential pricing strategy is used to manage fluctuating demand. During peak demand periods some service firms charge higher prices. **For example**, some hotels charge high prices during peak demand, but offer special low-price packages during the off-season. Some service firms offer several services. If a business customer wants two or more services, should the services be priced individually or a special price for a bundle of services? Many service firms offer a special price for a package of services, considering the marginal cost of additional services.

**Service Promotion** The promotional strategies for services are generally similar to those for products. However, there are some special considerations to be remembered while marketing services to business customers.

The business buyers of services are more influenced by word-of-mouth communications from their colleagues and friends who have used the services, as compared to product purchases. This is because of the difficulty in evaluating quality and benefits of a service. The service marketers can promote the word-of-mouth communications from their existing satisfied customers by encouraging potential customers to talk to them and featuring satisfied customers in advertisement and in promotional brochures.

Service providers play a major role in personal selling. Business customers prefer to deal with those who provide the service. Marketing and operations are generally inseparable in service business. It is, therefore, important for the service firm to train and motivate the service providers to deal effectively with customers.

In service promotion, the intangible elements (or attributes) are translated to tangible attributes of a service by showing pictures of buildings, equipment, and personnel. A recent study has found that promoting customer contact people by including them in the advertisement is an important success factor in the marketing of services. The service marketers should communicate those performance attributes that are not only attractive but also performable by their service providers.

**Service Distribution** When the service firm takes a decision on distribution, it considers the effective method by which its service package is made available to the target service-buyers. The most common method is direct selling in which either service providing firms go to the service buying firms, or the service buying firms go to service providing firms. **For instance**, software service suppliers like IBM, Infosys and Wipro have direct marketing (or distribution) channel through the company's sales force.

In some service businesses, service intermediaries are used. There are **several examples**, such as the ticket booking with airlines, real estate buying or selling, and freight transportation business in which intermediaries are used, because intermediaries provide some benefits such as wider coverage of market, cost-effective, or availability of bundle of services.

Franchising is another channel of distribution which has come up in recent years. Certain standardised services like recruitment agencies and factory/office cleaning services distribute through



franchised dealerships. The franchising arrangement gives a service firm an advantage of a rapid expansion of its market without much capital investment. **For instance**, the public sector unit (PSU), Bharat Sanchar Nigam Ltd (BSNL) is taking franchisee route for new projects. The company may be saving more than ₹ 10,000 crore (i.e., ₹ 100 billion) of capital investment by adopting the franchisee model. The franchisee will utilise BSNL spectrum to offer high speed broadband on a revenue sharing basis for the Wi Max project. The franchisee will make investments required to set up the network and also undertake marketing on behalf of BSNL.

### SUMMARY

A new product development is a difficult but necessary task for the profitable growth of a firm, which should analyse the factors responsible for the success and failure of new industrial products. The various *stages of new industrial product development* process are: (a) idea generation, (b) idea screening, (c) concept development and testing, (d) business analysis, (e) product development, (f) market testing, and (g) commercialisation.

There is a direct relationship between innovation and competitiveness. Two major characteristics that differentiate high-tech marketing are high technology uncertainty and high market uncertainty. For high-tech marketing, it is important to understand modified technology adoption life-cycle. To avoid falling into the deep gap between early adopters and early majority, we need to develop a unique high-tech marketing strategy, which includes targeting niche market, making a whole product, developing partnering relationships with key suppliers, evolving unique positioning and communication strategy, selecting multi-channel distribution, and adopting initial high price.

Product and service quality have strategic importance in business markets. PIMS study found direct impact of quality on profitability of an organisation. It is, therefore, important to understand the meaning of quality and deliver high quality goods and services to target customers.

*Business services* are classified into two groups. Products supported by services and pure services. The unique characteristics of services are: (a) intangibility, (b) inseparability, (c) variability, (d) perishability, and (e) non-ownership. These unique characteristics of services have their own marketing implications.

*Service marketing* requires three types of marketing: (a) external, (b) internal, and (c) interactive marketing. Marketing strategies for services differ in certain respects from those for products. Segmenting and targeting business services and service differentiation highlight some of the differences. The marketing-mix strategies for business services are discussed with respect to service packages, service pricing, service promotion, and service distribution.

### KEY TERMS

- |                       |                                  |
|-----------------------|----------------------------------|
| • High-tech marketing | • PIMS                           |
| • Innovation          | • Service differentiation        |
| • Inseparability      | • Technology adoption life-cycle |
| • Intangibility       | • Total quality management (TQM) |
| • Laggards            | • Variability                    |
| • Niche market        |                                  |

**Note:** Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. What is product lifecycle management (PLM)? How innovation in design is useful for manufacturing firms?
2. Explain briefly the stages in the new product development process.
3. What is high-tech marketing? Explain why crossing the deep gap between “early adopters” and “early majority” in the modified technology adoption life cycle is the most difficult and dangerous transition?
4. Describe similarities and differences in the marketing strategies for business services and those for industrial products.
5. Explain how a business services firm should measure the quality of its service.

**OBJECTIVE TYPE QUESTIONS**

1. Beta testing in industrial product testing means testing the new product at: (a) the company premises, (b) the potential users’ site, (c) the intermediary’s place, or (d) the supplier’s premises.
2. The technique used for ensuring timely completion and proper co-ordination of various activities involved in launching a new product is called: (a) management by objectives (MBO), (b) customer relationship management (CRM), (c) Critical Path Method (CPM), or (d) ABC Analysis.
3. The major characteristic(s) of high-tech marketing is (are): (a) high technological uncertainty, (b) high market uncertainty, (c) both the above, or (d) none of the above.
4. Services marketing requires external marketing, internal marketing, and one of the following: (a) international marketing, (b) viral marketing, (c) interactive marketing, or (d) none of the above.
5. PIMS study found that the most important factor that influences profitability of a firm was: (a) price, (b) delivery, (c) quality, or (d) service.

**APPLICATION QUESTIONS**

1. If you are recruited by a company to launch a new product, called Aluminium Extrusions, what all marketing activities would you perform and what management techniques would you use to ensure that all activities are completed in six-months, so as to be ready for the launch date. The products are required by household as well as business customers. The product applications are door and window frames, electrical control panels, heat sinks for electronic products, and other business applications. (Make suitable assumptions, if needed.)
2. Assume you want to start a recruitment services firm in India. You want to be successful in a highly competitive market. What kind of marketing strategies you would develop?

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## CASE 8.1

### Air-Flow Pvt. Ltd.: Launching a New Product

"We want you to plan and implement all the required marketing activities so that we will be ready to launch the new and unique Air-Flow table fan in the market by first week of March 2002. We need to target this fan initially for business customers, and later, as our volume of production goes up, we will consider targeting household consumers", said CEO of Star Group of Companies to Rohit Sharma, who had recently joined the company from a leading business management institute, as the marketing head of Air-Flow Pvt. Ltd.

Rohit Sharma had to establish marketing function of Air-Flow Pvt. Ltd. from scratch, since Star group had recently diversified into consumer durable products from its existing businesses of textile machineries and industrial electronics. Suresh Shah, the CEO of Star group, had taken over the family business from his father, Arvind Shah. Suresh had visited a trade fair in Germany in 2000, where he saw the Air-Flow fan for the first time. He thought it was a unique design. He liked the fan, which was

a prototype made by a firm that had no manufacturing experience. Suresh purchased the design and the prototype with the intention of manufacturing and marketing the fan in India.

Suresh Shah, thereafter, asked one of his engineering college friends, Anil Deshpande, to take over the manufacturing of the fan at Baroda factory. The marketing office was located at the corporate head-quarter at Mumbai. Rohit had eight months to plan and implement marketing strategies and action plan for the new Air-Flow fan.

In the first week of March 2002, Rohit was disappointed to know from Suresh Shah that the production of the new fan would be delayed by over two months and hence the launching was postponed to mid-May 2002, which was almost the end of the summer and peak season for the fan market. When finally the new fans were received at Mumbai warehouse of the company in the last week of May, the shipment to the business customers started. However, the complaints on oscillation mechanism started coming in from many customers. Rohit stopped the dispatches, checked the fans in the warehouse, and found to his dismay that there was a serious defect in the oscillation mechanism. He immediately contacted Suresh Shah, the CEO, and requested him to arrange a meeting along with the production head, Anil Deshpande.

In the meeting with production head and CEO, Rohit said that he would not like to sell the new product until the defects were rectified. Suresh Shah did not agree with Rohit and asked Rohit to continue selling the new fan. Rohit pleaded that his conscience did not permit him to sell a defective product to customers. Suresh thundered, “I order you to sell, Rohit”. Rohit was shocked and after a pause got up from his seat and told Suresh, “I don’t want to work in your company. I am resigning right now!”, and walked out of the meeting room.

### Questions

1. What were the major factors responsible for the failure of Air-Flow fan?
2. Which stages or steps of the new product development process were not followed properly by the company?
3. If you were Suresh Shah, how would you have managed the new product development?

## CASE 8.2

### K S Consultancy Services Ltd: Marketing Strategies for M.R. Services

“We would like to have from you a marketing plan, including marketing strategies, for our M.R. Services division, in 15 days,” said the Managing Director (M.D.) of K S Consultancy Services to Prabhakar Kulkarni, the new Vice-President (V.P.) of Marketing Research (M.R.) Services Division. “I cannot give you more time for preparation of the marketing plan, because we want to take urgent corrective actions in order to improve the performance on sales and profits of the M.R. division,” added the Managing Director. Kulkarni responded to MD by saying: “Sir, I wish I had 5 to 6 months to prepare the marketing plan, since there is a need to collect a lot of information about the customers, competitors, and the market environment, which would take about 4 months. However, as I have only 15 days, I will do my best within the available time.”

Prabhakar had earlier worked in engineering products organisations such as Blue Star (Air-conditioning and Refrigeration Products division) and Crompton Greaves Ltd (Electrical Engineering products) in sales, service, and marketing functions. He had not worked in a business services firm.

He, therefore, wondered whether the marketing plan and strategies for services like marketing research would be different from that of products. Being new to the company, Prabhakar thought he should first know his company well and thereafter started to collect information about existing and prospective customers as well as major competitors. Considering a short time available, he considered focusing on the marketing strategy and the action plan. In any case, he had to start the work without wasting any time.

### Question

1. If you were Prabhakar Kulkarni, how would you go about, and what would be your marketing plan, and strategies? (Make suitable assumptions, if needed.)

## CASE 8.3

### Precision Steel Tubes Ltd\*

In 1986, the Chairman and Managing Director (CMD) of Precision Steel Tubes Ltd (PST)—a medium sized (sales of ₹ 400 million) engineering company—called a meeting of his senior executives to discuss an idea for a new product. He stated that in order to maintain the leadership in the existing business of manufacturing and marketing “precision steel tubes”, there was a need to manufacture a new product called “cold rolled cold annealed” (CRCA) steel coils, which was a backward integration. CRCA steel coils were used as a raw material for manufacturing precision steel tubes. Although the company had been procuring the CRCA steel coils from Bokaro Steel Plant of Steel Authority of India Ltd (SAIL), the quality of the raw material was not consistent and the deliveries were uncertain. Besides, other major competitors such as Tube Investment Ltd and Tata Steel (Tubes Division) had their own cold rolled (CR) plants, which gave them a competitive edge in terms of superior product quality and timely delivery of precision steel tubes. The CMD formed a task force consisting of senior executives from finance, marketing, R&D, production, and purchase departments to carry out the initial screening. The major findings of the initial screening presented by the task force were as follows:

### Initial Screening

1. The raw material for CRCA coils were “hot rolled” steel coils, which were available from steel plants of SAIL as well as from imports.
2. There was a possibility to use CRCA coils not only as a raw material for precision steel tubes manufacturing, but also for marketing to the present customer segments like bicycle manufacturers and automobile manufacturers (2-wheelers, 3-wheelers, and 4-wheelers), besides other market segments.
3. The company could use the existing sales force and branch network for marketing CRCA coils.
4. The project would cost about ₹ 120 million, including building, plant, and machinery, which was within the company’s financial capability.
5. The project did not need any foreign technical know-how and the same could be implemented by the in-house team with the help of an Indian technical consultant.

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\* This case was prepared by Prof. Krishna K. Havaladar for classroom discussion. It does not indicate an effective or an ineffective handling of the business situation.

6. Although the new product would help in improving the company's market share in precision steel tubes industry by use of better quality and availability of the raw material, the cost of manufacturing of CRCA coils would be higher as compared to the purchase price from the SAIL.

The meeting of the senior executives chaired by the CMD, discussed the report of the task force on the initial screening. A few senior executives felt that as the cost of manufacturing CRCA coils in-house would be higher than the purchase prices of the same from SAIL, the profitability of the existing business would be reduced. The CMD, therefore, asked the task force to carry out business analysis, considering 50 per cent of the production of CRCA coils to be used for in-house consumption for precision steel tubes, and the balance 50 per cent production to be marketed at higher prices as CRCA coils.

### **Business Analysis**

A detailed business analysis was done by the task force. The marketing department carried out an in-house market survey (instead of assigning the work to an outside market-research agency). The market survey included (a) collecting and analysing information on market demand (past, present, and future); (b) technical and application needs of the potential customers; (c) competitors' information on prices, commercial terms, market share and production; and (d) information on imports and exports of CRCA coils.

The finance and technical departments worked on the techno-economic analysis. The requirement of investment in building, (land was already available at the existing company location), plant and machinery, and working capital were estimated. Based on the sales forecasts, product mix, cost of manufacturing, cost of marketing and likely price levels, profitability analysis, including return on investment and break-even volume were worked out for the next five years.

### **Decision on the New Product**

The business analysis report was discussed by the CMD with the senior executives. It was decided to go ahead with the new project with the initial capacity production of 24000 metric tons per annum in the first phase, considering 50 per cent production to be consumed internally for precision steel tubes and the balance 50 per cent of CRCA coils to be marketed to the customers. To improve profitability, it was decided to add 12000 MT per annum in the second phase, so that 65–70 per cent of the new product could be marketed at higher prices and the balance 30–35 per cent would be used in-house after completion of the second phase.

The company decided to go for initial public offer (IPO) with the new product becoming a separate division of the existing profit making company.

### **Implementation**

The product development work started with the help of a technical consultant who had a long experience in CRCA coils. Construction of the building, purchase of the plant and machinery, manufacturing process, layout, and others activities were completed in about 9 months, and the trial production commenced in the middle of 1987.

The marketing department supplied the samples against trial orders from the automobile and bicycle customers. There were certain suggestions from the customers on the technical parameters of CRCA coils since samples supplied were partly acceptable. The technical team from production and quality control visited the customers along with the marketing team to understand the problems faced by the customers and to take corrective actions for future supplies.

In the meantime, the marketing department worked out the marketing plan for the new product. The target market segments were initially identified as bicycle manufacturers and two-wheeler automobile manufacturers. Product catalogues were made, pricing and other commercial terms were decided, sales engineers from branches were given training for the new product, and the new product was launched in the market in August 1987.

#### **After the Product Launch**

The rejection levels at the factory and at the customers' end were about 9 to 10 per cent, which was considered as very high. The production manager attributed this to the lack of adequate experience to majority of the workforce. As the workers and supervisors gain more experience, he felt, the rejection levels would be reduced substantially. However, the customers either held back the repeat orders, or gave small quantities of orders till they experienced an improvement in the performance of CR coils supplied by the company. The finance manager reported a loss in the company's operations for the year 1987–88. The CMD called a meeting of the senior executives to discuss the performance of the company. He particularly wanted to know whether the company took the right decision in going for the new project of CR coils, and what could be done to improve the company's performance for the year 1988–89.

#### **Questions**

1. Has the company followed properly all the steps of the new product development process?
2. Did the company take the right decision in going for the backward integration? Discuss.
3. What should the company do to improve its performance for the year 1988-89.

# 9

## Business Marketing Channels and Market Logistics

*After studying this chapter you should be able to:*

- Know the distinctive nature of business marketing channels.
- Learn participants (or intermediaries) in business marketing channels.
- Understand the channel design process in business marketing.
- Know the major trends in business marketing channels.
- Learn the role of supply chain management, logistics, and market logistics in business marketing.
- Know the major cost centres of market logistics—i.e. transportation, warehousing, inventory, order processing, and material handling.

A **marketing channel** (also called distribution channel or trade channel) is defined as a set of inter-dependent organisations that make a product or service available to customers for use. In other words, the link between the manufacturers and the customers is the channel of distribution. A firm can easily change its decisions on pricing, advertising, or sales promotion, but it will be very difficult to change the decisions on distribution channel.

The **market logistics** (also called physical distribution) consist of delivering the completed products to customers and channel intermediaries. To assist in performing the tasks of storing and moving their goods and services, the business firms have to engage the services of warehouses and transportation companies.

### DISTINCTIVE NATURE OF BUSINESS MARKETING CHANNELS

Business marketing channels are quite different from the channels used for consumer goods and services. The distinctive nature of business channels can be understood from the factors discussed hereunder.

#### Factors Affecting the Nature of Business Marketing Channels

**Geographical Distribution** Business intermediaries (such as distributors or dealers) are concentrated geographically. They are found where business market exists, that is, in large cities or towns with industrial estates. **For instance**, Mumbai, Delhi, Calcutta, Chennai, Bangalore, Ahmedabad, Hyderabad are some of the cities that have large number of business organisations.

**Channel Size** Business channels are short and involve a type of intermediary for selling and handling the products. Sometimes the channels are direct from the manufacturers to the customers, without



intermediaries. The reason for the shorter channels in business markets is that the organisational buyers expect product availability, technical expertise, and servicing capabilities. These expectations have to be fulfilled by the intermediary (distributor or dealer) and the manufacturer.

**Characteristics of Intermediaries** Business intermediaries are often technically qualified and have close relationship with the business organisations. The types of intermediaries used by business marketers are also different from the wide variety of wholesalers and retailers used by marketers of consumer products. Business marketers use industrial distributors, manufacturers' representatives, or brokers to reach customers.

**Mixed System** Some business marketers use a mixture of direct and indirect channels in order to meet the requirements of different market segments, or when the company has resource constraints. The business firm may use its own sales force for a large-volume customers, and industrial distributors or dealers to cover small-scale organisations.

Some firms, due to resource constraints, have agents (or manufacturers' representatives) to serve the market segments consisting of geographical territories. Figure 9.1 shows the alternatives available to business marketers to structure industrial channels.

A good **example** of a mixed system (also called "**Hybrid Channels**" or "**Multi-Channels**") of direct and indirect channels is seen in an electrical equipment manufacturing company, viz. Crompton Greaves Ltd., where the company sales people serve large corporate and government customers, the authorised dealers serve a large number of small and medium-sized enterprises (SMEs), and the internet is used by all those buying firms who want to place orders, check delivery status, and make electronic payments through the extranets developed by the company.

Many business marketing firms use multi-channels<sup>1</sup> to serve different market segments, as seen from the above-mentioned example. **Another illustration** could be given about a steel component manufacturing company, which used its sales force to serve large volume OEM (original equipment manufacturer) customers, manufacturer's representatives (or agents) for serving medium volume customers who were geographically spread across the nation, and distributors for serving small volume buying firms.

## Electronic Channels

Electronic channels (or e-channels) are a part of e-commerce, about which there is a separate chapter in this book. Many business marketing organisations are using e-channels for (1) providing information, (2) online buying/selling, and (3) improved supplier–customer relationships<sup>2</sup>.

**Providing Information** E-channels provide information to customers through the supplier's website on product specifications, features, and applications. The website also provides a link to the supplier's branch sales and service offices and distributors.

**Online Buying/Selling** Prospective business customers not only use online information about the supplier's products, prices, services, and availability, but also do online quotations, order placements, and mode of payments. Many business buying firms expect the supplier firm to have online business transaction system. That is why many large organisations like GE, Ford Motor Company, Dell Computer, and Cisco Systems have invested millions in Web procurement systems. This has resulted in substantial cost reductions. **For instance**, invoices that used to cost \$100 for processing, now cost as little as \$20.

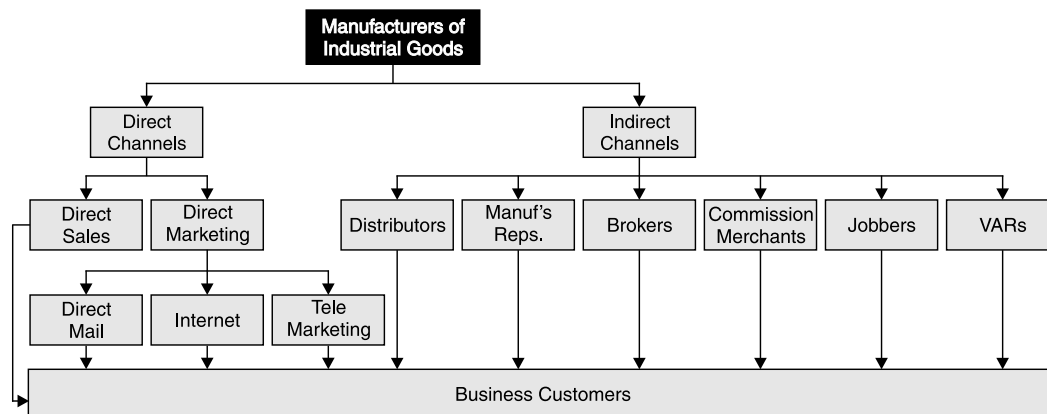
**Improved Supplier–Customer Relationships** B2B websites are changing supplier–customer relationships substantially. E-channels create communications between suppliers and customers which result in improved relationships and promotions. E-channels should be planned in such a way that there are no conflicts with traditional channels like distributors and manufacturer’s representatives. In fact, e-channels should support the traditional channels. For example, an engineering company marketing electrical engineering products had used multi-channels—i.e. the company’s sales engineers were selling to large OEM and government customers, the authorised dealers were selling to small and medium enterprises (SMEs), and the company website was available for all those current and prospective customers who needed information on the company, its products, branch sales offices, and dealers. Here, the e-channel (or the company’s website) was supporting the traditional channels by providing information to customers.

### Alternative Structures of Business Channels

Business channels can be structured in various ways, as shown in Fig. 9.1. Some channel structures are *direct* and some are *indirect*.

**Direct Channel** In *direct channel structures*, the manufacturers perform all the functions or the tasks necessary to create sales and to deliver the products to business customers. These tasks include contacting potential customers, negotiating, communicating, selling, financing, product storage, transportation, and servicing. The **examples** of direct channels are direct sales through the company’s sales force, and direct marketing through direct mail, telemarketing, and electronic business through computers (i.e online marketing) or the internet.

The direct distribution (or direct channels) approach is viable when (a) the value of each transaction is large, (b) the selling includes extensive technical and commercial negotiations at various levels, including top management, (c) the buying process is lengthy, and (d) the business buyers insist on buying directly from the manufacturers. The **examples** of the products and services where direct channels are used include furnaces, machine tools, textile machineries, and software services.



**Figure 9.1** Channel Alternatives in Business Marketing<sup>3</sup>

**Note:** Direct sales includes the manufacturer’s own sales force dealing directly, or through the manufacturer’s branch/regional sales offices, with business customers.

**Indirect Channel** In indirect channel structures, the manufacturer and the intermediaries share the tasks between them. **Examples** of the types of intermediaries in indirect channels are independent dealers or distributors, manufacturer's representatives (or agents), commission merchants, jobbers, value-added resellers and brokers. An indirect distribution (or indirect channels) approach is appropriate when (a) the value of transactions or sales are low, (b) the manufacturer has limited resources, (c) the business buyers are widely dispersed, and (d) the business buyers purchase many product items in one transaction. The **examples** of the products where indirect distribution are used include business chemicals, construction materials, electrical wiring materials and supplies, general industrial machinery, iron and steel products, and so on.

### Why Business Marketers use Intermediaries?

Before we answer the question, let us first see what functions or tasks are performed by them. There are different functions or services performed by middlemen. These are described below:

#### Services Performed by Middlemen

##### ***Buying***

The distributor or dealer purchases products from the manufacturer for resale to business end-users.

##### ***Promotion and Selling***

The middlemen contact potential or existing customers, promote the product, negotiate, and secure orders.

##### ***Assorting***

Some middlemen bring together several related items from various sources to serve potential customers. **For instance**, a dealer of electrical items carries switches, wires, and other related accessories.

##### ***Financing***

The dealers/distributors purchase products and invest in the inventory. They also extend credit to customers while reselling the products. Thus, they help manufacturers to finance the marketing process.

##### ***Warehousing***

The distributors or dealers must store the products properly at their warehouses to assure product availability in good condition to the business users.

##### ***Grading***

The manufacturer sometimes asks the middlemen to inspect and test the product and assign distinct quality grades. Precision welded steel tubes, **for instance**, are graded into different "prime" and "non-prime" quality. The prime quality (i.e. Grade I) is taken for further processing in the production line, while the non-prime tubes are further segregated into "second grade" (i.e. weak welded), "third grade" (i.e. partially welded) and "fourth grade" (i.e. unwelded) tubes, depending on the quality of welding. The dealer sells various grades of tubes, at different prices for various applications or uses, such as railings, scaffoldings and furniture.

**Transportation**

Some intermediaries also manage the physical movement of the product from their warehouses to customers' locations. Many business customers consider prompt delivery as an important benefit.

**Information**

The middlemen have responsibilities to provide information both to their customers and suppliers. Customers need information about product features, prices, deliveries, and so on, while suppliers need information about competitors, customer requirements, product performance, and others.

**Risk-taking**

When distributors or dealers buy a product, store it and then resale it there is a risk that the product may deteriorate, become obsolete, or may not be required by customers.

**Technical Service**

Some intermediaries are equipped to give pre-sales and after-sales services to the business users by recruiting and training service personnel.

Considering the above functions or services performed by middlemen or intermediaries the business marketer can now answer the question: Why use middlemen?

Out of the above functions, the business marketer must decide which functions are critically important (e.g. selling and quick delivery) and which of these functions cannot be performed effectively by the firm due to certain weaknesses (e.g. financial resources and inadequate manpower). If certain weaknesses exist, can some of these tasks or functions be performed efficiently and effectively by intermediaries, such as distributors, dealers, agents, or brokers. If the business marketer does the above analysis and takes a realistic and objective decision, then the middlemen will be viewed for what they can contribute and not only for what they will cost.

**Why Business Customers Buy from Distributors?**

Business marketers can market their products through distributors (or dealers) only if the business customers or users find it desirable to buy from distributors. A number of studies conducted on this subject indicate the following reasons.

**Dependable Delivery** The most important reason is fast and economical delivery. Dependable delivery enables the business buyer to reduce the inventory level and, therefore, the inventory carrying cost. Often, the distributors deliver the goods without charging the freight. These are some of the savings in costs that are important, particularly for small-scale manufacturers.

**Information** Useful information about the products of many competing manufacturers, like price, availability, and quality can be obtained from the local distributor. Sometimes, detailed technical information may not be available from the distributor's salesman but the same can be obtained from the manufacturer.

**Variety** There is an availability of various products at the distributor's store, which meet most of the requirements of small-scale manufacturers (or customers).

**Liberal Credit** Often this is offered by the local distributor or dealer who is familiar with the financial needs of the local manufacturers/customers.

On the whole, dependable customer service is the main reason considered by business buyers for buying from local distributors/dealers.

## PARTICIPANTS (OR INTERMEDIARIES) IN BUSINESS MARKETING CHANNELS

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Intermediaries are classified on the basis of the number of functions they perform. A *full-function intermediary* is the one who performs all or most of the distribution functions stated earlier. These middlemen are called **industrial distributors**. Some of the common types of middlemen or intermediaries are manufacturers' representatives (also called agents), dealers or industrial distributors, brokers, commission merchants, and value-added resellers (VARs) as well as jobbers and manufacturer's branch, district and regional offices.

**Manufacturers' Representatives** They are also called agents or manufacturers' agents. Their main functions are to promote sales and secure orders. They also fulfil the market information function. However, they do not buy, store, or finance the transactions. They are paid a commission on sales which varies from industry to industry and also according to the tasks involved in the selling job. Generally, the manufacturer has a long-term (i.e., strategic collaborative relationship with the manufacturer's representative or agent.

The manufacturers' representatives are generally needed by small and medium-sized business firms. These firms find it economical to have independent reps, who are paid commission only when the orders are generated. There are no other selling costs. The business marketer may use their own sales force in high potential business markets to support the selling expenses of salaries, perks, travelling, lodging, and boarding. But in territories with low or medium market potential, they find it economical to use the independent reps or agents. These agents have good product knowledge, sound understanding of the markets covered by them, excellent contacts with the business buyers as well as good selling and negotiating skills. They represent and have agreements with a number of manufacturers whose products complement one another, but are not competing.

**For examples**, a small-scale manufacturer of material handling equipment near Hyderabad in South India, who is not financially strong enough to have its own sales and service engineers, made agreements with four agents (i.e. manufacturer's representatives) located at Bengaluru, Chennai, Mumbai, and Ahmedabad, where business potential is high for its products. The main responsibilities of the manufacturer's representatives are to sell and service the manufacturer's material handling equipment, for which they are paid three per cent commission. Adequate technical training is given by the manufacturer to the sales and service people of the agents, as the product is highly technical in nature. The company has its own sales and service centre at Hyderabad, which is also its marketing head office. The marketing strategy of the company is to focus its marketing efforts initially in major business centres in Southern and Western regions of India and later on, as the company's sales and profits grow substantially, it will enter Northern and Eastern regions, either with its own employees or manufacturer's representatives for carrying out sales and service functions.

**Industrial Distributors (or Dealers)** Industrial distributor or dealer is the most important intermediary in distribution channels. Typically, industrial distributors are small and independent business firms serving narrow geographic market. They perform a variety of functions or tasks and that is why sometimes the distributors are called full-function middlemen or intermediaries. They are compensated

by the manufacturers through a standard discount on the price-list that varies depending upon the functions or activities performed. Typically, the manufacturer has a collaborative or partnering relationship with the industrial distributor or dealer which is of strategic nature.

**For example**, Crompton Greaves Limited, a major manufacturer of electrical equipment in India, offers a standard discount on its price-list to its dealers, who deal in standard industrial products like electrical motors, motor starters, and low-tension (LT) switchgears. These intermediaries are called 'authorised dealers' instead of 'industrial distributors'. They are paid a uniform or standard trade discount by the manufacturer, depending on the industry norms and the activities performed, varying from 10 to 20 per cent on the company's list price. The company list price (also called price-list) statement is given to all the authorised dealers, as it indicates basic prices of various sizes or parameters like horsepower (HP) of standard products. Based on the price-list, the dealers give quotations or offers to their customers. These authorised dealers buy the company's (as well as competitors') products; promote, sell and keep the products in stock in their warehouses; offer credit to their customers; deliver the product after the order is received from the customer through a transporter; and provide customer service when required. As the dealers carry out so many functions, they are called the most important and full-function intermediaries, and hence, they are paid highest discounts or margins compared to other intermediaries' margins or commissions.

### **Responsibilities**

The responsibilities or functions of industrial distributors or dealers are buying, storage or warehousing, promotion, selling, offering credit, transporting or delivering of products, providing service and market information. The main functions are selling and ensuring customer service.

### **Main Categories**

There are three major categories of industrial distributors. The *general-line distributors* carry a wide variety of generalised industrial products that are needed by the business buyers. **For instance**, a distributor located in an industrial estate like Peeniya (in Bengaluru) or Hosur (in Tamil Nadu), carries stocks of various products required by the buyers in that industrial area, such as fasteners, lubricants, fan belts, lamps, and so on. The *specialised distributors*, the second category, focus on a narrow range of related products such as valves and fittings, cutting-tools, hydraulic equipment and components. This type of distributors are growing in size and numbers in recent years due to a trend towards specialisation. The third category is called the *combination house* as they sell some products directly to business customers and some other to retailers or dealers, who in turn sell to final consumers. In other words, they sell to both consumer and business markets. Combination house category distributor carries products such as electrical items like lamps, fans and switches that are required by both business customers and household consumers.

**Brokers** These middlemen bring together buyers and sellers by providing information on what is available and required. They may represent either the buyer or the seller or both and this relationship is a short-term one. Their function is to find potential buyers, negotiate, and complete the sale. Brokers do not buy or handle products and are paid on commission basis. They deal with standard products or raw materials and their role is vital when information on markets and products is not available completely. **For example**, buyers and sellers of edible oil in Hyderabad, India, contact the broker for information on prices (which fluctuate continuously) and availability. Once the transaction is over based on the broker's

information, both the buyer and seller pay half per cent commission to the broker. **Another example** can be given about a specialised broker who deals in old machines and equipment. If a company wants to sell its old machines and equipment, it contacts the broker, who gives the information about the prospective buyers, for which he gets commission from the buyer or seller, depending on who hired the broker.

**Commission Merchants** These middlemen deal with bulk commodities such as raw materials. They have a short-term arrangement with manufacturers of products which are sold in large quantities. They do not buy the material, but they perform the functions of arranging inspection, physical handling, negotiating process, and completing sales. As generally they represent the manufacturers, their commission is paid by the manufacturers. **For instance**, suppliers of iron ore hire commission merchants at various steel plants for arranging inspection, transportation, and getting the initial sample lot accepted by the steel plants. For performing these tasks, the commission merchants are paid a commission by the suppliers of iron ore.

**Value-added Resellers (VARs)** In data processing (computer industry), a new type of middlemen, called value-added resellers (VARs), have emerged. The VARs customise the computer hardware and software to solve specific problems for particular industries (e.g. inventory control for industrial values and fittings). These intermediaries are specialists and provide valuable services to buyers and sellers.

**Jobbers** They represent manufacturers of products that are sold in bulk like coal, iron ore, and chemicals. Jobbers take title to the goods that they sell. However, they do not store or take physical possession of the goods. **For instance**, a coal jobber purchases coal from coal mines based on orders in hand or expected orders from several customers. Once the jobber identifies the customer for the grade and quantity of coal, the coal is shipped or dispatched directly from the coal mine to the jobber. The jobber takes the title (i.e. the invoice is raised by the coal mine on the jobber). The jobber raises his bill on the customer, endorsing the railway receipt (RR) to the customer during the time the goods are in transit.

The most common types of business middlemen are the manufacturers' representatives and the industrial distributors/dealers. Generally, in practice, business dealers or distributors, Jobbers and VARs are compensated or paid through trade discounts or margins on the price list, whereas the agents/manufacturers' representatives, brokers, and commission merchants are compensated or paid through commission on net sales value (exclusive of sales tax, freight and excise duties).

**Manufacturer's Branch/Regional Sales Offices** The manufacturer also participates in the business marketing channel through its regional or branch sales offices. Generally, there are two types of branch or regional offices: stock-carrying and non-stock carrying offices. Typically goods are dispatched from the manufacturer's factories to the branch/regional warehouses of stock-carrying offices in full-truck loads, thus spending less freight costs and time. Thereafter, the goods are distributed to business customers and distributors. The stock-carrying branch or regional offices allow the manufacturer the benefits of lower freight costs and reliable delivery service to customers. **For example**, Crompton Greaves had 11 branch offices and four regional offices in India, with warehouses to carry stocks for standard electrical products like motors, starters, ceiling and table fans, lamps and tubes. These branch and regional offices also carried out sales and service operations to meet the requirements of their business customers, such as commercial organisations, government customers, and institutions.

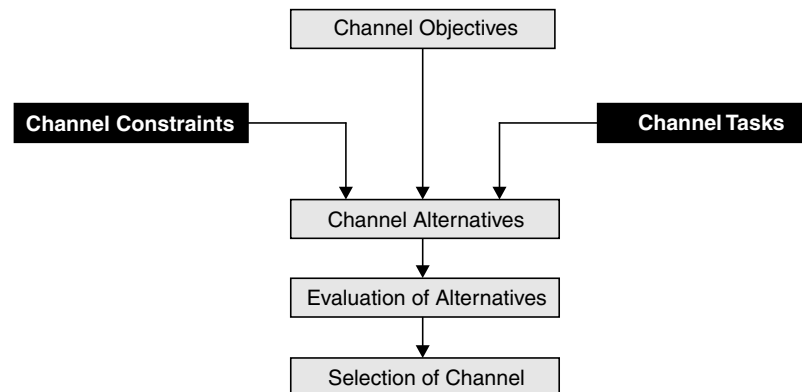
Nonstock-carrying branch and regional offices are sales offices or sales and service offices, which offer dedicated sales efforts and good service/technical support to business customers. This arrange-

ment is generally seen in capital goods manufacturing companies. **For instance**, a material-handling equipment manufacturer had branch offices at major industrial centres like Mumbai, Bangalore, Chennai, Hyderabad, Pune, Ahmedabad, Delhi, and Coimbatore for sales and service activities. No doubt, these operations are expensive and hence they can be justified if the volume of business is large. Sometimes, manufacturer's representatives (i.e. agents) are encouraged to carry out sales and service operations, for which they are paid commission on sales. This arrangement brings down the cost of sales and service of the manufacturer.

## CHANNEL DESIGN

Channel design is a dynamic process. It deals with developing new marketing channels and modifying the existing ones. For designing a channel, the business marketer must go through certain steps or procedure, as shown in Fig. 9.2. These steps are: (i) Developing channel objectives, (ii) Analysing channel constraints, (iii) Analysing channel tasks, (iv) Identifying the feasible channel alternatives, (v) Evaluating the channel alternatives, (vi) Selecting the marketing channel.

The purpose of going through the steps of channel design framework shown in Fig. 9.2, is to specify the channel structure that has the best possibility of achieving the company's objectives and goals. A *channel structure* consists of types of intermediaries, number of intermediaries, number of channels, and the terms and conditions of channel members.



**Figure 9.2** The Channel Design Framework

### Developing Channel Objectives

Channel objectives are derived from the firm's marketing objectives. The channel objectives should focus on customers' needs in terms of service levels required by the target market segments. The channel objectives vary depending on product characteristics.

The channel objectives are developed based on three factors: marketing objectives (e.g. improve customer service), product characteristics (e.g. raw material, components, capital items) and customer needs. **For instance**, for raw material or components, the target customer needs delivery service to be improved from, say, current level of 80 per cent to 90 per cent. For capital items like machines, the customer may need after-sales or repair service to be improved, **for example** from 24 hours to 8 working hours.



### Analysing Channel Constraints

The business marketer has to consider many constraining factors while selecting the channel structure. Some of these constraining factors are: (i) external environment, (ii) competition, (iii) company, (iv) product characteristics, and (v) customer.

*Legal issues*, as one of the external environmental factors, can affect channel design. **For instance**, Monopolies and Restrictive Trade Practices (MRTP) Act (now repealed and replaced by the Competition Act, 2002) puts certain restrictions on the channel arrangements, like, if a manufacturer restricts a distributor or dealer from selling outside a specified territory, it can become a major legal problem. It is, therefore, necessary to understand the legal issues while selecting a channel structure and advisable for the business marketers to get a legal advice when terms and conditions of agreements with intermediaries are prepared. The *competitive tactics* of appointing exclusive distributors may result in non-availability of good distributors, and *company's constraints* on financial resources may restrict the direct distribution through company salesforce to a few high potential territories. Let us consider **an example** of a material handling equipment manufacturer, a small-scale enterprise, who had the company salesforce at a few high-potential sales territories near its factory and for other large potential geographical areas the company appointed agents (i.e. manufacturer's reps.) due to financial constraints. The same channel strategy was adopted by another manufacturer of steel components, because of the company's financial constraints.

The *product characteristics*, as mentioned earlier, for technically complex products like furnaces and power transformers make it necessary to go for direct distribution, and the *customers' geographic locations* determine whether a company should go for direct or indirect distribution. For example, it is appropriate for widely-dispersed customers of a business marketer to have an indirect distribution with low-cost intermediaries, such as manufacturer's representatives.

### Analysing Channel Tasks

The business marketer has to make a list of various tasks or functions to be performed to move the product from the manufacturer to the business customers. Out of these tasks, as discussed earlier, the critical tasks must be identified. The next step in the analysis is to take objective and realistic decisions on which tasks can be performed effectively and efficiently by the company and which cannot be performed due to certain constraints. **For example**, a company manufacturing and marketing electric motors has selling, warehousing, financing, and transportation as important tasks or functions. Considering the financial constraints in reaching the large number of geographically widely dispersed customers, the company decides to share the important functions with business distributors, who would serve the business users having medium and low sales potential. The high potential OEM customers are to be served directly by the company's salesforce.

### Identifying the Channel Alternatives

Identifying the channel alternatives involves four major issues: (i) the types of intermediaries, (ii) the number of intermediaries, (iii) the number of channels, and (iv) the terms and responsibilities of channel members.

**Types of Intermediaries** The major factors to be considered in the identification of types of intermediaries are the tasks to be performed, and product and market conditions. As discussed earlier, a business marketer can select the types of intermediaries from the following channel alternatives.

- Value-added resellers
- Industrial distributors or dealers
- Manufacturers' representatives or agents
- Brokers
- Commission merchants
- Jobbers

A business firm may identify more than one channel or intermediary for the same product to serve different market segments. A company manufacturing precision steel tubes, **for instance**, and serving various market segments like bicycle, automotive, boiler, bus-body, furniture manufacturers, all over India can decide that large potential customers located in major geographical areas could be served by the company's salesforce through the company's branch offices, the medium-potential areas could be served by the independent agents (or manufacturer's representatives), and small furniture and bus-body manufacturers could be served by the distributors. Thus, major tasks can be shared between the company and the intermediaries.

**Number of Intermediaries** The business marketing firm has to decide how many intermediaries it should use for each type. There are three strategies available. A company may select one of these alternative strategies:

### ***Selective Distribution***

In selective distribution strategy, the business marketer selects a few (i.e. two, three, or even more) intermediaries to cover a particular geographical area. The criteria for selection depend on the product characteristics and customer needs. **For example**, the business customers of aluminium extruded products need advice about applications, quick delivery, competitive prices and installation services. The marketer of aluminum extrusions selects those few distributors (or dealers) who satisfy the customer needs. As the number of distributors are limited to a few in a particular market, selective distribution strategy gives the business marketer better control and less costs than intensive distribution strategy. However, the distributors or dealers can carry competing products.

### ***Intensive Distribution***

For standard products with less unit value and more frequent purchases, such as electric lamps and tubes, cleaning powder, intensive distribution policy is appropriate. When customers demand availability of such products near their factories, it is important to offer intensive distribution by placing the goods or services to as many distributors as possible in a given market. However, the manufacturer will lose some control on service levels and pricing by doing so.

### ***Exclusive Distribution***

When a manufacturer wants to have a very few intermediaries to handle the company's goods or services, and these intermediaries must not carry competing products, such arrangement is called exclusive distribution. By granting exclusive distribution, the business marketer expects superior selling and servicing efforts and skills.

In selecting one of the above distribution strategies, the manufacturer should consider the following criteria or factors. (1) End-users' willingness to search is an important factor. If the willingness to search is low, then a higher level of channel intensity, i.e. intensive distribution, is appropriate.

(2) Another factor is: do the intermediaries make enough money? The manufacturer should appoint enough intermediaries to cover the market, but not so many that none of them can make adequate money by selling the manufacturer's product. (3) The third factor is the price competition. If the manufacturer appoints large number of intermediaries, it can increase the intensity of price competition among them. The manufacturer should balance between these three conflicting factors and select an appropriate distribution strategy.

One good **example** of exclusive distribution is from a multinational company manufacturing, importing, and marketing hydraulic pumps, valves, and accessories. The company appointed initially nine exclusive dealers in India at various high-potential industrial areas for designing and assembling hydraulic equipment like power-packs, selling, and after-sales service. These exclusive dealers purchase hydraulic components from this company only. The company also allowed exclusive territories to the dealers, so that they would have adequate business. However, exclusive distribution has a legal constraint, if the company has a dominant market share in an industry.

**Number of Channels** In business marketing use of more than one marketing channel (called multichannel or hybrid channel marketing) is common. **For example**, Crompton Greaves for its industrial systems products like electric motors and alternators use the company's branch office salespeople for OEM (original equipment manufacturer) customers and government organisations, authorised dealers for small and medium enterprises (SMEs), and electronic channels for all those customers who prefer to use online buying process. Depending on the needs of serving various marketing segments, business marketers use more than one channels like, direct sales force, independent agents/representatives, distributors, and so on. The *benefits* of multichannel marketing are: (a) increased market coverage, (b) lower channel costs, and (c) more customised selling. However, the problem in using multiple channels is the possibility of conflict between the channels due to lack of clarity of territories or customers to be handled by different channel members. We shall discuss later in this chapter how to manage the conflicts.

**Terms and Responsibilities of Channel Members** The business marketer must spell out clearly the terms and conditions, and the responsibilities of the channel members in the agreements that are prepared after discussions. The major points covered are: (i) objectives, (ii) responsibilities, (iii) sales policy, and (iv) territory or market segments.

The agreement between the manufacturer and the channel intermediary like manufacturer's representative should generally start with the objective. **For instance**, the objective may be stated as 'to ensure a superior value to the target customers' or 'to work in partnering relationship to ensure superior service to customers'.

The *responsibilities or tasks* of both the parties should be spelt out to avoid future conflicts as to who will perform which tasks/services. **For instance**, if customers demand warranty service in equipment or machinery, it should be clear whether the manufacturer or the intermediaries will provide the warranty service.

The *sales policy* like the percentage of trade discounts to the distributors on the price list and the commissions to agents or brokers on the sales value of invoices should be agreed along with any incentives like cash discounts and quantity discounts. Other terms pertaining to payment or replacement of defective parts during warranty period should also be spelt out.

*Territory or market segments* to be covered by the intermediaries could be a source of legal issue due to restrictive nature of territory allocations. It is better to get a legal advice on this matter.

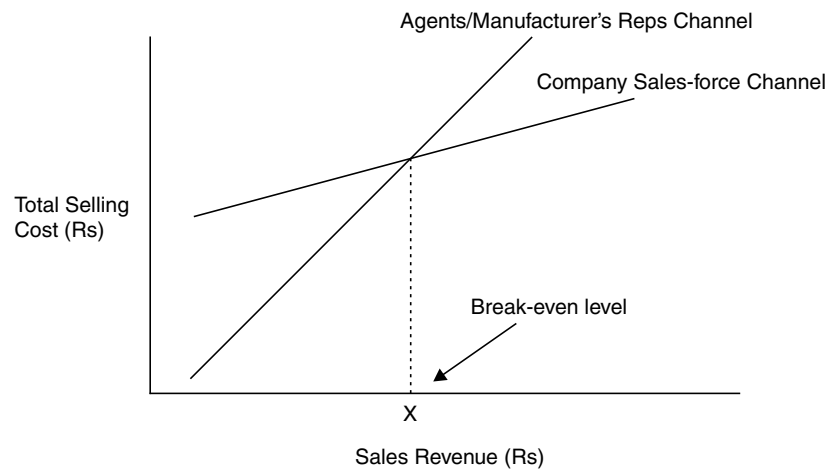
After analysing the four major issues the business marketer is in a position to identify the feasible channel alternatives. The next tasks are to evaluate the alternative channels and to select one or more channels.

### Evaluating the Channel Alternatives

The factors or criteria that are used for evaluating each of the channel alternatives are: (i) economic performance, (ii) degree of control, and (iii) adaptability to changing market situations, (iv) superior value.

**Economic Factor** Economic performance of each channel alternative should be compared. For this, the business marketer is required to estimate the levels of sales revenue and selling costs of each channel alternative. The different levels of sales revenue can be optimistic, realistic, and pessimistic. Similarly, the total costs of selling at the three levels of sales revenue can be estimated. These estimates are then plotted on a graph.

As shown in Fig. 9.3, at one level of sales revenue, say  $x$  sales, the total selling costs are same for the two channel alternatives. This is the break-even level. If the expected sales revenue is below the break-even level, the agents channel is appropriate because of lower selling costs. However, in case the estimated sales revenue is higher than break-even level, company sales force channel is more economical as the selling costs will be lower.



**Figure 9.3** Comparison of Channel Alternatives by Economic Factor

**Control Factor** The degree of control that the business marketer can exercise over the channels is an important factor. The degree of control means to what extent different channels implement the company's policies or strategies, such as not to charge the customer more than the price list, and to ensure no stock-out situation by carrying at least 15 days stock. The company sales force channel gives the marketer the maximum control followed by manufacturer's representative (or agent), and broker channels. The business distributor/dealer channel gives the least control. To **illustrate**, if a marketer wants a distributor to concentrate on the company's products which are not performing well, the distributor may not follow the advice because it is an independent business seeking to achieve its objective of

profit maximisation. Similarly, agents or brokers are interested in performing the selling function because they are paid commissions on sales value. Agents or brokers are generally reluctant to perform non-selling functions such as collecting market information, new product development, and payment collection.

**Adaptive Factor** In a rapidly changing market conditions, the business marketer must be able to control and modify the channel structure. At the same time there should be an agreement or commitment to each other among the channel members. The evaluation of channels must consider the degree of adaptability of the channels to the changes taking place in the market place.

**For instance**, a major competitor of STI, a manufacturer of steel components, started giving superior delivery service (from 70 per cent to 80 per cent) to major accounts like Tata Motors and Bajaj Auto at Pune. STI had to change its policy by having a warehouse near its major accounts at Pune, instead of getting the steel components from its warehouse near Mumbai, which was about 200 km from Pune. By doing so, STI improved its delivery service and the market share, better than its competitor. This change was possible because the company had a direct sales channel through its sales force.

**Superior Value** Business marketers must understand clearly what service outputs target market segments and customer firms need. This is because service is the major value (or benefit) that channels provide. **Examples of** service outputs are 95 per cent on-time delivery and 24-hour availability of spare parts. The type of services needed by customers will indicate the type of channels the supplier firm should select in order to give superior (to competitors') value. **For example**, if business buyers of large generating sets expect the supplier firm to ensure 24-hour availability of all spare parts, the supplier firm should have its own regional service centres to provide superior post-sales service.

### Selection of Channel Structure

The selection of one or more channels out of the various available alternatives can be done on the basis of the channel design framework, as shown in Fig. 9.2. However, it seems that the framework is not focusing adequately on the customer needs. To ensure an emphasis on customers' requirements, the business marketer should first understand the degree of importance given by the customers to service in their purchasing factors. The type of customer service may vary depending on the product and customer needs. **For example**, for the manufacturer of elevator, the customers may rate pre-sales and post-sales services as the most important purchasing factor. The manufacturer should select the channel which can effectively satisfy the customer needs better than the competitors.

The customer focus should be reflected in the channel objectives, as mentioned earlier. This may create an ideal channel design which can then be modified according to channel constraints and the evaluation factors.

Once the channel is designed, it must be managed or administered effectively.

## MANAGING OR ADMINISTERING CHANNEL MEMBERS

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After a particular channel structure is selected, the business marketer must manage or administer the channel members or intermediaries. Managing channel members includes (a) selecting intermediaries, (b) motivating channel members or middlemen, (c) controlling or managing channel conflicts, and (d) evaluating performance of channel members, or channel partners.

## Selecting Intermediaries

The selection of intermediaries or middlemen is a continuous process. Some intermediaries leave the channel and others are terminated by the business marketing firm. Hence, selection of channel members is not a part of channel design.

**Criteria for Selection** It is necessary for the business marketer to determine criteria or factors for selection of intermediaries. These criteria differ depending on the type of middlemen and the business firm's particular product/market situation. **For instance**, the criteria determined for selection of distributors for its hydraulic products, Bosch included minimum three years experience in designing hydraulic circuits, assembling power packs (i.e. equipment used to move goods), marketing, and customer service. Besides financial standing, location, and type of customers served in the past were the other factors considered for selection of distributors.

Companies need to select their channel members or intermediaries carefully. Generally applicable criteria for selecting distributors should be: (1) location, (2) relevant experience, (3) financial standing, and (4) infrastructure (like warehouse, sales and service people, office). If intermediaries are agents (or manufacturer's representatives), the selection criteria to be used by the manufacturer should be: number and characteristics of other products/services represented by the agent, contacts/relationships established with business customers in a geographic area, size and quality of the sales force, and leadership. However, as said earlier, the criteria will defer from a company to company, depending on channel objectives, tasks to be performed, type of intermediary, and product/market situations.

Business marketers thereafter generate a list of candidates for each type of intermediaries through trade associations, database marketing firms, or advertisements. They visit each prospective channel member (or intermediary) to assess capabilities, facilities, and interest. Next, business market managers negotiate with preferred or short-listed intermediaries. Finally, the manufacturer and its intermediaries finalise an agreement, which identifies the responsibilities of both parties and the compensation that each will receive.

## Motivating Intermediaries

The business marketers must continuously motivate their intermediaries (or channel partners) to achieve long-term success. Motivating their intermediaries to achieve top performance should start with understanding the middlemen's needs, perceptions, and outlook. The quality of support from channel partners will depend on the motivational techniques used.

**Partnership Concept** Some business companies have recognised the importance of partnership concept with their intermediaries. They prepare agreements signed by both the manufacturer and the channel partner, specifying clearly the objectives, policies, and the tasks or the services to be performed by both the parties. Both the manufacturer and the intermediary agree that a formal agreement or contract is the effective way to implement the partnership concept and avoid potential conflicts. Partnerships (or partnering relationships) require cooperation, communication, trust, and commitment among channel members. The objective is to lower total costs, and/or increase value for the channel, in order to achieve mutual benefits.

Similar to customer relationship management (CRM), partner relationship management (PRM) system is used for making it easy for a manufacturer (or supplier) to effectively communicate with channel partners (or intermediaries), and organise coordinated joint efforts on selling, marketing, and servicing.

The objective to be achieved is to deliver superior customer value to ultimate business customers. PRM systems involve Internet or extranet-based software. The supplier (or manufacturer) organisation creates PRM software modules, and establishes a website or online portal for use of intermediaries. PRM software modules carry out a number of applications. **For example**, the supplier firm distributes sales leads to intermediaries, provides technical training to distributors' personnel, routes technical service requests from customers to appropriate service providers, and follows deliveries. Whirlpool Corporation uses a PRM system in its joint venture operations in Mexico to coordinate the activities of distributors and repair service providers across Latin America for a wide range of branded home appliances like refrigerators, washing machines, dishwashers, and ovens.

**Vendor (or Supplier) Managed Inventory System (VMI)** This is a good example of the application of partnership concept. Through the VMI system, the company receives continuous information from distributors/dealers on balance inventory, via electronic data interchange (EDI). The company fills up the inventories automatically to the specific reorder levels, which are decided for each distributor/dealer based on the customer delivery service goals. The company sends electronic invoices, dispatch details, and order acknowledgements to its dealers/distributors. The VMI system shows stocks of slow-moving items at the distributors' warehouse and generates a material return order. The slow-moving stocks are sent back to the company. Distributors/dealers, due to VMI system, have reduced their costs and given superior delivery service to customers. This is how some companies help distributors (channel partners) to deliver superior value to customers, and thereby gain increased sales volumes.

In the new economy, that is based on "digital revolution" and the management of information, the intermediaries (or middlemen) are not considered as customers. They are treated as channel partners in delivering superior value to final customers.

**Reasonable Discounts and Commission** Generally, the main motivating factor for intermediaries is the compensation rates. The percentages of discounts (to distributors/dealers) and commissions to (agents or brokers) should be in line with the particular industry norms and must be adjusted to the changing conditions. **For instance**, if inflation in expenses on travel, lodging, and boarding is high over a period of one year after the agreement is signed between the manufacturer and the distributor, the discounts should be suitably adjusted, although such increases are painful to the manufacturer. Some companies, like 3M Corporation, have systems of distributor margins, which determine the compensations depending on the costs and services performed by distributors.

**Distributor Councils** Some companies have established dealer/distributor councils to bring together the manufacturer's executives and the distributors periodically to discuss and plan sales training, promotion, and sharing of industry and competitors' information. The distributor councils will be effective if the ideas or proposals discussed during the council meetings are implemented promptly.

**Training and Coaching** During distributor council meetings training and coaching programmes are planned. Typically, training programmes are: skill training and certification programmes. **Skill training** includes specific topics, such as selling skills, servicing/repairing, and selling to major customers. The manufacturer can provide such training programmes to distributors' sales and service representatives in class-rooms or based on CD-ROM. In a **certification programme** the supplier firm offers technical courses to the personnel from channel partner (or intermediary) firms. **For example**, Microsoft Corporation requires third-party service engineers to become certified to deliver value-added business solutions only after the engineers complete a series of courses and pass certification exams. Research has shown that participants of training programmes forget 80 per cent of what they learn within a few

months after attending a training programme<sup>4</sup>. **Coaching or reinforcement trainings** are needed in sixteen-weeks period after the initial training programmes. Coaching includes senior salespeople or sales managers coaching new or junior salespersons, web-based or online methods to reinforce formal training sessions, and refresher (or continuous) training for experienced salespeople.

**Channel Positioning** It is the process of establishing and sustaining the supplier's (or manufacturer's) reputation among targeted resellers (or intermediaries) for delivering superior value<sup>5</sup>. For this, the supplier develops a reseller value proposition and **channel offering**, consisting of (1) core elements (e.g. trade, quantity, and cash discounts), (2) capability-building programmes (such as training, promotional support, responsiveness system), (3) incentive programme (like bonus, commission on sales to distributors' salespeople). The supplier prepares a "**channel positioning matrix**", which does a comparative analysis on above three factors of what the supplier provides to its resellers (e.g. distributors), what its competitors provide, and what its resellers' requirements are. The channel offering not only compensates resellers adequately for their efforts, but also encourages them to give augmented services to ultimate customers. This process ensures resellers (or intermediaries) deliver superior value to customers, and also the supplier gains a reputation (or channel position) among resellers for delivering superior value to resellers.

**Other Motivational Practices** Some companies arrange annual retreat with company executives and distributors interacting in seminars and outings. Some other companies implement *quick response system* to distributor calls by assigning the responsibility to specific individuals. Some business firms have developed *computer aided management techniques* to assist their distributors in the areas of inventory control, order processing, and product performance.

The success of the motivational techniques depend on the business *marketer's attitude* towards channel members. Good relationships between the manufacturer and its intermediaries will be key to the success in a competitive market conditions.

### Controlling Channel Conflicts

Even though a manufacturer's channel design is done well, there will be some conflict because of the differences in the objectives and perceptions of the channel members. The conflicts or tensions between the channel members can damage channel performance. Business marketers should periodically undertake surveys of intermediaries or conduct formal/informal discussions with them to assess the areas or sources of conflicts. Some of the sources of conflicts are indicated in Table 9.1.

**Table 9.1** Sources of Channel Conflicts

<i>Sources of Conflict</i>	<i>Examples</i>
1. Differences in objectives	Manufacturers want long-term profitability but distributors prefer short-term profitability
2. Dealings with customers	Distributors and agents feel cheated when the manufacturer deals with large customers and asks intermediaries to serve small customers
3. Differences in interests	The manufacturer feels that the distributor is not giving adequate attention to the entire range of the company's products. The distributor is interested only in the products that are fast moving or have higher profits.

*Contd.*



4. Differences in perceptions	The manufacturer wants the dealer to carry a higher inventory due to the perception of good market conditions. The dealer does not want to carry higher stocks as the dealer's perception of the market is pessimistic.
5. Compensation	Manufacturer's representatives (agents) feel that the commission percentage offered by the manufacturer is not adequate. The manufacturer thinks otherwise.
6. Unclear territory boundaries	The territory boundaries between distributors or between distributors and agents are not clear, resulting in competition among the company's intermediaries to secure business from the same customers.

The channel conflicts can be controlled or managed in several ways, including effective communication network, joint goal-setting, diplomacy, mediation, arbitration, and developing vertical marketing system (VMS).

An **effective communication network** between the manufacturer and the intermediaries can be developed through periodic formal and informal meetings, distributor councils (discussed earlier), and co-optation of intermediaries on board of directors or advisory committees. **For example**, STI company had co-opted its three agents from Kolkata, Ahmedabad, and Chennai on the board of an associated company as directors.

In **joint goal-setting**, the channel members come to an agreement on the super-ordinate (or fundamental) goals they jointly seek. Such goals can be leadership in market share, customer satisfaction, and total quality management (TQM) in a highly competitive market where survival and success of channel members depend on their performance and cooperation.

The channel members may resort to diplomacy, mediation, or arbitration, when conflicts are sharp. **Diplomacy** is used when the conflict is resolved through discussions between the persons from both the parties. In **mediation**, a neutral third party tries to conciliate the interests of the two parties. In **arbitration**, both the parties present their arguments to a third party (i.e. the arbitrator) and agree to accept the arbitration decision. In mediation, the decision of the mediator is not binding on the parties in a dispute. However, in arbitration, the arbitrator's decision in a dispute is binding on both parties.

#### VERTICAL MARKETING SYSTEM (VMS)

Vertical marketing system (also called *vertical integration*) has emerged in recent years to challenge the conventional marketing channels discussed so far in this chapter. In the conventional marketing channels, the channel members (i.e. the manufacturer and the intermediaries) are the independent business firms who seek to maximise their own profits. No channel member has complete or substantial control over the other members. In contrast, the vertical marketing system, consisting of the manufacturer, distributors, and manufacturer's representatives, acts in a unified manner. The VMS was developed to control the behaviour of channel members and eliminate or minimise channel conflicts. The three types of VMS are: (i) corporate, (ii) administered, and (iii) contractual. In *corporate VMS*, high level of control is achieved through single ownership of production and distribution. An *administered VMS* achieves the channel cooperation through the dominant economic power of the manufacturer, and in *contractual VMS* the independent firms performing the production and distribution functions achieve the objective of value-adding partnership on the basis of legal contracts. These three types of vertical marketing systems compete with each other to achieve a superior customer service and economies in costs.

Consider the **example** of Royal Classic Group on vertical marketing system: Tirupur-based Royal Classic Group was in the process of becoming fully vertically integrated, right from production of fibre to distribution and retailing of apparel. The vertical chain included cotton cultivation on a 2000 acre land through contract farming. This was followed by cotton ginning to spinning, knitting, processing, garmenting, and retailing. The group invested ₹ 700 million on capacity expansion, vertical integration and retailing. The group stepped up its focus on its domestic apparel division, under the “Classic Pole” brand, which was present in 1000 multibrand outlets. However, the group’s mainstay was exports, which accounted for 90 per cent of its business.

### Evaluating Performance of Channel Partners

It is a good policy for the business marketer to evaluate the performance of each channel partner periodically. An evaluation is useful for the producer to know which intermediaries are achieving favourable results and which are not. The intermediaries not performing well need to be counseled, retrained, remotivated, or terminated. An evaluation data can also be used while deciding which type of middlemen to be used (channel structure design)—industrial distributor, manufacturer’s representative, broker, value-added reseller, commission merchant, or jobber.

The factors or criteria to be used for an evaluation of middlemen’s performance can include (a) sales achieved vs sales quota, (b) average inventory levels, (c) customer delivery performance, (d) customer complaints, (e) cooperation in market feedback, (f) support for new products, and (g) new customers generated. Out of these factors, the business marketer must first identify the factors that are relevant and useful for evaluating the performance of intermediaries. The second step is to assign weights (or importance) to each factor so that the total of weights assigned to various factors add up to 1.00, as shown in Table 9.2, in an **example**.

**Table 9.2** Weighted Factor Method for Evaluating Channel Partners

<i>Evaluation factors</i>	<i>Weightage (A)</i>	<i>Evaluation (B)</i>	<i>Channel Partner Score (A) × (B)</i>
1. Sales achieved vs sales quota	0.40	8	3.20
2. Customer delivery service	0.20	6	1.20
3. Customer complaints	0.15	6	0.90
4. Market feedback	0.10	5	0.50
5. New customers generated	0.15	4	0.60
<b>Minimum Total Score = 6.0</b>	1.00		6.40

The third step is to evaluate each middleman (channel partner) on each factor on a 10-point scale, where 1 represents a very poor performance and 10 represents an excellent performance. To ensure objectivity in evaluation, the business marketer should establish standards or norms of performance. **For example**, if sales achieved in a period is 100 per cent or more of the sales quota or target, the rating will be 10. If sales achieved is 80 per cent of the sales quota the evaluation rating will be 8, and so on. The next step is to multiply the weightages in Column (A) with the middleman’s evaluation in Column (B) and summing these scores. The outcome is a total score, which represents the performance of the middleman. The channel partner evaluated in Table 9.2 scores 6.40. This compares favourably to the expectation of the marketer that all the channel numbers must get a total score of at least 6.0. Similar exercises are carried out for other channel partners.

### TRENDS IN BUSINESS MARKETING CHANNELS

Some trends are shaping up in business marketing channels. These are briefly outlined below:

1. One of the most important channel developments in recent years is the vertical marketing system (VMS) which was discussed earlier in this chapter. The VMS has challenged the conventional marketing channels. Its objective is to have a better control on the channel members so that the channel conflicts are minimised. A VMS acts as a unified system and aims at a superior customer service at lower cost, compared to those of competitors'. The major types of VMS are corporate, administered, and contractual, as discussed earlier.
2. In recent years companies have started adopting multi-channel marketing instead of single channel marketing that was followed in the past. In multi-channel marketing, a business firm uses two or more marketing channels to reach one or more customer segments. The advantages of multi-channel marketing are increased market coverage, lower channel costs, and more customised selling. The disadvantage of multi-channel marketing is the problem of conflict which occurs when two or more channels compete for the same type of customers.
3. On an average, industrial dealer/distributor firms are becoming somewhat larger in size and volume of operations. In spite of increased competition and increasing cost of operations, large distributors can survive and succeed due to economies of scale, but small firms tend to disappear.
4. The large distributor/dealer firms are likely to use computers for data processing for inventory control, order processing, payment receivables, customer billing, and so on. Due to computerisation, the traditional service role of salespersons (e.g. inventory and delivery checking) will disappear and salespersons will get more time to do field selling (i.e. contacting more customers, or increasing the frequency of customer visits with the objective of increasing the sales volume).
5. The importance of industrial distributors or dealers will increase due to increasing costs of inventory carrying and payment receivables from customers. The manufacturers will shift more responsibilities to distributors for the same reason of concern for increasing costs. As a result, responsibilities, such as physical distribution of products, storage of final product, payment collection from customers, and after-sales-service to customers will be passed on to the dealers or distributors.
6. Intermediaries will increase their technical competence and product knowledge by employing and training sales representatives. Thus, there will be a trend towards product specialisation by distribution channels.
7. As a result of an increase in the size of an intermediary, performance of more functions or services, and a better hold on customers the trade discounts to distributors or commissions of manufacturer's representatives will go up. The management of intermediary firms will become more sophisticated.

## INTRODUCTION TO PHYSICAL DISTRIBUTION MANAGEMENT, LOGISTICS, AND SUPPLY CHAIN MANAGEMENT

In early 1960s, efforts were started in the United States to integrate various activities of distribution into a single function, called '**Physical distribution management**' (PDM). The major activities that were coordinated in PDM were transportation, warehousing, inventory management, order processing,

and material handling. The objective was to meet the customer's delivery requirement at minimum cost. PDM gave a focus to customer service and distribution costs.

Late 1970s saw emergence of **logistics** as a function that coordinated the flow of materials from suppliers to the manufacturing organisation through operations (or production) within the organisation and then out to the customers. The word logistics is derived from the Greek word 'logistikos,' which means 'to reason logically' or in other words, a logical arrangement of moving goods from the raw material stage to the finished goods stage.

The discussions on the concept of **supply chain management (SCM)** has started from early 1990s, with a focus on planning, organising, coordinating and controlling supply chain activities to deliver superior customer value. Supply chain management is a broader concept that sees a company at the centre of value network, which is a system of partnerships and alliances created by a firm to source, augment, and deliver superior value to its customers. This value network in supply chain management includes its suppliers and its suppliers' suppliers and its immediate customers and their end customers.

There is a debate on the definitions of terms like physical distribution management, logistics and supply chain management. However, we find a lot of evidence that these terms are used interchangeably. We shall define and discuss these terms in greater details hereunder, starting with supply chain management and thereafter dealing with logistics management as well as physical distribution (or market logistics).

## SUPPLY CHAIN MANAGEMENT (SCM)

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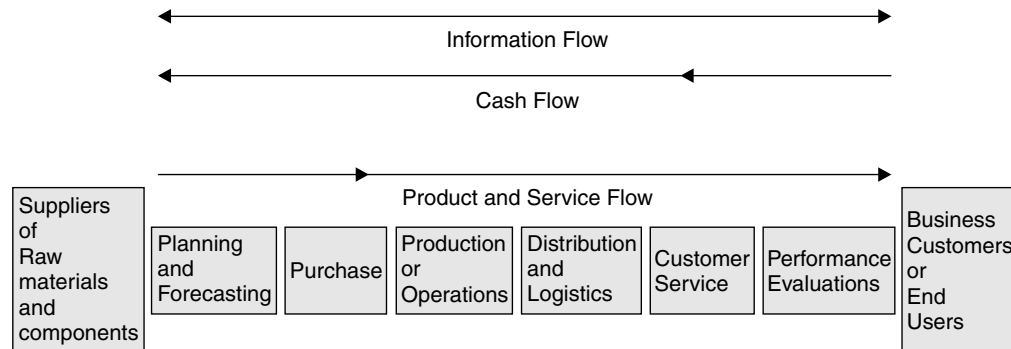
Traditionally, planning, marketing, purchasing, manufacturing and distribution departments operated independently, often with conflicting objectives, without integration. Both supply chain management and logistics management are involved in integrating various functions and companies as well as multiple flows of physical goods (e.g. raw materials and finished goods), financial services (e.g. payments and credits) and information (e.g. orders and delivery status). That is why they are used interchangeably. However, there is a need to define these terms to understand the difference. **The Council of Logistics Management (CLM)** has defined supply chain management (SCM) as : "the systematic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain for the purposes of improving the long – term performance of the individual companies and the supply chain as a whole." However, the **Supply Chain Council** has defined SCM differently : "supply chain management encompasses every effort involved in producing and delivering a final product or service, from the supplier's supplier to the customer's customer. Supply chain management includes managing supply and demand, sourcing raw materials and parts, manufacturing and assembly, warehousing and inventory tracking, order entry and order management, distribution across all channels and delivery to the customer."

As shown in Fig. 9.4, a typical supply chain extends from the company suppliers (i.e. point-of-origin) to its customers (point-of-consumption) and involves three flows (or movements): information flow, cash (or financial) flow, and product and service flow.

The overriding objective is customer satisfaction by delivering superior customer value.

The major *objectives* of supply chain management (SCM) are to: (a) reduce cost per unit for end customer; (b) minimise order-to-delivery cycle time; (c) reduce waste and duplication; and (d) ensure superior delivery service. Leading firms like Hewlett-Packard (HP) and Dell have successfully adopted supply chain management, which has given them competitive advantage.

Supply chain management includes all the activities that are connected with moving goods from raw material stage through various operations to the ultimate customer or end user. This is shown in Fig. 9.4. Supply chain management focuses on improving the flow of products, services, and information as they move from origin to end user.



**Figure 9.4** Supply Chain Management Framework

In order to achieve the objectives of supply chain management (SCM), a firm must coordinate and integrate various functions or activities that are carried out across different organisations. The *functions* performed in SCM are (a) purchase, (b) product design, (c) production planning, (d) production, (e) processing customer orders, (f) inventory control, (g) warehousing, (h) material handling, and (i) customer service. The different organisations that carry out these functions include suppliers of raw materials and component parts, wholesalers or distributors, transporters, material handling and information processing firms.

It is important that all organisations that are involved in SCM should have partnering or collaborative relationships, as they have to share sensitive information about customers, product demand and corporate plans. In addition, SCM includes forming teams of people that are drawn from various functions and organisations to plan, coordinate and implement SCM activities. **For example**, two- and four-wheeler auto manufacturers like Hero Honda, Bajaj Auto, TVS, and Maruti Suzuki have integrated their supply chain processes with those of component suppliers so well that they have achieved the objectives of on-time delivery, reduction in costs, and improvement in profitability.

### Components of a Supply Chain

A supply chain includes collaboration between a company and its partnering organisations, such as suppliers, intermediaries (or middlemen) and customers. We can broadly classify a supply chain into the following three components or parts:

**Upstream Supply chain** This component of the supply chain is mainly involved with the purchase of raw materials and components. The suppliers of raw materials and components could be manufacturers themselves with their own supply chain. **For instance**, a manufacture of passenger cars may buy steel from a supplier who may have its own supply chain. The major tasks performed in this part of the supply chain are procurement and transportation.

**Internal Supply Chain** In this part, first raw materials and components are received and stored in a warehouse by using material handling equipment. Thereafter, these raw materials, components and

supplies (such as operating and maintenance items like fasteners and lubricants) are used to produce finished goods. The finished goods are stored in the factory warehouse. The main functions carried out in this part are material handling, warehousing, inventory management and manufacturing.

**Downstream Supply Chain** This is the last component of the supply chain that is involved in delivering the finished product from the manufacturing unit of the company to its intermediaries and also directly to its customers. The major activities included in this part are transportation, warehousing, inventory management and customer service. These activities are performed by the manufacturer as well as intermediaries.

### Need for a Supply Chain Review<sup>6</sup>

There are some visible symptoms in business that indicate the need for a review and redesign of the supply chain functions. Some of these symptoms are as follows:

1. Slow response to changes in the marketplace. **For instance**, if a major competitor makes a change in the pricing policy in terms of trade and quantity discounts, the company does not react in time.
2. Rejection and return of large quantity of materials by customers, as the materials supplied do not meet with customers' requirements.
3. Building up large inventories at the warehouses in order to meet customer's demanding delivery service needs of 90 per cent to 95 per cent levels.
4. The company is not confident of committing specific delivery dates, under penalty clauses, for large valued domestic and export orders.
5. Improper planning, including forecasting, resulting in either excess stocks or no stocks when required.
6. Internal departments (or functions) as well as partnering organisations involved in supply chain management blame each other for high costs and customer dissatisfaction.

Once the above-mentioned symptoms are observed, the company can either conduct a detailed study and take corrective actions internally, or seek assistance from supply chain management (SCM) consultants, who are also sometimes SCM software vendors.

### Supply Chain Integration

Richard Williams, Director, Safeway said: "While there will be many opportunities to improve our own (internal) processes, the greater prizes will be achieved by working together (of organisations involved in SCM) to optimise the total supply chain across organisational boundaries." A firm must coordinate and integrate various functions, processes, policies, and databases across different organisations, such as suppliers, distributors, transporters, material handling and information processing firms. In supply chain management, the firm extends integration beyond its boundaries to supplier's supplier and customer's customer. Whereas in logistics management, the integration and coordination is carried out between various functions within the organisation. **For example**, a steel component manufacturing company was buying cold rolled (CR) coils from a public sector manufacturer (or supplier). The company discussed its problems on product quality and delivery with the C.R. Coil supplier, who had similar problems with the iron ore (i.e. raw material) supplier. Using SCM concept, the company approached the supplier's supplier (i.e. iron ore supplier) to solve its problems.

All organisations that are involved in SCM should have partnering relationships, which require transparency and trust in sharing information on planning, customer needs, and market demand. Supply chain integration has clear **benefits**. These are:

- Reliable demand management, with more accurate sales forecasts.
- Achievement of high levels of customer service.
- Reduced lead time (between order placement and delivery).
- Reduction in supply chain and working capital costs.
- Improved customer satisfaction.

Whilst the phrase ‘supply chain management’ is now widely used, a broader view has termed it as ‘*demand chain management*’ because the chain should be driven by the market, not by suppliers. This view considers the company at the centre of a network that includes its suppliers’ suppliers as well as its immediate customers and their end customers. With this idea, a supply chain could be more accurately defined as<sup>8</sup>: “A network of connected and interdependent organisations mutually and cooperatively working together to control, manage, and improve the flow of materials and information from suppliers to end users.”

An **illustration of “demand chain management” concept**, instead of “supply chain management” concept, can be given from the twist Procter & Gamble (P&G) is making to its supply chain. Global product supply officer of P&G, Keith Harrison said: “We want to produce things that are actually selling and not just things that are forecast to sell. The company’s move is towards a consumer-driven or demand-driven supply network. In the past, the thought process behind a supply chain started with the procurement of materials and moved through the organisation to retailers. Now, P&G is thinking about the chain starting with store shelves and moving back to its suppliers.” This change reduced the average level of out-of-stock products from 10 to 15 per cent to about half, which generated about \$700 million a year of incremental top line growth. Harrison further added “The company is on the brink of generating at least \$1 billion in annual sales by renewing its focus on supply chain network.”<sup>9</sup>

## Trends in Supply chain management

The major trends in supply chain management are as follows:

**(i) Use of Technology** For effective management of a supply chain, various technology tools are required. **For example, EDI** (electronic data interchange) is the electronic transmission of business documents like purchase orders, invoices, and order acceptance between computer systems of companies doing business with each other. Now, internet based EDI is available that is almost free. An **ERP** (enterprise resource planning) system integrates key businesses and management processes within and beyond an enterprise’s boundary. It integrates many information systems into one enterprise-wide system. The **RFID** (radio frequency identification device) uses the radio frequency electromagnetic field to extract data from a tag attached to an item for automatic identification and tracking. The Global Positioning System (**GPS**) technology enables the supply chain managers to locate the exact position of vehicles, people, or even inventory in the supply chain. The Electronic Procurement System (**EPS**) facilitates the supplier discovery and sourcing, supplier management, procurement, order placement, and so on. Companies which use technology will be able to provide superior quality of service at a lower cost compared to their competitors.

**(ii) World Class Supply Chain Management (WCSCM)** A world class company is recognised globally and is able to provide superior value to its customers than its competitors. At the same time, it makes profits in the long term. The strategies used by these companies include: (i) use of world class manufacturing model, (ii) all processes like planning, sourcing, production, and distribution of products and services are value centric, and (iii) linkages between suppliers, the company and customers take place through linked networks of workstations, shared data bases, technology tools and facilities. The concept of world class supply chain management is spreading across the globe in most of the countries. However, more such companies are seen in advanced economies.

**(iii) Lean and Agile Supply Chains** Two major developments in supply chain management are seen recently. One is lean supply chain which has come from Japanese management approach. In this proposal, first the company tries to understand clearly the value from the target customers. Thereafter, the company identifies and organises all the supply chain activities to satisfy the customer value and eliminates the nonvalue-creating activities. Instead of traditional “batch and queue” approach, the focus is on continuous flow of products in the supply chain. This approach eliminates time wastage, storage and scrap. The products, in this method, are produced against customer orders, and hence, customer waiting time and finished goods inventories are substantially minimised. The objective here is to have stable demand as a result of joint working in cooperative way between suppliers and distributors. The companies that are following lean supply chain approach are Toyota and Dell. However, this approach cannot respond adequately to unexpected changes in market demand. The agile supply chain reserves production and distribution capacity to respond to unpredictable market demand. The agile models are flexible and have capacity for rapid changes. The focus of the agile supply chain is increased responsiveness to the market and customer satisfaction.

## LOGISTICS MANAGEMENT

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Logistics term was originated in the military. It came into practice in business management in two broad areas, viz. materials management (or physical supply) and market logistics (or physical distribution) in 1970s, as shown in Fig. 9.5. Logistics management coordinates and integrates flow of physical supply and physical distribution to meet the delivery requirements of business customers. Logistics management was extended to the concept of supply chain management by integrating operations with suppliers' suppliers and customers' customers.

### Definitions of Logistics

Logistics has been defined in various ways. A broad definition is “having the right thing at the right place at the right time and at the right cost.” Logistics world 1997 defined it as “The science of planning, organising, and managing activities that provide goods or services.” Council of Logistics Management has defined logistics as “the process of planning, implementing, and controlling the efficient, cost-effective flow of goods, services, and related information from the point-of-origin (i.e. suppliers) to the point-of-consumption (i.e. customers) for the purpose of conforming to customer requirements.” This definition is almost same as the definition of supply chain management, done by the same council of Logistics Management! We, therefore, suggest the following definition, which seems to be more appropriate: “Logistics refers to the design and management of all activities (mainly transportation, warehousing, and inventory) necessary to make materials available for manufacturing and to make finished goods/products available to customers, as they are needed and in the condition required.”



Logistics has assumed strategic significance for creating customer value. “Logistics has the potential to become the next governing element of strategy as an inventive way of creating value for customers, an immediate source of savings, an important discipline on marketing, and a critical extension of production flexibility. Customer needs vary and companies can tailor logistics systems to serve them better and more profitably,” according to Fuller, O’Connor, and Rawlinson.<sup>10</sup>

**Scope of Logistics** Logistics is relevant to a wide range of manufacturing and service organisations, who believe in maximising customer service. It is important to manufacturing units; government departments; institutions like educational, health-care and hospitality and service organisations, such as retailing, financial services, trading, and so on. Scope of logistics can include: (1) inventory management and control, (2) customer service, (3) transportation, (4) warehousing, (5) plant and warehouse locations, (6) order processing, (7) logistics communications, (8) packaging, and (9) material handling. Logistics industry has now shifted from providing transportation to giving solutions, as per the *Economic Times*’ ETIG survey conducted in December 2006 in India. Currently, the trend of outsourcing the entire logistics function to a “third party logistics” (3PL) service provider is visible only in a few sectors like auto mobiles in India. The 3PL market, which was valued at ₹ 38 million in 2005, is projected to grow at a CAGR of 22 per cent, to reach ₹ 150 billion by 2012.

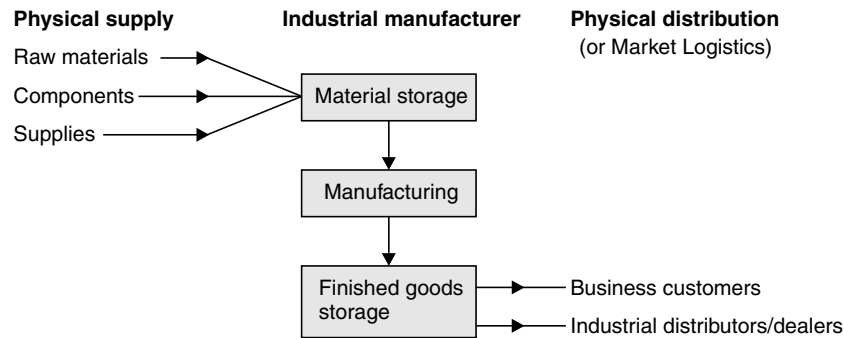
### Integration of Sales, Marketing, Logistics, and IT

Increasing number of business marketing firms have been realising the strategic importance of logistics to create value for customers. These firms are integrating sales, marketing, and logistics functions with information technology (IT) systems. They form unified cross-functional teams, which develop and implement “**Integrated logistics systems (ILS)** that are offered to business customers. The cross-functional team from sales, production, logistics and information technology makes sales calls on the key business customer to understand the customer’s requirements and then offer logistics solutions to the customer’s problems. Often integrated logistics systems are designed and managed by logistics companies. **For instance**, Om Logistics provides logistics solutions to Muruti Udyog and other automobile companies. Similarly companies like Hindustan Unilever (HUL), BPL, HP, Zenith Computers and others are using logistics companies like Safexpress, Gati, Blue Dart, AFL, Patel Roadways, and others to improve customer response time and lower distribution costs. Logistics industry, which was about ₹ 1000 crores (₹ 10 billion) in size in 2005 in India, has been growing at 35–40 per cent per annum. Some of the logistics companies, like DHL and UPS, have been focusing on providing end-to-end solutions (by integrating back-end and front-end of the business) to small and medium enterprises (SMEs)<sup>11</sup>.

### MARKET LOGISTICS/PHYSICAL DISTRIBUTION

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Though the term logistics originated in the military, it has a usage in business. In business, logistics system has two major product movement: (i) Physical supply, consisting of supply of raw materials, components, and supplies to the manufacturing process. This is a part of materials management or purchase function (*see* Fig. 9.5). (ii) Physical distribution, consisting of delivering the completed (or finished) product to customers and intermediaries. It is a part of marketing management and is also called as market logistics. We shall focus on physical distribution (or market logistics).



**Figure 9.5** Business Logistics System

Many business marketers consider physical distribution as an important part of marketing strategy. The business marketer's capability to efficiently deliver the product can create a value for customers as a source of savings in costs. An efficient use of logistics has a significant impact on customer service. It creates a competitive advantage in the market place. In a study carried out on more than 1000 companies by Donald Bowerson, it was reported that companies with superior logistics performance gained higher percentage of customer loyalty.

#### JUST-IN-TIME (JIT) SYSTEM

Many business firms have adopted the just-in-time (JIT) system. In JIT system, all suppliers of materials and supplies must deliver products few hours before they are used. The system expects the suppliers to deliver the products at the precise time and in the exact quantity needed by the customer. The quality of the product must be perfect as there is no inspection at the customer's factory. The suppliers must coordinate with the customer's production schedule. The frequency of deliveries are more. Meeting the requirements of JIT system has the advantage of growing share of business with JIT-oriented business customers.

### Tasks of Physical Distribution

The tasks or activities which make up physical distribution are many. These are shown in Table 9.3. Each task affects customer value in terms of timely availability of the product.

The relationship between the various tasks or activities described in Table 9.3 can be complex. Like, there is a conflict between the objective of maximising customer service and the objective of minimising the distribution costs. At operational levels there are trade-offs among the tasks of physical distribution, like, to give prompt post-sales service to customer, the marketing executive may want to airfreight some spare parts, but the logistics manager may differ due to high airfreight cost. To manage the conflicts or complexities it is useful to consider the *total cost approach*.

### Total Cost Approach

It focuses on balancing the two important elements: (i) total distribution costs, and (ii) the level of service provided to customers. The objective of this approach is to evolve a system by balancing the total

distribution costs and customer service levels so as to maximise profits to the company and its channel members. It means that instead of considering individual cost elements of physical distribution, the total cost of distribution should be considered. Similarly, customer service level should be determined based on (a) customers' service needs, (b) competitors' service levels, (c) company's profitability objective. Thereafter, a relationship must be established between cost and service to determine the optimum service level.

**Minimising the Total Distribution Cost** It should be understood that individual cost elements interact in complex ways and any attempt to minimise any single cost element can actually increase the total cost. **To illustrate**, a business firm's policy decision to minimise inventory (stock) to a very low level so as to reduce inventory carrying cost resulted in stockouts and increase in order backlogs, special production runs for the stock out items, costly air-freight shipments to customers whose production had stopped due to non-delivery, and even reduction in orders due to poor performance on delivery. Thus, the result was that the total cost of distribution went up substantially. The major individual cost elements are transportation, inventory carrying, warehousing, and the hidden cost of lost business. The interactions between the cost elements involve cost trade-offs because these cost elements are sometimes in economic conflict with one another. Hence, the company must consider the total distribution cost of the proposed distribution systems and select the system that minimises the total distribution cost.

**Table 9.3** Tasks of Physical Distribution or Market Logistics

<i>Tasks</i>	<i>Brief Description</i>
1. Transportation	It is the means of moving goods from production unit to customers. It is the most important cost area in physical distribution
2. Warehousing	It provides storage space for products which are made available to customers when needed. It can improve customer service and reduce transportation costs
3. Inventory control	Inventory is used to ensure the products are available to customers in the right product-mix, at the right location, and at the right time
4. Packaging	It provides protection to products and maintains product identity when products arrive at the market place
5. Material handling	It increases speed and minimises costs of order-picking, moving products between storage and transport carriers, loading and unloading operations
6. Order processing	It starts the physical distribution process and directs various activities which are necessary to deliver the products to customers. Speed and accuracy of order processing affect customer service and costs
7. Communication	Information is exchanged between the company's physical distribution or market logistics department and its customers. It assists in performing various tasks
8. Factory and warehouse locations	Right locations of manufacturing plants and warehouses (or godowns) increase customer service and reduce transportation (or freight) costs
9. Customer service	The result of physical distribution activities is customer service. It creates customer value (or benefit) that has impact on the company's market share, total cost, and profitability.

$$\text{Total Distribution Cost} = \text{Freight} + \text{Warehouse Cost} + \text{Inventory Cost} + \text{Cost of Lost Sales due to Delayed Delivery}$$

**Return On Investment (ROI) Approach** Another approach companies use for balancing the two important elements or variables, viz. (1) total physical distribution costs, and (2) the level of logistical service provided to customers, is called total systems approach, ‘return on investment’ (ROI), or channel integration. In this approach, a company’s channel members work together to improve the level of customer service, which results in higher sales revenue. The channel members make incremental capital investment in technologically advanced warehouses and material handling systems. These capital investments, improve customer service substantially, resulting in much higher levels of sales revenue. The increase in sales revenue is much higher than increase in total physical distribution cost, resulting in a healthy return on investment of over 30 per cent. The formula used to calculate the ROI is:

$$\text{ROI} = \frac{\text{Sales revenue} - \text{total physical distribution cost}}{\text{Capital investment}} \times 100$$

## CUSTOMER SERVICE

There are various elements or components of customer service in business marketing, as shown in Fig. 9.6. In this chapter, we focus on distribution or logistical service (i.e. during—sales service), which mainly includes availability and delivery of the product. The elements of distribution service are indicated in Table 9.4. A research study has concluded that many business buyers rate distribution service second only to product quality as a buying decision factor.<sup>12</sup> In another interesting study, it was found that in some industries, a quality product at a competitive price was recognised as a given, and customer service was the key differentiator among competitors.<sup>13</sup> It is logical to understand that for a manufacturing firm an industrial product should be available for production and for a business distributor or dealer, it must be available for resell. It is important that business marketers integrate distribution or logistics service into the firm’s overall marketing objectives and strategy.

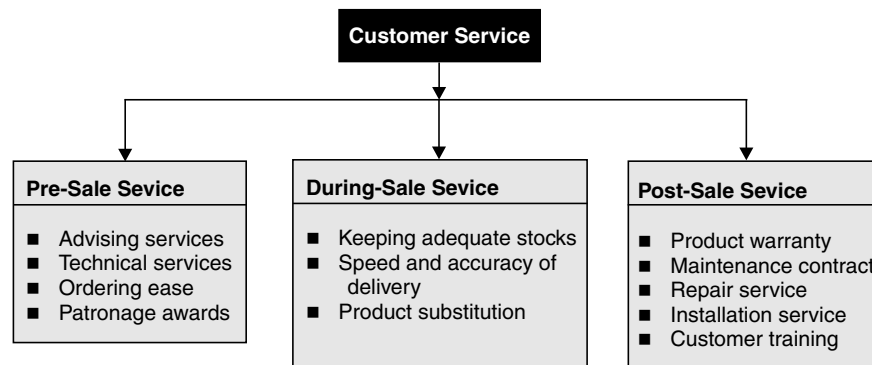
**Determining Customer Service Levels** Neither all customers nor all products require the same level of service—the buyers of heavy machines require lower service levels (i.e. ready availability) than the buyers of component parts. Similarly, which elements of service (as shown in Fig. 9.6) are more important to customers and what are the needs or expectations of service should be first understood by business firms. Next, the competitive environment in terms of the particular industry’s service standards or levels (as provided by competitors) must be established. Both the above information can be obtained through marketing research study.

The importance of each of the elements of service, as shown in Fig. 9.6, will vary from industry to industry and even from company to company within an industry. The following steps must be taken after determining the important elements of customer service.

- (i) Set the goals of customer service levels for each of the important service elements.
- (ii) Measure the actual performance for each service element.
- (iii) Analyse the variance between actual service performance and the goals.
- (iv) Take corrective actions to minimise the variance.

**Table 9.4** Elements of Distribution Service

<i>Elements</i>	<i>Description</i>
▪ Product availability.	Items available in stock for dispatch.
▪ Order cycle time (or Delivery time)	Time from the order placement to delivery of that order (includes order processing and transportation time).
▪ Order accuracy (or Perfect delivery)	On-time delivery and all items of the order delivered as per quantity and specification of the order.
▪ Information	Accurate and timely information on product availability, order status, dispatch details, and so on.
▪ Damage handling	Quick corrective actions on physical damage or claims due to errors.
▪ Ease of doing business	Includes many factors like order acknowledgement, timely information, order accuracy, product availability.

**Figure 9.6** Elements of Customer Service

### Integrated Approach to Total Distribution Cost and Customer Service

A well-known management consulting firm (viz. Hutchinson & Stolle) developed an approach—"How to Manage Customer Service", which integrated customer service with the total distribution cost. It is a six-step approach, as follows:

1. Define the various elements of customer service such as shown in Fig. 9.6.
2. Determine customers' opinion of service by collecting information from customers on the elements of service that are most important, its economic measure or importance, service levels offered by the firm and its competitors.
3. Develop a service package by keeping in mind that distribution should respond to customers' needs and expectations. Creativity is important at this stage, by looking at cost/benefit trade-off decisions. That is, how to achieve improved customer service at lower total distribution cost. **For example**, it may be better to use airfreight to despatch repair parts to customers from a

central warehouse location, instead of carrying inventory at many regional or branch warehouse locations and despatching them by truck to customers.

4. Develop a programme to sell the superior service offered to customers.
5. Test market the service package along with the selling programme (developed in step 4) to the existing customers for getting their reaction.
6. Develop performance standards and control for measuring the actual performance against standards or targets set, and take corrective actions where necessary.

### **Impact of Market Logistics on Intermediaries**

The business marketers must understand the impact of performance of physical distribution or market logistics on the operations of intermediaries. The marketer should then prepare and implement a plan that will improve the performance and coordination of the entire channel.

Inefficient performance of physical distribution such as erratic delivery either increases distributors' inventory costs or creates stockout situations resulting in loss of business. Such situation should be avoided by the supplier since it will affect the distribution loyalty and the marketing effort. A study has revealed that a five per cent reduction in customer service can result in a sales decrease of twenty per cent. The business marketer can improve the performance of physical distribution in the entire channel system by taking the following steps.

1. Develop computerised information system that will link individual channel members to the manufacturer's system. This will provide realistic sales and inventory of the channel members to the manufacturer.
2. Standardise packaging and material handling at all channel members to assist in efficient operations.
3. The manufacturer and the channel members should improve the performance of their respective tasks or services. Thus, the physical distribution must be integrated with the channel members to improve marketing effectiveness.

## **MAJOR COST CENTRES OF MARKET LOGISTICS**

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We discussed earlier total cost approach in distribution cost, where major cost centres are transportation, warehousing, inventory, order processing, and material handling. Although the focus is on total distribution cost, it is necessary to identify the major cost centres of market logistics (or physical distribution) and evaluate them. However, it should be recognised that these cost centres are interlinked and hence, in the final analysis, the evaluation of each cost centre should be done along with other cost centres of market logistics.

### **Transportation**

Transportation is usually the most expensive among the cost centres of market logistics. Transportation decisions affect customer satisfaction because it affects product pricing, delivery performance, and the condition of goods when they arrive. Transportation decisions include evaluation and selection of mode of transportation as well as individual carriers to achieve the objectives of excellent delivery performance and lowest cost.

**Transportation mode** means type of carrier. Rail, air, truck, waterway and pipeline are the primary transportation modes. Shippers are increasingly using a combination of two or more transportation modes, called “intermodal transportation”. This is possible due to containerisation, which consists of putting the goods in boxes or trailers that are easy to transfer between two transportation modes. **For example**, combination of rail and truck is described as “piggyback”; waterway and trucks are called as “fishyback”; waterway and rail is described as “trainship”; air and trucks are combined as “airtruck”.

**Criteria for selecting transportation modes** The major criteria used by shippers for selecting the mode of transportation out of the various alternatives (i.e. five primary and four intermodal transportation modes) are: (1) speed of service, (2) availability of service, (3) cost of service, (4) dependability of service, (5) capability of the carrier, and (6) frequency of service.

**Speed of service** is the elapsed time to move products from one facility (e.g. company’s warehouse or factory) to another facility (e.g. distributor’s warehouse or customer’s plant). Sometimes speed of service is more important than cost of service. Slower transportation modes like rail and waterway involve lower transportation costs, higher inventory costs, and lower service levels. The faster modes like air and truck have the opposite effect.

**Availability of service** is the ability of a transportation mode to serve any given pair of locations. Rail and air modes have to be combined with trucks for pick up and final delivery of goods, in order to make these modes available.

**Cost of service** consists of variable cost of moving goods from one facility to another. Transportation costs depend on locations of customers and the customer service goals to be achieved. The cost of service has to be seen in relation to customer service levels. **For instance**, a customer of a textile machinery manufacturer may need urgently some spare parts, and the manufacturer may decide to use air transportation mode instead of truck mode, although air freight is much more expensive than truck freight, in order to ensure superior customer service and customer satisfaction.

**Dependability of service** is important because it refers to the ability of the transport carrier to deliver the product on time and in good condition to customers consistently. Gati transport, therefore, had positioned itself in its advertisements as “on time, every time”.

**Capability to the carrier** means physically accommodating the size and weight of the product shipped. **For instance**, if bulk material like iron ore, steel, and coal are to be shipped, railways have the capability to carry the same. Automobiles are carried by specially designed trucks.

**Frequency of service** refers to number of planned movements of goods between two facilities. Petroleum products are transported by pipeline and trucks. Similarly, air freights are used for highly perishable products like flowers and fresh seafood.

The decision on transportation should also consider type of carriers to be used. Generally there are three types of carriers available: (1) common carriers, (2) contract carriers, and (3) private carriers.

**Common carriers** provide services between predetermined geographical points and these services are available to all shippers at standard rates. **For example**, railways are common carriers for transporting goods like raw materials, agricultural products and petroleum products.

**Contract carriers** are independent organisations selling transportation services to others on a contract basis. Contract carriers are available in trucking and waterway carrier industries. Some of the **examples** of contract carriers in trucking industry are Transport Corporation of India (TCI), and Saf-express.

**Private carriers** are those shippers who own truck or air fleets to ensure consistent delivery performance. Service improvement is the major point to justify the company owning a fleet of trucks, because private fleet are usually more expensive than contract carriers. **For example**, Future Logistics Solutions Ltd. of Future Group operates a fleet of 400 dedicated trucks for home and store deliveries and have plans to increase to 600 trucks.

The decision on transportation modes and the type of specific carriers is based on the cost and the desired delivery performance. To achieve the required customer service level, transportation is used in combination with warehousing and inventory management.

## Warehousing

The major warehousing decisions consist of number and locations of warehouses as well as type of warehouses. The **objectives** to be achieved in the warehousing decisions are to improve customer delivery service, and increase sales. **For instance**, a steel component manufacturing company opened a branch without a warehouse at Pune industrial area, which consisted of several customers including two OEM customers. The company decided to use its warehouse near Mumbai, which was 200 KM from Pune, for Pune customers. The sales and market share did not improve for about three years. Only when the company opened a new warehouse at Pune, its customer delivery service improved substantially, resulting in substantial increases in sales and market share that was much higher than the marginal increase in the warehousing cost. Decisions on number and locations of warehouses depend on market coverage, customer service level, and distribution cost.

**Impact of channel structure** Warehousing decisions are influenced by the channel structure used by a company. **For example**, when a manufacturing company uses its own sales force and agents (i.e. manufacturer's representations) in its channel structure, the company will need its own strategically located warehouses. Instead, a channel structure using industrial distributors or dealers will need a few company-operated warehouses to service the distributors, who will take care of local warehousing.

**Type of warehousing facilities** The decision on using the type of warehousing facilities to be used depends mainly on three factors: requirements of customer service levels, investments, and operating costs. The alternatives available to the company are: (1) private warehousing facility by owning the warehouse space, (2) public warehousing by renting the warehouse space.

**Private warehousing** has certain advantages such as a good control over warehousing operations and people, resulting in superior customer service. The major drawback of private warehousing is that it is not flexible. When sales of the company's products fluctuate, the warehouse capacity is not fully used, which may result in a loss.

Many third-party logistics (3PL) service providers, such as Safexpress, Transport Corporation of India (TCI), Blue Dart, Indo Arya, TNT, and Gati have planned to add 2 to 10 million sq. feet of warehousing capacity as a result of Government of India's decision of phasing out central sales tax (CST).<sup>14</sup>

**Public warehousing** has a major advantage of flexibility. The company can increase or decrease the warehousing space, or move out into any market, depending on demand for its products. Additional benefits of public warehousing are that the company's costs are variable (because only when the company uses the space provided by public warehouses, it incurs the warehousing rental expenses) and there are no fixed investment (as the company does not own the warehouse). Public warehousing firms, third-party logistics service providers, or contract warehouseers (who provide long-term and special services) may be appropriate when the company sales are seasonal, low to medium, or erratic. Public



warehousing can be used effectively when the company uses the channel structure of its own sales force and/or agents (i.e. manufacturer's representatives) as an additional warehousing facility.

## Inventory

Inventory levels are a major cost. They act as a buffer (or safety) stocks to minimise the impact of harmful effects due to deficiencies in the logistical system. The deficiencies may include (1) delayed shipments from the manufacturer, (2) poor performance of transport carrier, (3) production and demand not matching, and (4) customers unable to estimate their requirements accurately. The level of inventory will depend on the level of customer service required and knowledge of inventory carrying cost.

**Inventory cost or inventory carrying cost** includes (1) storage space charges, (2) cost of capital, (3) taxes and insurance, and (4) inventory risk costs (such as damage, pilferage, and obsolescence<sup>15</sup>). Inventory carrying cost is typically started as a percentage of the total inventory value of the products held in inventory. **For instance**, an inventory carrying cost of 24 per cent means that the cost of holding one unit in stock for one year is 24 per cent of the value of the product. This cost can vary from 12 to 36 per cent, depending on the type of product and other cost elements stated earlier. Hence, before taking any decisions on inventory, inventory carrying cost of each product must be calculated, instead of using a rule-of-thumb percentage representing inventory carrying costs<sup>16</sup>. Marketers should also recognise that inventory cost increases at a faster rate as the customer service level approaches 100 per cent.

**Inventory decisions** mainly include (1) when to order, and (2) how much to order, keeping in mind that the objectives of meeting customer service needs, and the company's cost standards. The decision on when to order can be taken based on reorder (or order) point, which can be calculated by the basic reorder point formula, as shown below:

$$R = D \times T$$

where  $R$  = reorder point in units  
 $D$  = average daily demand or requirement  
 $T$  = average delivery lead time

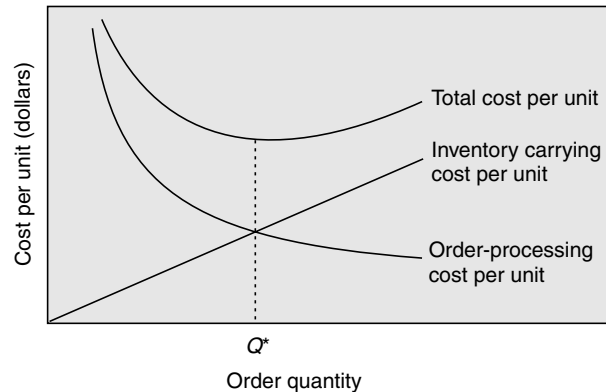
**For example**, if the delivery lead time (that is, the time taken from the date of placement of an order for a product on the supplier to the time the product is received by the manufacturer from the supplier) for a component part is seven days and the average daily requirement is 500 numbers, then the reorder point for the component is 3500 numbers. However, when there is uncertainty in either demand ( $D$ ) or delivery lead time ( $T$ ), an inventory safety or buffer stock (in units) is necessary to compensate for the uncertainty. As the stocks (or inventory) draws down to the reorder point, the order is released (in many companies, automatically by the computer) on the supplier. The reorder point should balance the costs of overstock against the risks of stockout.

The decision on how much to order is made by a firm by using inventory software (e.g. IBM's) or by observing how order-processing costs and inventory-carrying costs sum up at different order levels. Figure 9.7 shows how these two cost curves sum up into a total cost curve. The economic (or optimal) order quantity, ( $EOQ$ ),  $Q^*$ , is the lowest point on the total cost curve, which is projected down on the horizontal axis.

The standard formula for calculating the economic order quantity ( $EOQ$ ) is:

$$EOQ = \sqrt{\frac{2C_o D}{C_i U}}$$

where,  $C_o$  = cost per order (or ordering cost)  
 $C_i$  = annual inventory carrying cost (in percentage)  
 $D$  = annual demand (or sales) volume (in units)  
 $U$  = average cost of inventory per unit



**Figure 9.7** Optimal Order Quantity Determination

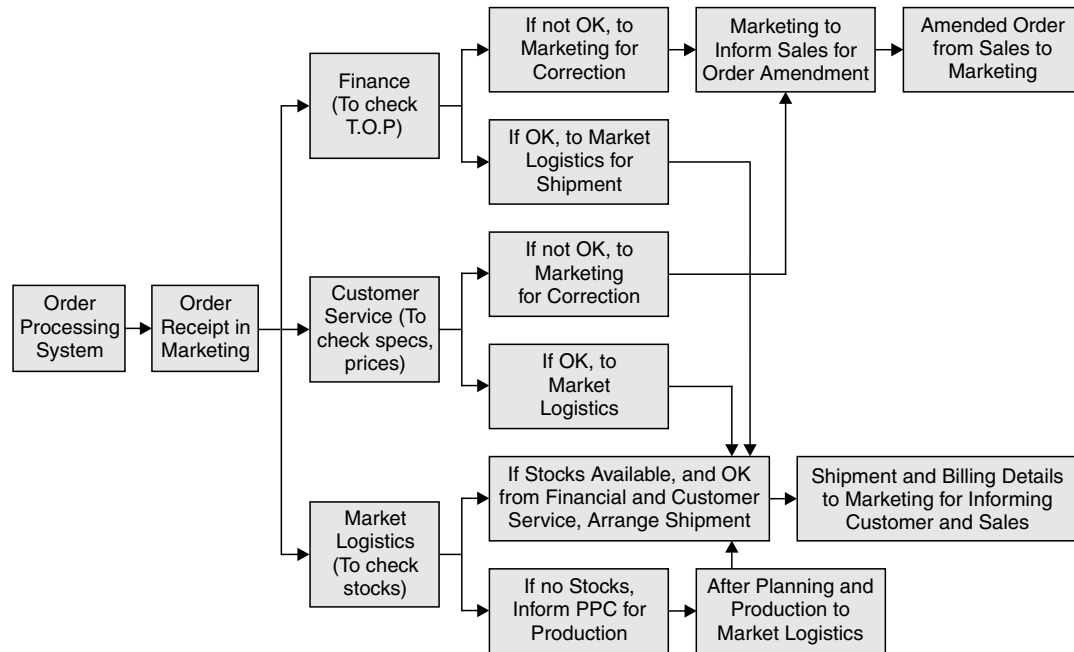
Inventory planning and decisions have changed because of **just-in-time (JIT) production techniques**, which includes arranging materials and parts to come into the manufacturing unit at the time and rate they are needed. The manufacturer can carry much lower levels of inventory and still meet the customer needs of on-time deliveries of finished products, if the dependable suppliers work in partnering or collaborative relationships. Just-in-time (JIT) is practised, **for example**, by Hero Cycles, in India, by getting all components, parts, and supplies required for the manufacturing bicycles from the dependable and collaborative suppliers every day twice. Suppliers had to ensure good quality as well as flow of materials. In turn, Hero Cycles made payments to suppliers on weekly basis.

Today, successful business marketing firms manage inventory, through sophisticated computer programs. Inventory management software packages are used to meet the customer's delivery service needs as well as the company's cost standards.

## Order Processing

Responsibilities for order processing (or **order fulfilment**) typically cut across many functional groups, and in many companies, no one person coordinates cross-functional activities. Often no one person in the organisation understands how order processing or fulfilment works in totality. This results in customer dissatisfaction due to non-adherence to delivery schedules, incomplete order execution, and communication lapses.

Order processing starts with the receipt of a customer order and ends when the customer receives the product as per delivery schedule and the quantity (and of course the specification) mentioned in the customer order. Figure 9.8 indicates the steps involved in the order processing system and the role played by various functions for performing each of these steps, in a typical company.



**Figure 9.8** Order Processing System

The order is received from field salespeople and sometimes from business customers in marketing department (or function), which records the order in the computer system and forwards the order to finance for checking and approving the terms of payment (TOP) and also to customer service (also called marketing services) department for checking and approving the technical specifications of the product ordered and the prices (as per the company's pricing policy or not). If both these departments find that the order is okay, they forward the order with their remarks to market logistics (or physical distribution) department, which arranges the shipment of goods as per the order and informs the shipment details to marketing, which communicates the same to the field sales managers and the customer. If the order is not okay, it goes back to marketing for getting the necessary amendment to the order. Marketing, in turn, sends the order to the field sales manager (i.e. branch, district, or regional sales manager) with its comments for getting the amendment to the order from the customer. However, if market logistics finds that the ordered products are not in stock, it informs the same to production-planning and control (PPC) department, which includes the order in the production plan that is released to production and purchase functions. Purchase department's responsibility is to ensure required materials are made available to production function to produce required finished products. After production, the finished goods are transferred to market logistics, which arranges the shipment as per the order, and informs the shipping and billing details to marketing, which in turn, communicates the same to the field sales manager and the customer. The field sales manager checks if the goods are received by the customer in proper condition.

It can be seen from Fig. 9.8 and the above-mentioned description that unless there is an effective coordination and communication between the various functions or departments involved in the order-processing system, order fulfilment will fall short of customers' expectations, leading to customer

dissatisfaction. Shapiro, Kasturi Rangan, and Sviokla have suggested providing training to concerned people, group rewards for persons working in the order processing system, and placing a senior manager in charge of the overall order processing or order management cycle<sup>17</sup>. Apart from effective coordination, the order processing system should ensure prompt and accurate communication with customers regarding order amendments, anticipated delays in shipments, shipment details, and so on.

## Material Handling

It physically handles in-coming, out-going, and work-in-process materials in warehouses and on the shop-floors. The objectives to be achieved in material handling are: (1) minimise costs, (2) increase usable capacity, and (3) increase the speed of operations. These objectives are achieved by using sophisticated material handling equipment, such as forklifts, hoists, pallet-trucks, conveyors, stackers, dock-levellers, lift-tables, and computer-aided stocking and retrieval equipment. **For instance**, stackers stack materials in the warehouse to a height up to nine metres by using cubic space (rather than using floor space) with speedy operations vertically saving large amount of cost of warehouse floor space. Similarly, dock-levellers and lifttables are used for loading and unloading materials from trucks; and forklifts and pallet-trucks are used to move the goods from one place to other place quickly in shop-floors and warehouses.

**Guidelines of material handling** Organisations will be benefited if they recognise and implement some of the following guidelines of material handling:

- Optimise material flow.
- Simplify material handling by minimising, combining, and eliminating material movements.
- Use gravity principle.
- Make optimum use of building space by using cubic space, instead of floor (or area) space.
- Select right kind of material handling equipment.
- Standardise material handling methods and types of equipment.
- Adopt safety principles.

## Role of Market Logistics

Market logistics or physical distribution should be considered as a long-term strategic issue. In recent years it is considered by business marketers as a source of creating a unique competitive advantage. The competitive advantage of superior customer service at lower total distribution cost cannot be easily copied by competitors, as it needs high investment in people, systems, money, and time. The logistics will play a more important role in future due to important factors of global competition, worldwide sourcing, JIT system, and total quality management.

## SUMMARY

Business marketing channels are quite different from the channels used for consumer goods and services in terms of geographical distribution, short channel size, characteristics of intermediaries (or channel participants), mixed channel system (also called hybrid channels or multi-channels), and e-channels.

Alternative structures of business channels consist of both direct and indirect channels. Direct channels (or direct distribution) include manufacturer's own salesforce (i.e. direct sales) and direct marketing

channels, consisting of direct mail, the internet, and telemarketing. Indirect channels (or indirect distribution) include one or more intermediaries. Participants in business marketing channels include distributors, manufacturer's representatives (or agents), brokers, commission merchants, value-added resellers (VARs), jobbers and manufacturer's branch/regional sales offices.

For designing a channel system, a business marketer should go through the following steps: developing channel objectives, analysing channel constraints, analysing channel tasks, identifying channel alternatives, evaluating channel alternatives, and selecting a channel structure or system.

After selecting the channel structure, the business marketer should manage or administer the channel partners. This includes selecting intermediaries, motivating them, controlling channel conflicts, and evaluating the performance of channel partners.

Some of the trends in business marketing channels are vertical marketing system, multi-channel marketing, and increase in the importance of distributors.

Importance of supply chain management (or demand chain management) is recognised by many successful business marketing firms. It is an extension of logistics management. Whereas logistics management integrates various material flow activities within an organisation, supply chain management extends materials flow integration upstream to suppliers' suppliers and downstream to customers' customers. Both supply chain management and logistics create a superior value for customers and hence, give a competitive advantage to a firm.

The components of a supply chain are classified as upstream, internal and downstream. Major trends in supply chain management are (1) use of technology, (2) world class supply chain management, and (3) lean and agile supply chains.

Market logistics (or physical distribution) consists of delivering the finished product to business customers and intermediaries. It includes various tasks like transportation, warehousing, inventory control, and so on. Approaches used for balancing distribution costs and customer service are called "total cost", and "return on investment (ROI)".

Major cost centres of market logistics are identified and evaluated. These cost centres are: transportation, warehousing, inventory, order processing, and material handling.

## KEY TERMS

- |                                      |                                   |
|--------------------------------------|-----------------------------------|
| • Arbitration                        | • Inventory carrying cost         |
| • Channel positioning                | • Jobbers                         |
| • Commission merchant                | • Just-in-time (JIT) system       |
| • Demand chain management            | • Logistics                       |
| • Diplomacy                          | • Manufacturers' representative   |
| • Direct channel                     | • Marketing channel               |
| • E-channels                         | • Marketing logistics             |
| • Exclusive distribution             | • Mediation                       |
| • Hybrid/Multi-channels/Mixed system | • Selective distribution          |
| • Indirect channel                   | • Supply chain management (SCM)   |
| • Industrial distributor/dealer      | • Value-added resellers (VARs)    |
| • Intensive distribution             | • Vertical marketing system (VMS) |
| • Intermediaries                     |                                   |

**Note:** Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. Explain why business channels are usually shorter in length than channels used in consumer goods marketing?
2. Why increasing number of business marketing firms have been adopting mixed-channel systems (or multi-channel structures)?
3. What are the functions (or activities) performed by industrial distributors and manufacturers' representatives? How are they compensated?
4. How does a manufacturer participate in the business marketing channel through its regional or branch sales offices?
5. Describe how business marketing organisations are using electronic channels (e-channels)?
6. Explain the difference between selective distribution strategy and intensive distribution strategy with examples.
7. What are the possible sources of conflict between a manufacturer and its agents (or representatives)? How these conflicts can be controlled or managed?
8. Describe a vertical marketing system (VMS), which is one of the most important channel developments in recent years.
9. What is supply chain management? How is it different than logistics management?
10. What are the approaches available for balancing customer service and distribution costs? Which are the important elements of market logistics?

**OBJECTIVE TYPE QUESTIONS**

1. Rail, truck, air, waterway and pipeline are called: (a) intermodal, (b) primary, or (c) secondary transportation modes.
2. Order processing starts with the receipt of a customer order and ends when the customer receives: (a) the order acknowledgement, (b) the order status, (c) the product ordered, or (d) the invoice for the order.
3. Material handling system physically handles: (a) in-coming, (b) out-going, (c) work-in-process, (d) all of these, or (e) some of these.
4. Distribution channels are also referred to as: (a) marketing channels, (b) sales channels, (c) trade channels, (d) all of them, or (e) none of them.
5. Market logistics is also called as: (a) logistics, (b) supply chain management, (c) demand chain management, or (d) physical distribution.
6. Direct channels include direct marketing channels and also one of the following: (a) manufacturer's sales representatives, (b) manufacturer's representatives, (c) brokers, or (d) value-added resellers.
7. The major cost elements of physical distribution cost include transportation, warehousing, inventory carrying and one of the following: (a) order processing, (b) material handling, (c) cost of lost sales, or (d) communication.

**APPLICATION QUESTIONS**

1. For a new electrical equipment, called "moulded case circuit breaker" (MCCB), required for large manufacturing plants like steel plants, two leading engineering companies—viz L&T and CGL—adopted two different distribution channel structures. L&T promoted the new product

through its technical sales team and asked the business customers to place orders on their industrial distributors, who would carry the inventory of MCCBs for supplying to business customers. Crompton Greaves Ltd. (CGL) promoted the new product by organising technical seminars, followed by visits by their sales engineers along with manufacturer's representatives (or agents), but inventory carrying, the shipments and billing of MCCBs were made by the company. The role of manufacturer's representative was to build relationship and follow-up for the orders and payments. Evaluate the two channel structures by using appropriate criteria and suggest which channel structure, in your opinion, would be more appropriate and why.

2. Assume you are a head of marketing of a new company, which will be launching a new product, called aluminium extrusion, required by business and household customers for various applications. The factory is located in Hosur, Tamil Nadu, but the marketing office is located at 38 km away from factory in Bangalore. Applications of aluminium extrusions include door, window, and partition frames, electrical panels, heat sinks in electronic equipment, water purification equipment, and so on. These applications needed effective pre-sales technical service and in some cases, post-sales installation service. Competition is severe, with the leader of aluminium extrusion industry, Jindal Aluminium's factory and headquarter located at Bangalore. You are required to design a channel structure, as a part of marketing strategy. Explain how would you do it. (Make suitable assumptions, if needed.)
3. Suppose you are a branch manager of Mumbai branch selling electrical engineering products like motors, alternators, starters, and so on directly by your own salespeople as well as through your company's authorised dealers to business customers. The relationships between your company and dealers are characterised by conflicts, as dealers feel that major business customers who have high sales potential are dealt by the company salespeople and that the company's salespeople offer special low prices for such customers. They also complain that the discounts (or margins) given on the list prices are not adequate, and that the territory boundaries between dealers are not clear resulting in conflicts between dealers. As the branch manager what steps would you take to minimise the level of conflicts and improve channel performance.

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## CASE 9.1

### Cable Systems Pvt. Ltd.: Managing Channel Members

Arun Prasad, Director of Cable Systems Pvt. Ltd., was concerned about the behaviour of some of his dealers, who were selling the products of the company at 15 to 20 per cent higher than the prices mentioned in the company's price-list.

Cable Systems was one of the leading manufacturers of high quality moulded power cables and connector cable assemblies, which were used in electrical and electronic components, including mobile charging cables, and LAN and WAN cables. The company supplied moulded power cables, customised to the specific requirements of OEM customers like VXL and Heidel Berg, as well as, to government customers like Bharat Electronics Ltd. (BEL). The company manufactured at its well-equipped plant at Bangalore a wide range of over 90 types of cables, which were reputed for excellent quality.

The percentage of revenue obtained from different types of customers was as follows:

<i>Type of Customer</i>	<i>Percentage of Total Sales Revenue</i>
Government and Public Sector	15
OEMs	40
Authorised Dealers	45

The company had 30 authorised dealers in South India, out of which 10 dealers were in Bangalore. Some of the dealers supplied moulded cables to business customers at 15–20 per cent higher than the price-list of the company. This made the company prices higher than that of the major competitors. The dealers had independent businesses and were trying to maximise their profits without any concern for Cable System's objectives and strategies. The company had appointed the authorised dealers without any written agreements or contracts with them. Arun Prasad wondered what actions he should take to manage the dealers.

### Question

1. If you were the consultant to Arun Prasad what would you recommend to him for managing the dealers?



**CASE 9.2****Pinnacle Software – Managing Channel Conflict<sup>1\*</sup>**

Praneet, the channel manager of Pinnacle Software, was very surprised to read a copy of the e-mail sent by Suresh, the business development head of one of its oldest and trusted channel partners, DigiPoint Solutions: “This was not expected from your company whom channel partners trust the most. We expected you to update us on LDD Steel Works account. Instead, you bypassed us. This has created a lot of distrust. VERY DISAPPOINTED.”

Pinnacle Software is a software product development company, having developed innovative and niche IT security solutions. Majority of its customers are based in India and Africa.

DigiPoint Solutions, the channel partner of Pinnacle Software, introduced a prospect, viz. LDD Steel Works, to whom DigiPoint was providing other IT services. The technical discussion on the requirement of security solutions of LDD Steel Works was led by Praneet, in presence of Suresh. After the technical discussion, Praneet conducted a proof of concept (POC – which was a trial to show the working of the security solution offered by Pinnacle Software to meet the requirements of the prospect). This had a fruitful outcome, as LDD Steel Works requested for a proposal (RFP) from Pinnacle. The company after due deliberation with DigiPoint, submitted its techno-commercial proposal to the prospect. For about a month after submission of its proposal, there was no response from LDD Steel Works. Praneet spoke to Suresh and asked him to follow-up with the prospect. Suresh found that the prospect was in touch with another supplier of security solutions. After about two weeks, suddenly on one day LDD Steel Works called Praneet and told him that they want to deal with Pinnacle Software directly, as they were not happy with the changes made by DigiPoint in their organisation structure, which resulted in LDD Steel Works’ perception that they were being ignored by DigiPoint. Praneet was in a dilemma. He did not want to lose LDD Steel Works, which was a high sales potential prospective customer and at the same time maintaining good relationship with the old and trusted channel partner like DigiPoint was also important.

Praneet thought that he should first try to get the order from LDD Steel and thereafter talk to DigiPoint and offer the 20 per cent commission as per their agreement. With this plan in mind, Praneet started his efforts in overcoming the objections of LDD Steel Works. After a number of meetings, Pinnacle Software received the valuable order from LDD Steel Works.

Praneet tried to get in touch with Suresh, but there was no response. However, DigiPoint got the information about the order placement by LDD Steel Works on Pinnacle Software from a third party. This infuriated Suresh, who sent the e-mail to the CEO of Pinnacle Software with a copy to Praneet.

**Questions**

1. If you were Praneet, what would you do after seeing the copy of Suresh’s e-mail?
2. What is the role of the CEO of Pinnacle Software in a channel conflict situation?

<sup>1\*</sup> This case was prepared by Ajit Kari, an alumnus of Alliance Business Academy, under the guidance of Prof. Krishna K. Havaladar, for classroom discussion.

**CASE 9.3****Snow White Paper Company (3)\***

Snow White Paper Company is located in an agricultural belt about 300 kilometres from a metro city. It makes writing and printing paper. Its primary raw material is wheat straw. Last year the company had a turnover of ₹ 134 crore on a volume of 45,000 tons of paper. While preparing the business plan for the current year, the top management was concerned with the following 'logistics' issue.

Snow White (SW) sells its paper in about seven states with about three of them accounting for 60% of its business. The paper has to be transported from its plant to the geographic territories.

The transport rates for the paper depend, naturally on the distance of the 'market' from the plant/mill. SW has a market share of about 15% in its entire selling area but it is still a small plant compared to some of the giants in the industry.

There is a problem on the outbound transport, which is evident from the points mentioned below:

- Total transport cost of the paper for the year is ₹ 9 crore (₹ 90 million) approximately.
- There is a transporter's union in the town where the SW paper mill is located. SW has to distribute all its finished goods only through the transport union trucks. They cannot even get the trucks from the truck market.
- Rates for the trucks for every location are decided by the union and are not always favourable to SW.
- The union allots the loads from SW to its members through a roster system – SW cannot be sure of the truck which will carry its goods to the same location every time.
- In case the allotted truck does not have the required destination state permit, SW has to delay the dispatch till the next truck on the roster with the correct permit comes. Trucks need state permits for some states to enter or pass through the state in the country.
- SW accounts for about 36% of the union's transport business from this location.
- The union president also happens to be a politically influential person of the area.

The 'constraints' under which SW has to plan its transportation has been explained above.

**Questions**

1. How can you ensure for SW regular availability of transport for its finished goods at more competitive rates?
2. What are the alternatives available to SW?

**CASE 9.4****Metal Products India Limited\*\***

"Shekhar, it is high time we did something to arrest the loss in our business in Karnataka," urged Mr Bhatia, President of Metal Products India Limited (MPIL).

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\*\* This case was prepared by Mr Shailendra Dasari, General Manager, SPIL, for classroom discussion. It is re-printed with his permission.

“Yes Sir, I do appreciate your concern and shall certainly do something before it is too late,” was the pensive reply from the Marketing Manager, Mr. Shekhar.

### **Company History and Background**

MPIL was one of the leading manufacturers of MS (mild steel) metal sections widely used in construction, furniture, rolling shutters, and industrial sheds. The factory was located at Whitefield, on the outskirts of Bangalore.

The market for metal sections was highly regionalised. In and around Bangalore, there were four manufacturers of metal sections. MPIL was set up in 1987 by its parent company, Madhya Bharath Metal Sections Ltd. (MBMS), Bhilai, mainly to serve the southern markets. Before this unit was set up, material was supplied to dealers/customers in South India direct from Bhilai. The advantages perceived by the promoters in setting up MPIL were substantial savings in freight cost coupled with better availability of material. Prior to 1987, there was only one manufacturer of metal sections at Bangalore, viz. Karnataka Metal Sections (KMS). Between 1993 and 1996 two more manufacturers set up their units at Bangalore, viz. Adarsh Metals and Mahavir Metal Sections.

The total size of the market for metal sections in South India in 1998 was estimated at 40,000 metric tonnes (MT) with an annual growth rate of around 6 per cent.

### **Distribution Channel**

MPIL had tied up with the existing dealers of MBMS for distributing their products. MBMS had dealers at all the important locations in the South. However, in Karnataka they had only one dealer—Bangalore Metal Traders (BMT)—based at Bangalore.

Apart from making use of the existing distribution channel of MBMS, MPIL also appointed new dealers at places like Vijayawada, Calicut, and Erode. Most of the dealers supplied the metal sections in smaller lots to the customers, who were mostly fabricators and small-scale industries. Apart from this, some of the dealers also operated through sub-dealers. The price to dealers were decided by the manufacturers and the dealers usually marked up the prices by 7 to 8 per cent. The prices at which dealers operated were not controlled by the manufacturers but were solely at the discretion of the dealers. Depending on the purchase, dealers got volume discounts from manufacturers varying from 3 to 7 per cent.

Apart from distributing the products through dealer network, MPIL also sold their products directly to OEMs (Original Equipment Manufacturers) and Government customers. However, this added up to only 20 per cent of their total sales.

To support the dealers, MPIL had opened depots (i.e. warehouses) at Chennai, Coimbatore, Ernakulam, and Hyderabad.

### **Market Structure**

Bangalore Metal Traders (BMT) were the largest dealer of metal sections in South India with a purchase of 2,000 MT per annum, which was 20 per cent of the MPIL's production. By virtue of their purchase, they enjoyed the highest slab of volume discount offered by the company. As per the understanding with BMT, MPIL was not supposed to appoint dealers at other centres in Karnataka. However, there was no specific written agreement which debarred the company from appointing dealers at other stations.

Prior to the entry of Adarsh Metals (AM) and Mahavir Metal Sections (MMS), BMT enjoyed more than 50 per cent share of the market in Karnataka. In view of the informal agreement with the company

not to appoint dealers at other stations in Karnataka, BMT also did not deal with other manufacturers and sold exclusively the products of MPIL. KMS also had a dealer at Bangalore by the name of Kavery Agencies, which had branches at other major centres in Karnataka. Prior to the entry of AM and MMS, the combined market share of MPIL and KMS in Karnataka was more than 80 per cent.

### **Strategy of New Entrants**

AM and MMS found it difficult to compete with BMT and Kavery Agencies, which were well-established in the market and had exclusive arrangements with their principals. To penetrate the market, AM and MMS adopted a different strategy, that is, offering materials direct to customers in Bangalore, though it was not as cost effective as selling through the dealers. In the upcountry markets, they identified potential dealers dealing with steel and hardware and offered the same discounts as offered by MPIL and KMS to their respective dealers. The new entrants succeeded in attracting the hardware dealers at locations like Mysore, Mangalore, Hubli, and Belgaum.

Most of the upcountry hardware dealers were earlier sub-dealers of BMT. Out of the volume discount of 7 per cent offered by the company, BMT used to keep 3 per cent for themselves and pass on the balance 4 per cent to the sub-dealers. To break the stronghold of BMT and Kavery Agencies, the new entrants started offering discounts of 6 to 7 per cent to upcountry sub-dealers who found it more comfortable to deal directly with the manufacturers instead of being sub-dealers of BMT.

### **Present Problem**

The aggressive marketing strategy adopted by the new entrants resulted in the loss of business volume for MPIL on account of reduced purchase by BMT. As compared to 2,050 MT lifted by BMT in 1996–97, during the first six months of the year 1997–98, their purchase was only 850 MT. Though the drop in sales volume was noticed by Mr. Bhatia during the first quarter itself, in the quarterly review meeting, Mr. Shekhar attributed this to the recessionary trends prevalent in the market and the poor performance of the economy as a whole. However, this did not satisfy Mr. Bhatia on whose insistence Mr. Shekhar undertook an extensive tour of Karnataka along with the representative of BMT, and found to his dismay that in Hubli and Belgaum they did not enjoy even 30 per cent of the market share, whereas the new entrants had captured more than 50 per cent of the market. Most of the hardware dealers who were earlier sub-dealers of BMT, had been appointed as the authorised dealers of AM or MMS. However, they had not stopped dealings with BMT totally, though the dealings were confined to ordering only those sizes which were not readily available with AM and MMS. When this was pointed out to Mr. Bhatia, he advised Mr. Shekhar to come out with a suitable strategy to recapture the market in north Karnataka. Attempts by Mr. Shekhar and representatives of BMT to get the sub-dealers back to their fold by emphasising on the superior quality of their product compared to the competitors' and offering special incentives subject to certain guaranteed purchase did not yield the desired results, leaving Mr. Shekhar, who had been given the ultimatum by Mr. Bhatia, a frustrated man.

### **Questions**

1. If you were Shekhar, what strategy would you suggest to the president of MPIL to recapture the lost market share?
2. From the above strategy, develop an action plan for implementation of the strategy.

# 10

## Managing the Personal Selling Function

*After studying this chapter you should be able to:*

- Understand the role of personal selling in the business marketing strategy.
- Understand the relationship of business buying behaviour to the personal selling process.
- Learn the organisation and management of the sales force, i.e. structure of organisation, recruitment, selection, training, supervision, motivation, development, compensation, evaluation and control.
- Know deployment of sales force.
- Understand key account management.
- Know ethical issues in the personal selling function.

In business marketing, personal selling through the company's salespersons (or sales force) is a major tool of communications as compared to consumer marketing's focus on advertising and sales promotion. The reasons for this are seen in the nature of customer's buying decision process (as discussed in Chapter 3) and also the buyer-seller relationship (described in Chapter 4).

A business sales/marketing manager is responsible to achieve the short-term objective of achieving sales target/goal and a long-term objective of developing an effective sales organisation that maximises the opportunities for profitable sales growth over a long period. The sales manager is required to make important decisions for developing and managing the business salesforce.

Sales management plan in business marketing consists of the following steps: (1) understanding the role of personal selling; (2) taking decisions regarding the organisation and management of sales force, including the size and structure of the sales organisation, as well as recruitment, selection, training, supervision, motivation, development, compensation, evaluation and control of salespeople; (3) deploying the sales force and allocating them to specific sales territories and business customers. We shall discuss the above three steps and also the trends in the personal selling functions in recent years as well as the management of key accounts. It is also necessary to look into ethical issues involved in personal selling function.

### ROLE OF PERSONAL SELLING

In business marketing, personal selling through the company's sales people plays a greater role than that of consumer marketing. Once the business marketer decides the target market segments, the salesforce is deployed to meet the needs of these segments. In other words, business marketing strategy is implemented mainly through the personal selling function. The ability of the selling firm to meet the needs of the buying firm is, to a large extent, communicated by the sales people. The salesperson, with

the help of technical person, offers not just a physical product but also technical assistance, ideas, and suggestions to solve the business customer's problems.

Thus, there are two major roles of personal selling: (i) as a part of problem solving capabilities, and (ii) as a part of communications mix. Let us examine these two roles in greater details.

## Major Roles of Personal Selling

**Sales Rep as a Part of Problem-Solving Capabilities** A field salesperson is considered as a part of a company's problem-solving abilities. There are several dimensions or elements of this role. **First**, the sales rep has an important job to help customer to define the buying problem. He must show the customer how the purchase of particular products or services will help in solving the problem or achieving the customer's objectives. **For example**, a sales engineer of a material handling company showed the purchase manager of a large automobile manufacturing company how the equipment made by his company can substantially minimise the loading and unloading time of components and raw materials to solve the problem of trucks' long waiting time complaints from suppliers. If products are highly technical, the sales person should have good product or technical knowledge. If products are less technical oriented, the sales person acts as a business consultant to show the customer economic advantages of various purchase alternatives.

The **second** important responsibility of a sales rep is to give an effective customer service. This may consist of drawing product specifications, application engineering, value analysis, installation, maintenance or repairs. Some companies have separate service engineers, but it is the responsibility of the sales person to ensure that prompt and effective service is given to customers. **For instance**, sales executives of an airconditioning and refrigeration company, selling large plants to business customers, such as hotels, malls, and cinema halls do not give after-sales technical service themselves, but they do effective coordination with their after-sales service department during warranty to ensure prompt and effective customer service.

The **third** responsibility is to "represent the customer at the factory or head office marketing". Sometimes, a salesperson has to "fight" for his customer with his factory or planning department so as to ensure timely delivery, or reasonable credit terms, or solving quality problems, and so on. **For example**, in a steel component manufacturing firm frequent "verbal fights" take place between production planning and control (PPC) manager and branch sales managers on delivery issues to key accounts (i.e. important customers).

In solving the problem of the customer, a salesperson needs to have human relation skills (i.e. interpersonal skills) in managing pressures and relationships in customer organisations and in his own organisation. In this role, a sales rep may be disliked by some persons in his own organisation who resist change in operations and procedures. However, these changes are asked for by the sales rep based on the customer demand or competitive situations. It is, therefore, important that organisation should be geared up to respond and operate as an effective team to the customers' needs and competitive situations.

**Sales Rep as a Part of Communication Mix** This means that the sales rep is responsible for conveying selling messages to potential as well as the existing customers. He should keep them informed about products and services. He should, therefore, be a good communicator. There are other elements of company's communications mix such as advertising, direct mail, catalogues, exhibitions, and trade shows.

The sales rep also has the responsibility of securing orders from customers, communicating market information on competition, market trends, and so on, in the form of sales reports to the marketing chief at head office or branch sales manager.

### TRENDS IN PERSONAL SELLING IN BUSINESS MARKETS

**Team Selling** Increasing number of business marketing firms are using team selling approach to meet customer demands of specialised technical information, superior service, and just-in-time delivery. This is particularly applicable for high sales and profit potential customers, who are referred to as key, major, or national accounts. Business marketing organisations put together a cross-functional sales team consisting of outside salesperson (i.e. a key accounts salesperson who visits customers), inside salesperson (i.e. a salesperson who remains within the organisation to assist outside salesperson, to respond to customers' queries, and to do prospecting on telephone), a technical support person, a logistical person (if the customer wants the supplier to do shipments of goods at various geographical locations), and a senior executive as a team leader (e.g. national or key accounts manager, or a branch sales manager). Top management of the company should look into the process of teamwork, including training individuals on how to work together as a team and develop their interpersonal skills.<sup>1</sup>

**Improved Productivity** In order to increase the productivity and ability of salesforce, new tools and technologies are used. These tools are portable computers, cellular phones, fax machines, tele-marketing and sales support systems. Progressive firms use CRM systems or technologies to improve salesforce productivity. CRM modules consist of sales lead distribution, territory management, contact management, call reporting, pricing, and sales tracking of prospects. These CRM modules allow all supplier firm employees, who are in contact with the prospective customer to know in real time what actions the company has taken for each prospect, what further actions need to be taken.<sup>2</sup>

**Relationship Selling** Due to substantial increase in competition, salespeople are giving importance to building a long-term supplier-customer relationship with key accounts, instead of transaction oriented personal selling which has the purpose of closing a specific sale. Relationship selling or marketing involves a process where both customer and supplier firms form strong and extensive social, economic, service, and technical ties over a long period of time, with the intent of lowering total costs and/or increasing value, thereby achieving mutual benefits.<sup>3</sup> Competitive situations have changed buyer-seller relationships to partnerships in automobile, tele-communication, information technology, and other industries.

**Creating Value** In today's demanding sales environment, salespeople should be highly knowledgeable and skilled. They must be able to understand clearly customer needs, demonstrate value, negotiate, and take the order, as a part of "**transactional field salesforce**". These salespersons are also responsible for profitability from each customer. To ensure that these tasks are performed effectively, salespeople should be trained to create value (i.e. benefits less cost of buying) to customers.

**Multiple Selling Units** Modern sales managers recognise that sales and profit potentials of business customers differ substantially within target market segments. They have, therefore, identified multiple selling units (or many types of field salespeople) with different responsibilities. These are: (1) transactional (i.e. territory) salespersons, (2) key (i.e. major or national) accounts salespersons (or key accounts executives), (3) inside salespersons. Each **transactional or territory salesperson** is responsible for visiting medium/low sales and profit potential customers in a geographic territory. They perform traditional selling activities like submitting quotations, making

presentations, negotiations, getting orders and making post-sales calls.<sup>4</sup> **Key or major accounts salesperson** is a part of a cross-functional sales team responsible to build long-term collaborative relationships with key, major, or national accounts (or customers), who have high sales and profit potentials. The sales team is headed by a national or key accounts manager or a branch manager, depending on the location(s) of the major customer's plant(s). Major account salesperson calls on these key customers to manage customer relationship, and carry out joint research and development tasks.

**Inside salespeople** work from within the supplier organisation and are responsible to maintain customer relationship by using telephone (i.e. telemarketing), fax, or e-mails. Sometimes, inside salespeople are organised into different groups. (1) **Customer service group** provides technical, commercial, or any type of information required by customers as well as helps outside or territory salespeople in coordination and communication with customers. (2) **Tele prospecting group** makes phone calls to prospective customers to find their requirements and then categorise them into high ('A' class), medium ('B' class), and low ('C' class) potential customers. The responsibilities include prospecting and qualifying. (3) **Tele selling group** is responsible to contact low sales potential ('C' class) customers on phone or e-mails to take orders and to process the same.

### Intrapreneurial Philosophy

The word “intrapreneurship” is derived from “intra-corporate entrepreneurship”, which means entrepreneur within a company. When sales or marketing persons, who are employees, behave and act like owners of the company, they have adopted intrapreneurial philosophy. To implement this philosophy, the top management should advocate and support it by (i) inviting or asking for innovative or creative ideas, (ii) giving freedom to follow those ideas, and (iii) rewarding persons who act like “intrapreneur”. Sales persons, who follow intrapreneurial philosophy take initiative, and are proactive as well as creative. They give superior value to customers, by identifying customer needs correctly, and satisfying those needs with superior products and services. Organisations which follow intrapreneurial philosophy show consistently good performance.

### Systems Buying and Selling

Many business buyers prefer to buy a total solution to their problem from one seller. Business sellers have recognised this preference of buyers and hence they have taken up “systems selling” approach. This approach is useful in large industrial projects or contracts, such as building electrical substations, steel making factories, dams, sanitation systems and so on. **For example**, a company manufacturing and marketing material handling equipment decided to follow the “systems selling” marketing strategy to ensure customer satisfaction. The company promised and delivered “total solution to the customer's material handling problem”, by studying each customer's material handling needs, designing the system, manufacturing customised equipment, installing, commissioning, giving warranty and after-sales service. It also includes buying those products and services not available within the company. The business buyer or customer choose this approach because they hold one party responsible, if anything goes wrong. Business marketers or sellers adopt systems selling strategy, because it gives them a competitive advantage.



## **DISTINCTIVE CHARACTERISTICS OF INDUSTRIAL SALESPERSON**

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It is recognised that business salespeople are different from those who sell consumer goods and services. Business selling requires more technical background, which may be obtained through college education, practical experience, or training. Business salespeople are required to communicate with different types of people having technical and commercial backgrounds, in various functional areas (such as purchase, production, finance) within the customer organisation. They are required to build a long-term customer relationship. Business salespeople are required to fill any of the following sales positions.

**Trade Selling** When the manufacturer or supplier is using business distributors (or dealers), salespeople make visits to the company's authorised distributors to explain the marketing strategies and policies on product, promotion, pricing, channels, marketing logistics, and target market segments. Business salesforce also provide service to the intermediaries in terms of handling customer complaints, training distributors' salespeople, expediting delivery, overcoming competition, and so on. They work with intermediaries to ensure achievement of the organisation's sales goals. **For example**, in Crompton Greaves, salespeople of "dealer segment" in industrial systems strategic business unit (SBU) were required to contact the company's authorised dealers for achieving sales goals for industrial products like electric motors, starters, switchgears in specific geographical areas. The salespeople provided service, build relationships, and resolved conflicts, if any, with dealers.

**Missionary Selling** A missionary salesperson is required to provide information and build goodwill with customers, instead of attempting to close the sale. Customers are asked to place orders on the company's authorised distributors (or dealers). **For instance**, Larson and Tubro (L&T) sold its new product, called moulded case circuit breakers (MCCBs), through its sales engineers, who called on business customers like Rourkela and Bhilai steel plants to promote the new product, but the customers were asked to release the orders on local distributors, who carried the stocks of the product.

**Technical Selling** This is one of the most common types of selling in business markets. The technical sales engineer (or support person) has a technical expertise and is qualified in engineering or sciences. One approach to technical selling is to put together a sales team, consisting of a non-technical salesperson, a technical support person, a financial expert, and if needed, a marketing logistics person. The technical support person focuses on the product specifications and applications. **For example**, industries like steel, chemicals, and heavy machinery need technical inputs during negotiations with business customers<sup>5</sup>.

**Business Selling** The salesperson has an expertise in solving the business customer's problems with the company's products and services. In other words, it is a problem-solving approach. There are several **examples** in computer hardware and software as well as in telecommunication industries. In software companies like Oracle, Infosys, and Wipro, the business development executive has the role of a typical salesperson to make the initial sales call on a business customer to understand the customer's needs, and later put together a sales team consisting of an industry expert (e.g. banking, retail, manufacturing, usually referred to as "verticals") and a technology expert (e.g. ERP, CRM, SCM, generally referred to as "horizontal"). This sales team understands customer's technology and business problems, prepares a quotation, negotiates, and gets the order.

## ORGANISATIONAL BUYING BEHAVIOUR AND PERSONAL SELLING

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For successful personal selling, it is necessary to have a knowledge of buying behaviour of organisational (or business) customers. A salesperson should study a business customer's buying behaviour from two main factors (as described in Chapter 3). These are:

1. *Is the specific buying situation, perceived by the buying company, a new-task (i.e. new purchase), modified rebuy (i.e. change in supplier), or straight rebuy (i.e. repeat purchase)?* Each buying situation requires a different selling strategy. **For example**, in the new-task decision the risks are more, time taken is longer, more people are involved, and more information is required. The personal selling strategy should consider team selling by technical and selling persons, giving third-party references where products were supplied to minimise buyer's risk perceptions, and arranging the visit of buying-centre members to the factory.
2. *What are the influences of environmental, organisational, buying centre, and individual variables on the firm's buying process?*
  - Environmental variables such as technological, economic, political, and legal, can influence the buying decision. Like, in a recessionary economic condition, the business buyer minimises the quantity and cost of purchases.
  - Organisational variables include purchasing policies, degree of centralisation or decentralisation followed by the buying firm.
  - Buying centre variables indicate size of the buying centre, which members of the firm are included, who are the key influencers, and how is the interpersonal relationship of the buying centre members.
  - Individual variables include personal goals, values, lifestyle, education and expertise of individual members of the buying centre.

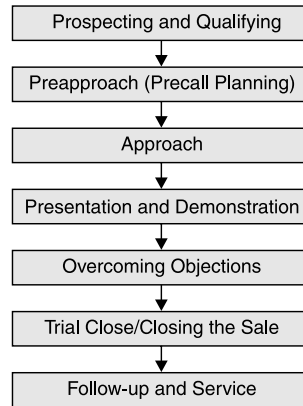
In addition to the above, the personal selling function should have the knowledge of the competition faced by the buying organisation, and the costs and benefits analysis of the product offered from the buyer's point of view. These insights of the buyer organisation make personal selling function successful. Besides, there is a trend towards close, mutually beneficial, and long-term buyer-seller relationship referred to as *relationship marketing*, described in Chapter 4. Relationship marketing should be made applicable only to high potential business customers as it involves high cost and time. For medium and low potential customers, a single salesperson can achieve the objective of getting adequate sales through *dyadic (two persons) interaction*, which consists of transaction between a buyer and a seller. The transaction oriented interaction focuses on the selling process.

## THE SELLING PROCESS

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In business marketing the transactional (or territory) salesperson should follow a distinctive selling process. This process is described in detail below, because it is important for the success of a business salesperson.

There is no magic formula to make a sale. However, it is widely believed that if a salesperson follows the steps shown in Fig. 10.1, the chances of success are greatly improved. The steps or the phases may not occur in the same sequence or order that is shown. Customers may raise objections during a sales presentation and trial close may be attempted after the presentation, if the customer's interest is high. Similarly, the customer may or may not start the negotiation, after a presentation. The sales process is a recommended set of phases or steps that works better than any other process in certain situations. Let us discuss each of the steps.



**Figure 10.1** *The Personal Selling Process*

## Prospecting

A prospect is an individual, a family, or an organisation who needs the product or the service a salesperson is selling and also has the ability to buy. A prospect is not the same as a sales lead or a lead. A sales lead generates the name and address of a person or a business firm that is a probable prospect. Once it is found that the sales lead wants the product and has the ability to buy, the sales lead becomes a prospect or a potential customer.

Prospecting is an important activity for succeeding in today's competitive environment. To increase or even maintain sales volume, particularly if the sales from the existing customers is stagnating or declining, a company must continuously prospect for new customers. Earlier most organisations had left it to their salespeople to find leads. Now more companies are taking the responsibility of searching and qualifying the leads. This enables salespersons to use their expensive time on selling activities. Organisations can generate leads (or obtain names and addresses of probable prospects) in a number of ways, as shown in Table 10.1.

**Table 10.1** *Prospecting/Lead Generating Methods*

<i>Sl.No.</i>	<i>Prospecting Method</i>	<i>Brief Description</i>
1.	Referrals from existing customers	Requesting existing customers to suggest the names of prospects. This is a convincing source <sup>6</sup> of nearly two thirds of total leads.
2.	Referrals from internal company sources	Company advertising, direct mail, website, trade shows, and teleprospecting activities.
3.	Referrals from external sources	Suppliers, intermediaries, bankers, trade associations, commercial list vendors.
4.	Networking by salespersons	Salespersons become members of civic/social organisations like Lions Club, Bangalore Club, and Rotary Club to meet new people who may be prospects or may provide leads.
5.	Industrial directories	Yellow pages published by government and private publishers.
6.	Cold canvassing	Unannounced calls by salespeople on firms that may need the product/service the salesperson sells. Costly and time consuming. Used for widely needed products like office supplies.

*Contd.*

7.	Standard Industrial classification (SIC) system	A major secondary data source, it provides an identification of the prospective customers in each industry group.
8.	Use of telephone, mail, and the Internet.	Telemarketing, direct mail, and the Internet can be used for prospecting as well as qualifying the leads.

## Qualifying

It is important that the lead, or the probable prospect is qualified (to meet the necessary standards or conditions to receive further attention). The necessary conditions for the probable prospect or the lead to get qualified to the prospect or potential customer are:

- The probable prospect has a need for the product/service being sold.
- The probable prospect (could be an individual, a family, or an organisation) can afford (or has an ability) to buy the product or the service.

Most companies contact the leads by phone, mail or the internet to find out their level of interest and financial capacity. Traditionally, the salespersons were expected to contact the leads or probable prospects. Today, the marketing department in many companies undertakes the tasks of prospecting and qualifying. This is done because the cost of a good salesperson has gone up substantially in terms of salary, incentives, travelling, lodging and boarding. Instead of using costly salespeople for prospecting and qualifying (which can be done economically through telephone and e-mail), they are used for making sales presentations, negotiations, closing the sale, and building long-term relationships with key prospective customers. The prospects, after qualifying, are placed in three groups: hot prospects, warm prospects, and cool prospects.

- **Hot prospects** These prospects have good requirements of the company's products/services and are financially sound. Such prospects are handed over to the company's salespersons to convert them to the company's customers.
- **Warm prospects** This group of prospects have medium or average requirements of the company's products/services and are financially sound. These prospects are given to the company's telemarketing team for follow-up.
- **Cool prospects** These prospects have low requirements and their financial capacity may or may not be good. Such prospects are either handed over to the company's intermediaries like dealers/distributors, or their names are kept in pending list for future follow-up.

It is important that salespeople follow-up the hot prospects that are handed over to them, because a study<sup>7</sup> has found, that generally, salespeople get more than 80 per cent of the buyers' business if they follow-up a sales enquiry, as compared to 40 per cent share, if not followed-up. Sales managers should also advise the salespeople that usually it takes about four calls on an organisational prospect to convert an initial enquiry into sales.<sup>8</sup>

## Preapproach

The preapproach step generally includes two tasks: information gathering in greater depth about the prospect, and planning the sales call on the prospect.

### *Information gathering*

The salesperson needs to collect as much information as possible about the prospect. The prospect's business, its products and services, purchasing practices, location of plants, names and background of people who make buying decisions, purchasing orientations and practices, the major problems or issues faced by the prospect and the industry in which it is operating, and so on. The sources of obtaining

information about the prospect include the internet or online information services, trade magazines, industrial directories, chambers of commerce, annual reports of companies, existing customers and suppliers, and government publications. In-depth information about the customer makes the salesperson confident.<sup>9</sup>

### ***Planning the sales call***

The salesperson should then do the planning, before approaching the customer. This consists of setting objectives for the sales calls, and planning the sales strategy.

**Setting call objectives** This includes gathering information about needs from the prospect, understanding buying orientation and practices, checking merchandise and making a reorder from the existing distributor, or making a sales presentation. The salesperson must set an objective for each of the sales calls.

**Planning the sales strategy** It consists of finding out when (date and time) and whom (purchase executive or administration officer) to approach by phone call, followed by personal visit. It includes a tentative judgement about which of the company's products best meet the customer's needs and a tentative plan for presenting the specific product features and benefits. It should be understood that the tentative planning of the sales strategy that is made at this stage may have to be changed later on after gaining the information based on the actual calls made by the salesperson. This type of modification to selling objectives or plans is called *adaptive selling*. Salespeople often deal with multicultural customers in domestic as well as international markets. Because salespeople can change their sales presentations, sales messages, or behaviour for different customers and differing sales situations, personal selling is referred to as adaptive selling.<sup>10</sup>

### **Approach**

After collecting the prospect's name and other relevant information, as mentioned earlier in preapproach, the next step is to make an appointment to see the prospect. This is called the approach. The approach (or meeting the buyer for the first time) takes a few minutes of a call, but it can make or break a sale. When a salesperson meets a potential customer for the first time, the first impression should be favourable<sup>11</sup>. The initial impression of a salesperson is based on his/her appearance (**for example**, wearing clothes similar to what the buyers wear), the attitude, and the opening line. Depending on the selling situation, a salesperson can decide on the methods or techniques to be used to approach the prospect. These approach techniques are shown in Table 10.2.

**Table 10.2** Approach Techniques Commonly Used

<i>Sl.No.</i>	<i>Name of the Technique</i>	<i>Brief Description</i>	<i>Example/Application</i>
1.	Introductory approach	The salesperson states his/her name and the company's name, preceded by a friendly and smiling greeting and a firm handshake or Namaskar. Most salespersons also present a business card.	"Good morning, Mr Dasgupta, I am Krishna Kumar from Crompton Greaves, here for 11 a.m. appointment". This is said with a friendly smile and a firm handshake. Thereafter the business card is presented.
2.	Customer benefit approach	The salesperson should identify one major buying motive (or benefit) that generally a prospect (an individual or organisation) has and appeal to it.	"By converting your existing insurance policy to our new insurance plan, you can get ₹ 2,00,000 more coverage at the same price you are paying now."

*Contd.*

3.	Product approach	This technique is useful if the product is new, unique, or colourful. Some salespeople carry the new product or its cutaway cross-section in order to make a smooth transition into the sales demonstration/presentation.	The sales person hands over the new bottle of Pepsi to the retailer and waits for the retailer to begin the conversation.
4.	Question approach	The salesperson asks a question to start a two-way communication or to make the prospect curious about the product or service.	“May I help you?” is a typical question asked by many retail salespeople. The prospect can easily respond with, “No, thanks”. Hence, a question that is linked to a customer benefit or making a prospect curious should be asked. “What benefits you want most in a new washing machine?” or “Do you know why most business schools are using this book for their sales and distribution management course?”
5.	Praise approach	An indirect praise conveyed sincerely and subtly can have a positive impact on the prospect.	“Your office is so well designed and comfortable that I would remember it when we design our new office” or “congratulations on your promotion to general manager”.

Some other approaches like free gift or dramatic alternatives may not be liked by some prospects as these approaches may violate ethical guidelines or become showmanship. A salesperson should select an appropriate approach that will get the attention and arouse the interest of the prospect. It is important that the salesperson collects information on the prospective customer and competitors during the approach phase, before making any proposal and sales presentation. For collecting the vital information, which includes deep understanding of the prospective customer, the salesperson may have to make more visits to meet various members of the buying centre, such as purchase executive and technical persons from production, design, and quality control departments. A salesperson can get a deep understanding of the prospect's need by asking questions. What kind of questions to be asked is described in the following page. In addition, the salesperson should find out key members of the buying centre, buying orientation and buying practices of the prospective customer, important buying factors (e.g. product quality, service quality, and price), and perceptions about competitors' products and service performance as well as prices. After getting the above information, the sales person would be in a much better position to make an attractive proposal or quotation as well as sales presentation that would meet the needs of the prospect better than the competition.

## Presentation and Demonstration

Considering the current importance of relationship selling, it is necessary for a salesperson to understand customer needs first before considering the methods of sales presentation and developing an effective presentation. The sequence of our discussions will be: (a) understanding the buyer's needs, (b) knowing sales presentation methods (or strategies), and (c) developing an effective presentation.

### *Understanding the buyer's needs*

The best way to understand the prospect's needs is by asking questions. Based on a research study of 35,000 sales calls developed by Neil Rackham<sup>12</sup>, salespeople should ask questions in the logical order presented below:

**Situational questions** These questions are about the prospect's current situation or any facts the salesperson needs. **For example**, who are involved in buying decision making for this product/service? or are you buying this product/service for the first time or making a change from the existing supplier?

**Problem Identification questions** Salespeople ask these questions to identify or uncover the customer problems, difficulties, or needs. **For instance**, have you experienced any problems on quality or delivery from the existing suppliers? or which parts of the existing system create errors?

**Problem impact questions** Salespeople ask these questions to make the buyer realise the impact or consequences of the problem and the need to solve the problem. These are the most important questions and the salesperson should ask as many as needed. **To illustrate**: what impact the quality and delivery problems will have on your costs and customer satisfaction? or what impact the errors in your system has on your customers?

**Solution value questions** Salespeople ask these questions to help the buyer assess the value or usefulness of a solution. **For example**, if the rejection rate due to the quality of this component is reduced to 0.5 per cent, how much amount would you save? or how would an error-free system help?

**Confirmation questions** Salespeople ask these questions to get confirmation from prospects to hear about the products or services. **For instance**, if I can show you the proof that our component supply would reduce the rejection rate to less than 0.5 per cent, would you be interested? or would you be interested to know how our service can minimise the errors in your system to zero level?

It is recommended that salespeople ask fewer situational questions and more questions on problem identification and impact, and solution value.

### ***Knowing sales presentation methods***

Salespeople must know the various methods (or strategies) used for making a sales presentation. These are:

- Stimulus response method,
- Formula method,
- Need-satisfaction method,
- Team selling method, and
- Consultative selling method.

**Stimulus response method** It is also called as *canned approach*, a memorised sales presentation, or a prepared sales presentation. This method assumes that if a salesperson makes the right stimuli (e.g. sales presentation), he can get a favourable response from the prospect. The salesperson does most of the talking. Without knowing the needs of the prospect, the salesperson presents all the features of the product and then asks the prospect to buy the product. If the prospect does not agree to buy, another attempt is made to sell the product. This method is used by telemarketing people, door-to-door salespersons, and for training new salespeople, when the time for sales presentation is short, and the product is non-technical. However, making the same presentation to all prospects or giving the same sales talk is not effective for sophisticated buyers or in creating selling situations. The major fault in this method is that the salesperson does not find out the needs of the prospect by asking him questions and listening. The salesperson talks about the product features and benefits, which may not be important to the buyer.

**Formula method** This method is also based on stimulus response thinking and is also known as ‘formulated approach’ or ‘mental states selling’. The salesperson assumes that most buyers can be led through mental states or steps in the buying process and hence uses a well-known formula, which has four stages: attention, interest, desire, and action (AIDA).<sup>13</sup>

**Attention** The sales representative plans the sales talk by first getting the attention of the prospect by making favourable comments about the prospect or the prospect’s business. *Favourable first impression* is also created by proper dress, neatness, a genuine smile, and a cheerful expression of genuine admiration or arousal of customer’s curiosity. The objective of the first few minutes of the meeting is to put the prospect into a receptive state of mind. It is always a good strategy for a salesperson to make an appointment with the prospect. Even with an appointment, the first few minutes are very important and hence a successful salesperson chooses a proper conversation opening sentence.

**Interest** The salesperson leads the prospect’s mind to the second stage of gaining an interest. In other words, the salesperson finds out which aspect(s) or factor(s) of the product or service appeals or attracts the prospect. Different methods are used to uncover the prospect’s interest, or appeal. Some salespeople carry a sample of the product, or the product, if it is not bulky, for showing or demonstrating to a customer. Some other salespeople carry visual aids like CD, the product leaflet, or the product photographs.

**Desire** The objective in this stage is to arouse a strong feeling in the prospect of wanting to have the product or the service. The salesperson continues with the sales presentation and demonstrates to the prospect of how his/her product or service can solve the buyer’s problem. In this process, the buyer may raise some *objections*, which need to be answered properly. We shall discuss how to overcome these objections subsequently in this chapter. Sometimes salespeople face the problem of external interruptions like prospects getting phone calls. After the interruption, it is advisable that the salesperson quickly summarises what has been said earlier before continuing with the sales presentation.

**Action** The action, in this stage, means buying action, or closing the sale. Some salespeople use trial close to test whether the prospect is ready to buy. If it is ‘yes’, then the salesperson asks for the order. If it is ‘no’, the salesperson continues with the presentation to fully convince the prospect about his/her proposal. We shall discuss more on closing the sale subsequently in this chapter.

The advantages of this method are that the salesperson has to plan the sales presentation and understand the customer’s mental stages. The disadvantage is that the customer’s needs are not understood clearly and so the method is less effective.

**Need-satisfaction method** This method is most challenging and a creative form of selling. It is an interactive sales presentation, which is different from the stimulus-response and the formula methods discussed earlier. The salesperson typically starts with ‘understanding the buyer’s (or the prospect’s) needs’ by asking situational, problem identification, problem impact, solution value, and confirmation questions, as described earlier. Only after clearly understanding or investigating the needs or the problems of the buyer, the salesperson gives a written proposal or moves into sales presentation (or demonstrating capability) stage to show how his/her product or service can solve the buyer’s problem better than that of a competitor. This is done in three ways: features, advantages, and benefits as described below:

- **Features** The salesperson describes the features or characteristics of the product, service, or market offering. **For example**, “our ceiling fan has two ball bearings”.



- **Advantages** The salesperson describes how the feature can help or give advantage to the prospect. **For instance**, “because of the ball bearings, our ceiling fans make hardly any noise and have a longer life”.
- **Benefits** The salesman then describes how the feature or advantage meets a clear and detailed need expressed by the prospect. When a prospect states the benefit, it becomes a powerful statement that can be used by the salesperson effectively for making a sale. To illustrate from the earlier **example**, “our ceiling fans can be used in the class-rooms where noise level should be low as needed by you”.

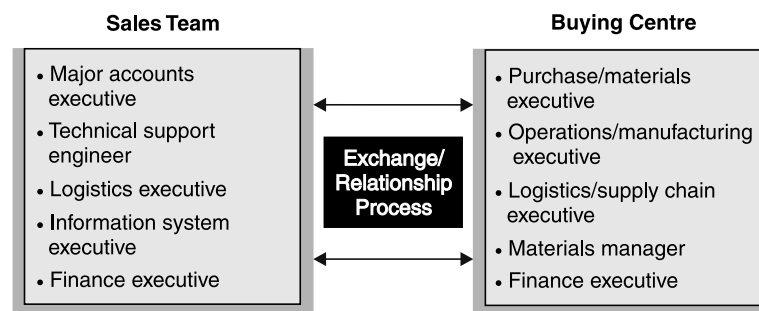
Table 10.3 gives some **examples** of products and services along with their (FAB) features, advantages, and benefits.

**Table 10.3** Use of FAB Approach

<i>Product Service</i>	<i>Feature</i>	<i>Advantage</i>	<i>Benefit</i>
Electric Motor	Special design for low voltage application.	This means the equipment like pump sets can be used even under low voltage situations.	Our motor can be used even when you have low voltage conditions, as needed by you.
Annual maintenance contract (AMC) for computer systems	We have twelve service engineers.	This will ensure a quick service.	Our service person will attend to your service needs within eight working hours as desired by you.
Lift table or loading and unloading equipment	We have offered a customised design to take care of your loading and unloading tasks.	Our lift-table will reduce the time taken for loading and unloading your finished goods substantially.	Time taken for loading and unloading of your goods is reduced by 50 per cent, as required by you.

Most customers like this method and are willing to spend time to describe their needs. This method focuses on the customer, unlike stimulus response that focuses on the salesperson. The sales effectiveness of this method is much higher.

**Team Selling Method** As noted in Chapter 1, team selling is one of the latest developments in personal selling and growing number of organisations are using multi-person sales teams to deal with multi-person buying centres (or buying committees) of their customers<sup>14</sup>. Figure 10.2 shows an **example**



**Figure 10.2** Relationship Process between a Sales Team and a Buying Centre Members

of relationship between a sales team and a buying centre of a firm. The salesperson (or key accounts executive) from the selling firm typically co-ordinates the selling activities of the sales team and the purchase executive or a materials executive of the buying firm typically co-ordinates the purchasing activities of the buying centre. Individual members of the sales team and the buying center are from different functional areas and play one or more roles in the exchange process as shown in Fig. 10.2.

**Strategic issues** Team selling approach is not the best alternative in all selling situations. Since team selling is expensive, it should be used for key accounts, who have high sales and profit potential. It can also be used for complex selling situations, customised products and services, long-term contracts, or new customers. Team selling should not be used for low sales and profit customers, who could be served by a salesperson with transactional selling approach. Similarly, routine (or repeat purchase) situations can be handled by a salesperson, without any need for a sales team. Generally, the decision to use sales teams depends on the needs of the buyer. If a customer uses a team of buying centre members for purchasing products or services, then the marketing firm should use a sales team to match the functional areas and management levels of the buying firm. Companies like IBM, Xerox, HP, 3M, Wipro and Siemens use team selling approach extensively. At IBM, the sales team consists of client executive, systems engineer, consultant, and product representative. At Wipro technologies, the selling team consists of a business development executive, a solutions expert, and a domain expert. The emphasis in team selling is on building a long-term relationship between selling and buying firms by focusing on the whole company and its capabilities, rather than just selling a product or a service.

**Group presentation** When a sales team or a salesperson makes the sales presentation to a group of decision-makers from the buying organisation, it is called a group presentation. Some of the guidelines for an effective group presentation are as follows:

- **Need-analysis** Before the group presentation, the salesperson should talk with all or most members of buying centre (or purchase committee) to understand their needs or problems and what benefits they are looking for. Also, use the opportunity to build a rapport or a good relationship.
- **Introduction** First part of the group presentation should include the company name, members of selling firm and their designations, and a brief statement of the purpose or objectives of the presentation.
- **Convincing** Mention, during presentation, the company's experience, names of renowned customers, third-party certification of satisfaction, and quality assurances.
- **Specific-benefits** If need-analysis was not done before the presentation, ask each person the benefits they look for in the product or service they intend to buy. Then go through the presentation and show how the product or the service offered meets with each person's specific benefits.
- **Well prepared** At the end of the presentation, the selling team should answer questions from the buying team. The selling team should be so well prepared that all the questions are answered well. The selling team should make each team member responsible to his/her area of specialisation such as technical, commercial, and so on.

**Consultative selling method (or problem-solution presentation)** Consultative selling is increasingly used as a professional selling process in the 21st century. This is also sometimes referred to as problems-solution method or problem-solving approach. Buyers have problems, and they know

that they do not have expertise to solve the problems. Buyers want solutions within their budget to achieve their strategic goals. Consultative salespeople or sales teams help customers not only in solving their problems, or meeting the needs, but also achieve the strategic goals of the customer. Salesperson uses the resources of the selling organisation by seeking help from design, production/operations, or any other persons or functions within or outside the organisation, in order to solve the customer's problem. Salespeople understand the customer's strategic goals, and work in a collaborative or partnering relationship with the customer to achieve the strategic goals and to solve the customer's problems. Many software suppliers, like Wipro and SAP, use consultative selling approach to solve their customer's business problems, such as enhancing business performance, setting up quality framework, or creating value for their clients. For successful consultative selling, the requirements are as follows:

- Salespeople should have an in-depth knowledge of the customer's company and the customer's industry, and carry out a detailed analysis of the problems or needs.
- Salespeople should be aware of key members of the customer's buying centre (or purchase committee) and get their acceptance of the needs/problems.
- Salespeople should prepare the proposal for solving the buyer's problems and make the sales presentation.
- Salespeople should use the selling firm's cross-functional expertise to provide solutions to the customer's business and technology related problems. If needed, external sources should be used by the sales team to become an expert on the customer's business and to solve the problems.
- This is also sometimes referred to as problems-solution method or problem-solving approach.
- Salespeople should build long-term partnership with the customer.

### ***Developing an effective presentation***

For developing an effective presentation, the following guidelines would be helpful:

- **Planning** As stated earlier in pre-approach, it is important that the salesperson does planning, including setting objectives for each sales call and each presentation.
- **Use Technology** Salespeople should use the latest technology like dynamic software packages, multi-media presentation that bring computer images to life.
- **Adapt Presentation** The salesperson should modify or adjust his/her presentation tailored to the given situation and person(s).
- **Benefit Plan** Salespeople should use persuasive communication to create a visual picture in the prospect's mind of the benefits of the purchase.
- **Don't Overload** The salesperson should avoid telling everything about the company, product, and service. Only the information that is relevant should be presented, because the prospect can absorb only limited information at a time.
- **Prospect's Language** The salesperson should use the language that is understood by the prospect. Salespeople should not use difficult words (or jargons), which are not understood by the customers.
- **Convincing** Salespeople must make the presentation convincing, by proving each point with the help of a third party proof. It is important that the prospect must believe in the statements made by the salesperson.

***Demonstration***

Demonstration is one of the important selling tools of a salesperson. Sales presentation can be improved by demonstration<sup>15</sup>. Demonstrations prove the benefits of the product and reduce the risk of a wrong purchase to the buyer. That is the reason car salespeople allow prospective customers to test drive cars and many industrial products manufacturers arrange demonstration of their products in use.

Some of the benefits of using the demonstration as a tool for selling are as follows:

- Buyers' doubts or objections are cleared and their questions are answered. This improves a buyer's purchasing interest.
- It provides a good support in the selling process.
- It helps the salesperson to find out specific benefits of the prospective customer. The salesperson can then show how his/her products or services can meet with those benefits better than the competitors.

***Planning and conducting demonstration***

The salesperson should do necessary planning by rehearsing the demonstration with colleagues, who act as buyers, to ask questions or raise objections. There should be a contingency plan in case of power failure or product break-down. The demonstration should be planned in two parts. In the first part, the salesperson should explain briefly the product features, advantages, and benefits of the product (as described earlier in the use of FAB approach) and also how the product works. In the second part, the salesperson should show demonstration or actual working of the product. The salesperson should use simple language and avoid technical words or jargons, if possible. If jargons are necessary, the same should be explained in simple, commonly understood words. The salesperson should also understand the purpose of demonstration—to obtain a sale or to lead for further discussions or negotiations. For achieving this purpose, the demonstration should be made interesting and the buyer should find it satisfying. Understanding the buyer's needs or specific benefits, and showing how the product, that is demonstrated, meets with the specific needs or benefits of the buyer are important parts to be kept in mind when the demonstration is conducted. At the end, the salesperson should summarise the important points, including the buyer's specific benefits and how these are met fully by the product. The salesperson should then use closing techniques to get the order or any action, like final negotiation or meeting, that will take the sale forward.

If the product is bulky or heavy and cannot be carried for sales presentation, the salesperson can use demonstration aids like product samples, visual aids like movies and audio and video cassettes. Booklets and brochures can be left behind for customer reference.

***Matching presentation methods with situations***

The salesperson should understand the sales situation and then use a suitable method of presentation. This would make the sales presentation more effective, resulting in improved sales performance. Table 10.4 shows different methods of sales presentations and appropriate situations.

**Table 10.4** Matching Sales Presentation Methods with Sales Situations

<i>Sales Presentation Methods</i>	<i>Suitable Sales Situations</i>
Stimulus—response method, canned approach, or memorised sales presentation	Suitable when selling time is short and product is simple or non-technical. The method is used by salespeople with less experience, as it gives them more confidence. Used for door-to-door or telephone selling.
Formula method, formulated approach, or mental states selling	In straight rebuy or repeat purchase situation, when the customer is familiar with the products or services of the salesperson's company or when the salesperson is aware of the buyer's needs, this method is appropriate.
Need—satisfaction method	It is a creative form of selling, suitable for selling industrial products, or consumer durable products, where the salesperson has to understand the prospect's needs first.
Consultative selling or problem-solution method	For selling high-cost technical products or services like computer hardware and software, power transformer and furnace, this presentation method is used to present to a group of individuals, using team selling approach.

### Overcoming Objections

Sales objections, resistances, or oppositions may typically take place during sales presentation or when the salesperson asks for the order from the prospect. Objections should be welcomed because they show that the prospect has some interest, and that if the objections can be answered satisfactorily, it would result in sales.

Two types of objections or resistances happen: Psychological (or hidden), and logical (practical or real). Psychological or hidden objections include predetermined ideas or beliefs, preference for established brands, dislike of making decisions, anxiety or resistance to spend money. Logical or real objections are tangible such as quicker delivery schedules, high price, product quality, or product availability.

### *Methods for handling and overcoming objections*

Some of the common methods of handling and overcoming the sales objections are:

- I. Ask questions,
  - II. Turn an objection into a benefit,
  - III. Deny objections tactfully,
  - IV. Third-party certificate, and
  - V. Compensation.
- **Ask questions** First listen to the buyer's objection carefully. Clarify the objection by rephrasing it into a question and get the buyer's acceptance of the question. Let us take an **example**:  
**Buyer:** "It seems price of your product is higher than your competitor."  
**Salesperson:** "I accept your concern. Do you want to know why the price of my product is slightly higher than that of another supplier?"  
**Buyer:** "Yes, that's what I want to know."  
**The salesperson** then explains the benefits of his product to make it worth the price.
  - **Turn an objection into a benefit** An experienced salesperson, with positive attitude and quick thinking can turn an objection into a benefit or a reason to buy. Consider the following **example**:

**Prospect:** “The delivery period of four weeks for your equipment seems to be too long, as we need it in about two weeks, so that including installation and commissioning the project will have to be completed in five weeks from now.”

**Salesperson:** “I appreciate your point, but this equipment is specially designed and manufactured to your specific needs. With four weeks delivery, we can do installation in less than one week, so that overall it would be five weeks or earlier. Is that OK with you?” (Trial close)

- **Deny objections tactfully** Sometimes, objections are incomplete or not correct and in such situations salespeople should tactfully deny the objections either directly or indirectly—the difference is that indirect denial is more tactful and softer. Consider the following **example** of indirect denial:

**Buyer:** “I don’t want to buy your car, because a friend of mine told me that he had a lot of problems when he purchased your newly launched vehicle two years ago.”

**Salesperson:** “Yes, I agree, two years ago when we launched our new brand of car, we had a few problems, but we solved all those problems within six months at our factory and also at our customers’ premises free of cost. In the last one and half years our sales are highest, as compared to other brands and you can check with your friend now about the performance of the vehicle. If he gives you a good opinion, would you buy our car?”

In direct denial also, the salesperson should be tactful, by saying, “I understand your concern, let me explain to you the facts ...”. The salesperson should not be arrogant or sarcastic when he denies incorrect objections.

- **Third party certificate** When the prospect expresses doubts about the product quality or performance, the salesperson uses some other customers’ experience of using the product as a proof or testimony. However, the salesperson should get the prior approval from such customers. Sometimes, the prospect takes the initiative and asks the salesperson to give the names and telephone numbers of customers who have been using the product or service of the salesperson’s organisation. Favourable response from such customers results in getting the order for the salesperson. **For instance**, before buying six numbers of the equipment used for loading and unloading materials from trucks, ITPL, Bangalore, not only visited the manufacturer’s plant, but also went to Ashok Leyland’s plant (the manufacturer’s customer) at Hosur to see the performance of the equipment as well as to know the quality of service, including the availability of spare parts.
- **Compensation** Sometimes, the buyer has a valid objection, which makes the salesperson offer some kind of compensation or benefits to counter balance the objection. **For example**, Reliance Industries were considering to buy certain material handling equipment for the first time for their factories in Gujrat from a manufacturer, located in Karnataka. Reliance raised an objection to know how the manufacturer would ensure efficient warranty service and after-sales service. The manufacturer’s senior marketing executive promised to station one service engineer at the customer’s premises for one year and thereafter open a service centre near Reliance Industries premises. This assurance satisfied the customer, who placed an order initially for a small value with an assurance to place substantial value of orders subsequently.

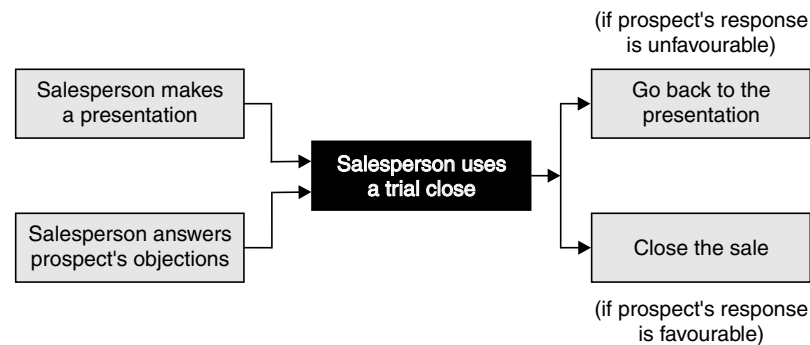
### Trial Close/Closing the Sale

Trial close is one of the selling techniques. It checks the attitude, or asks the opinion, of the prospect. Trial close does not ask the decision of the prospect to buy. It is used after the sales presentation and, after an objection is answered, or before closing the sale. The reason for using the trial close is that if

the sales person tries to close the sale by asking for the order after the presentation, and if he gets the answer as 'no', it would be very difficult to change the mind of the prospect. Some of the trial close **examples** are as follows:

- To what extent this product meets with your needs?
- Which of these benefits are important to you?
- Out of the three models that are here, I think you like this model. Am I right?

If the prospect has responded favourably to the salesperson's trial close question, then the salesperson should know that it is time to close the sale. However, if the prospect's feedback or response to the trial question is negative, it means the feature, advantage, or the benefit presented by the salesperson is not liked by the prospect. In such a case, the salesperson should go back to the presentation, instead of closing the sale, as shown in Fig. 10.3.



**Figure 10.3** Steps to be Followed by the Salesperson

Closing the sale means asking for the order. Closing is the process of helping the buyer to make a decision that will benefit him/her. When should a salesperson close the sale? The answer is when the buyer is ready in the mental buying process. Most of the time, prospective buyers give indications about their readiness to buy. Some of these *buying signals* are as follows:

- **Examines the product** When a prospect examines the product carefully, the salesperson should use a trial close question such as “What is your opinion about this product?” If the answer from the prospect is positive, the salesperson should move on to close the sale.
- **Asks another person's opinion** The prospect asks the opinion of another person—a colleague in office, or a relative at home—“What do you think about this product?”
- **Asks questions** Some of the questions the prospect may ask are: “When can you deliver this product? or What is the price? or What are your payment terms? Sometimes, the salesperson asks another question in response to the prospect's buying signal question in order to better understand the prospect's needs or thoughts, such as “When do you want the delivery?”, “How much quantity is required?”, or “What payment terms you want?”

**Becomes friendly** The prospect becomes friendly, once he mentally decides to buy. The anxiety or pressure of buying changes into relaxation. An ability to understand the prospect's buying signals correctly helps a salesperson decide when and how to close the sale. Although most of the time, the time to close the sale is after the presentation, it can also happen after trial close, during presentation, or after answering the objection.

It is important for a salesperson to remember that when he/she asks for the order, he should remain quiet and not say anything for a few seconds (This is called ‘golden silence’). If the salesperson says something after asking for the order, the pressure on the prospect to make a decision goes off, and may result in losing the sale.

### ***Closing techniques***

There are many closing techniques. Some of the closing techniques are discussed below:

**Alternative-choice close** In this technique, the prospect is given a choice between two or more items or models, and not between buying or not buying. **For instance**, “Which of the three models do you prefer?” By giving a choice, either the salesperson gets a “yes, I prefer this model”, or some kind of objections, which if satisfactorily handled, would enable to come closer to making the sale. This technique is effective if used correctly.

**Minor points close** This technique is similar to the alternative-choice close, discussed above. It is sometimes easier for a prospect to decide on many minor points than to make a bigger decision on whether to buy or not to buy. By having the prospect make decisions on a product’s minor points, the salesperson can cleverly lead into the decision to buy. **For example**, the salesperson may ask questions in quick succession, “If you buy this solar heater, which model would you prefer?”, “how soon would you like it to be delivered?”, or “would you like to pay on instalment basis?” With these kinds of minor point questions, the prospect typically develops a positive inclination towards buying the product.

**Assumptive close** This technique is effective when the salesperson has earned the customer trust to such an extent that the salesperson prepares the order and hands it over to the customer for his signature. The salesperson assumes that the prospect will buy and conveys his assumption through comments, such as “would you like to take it with you or have it delivered?” and non-verbal actions like starting to wrap the package, or getting out credit card charge-plate machine.

**Summary-of-benefits close** This technique is very popular, because it is simple and straightforward. The steps involved are: (i) find out the important benefits of your product or service that appeal to the prospect, during a sales presentation, (ii) summarise these benefits by using FAB (features, advantages, and benefits) statements and SELL sequence (show feature, explain advantage, lead into benefit, let customer talk), and (iii) make a proposal. Consider the following **illustration**:

The salesperson selling airconditioners would say, “Our air-conditioner has a high efficiency rating (feature), due to which it uses less electricity (advantage), which results in 15 per cent saving in your electricity bill (benefit). That’s good— isn’t it?” (trial close). If the response is favourable, the salesman says, “when do you want the delivery—this week or next week?”

**T-account (or modified T-account) or balance sheet close** This technique is used by the salesperson when he takes a piece of paper and draws a large T on it. He places ‘to act’ (or assets) on the left side and ‘not to act’ (or liability) on the right side, as shown in Fig. 10.4.

To act (Assets)	Not to act (Liabilities)
Time saving Less efforts Easy instalment payment Immediate delivery	More models

**Figure 10.4** *T-Account (or Balance-Sheet) Close Technique*



The salesperson reviews the presentation with the prospect, writes down all the positive points of advantages and benefits on the left side of the T, and all the negative points on the right side. Let us consider **an example**, as mentioned below:

**Salesperson:** “Madam, this vacuum cleaner’s high speed motor (feature) works very fast (advantage) with less efforts (advantage), and saves about 20 minutes in cleaning time (benefit). We will also give you immediate delivery (benefit) and easy instalment payment scheme (benefit). Which of these benefits you like, you may kindly write on the left of T section, under ‘to act’ (Assets).”

**Prospect:** “Yes, I like the benefits of time saving, less efforts of pushing, easy instalment payment, and immediate delivery.”

**Salesperson:** “OK, Now is there anything that you want us to improve?”

**Prospect:** “Yes, I want more choice to select from more models.”

**Salesperson:** “OK, please write that down, on the right side. Is there anything else, you would like to add?”

**Prospect:** “No.”

The example shows that the product’s benefits (assets) are more than the liabilities. The salesperson should then use trial close, or overcome the objections (if any), and close the sale. In the modified T-account, some salespeople make a list of reasons ‘to act’ (or assets), and do not remind the prospect about the negative points (liabilities). Only the benefits are written on a piece of paper. This technique can be used as a back-up, if the “summary-of-benefits close” technique did not make the sale.

**Special-offer (or special-deal) close** When a salesperson has done his/her best to close, but the prospect is resisting, the special-offer or special-deal may close the sale. **For instance**, the salesperson might say, “If you buy this refrigerator today, I can give you a discount of two per cent, because I can reach my monthly quota”.

**Probability close** This technique is used, when the prospect says, “I will think it over” or “I will let you know”. The salesperson allows the real or hidden objections to come out by asking the prospect: “please tell me what is the probability in percentage terms out of 100 that next week when I call you back, you will take the decision of buying”. If the probability is more than 50 per cent for buying, the salesperson can convert the real objection to closing sale, by using the various techniques described earlier. However, if the probability is less than 50 per cent for buying, the chances of closing the sale is low. In such a case, return to the original position and start the selling process again.

**Negotiation close** Most salespeople close the sale after successful negotiations with buyers (or prospective customers). The attitude and style of negotiation of the salesperson determines the outcome of negotiation. The salesperson should have a positive and helpful attitude. Out of the various styles of negotiation, the salesperson should use ‘both of us win’ style. This style helps the salesperson and the selling organisation to build a long-term mutually beneficial relationship with the buyer and the buying organisation. It is, therefore, necessary that salespeople possess the skills of negotiation.

### ***Closing techniques and sales situations***

In order to understand better different closing techniques to be used for suitable or appropriate sales situations, a matrix is prepared, as shown in Fig. 10.5.

Salespeople can review their customer profile to understand the sales situations, and use different closing techniques based on the matrix shown in Fig. 10.5. They should be well prepared before each sales call. This would result in superior sales performance and customer satisfaction.

<div>Closing Techniques</div> <div>Sales Situations</div>	Negotiation	Probability	Special-offer	T-Account/modified T-Account	Summary of benefits	Assumptive	Minor points	Alternative choice
Buyer is hostile	✓	✓						
Buyer is a friend	✓	✓				✓		
Buyer is unable to make a decision	✓	✓	✓	✓	✓		✓	✓
Buyer is selfish or greedy	✓	✓						
Buyer has certain opinion in advance	✓	✓		✓				
Buyer is an expert with a large ego	✓	✓		✓				

**Figure 10.5** Matrix on Closing Techniques and Sales Situations

### Follow-up and Service

Salespeople must understand that their job is not over after getting the order. Successful salespeople follow-up a number of related tasks, some of which are called customer service, as described below:

#### ***Check customer order***

After getting the customer order, the salesperson should go through the same carefully to check if all the details such as delivery period, address of delivery, advance payment (if any) and so on are mentioned. If this checking is not done now, later on there may be delay due to non-receipt of the information from the customer.

#### ***Plan follow-up visit at the time of delivery***

The salesperson should plan a follow-up call when the equipment or item is to be delivered. This visit includes checking if the product is received on time and without any damage in transit (if received in damaged condition, to arrange for insurance formalities), installation (if any), operating instructions, training (if needed). This visit is very important because it will detect any problems or complaints, which the salesperson should solve to the customer's satisfaction. Consider the following **example** of handling customer's complaints promptly:

Crompton Greaves launched its new table fan in Mumbai in 1973 with a lot of fanfare in a five star hotel. On the next day of the launch, dealers complained about improper oscillation of the new fan. The area sales manager and his salesforce, along with a team of technical people from the manufacturing unit of the company immediately swung into action, detected the minor fault, and repaired all those fans. This restored the confidence of the dealers to sell the new product, as the complaint was handled promptly.

Some buyers suffer from post-purchase anxiety (cognitive dissonance) about the wisdom of their purchase decision, particularly if there are problems on high value products or services. The follow-up visit of the salesperson assures the buyer and reduces the dissonance. **For instance**, many buyers of the newly launched Indica car suffered post-purchase anxiety due to certain technical problems. Immediate corrective actions from Tata Motors (Telco) in solving the problems reduced the dissonance substantially.

### ***Account penetration***

Successful salespeople know that there is still a lot of work to be done after making the sale. By contacting the customer after the sale, the salesperson lays the foundation of a positive business relationship. Account penetration means working and contacting people throughout the account (or customer organisation) and discussing about the selling firm's products and services. The successful account penetration depends on the knowledge of that organisation's key people and their buying situations.

## **SALES FORCE ORGANISATION AND MANAGEMENT**

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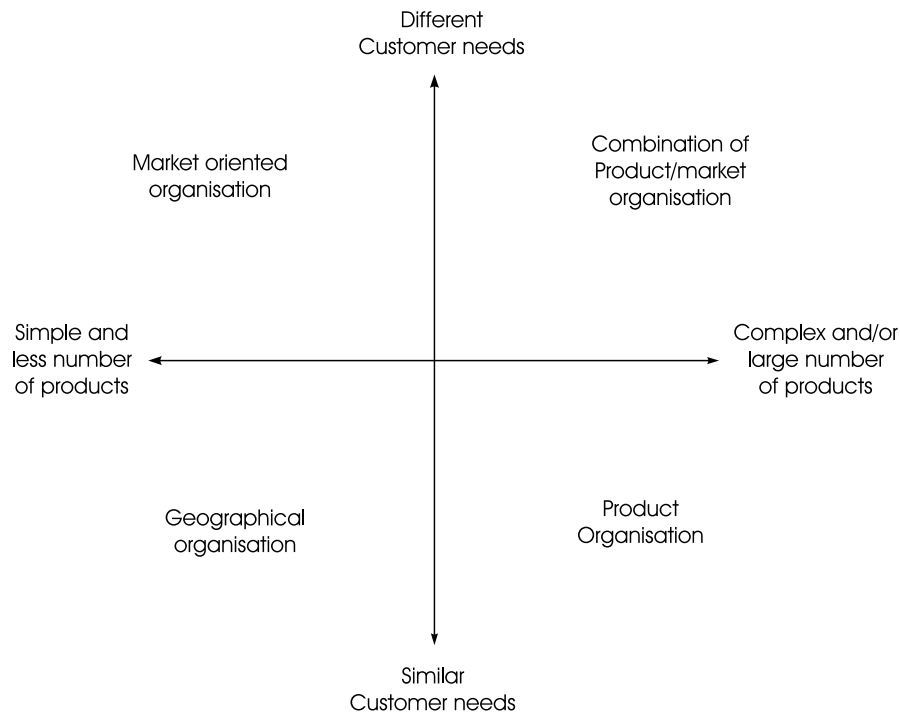
Companies can execute their selling strategies with a sound salesforce organisation structure. The salesforce organisational design should be consistent with the selling and marketing strategies.

The answer to the following questions are helpful in selecting the right design and type of salesforce (or sales) organisation.

- What tasks or activities are to be performed by salespersons?
- Are specialised selling efforts required to meet needs of different types of customers and for handling complex and/or large number of products?
- Are sales teams needed and if so, what will be their composition?
- What is the role of intermediaries and how important are relationships with them?
- How many and what kinds of sales management levels are needed for effective supervision?

We shall consider two most important factors which influence the design of the sales organisation. These are: (1) different or similar needs of customers, and (2) simple or complex products and length of products. Based on these two factors, major types of organisational designs are shown in Figure 10.6A.

Geographical organisational design is appropriate to small and medium size companies with simple and less number of products for customers whose needs are similar. Market-oriented organisational design (or type) is suitable whenever there are distinct customer groups (or market segments) whose needs and buying behaviour are different. Similar customer needs and complex and/or large number of products point towards product organisation. A combination of product and market organisation considers both the factors – viz. different customer groups needing different and sometimes complex products. We shall now discuss the various types or designs of sales organisation in greater details.



**Figure 10.6A** *Design of Sales Organisation*

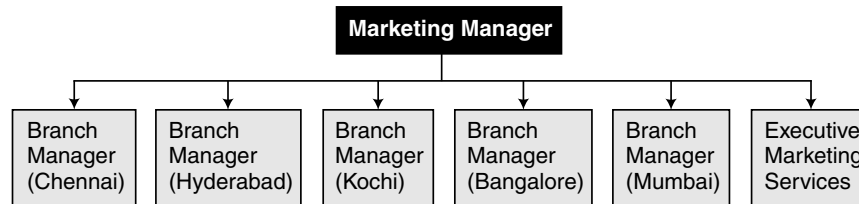
**Geographical Organisations** These are most common in business marketing. In this organisation a salesperson is assigned a particular territory, branch, or region for promoting all the products of the company to all the customers located in that geographical area. This type of sales organisation is most economical and it ensures that all the customers in the territory are covered. It is beneficial to customers because one salesperson selling all the products of the company is responsible for efficient service and communication. This organisation is suited to a small or medium-size company with less number of products.

**For instance**, the marketing manager of a company manufacturing aluminium extruded products decided to plan the sales organisation based on the geographical type. The marketing manager had analysed that initially the company size was small, the financial resources were limited, and the product sold was one, although the applications and market segments were many. As the company was located in southern India, in the first phase the selling efforts were concentrated in southern and western parts of India, and subsequently, after two years, in the second phase, it was planned to expand its sales activities to northern and eastern parts of India. As a consequence, branch managers and sales engineers were recruited for field selling function, along with support staff, on geographic location basis.

The sales organisation structure in the first phase (Fig. 10.6) shows “Executive marketing services” position at the marketing head office, with responsibilities of coordination with factory, planning customer orders, communicating with branches on delivery status and quality complaints (if any), and so on. Branch managers and executive-marketing services were reporting to the marketing manager.

However, if a firm has a large number of products manufactured by several product divisions, one salesperson assigned to a particular geographic area will find it extremely difficult to master knowledge

of products, customers, and marketing policies for all the products. Besides, the product division heads of various divisions may have doubts that the salesperson is not paying adequate attention to their products.



**Figure 10.6** *Geographical Sales Organisation*

**Product Organisation** In this organisation salespersons are assigned a few products out of the various products of a company. Thus, different salespersons specialise in selling different group of products. This type of sales organisation is suited to a large organisation having several products or technically complex product groups. It can permit product specialisation because different products need different types of product knowledge, application knowledge, and selling skills. Besides, the customers' buying behaviour for various products may be different.

The major advantage of the product oriented sales organisation is that it gives a competitive advantage due to the greater product knowledge permitted by product specialisation, which in turn improves the value of the total offer to the customers.

The disadvantages of product organisation is that the selling expenses are higher and customers may have difficulties in dealing with more number of sales persons dealing with different product groups of the same organisation. However, if the higher cost of selling are off-set by higher volume of sales, it can result in reasonable profit margins for each product group.

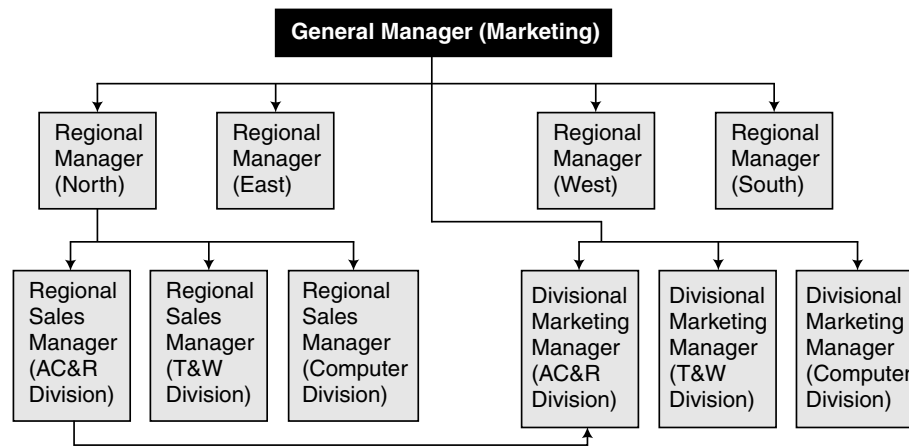
### ***Combination of Geographic and Product Specialisation***

In practice, a combination of geographic and product specialisations become necessary, an **example** of which is given below.

A large public limited company had three different product groups or divisions: (i) Air-conditioning and refrigeration division (AC&R Division), consisting of central air-conditioning plants, packaged air-conditioners, room or window air-conditioners, water coolers, refrigerators and cold storage plants; (ii) Testing and weighing machines division (T&W Division), consisting of material testing equipments and weighing machines; and (iii) Computer hardware and software division (Computer Division), consisting of personal computers (PCs), printers, and computer programming. Since all the three divisions had distinct products and services, which needed specialised application knowledge and selling skills, the company decided to have a combination of geographic and product specialisation as shown in Fig. 10.7. There were four regional offices located at Delhi, Kolkata, Mumbai and Chennai, and each was headed by a regional manager. Each regional manager was supported by three product-sales groups consisting of a regional sales manager (for each product group or division) along with sales executives, and sales engineers or sales officers—depending upon the sales volume. The regional sales manager reported to the concerned regional manager for administrative matters (i.e. for sanctioning leave, approval of tour expenses, etc.), and functionally (i.e. for target setting, pricing, product development, delivery

adherence from factory, product/service quality, etc.) reporting to the divisional marketing manager (which is shown in Fig. 10.7). The sales organisation in a matrix form combines geographic and product division specialisations.

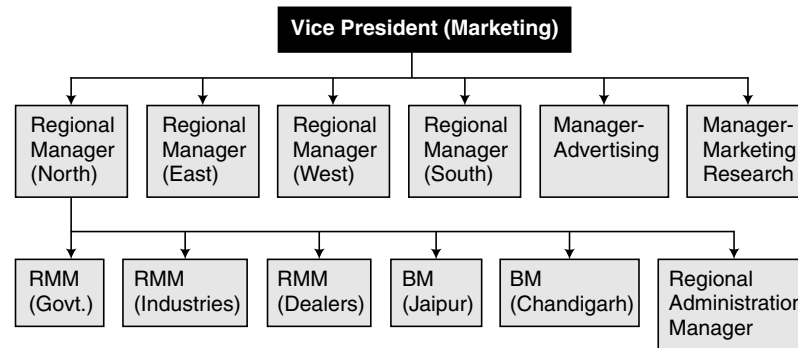
In the sales organisation as shown in Fig. 10.7, the structure shown for northern region is repeated for the east, west, and south. The sales executives, sales engineers, sales officers and supporting staff reporting to each regional sales manager are not shown in Fig. 10.7.



**Figure 10.7** Combination of Geographic and Product Specialisation Sales Organisation

**Market (or Customer) Oriented Organisation** This type of organisation is generally combined with geographic specialisation. It is found suitable whenever there are distinct customer groups who are not only large in size and potential, but also have different buying behaviour. It helps salespersons to develop a detailed knowledge of a particular group of customers. With this kind of customer/market segment specialisation, different salespersons sell the same products of the company but their strategies of selling, customer service, and buyer-seller relationships are different for different market segments.

**For example,** a large organisation in private sector, manufacturing and marketing electrical engineering products, with several product groups or divisions, decides to make a change in the sales organisation from the geographical-product group specialisation to the geographical-customer group combination, in order to improve marketing effectiveness. The company has four regional sales offices at Delhi, Kolkata, Mumbai and Chennai, each headed by a regional manager. It has branch offices at each region, headed by branch managers who report to the respective regional managers. Its product groups or divisions are (a) electric motors, (b) fans, (c) transformers, (d) lighting products like lamps, tubes and luminaires, (e) switchgear. The customer groups for the above-mentioned products are (i) government organisations, such as state electricity boards, railways and others; (ii) original equipment manufacturers (OEMs) and business users in private sector; and (iii) authorised dealers. Instead of *product group* oriented sales organisation, the company decides to have *customer group* oriented sales organisation, keeping the geographical set-up of regional and branch offices unchanged. The sales organisation with the geographic and customer combination for selling the entire range of the company's products is shown in Fig. 10.8.



**Figure 10.8** *Geographic and Market-Oriented Sales Organisation*

The regional marketing managers (RMMs) for the three customer groups are responsible to sell the entire product range of the company in the respective regions to the assigned customer groups. The branch managers (BMs) are responsible to sell the entire product range of the company to all the three customer groups. The RMMs and BMs communicate with the five divisional marketing managers at the divisional head offices for the marketing services, such as pricing policies, delivery schedules, advertising, sales promotion, new product development, product quality, and so forth. The sales organisations for east, west, and south are the same as shown for the northern region in Fig. 10.8. The sales executives, sales engineers, sales officers, and other support staff report to RMMs and BMs (not shown in Fig. 10.8). Each regional manager has a regional administration manager and each branch manager has an executive—accounts and administration. The vice-president (marketing) at the corporate office has advertising (M-Adv.) and manager—marketing research (M-M.R.), in addition to the four regional managers (RMs), reporting to him.

However, the divisional marketing managers report to the divisional general managers at the respective factory locations (not shown in Fig. 10.8).

The matrix organisation, shown in Fig. 10.8 seems to be desirable in a large, multi-product, multi-market company. However, there are problems in terms of conflicts as to where the authority and responsibilities reside. The conflicts can be minimised if the roles of various managers are clearly defined.

It should be emphasised, that in practice a combination of geographic, product or market types is very common. The examples given earlier would prove this point.

### **Organisational Hierarchy**

A salesforce consists of field selling and inside sales persons (or representatives). Both the positions have important roles to play. In a typical sales organisation, sales representatives report to a first-line supervisor, referred to as sales supervisor or a branch manager or an area manager. The designations vary from organisation to organisation.

The number of levels of management in the hierarchy between sales reps and the head of marketing will depend upon the size of the organisation and the span of control (i.e. the number of persons reporting to a manager). Although the concept of optimum span of control is now outdated (because of the effectiveness of a flatter organisation structure), it is generally believed that six to eight persons reporting to a manager is reasonably optimum. This can be seen from the sales organisation's structures shown earlier under types of sales organisation.

As mentioned earlier, the trend in organisation structure is to have minimum possible hierarchical levels. In other words, many business firms have now switched over to flatter forms of organisation. These kind of organisations have competitive advantages in minimising communication delays, faster decision making, resulting in speed and accuracy in responding to the demands or problems of the customers.

## MANAGEMENT OF SALES FORCE

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The management or administration of sales force involves recruiting and selecting, training, supervising, motivating, developing, compensating, evaluating, and controlling the sales representatives. The business marketer should create an organisational culture that will have positive effects on sales performance and job satisfaction of the salespersons.

### Recruitment and Selection of Industrial Salespersons

In selecting and recruiting sales people, an organisation can use one or more selection methods. These are: (i) Personal interviews, (ii) Evaluation of application forms, (iii) Checking with references mentioned in the application form, (iv) Personality tests, (v) Tests of interests, intelligence, aptitudes, and knowledge.

Out of the above methods, based on studies conducted, the most commonly used method in practice are personal interviews, evaluation of application forms, and personal reference check. The personality tests (to measure emotional, social, and motivational aspects of behaviour) are least reliable. The tests of interest, intelligence, aptitude, and knowledge are more straightforward and are helpful only if a company has developed a database that correlates job success with the dimensions measured by such tests.

Application form or blank can be an important source of data. Many companies develop their own application forms to suit their individual needs. It should contain all relevant information, including education, previous experience, reasons for leaving previous jobs, salaries drawn, personal health, family background, and career objectives. It can provide a useful basis for personal interview.

### Selection Criteria

In selecting industrial sales representatives, the criteria commonly used are: (i) human relation skills, (ii) communication skills, (iii) technical background, (iv) job knowledge, (v) negotiating skills.

A salesperson has to maintain good interpersonal relationships with customers and also within the sales organisation of the company, and hence, human relation skills are important. As discussed earlier in the role/responsibilities of personal selling, a sales rep is a part of company's communication mix, and therefore, he should be a good communicator. Salespersons with good technical background are in a better position to find out customer problems and suggest appropriate solutions, which is an important factor in business selling. Negotiating skills and job knowledge are also important as salespersons are required to negotiate with customers and get orders, which is the primary objective of selling. However, each business organisation develops its selection criteria.

**Personal Interviews** The primary method used by over 90 per cent of all business firms to select salespersons is by personal interviews. Personal interviews can be conducted by a manager of the company, or by multiple interviewers, or by a panel of interviewers. Personal interviews conducted by one manager can be biased and are less reliable as compared to multiple or panel-type interviews.



Multiple interviews consist of interviewing the candidate at different times by various company executives. In panel interviews, a candidate appears before a group of company executives on just one occasion. In practice, however, there is a combination of all the three techniques.

One of the interviewing methods is the *structured (or patterned) interview*. This involves asking the interviewees a set of previously prepared same questions. This technique helps interviewers to compare the responses of the candidates. Another method is *stress interview*. Here, the interviewer simulates stress situations by using psychological techniques. Trained psychologists are required for this method to be effective. However, this method is not approved by many interviewers.

Problem-solving questions are also used to find out a candidates' communicating and technical abilities. These are open-ended questions (i.e. questions that cannot be answered by simple "yes" or "no").

The objective of a personal interview is to permit a two-way communication between the applicant and the company manager so that both can assess the other. In a good interview, the candidate is given an opportunity to ask questions so as to learn about the company, its products, its markets, and the nature of the job. Experienced interviewers initially ask simple questions and later dwell on in-depth questions on the subjects the candidate is familiar with or has specialised knowledge of.

The responsibility for recruitment and selection of salespersons depends upon the size of the organisation, its policies, and the professional environment. Generally, sales-force recruitment and selection is a part of a local branch or regional manager's responsibility, in coordination with the human resource department and senior sales/marketing managers.

## Training Industrial Salespersons

Many business firms spend a considerable amount of time and money to train the salespersons. This is particularly applicable in today's competitive environment where salespersons need to be effective. The training programmes for salespersons should be carefully planned. There are five steps involved in planning and executing a sales training programme, called *ACMEE*—*Aims, Contents, Method, Execution, and Evaluation*.

### Aims (or Objectives) of Sales Training

The broad aims of training are to improve the performance of a company and that of sales people, or to increase customers' satisfaction level. However, specific aims will vary, depending on training needs of newly recruited and experienced salespersons, type of products and markets, and job description. **For example**, initial training for newly recruited salespersons, selling capital items like textile machinery to textile mills, will have specific aims of imparting product and application knowledge, and customer knowledge. For experienced salespersons the specific aims should be determined on the basis of individual needs, after studying their performance, and sales reports.

### Contents of Training Programme

The contents of training vary for initial training (for newly recruited salespersons) from the continuing training (for experienced salespersons). The contents in initial training are:

**Company Information** Sales representatives should be informed about the company history, objectives, organisation structure, key executives, major operations and products, past performance on sales, profits, and so forth.

**Product Information** Sales trainees are shown how the products are produced and used for various applications.

**Market Information** This includes information on customers and competitors, such as types of customers, their needs, and buying behaviour; competitors' strengths, weaknesses, strategies, and tactics.

**Sales Policies and Procedures** Sales trainees learn about sales policies, such as discounts, payment terms, and deliveries. They are also informed about sales procedures like sales reports, travelling, lodging and boarding expenses.

**Selling Techniques** For sales trainees, it is important to learn about selling styles, sales presentation, negotiation skills, team selling, and relationship marketing.

For experienced salespersons, the contents depend on the deficiencies or needs of the individual persons. Experienced salespersons, **for instance**, need training in communicating skills, or in sales forecasting techniques, or human relation skills.

## Methods of Training

There are broadly two types of training methods as shown in Table 10.5.

**Table 10.5** Training Methods

<i>Group Methods</i>	<i>Individual Methods</i>
1. Lecture	Personal counselling
2. Case discussion/Case studies	Correspondence course
3. Group presentation/discussion	On-the-job training
4. Role playing	Product demonstration
5. Films	Self-study system
6. Business games/simulation games	Individual presentation
7. Sensitivity analysis	Online training
8. Videotapes	
9. Product demonstration	

The selection of training methods for a particular training programme depends upon whichever method that effectively conveys the contents of training.

## Execution of Training Programmes

While executing or organising a training programme, the following questions need to be answered.

- Who will be the trainees?
- Who will impart the training? (If outside trainers are called, their honorarium and transport arrangements are determined)
- What are the subjects to be covered, the duration of each subject and the methods to be used?
- When will the training take place and of what duration?
- Where will be the venue of training?

- What instruction materials (such as product leaflets, company publications, manuals, writing pads) are to be used for the training?
- What will be the budgeted expenditure for the training?
- What kind of training aids (such as black/white board, overhead projector, TV with VCR, power points) are required for the training programme?
- Is the time-table giving all details of the training programme like days, timings, subjects, trainers, prepared?

### Evaluating the Sales Training Programme

It is difficult to evaluate or measure the sales training programme. But to get an approximate measure, some of the methods used are:

- Actual sales performance against sales targets for trained and untrained salespersons.
- Written tests conducted before and after the training.
- For experienced salespersons, on-the-job sales performances are compared, before and after the training programme.
- In some executive development programmes, the trainers rate the performance of trainees in role-playing, group discussions, and case discussions.

Towards the end of the training programme, trainees are asked to evaluate the training programme and each trainer's session. This helps to improve the effectiveness of the trainers and the training programmes in future.

### Supervision and Motivation

Through supervision the salesforce is directed to perform the selling job in accordance with marketing objectives and sales policies of the company. Each sales supervisor or manager has a supervisory responsibility for the people who report directly to him or her. The responsibilities of the sales supervisor includes (a) communicating and implementing company policies and strategies; (b) counselling on problems and deficiencies of salesforce; (c) establishing standards of performance, both through formal setting of goals or targets and setting as example for others to follow; (d) creating a favourable work environment and working relationship with salesperson; (e) continuous training and development of sales reps; and (f) clarifying the responsibilities or expectations clearly to the salespeople.

The unique feature with respect to field salespersons is that most of the time they are alone in the field, outside the presence of direct supervision. Because of their physical isolation from supervisors and colleagues, sales reps experience fluctuations in their morale and motivation, from low levels (because of negative responses from customers and frustrations of selling process) to the high levels (on account of getting a major order or breakthroughs in solving customer problems).

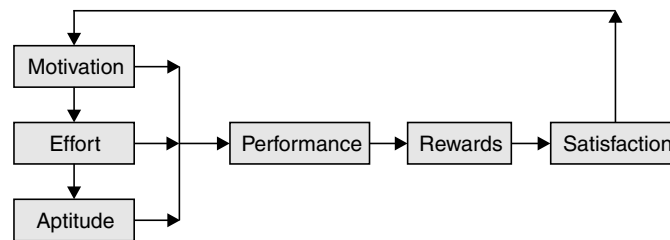
A study carried out by Churchill, Ford and Walker on "organisational climate and job satisfaction of sales persons", has brought out the following important conclusions.

1. Business salesperson's job satisfaction improves by close supervision. This is because the sales reps feel that through close supervision they understand their jobs and the company policies better.
2. Business sales reps are motivated if they are involved while deciding their targets or goals, and also while determining company policies and procedures.
3. The job satisfaction/motivation is also related to the extent to which the sales rep understands clearly what is expected of him and how to satisfy those expectations.

4. Frequency of contact or communication is not important, but the quality of relationship with the supervisor is important.
5. Business sales reps are willing to accept direction and authority from a number of departments in the company. This finding is inconsistent with the nature of business selling but contrary to a commonly accepted notion of the importance of unity in command.

The above findings are important in understanding the nature of business salesforce motivation. For motivating salespersons, a sales manager should involve his people in decision making (or get their suggestions and opinions), clarify their responsibilities more clearly, help in solving their problems by first listening to the problems and then making suggestions, respect their views or opinions, trust the subordinates, understand the individual differences and peculiarities, encourage development of personal friendship in workplace, recognise and reward good work, and set a good example for others to follow.

In another study on “motivation and performance in industrial selling” Churchill, Ford, and Walker have developed a model shown in Fig. 10.9.



**Figure 10.9** Model of Sales Force Motivation and Performance

**Source:** Churchill, Ford and Walker, “Motivation and Performance of Industrial Selling—Present Knowledge and Needed Research,” *Journal of Marketing Research*, 14, p. 2 (May 1977). Reprinted with permission from American Marketing Association.

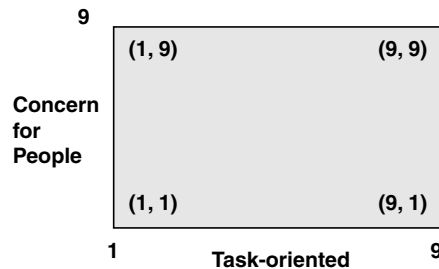
The model in Fig. 10.9 indicates that a salesperson’s performance depends on three factors: degree of motivation, efforts, and aptitude (or ability). A higher degree of motivation, efforts, and aptitude will lead to a greater performance. Greater performance will lead to greater rewards, (such as higher pay, financial incentive, recognition, and feeling of self-worth). Greater rewards will lead to greater satisfaction. Greater satisfaction will reinforce motivation.

The sales supervisors or managers should, therefore, convince sales people to put more efforts, and arrange training programmes to improve their aptitudes or abilities. They should also ensure that rewards are attractive, so that sales people should feel that rewards are worth the extra effort. The salesperson’s job satisfaction declines if **(a)** expectations of superiors are not clear, and **(b)** conflicting demands from the company and the customers cannot be resolved. The sales supervisors have an important role to play in all these areas.

## Developing Sales Force

Presently, the challenge for a sales manager is to balance the company’s goals of sales, profits, and receivable collections with salespersons’ need of job security and financially rewarding work. The sales manager must be skilled in human relations (or be people-oriented) and also be task-oriented. The task-oriented sales manager shows concern for achievement of sales, profits, payment collection, and other goals of the organisation. The people-oriented sales manager shows concern for salespeople and develops them.

**Blake and Mouton Grid for Managerial Styles** There are various styles of day-to-day functioning of managers, one among them being the *Blake and Mouton grid* for managerial style, which was developed in early 1980s (see Fig. 10.10).



**Figure 10.10** Blake and Mouton Grid for Managerial Style

The four corners of the grid in Fig. 10.10 represent four distinct managerial styles. Coordinate (1, 1) depicts the *Mushroom Manager* style. This type of manager likes to keep the salespeople in dark. He/she does not communicate to salespeople the expectations of the management, what tasks are to be performed, and how to achieve the goals. The manager does not show any concern for the salespeople or make any efforts to develop them.

Coordinate (9, 1). This manager has an authoritarian style. The manager is a real task-master, asking salespersons to perform a lot of sales activities and paper work. However, he or she does not show any concern for the needs of sales people.

Coordinate (1, 9) shows the *Great Communicator*. This managerial style shows a great concern for the salespeople by talking and building a good rapport with them, and keeping them well informed about the goals to be achieved. However, this style is not task-oriented.

Coordinate (9, 9) depicts the *Renaissance Manager*. This is the ideal style where a manager shows not only a strong concern for the salespeople but also is task-oriented. This managerial style involves sales people in goal setting and allows them to plan their sales activities. Here, the manager communicates with sales people about the company's goals, the tasks to be performed, and how to perform the tasks. The manager balances the company's goals and the needs of the salespeople.

## Sales Force Compensation

The purpose of a sales compensation is to attract and motivate sales people. The requirements of an effective sales compensation plan are:

1. It should give certain degree of financial security or stability to salespersons.
2. It should be related to the "going market-price" of salespeople. However, it is difficult to define the market price for salespeople if published data on sales force compensation with complete details are not available.
3. It should be easy and clear enough for salespersons to understand.

A sales compensation plan has the following four components.

- *Fixed amount* is the salary that is paid to satisfy the salesperson's need for stable income.
- *Variable amount* may include commission, profit-sharing, or financial incentive that is paid to motivate salespeople for greater efforts, leading to higher performance.

- *Fringe benefits or perks* such as leave travel assistance (LTA), medical reimbursement, personal or group insurance scheme, pension or superannuation scheme, are given to satisfy the salesperson's needs for security and savings in income tax at higher salary levels.
- *Expense allowances or reimbursements* include travelling, lodging, boarding, and customer entertainment, as per company rules. This may not be considered strictly under the sales compensation, as it is generally paid based on actual expenses incurred by the salesperson.

The types of compensation plans available to a company are: (i) straight salary, (ii) straight commission, (iii) combination of salary and perks, (iv) combination of salary and commission, and (v) combination of salary, perks, and commission.

A fixed (or straight) salary is preferred when non-selling tasks (such as collection of payments, concessional sales tax forms, and market information) are more, or team selling efforts are needed for technically complex products. A straight commission or variable compensation is used when the main task is selling. However, many companies adopt compensation plans that are combinations of salary, commission, and perks. The popular rule followed in such cases have a ratio of fixed to variable elements between 60/40 per cent to 80/20 per cent.

## Evaluation and Control

One of the responsibilities of sales force management is to evaluate and control the business salespeople at various levels, like individual, branch, regional, and national levels. An evaluation includes (a) obtaining information about salespersons' performances at regular intervals (weekly, monthly, quarterly, and yearly), (b) evaluating or examining the actual performances with the goals or targets, and (c) determining if the goals are being achieved. Controlling includes identifying the problems (if goals are not being achieved) and taking corrective actions to achieve the goals. Thus, *evaluation is backward-looking but control is forward-looking*.

**Sources of Information** The first step in evaluation is to obtain information about salespersons' performances on regular basis. The sources of such information are *sales analysis* (i.e. computerised statements on actual sales against goals by salespersons, branches, regions, and national levels); *sales call reports* (i.e. giving information about customer-calls planned, outcome of actual visits, progress on various activities); *customers' letters or complaints*; *market surveys*, and so on.

**Types or Bases of Evaluation** The sales managers use two types or bases or criteria of evaluation to measure the performance of sales force. These are: (i) Quantitative (or outcome-based), and (ii) Qualitative (or behaviour-based). While determining quantitative measures, the sales management should focus on important performance variables and ignore other non-important parameters. Some of the important variables are: (a) comparison of actual sales performance (product-wise) with sales quotas or goals; (b) sales expenses to total sales in per cent, number of new customers developed, and an increase in market share. The selection of the important variables should depend on the marketing objectives of a company. The qualitative (or behaviour-based) measures include customer satisfaction, product knowledge, sales presentations, negotiating skills, and team orientation. Each company should decide which variables or measures are most useful to it. Recent studies have indicated that companies should have a balanced approach by emphasising both quantitative and qualitative evaluation, to achieve desired sales or marketing results. Once a company decides on the most-useful evaluation variables, it should communicate the same to the sales people through job description or separately, in writing. The salespersons can then make efforts to improve their performance.

**Management by Objectives (MBO)** MBO is an effective control tool, and is also an effective system for involving and evaluating salespeople in which the sales manager has an in-depth discussion with the sales representative, and together they decide the goals and action plan for the sales rep. These goals are reviewed against the actual performance periodically during the performance review meetings, the causes of performance deviations are determined, and corrective actions are taken and then new goals are set for the future. For the success of MBO, the sales manager should spare adequate time and must have a participative style of management. If not, the sales manager should be trained to use MBO system.

Controlling, as mentioned earlier, includes identifying the problems, if any, and taking corrective steps. If the actual performance of a sales rep is in line with the goals, the sales manager need not take any corrective action, but must appreciate the good performance and reward him suitably. If the marketing or sales manager finds substantial deviations between the actual performance and the goal, he considers the following alternatives.

1. Identify the reasons for deviations, such as the salesperson lacks in the product knowledge, selling skills, communication skills or, customers' and competitors' knowledge.
2. Take corrective actions by organising training programme in the areas of deficiencies so as to improve the salesperson's effectiveness.
3. In some situations there are major changes in the external environment, like recession in the target market segments, or entry of a major multinational company, due to which the sales goals could not be achieved. In such situations, the marketing strategies or tactics need to be changed.
4. If the above alternatives are not helpful, the management decides to change the sales goals.

Normally, a company takes minor corrective actions, as indicated in point number two above. If they fail to give desired results, more drastic actions, as mentioned above in points three and four are undertaken.

## DEPLOYMENT OF SALES FORCE

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While discussing the management of sales force, one important task of deployment of sales force remained to be discussed. Planning for sales force deployment involves the following decisions:

1. Setting up or revising sales territories.
2. Determining size of sales force.
3. Allocating sales force to the sales territories and customers.

### Setting up Sales Territories

This includes the following steps. The sales manager should first select a basic geographic control unit, such as an industrial city or town (e.g. Mumbai, Ahmedabad, Chennai, Bangalore, Delhi, Kolkata).

The second step is to determine the sales potential of each geographic control unit by conducting a market survey. The sales manager should then combine the geographic control units into basic sales territories. The last step is to make adjustments for coverage difficulty and then finalise the sales territories. **For example**, Hosur industrial town is nearer to Bangalore (and hence can be easily covered from Bangalore) compared to Chennai, although Hosur is a part of Tamil Nadu. Hosur, therefore, gets included in Bangalore sales territory.

## Determining Size of the Sales Force

The decision on how many salespeople are required to meet the company's sales volume and profit objectives is a key decision. The methods available to determine optimum sales force size are: (1) workload, (2) sales potential (or breakdown), and (3) incremental. We shall briefly describe the workload method, which has the following steps, with an **example**:

### 1. Group present and potential customers according to their sales potential

Suppose the company estimates 500 numbers 'A' class (large sales potential) and 1000 numbers 'B' class customers (medium sales potential) to be covered by the company salespeople in the entire nation. Customers with small sales potential (class 'C') will be looked after by telemarketing people or the company's dealers.

### 2. Decide time per sales call and desired call frequencies for each customer class

Assume that both present and prospective customers require the same time per sales call and the same call frequencies per year, time per call and call frequencies for 'A' and 'B' class customers are as follows:

Class 'A': 60 minutes per call  $\times$  36 calls a year = 36 hours/year  
 Class 'B': 30 minutes per call  $\times$  12 calls a year = 06 hours/year

### 3. Calculate the total (market) workload necessary to cover the entire market

In the above **example**, this calculation is as follows:

Class 'A': 500 customers $\times$ 36 hours/year	=	18000 hours
Class 'B': 1000 customers $\times$ 06 hours/year	=	6000 hours
Total	=	<u>24000 hours</u>

### 4. Decide the total work time available per salesperson

Suppose the company decides that salespeople should work 40 hours per week, 45 weeks per year (allowing seven weeks for casual and earned leave and holidays), then each salesperson has 1800 hours/year (40 hours/week  $\times$  45 weeks per year) for selling and, non-selling activities, and travelling time.

### 5. Divide the total work time available by different activities per salesperson

Suppose the management decides that salespeople should divide their work time as follows:

Selling activities:	40 per cent	=	720 hours
Non-selling activities:	30 per cent	=	540 hours
Travelling:	30 per cent	=	540 hours
Total	<u>100 per cent</u>	=	<u>1800 hours</u>

### 6. Calculate the total number of salespeople needed

This is done by dividing the total market workload by the total selling time available per salesperson:



$$\frac{24000}{720} = 33.3 = \text{Salespeople needed}$$

Workload method is relatively simple to apply with managerial judgement. The method is also conceptually sound, as the size of salesforce is based on the selling efforts needed. It can be adopted for all types of selling situations. However, the method needs accurate information on prospective customers and sales potential of existing and prospective customers. The disadvantage of workload approach is that it neglects sales productivity in terms of sales per salesperson and also salesforce turnover.

### Allocating Sales Force to Sales Territories and Customers

One of the approaches followed in allocating or assigning salespersons to specific customers (or sales territories) is to use the judgement. The other approach is to consider two factors: (i) relate abilities of salespersons to sales potential of territories, and customers, and (ii) relate sales rep's education, experience and training to customer characteristics, language, and ethnic influences.

#### *Sales resource opportunity grid*

This is another useful approach or method used for allocation of sales force to various customers or sales territories. Here, customers or sales territories are represented by planning and control units (PCUs), which are served by the business firm. Sales resources include sales calls, number of salespersons, and percentage of salesperson's time.

Sales Resources		Planning and Control Units
High	Low	
Assign high level sales resources to high opportunity PCUs	Direct high level sales sources to take advantage of high opportunity PCUs or shift sales resources to other PCUs	
Assign average level sales resources to stable opportunity of PCUs	Assign minimal or nil sales resources to low opportunity PCUs, or ignore the PCUs	
Low	High	

**Figure 10.11** Sales Resource Opportunity Grid

**Source:** Adapted from "Steps in Selling Effort Deployment", by Laforge and Cravens, *Industrial Marketing Management*, 11, p. 187, July 1982. Reprinted with permission from Elsevier Science.

In Fig. 10.11, PCU opportunity is the total sales potential of each PCU for all suppliers, and sales resource strength is the strength of the company within the PCU. By positioning all PCUs on the grid,

the sales manager can allocate or assign high level of sales resources to high PCU opportunity and moderate or low levels of sales resources to moderate or low level of PCU opportunity. This grid helps the sales manager to revise the size of the sales force, sales territories, and allocation of sales calls, depending on the opportunity of the PCUs, and sales resources strength of the firm.

Another simple and practical approach to allocation of sales force to business customers with differing sales potential is *ABC Analysis* of business customers. A real-life **example** will help in understanding the usefulness and result-oriented nature of this approach.

### **ABC Analysis of Business Customers—An Example**

An area sales manager, western region, in a large private sector organisation was transferred from Mumbai (western) regional office to Kolkata (eastern) regional office with a short brief—“to set right eastern region sales performance”. He was promoted as regional marketing manager— east and was responsible for the field selling operations in the eastern region, to business customers consisting of OEMs and users of five product-groups of electrical engineering.

Since the regional marketing manager was new to the customers and the sales professionals of the eastern region consisted of branch managers, marketing executives and sales engineers, he decided to apply the technique of ABC analysis to the business customers. The main objective was to improve the sales performance by optimising the resources of manpower, time, and money. The methodology adopted was as follows:

1. Each sales engineer was assigned the responsibility to contact about 10–15 business customers within the specific territory of eastern region so that all the existing or known customers are covered.
2. The sales force was asked to collect the information from the business customers on what were the total requirements (i.e. sales potential) of the company’s products for the current year and the subsequent year.
3. The quantity requirements of the customers for the various products were converted to the value requirements by multiplying the quantity with the *average unit selling price* of the products. The total sales potential of each customer was arrived at by adding the individual values of the products required.
4. The sales potential values of all the customers were then put in descending order, starting with the highest potential on the top of the list. A total was then made by adding the potential of all the customers.
5. The top few customers (typically 10 per cent of the total number of customers), whose sales potential values together accounted for 70 per cent of the total sales potential were called “**A**” customers. The next group of customers (generally, 20 per cent of the total number of customers), whose sales potential values together accounted for 20 per cent of the total sales potential, were called “**B**” customers. The balance group of customers (generally 70 per cent of the total number of customers), whose sales potential values together was 10 per cent of the total potential, were called “**C**” customers.
6. Each member of the sales team was asked to prepare a customer visit plan at the beginning of every month with the following guidelines. “**A**” customer to be visited at least four times a month (if the customer was in the same city where the salesperson was located) or at least two times a month (if the customer was located outstation); “**B**” customer was to be visited at least two times a month (if the customer was located in the same city) or once a month (for the

outstation customer); “C” customer was to be visited once a month (if in the same city) or once in two months (for the outstation customer).

7. The regional marketing manager, branch manager, and marketing executives also periodically visited the “A” and “B” customers along with the sales engineers, based on the visit plans of sales engineers.

The result of applying this simple technique was dramatic. In the first year of eastern region operations, the growth in sales was 113 per cent over the previous year; in the second year, the growth was 69 per cent; in the third year the growth was 47 per cent, and in the fourth year the growth was 33 per cent, against the overall company’s growth (of all regions) of between 15 per cent and 20 per cent per year.

## KEY ACCOUNT MANAGEMENT

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Key account management (KAM) has, since 1990s, become an important topic in business marketing. It is defined as a “seller-initiated type of strategic alliance.” The role of KAM is to solve the problems of its customers.

A **key account** is an important customer and is also called as major account, national account, strategic account, and house account. A key account is defined by a selling company as “a customer of strategic importance”. The characteristics of key accounts or major customers are as follows:

- They purchase large volumes as a major percentage of selling firms’ total sales. In other words, key accounts should have high sales and profit potential.
- They buy either for one unit or several units of their organisations.
- Typically in the key account’s buying process, several company members are involved.
- Generally they expect customised core products and services, superior and coordinated services, and special price.

**Choosing Key Accounts** It is extremely important for a business marketing firm to select right kind of customers as key accounts because cost of serving a key account is much more than that of other normal customers. Frank V. Cespedes recommends a three-step method of selecting key accounts, which is as follows:

1. In the first step, he suggests measurement of sales and profit potential which should be high for a key customer. In addition, the extent to which a customer values the supplier firm’s superior support services and willingness to pay a premium price should also be determined. **For example**, prompt and effective after sales services are valuable to buyers of machines and capital equipment like furnaces and machine tools, which are used in production.
2. From step 1, identify those customers who need special support services that provide profitable learning opportunities to the selling firm. **For instance**, the marketing firm may invest in distribution warehouses at central places in the four regions for carrying spares that would be beneficial to many customers who value prompt supply of spares.
3. The business marketing firm should also consider to what extent the transactions with the potential customer would help in improving the profitability of the company. **For example**, a precision steel tube manufacturer found that two-wheeler manufacturers require more quantity of value-added steel tubes that have higher contribution to profits than other types of steel tubes.

For selection as a key account, a potential customer should meet the screening requirements of all the three steps described above.

**Implementing KAM Programmes** After selecting the key accounts, a business marketing firm should prepare a written document of the key account management plan or programme for each key account. The broad contents of the key account management programme are as follows:

- (i) **Objective.** The objective(s) of the KAM programme should be stated in clear terms. **For example,** to become the preferred or sole supplier to the key account, or to enhance profitability through KAM programme.
- (ii) **The tasks** involved to achieve the objective are:
  - Give the responsibility of implementing the programme to a **key account manager**, who has a very important role.
  - The key account manager should have complete knowledge and understanding of the key account's business and the needs.
  - He identifies and obtains a team of internal experts as well as outside experts, if needed, to deliver a solution that matches the customer's immediate and future needs.
  - He adopts a strong **relationship management approach** with collaborative relationships at various levels of selling and buying firms.
  - The key account manager gets technical approval of the supplier firm's products and services from the key account, uses **team selling approach** in negotiations with key accounts, and gets orders.
  - For the success of the KAM programme, top or senior management's involvement, commitment, and support is important.

Key account relationships are required to be managed strategically. Strategic key account management positions are senior positions that may not fit easily into the conventional sales organisation, as they carry major marketing and cross functional responsibilities. However, key account management function should be placed in the sales department to ensure effective coordination between the company's selling strategy and its strategy for key accounts. Business marketing firms highlight qualities of a successful key account manager as having abilities in understanding customer requirements, mobilizing internal experts, and creating desired customer solution.

**Benefits and Risks of KAM** A study by Cardozo et al. (1987) has reported major benefits of key account management to supplier firms as increase in market share, improvement in customer service and enhanced customer satisfaction. Another study by Foster and Cadogan (2000) stated the benefits of KAM as increased trust, enhanced loyalty and purchase intentions, and greater likelihood that the buyer will recommend the supplier to other firms. However, there are also risks associated with a KAM strategy. By concentrating scarce resources on a few customers, other customers may receive less attention and customer prospecting may be neglected. This may lead to lower growth of the customer base.

A recent study of the U.S. and German organisations shows superior performance of companies with key account management programmes as compared to their competitors without such programmes. Companies like IBM, 3M, and Dow Chemicals have established key account management programmes. In India, many software service organisations, such as TCS, Infosys and Wipro have started focusing their efforts on high potential customers, who are called key accounts.

## ETHICAL ISSUES IN PERSONAL SELLING FUNCTION

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Studies on ethics have indicated that sales and marketing managers are confronted with a variety of difficult ethical issues. Often sales managers face ethical dilemmas in carrying out various tasks of personal selling function, such as getting orders from some government customers, hiring salespeople, evaluating salespeople, and so on. 58 per cent of the sales managers surveyed said that they have caught salespersons cheating on an expense voucher. Ethical problems concerning bribery are most common.

### Ethical Situations Involving Salespeople and Sales Managers

Occasionally salespeople and sales managers may be involved in some of the following ethical situations:

#### *Relations with the company*

Changing jobs, expense accounts, and damaged-merchandise credits are the examples of ethical problems involving salespeople and sales managers' relations with the companies. A salesperson or sales manager may give credit for damaged merchandise when no damage has taken place. When changing the job, a manager may want to take key customers to the new employer who is also the company's competitor. As mentioned earlier, there are many situations involving salespeople cheating on expense vouchers.

#### *Relations with customers*

Here the main ethical issues involve gifts, information, and entertainment, as explained below:

- **Gifts**

Giving gifts to customers, particularly at the time of New Year or a festival season, is time-honoured business practice. But, it is under careful scrutiny. A \$10 worth gift to a \$10,000 worth customer may be merely a gift, but is it acceptable for a pharmaceutical company to invite its doctor-customers to Jamaica for an all-expense-paid seminar? Sales personnel should follow some time-tested guidelines to avoid gift giving that is unethical or in bad taste:

- Follow your company's policy on gift giving.
- Keep the value of gifts low.
- Do not give gifts to customers' spouses.
- Never give gift before a customer does business with the firm.
- Walk away from 'the business if the customer pushes for something, that exceeds these guidelines<sup>16</sup>.

- **Information/Misrepresentation**

Salespeople sometimes exaggerate the capabilities of their products or services and sometimes make false statements just to close a sale. Knowingly, sometimes salespeople sell a higher priced product when lower priced product would have satisfied the customer need. **For example**, pharmaceutical salespeople were pushing higher priced calcium channel blockers for high blood pressure when cheaper diuretics and beta blockers were equally effective<sup>17</sup>.

- **Entertainment**

Business entertainment is a part of sales promotion. Some salespeople spend this money on customers who have less business potential. Some useful guidelines have been developed on this subject:

- Keep the entertainment suitable to the customer and its business potential.
- Be sensitive to customer attitudes towards types of entertainment.
- Entertain to develop long-term business relationship, and not for one order.

### Setting Ethical Guidelines/Developing a Code of Ethics

Sales managers and salespeople must understand that ethical behaviour is not only morally right, but also sound over a long-term point of view. A survey by Ethics Resource Centre showed that 84 per cent of the firms surveyed have codes of conduct and 45 per cent have ethics offices. The code of ethics adopted by the American Marketing Association is a good **example**. Other **examples** are Boeing company's "Business Conduct Guidelines" and Norton company's "Policy on Business Ethics". A code of ethics can contribute to the general ethical climate of an organisation, if it is endorsed and enforced by the top management. A code of ethics becomes an effective means of guiding behaviour only if it is enforced, otherwise, it is meaningless.

#### SUMMARY

The role of personal selling in business marketing is much greater than that in consumer marketing. The major roles of salespeople are in solving customers' problems and in communicating the company's selling messages to business customers. Distinctive characteristics of business salespeople are in terms of their technical background, building customer relationship, and to be able to fill any of the sales positions like trade selling, missionary selling, technical selling, and business selling.

Some of the trends in personal selling in business markets are: team selling, improved productivity, relationship selling, creating value, and multiple selling units.

In business markets, a transactional or territory salesperson should follow a distinctive selling process, consisting of a number of steps: (1) prospecting and qualifying, (2) preapproach, (3) approach, (4) presentation and demonstration, (5) overcoming objections, (6) trial close/closing the sale, and (7) follow-up and service.

Sales organisation is required for implementing selling strategy. The types of sales organisations are: *geographical*, *product*, *market*, and *combinations of the three types*. The choice of the type of sales organisation for a company depends on the company's size, products, markets, resources, abilities of people employed, and responsibilities of the intermediaries.

Management or administration of sales force includes recruiting, selecting, training, supervising, motivating, developing, compensating, evaluating, and controlling the salespeople.

Deployment of sales force is also a part of sales management. It involves three major decisions: (i) Setting up or revising sales territories, (ii) Size of the sales force, and (iii) Allocation of salespersons to sales territories and customers.

Key account management (KAM) has become an important topic in business marketing. It is a seller-initiated type of strategic alliance. Key account is an important customer and is also called as major, national, strategic, and house account. Choosing right kind of customers as key accounts and implementing KAM programmes would result in benefits like increased market share and enhanced customer satisfaction. However, the companies should be made aware of the risks of concentrating scarce resources on a few customers.

Ethical issues in the personal selling functions need to be discussed, particularly ethical situations involving salespeople and sales managers, and establishment of ethical guidelines by an organisation.

## KEY TERMS

- Consultative selling method
- Formula method
- Inside salespeople
- Intrapreneurial philosophy
- Key account management
- Key account salesperson
- Management by Objectives (MBO)
- Missionary selling
- Need-satisfaction method
- Prospecting
- Relationship selling
- Role playing
- Selling process
- Sensitivity analysis
- Stimulus response method
- Systems selling
- Team selling
- Trail close
- Transactional/territory salesperson

**Note:** Glossary of the key terms is given at the end of the text.

## CONCEPTUAL QUESTIONS

1. Compare the role of a territory salesperson with that of a key accounts salesperson.
2. How trade selling position is different from technical selling?
3. Describe team selling and improved productivity trends in personal selling function.
4. Explain FAB approach of sales presentation with an example.
5. What is the difference between trial close and closing the sale?
6. Under which situations market-oriented organisation structure is suitable?
7. How contents of training programmes for initial and continuing training differ for salespeople?
8. Explain how Churchill, Ford, and Walker model is useful in understanding sales force motivation.
9. What are the methods available to determine size of the sales force? Describe any one of these methods.
10. Explain how a business marketing firm should manage key or national accounts.

## OBJECTIVE TYPE QUESTIONS

1. One of the major roles of a business salesperson is to communicate selling messages to existing and prospective business customers. The other major role is: (a) direct marketing, (b) publicity, (c) problem-solving, or (d) tele-marketing.
2. One of the most common types of sales positions in business-to-business marketing is: (a) missionary selling, (b) technical selling, (c) delivery salesperson, or (d) trade selling.
3. Modern business marketing manager uses multiple types of salespeople, including transactional (or territory) salespersons, key (or major) accounts salespersons, and one of the following: (a) delivery salespersons, (b) retail counter salespersons, (c) inside salespeople, or (d) none of the above.
4. The most successful and interactive sales presentation method is: (a) canned approach, (b) need-satisfaction method, (c) formal method, or (d) none of the above.
5. In trial close technique a salesperson asks the: (a) opinion, (b) decision, (c) objection, or (d) needs of the prospect.

6. The most appropriate sales organisation for a small and medium enterprise (SME) with less number of products and market segments is: (a) product organisation, (b) geographical organisation, (c) market oriented, or (d) none of the above.
7. Out of the various methods, one method used for both individual and group training is: (a) on-the-job training, (b) role-playing, (c) case discussion, or (d) product demonstration.
8. The term 'key accounts' is associated with (a) accounts and finance, (b) sales and marketing, (c) production and quality control, or (d) design and R&D.

### APPLICATION QUESTIONS

1. Satish joined Canon company in New Delhi as a sales trainee in business marketing division. After about a year, he was made a territory sales representative, selling canon products like printers, scanners, optical and medical equipment to business customers in a geographic area in north India. Recently, after three years as the territory sales rep., he was promoted to the position of key accounts executive, looking after six key accounts. Explain how the selling tasks may differ in both the types of sales positions.
2. Assume you are asked to take charge of a branch which has not been performing well in terms of sales and profits. You are asked by your regional manager that the management expects you, as the branch manager, to turn around the branch performance in about one year. You are assured of the support of the senior management. What would you do? (Make suitable assumptions, if needed).
3. Suppose you are an area sales manager and one of the salespersons reporting to you approaches you for help in getting a breakthrough with a high sales potential customer. The customer has been buying the steel components from three other suppliers regularly for the past two years. Your salesperson has been trying to get business from this customer for the past 18 months but without any success. It seems the customer is happy with the existing suppliers and does not want to take the risk of buying from a new supplier, whose poor performance on quality and/or delivery may result in disruptions in production. What would you do?

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### CASE 10.1

#### Galaxy Solutions Inc.: Getting a Major Business\*

Ashok Kumar, Marketing head of Galaxy Solutions Inc. was keen to get business from State Bank of India, the largest bank in India.

State Bank of India (SBI) had over 13000 branches, including seven associate banks. It was looking for implementing core banking solution which could reduce the transaction time and allow the bank to do greater volume of business. The estimated cost of the core banking solution contract was US \$100 million.

Galaxy Solutions was a world leader in providing information technology (IT) solutions to the financial services industry. Galaxy Solutions had a core banking software product, which could offer the following:

- A single application for retail, corporate and investment banking needs
- Support for diverse delivery channels like ATM, Internet, and others
- Integrated with business intelligence and Internet banking solutions

Ashok Kumar knew that his product was very good and that he had offered a competitive price. However, his rapport or relationship was not as good as the major local players like Infosys, Tata Consultancy Services (TCS), and Wipro.

Ashok Kumar wondered what should he do to get this major business.

#### Question

1. If you were the consultant to Galaxy Solutions, what would you advise and why?

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Pradeep Jampana, P.K. Pramanik, R. Reddy, and Rajat Khanna of SBS-MBA students of Alliance Business Academy, Bangalore.

**CASE 10.2****R S Switchgear Ltd.: Ethical Issue**

The regional manager of R S Switchgear was confident of getting at least 50 per cent of business from the large steel plant, which needed high tension (HT) switchgears to replace the existing old equipment. There were only two suppliers of HT switchgears at that time, and both the suppliers had good market reputation for the product quality and technical service. However, R S Switchgear had developed recently the new HT switchgear and had not supplied it earlier to the steel plant. The other supplier had developed the product about one year earlier and had already made the supplies to the steel plant.

R S Switchgear had conducted the technical seminar at the steel plant to make all the concerned technical people aware about its superior product features. After the seminar, technical people from R S Switchgear met with various indenting persons (i.e. users of HT switchgears) to respond to their individual queries. Subsequently, R S Switchgear submitted its quotation in response to the enquiry for HT switchgears received from the steel plant. The regional manager came to know from the local agent (i.e. the manufacturer's representative) that the prices from both suppliers for HT switchgears were close to each other.

One day, the regional manager received a call from the agent saying, "... the chief engineer of the steel plant, who is a key influencer of the buying centre, has given me a list of various household items like refrigerator, T.V., washing machine, etc., to be purchased within one week and to be given to him for his daughter's wedding!". The regional manager was shocked to hear this and said, "I never expected this from the chief engineer. Anyway, I will come back to you soon".

**Question**

1. If you were the regional manager, what will you do and why?

**CASE 10.3****E&C Technologies: Developing New Customers\***

Anil Mehta, CEO of E&C Technologies, was concerned about the stagnant pool of customers for the past few years. He called the sales director and his brother-in-law, Vinod Dhawan, and asked him to come over for a discussion. Vinod walked in to Anil's office, opened the door and greeted him with "good morning, Anil. How are you?"

With a serious look on his face Anil responded, "Vinod, I don't know how good is this morning, but I am deeply worried about the fact that we have not been able to add any new customers for the past few years. As you know, our current customers have been developed due to my personal contacts. I had excellent relationship with these customers during my long tenure of work with Hindustan Aeronautics Limited (HAL), a government of India undertaking. I have already converted all my previous contacts to our customers. Now, we have to expand our customer base to take care of future growth in sales and profits. How should we go about?"

Vinod gave a reassuring smile and said "don't be worried, Anil. We have been working on it and I think, we should be converting a few prospects to customers".

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\* This case was prepared by Spoorti.S, an MBA student of Alliance Business Academy, under the guidance of Prof. Krishna K. Havaladar, for classroom discussion.

“But how long will it take, as we don’t have adequate orders after three months”, Anil responded, showing anxiety on his face.

“OK, to expedite the process, let us hire two MBA students as summer interns for two months to carry out prospecting work online for USA and UK markets, which have high potential for our type of specialised services. Besides, we will participate in a trade show or exhibition to identify prospects as well as book orders.” Vinod indicated his action plan confidently.

Satisfied with Vinod’s response, Anil nodded his head and asked Vinod to go ahead to implement his plan.

### **About the Company**

E&C Technologies, a family-owned small business firm, was established in 2008 at Bangalore, India. The company has an expertise in a specialised field of offering mechanical designs to organisations in the sectors of space, defence and commercial electronics. The current customers, developed through Mehta’s personal contacts, are located in UK.

There is no domestic market at present. Major BPO companies like TCS, Infosys and HCL are competitors to some extent, but the major competitor is Quest Technologies, Bangalore.

### **Implementation of Action Plan**

To carry out the prospecting work online from Bangalore for the US and UK markets, Dhawan identified two interns from a reputed management institute locally at Bangalore. The interns were asked to report to two administrative staff, since there were no sales or marketing executives employed by the company. The two interns were asked to categorise prospective customers based on their business potential; operating in the three focused sectors of space, defence and commercial electronics; and using the same type of software products or tools (e.g. Solidworks, PRO/e, and Autodesk Inventor) developed by E&C Technologies.

The next task was to participate in a trade show in UK. There are many trade shows conducted every year nationally and internationally. To select the right trade show, the company used the following criteria:

- Major customers should have visited the trade show in the past years
- Should be one of the largest and most popular trade shows
- Should get positive reviews from those who have visited earlier

Based on the above criteria, E&C Technologies selected Defence and Security Exhibition (DSEi), London, for participation. One more MBA intern was hired to obtain online data by visiting the websites of potential customers who are likely to visit the trade show. Based on geographic locations, revenues, media news, large orders received recently, and trade show area booked, appointments were finalised with 15 short-listed potential customers. Besides, new brochures were prepared for handing over to visitors at the trade show. With a lot of preparation and hopes Mehta and Dhawan went to UK to participate in DSEi.

However, to their dismay, only four out of 15 shortlisted potential customers were available for meeting with Mehta and Dhawan, and only one showed interest to buy the company’s software products and none placed any order at the exhibition. The participation in the exhibition turned out to be just a learning experience!

**Questions:**

1. Where did the company go wrong?
2. What should the company do to develop new customers in a short time?

**CASE: 10.4****Corus Distributors: Turnover of Sales Executives\***

Bhuvan, managing director, Corus Distributors Pvt. Ltd., wondered why the average tenure of the sales executives with the company was just around two years. He thought it might be a good idea to ask an MBA student from a management institute to carry out a study as a part of the university curriculum for the MBA programme and suggest a solution to resolve the problem.

Corus Distributors carry out sales and service of mechanical engineering products such as material handling equipment and air compressors. The company is the authorised dealer for reputed manufacturers of these equipment. Corus targeted small- and medium-size manufacturing companies located in various industrial estates in South India. Bhuvan has employed eight sales executives with varying experience from six months to four years. Only two out of eight sales executives are continuing with the company for around four years and the remaining sales executives are with the company for less than two years.

Bhuvan briefed Varun, the MBA student, who is to carry out the study. Varun thought that it would be appropriate to carry out depth interviews with each of the eight sales executives, by using open-ended questions. The objectives of the exploratory research, as indicated by Bhuvan, are as follows:

- (1) To know the extent of job satisfaction of sales executives
- (2) To find the reasons for turnover of sales people
- (3) To suggest measures to resolve the issue of sales force turnover

The major findings of the depth interviews of eight sales executives in line with the objectives are as under:

- Majority of salespeople were satisfied with the sales job.
- The main reasons for turnover of sales people were:
  - (a) No immediate recognition by superiors for a good job done.
  - (b) The incentive scheme is not adequate, particularly when the sale targets are exceeded by large margins.
  - (c) Instead of quarterly payment of incentives, it should be done on monthly basis.
  - (d) Salary scales are much lower than the prevailing market levels.

Varun wondered why turnover of sales executives should be about two years, when the majority of salespeople are satisfied with their job in the company, and whether the average sales force turnover of two years is normal with competing companies. He is also deep in thought on suggestions to be given to Bhuvan to resolve the issue, particularly because Bhuvan had expressed his views about the

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\* This case was prepared by Dilip Kumar U. an MBA student of Alliance Business Academy, Bangalore, under the guidance of Prof. Krishna K. Havaladar, for classroom discussion.

recruitment and training costs of sales executives being high and that when they are ready to contribute in about two years after recruitment, they leave the job.

**Question:**

1. If you were Varun, what suggestions would you give in your report to the company?
2. Was the process adopted by Varun for the study proper? Would you conduct the study differently?

## CASE 10.5

### Shah and Company—New Training Package for Sales Personnel\*

#### **Background**

Shah and Company is one of the leading players in the field of automobiles. The company enjoys a very good position in the market in the automobile spare parts sector. It is one of the pioneers in the country's auto components manufacturing industry. It has a joint venture with Brain and Company of the US. The company has two divisions, one is the Gears Division and the other is the Foundry Division. The gears division is one of India's largest manufacturers of complete gear systems for automotive applications. The foundry division is also one of India's largest manufacturers of permanent mould ferrous die-castings. Grey iron and ductile iron are also manufactured by this division. Shah and Co has its production units at Andhra Pradesh (Hyderabad), Gujarat (Porbandar), Karnataka (Belgaum), Kerala (Trivandrum) and Madhya Pradesh (Bhilai). The company enjoys 40 per cent market share in the domestic segment besides exporting its products to 25 countries worldwide.

#### **The Issue**

The new top management team came out with new policies and resolutions. The new systems are the refined and modified versions of their old systems. The management specifically intends to base their whole organisation on their vision, as follows:

- We shall achieve customer satisfaction by providing products and services of high quality at a globally competitive prices. We shall be a leading player in our chosen area of operations in the field of automobile sector.
- We shall improve the quality of life of our employees and fulfil their reasonable aspirations by creating an atmosphere of trust and care. We shall work as a cohesive team always encouraging higher standards of performance.
- We shall provide adequate returns to our stockholders and facilitate the growth of the organisation.
- We recognise our vendors as our partners in progress by giving them a fair deal and nurturing a healthy relationship.
- We shall conduct ourselves as a responsible corporate citizen with integrity and ethics.

Based on the vision, the newly formed Supplier Development and Integration (SDI) department drafted its mission. The manager of SDI states as follows:

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\* This case was prepared by Dr Ashok Kumar Madhav for classroom discussion. He has permitted to print this case.

We shall build a strong supplier base for our organisation,

- (a) which will provide on a sustained basis quality products and services in “just-in-time” (JIT) required manner and volumes at most competitive prices.
- (b) which will encourage development of a healthy long-term relationship based on trust and mutual respect, and which will support us in attaining our organisational goals.

In a highly competitive market, there is a need to provide products and services of high quality at globally competitive prices. In this context, our interest would be in suppliers who are committed to the following:

- Long-term perspective and willingness to grow along as partners in progress.
- Implementation of quality systems (ISO 9000, QS 9000, etc.).
- Continuous updation of technology.
- Willingness to invest and expand as need arises.
- Working for continuous improvement and cost reduction.
- Implementing JIT deliveries.

The company intends to start a new training programme for its salesmen serving business customers. It feels that the salesmen need to be updated and re-equipped with the knowledge of the products in the product line. The whole training programme is of a different type. The manager thinks that new techniques should be adopted to train them.

The consultant prepares a series of training packages, which are to be administered in phased manner for over six months. These packages have a basic feature of “off-the-job” training, where the salespersons are reluctant to stay back and undergo training after their working hours.

With a great amount of enthusiasm, these new training packages are introduced. Performance evaluation of salesmen after some time reveals not much difference in their sales compared to the performance prior to training periods. Further feedback received from salespersons reveal the following facts.

The new training programmes are not complete since it focuses only on the company’s sales executives. The reality lies in the performance of the dealers’ salesmen in the market who are not well equipped or totally ignorant about these new concepts, hence, there arise a need for including even the dealers’ sales people in these training programmes. These are the opinions of the young sales executives of the company.

The opinions of the older sales executives are that the management is just wasting its time, resources, and energy. They further opined that these new training packages do not make any psychological impact on them or on their work performance.

After reviewing the sales records, sales performance of the executives, their feedback about the new training packages, the manager called for a meeting of the representatives of different groups to set right the issue about their new training package programme for sales executives.

### **Questions**

1. Are the mission statements of SDI department in line with the company’s vision? Should a department of the company have a mission?
2. What corrective steps the company should take in the training programme for its salesmen?
3. If you are asked to design a training programme for the salespersons of the company, how would you do it?

# 11

## Business Marketing Communications

*After studying this chapter you should be able to:*

- Understand the concept of hierarchy of effects of communication.
- Know development of an effective business communication programme.
- Definitions, process and benefits of integrated marketing communications
- Discuss the role of advertising in business marketing.
- Recognise the role of sales promotion, public relations, publicity and direct marketing in business marketing.

The communications (or promotional) mix for industrial products and services is different from the promotion mix for most consumer goods. This is because of the technical nature of industrial products, the relatively smaller number of business buyers, and the complex nature of organisational buying process. The communications mix consists of personal selling, advertising, sales promotion, direct marketing, publicity and public relations. Personal selling, the dominant component of business marketing communications mix, is already discussed in Chapter 10. We shall discuss the other elements of the business marketers' communications strategy.

Advertising, sales promotion, direct marketing, and publicity are mainly used to create awareness, enhance company reputation, disseminate information on products, or generate leads for the sales people. Personal selling is often the most important element of the business marketer's communication strategy, because of the technical complexity of many industrial products and the extensive negotiating process involved in selling of industrial goods or services. To have an effective communication strategy, advertising, sales promotion, direct marketing, and publicity must be coordinated with personal selling efforts. A business marketer should carefully consider all the elements of communication or promotional mix in order to develop an effective communication (or promotional) programme.

Before developing an effective communications programme, it will be useful to understand the hierarchy of effects, which is about the buyer's mental stages.

### THE HIERARCHY OF EFFECTS

The aim of business marketing communication is to move the prospective buyer from unawareness to purchasing action. Earlier, in Chapter 3, we described the eight phases (or stages) in the buying decision process of an organisation, starting with recognition of a problem or need and ending with performance feedback and post-purchase evaluation. This buying process is followed by the buying centre or purchase committee of the organisation. However, with respect to marketing communication,

we should consider the changes in the individual buying centre member's awareness level, attitude, and buying behaviour.

The individual buyer's mental process or stages is called a hierarchy of effects of communication. There are a number of models which describe the hierarchy of effects. Lavidge and Steiner have proposed a six-stage model consisting of (1) awareness, (2) knowledge, (3) liking, (4) preference, (5) conviction, and (6) purchase<sup>1</sup>. Howard and Sheth have proposed another model in their theory of buyer behaviour: (1) attention, (2) comprehension, (3) attitude, (4) intention, and (5) purchase behaviour<sup>2</sup>. These models describe mental stages or process of the buyer from awareness (cognition) through the development of favourable attitude (or preference) to buying action. Business marketers recognise from the above discussions that awareness is a necessary precondition to the development of favourable attitudes, and favourable attitudes are often, but not always, needed before buying action can take place. The benefit of the models on hierarchy of effects is that the business marketer can think about the communication objectives (or goals) clearly, which enable the marketer to measure whether the same have been achieved or not, as a result of communication effort.

**Importance of information sources** Studies have shown that impersonal information sources (such as advertising, sales literature) are important at earlier stages of the buying decision process (like recognition of a need and search for potential suppliers). Whereas personal sources (e.g. sales representatives, intermediaries, opinions of colleagues and friends—i.e. word-of-mouth communications) are more important at the later stages of the business buyer's decision process (such as evaluation, selection, and purchase decision)<sup>3</sup>. These research results indicated that business buyers depend more upon commercial personal sources of information, such as salespersons and dealers, when the perceived risk and investment amount are higher. The role of non-commercial personal sources is seen at all stages of the buying process, which suggests that the nurturing of satisfied users and the cultivation of favourable word-of-mouth can pay significant dividends.

**Source credibility** If we consider the company as a source of communication, then the company will have a degree of credibility (or believability) as a communicator. **Source effect** is a measure of the degree to which the effectiveness of a given message is raised or obstructed by the reputation of the source. Theodore Levitt's research on source effect in business selling concluded that salespersons for business companies with good reputations always get a more favourable response than salespeople for companies that are unknown or have poor reputations. In business marketing, an important component of source credibility is often technical expertise.

## DEVELOPING THE BUSINESS COMMUNICATION PROGRAMME

The major steps in developing an effective communication or promotional programme are: (i) Determine the communication objectives; (ii) Identify the target audience; (iii) Determine the promotional budget; (iv) Develop the message strategy; (v) Select the media; (vi) Evaluate the promotion's results; (vii) Integrate the marketing communications. We shall now discuss each of these seven steps.

### Determining the Communication Objectives

Communication (or promotion) objectives cannot be formulated in isolation. They are formulated based on the firm's overall corporate and marketing objectives. Once the objectives are established, a business organisation chooses the strategies and actions (or tactics) required to achieve the objectives.



Before determining communication objectives, the business marketer should find out the communication problems. This can be done by collecting the data (through marketing research) on the existing levels of awareness and attitudes of the existing and prospective customers. Such data would help in setting specific communication goal.

The purpose of the communication programme (or plan) is to move the potential buyer from unawareness to buying action. We have examined earlier in Chapter 3, the eight phases of industrial buying-decision process, beginning with problem need recognition and ending with performance feedback and post-purchase evaluation. For the purpose of determining communication objectives, we must look at three stages of buyer behaviour: (i) Buyer's awareness levels; (ii) Changes in buyers' attitudes; and (iii) Buying action. These stages of buying are described by different models, called **response hierarchy models**. There are similarities between the various models (viz. AIDA model, hierarchy-of-effects model, innovation-adoption model, and communications model) that are important to us. The marketers know that making customers aware of the company and its product is not enough for buying action. What is needed further is to develop favourable attitudes which may lead to the buying action.

**For example**, a business marketing firm's corporate objective is to achieve a growth in sales of 20% in the following financial year and the marketing objective is to increase the market share from current year's 12% to the next (budget) year's 14%. Based on the corporate and marketing objectives, the marketing communication objectives are quantified as to increase the awareness of target audience from 40% to 50%, favourable attitude or preference of the buyers from 30% to 35%, and sales (or buying action) from ₹ 100 million to ₹ 120 million.

A mix of communication media is required to achieve certain communication objectives. Like, if the communication objective is to create awareness among the prospective customers or to enter new market segments, advertising in business magazines or journals or direct mail of company catalogues may be the appropriate media. However, if the communication objective is to create a preference for the company's products over the competing products, the communication mix would rely more on personal selling through the company's sales force, advertisements in trade journals, and participation in trade shows or exhibitions.

### Identifying the Target Audience

A business marketer must be clear about the target audience. In business marketing the target audience is identified at two levels. *First*, identify the buying organisations based on the target market segments, defined earlier in Chapter 6. The *second* level is the identification of the attitudes and buying factors used by the buying centre (or buying committee) members in the organisations identified in the first level.

**For instance**, a steel manufacturing firm, determines its target market segments as building construction industry and consumer durable manufactures, such as automobile, refrigerators, cold storage plants and washing machines. The buying centre members in these organisations, like purchase, production, quality control and finance executives are the target audience to whom the communication message with respect to the specific product offerings and benefits will be addressed.

It is important to assess the target audience's current image of the company, its products, and its competitors. The company management should then propose a *desired image* in contrast to the *current image*. This information can be obtained by conducting a marketing research study to understand the

awareness levels and attitudes of the buying centre members towards the company and its products in relation to its competitors. The data will also be useful in developing message strategy and media plan.

### Determining the Promotional Budget

One of the most difficult decisions the companies are facing is the question as to how much to spend on promotion or what should be the promotional or communications budget. It is, therefore, not surprising that there is a considerable variation in how much companies spend on promotion or communication. The promotional budgets consisting of advertising, sales promotion, direct marketing, and publicity, of companies marketing industrial products or services are not large enough in comparison with those of the consumer products. There are four common methods used to set a promotion budget. These are: (i) Affordable method, (ii) Percentage-of-sales method, (iii) Competitive-parity method, and (iv) Objective-task method.

A study in the United Kingdom indicated that most business marketers used more than one of the four methods, mentioned above, to set advertising (or promotional) expenditure budgets<sup>4</sup>. The study also indicated that the use of the objective-task method was on the rise. In another study, the percentage of respondents using each of the above four methods were as follows<sup>5</sup>: objective-task (74), per cent of past year's sales and per cent of anticipated sales (23+16=39), affordable (33), match competitors (21), arbitrary (13), all with multiple responses. However, for business marketing firms, as advertising or promotional expenditure is a relatively small part of the total marketing expenditure budget, marketing managers often follow simple rules of thumb method of percentage-of-sales by allocating a percent of sales to advertising, or promotion.

**Affordable Method** Many companies set the promotion budget based on what they think the company can afford. This method ignores the role of promotion as an investment and its impact on sales volume.

**For instance**, the marketing manager of a business marketing firm discussed with the finance manager, how much they could afford to give him for the promotion. The finance manager, based on the budgeted sales revenue, other essential expenditures and the profits, came up with a figures of ₹ 20 lakh. Thus, the promotional budget of ₹ 20 lakh was finalised, after discussing with the managing director of the company.

**Percentage-of-Sales Method** The most common method used in business marketing to set the expenditure budget for promotion is a specified percentage of sales, either sales in the previous year or in the current year budgeted or forecasted sales. Sometimes, a percentage of sales price is also used to determine promotional budget. While deciding a specified percentage of sales, a business marketer is influenced by “what are the other competing firms doing” and “what can we afford”, thus using all the three methods.

In practice, the promotional budget is decided in two steps. *First*, total marketing budget (expenditure) is finalised as a percentage of budgeted sales (revenue). *Secondly*, the advertising or promotional budget is decided as a percentage of total marketing budget. In business marketing, many companies allocate one per cent of sales to promotion (advertising, direct marketing, and sales promotion) budget, and about ten per cent of total marketing expenditure budget is spent on promotion.

The advantages of using percentage of sales method are: (a) the finance managers are satisfied that the promotional expenses have a close relationship to the sales; (b) the method considers affordability; and (c) the parity with competitors is maintained.

The disadvantage, however, is that the method indicates that the sales volume causes promotion rather than promotion causing sales. Besides, it does not encourage building up promotional budget by determining what each product and territory deserves.

**Competitive-Parity Method** Some companies set their promotion budget by spending the same percentage of the sales on promotion as that of competitors. There are two arguments advanced for this method. One is that the *average expenditure of the competitors would represent a collective wisdom of the industry*. The other is that by *maintaining parity with competitors, it would help to prevent promotional wars*. However, both of these arguments are not valid because companies in the same industry, differ substantially in terms of their objectives, resources, and opportunities.

In business marketing, the amount spent on promotion (including, advertising, direct marketing, sales promotion and publicity) is relatively small as compared to that in consumer marketing. Hence, rule of thumb methods such as affordable method, percentage-of-sales method and competitive-parity method are common.

To **illustrate** the above, the general manager (marketing) of a textile machinery manufacturer was asked by his managing director to propose an advertising (including sales promotion and publicity) budget for the year 1990–91, as a part of an overall marketing budget. The company's sales for the previous year, 1989–90, was ₹ 200 million and the sales budget finalised for the year 1990–91 was ₹ 250 million. The general manager carried out a study on how much money the major competitors were spending on total marketing expenditure and on promotion, as a percentage of sales. The study data are shown in the Table 11.1.

The general manager then discussed with the company's financial controller on how much amount the company could afford to spend on total marketing expenditure budget, including promotion. The financial controller, after studying the budget for the year 1990–91, suggested a figure of ₹ 20 million for total marketing expenditure and ₹ three million for promotional expenditure budget. The general manager consulted the Managing Director, and the marketing and promotional budgets of ₹ 20 million (i.e. eight per cent of sales budget) and ₹ four million (i.e. 1.6 per cent of sales budget) respectively were finalised for the year 1990–91. The general manager, thereafter, started working on allocating the promotional budget to the various items, such as advertisements in textile journals, catalogues, direct mail, and exhibitions/trade shows, and others.

**Objective-and-Task Method** In this method, business marketers develop their promotion budgets by defining promotional objectives, determining the tasks that should be performed to achieve the promotional objectives, and estimating the costs of performing the tasks. The sum of these costs is the proposed promotional budget. This method is relatively logical and the steps involved, as shown in Table 11.2, form the basis for allocating the funds for the various promotional media.

**Table 11.1** Promotional Budget in Textile Machinery Industry

	<i>Total marketing expenditure divided by sales revenue</i>	<i>Promotional expenses divided by total marketing expenditure</i>	<i>Promotional expenses divided by sales revenue</i>
Average	7%	12%	1%
Range	3% to 15%	5% to 20%	0.1% to 2%

**Table 11.2** Steps in the Objective-and-Task Method

<i>S.No.</i>	<i>Steps</i>	<i>Examples</i>
1.	Establish marketing objectives or goals	Set a target or goal of 25 per cent market share
2.	Define specific promotional goals	Increase product awareness to 75 per cent of potential customers' and increase sales leads by 30 per cent over the previous year
3.	Identify the target audiences to be reached	Purchasing executives, production managers, and design engineers in automotive, luggage, steel tube, and metal container industries
4.	Determine promotional media to reach target audience	Advertising in trade journals, trade shows, and direct mail
5.	Establish other promotional support needs	Product catalogues, technical data sheets, and promotional novelties
6.	Decide evaluation of promotion plan	Measure awareness and sales leads before and after promotional plan is implemented
7.	Estimate promotional expenditure	Use computer to work out the costs in steps four, five, and six

The major advantage of the objective-and-task method is that it forces a business marketing firm to think in terms of objectives or goals and how to achieve those goals. However, its drawback is the difficulty of determining in advance the amount of funds required to achieve the objectives or goals.

The major question is how much weightage should promotion receive in the total marketing mix (consisting of price, product improvement/development, and distribution) in business marketing. The answer depends on where the company's products are in their product life-cycles, whether the products are highly differentiable, are the products routinely needed (e.g. raw materials and components) or they have to be sold (e.g. capital items like machineries).

Further, the studies conducted by the researchers indicate a greater use of the objective-and-task method in advertising or promotional budgeting in business marketing.

### ***Communication expenditure in business markets***

The findings of the two studies, known as ADVISOR1 and ADVISOR2 (where ADVISOR stands for Advertising Industries products: Study of Operating Relationships), are similar with respect to advertising (which represented all marketing communications elements except personal selling)-to-sales (A/S) ratio, which is a two-step process. First, the ratio of marketing expenditure to sales (M/S) is determined, and then the business marketer makes a decision to allocate a part of the marketing expenditure budget to advertising (A/M).

$$\text{The equation is: } \left( \frac{A}{S} \right) = \left( \frac{M}{S} \right) \times \left( \frac{A}{M} \right)$$

The median figure of marketing budgeted expenditure to sales (M/S) was 7.0 per cent, the median of advertising to marketing budget (A/M) was 10 per cent, and the median figure of advertising to sales (A/S) was 0.7 per cent. Within advertising (i.e. marketing communication) expenditures, there were four main media: space (41 per cent), sales promotion (24 per cent), direct mail (24 per cent), and trade shows and exhibitions (11 per cent)<sup>6</sup>.

In another study on where business promotional dollars are spent, it was found that maximum allocation of promotional budget was done on business publication advertising (30.2 per cent), followed by trade shows and exhibitions (16.5 per cent), catalogs and technical bulletins (15.4 per cent), direct mail (12.3 per cent), general magazine advertising (5.1 per cent), all other advertising like newspapers, TV and Radio (6.3 per cent), distributor/dealer materials (5.7 per cent), publicity and public relations (4.7 per cent), and directories/yellow pages (3.6 per cent).<sup>7</sup>

### Developing the Message Strategy

The message strategy indicates how to achieve the communication objectives. The message is developed to determine “what to say” to the target audience so as to achieve the desired results.

In business marketing, the most common way of communicating the message is through rational appeal. Unlike household consumers, where emotional or moral appeals are sometimes used, the business buyers are most responsive to rational appeals. The rational appeals are communicated either from the positioning strategy discussed earlier in Chapter 6, or by conducting marketing research studies. The marketing research studies find out problem-solving benefits or the satisfaction of needs sought by the target audience. The **examples** of these benefits would be a product’s superior quality, versatility (i.e. complete range of products), economy, or faster delivery time.

Business marketers should remember two important points while developing communication messages. *First*, typical business buyers are fairly well-informed or knowledgeable. *Secondly* instead of the message discussing product features, the message should focus on customer benefits.

An interesting study<sup>8</sup> of message strategy in business markets revealed that business marketers often did not have a good understanding of their target customers (or audiences), and what was important to them. The results of this research stressed the importance of collecting data on target audience predispositions and buying criteria, based on which the advertising messages should be developed.

Advertising agencies dealing with business marketing accounts should have the knowledge and experience needed to work effectively with many communication media, such as advertising in trade journals and yellow pages, trade shows, direct mail, product catalogues, and salespeople’s presentations. For developing effective messages, the creative people in an advertising agency should be trained to deal with many communication media, which are used in business marketing. In addition, extensive marketing research is required to understand the key buying criteria of targeted market segments. In the same study of McAleer,<sup>8</sup> it was found that business marketers often do not understand the important buying motives (or criteria) of key market segments. Business marketers should not assume that a standard set of buying criteria like superior product or service quality, reliable delivery, and low prices are applicable to each purchase situation and market segments. Hence, it is important that

business marketing firms understand the important buying criteria of key influencers in each buying organisation, which is included in the target market segment.

## Selecting the Media

Selection of the appropriate media depends on the target audience to be reached, the statement of the communication objectives, and the promotional budget.

The media selection also depends on whether the advertiser wishes to penetrate a particular industry or cut across various industries. **For example**, a manufacturer of textile machinery can select “textile journals” which are directed to the textile industry, for the advertisement of its products.

On the other hand, a manufacturer of fork lift truck (material handling equipment) can select general business publications (such as *Business India* and *Business World*) that cut across many industries and functional areas, that many industries are the potential users of the material handling equipment, and the key members of buying centres are purchase, production, and logistics (or physical distribution) who read the business magazines.

Selection of media also depends on the circulation and the cost of advertising space. The media planners use the data published by circulation audits such as Audit Bureau of Circulation, which not only give data on circulation figures but also define the type of readers (or audiences) of particular publications. The different communication or promotion tools, promotion media, and supports that are used in business marketing are shown in Table 11.3.

**Table 11.3** Communication/Promotion Tools Used in Business Marketing

<i>Advertising</i>	<i>Sales Promotion</i>	<i>Public Relation and Publicity</i>	<i>Direct Marketing</i>	<i>Personal Selling</i>
<ul style="list-style-type: none"> <li>• Print media</li> <li>• General business publications</li> <li>• Trade journals</li> <li>• Industrial directories</li> <li>• Internet</li> </ul>	<ul style="list-style-type: none"> <li>• Trade shows</li> <li>• Exhibitions</li> <li>• Catalogues</li> <li>• Sales contests</li> <li>• Promotional novelties (gifts)</li> <li>• Seminars</li> <li>• Demonstration</li> <li>• Promotional letters</li> <li>• Entertainment</li> </ul>	<ul style="list-style-type: none"> <li>• Charitable donations</li> <li>• Adopting villages</li> <li>• Community relations</li> <li>• News item in press</li> </ul>	<ul style="list-style-type: none"> <li>• Direct mail</li> <li>• Telemarketing</li> <li>• Internet and new-age media</li> </ul>	<ul style="list-style-type: none"> <li>• Sales calls</li> <li>• Sales presentation</li> <li>• Team selling</li> <li>• Relationship marketing</li> </ul>

Table 11.3 shows five promotional tools, and the relevant promotional media (and promotion supports) under each promotional tool. Personal selling is discussed in Chapter 10. We deal with other promotional tools and media, and their unique characteristics subsequently in this chapter.

Some rankings were evolved in a study which asked business marketers to evaluate the effectiveness of various media. These are presented in Table 11.4.

**Table 11.4** Business Marketers' Rankings on the Effectiveness of Promotional Media

<i>Ranking</i>	<i>Promotional Media</i>	<i>Index of Effectiveness</i>
1.	Personal selling (Sales calls)	100
2.	Catalogues, specification sheets	46
3.	Direct mail	39
4.	Advertising	38
5.	Trade shows and exhibitions	35
6.	Samples, demonstrations	34
7.	Publicity and public relations	31
8.	Customer entertainment	26
9.	Promotional novelties (gifts)	24

**Source:** Peter M. Banting and David L. Blenkhorn, "The Role of Industrial Trade Shows", *Industrial Marketing Management*, 3, 5 (October 1974), Reprinted with permission from Elsevier Science.

It should be emphasised that the rankings in Table 11.4 are based on the opinions of business marketers rather than an objective measurement of media effectiveness or a measure of actual money allocations. In another study published by *Business Marketing* magazine in 1985, the rankings of promotional media based on the money spent by business marketers were as follows:

1. Direct marketing, consisting of direct mail and telemarketing.
2. Trade shows, including show costs, exhibitor travel, and entertainment.
3. Incentives, including business or trade promotion incentives.
4. Advertising, including business or trade publications, directories, yellow pages, and others.
5. Sales promotion, including catalogues, promotional novelties (or gifts), audio visual presentations, dealer contest, and so on.
6. Public relations, including publicity.

Within the same industry the companies differ considerably while selecting media or allocating their promotional budget.

It is interesting to find from another study how subscribers (or potential buyers) have rated different media (or information sources) with regard to usefulness, as shown in Table 11.5.

**Table 11.5** Subscribers' (i.e. Potential Buyers') Media Rating with Regard to Usefulness

<i>Rating</i>	<i>Communication Media</i>	<i>Usefulness (per cent) Rating</i>
1.	Specialised business publications	76.4
2.	Trade shows	67.6
3.	Salespeople	67.1
4.	Seminars/Conventions	61.4
5.	Direct mail	56.4
6.	Business directories	46.8
7.	General business publications	35.7
8.	Daily Newspapers	31.9
9.	News magazines	25.0
10.	Network Television	22.0
11.	Radio	21.0
12.	General magazines	20.9
13.	Cable Television	16.0

**Source:** Adapted from S. Kapp, "Study Says Business Press Most Effective Medium", *Business Marketing* (June 1990), p. 44.

In yet another study conducted by B to B magazine in 2003, it was found that business marketing firms spent 70% of their communications budget on print media, consisting of trade journals, business magazines and newspapers. The main reasons are that they have highly selective audience and advertisements have longer life spans in print media.

As mentioned earlier, a business marketing firm selects specific media to be used at a given point based on the target audience to be reached, communication objectives to be achieved, and the promotional budget.

### Evaluating the Promotion's Results

After implementing the promotional plan it is necessary for the business marketer to evaluate its impact on the target audience. An evaluation is done by measuring the awareness, attitude and actual purchase *before* and *after* the promotional plan is implemented.

The evaluation task becomes easier if the data on awareness, attitude, and purchase have been collected by conducting a marketing research study before the promotional plan is implemented.

The marketing research study, conducted after the promotional plan is implemented, involves asking the target audience whether they are aware of the company's products, whether they recall the



promotional message, their previous and current attitudes (favourable, indifferent, or unfavourable), whether and in how much quantity they have purchased the company's products during the period.

The marketing research studies could be carried out internally by the company or through an external agency, like a marketing research firm.

The major mistakes of companies in practice are that of failure to quantify the promotional objectives into measurable goals and not to plan the evaluation. In both the cases, the business marketer is unable to learn from the experience and hence, may continue to repeat the mistakes in future.

### Integrating the Marketing Communications

Many organisations have started moving towards the process of integrating communication elements and other marketing activities. The **integrated marketing communications (IMC)** approach shows an improvement over the traditional method of treating the various marketing and communication elements as separate activities. The move toward IMC happened during 1990s and the IMC approach has been adopted by both large and small companies. They understand the value of strategically integrating the various communication functions and developing efficient and effective marketing communications programmes. For a company, it is one of the easiest ways to maximise the return on its investment in marketing and communications.

**Definitions** The concept of integrated marketing communications has many definitions. One of the first definitions of IMC was developed by American Association of Advertising Agencies:

A concept of marketing communications planning that recognises the added value of a comprehensive plan that evaluates the strategic roles of variety of communications disciplines – **for example**, general advertising, direct response, sales promotion, and public relations – and combines these disciplines to provide clarity, consistency, and maximum communications impact.

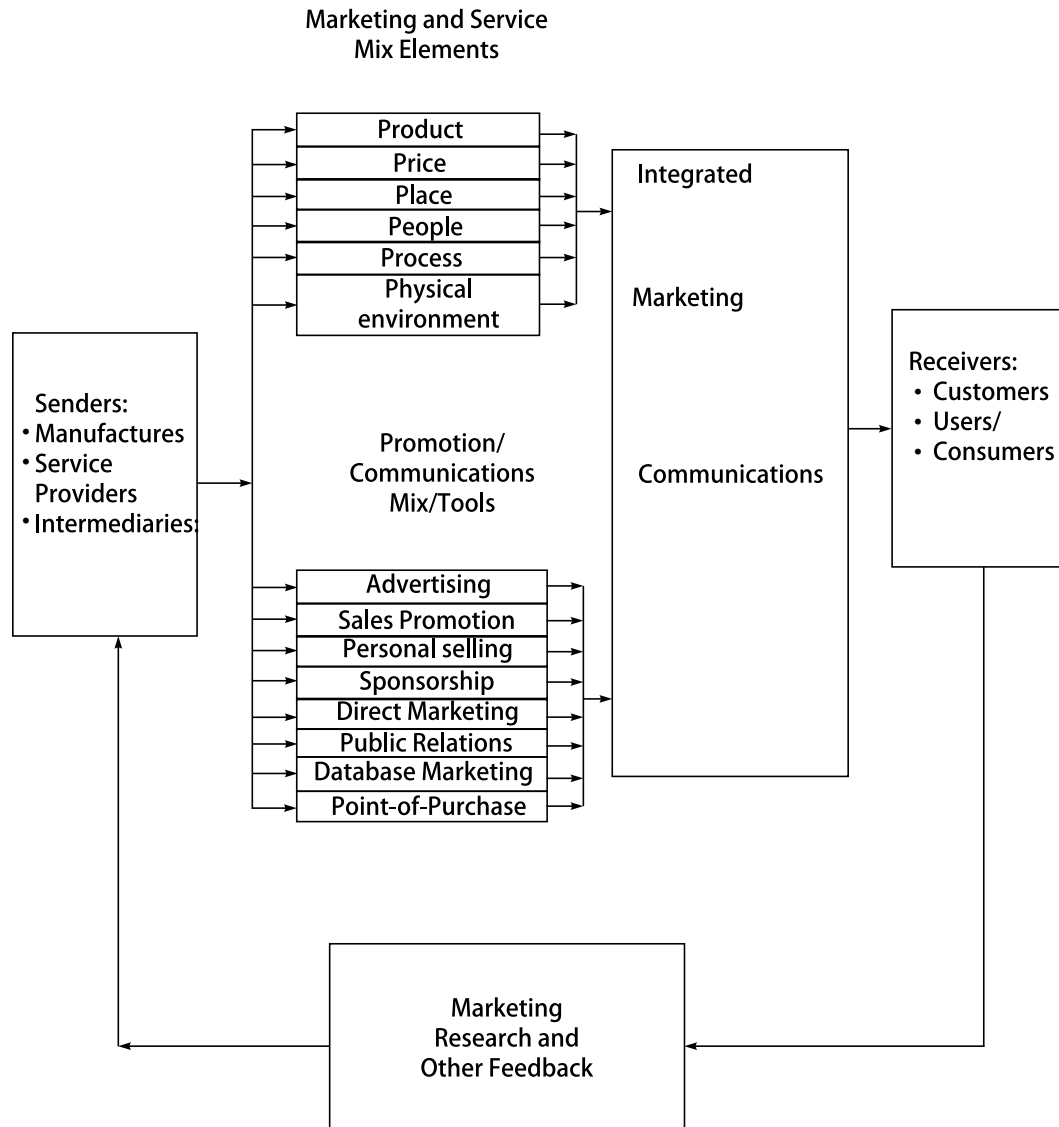
Another definition is as follows:

Integrated marketing communications (IMC) is the coordination and integration of all marketing communication tools, avenues, and sources within a company into a seamless programme that maximises the impact on consumers and other end users at a minimal cost. This integration affects all of a firm's business-to-business, marketing channel, customer-focused, and internally directed communications.

There are some more definitions, but common elements in all definitions are as under :

- Integrating marketing mix and service mix elements as well as communication tools.
- Maximising the impact on customers at a minimal cost.
- Creating strategic consistency and clarity across all messages a customer receives.
- Application of the IMC process to any type of organisation.

**The IMC Process** The definitions of IMC focuses on the process of using and integrating marketing mix and service mix elements as well as communication tools to achieve maximum communications impact. Figure 11.1 shows all these elements plus marketing research, which is a part of an effective two-way communications process. The need to integrate all promotional or communicational efforts has expanded beyond the three traditional tools of advertising, sales promotion and personal selling. At present, promotion or communications also includes sponsorship, direct marketing, public relations, database marketing, and point-of-purchase.



**Figure 11.1** *The Integrated Marketing Communications Process*

**Source:** Paul Smith et al., *Strategic Marketing Communications*, Kogan Page Limited, 1997, pp.169.

To show how managers can ensure that they become integrated and stay integrated in their marketing communication planning, a helpful set of **‘ten golden rules of integration’** are described by Smith (1996), as follows:

- Get senior management support.
- Practice vertical and horizontal integration by working together by all managers, for all types of meetings, for all activities, and for consistent and clear message.

- Use design manual to maintain common visual standards for the use of logos, typefaces, and colours. Use brand book to maintain consistent brand personality across all communications.
- Focus on a clear marketing communications strategy by having clear communications objectives, positioning statements, core brand values, and competitive advantage.
- Start with a zero budget and build the communications budget based on what tasks need to be done to achieve the objectives.
- Think customers first and develop communication activities around the customer's buying process.
- Build customer relationships through communications tools to ensure customer retention and brand value.
- Develop a good marketing information system and a customer database to help, for example, telesales and the sales force.
- Share artwork of one communication tool (e.g. advertising) that can be used in trade shows, the internet, and other media.
- Learn from experience. Be prepared to experiment and improve each year.

**Benefits of IMC** Integrated marketing communications helps an organisation or a brand to consolidate its image, develop a dialogue and nurture a relationship which builds a bond between the buyer and the seller. This bond can protect the seller from the onslaught of competition, thereby retaining the buyer for life. IMC also increases profits through increased effectiveness. A consistent and clear communication strategy can boost awareness and increase customer response.

Integrated marketing communications can substantially increase sales by creating more awareness for customers, who become aroused and, ultimately buy a product or service on a repeat basis. Carefully linked messages help buyers with timely reminders, relevant information and move them comfortably through the stages of their buying process.

Unintegrated communications, on the other hand, send disjointed messages which dilute message impact and sometimes confuse, frustrate and arouse anxiety in some customers. In contrast, integrated communications help nurture long-term relationships with customers. IMC also saves money as it can eliminate some duplication in areas like graphics and photography which can be shared across various communications tools.

**IMC Advocates** Companies such as Xerox and Hewlett-Packard (HP) are bringing together their advertising, direct marketing, public relations and employee communications experts into "Super councils" that meet a few times each year for training and improved communication. Consider below two companies—Hewlett Packard (H.P) and Duke Power, utility company from the US – that are excellent **examples** of IMC programme and its usefulness, respectively.

### **Hewlett-Packard (HP): "We Understand"**

An excellent example of an integrated marketing communications program is provided by the software systems engineering division (SSED) of Hewlett-Packard (H-P). This group initiated its IMC process through workshops designed to help H-P's employees better understand the dilemmas faced by its customers. These workshops were directed by representatives from sales, product marketing, engineer-

ing, and customer support departments within H-P. Each had a different perspective of the customer and provided valuable input into the various dilemmas faced by end users. The team approach allowed everyone to see the customer from a more holistic perspective.

Based on input from these departments, a creative strategy emerged with a strong focus on customer needs. The theme “we understand” was adopted. H-P’s marketing emphasis centered on the idea that members of the company understood the issues, pressures, and constraints that software developers faced. Knowing about unrealistic deadlines, hidden-code errors, and other problems and how to cope with these issues was the key. H-P’s leaders believed they could solve transition problems for customers by moving to object-oriented programming and simultaneously developing multiple applications of company software. The theme was integrated into all of H-P’s marketing problems. It was launched in an advertising campaign and then reinforced in three direct mailings. The same message was used in trade show handouts and displays. H-P’s website was redesigned around the same principle.

The “**we understand**” idea served as an umbrella for all marketing strategies and tactics. The integrated approach allowed H-P to speak with one voice regardless of the communication method customers encountered when they contacted the firm. This more fully integrated program was more than just the theme, however. It began with effective communication within and built outward to the point where H-P’s end users (other businesses) could see and experience a real difference in the products and services that were being provided.

**Source:** P. Griffeth Lindell, “You Need an Integrated Attitude to Develop IMC,” *Marketing News* 31, no 11 (May 26, 1997). p.6.

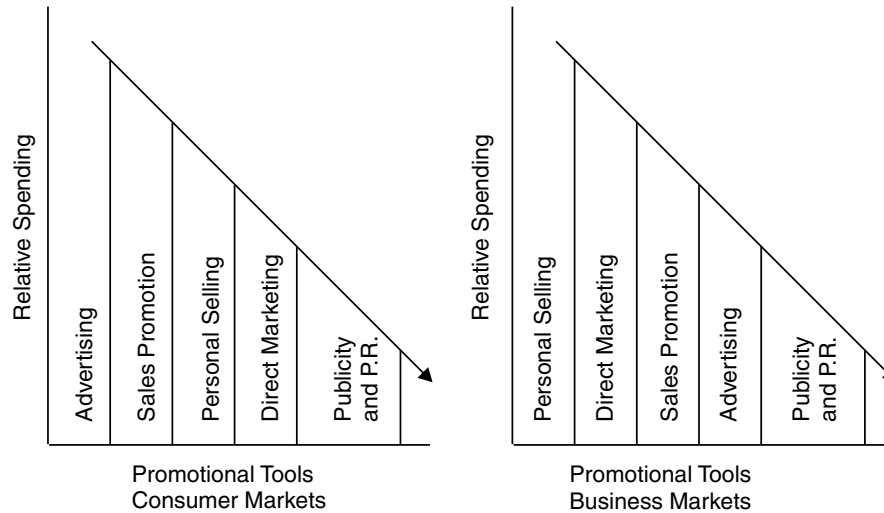
**Duke Power:** To develop IMC, Duke Power conducted lengthy interviews with company officers, customer surveys, literature reviews, and “best practice” interviews with other companies. Out of this process, came four recommendations: (1) that Duke manage its reputation as a corporate asset; (2) that the company develop and implement an integrated communications process to manage all aspects of its communications; (3) that the company train all its employees in how to communicate, because Duke’s customers responded more to employees’ actions than to specific planned programmes; and (4) that the company develop and enhance strategic database to help it anticipate customer interests and improve customer satisfaction and retention. Based on these recommendations, Duke Power developed integrated communications processes that are directly tied to the company’s business processes.

## THE ROLE OF ADVERTISING IN BUSINESS MARKETING

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The relative importance of promotional tools between consumer and business markets vary, as shown in Fig. 11.2. Consumer products (or services) companies rate advertising, sales promotion, personal selling, direct marketing, publicity, and public relations (PR) in that order. Industrial goods (or services) companies rate personal selling, direct marketing, sales promotion, advertising, and publicity and public relations (PR) in that order.

While advertising is less important than sales calls by sales force (or personal selling) in business markets, it still plays an important role.



**Figure 11.2** *Relative Importance of Promotional Tools in Consumer and business Markets*

### Functions Performed by Business Advertising

If the functions performed by business advertising are considered, there are many valid reasons to advertise industrial products or services. They are:

**Creating Awareness** Business advertising is an effective means to create awareness among potential buyers about the business supplier and its products. The business buyers who are not aware of the supplier company or its products may refuse to see the supplier company's sales representative. Besides, the sales representative may have to use a lot of time describing the company and its products if the awareness and reputation are not created by advertising.

**Reaching Members of Buying Centre** It may not be possible for sales people to make contacts with all the individuals who are involved in a purchasing decision in a business firm. Business advertising is an effective means of reaching the inaccessible or unknown buying centre members, such as quality control manager, R&D manager, or production engineer. These buying members read trade journals and general business publications and they can be reached through advertising. Studies have shown that on an average, sales people do not reach two-thirds of those persons who have an influential role in buying decisions.

**Increasing Sales Efficiency and Effectiveness** When buyers are more aware of a business marketing firm, its products and its reputation through advertisements, sales people are more effective. According to one study, the sales revenue per sales call were substantially higher by 23 per cent when personal selling and advertising were combined, compared to the sales revenue per sales call without advertising. This shows that an effective advertising can make personal selling more productive. Besides, the cost of reaching large numbers of business buyers through personal contacts of salespersons is much higher than the cost of advertising to reach a large portion of the market. Advertising can

reduce the total promotional cost as a percentage of sales by 20 per cent, resulting in higher levels, of efficiency.

**Efficient Reminding** If potential buyers know about the product but are not ready to buy (e.g. capital items like machinery), reminder advertising would be more economical than sales calls. Besides, for certain industrial products such as industrial supplies (e.g. maintenance items like lamps, tubes, tool-box), where there is little or no product differentiation between many industrial products, the buyers are reminded economically through advertising about the firm's service capabilities (e.g. reliable service or dependability of timely supplies).

**Sales Lead Generation** Advertisements carrying reply cards or telephone numbers for potential buyers are the effective ways to generate leads for sales representatives. The business marketer can generate a list of potential buyers (called sales leads) after scrutinising the names of all those who responded to the advertisements.

**Supporting Distribution Channel Members** Business marketing firms who use middlemen (such as dealers or distributors), must support them by making the ultimate users aware of their products. Business advertising frequently provides an economical and efficient support to selling efforts of dealers or distributors.

**Sales Growth during Recession** Companies that don't reduce their advertising during recessions have substantially more sales growth—both during and after the recession—than sales growth of companies that cut back advertising. This was revealed in a study conducted by McGraw-Hill, Inc., during the 1981–82 recession<sup>12</sup>. Similar research conducted during 1974–75 recession produced the same findings.

## Media Used for Business Advertising

Selection of media in business advertising depends on the target audience to be reached, promotional objectives or goals to be achieved, and the expenditure budget allocated for advertising. We have discussed earlier about the target audience and the promotional objectives. The effectiveness of advertising budget or cost is measured by the following formula.

$$\text{Cost per thousand} = \frac{\text{Cost per page}}{\text{Circulation in thousand}}$$

This formula is useful to allocate advertising budget among various business publications or trade journals. If the information on circulation to the target audience, instead of total audience, is available, it will be more cost-effective and less wasted circulation.

The media generally used for business advertising are general business publications, trade journals, and business directories.

**General Business Publications and Trade Journals/Publications** Trade publications are of two types—horizontal and vertical. **Horizontal publications** are directed at individuals working in a particular occupation, organisational function, or a particular technology, which cuts across various

industries. Purchase, Advertising and Marketing (A&M), and Modern Material Handling are some of the **examples** of horizontal publications.

**Vertical publications** are directed at individuals working in a specific industry. *Textile Trend*, *Iron and Steel Age*, and *Chemical Week* are some of **examples** of vertical publications which contain articles and advertisements of interest to all the individuals in a specific industry. Many company personnel, from senior executives to purchase officers, are likely to read such publications or trade journals.

General business publications, such as *Business India*, *Business World*, or *Business Today* are directed at business professionals across all industries. These publications cover broad range of subjects and have superior editorial quality. General business publications are good media for advertising those products and services which have wide appeal to geographically disperse customers. These publications are also good media for corporate image advertisements to a broad-based audience.

The advertising cost per page of general business publications are generally much higher compared to the cost per page in trade publications. Also, since general business publications are read by individuals from many occupations and industries, it is difficult to reach a specific target audience. If business marketers want to reach a specific target audience in an industry, selection of vertical publications (trade journals) will be the appropriate media. In case the business marketer wants to reach the specific target audience with a particular occupation or function such as purchase executives, in various industries, the right choice will be trade journals with horizontal publications.

**Industrial directories** (yellow pages), which are buyer's guides, are useful for advertising, and company listing. Many business buyers buy these directories as they consider them as a purchasing tool. Business directories are published by central and state governments and private publishers (e.g. Tata yellow pages).

**Advertising Agencies** While most advertising agencies concentrate on marketing promotion of consumer products, there are some agencies that specialise in business marketing promotion. One of the difficulties in business marketing promotion is that expenditures in traditional advertising media (such as print media like newspapers and magazines, and broadcast media like radio and television) are relatively low. The standard method of compensating advertising agencies is to pay them 15 per cent of the company's billings in commissionable media (i.e. print and broadcast media). As business marketers use many other media like trade shows and direct mail more heavily than print and broadcast media, the advertising agencies are compensated on the basis of negotiated fees. Moreover, the business advertising agencies must have the experience and skill required to work effectively with the broad range of promotional media used in business marketing promotion.

Some of the leading advertising agencies in India are J. Walter Thompson, Lowe, Mudra, O&M (Ogilvy and Mather), Rediffusion, and others. In 1989, it was estimated that advertising expenses in India were to the tune of ₹ 12,000 million in all media put together. Out of this, around ₹ 9,000 million were spent on print media, ₹ 1,750 million on television advertisement, and the remaining ₹ 1,250 million on other media.

Though B. Dattaram and Co. started the first advertising agency in India in 1905, foreign companies entered the Indian market only in 1920's. The first was OBM in 1928, followed by J Thompson in 1929 and Lintas in 1939. Now almost all the top foreign advertising agencies are represented in India in a series of tie-up arrangements. With the economic reforms and liberalisations carried out in India since July 1991, and globalisation strategies adopted by many Indian companies, there is bound to be a phenomenal growth in business as well as in competition for advertising agencies in India.

### WHAT MAKES A BUSINESS ADVERTISEMENT STAND OUT?

It is important for business marketing firms to know what makes a business advertisement stand out. The major guidelines to be followed for an effective business advertisement are as follows:

1. The industrial product's USP (unique selling proposition) should be clearly reflected in the headlines. The USP could be "The largest range of a product", "Highly reliable product", "Keeping in pace with global trends and design", "Making user's work simpler", "Innovative technology giving benefits of faster work", or "Just-in-time delivery".
2. The copy (i.e. write-up) of the advertisement, should describe the benefits offered to customers in a simple language.
3. A photograph of the product or of the relevant service should appear prominently in the advertisement.
4. At the bottom of the advertisement, the addresses and telephone numbers of the company's marketing offices and/or that of authorised dealers should appear. The company's name should also appear in bold letters at the bottom.

## THE ROLE OF SALES PROMOTION, PUBLIC RELATIONS, PUBLICITY AND DIRECT MARKETING IN BUSINESS MARKETING

In addition to advertising, sales promotion, public relations, publicity and direct marketing play important parts in the overall communication strategy of a business firm.

### Sales Promotion

In business marketing, the objectives of sales promotion are gathering business (or sales) leads, impressing and rewarding customers, and stimulating the sales force to greater effort. The methods used in business marketing for sales promotion (more commonly referred to as business promotion) are (i) trade shows (or exhibitions), (ii) catalogues, (iii) sales contests, (iv) promotional novelties (or gifts), (v) entertainment, (vi) promotional letters, (vii) seminars, and (viii) demonstrations.

**Trade Shows** For some business marketing firms, trade shows (or trade fairs) are the second most important marketing promotional expenditure after personal selling. Industry or trade associations organise annual trade fairs or exhibitions. Companies selling products and services to particular industries buy space and set up displays or stalls to demonstrate their products at the trade show. The benefits from trade shows are many: (i) an opportunity to introduce new products to a large audience in a short duration, (ii) establishing personal contacts with new customers, (iii) establishing contacts and increasing company awareness with key members of decision making units who cannot otherwise be reached, (iv) making direct sales (by booking orders at the trade fair), (v) display and demonstration of products, (vi) evaluating competitors' products, (vii) discovering new suppliers and distributors, (viii) obtaining new product ideas, (ix) training for new salespersons, and (x) generating new sales leads which help salespersons to close sales (i.e. getting orders) with substantially less number of sales calls.

There are, however, some problems associated with trade shows. Increasing costs of construction and exhibits, personnel travel, lodging and boarding and pre-trade show promotion costs, all add up



substantially. Which trade shows to participate out of many trade shows that take place every year, how much to spend on each trade show, and how to build attractive exhibits are some of the challenges faced by a business marketer.

To ensure success at trade shows, business marketers should have specific objectives, such as (i) overall purpose for participation, (ii) creating actual sales, (iii) identifying potential customers, or obtaining sales leads, (iv) gathering competitive intelligence, (v) target audience to be reached.

Effectiveness of trade shows can be understood from the findings of research studies: (1) 61 per cent of those who attended the trade shows planned to purchase products displayed at the trade shows<sup>13</sup>; (2) 91 per cent of the audience attending trade shows had not been visited by trade show exhibitors' sales representatives in the previous year<sup>14</sup>; (3) Among business marketing promotional tools, trade shows are ranked third after personal selling, and peer recommendations (i.e. word-of-mouth communication).<sup>15</sup>

As mentioned earlier, deciding which trade shows to attend is a challenge. Some business marketing firms use the reports published by Exhibit Surveys, Inc., a company that surveys trade show audiences. According to Exhibit Surveys, the "Net Buying Influence" (i.e. the percentage of the trade show audience that has decision authority) averaged 84 per cent for industrial trade shows in 1989, with a range of 58 per cent to 98 per cent<sup>16</sup>. Another method of selecting trade shows based on expected profitability, which is calculated based on past data of the trade show. First, lead efficiency is calculated by the ratio of the number of sales leads obtained and the total number of trade show visitors. Thereafter, information on lead conversion to sales and gross margin are obtained, as illustrated by Srinath Gopalkrishna and Jerome Williams.<sup>17</sup>

**Sales Contests** Many business marketing firms hold sales contests or incentives for their and/or dealers' salespeople. The objective is to motivate the sales force to improve their sales performance over the period of one year. Those who perform well get cash prizes or gifts or foreign trips.

**Seminars** Some business marketers conduct educational (or technical) seminars for buying organisations about the state-of-the-art developments. The benefits of conducting technical seminars are creating favourable image and establishing contacts with technical people (from design, research and development, production, maintenance, and/or quality control) who are the members of buying centres or purchase committees in the buying organisations. Audio-visual presentations are made by the company technical experts, followed by question-answer sessions on technical matters. These seminars give good results in terms of sales for the new products and establish contacts with technical members of buying organisations, who are key buying influentials.

**Demonstration** The business salespersons improve their sales presentations by using demonstration aids. These are flip charts, product photographs, slides, audio and video cassettes, movies, and actual product samples (if it is possible to carry them). The purpose of using the demonstration aids is to improve the buyers' attention and interest during the sales presentation. It also helps the buyers to remember the product features and benefits. However, if the product is bulky or large, the product demonstration is done during the trade shows or exhibitions. Sometimes the product demonstrations are done when the potential business buyers visit the seller's factory, or when the product is shown in operation at another (existing) customer's premises. A demonstration is particularly effective when the prospective business buyer is buying an equipment or a machine for the first time (i.e. new task).

**Catalogues** Printed catalogues are one of the few promotional supports that provide buyer organisations information about a supplier's product lines and product items. Buyer firms rely on catalogues to determine which suppliers make what products or services. From the information available in catalogues, a buyer may prepare a list of potential suppliers for a new purchase and ask these suppliers to submit quotations or bids. Distribution of catalogues also helps salespersons to establish contacts with technical persons in the buyers' organisations.

The catalogues are either general or specific type. A general catalogue is used by companies with extensive product lines and product items. It contains brief information about all the products of the company. A specific or specialised type of catalogue or leaflet contains information about the specific product in which a specific group of customers are interested. While preparing the catalogues, the business marketer should include the information that buyers are likely to need, such as product specifications, applications, performance data, illustrations or drawings, and service requirements.

Catalogues are a form of direct marketing. For distribution of catalogues, the business marketer should prepare a mailing list of prospective customers and it is important to continually update the mailing list. Salespersons and trade shows are the other methods of distributing catalogues. Catalogues may themselves be updated to reflect the changes in the suppliers' products or services.

**Promotional Letters** Promotional letters, particularly for products purchased infrequently (e.g. heavy machinery), are effective in keeping in touch with customers. It also facilitates the work of business salespersons. Individualised letters or e-mails (i.e. promotional letters), when sent to specific customers along with catalogues, advertising reprints, and technical data sheets, receive good attention. The task of sending promotional letters may be assigned to a special correspondence section. Salespersons can then advise this section about what kind of covering letter to be sent, to whom the letter or e-mail should be addressed, and the type of technical literature to be sent. The objective of the special correspondence section is to convey the message that the company is a good one with which to do business.

**Entertainment** Entertaining business customers can have positive or negative effects, depending on buying situations, nature of products, policies of buyer organisations, and buyers' culture. There may be a rationale for entertainment if the business marketer's products have standard specifications and are sold in bulk. But for products which are highly differentiated (e.g. special purpose machines), it may be difficult to find a rationale for customer entertainment.

**Promotional Novelties** This is nothing but gift items given by salespersons to existing and new customers. Many companies get gift items made once a year (during a festival or New Year), bearing company's name and address, and if possible, an advertising message in a discreet manner. The common gift items are calendars, diaries, ball-point pens, leather bags, memo-pads, and so on. An effective promotional novelty (or gift) should be inexpensive, unusual, eye-catching, and useful. The purpose is to keep buyers constantly aware of supplier's identity. Some companies make two or three categories of gift items, based on high, medium and low costs, for distribution of the gifts to senior, middle, and junior management positions in customer firms. It also gives an opportunity for salespersons to meet the various decision making persons in an organisation like technical (i.e. R&D, production and quality control), commercial (i.e. purchase, marketing, accounts), and top management. However, care should be taken by salespersons to distribute the gifts in a discreet manner at the offices or residences of key persons in the customers' organisations so that the buyers should not misunderstand or find it offensive or embarrassing.

## Publicity and Public Relations

Public relations department is typically located at the corporate headquarters and deals with various categories of people, including customers, suppliers, shareholders, employees, press, legislators, government officials, and public interest groups. A company is required to manage successful relations with these people in order to build a good image. The public relations (PR) department achieves its objective of managing good relations with the people by performing certain tasks like placing newsworthy information into the media, internal and external communications, dealing with legislators (MLAs/MPs) to promote or defeat a particular bill or regulation, and advising the top management about public issues.

Because the PR department is required to deal with a variety of people, it tends to neglect the marketing objectives. Publicity is a form of marketing public relations. Publicity has more credibility and lower cost compared to advertising. In business marketing, the major tool used in publicity is in terms of contributing technical articles from the company's technical personnel and placing such articles in trade journals. This creates a good image about the company's technical competency and reaches the members of buying centres in an inexpensive and effective way. It also generates sales leads from the interested potential buyers.

Publicity is effective when it is used as a part of the total promotional programme.

## Role of Direct Marketing

Direct marketing has come up in recent years. Business marketers are increasingly using direct marketing tools such as direct mail, telemarketing and online marketing channels. Direct marketing attempts to achieve direct sales without using an intermediary between the company and its customer.

Direct marketing is not only used by consumer marketing firms but also by business marketing firms, mainly because of high cost of reaching business customers through the company sales force. To reduce the marketing costs, business marketers first use direct marketing tools like direct mail the internet and telemarketing to identify and create interest with potential or prospective customers, before salespersons visit them.

**Direct Mail** In direct mail, a business marketer mails promotional letters, product leaflets/catalogues, audiotapes, videotapes and even computer diskettes to the prospective customers. The objectives in direct mail are to sell a product or service, collect sales leads for salespersons to visit, and introduce a new product. Direct mail is becoming increasingly popular because it offers target customers selectivity, low cost, flexibility in timing and a considerable space for providing a complete information about the company, its products, and its attractive offers. However, it can be wasteful if the target customers are not clearly identified. The mailing lists of direct mail should contain the names, titles, and functions of the target customers. The mailing lists can be obtained from trade publications, business directories, mailing list brokers, tradeshow, and the company's marketing information system.

**Telemarketing** Telemarketing (i.e. marketing through a telephone) is used by many business marketing firms to generate sales leads. When a company's telephone numbers are included in print media or direct mail, existing and prospective customers can easily respond on telephone to get immediate information or to make complaints and suggestions. Telemarketing has helped many business marketing firms to reduce the sales force costs and to increase the sales volume substantially. For telemarketing to be effective, companies use personnel who are highly trained in telemarketing.

## The Internet and New-Age Media

The internet allows people and organizations all over the world to communicate with each other through their computers. The internet changes marketing communications process from one-way to a two-way.

The use of the internet as an advertising medium for business marketing has increased substantially. Reaching buying centre members through advertising on the internet has become increasingly productive. For advertising in business markets, growing importance is given to search engine marketing, display and video advertisements. **Search engine marketing** operates in the same way as a company chooses to list its name and other details in directories (yellow pages). Message created by the business marketing firm includes key words which are used by prospects for associating the marketer and its products. Horizontal search engines like Google, Yahoo and Bing are used by individuals, but business customers are likely to search from general B2B engines like [www.Business.com](http://www.Business.com) as well as **vertical engines** such as [www.Globalspec.com](http://www.Globalspec.com) (serving engineering, manufacturing and related sectors) and [www.knowledgestorm.com](http://www.knowledgestorm.com) (used by the technology sector). Vertical search engines allow searchers to locate more specific and focused information and for the business marketer, it enables a more precisely targeted advertising message and sales leads.

**Display advertising** is basically a graphical unit contained within a web-page. Business marketers may place display advertising on a variety of websites, including search engine sites. **Video advertising** effectiveness is better than display advertising, because of its capacity to engage prospective customers and capacity to tell a story. **The illustration** described below shows how General Electric Company used video to build brand awareness.

The General Electric Company has a vast array of products from power generation and electricity distribution to jet engines and rail locomotives, serving both consumer and business markets. The scope of its activities provides the firm with ample material that can be used to tell good stories, but one of the challenges lies in presenting these so that customers learn about the firm rather than being showered with words. In 2007, the company developed eight 'ecomagination' films in different countries featuring inhabitants who examined local challenges and suggested GE solutions, so **for example** electricity generation featured in Austria, clean water technology in China, and bone scanning in France. The 2-minute videos were shown on portals such as AOL, MSN and Yahoo and viewers were invited (via click – throughs) to visit GE websites for further information. The videos increased visitor totals by 357 per cent compared to GE's display advertising campaign in 2006; amongst those who viewed the videos, brand favourability increased by 63 per cent and opinions of GE as a forward-thinking company increased by 34 per cent.

**Source:** Adapted from Hosford, 2008.

According to a report prepared in December 2012 by the Internet and Mobile Association of India and Indian Market Research Bureau, the Indian online advertising market including classifieds, will grow by 54 per cent in the next 12 months.

**Social Networking Sites** A study by McKinsey covering 20,000 companies spanning the five sectors of automobile, skincare, insurance, consumer electronics and mobile telecom reveals that consumers are connecting with brands in new ways that extend beyond the control of manufacturers and retailers. The traditional mass media is now losing ground to 'owned media' (like company channels and websites) and 'earned media' (customer created channels, such as blogs, opinion forums, and social networking sites). Globally, of over 1 billion Facebook users, more than 600 million access the social

networking site on their mobile devices. Facebook recently launched 'Facebook Exchange' to target those searching for home loans with advertisements on their news feed. LinkedIn launched a tool used for targeting affluent users with bespoke programs. Twitter has become a place to track politicians, celebrities and sportsmen. Corporate interests are seen in new sites like Pinterest. Consumer products and services with non-recurring purchases, such as mobile phone, hotel, and airline are most worried about social networking media, which can build or destroy the brand reputation. As on June 2012, there are 150 million internet users in India, out of which over 100 million Indians are on social networking sites like Facebook, Twitter, LinkedIn and other sites. It is an instant media and hence the swiftness with which a company responds is critical. There is a growing demand for online reputation management. To meet this demand and to help companies deal with social media, a set of service providers, such as Pinstorm, Social Wavelength, and Convonix have come up. Marketers are finding out viable ways to reach increasingly networked consumers.

## SUMMARY

Communicational (or promotional) mix for industrial products and services is different from that for most consumer products. Before developing an effective communication programme, business marketers should understand the concept of hierarchy of effects, which is about the buyer's mental stages. Number of models describe the mental process or stages of business buyers. Different information sources or media are important at various stages of buyers' decision process. Source credibility is an important component in business marketing.

For developing an effective communication programme (or plan), business marketers have to go through certain steps: (a) determining the communication objectives, (b) identifying the target audience, (c) determining the promotional budget, (d) developing the message strategy, (e) selecting the media, (f) evaluating the promotion's results, and (g) integrating the marketing communications.

Advertising has an important role in business marketing and the major reasons for advertising business products and services are creating awareness among potential buyers, reaching members of buying centres, increasing sales efficiency and effectiveness, efficient reminding, and generating sales leads. The media generally used for business advertising are general business publications, trade journals, and industrial directories.

Some advertising agencies specialise in business advertising, though many concentrate on promotion of consumer markets. Most of the top foreign advertising agencies are represented in India. It is expected that growth in advertising business and competition will be remarkable in India in coming times.

Sales promotion will also play an important role in the promotional-mix of business marketing firms. Some of the methods used for sales promotion are trade shows, sales contests, promotional novelties, and seminars.

Because public relations (PR) department of a business marketing firm deals with various public, it tends to neglect marketing objectives. Publicity is, therefore, considered as a form of marketing public relations. The major tool used in publicity is to contribute technical articles in trade journals. This is cost effective and has good credibility.

Direct marketing, which has come up in recent years, is increasingly used by business marketers. The major tools of direct marketing are direct mail, telemarketing, the internet and the new-age media, including social networking sites.

**KEY TERMS**

- Direct marketing
- Hierarchy of effects
- Integrated marketing communication (IMC)
- Objective and task method
- Response hierarchy models
- Source credibility
- Source effect

**Note:** Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. Describe how it is useful for business marketers to understand the concept of hierarchy of effects.
2. Explain the steps involved in developing an effective communication programme.
3. Describe the functions performed by business advertising.
4. Which are the major communication media or tools used in business marketing? Explain any one of them.
5. Describe the role of sales promotion in business marketing.
6. Explain the concept of integrated marketing communications (IMC), its objectives and how these objectives are achieved.

**OBJECTIVE TYPE QUESTIONS**

1. The most important and often used element of business marketers' communication mix is: (a) sales promotion, (b) advertising, (c) personal selling, (d) direct marketing, (e) publicity, or (f) public relations.
2. The concept of hierarchy of effects deals with: (a) individual buyer's mental stages, (b) buying centre's buying stages, (c) sources of information for buying decision process, (d) degree of credibility of the source, or (e) none of the above.
3. Communication objectives of a business marketing firm is determined based on: (a) SWOT analysis, (b) marketing strategies, (c) marketing objectives, or (d) target audience.
4. The most logical and increasingly used method out of the four methods for setting promotional (or advertising) budget is: (a) affordable method, (b) percentage-of-sales method, (c) competitive-parity method, or (d) objective-task method.
5. In business marketing, the selection of appropriate media is based on three major factors: target audience, promotional budget, and one of the following: (a) product/service, (b) competitors' strategy, (c) environmental factors, or (d) communication objectives.
6. The major challenge in implementing integrated marketing communications (IMC) is to: (a) determine its objectives, (b) coordinate the efforts of sales and marketing persons simultaneously, (c) build a database, or (d) develop an appropriate strategy.
7. Vertical publications are directed at individuals working in a specific: (a) industry, (b) occupation, (c) function, or (d) technology.

### APPLICATION QUESTIONS

1. Suppose you are working in a courier services company, which is ranked fourth in the domestic Indian market in terms of market share. Your company management thinks that one of the ways to improve sales and profit performance, as well as the company's market share, is to implement the concept of integrated marketing communications (IMC). You are asked to prepare a proposal indicating the objectives, strategies, and challenges in implementing the IMC.
2. Assume you are a head of marketing in a leading Airconditioning and Refrigeration company. Your company markets central airconditioning plants and cold storage units on contract basis to business customers like hotels, restaurants, large retail units, cold storage owners, and other business organisations. Last year the management approved your proposal to increase the promotional expenditure by 18 per cent, but sales went up by only five per cent against the targeted growth of 15 per cent. You expect your company's CEO to ask you to explain the difference during the forthcoming performance review meeting. How would you respond?
3. Consider any business marketing organisation of your choice and develop an effective communication programme for the company.

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## CASE 11.1

### Nepal Boards Ltd.: Effective Communications Programme\*

The marketing manager of Nepal Boards Ltd. thought that one of the major factors that needed improvement was to make their communications programme more effective. The company's market share for Prelaminated Particle Boards (PPBs) in India was 35 per cent, as compared to 40 per cent market share of the dominant competitor, Novopan, in the year 2006.

The company found that not only the awareness in prospective customers was low about the advantages of PPB, but also about the quality of the product made by it. PPBs, which were introduced in the Indian market in the year 1975 as a substitute of plywood, had three major advantages over plywood:

- More economical
- Environment friendly
- More attractive colours

Nepal Board's PPBs were not only conforming to Indian Standards (IS 3087, 1985), but also to international quality standards.

The company and its manufacturing plant were located in Nepal. The target market segments were the government organisations, information technology (IT) firms, and multi-national companies (MNCs) in India. The marketing manager thought that the target audience were architects, interior decorators, and carpenters. The company started educating carpenters by conducting workshops, since the carpenters did not know how to use PPBs and due to their ignorance of the product, they were calling it "Bhusa Board" (meaning, powder piece of wood).

The marketing manager was not sure about the promotional budget, the message strategy, and the media to be used. He wondered whether the management would ask him to evaluate the results of the promotional programme.

### Question

1. If you were the consultant to the marketing manager, what advise would you give and why?

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Suman Yadav, T. Das, Toshi Gairola, and Subashree Shankar, MBA students of Alliance Business Academy, Bangalore.



# 12

## Pricing in Business Marketing

*After studying this chapter you should be able to:*

- Examine the special meaning of price in business marketing.
- Understand and analyse the factors (i.e. price determinants) which influence pricing decisions.
- Study the different price-setting methods.
- Describe pricing strategies for various product/market situations and marketing environment.
- Learn pricing policies for different types of customers.
- Examine practical aspects of commercial terms and conditions prevailing in business markets.
- Describe the role of leasing in business markets.

Pricing is a critical part of business marketing strategy. Pricing strategy is related to market segmentation and positioning strategy, product strategy, distribution strategy and communication or promotional strategy. A business marketing manager should integrate the various strategies or the elements of marketing mix (such as product, price, promotion, and place) so as to ensure that the total offering not only satisfies the market needs but also meets the company's objectives.

It is important for business marketers to understand that they should focus their efforts on presenting superior value of products and services to ensure profitability<sup>1</sup>. A study had concluded that product quality, not low price, was the driving force in establishing profitable operations<sup>2</sup>. It may be a wrong strategy to use low price to achieve market leadership, which is suggested by the traditional product portfolio analysis. **For instance**, Texas Instruments (TI), which followed the strategy of market dominance through low prices, suffered millions of dollars of losses on calculators in the mid-1970s, on watches in 1981, and on personal computers in 1983<sup>3</sup>. However, in spite of these warnings of using price to achieve market leadership, price is an important component of the marketing mix. Business marketers should blend effective pricing strategy with product, communication, and distribution strategies in order to achieve market leadership and profitability<sup>4</sup>.

In this chapter, we will first examine the special meaning of price in business marketing. Thereafter, we shall analyse the factors which influence pricing decisions. Next, we will consider different methods or approaches used to establish the basic prices of the market offering, that is, price-setting methods. Thereafter, pricing strategies are discussed for different product and market situations to set basic prices. Pricing policies are then considered to adjust the basic prices for various types of customers. Towards the end of the chapter, we shall examine commercial terms and conditions, as well as the role of leasing in business-to-business markets.

## SPECIAL MEANING OF PRICE

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When a business buying firm buys a product from XYZ supplier firm which is in competition with several other suppliers of the similar product, it means that the buying firm perceives that XYZ supplier offered the highest delivered value. The highest delivered value is the difference between the overall perception of benefits and the total cost to the buying firm.

The overall *perception of value* will vary in degrees of importance to the different individuals within the buying committee (or the buying centre) of a buying firm. If there is no agreed formula on the importance to be given to various benefits (or attributes), different individuals in the buying centre will have different perceptions of value provided by various suppliers—production managers may consider quality and reliability of delivery as the most important benefits for the raw materials and components supplied for manufacturing operations, financial managers may give more importance to the lowest cost and liberal payment terms, and purchase (or materials) managers may consider reputation of the supplier firms and dependable salespersons as equally important attributes. Besides, different market segments may give varying degrees of importance to these benefits.

The benefits could be tangible and intangible, which may vary for capital goods, raw materials and components, and core services. **For example**, for purchase of a CNC (Computerized Numerically Controlled) machine, a business buyer would consider productivity (i.e. output of good quality components per hour) as the most important tangible benefit and intangible benefit of prompt after-sales technical service as critical. For supply of a steel component, a two-wheeler manufacturer would consider flexibility in delivery to meet with fluctuating market demand of different models as a very important intangible benefit, and consistent good quality of the component as the critical tangible benefit. For a courier service, “on time, every time delivery service” will be a vital intangible benefit and excellent physical infrastructure as crucial tangible benefit expected by a customer.

The total cost to the buying firm includes not only the price of the product, but also transportation (or freight) cost, transit insurance cost, and installation cost (for certain equipment and machinery). In addition, the buying firm also considers the risks of product failure, the delays in delivery, and the lack of technical support or service. Hence, the supplier offering the lowest price may not be the lowest in the total cost, if other costs and risks are considered. Besides, some suppliers give volume discounts or cash discounts (which we shall discuss in this chapter subsequently) on the quoted prices.

The business marketers should understand the various aspects of perceived benefits and the total cost from the buyers’ point of view, particularly, the difference between the price and the total cost should not be overlooked. This point was supported in a study in which out of over 100 purchase decisions, the lowest price bidder was not selected in over 40 per cent of the cases<sup>5</sup>.

## FACTORS INFLUENCING PRICING DECISION

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Business marketing firms should consider the following factors before they make pricing decisions like price setting and pricing policies. What happens, if a business marketer makes pricing decisions without considering the below-mentioned factors? In such a case, the pricing decisions will not be effective.

1. Pricing objectives
2. Demand analysis

3. Cost analysis
4. Competitive analysis
5. Government regulations.

While each of these factors is important, the pricing objectives represent the most important factor in pricing decision.

### Pricing Objectives

Pricing objectives should be derived from corporate and marketing objectives. Some companies give more priority to certain objectives and less priority to others. There are many possible pricing objectives which business firms can pursue. Some of these objectives are described here.

**Survival** A short-term objective followed by some companies is survival if the factory production capacity is underutilised to a large extent, or unsold finished products have piled up, or due to intense competition, a firm is unable to sell its products. To keep the factory going and to convert the inventory (or stocks) to sales, as a part of survival objective, a business firm reduces prices. Profits are less important than survival. The prices are set in such a way that they cover variable costs and part of fixed costs so that the company stays in business. This is done for a short-term. However, in the long run, the firm must raise its prices to cover total costs or face losses.

**For example**, a precision tube manufacturing company had to adopt 'survival' pricing objective, when it faced with a situation of recession in bicycle industry, which was its target market segment. The factory, which normally worked on three-shift basis, did not have adequate orders even for one shift, forcing the management to lay off large number of workers.

**Maximum Short-term Profits** Some companies try to set prices with the objective of maximisation of short-term profits. These companies estimate the market demand and costs at alternative prices and select the price that gives maximum current profits. However, in practice it is difficult to accurately estimate demand and cost functions. Moreover, the emphasis is on short-term profit maximisation rather than long-term performance and customer relationships. The companies following this objective do not consider competitors' reactions and legal implications.

**For instance**, a leading electrical equipment manufacturer developed a 'transwitch unit', which is used in the underground coal mines as an import substitution. The company had set a price with the objective to maximise the short-term profits in order to recover the product development cost within a few years. The price established for the new equipment was much lower than the imported equipment price and hence, the customer readily accepted the price set by the company.

**Maximum Market Share** Some companies fix the prices of commodities as low as possible with the objective of maximising sales volume and market share of its products. The assumption is that the market is price sensitive, and that the low prices will increase sales. Other assumptions are: (i) Highest volume will reduce the production and distribution costs, leading to higher long-term profits. (ii) Low prices will discourage entry of potential competitors.

**For example**, the US company, Texas Instruments, follows the pricing objective of maximising market share. The company uses the strategy of economies of scale by building large plants, which helps in bringing down the costs. Low costs enable the company to set its price as low as possible to maximise its sales and market share. This practice of setting low price for achieving maximum market share objective is called '**market-penetration pricing**'.

**Maximum Market Skimming** If the market penetration price is placed at one end of pricing alternatives, skimming price would be found at the other end of the continuum. Some companies set high prices in the initial stages of the product life-cycle when they introduce new and innovative products. The new product is initially aimed at those market segments where demand is least sensitive to price, that is, customers in those market segments are willing to pay high prices for the product. By following the skimming objective, the company skims maximum revenue and profits. As the time passes and sales slow down, the prices are lowered in stages to attract new customers from price-sensitive market segments. The objective in market skimming is to maximise sales revenue and profits. The assumption made in this strategy is that different prices can be charged to different segments of customers and also at different times. The risk involved is that high profits resulting from high prices, will attract entry of competitors.

**For example,** Elechem company brought a new technology to India from its business partner in the US to join the underground jelly-filled telecommunication cables. The new technology helped prevent water entering the cable joints, particularly during the rainy season. The company had set high prices in the initial years to “skim” the market and achieve maximum revenues and profits. As the competition increased, due to attractive profit margin, the prices were lowered in the subsequent years.

**Product-Quality Leadership** A company may have an objective to be product-quality leader in a market. The company, therefore, produces superior quality product (superior to any other competitor) and charges slightly higher prices than the competitors’ prices. This pricing objective results in higher profits.

**For instance,** a material handling manufacturer produces superior quality of an equipment, called ‘Dock leveller’, which is used for loading and unloading materials to and from trucks. Not only the product quality is superior, the company also manages to provide superior quality pre-sales and post-sales technical service. The company sets the price of its equipment higher than competitors’ products by as much as 20 per cent and many customers are willing to pay the higher price, due to the quality leadership of the company.

**Other Pricing Objectives** Between the two extremes of market skimming and market penetration, there is an intermediate range of moderate pricing alternatives. An intermediate range pricing is suitable to achieve other pricing objectives like “be regarded fair by customers”, “avoid government intervention”, “try to stabilise the market” and “meeting the competition”. In a study, Lanzillotti noted that in any given company pricing decisions were not always ruled by a single pricing objective.<sup>6</sup> Each business marketing organisation faces unique external and internal environmental factors. Pricing objectives must be established with care, consistent with corporate and marketing objectives, because they have far reaching effects.<sup>7</sup>

## Demand Analysis

Theoretical concepts of derived demand, joint demand, and cross-elasticity of demand have been described in Chapter 1. The concepts of demand curve and price elasticity are useful starting points in the relationship between demand or sales volume and price. The relationship between price and sales volume can be measured by an experimental research. In measuring the price and demand relationship, the market researcher should control other factors like promotion and customer service which may also affect demand. The basic purpose of estimating the demand curve (or demand schedule) is to find out to what extent the demand for a product changes with the changes in prices. The demand curve sums up the price sensitivities of many buyers. It indicates whether buyers are less price sensitive (inelastic demand), or more price sensitive (elastic demand).

If demand hardly changes with a small change in price, then the demand is inelastic. However, if demand changes substantially with a small change in price, then demand is elastic. The price elasticity of the demand is determined by the following formula:

$$\text{Price elasticity of demand} = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$$

To **illustrate** the above, if a manufacturer of steel sheets increases the price by two per cent and the demand (or the quantity sold) of steel sheets falls by five per cent, then the price elasticity of demand is  $-2.5$  (the minus sign confirms the inverse relationship between the price and the demand) and the demand is said to be elastic. However, in case of a machine tools manufacturer, if the price is reduced by 10 per cent and the quantity demanded (or quantity sold) increases by five per cent, the price elasticity is  $-0.5$ , that is the demand is said to be inelastic.

**Conditions Determining Price Elasticity of Demand** The demand is likely to be less elastic (or inelastic) under the following conditions: **(i)** There are few competitors, **(ii)** No availability of substitute products from other industries; and/or **(iii)** The buyers think the higher prices are justified by normal inflation or changes in government policies on excise duty or sales tax, and others.

However, the demand for many industrial products is relatively inelastic or less price sensitive because these industrial products are technically sophisticated, customised, or important for buyers' operations. The demand is also inelastic for those industrial products which are a small percentage of the item's total cost (called 'C' items in ABC analysis).

### Cost-Benefit Analysis

When demand analysis is carried out, it is useful to undertake an analysis of benefits received and the costs incurred by the target customers in purchasing and using the product. For an appropriate pricing strategy, an analysis of the benefits and the costs of the product from the customer's point of view is necessary.

Benefits can be categorised into hard and soft benefits. **Hard benefits** refer to the physical attributes of the product such as production rate of a machine, rejection rate of a component, and price/performance ratio (dividing the price in rupees by the performance or benefit measured in units). **For example**, price/performance ratio for computers can be rupees per unit of processing speed or MIPS (million instructions per second).

**Soft benefits** includes company reputation, customer service, warranty period, customer training, and are more difficult to assess.

For business customers *costs* include not only price but many other expenses that are incurred in purchasing and using the product. **For instance**, the costs of a new textile machine purchased by a textile mill will include price, transportation (or freight), installation, energy usage, repair and maintenance. The buyer of the textile machinery may go further to calculate the costs of the production stoppage due to machine failure although it may be difficult to estimate such costs accurately. The buyer may be willing to pay a higher price to reduce the risk of failure. While buying capital items, the buyer can use the *life-cycle costing concept* by estimating the total cost of the product over its life span. Life-cycle costing includes the price, freight, transit insurance, maintenance, energy, material and labour costs over the useful life of the product. The concept of **life cycle costing** is increasingly used by buying organisations, typically for capital items like sugar and textile machines, furnaces, heavy equipment,

due to rising costs of energy, spare parts, maintenance, and labour. The business marketer may be able to justify a high initial price of a machine, by using life cycle costing as a marketing tool, if there would be cost savings on the above-mentioned cost elements over the life of the machine<sup>8</sup>.

After understanding the important benefits and the costs to the customers based on the customers' perceptions, the business marketer should then evaluate the possible cost/benefit trade-off decisions made by the business buyers. Like, the volume (or quantity) discount can be considered by the customer as an incentive to purchase larger stocks if the quantum of discount is more than the costs of carrying the inventory. The business marketer can set an appropriate price by understanding how the customers evaluate the competing offers on cost/benefit analysis.

Irwin Gross asserts that a product offering may have several attributes like product quality, responsive delivery system, after-sales-service, retraining, and innovation. However, business marketing managers should analyse the relative importance of these attributes to different market segments and should also find out the strengths and weaknesses of the company's product offering on each of the important attributes in relation to that of competitors. Perceived relative value of two competing offerings can be calculated by using the following equation<sup>9</sup>:

$$\begin{aligned} \text{Relative Perceived} \\ \text{Value of Offering "A"} \\ \text{vs. Offering "B"} &= \left( \begin{array}{c} \text{First} \\ \text{Attribute} \\ \text{Value} \end{array} \right) \times \left( \begin{array}{cc} \text{Perceived} & \text{Perceived} \\ \text{Performance} & \text{Performance} \\ \text{of Offering "A"} & \text{of Offering "B"} \\ \text{on First} & \text{on First} \\ \text{Attribute} & \text{Attribute} \end{array} \right) \\ &+ \left( \begin{array}{c} \text{Second} \\ \text{Attribute} \\ \text{Value} \end{array} \right) \times \left( \begin{array}{cc} \text{Perceived} & \text{Perceived} \\ \text{Performance} & \text{Performance} \\ \text{of Offering "A"} & \text{of Offering "B"} \\ \text{on Second} & \text{on Second} \\ \text{Attribute} & \text{Attribute} \end{array} \right) \end{aligned}$$

**For example,** if product offering "A" has a total relative perceived value of ₹ 1200 per unit, compared to ₹ 1000 per unit for product offering "B", then the offering "A" gives a benefit of ₹ 200 per unit to the buying organisation in relation to the offering "B".

## Cost Analysis

Company costs set the lowest point on the price range. Hence, pricing strategy or decisions must consider the costs involved. Generally, the total costs consist of the sum of the fixed costs and variable costs for a given level of production. Some of the cost elements fluctuate with volume, other cost elements vary over a period of time, and some are relevant to the pricing decisions. For making profitable pricing decisions, the business marketer must identify and classify costs. Table 12.1 would help in understanding classification of costs. The production, marketing, and distribution costs must all be classified.

**Table 12.1** Classification of Costs/Types of Costs

<i>Cost Elements</i>	<i>Descriptions</i>
1. Fixed costs (also known as overheads)	Costs that do not vary with production or sales. <b>Examples</b> are rent, interest charges, and managerial salaries. Fixed costs or overheads are incurred irrespective of production levels or sales volume.
2. Variable costs	Costs that vary (or fluctuate) in direct proportion to the levels of production. <b>Examples</b> are raw materials and direct labour costs. They are called variable because the total variable cost varies with the number of units (or quantity) produced.
3. Total costs	Sum of the fixed and variable costs for any given level of production is called fixed costs.
4. Semivariable costs	Costs that vary (or fluctuate) with changes in output but not in direct proportion to quantities produced. <b>Examples</b> are equipment repair and maintenance costs. Semivariable costs have components of both fixed and variable costs.
5. Direct costs	Fixed or variable costs that are incurred directly for a specific product or sales territory. <b>Examples</b> are selling expenses, freight, and raw material.
6. Indirect costs	Fixed or variable costs that can be traced indirectly to a sales territory or a product. <b>Examples</b> are production overhead and quality control that are indirectly assigned to a product.
7. Allocated costs (or General costs)	Costs that support a number of activities but cannot be objectively assigned to a specific product or a market. These costs are usually allocated across business groups or divisions by some arbitrary criterion (such as sales volume). <b>Examples</b> are administrative overhead and corporate advertising.

A business marketer must understand:

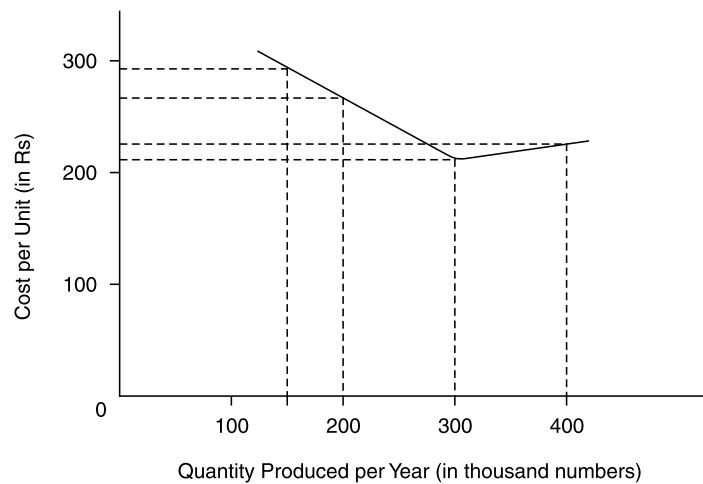
1. The costs vary at different levels of production, and economies of scale can be planned.
2. Accumulated experience helps in reduction of costs.
3. The effect of break-even analysis on costs and sales volume.

**Cost Behaviour at Different Production Levels—Economies of Scale** To price appropriately, a company should know how its costs vary with different levels of production. To compete effectively, a company may use economies of scale by building a larger plant size. Let us consider an **example** of a company planning to manufacture special type of luminaires (or fittings) used for lamps. Table 12.2 shows the average total cost per unit of luminaire at three alternative production volumes per year. If the company forecasts to sell 3,00,000 luminaires, it should build a production capacity of 3,00,000 units, which will bring down the unit cost to ₹ 209. The average total cost per unit decreases as the production volume increases. However, the average total cost per unit increases (due to operational reasons) as the production is increased to 4,00,000 units, as shown in Fig. 12.1, in economies of scale curve. The company should, therefore, plan a production capacity of 3,00,000 units per year, which is the optimum size if the company sales forecast indicates the sales of 3,00,000 luminaires.

The reason for the fall in the average total costs per unit is that the fixed costs are reduced by spreading them over more units with each unit produced bearing a smaller fixed costs. Figure 12.1 shows the relationship between cost per unit (or average total unit cost) and the quantity produced per year (or yearly production volume). In other words, it reflects economies of scale.

**Table 12.2** Unit Costs at Different Levels of Production Per Year

Cost Elements	Yearly	Production	Volume (Nos.)
	1,50,000 (₹/Unit)	2,00,000 (₹/Unit)	3,00,000 (₹/Unit)
<b>Fixed costs:</b>			
Executive salary	30	25	15
Marketing persons' salary	30	25	20
Tax and insurance	4	3	2
Depreciation	60	47	30
Interest on capital	60	45	30
Total fixed cost per unit	184	147	97
<b>Variable costs:</b>			
Direct labour	50	50	50
Direct materials	45	45	45
Factory supplies	7	7	7
Inventory carrying	10	10	10
Total variable cost per unit	112	112	112
Average total unit cost	296	259	209

**Figure 12.1** Economies of Scale

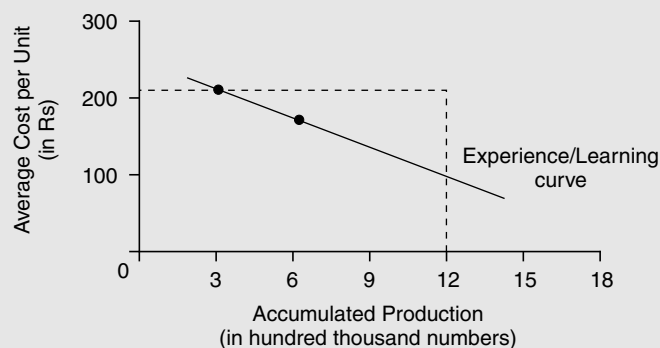
In Fig. 12.1, the plant with the production capacity of 3,00,000 units is the most efficient and with the lowest unit cost. It is the optimum size as the production capacity of 4,00,000 units per year increases the unit cost due to operational reasons. If the market demand is strong enough to support a plant capacity of 3,00,000 units per year, the company should take the advantage of economies of scale to compete effectively and to make adequate profits.



### THE LEARNING CURVE

Also called *The Experience Curve*, this concept specifies that certain costs (particularly variable costs) decline as cumulative volume of production increases. In other words, the average unit total cost of a product declines over a period with accumulated experience of production and sales.

Most companies who have applied the learning curve concept came to the same conclusion that many costs, such as cost of defective parts, cost of machine down-time, procurement costs, and so forth decline. The major impact of cost reduction takes place in variable costs although the fixed costs can also be reduced to some extent. This is in addition to the improvement in productivity not only in the area of production but also in the field of selling function due to the process of learning from experience. Many studies have shown that the impact of improvements due to learning process, (or the learning curve) on the reduction in the average total cost per unit of production or sales, is to the extent of 10 to 30 per cent. The learning curve is usually defined by its slope, as shown in Fig. 12.2.



**Figure 12.2** Learning/Experience Curve

Considering the unit cost of ₹ 209 at a production volume of 3,00,000 per year (given in Table 12.2), it is shown in Fig. 12.2 that with accumulated production volume of 6,00,000 units, the average total unit cost (i.e. average cost per unit) has declined by 15 per cent, that is, 85 per cent learning curve. Assuming the same level of reduction in unit cost at 9,00,000 and 12,00,000 units of accumulated production, the experiences cost curve is drawn as shown in Fig. 12.2. However, in practice, the reduction in costs due to learning or experience, over a period of time, would vary by about 10 per cent to 30 per cent, if the company management implements the *continuous improvement* concept. It is necessary to measure the improvements not only in terms of cost reduction but also in quality and productivity improvements. An experience curve can be used for cost reduction in broad range of manufacturing, marketing and administrative functions.

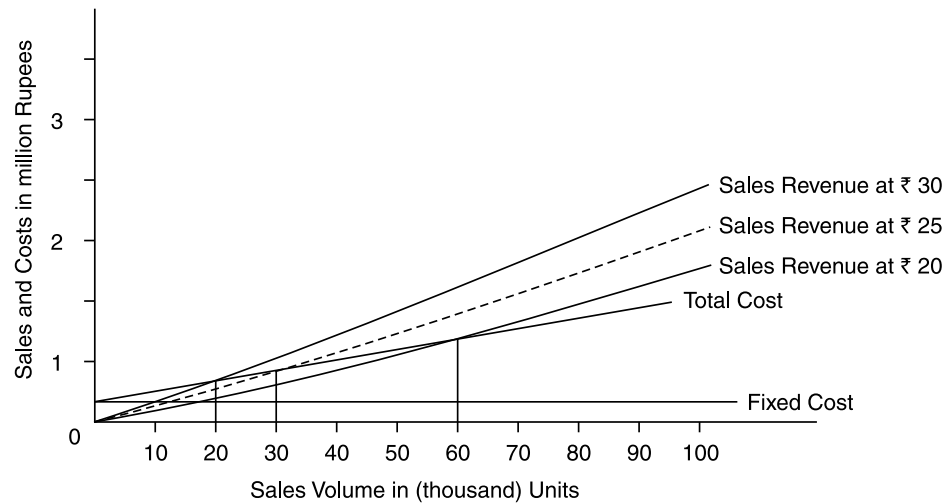
**To illustrate**, the new managing director who took over the operations of a large multi-product, multi-division organisation, wanted to improve the profitability which had declined due to severe competition and internal deficiencies. He adopted two methods to improve profits. One was to diversify into new products, which had potential to generate good profits and the other approach was to improve the profitability of the existing business groups or divisions. For this, by using experience or learning curve, he motivated each division to set a target for *profit improvement plan* (called PIP).

A target of 10 per cent to 15 per cent was set for each division. He told the managers that costs do not decline automatically due to gaining of experience. Thorough efforts are needed to exploit the benefits of experience. This can be done by not only improving the productivity (i.e. output per person or output per department in each division), but also reduction in cost of production, marketing, finance, materials and so on, without compromising on quality.

**Importance of Learning/Experience Curve** Researchers have found that experience or learning curve have strategic importance in forecasting cost and prices. The theory states that costs decline by a specific percentage each time accumulated production volume (i.e. experience) is doubled. In a study it was found that each time accumulated volume was doubled, the unit costs of the products fell, typically by 10 to 30 per cent.<sup>10</sup> However, in practice, as experience is gained, costs do not automatically fall. A definite effort from the company management is needed to make good use of the benefits of experience. The experience curve concept gives an opportunity to the company management to try to obtain cost reductions and efficiency improvements.

### Break-Even Analysis

It is a financial technique which is used by the marketer to consider different prices and their possible effects on sales volumes and profits. The break-even chart shown in Fig. 12.3 is drawn by assuming fixed costs of ₹ 3,00,000, variable costs of ₹ 15 per unit, selling price of ₹ 20, and production capacity of 1,00,000 units. The break-even volume is calculated by the formula:



**Figure 12.3** Break-Even Chart

$$\text{Break-even Volume} = \frac{\text{Fixed costs}}{\text{Selling price} - \text{Variable Costs}}$$

$$\text{In the above example, the break-even volume} = \frac{3,00,000}{20 - 15} = 60,000 \text{ units}$$

If the company chooses trial (or projected) selling prices of ₹ 20, 25, and 30, the break-even volumes where the sales revenue lines intersect the total costs line are 60,000, 30,000, and 20,000 (which can be also verified by the earlier formula). The price to be chosen should consider the competitors' prices and price elasticity of demand. The company should also consider lowering its fixed and/or variable costs by using economies of scale and learning curve concepts. Bringing down the costs will further lower the break-even volume and improve profits.

### Competitive Analysis

Many business marketers regard *competitive-level pricing* as the most important pricing strategy. A business firm should get the information on not only competitors' prices and costs but also about the competitors' product quality, technical expertise, and delivery performance. This is important because price is only one factor out of several factors considered in the buyer's cost-benefit analysis.

The information on competitors can be obtained in several ways. The firm's sales people and dealers can ask buyers about the quality, prices, services, and delivery performance of the competitors during their sales calls. Other sources of competitive information are the internet (competitors' websites), business and trade press (articles), trade shows, and advertisements. Another effective method is to commission a marketing research firm to conduct a market survey to get the competitors' information either directly or as perceived by the buyers. The company can buy competitor's product and take it apart to estimate the cost of production.

Once the business firm gets the information about competitors, it can use price to position its product *vis-à-vis* competitors. This means that if a firm's product quality is superior to all its competitors and its service (including delivery, after-sales, etc.) is equally good, it can price its product higher than competitors'. However, if the firm's quality of the product and service are similar to that of major competitors, then its price should be close to the major competitors' prices (if it decides to price its product higher, it would lose sales).

It is said that competition sets an upper limit on price.<sup>11</sup> Some business organisations consider their products as commodity-like and hence they think their products cannot be differentiated from competitors. McKenna says that such companies should leave their commodity-mentality in the factories and bring a mentality of diversity to the marketplace.<sup>12</sup> Even commodity-like products can be differentiated from its competitors by product features, reputation, delivery reliability, technical expertise, service, or target markets. This differentiation perceived by organisational buyers gives the business marketer greater freedom in the pricing decisions.

**Competitors' Response to Price Changes** If a business firm is considering a price change, it has to predict the reactions of customers and competitors. A business marketer must first study the major competitors' financial situations, utilisation of production capacity, actual sales, costs, corporate objectives, and strengths and weaknesses. After collecting the information on competitors, the next step is to anticipate the reactions of the competitors. If the competitor's corporate objective is to increase the market share, the competitor is most likely to match the price reduction. If the major objective of the competitor is to maximise the profits, the competitor's likely response to a price change will be in some other ways, such as improve customer service or product quality.

A competitor's response depends on its mind-set. To understand the competitor's mind-set, a business marketer must study the business philosophy, internal culture, and the past practices of the competing firm. Some of the common reaction profiles of competitors are:

1. Some competitors do not react strongly or quickly to a price change for various reasons like slowness in noticing the price change, or confident of their customer loyalty.

2. Some competitors react in selective manner. They may not respond if the price change is small in degree or amount or initiated by a weak competitor. They may react if the price change is large and initiated by a major competitor.
3. Some competitors react strongly and quickly to any attack on their markets. They fight to finish.
4. Some competitors are unpredictable. It is very difficult to predict their response based on their past behaviour, financial situations, or objectives.

Let us reverse the question of how competitors would respond to a price change and ask how a business marketing firm would respond to a price change initiated by a competitor. The answer is that a business marketer should respond only after getting answers to the following questions:

1. Why the competitor has changed the price? Is it to increase its market share, to meet changes in the costs, or to utilise excess production capacity?
2. Is the price change temporary or permanent? If it is temporary and directed at reducing accumulated stocks, then there is no need to respond.
3. What will be the impact of the price change on the company's sales and profits if the company does not respond?
4. What would be the reaction of other competitors? If some competitors match the price change, there is a high probability that other competitors will also match it.

The competitors are likely to respond when the number of business buyers are less, the buyers are aware of the price change, and the products are similar or homogeneous. George E. Cressman and Thomas T. Nagle offer the following guidelines on competitive strategy development:

- Never participate in a competitive engagement you cannot win. Fight those battles where you have competitive strength, and avoid those where you are at a disadvantage.
- Always participate in competitive engagements from a position of advantage. Don't fight by competitors' rules (which they select for their advantage). Use what is advantageous for you.

## Government Regulations

Business marketers must be aware of the effect of government regulations on pricing decisions. Though we have a "free market" economy, there are some necessary restrictions that must be placed on business to ensure fair play, and to protect consumers and smaller companies.

**For instance**, "price-fixing" or "price cartels" are illegal, as per "Monopolies and Restrictive Trade Practices" (MRTP) act (now Competition Act, 2003). In a real-world **example**, the US Department of Justice fined several companies and individuals, including sentencing some CEOs to serve in jail, in March 2000, in international graphite electrodes price-fixing conspiracy. As a result of price-fixing by the suppliers of graphite electrodes, steel manufacturers paid higher non-competitive prices for the electrodes used in steel manufacturing.

**Price Discrimination** The price discrimination by offering different trade, volume or cash discounts to dealers or distributors, is also prohibited. A company must offer the same discount structure to its intermediaries, otherwise it may be interpreted as price discrimination. It is a difficult area to generalise because court interpretations have been somewhat inconsistent.

**Predatory Pricing** This mode of pricing is not permitted, because it takes place when a company with dominant position lowers its pricing structure so that new or smaller firms cannot operate in a

profitable manner. The pricing strategy of the dominant firm aims to kill (or drive out) competitors. **For instance**, in a ₹ 60 crore tender of Department of Telecommunication (DOT) for supply of “jointing kits”, a dominant firm, with diversified and financially strong businesses, quoted very low prices with the intention of finishing off some of the new and smaller firms.

## PRICING METHODS

After analysing the five factors (viz. pricing objectives, demand, cost, competition, and government regulations), the business marketer is ready to make pricing decisions. Business marketers must analyse these five pricing factors (also called, price determinants) before making any pricing decisions, so that the pricing decisions are effective. Generally, pricing decisions include (a) setting the basic prices (i.e. price-list prices) through pricing methods and pricing strategies (pricing methods are general approaches used for setting prices, whereas pricing strategies are used to set prices when a company faces specific product/market situations), and (b) adjusting price-list prices through pricing policies or price administration. The pricing decision that needs to be taken first is setting or establishing the basic price of a product. There are a number of pricing methods for setting prices. We will examine three major price-setting methods that are used by most business market managers. These are: (1) cost-based pricing, (2) value-based pricing, and (3) competition-based pricing.

### Cost-Based Pricing

One of the traditional methods of pricing is cost-based or cost-plus (also referred to as markup) pricing. The procedure followed is: (1) estimate variable cost per unit, (2) allocate a portion of fixed costs, and (3) add the supplier's markup or target profit, assuming the quantity that will be sold. Let us consider an **example**: A manufacturer of ceiling fans has the following costs and sales volume expectations:

Variable cost per unit	: ₹ 600
Fixed cost	: ₹ 200,000,000
Expected sales volume in numbers	: 1,000,000

The manufacturer's cost per unit is calculated by:

$$\text{Cost per unit} = \text{Variable cost} + \frac{\text{Fixed cost}}{\text{Sale in nos.}} = 600 + \frac{200,000,000}{1,000,000} = ₹ 800$$

Suppose the manufacturer wants to earn a markup or target profit of 25 per cent on sales, the mark-up or cost-based price is worked out as follows:

$$\text{Cost – based price} = \frac{\text{Cost per unit}}{(1 - \text{Target profit on sales})} = \frac{800}{(1 - 0.25)} = ₹ 1067$$

Cost-based pricing method is used typically by construction companies by estimating the total project cost and adding a markup or profit. Marketing research agencies, chartered accountants and lawyers also use this method by adding a profit margin on their time and cost.

The arguments favouring cost-based pricing are that it is fair to both buyers and sellers. Sellers do not take advantage of buyers when the buyers demand becomes less, and sellers earn a fair return on investment. Second, suppliers can estimate costs more easily than they can estimate demand. Third, price competition is minimised, if all supplier firms use cost-plus (or cost-based) pricing method.

However, there are a number of difficulties with cost-based pricing. First, this method ignores current demand, customers' perceived value, and competition, and hence it will not lead to optimal price. Second, many supplier firms lack an accurate understanding of costs, including those firms who have established activity-based costing for their production, but may have neglected customer service and components of sales and marketing. Third, when fixed costs are shared by many products, it is difficult to allocate these costs among individual products. Fourth, the costs are based on expected (or forecasted) sales volume. If the product offering is priced high (compared to competitors' prices), the number of units actually sold may fall below the forecasted volume, making the costing calculations wrong. Thus, this method of pricing will work if the cost-based price actually achieves the sales equal to the expected or forecasted sales volume.

### Value-Based Pricing

An increasing number of business marketing firms are using value-based (or perceived-value) approach for setting prices. In this method, the price is set based on the customer's perceptions of the value of the product or market offering. Business marketers must deliver the value promised by their value proposition, and it is important that target customers must perceive this value. Business market managers use various communication mix elements like advertising, the internet, trade shows, and salespeople to communicate and increase the value (or perceived value) in buyers' minds.<sup>13</sup>

The customers' perceptions of the value of the product or product offering are made up of several parts, such as the customer's impression of the product performance, quality, warranty service, technical support, and supplier's reputation. In addition, each prospective customer gives different degree of importance (or weightage) to these parts. This may result into three broad groups of buyers—price buyers, value buyers, and loyal buyers. Business marketers have to develop different strategies for these three groups of customers. One strategy for price buyers could be to offer the basic product, without any tangible benefits (e.g. product features) and intangible benefits (e.g. door-delivery, or training). For value buyers, the company should offer additional product features (e.g. a camera with LCD projector) and extended warranty period (like 3-years instead of standard one year warranty period). For loyal buyers, the business marketer should invest its resources in relationship building.

To achieve success in value-based pricing, the business marketing firm should first undertake marketing research to understand clearly the decision-making process and the value drivers of the target market segments and customers. The company should then decide its value propositions for different groups or segments of customers. Thereafter, the firm should deliver more value than its competitors and show clearly this aspect to its target customers.<sup>14</sup>

DuPont company is one of the companies that uses the value-based (or perceived-value) pricing method. When the company markets chemicals, each chemical offering is seen as a solution to a customer's problem, rather than a commodity. This is illustrated by an **example**: Regarding one particular chemical, the company makes two offers, viz. standard and premium. The standard offer's price is \$100

a pound, and this chemical has more impurities (i.e. lower quality), longer delivery period (i.e. within two weeks), and only chemical is supplied (instead of supply of total system). The premium offer's price is higher at \$105 per pound, with less impurities (i.e. higher quality) of the chemical, shorter delivery period of within one week, and supply of total system. In this, DuPont gives its customers a choice by offering its chemical at different prices for different values.

### Competition-Based Pricing

Some business market managers follow competition-based pricing method by setting their prices in relation to what the competitors' prices are. They set the price the same as the dominant competitor, or slightly higher or lower due to perceived difference in product quality, delivery service, or reputation. Any changes in the prices by the dominant competitor are copied by other players without much changes or thinking. **For example**, in the precision steel tube industry, sometime ago competition-based pricing method was followed in India. Out of about 10 players in the industry, two dominant suppliers, whose product quality, reliable delivery, and company reputation was perceived higher by the organisational buyers, received higher share of business and also higher prices. Next to them were two other suppliers whose product quality and delivery performance was perceived by the buying firms as acceptable or average and hence received lower market share and also lower prices (i.e. about five per cent lower than the prices of dominant suppliers). Balance six suppliers sold the product at much lower prices to small and medium enterprises, since the large buyers could manage their supplies of precision steel tubes from the top four suppliers.

In competition-based pricing, often the supplier with the highest market share provides price leadership. It is difficult for marketing managers of supplier firms to know competitors' prices accurately, because competitors may give discounts or rebates which are not shown in the invoices. Even customers may not give correct information about the prices of other suppliers. However, many suppliers do not accept these realities and keep on reducing the prices to match or quote lower than competitor's prices. By following this method of pricing, marketing managers may be giving away value of their market offerings.

Competitive bidding and negotiated prices are common practices in business markets, particularly due to the purchasing practices followed by government organisations. This will be discussed subsequently in the pricing strategies for different product and market situations.

## THE PRICING STRATEGIES

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There is not much difference between the terms pricing methods and pricing strategies, as both are used for setting or establishing the basic or book prices, which is generally referred to as list prices. Both are a part of the pricing process, which includes an analysis of five factors (also called as price determinants)—viz. pricing objectives, demand, costs, competition, and government regulations—that we discussed earlier in this chapter. The pricing strategies that we will examine here are relevant to specific product-market situations. These are as follows:

1. Competitive bidding and negotiation.
2. Pricing new products.
3. Pricing across the product-life cycle.

## Competitive Bidding and Negotiation

In competitive situations of business markets, it is seen that competitive bidding and negotiation of prices are common strategies adopted by purchasing departments of government and commercial organisations. In negotiated pricing strategy, the buying organisation negotiates not only prices but also technical specifications (for non-standard products and services), delivery period, quantity to be purchased, payment terms, transportation costs, and so on. For a standard product, the starting point of negotiation may be the list price (or the basic price), but it gets changed to net price after negotiation of discount. Many buying firms first conduct technical negotiations (for complex and non-standard or customised product/service), and thereafter they go on to commercial (including price) negotiations. Negotiated pricing is similar to open bidding, which we will discuss shortly. The process of negotiation generally starts with a quotation or a bid, which gets modified during negotiation based on the requirements of buying and selling firms. We have discussed various aspects of negotiation in Chapter 4.

A large volume of business in the business market is decided through competitive bidding. Generally, selling to government undertakings (e.g. state electricity boards, department of telecommunication, railways) and public sector companies (e.g. Bharat Heavy Electricals Ltd., Engineers India Ltd.) are done by competitive bidding. In private sector (or commercial enterprises), competitive bidding is much less and is generally used to buy non-standard materials or fabricated products which are made as per the buyers' specifications. In competitive bidding to government buyers, generally the orders (or contracts) are decided in favour of the lowest price bidders. However, in case of commercial enterprises, the orders are finalised based on the evaluation of bidders' quality, design, delivery, and price factors. Competitive bidding can be either closed or open.

In closed (or sealed) bidding, the government or public sector buyer invites the potential suppliers through newspaper tender notices to submit written sealed bids (often in the buyers' tender papers). Typically, all the sealed bids are deposited by the potential suppliers in a tender box kept in the buyer's office by a specified date and time. The sealed bids are then opened on a specified date and time in the presence of the representatives of the potential suppliers. Each bidder's price and other commercial terms are read out. Subsequently, the orders are placed on the lowest price bidder who meets the desired specifications of the product. If the value of the tender is large, the government buyer may decide to place orders not only on the lowest price bidder (**L1**), but also on the second lowest (**L2**) bidder and the third lowest (**L3**) bidder. These orders may be placed on decreasing percentage share of the total value of the tender, provided **L2** and **L3** bidders agree to match the price of **L1** bidder. There are other commercial terms and conditions involved in government tenders which will be discussed subsequently in this chapter.

In open (or negotiated) bidding, the buyer asks the potential suppliers to submit bids (or quotations or offers). The buyer after studying the various offers, negotiates the commercial and technical aspects of the offers with the suppliers, and thereafter, finalises the orders. Open bidding method is generally followed by commercial enterprises in private sector. It is particularly appropriate when the offers for products and services of competing suppliers vary considerably. Open bidding is a combination of bidding and negotiation. In this way, open bidding and price negotiation methods are virtually synonymous.



**Strategy for Competitive Bidding** One of the commonly used strategies is *probabilistic bidding*. This strategy (or technique) makes two assumptions: (i) The pricing objective is profit maximisation, and (ii) The buying organisation will decide the order on the lowest price bidder.

Three variables are used in this technique: (a) amount or price of the bid; (b) expected profit if the bid price is accepted; and (c) the probability of acceptance of the bid price. A business marketer tries to seek an optimum trade-off between the bid price or profit on one hand and the probability of winning the contract on the other. The basic equation used here is as follows:

$$E(A) = P(A) \times T(A),$$

where

A = Bid price in rupees.

E(A) = Expected profit at bid price A.

P(A) = Probability of acceptance of the bid price A.

T(A) = Profit if the bid price A is accepted.

For a business marketer the most difficult task is to estimate the probability of the acceptance of its bid price as *being the lowest*, i.e. the variable P(A). The ability to estimate P(A) correctly depends on the marketer's knowledge of the competitors' costs, strengths and weaknesses, and the mind-set.

Let us consider **an example** of a business firm—EPL—bidding for a government tender, valued at ₹ 60 crore, for the supply of underground cable jointing kits. There are 18 firms which are expected to submit the bids and the lowest bidders (as the value of the tender was large, more than one bidder) are likely to get the orders. The total cost per unit of EPL Company is ₹ 350. The marketing manager's assessment on the possible bid prices and the probabilities of winning are shown in Table 12.3.

The optimum bid price in Table 12.3, where the expected profit is the highest, is ₹ 400. EPL Company, therefore, submits its bid at ₹ 400. When the government buyer reads out the price bids of the 18 bidders, the lowest bid price (L1) is ₹ 330, the second lowest (L2) price is ₹ 350, L3 is ₹ 380, and EPL Company's price of ₹ 400, is L4. The buyer places 40 per cent of the total order of ₹ 60 crore on L1 bidder, 20 per cent on L2 bidder, 10 per cent on the three L3 bidders, and five per cent on the two L4 bidders, after L2, L3, and L4 bidders agree to match L1 price.

This shows that EPL Company went wrong in not estimating the competitors' costs and not analysing and minimising the company's cost per unit.

## Pricing New Products

There are two pricing strategies available for a new product which is in the introductory stage of its life cycle. These are: (i) Skimming (high initial price) strategy, and (ii) Penetration (low initial price) strategy. While evaluating these strategies a business marketer must study the price from the business buyers' perceptions. Another factor to be considered by a marketer is how soon the company should try to recover the investment on the new product.

**Table 12.3** Application of Probabilistic Bidding Technique

<i>Bid Price (₹) (A)</i>	<i>Total Cost Per Unit (₹) (C)</i>	<i>Probability of Winning at this Bid Price P(A)</i>	<i>Profit (₹) <math>T(A) = A - C</math></i>	<i>Expected Profit (₹) <math>E(A) = P(A) \times T(A)</math></i>
450	350	0.00	100	0
440	350	0.05	90	4.50
430	350	0.15	80	12.00
420	350	0.25	70	17.50
410	350	0.40	60	24.00
400	350	0.50	50	25.00
390	350	0.60	40	24.00
380	350	0.72	30	21.60
370	350	0.85	20	17.00
360	350	0.90	10	9.00
350	350	0.92	0	0
340	350	0.95	(10)	(9.50)
330	350	1.00	(20)	(20.00)

**Skimming Strategy** This strategy is used for a distinctly new product which is to be purchased by a market segment that is not sensitive to the initial high price. It has an advantage of recovering the investment in the development of the new product sooner by generating larger profits. A business marketer thereafter reduces the price to reach other market segments that are more price sensitive. The disadvantage of the skimming strategy is that it attracts competition due to high profits. Hence, this strategy is appropriate for a new product that is distinct, high on technology, or capital intensive—the factors which would create a strong barrier to market entry for the competitors. The skimming strategy is also appropriate if the demand curve is stable over a period of time and the production costs decline with accumulated production volume (application of experience curve effect).

**Penetration Strategy** This strategy is effective when (i) price elasticity of demand is high or the buyers are highly price sensitive; (ii) strong threat exists from potential competitors; and (iii) opportunity exists to reduce the unit cost of production and distribution with increase in volumes.

The company can draw on the experience curve effect and can also achieve the economies of scale. This would give the company a strategic advantage of cost leadership over the competitors. Instead of short-term profit objective, the company can adopt the pricing objective of long-term profit through large market share.

In penetration strategy, the supplier organisation plans to make its overall profit by selling a larger number of product items at a lower profit per item. Whereas in skimming pricing strategy, the selling firm aims to make its overall profits by selling fewer items at a higher profit per item. When a supplier firm follows a strategy of using skimming (i.e. high initial price) at the beginning, followed by penetration (i.e. low) pricing as the product matures, it is referred as **time segmentation** by Joel Dean.<sup>15</sup> The main point to be remembered is that the pricing strategy of a business marketing firm can

be known only after understanding the marketing strategy of the firm, because pricing strategy has to be in harmony with other marketing strategies.

### **Pricing Across Product Life-cycle**

Pricing strategies vary as the industrial product moves through its economic life-cycle. The concept of the product life-cycle (PLC) was discussed in Chapter 7. The pricing strategy is a key factor in each of the four stages of the PLC. We have already discussed earlier the pricing strategy in the introduction stage (i.e. pricing new products). We shall now discuss the pricing strategies in the other three stages.

#### ***Growth Stage Pricing Strategy***

During the growth stage of the product, new competitors enter the market and more customers start using the product. Business marketers, therefore, face a pressure of lowering the prices below the introduction stage. In the growing market, the business marketer tends to focus on product differentiation, product line extension, and building new market segments. Business buyers follow the purchasing policy of developing more than one supplier as more suppliers enter the market. This puts the pressure on the innovator firm to lower the price.

**For example,** Elechem company, which introduced a new technology in India for joining underground telecommunication cables, focused on building new geographical market segments in order to meet the requirement of the department of telecommunication (DOT) to cater to various divisions located all over the nation. Due to this, the company's sales volume went up substantially in the growth stage, though two more competitors entered the market with the same technology. Instead of lowering the price, the company increased the price of the jointing kit. Substantial profit margin attracted many more competitors, resulting in sudden and major drop in price in the following government tender.

#### ***Maturity Stage Pricing Strategy***

In the maturity stage of the product, the competitors are well-entrenched and aggressive. To increase sales volume, the marketer has to cut into the competitors' market share. This can be achieved by adopting the pricing strategy of lowering the price to match the competitors' prices. Besides, business customers' buying behaviour will take full advantage of the cost-benefit analysis of various suppliers.

**For instance,** Crompton Greaves realised that one of its major products, viz. electric motors, is in a maturity stage of the product life-cycle. The competition is severe both from international and local firms, particularly small and medium enterprises (SMEs). To minimise the pressure on prices and to ensure normal profitability, the company adopted a strategy of better availability of standard motors and faster delivery for non-standard motors compared to that of its competitors. The quality of all motor manufacturers is equally good as they conform to Indian and International standards. The company also practices various cost cutting measures like value analysis and supply chain management concepts.

#### ***Decline Stage Pricing Strategy***

There are a number of pricing strategies open to the business marketer during the decline stage, depending on certain conditions. If the company has built a reputation of good product quality and dependable service, it need not cut the price but reduce the costs to earn some profits. Another strategy is to cut the prices to increase sales volume above break-even volume and use the product to help sell other products in the product-mix. If some of the competitors have withdrawn from the market, the business

marketer can even consider selective increase in prices for some segments of the market which are not price sensitive.

### **Flexible Pricing Strategy**

When business marketing firms face dynamic marketing environment, including demand slow down, double-digit inflation, and extreme competition, flexible pricing strategy becomes a necessity to meet competition and to maintain market share. Flexible pricing strategy means adjusting the prices or profitability for certain products and services, when market conditions change. Most business markets are global and business customers have many alternatives for procurement of products and services. A large business buyer with strategic buyer–seller relationship may suggest a specific price target that the supplier is expected to meet. The price will be finalised through negotiation. Professor Lanzillotti commented that large firms committed to target return pricing found their market share eroding as aggressive competitors sought business with flexible pricing<sup>16</sup>. Hence, target pricing is not as viable today as it was once, and firms are becoming more flexible in their pricing decisions now. Target rate-of-return pricing may be meaningful pricing objective when a company introduces a new product or enters a new market segment. However, when internal and external environment indicate unused production capacity, less demand, high fixed costs, and intense competition, to maintain market share flexible pricing strategy is necessary. Price flexibility does not always mean change of list prices. The net prices to business customers can be worked out with quantity discounts. In addition, extended warranty period, free supply of spare-parts, and extended credit could be considered to contribute to flexible strategy. **For example**, when Owens-Illinois, a large player in glass container industry, raised beer bottle prices by 4.5 per cent, its smaller competitors got orders from major brewers by offering quantity discounts.<sup>17</sup>

### **Customer Relationship and Pricing Strategy**

Business market managers develop pricing strategy depending upon their relationship strategy with different customers. For the customer with whom the supplier firm has transactional relationship, the pricing strategy is to offer lower prices through “defeaturing”, i.e. removing some of features or attributes of the product offering, including door-delivery, installation, training, and technical service. The pricing strategy may include marketing these features and services, in menu-like manner, on an incremental price basis. For the customer with whom the supplier firm has collaborative or partnering relationship, the product offering gives superior value with full-services at lower cost, ensuring substantial cost savings to the customer firm’s operations. In return, the supplier firm seeks higher share of the customer’s business. Collaborative relationship also allows the supplier firm to propose changes in the customer’s product specifications that will enable it to lower its price. The supplier firm modifies or adapts its offerings so that its prices are in line with the requirements of customers with transactional and collaborative relationships.

### **Auction and Reverse Auction Pricing**

Auction and reverse auction type pricing is growing popular, particularly with the growth of the internet. Organisations should be aware of the major types of auctions and their separate pricing procedures.

**English auctions (ascending bids)** In this auction, there is one seller and many buyers. The seller offers an item for sale to interested buyers, who bid until the top price is reached. The item goes to the

buyer who makes the highest bid. English auction is used for selling used equipment and vehicles and generally unwanted items.

**Dutch auctions (descending bids)** This is also called ‘reverse auction’, involving one buyer who invites bids from several interested suppliers, with the order going to the supplier company that makes lowest price bid. Reverse (Dutch) auctions have become a trading mechanism for business buyers. In reverse auction, a buying organisation hosts the online auction and invites suppliers to bid on announced ‘request for quotation’ (RFQ). Reverse auction is simply an electronic form of the competitive bidding process that is described earlier in this chapter, under the pricing strategies. It is claimed that reverse auctions can lower the cost of procuring products and services by more than 20 per cent. Generally, reverse auctions are suitable for commodity-type items like chemicals, diesel fuel and certain raw materials. It is normally not appropriate for strategic relationships where buyers expect superior quality of products and services.

**Sealed-bid auctions** These are not ‘real-time’ auctions like English and Dutch auctions. In Sealed-bid auctions, each bidder or supplier can submit only one bid and cannot know the other bids. All bids are opened at a specified time. The supplier submitting lowest bid price is the winner. Many governments use this method.

**The internet auction** is a fast growing mechanism for B2B transactions. General Electric Company was a pioneer in developing its own in-house auction site, which has become one of the most successful internet auction sites. Subsequently, many other large firms have developed their own in-house auction sites. Independent online auction sites such as eBay and Alibaba.com offer a wide range of B2B auctions.

## PRICING POLICIES

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Business marketers deal with different types of customers (like users, OEMs, and dealers) who buy in various quantities and are located in various geographical locations. To account for these differences, pricing policies are evolved to adjust the base price (or list price) of a product. Besides, business marketing firms do not set a single price, they set a price structure that covers different product items which describe different sizes and specifications of a product.

**For example**, electric motor is a product with different horse power or kilowatt ratings, with different speeds, different enclosures, and different applications. It is, therefore, necessary for a manufacturer of electric motors to set the base prices (or list prices) for the entire range of the product items manufactured.

### Key Terms Associated with Pricing

**List Price** Also called *price list*, it is a base price or the basic price of a product consisting of various sizes or specifications. It is the published statement of basic prices which is sometimes distributed to the customers. The list price statement indicates the effective date of its applicability and mentions the extra charges (as applicable) for optional product features (if any), the excise duty, freight, sales tax, octroi, and/or transit insurance (if applicable). The *net price* is worked out based on list price less discounts (such as trade, volume or cash discounts) shown in Table 12.4, or any other concessions (e.g.

freight charges). The net price is most important to the organisational buyers because that is the price which is applicable to the business buyer after subtracting discounts and concessions. **For example**, if the list price of a product is ₹ 1,000 and the business marketer gives the discount of 10 per cent and the concession of not charging the freight (say, three per cent of list price), the net price is ₹ 870.

**Table 12.4** Application of Discounts to Business Customers

<i>Types of Discounts</i>	<i>Characteristics</i>	<i>Example</i>										
Trade discounts	Offered to intermediaries (i.e. dealers, distributors). Subtracted from the list price of a product item	List price of a product is ₹ 1000 and the product is offered to the company dealer at 15 per cent trade discount Net Price = ₹ 1000 – 0.15 × ₹ 1000 = ₹ 850										
Quantity discounts (non-cumulative)	Granted on the basis of volume of a single purchase to encourage customers to buy large quantities. Subtracted from the list price of a product	<table><tr><th><i>Size of each purchase order</i></th><th><i>Percentage of quantity discount</i></th></tr><tr><td>Less than 10 no.</td><td>Nil</td></tr><tr><td>11–20 no.</td><td>5</td></tr><tr><td>21–30 no.</td><td>10</td></tr><tr><td>31 or more no.</td><td>15</td></tr></table>	<i>Size of each purchase order</i>	<i>Percentage of quantity discount</i>	Less than 10 no.	Nil	11–20 no.	5	21–30 no.	10	31 or more no.	15
<i>Size of each purchase order</i>	<i>Percentage of quantity discount</i>											
Less than 10 no.	Nil											
11–20 no.	5											
21–30 no.	10											
31 or more no.	15											
Quantity discounts (cumulative)	Granted on the basis of the volume of cumulative total purchases over a specific period. Subtracted from the total product value of the bills before taxes and duties	<table><tr><th><i>Total yearly purchases</i></th><th><i>Percentage of quantity discount</i></th></tr><tr><td>Less than ₹ 1,00,000</td><td>Nil</td></tr><tr><td>₹ 1,00,001–₹ 5,00,000</td><td>5.0</td></tr><tr><td>₹ 5,00,001–₹ 10,00,000</td><td>7.5</td></tr><tr><td>₹ 10,00,001 or more</td><td>10.0</td></tr></table>	<i>Total yearly purchases</i>	<i>Percentage of quantity discount</i>	Less than ₹ 1,00,000	Nil	₹ 1,00,001–₹ 5,00,000	5.0	₹ 5,00,001–₹ 10,00,000	7.5	₹ 10,00,001 or more	10.0
<i>Total yearly purchases</i>	<i>Percentage of quantity discount</i>											
Less than ₹ 1,00,000	Nil											
₹ 1,00,001–₹ 5,00,000	5.0											
₹ 5,00,001–₹ 10,00,000	7.5											
₹ 10,00,001 or more	10.0											
Cash discounts	Offered for the prompt payment of a bill (or invoice) within a specified time period	2.5 per cent cash discount is granted if the payment against a bill is made within 7 days from the date of the bill. Otherwise the payment is to be made in 30 days from the date of invoice.										

**Trade Discounts** As the name suggests, the trade discounts are offered to the trade, that is, intermediaries (or middlemen) such as dealers and distributors. The amount of trade discount depends on the particular industry norms or the functions performed by the intermediaries. The details of the various functions performed by middlemen are described in Chapter 9. The business marketer should ensure that the trade discounts are uniform to all the dealers or distributors. Any variance in discounts can amount to violations of Competition Act, 2002.

**Quantity Discounts** A quantity (or volume) discount is granted to business customers who buy large volumes. It is a price reduction given by subtracting the volume discount from the list price. The quantity discounts are justified as they reduce the cost of selling, inventory carrying, and transportation. The quantity discounts are given either on individual orders (i.e. non-cumulative basis) or on a series of orders over a longer period of time, usually one year (i.e. cumulative basis), as shown in Table 12.4. The purpose of quantity discount is to encourage customers to buy larger quantities and to maintain their loyalty. The decision on the quantum of quantity discount depends on demand, costs, and competition analysis.

**Cash Discount** It is common in business market to offer cash discounts to customers with the objective of getting prompt payments. It is a discount applicable on the gross amount (i.e. basic price plus excise duty plus sales tax) of the bill, provided the customer pays the bill within the stipulated period (of say seven or 10 days) from the date of invoice.

**For instance**, against the normal credit granted to a customer of 30 days, if a customer pays the bill in advance or within seven days from the date of invoice, the customer is given a 2–2.5 per cent discount on the gross amount of the bill.

However, sometimes large customers take the advantage of cash discounts but do not make the payments as per the condition of cash discount. One of the ways to correct the situation is that the business marketer should not include cash discounts in the bills, but to give them separately by way of *credit notes* if customers pay the bills within the stipulated period of seven days. However, if the business customers do not accept the method of receiving credit notes and the cheques towards cash discounts, the problem should be resolved through discussions, keeping in mind the importance of buyer-seller relationships.

### Geographical Pricing

Geographical pricing consists of deciding how to price the company's products to customers in different geographic locations. Should the company charge higher prices to customers located at distant places in order to cover the higher transportation (freight) costs and risk losing the sales? Hence, a business marketer must decide how certain costs, such as freight and transit insurance will figure into the overall price structure of the firm. It also involves sales tax and other levies like octroi or entry tax which have bearing on the final (landed) price to customers. In geographical pricing, there are generally two methods of price basis which are stated in the offers or quotations submitted by a seller to a buyer. These are: (i) Ex-factory and (ii) FOR destination.

**Ex-Factory** When a seller quotes to a buyer "ex-factory price", it means that the freight and transit insurance costs are to the buyer's account. In other words, the seller will charge the costs of freight and insurance to the buyer. The more distant customers' landed costs are higher because of freight (transportation) cost. Here, "ex-factory" means the prices prevailing at the supplier's factory gate.

**FOR Destination or FOB Destination** When a seller quotes (or offers) to a buyer "FOR destination or FOB destination" (free on road/free on board destination), it means the freight (transportation) costs are absorbed by the seller or included in the quoted prices. However, transit insurance costs, which are small amounts, are generally absorbed by the seller, but sometimes the goods are dispatched under the *open insurance policy* of the buyer (so that the buyer will take care of insurance formalities in case of any damage or theft in transit). In this method of price basis, all the customers get the product at the same price irrespective of their locations from the seller's factory premise. If the quotation or the price list is on FOR destination basis, generally the business marketer estimates the average freight and insurance costs and adds the same to the basic product prices. Absorbing these costs are rarely done by a seller; it is done only in an intense competitive situation to get business from a particular customer.

### ***Taxes and Levies***

In India, the knowledge of central sales tax (CST), state sales tax, octroi, entry tax, and road tax prevailing in various states is necessary for a business marketer. Sometimes businesses are won or lost due to different levels of central and state sales taxes.

**To illustrate**, if there is a large customer located in Maharashtra, the supplier from Maharashtra charges 10 per cent Maharashtra sales tax in the bill, and another supplier from Karnataka State charges four per cent central sales tax (for inter-state sales, if the customer can submit concessional CST form). Thus, even if the basic price of a product is same, the supplier's price from Karnataka State is cheaper by six per cent on account of difference in sales tax.

### ***Legal Aspects***

Business marketers should be aware of legal aspects in pricing policies or administration. Legally, all competing customers must be offered similar prices, discounts, and other terms of sale. As per the, the Competition act (in India), or the Robinson–Patman Act (in U.S.A. ), it is unlawful to “discriminate in price between different purchasers of commodities of like grade and quality .....where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly, or to injure, destroy, or prevent competition”. Price differentials are permitted, but they must be based on cost differences or the need to meet competition<sup>18</sup>.

## **COMMERCIAL TERMS AND CONDITIONS IN BUSINESS MARKETS**

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It is important for sales/marketing persons to have knowledge and understanding of commercial matters at the time of preparation of bids (or quotations), and while negotiating with business customers. We shall, therefore, discuss some of the commercial terms and conditions prevalent in business markets, particularly in India.

### **Terms of Payment (TOP)**

Generally, there are two broad types of TOP: **(i)** Direct payment, **(ii)** Payment through bank. These are used by private sector organisations. However, most government or public sector organisations use “95/5 or 98/2 per cent” payment terms.

**Direct Payment** Credit is normally offered to a customer who is a good paymaster or creditworthy. The goods are despatched directly to the customer and the bill or invoice is sent to the customer along with other documents such as invoice-cum-excise gate pass (for excisable goods), delivery challan (sometimes it is invoice-cum-challan), inspection (or work test) certificate and consignee copy of lorry receipt (LR) or rail receipt (RR). A seller may allow 10, 15, 30, 45, 60, or 90 days' direct credit to a buyer, depending on the agreement between the seller and the buyer. However, this is not considered as a secured or safe payment term. To make it more safe, the seller sends the consignee copy of RR or LR to the branch sales representative who collects payment (by demand draft) from the buyer before handing over the consignee copy of LR (or RR). Only after the receipt of the consignee copy of LR (or RR), the buyer can collect the goods from the transporter (or railway yard).



**Payments through Bank** These are of different types, viz. (i) LC (letter of credit); (ii) DA (documents on acceptance); and (iii) DP (documents against payment). Whenever payments are through bank, with LC, DA, or DP terms, the supplier routes the bill and other documents (such as LR/RR, challan, inspection certificate) through the bank. LC is the safest as the payments are assured, provided there are no mistakes in LC. It is better to check the correctness of the LC on receipt and before despatch of goods. The LC can be with credit of 30, 45, 60, or 90 days', or without credit (at sight).

Next to LC, *DP terms* of payments are safe. In case of DP terms, the documents (i.e. bill, LR/RR, test certificate and challan) are sent to the customer's bank without any credit. Only after the customer makes the payment to the bank, the documents are handed over to the customer by the bank, for taking delivery of the goods from the transporter (or railway) against the consignee copy of LR/RR.

Care should be taken by supplier to despatch the goods through the supplier's reliable transporter, otherwise sometimes unscrupulous transporters hand over the goods to buyers without the consignee copy of LR (i.e. without the buyer paying the bill for the goods sent through the transporter). However, if the buyer does not retire the documents (i.e. pays the bill) within the grace period given by the bank, the buyer's bank returns the documents unpaid to the supplier's bank, and the goods remain with the transporter/railways incurring demurrage (i.e. extra charges towards storage).

In case of *DA terms*, the documents are sent through the supplier's bank to the buyer's bank on 30, 45, 60, or 90 days' credit. The buyer's bank hands over the documents to the buyer on getting the acceptance (signature) that the payments will be made (promises to pay) on due dates. The buyer can then collect the goods from the transporter/railway against LR/RR. However, if the buyer does not pay on the due date, the buyer's bank returns the documents unpaid to the supplier's bank. The supplier has no other way but to persuade the buyer to pay or in extreme case take legal action. Hence, DA terms (although they are routed through bank) are not assured or safe.

A supplier can get *bill discounting* limits sanctioned by the bank for discounting the bills (or *hundis*) for credit bills of LC/DA payment terms. The advantage of bill discounting scheme is that the supplier gets immediate payments from the bank to the extent of 75 to 100 per cent of the bill amount. However, the bank will deduct its commission plus the interest amount for the bill discounting facility. In case the discounted bill is returned unpaid, the supplier's bank debits to the supplier's account the bill value plus penal rate of interest over and above the normal bank rate. If the bills are not discounted, such bills are sent for collection of payments through the bank in the usual way.

**95/5 or 98/2 per cent Payment Terms** These terms are used by government organisations like Indian Railways, Department of Telecommunication (DOT), DGS&D (Director General of Supplies and Disposal), and so on. In case of 95/5 per cent payment terms, 95 per cent payment is made by the government customer after the supplier sends the bill (with 95 per cent of the total amount of the bill) along with proof of despatch (RR/LR), delivery challan, and inspection certificate. However, 95 per cent payment is released immediately only if railway receipt (RR) is enclosed with the bill. In case of despatch by road through lorry, 95 per cent payment is released only after the material is received by the consignee in good condition, and after receipt of bill copy payable challan (BCPC) duly certified and acknowledged by the consignee along with inspection certificates. The balance five per cent payment is released to the supplier only after getting the certified copy of BCPC along with bill with five per cent on the total bill value.

The 98/2 per cent terms of payments are applicable for running contract of DGS&D or Indian Railways or other Government-undertakings. The system of payments is similar to 95/5 per cent described earlier.

**Bank Guarantees** Some business customers, particularly the Government undertakings, ask suppliers to furnish bank guarantees (BG) towards the security deposit for the fulfilment of the contracts. The values of BG towards security deposit are specified sometimes as five per cent of the ordered value with a ceiling of say, ₹ 75,000 or ₹ 1,00,000. Generally, the BG for the security deposit should be furnished by the supplier to the buyer within two weeks from the date of placement of the order. The period of BG may vary, depending on delivery period of the order, from six months to three years.

The bank guarantees are also furnished towards *bid guarantee* at the time of submission of the bids (or quotations) by suppliers instead of payment by demand draft towards EMD (earnest money deposit) or bid guarantee.

Some business buyers ask for bank guarantees from new suppliers while making advance payments against orders.

It should be remembered that the bank charges its commission and also collects margin money from the firm which wants a BG. The margin money is to be deposited in the bank, generally, by way of fixed deposit.

In case the BG is submitted against security deposit and the supplier does not fulfil the contract (non-completion of the order), the buyer can invoke the BG and collect its value. However, the BG can be extended at the request of the supplier for which the bank will charge its commission for the extended period. If the validity period of the BG expires, the buyer cannot invoke (get the money against) the BG. In such cases, the expired BGs are returned to the bank by collecting the same from customers.

**Price Basis** Generally, the prices for industrial products are quoted excluding excise duty, sales tax or any other Government duties/levies (such as octroi, entry tax, etc.). As mentioned earlier, the prices are quoted on the basis of ex-works or FOR destination. Generally, the price for the product quoted on ex-works (or ex-factory) basis would include net price of the product and the cost of packing and forwarding. The ex-works price does not include excise duty, sales tax, octroi (if applicable), freight and transit insurance. In case the price is quoted on the basis of FOR destination, the price is inclusive of packing, forwarding, freight, transit insurance, but is exclusive of excise duty, sales tax, octroi/entry tax (if applicable).

The prices are quoted either *firm* (no changes in price), or with *price variation clause* (PVC), or prices ruling at the time of delivery (called PRD). Generally, PRD clause is not acceptable to most customers except in a monopoly or in case of violent changes in price situations. However, for long delivery orders and in uncertain raw material price situations, a supplier may quote price variation clause with a formula which is acceptable to both the parties. In certain industries (such as electrical), the PVC formula is finalised by the industry association in consultation with the representatives of suppliers and buyers. Generally, the firm prices are prevalent for most industrial products excepting in cases of long (over six months) deliveries and violent price variations of raw materials.

**LD/Penalty** When a buyer mentions in the enquiry that “the delivery is the essence of the order/contract”, it means that legally the supplier is bound to meet the delivery period mentioned in the order/contract. If the supplier fails on delivery, the purchaser will enforce the penalty by use of liquidated damages (LD) or risk-purchase clauses of the enquiry (or the purchase order).

Generally, the penalty against LD clause for late delivery is charged at the rate of half per cent per week or two per cent per month, on the undelivered portion of the order, subject to a ceiling of five to ten per cent of the ordered value.

In **risk-purchase clause**, after cancelling the order on the supplier, the purchaser procures the same material from other suppliers at the risk and cost to the first supplier. That is, if the prices are higher from other suppliers compared to the purchase order prices of the first supplier, then the difference in the value of prices are recovered from the first supplier along with any other costs incurred. The penalty amount is generally recovered from the security deposit bank guarantee furnished by the supplier to the purchaser.

## ROLE OF LEASING

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Leasing, as an alternative to direct purchase, is gaining increasing importance in the business market and has experienced excellent growth.<sup>19</sup> The main benefit of leasing is that it provides greater tax protection than depreciation or investment payments.<sup>20</sup> A business marketing firm can make leasing arrangements for capital equipment in three different ways: (1) the firm can lease directly to the business customer by working out lease and financing arrangements itself; (2) the firm arranges leasing through other large organisations who form credit subsidiaries to provide leasing to business buyers; (3) the firm arranges leasing to its business customers through a bank or financial institution who is involved in leasing industrial equipment.<sup>21</sup>

Business buyers have an option of either buying or leasing capital items. A **lease** is a contract through which the asset owner (called lessor) extends the right to use the asset to another party (called lessee) in return for periodic payment of rent over a specified period. Many capital items such as heavy-construction equipment, machine tools, material handling equipment, are available for leasing.

### Lease versus Purchase

Business buyers examine the cost/benefit trade-off of alternatives of buying versus leasing. If the benefits of leasing are more than the benefits of owning a capital item, the business buyer will lease instead of purchasing the product. The benefits of leasing are: (a) conserving capital; (b) gaining tax advantages; and (c) getting the latest products. The cost of leasing includes the lease payment and sacrifice of asset's salvage value. Business buyers have to basically evaluate the costs/benefits of the lease based on whether the cash flow benefits of the lease exceed the cash flow costs.

### Types of Leases

There are two types of leases: (i) Financial (or full-payment) leases, and (ii) Operating (or service or rental) leases.

**Financial Leases** These are non-cancellable, long-term agreements or contracts and are fully amortised. The sum of the lease payments over the contract period equal or exceed the original purchase price of the capital item. The buyer is generally responsible for operating and maintenance expenses. The buyer is usually given the option of purchasing the asset at the end of the contract period, on the basis of the assets' fair market value.

**Operating Leases** In contrast these are cancellable, short-term agreements or contracts, and not fully amortised. Because the asset is provided for a short period, the purchase option is not included. The rates for operating lease are usually higher than the rates for financial lease because the responsibility of the operating expenses and the risk of obsolescence are that of the marketer (or the lessor).

## Pricing Strategy in Leasing

The business firm that markets the capital items should consider the prospective customers needs and problems. Some business firms have responded to the needs of the buying organisations by creating the position of specialist representative who can provide financial consulting services to the buying-centre members for leasing or outright purchase. Xerox Corporation is one such company.

Depending on the marketing objectives of the firm, the pricing strategy could be decided out of the possible three alternatives: (i) decide lease rate to favour leasing, (ii) decide the lease rate to favour outright purchase, and (iii) achieve the balance between lease rate and sale rate. To stimulate the demand for new capital items, the firm may decide to offer alternative lease rates so that the potential adopters (customers) can try the new product on a limited basis.

### SUMMARY

Business buyers purchase the product from the supplier who offers the highest delivered value, which is the difference between perceived benefits and the total costs. The total cost of a product includes not only the price but also other costs such as freight, transit insurance, and installation. The factors which influence the pricing decisions must be considered before the pricing decisions are made. These factors are: pricing objectives, demand analysis, cost analysis, competitive analysis, and government regulations.

*Pricing objectives* are numerous. Some of these are survival, maximum short-term profits, maximum market share, market penetration, market skimming, and product quality leadership.

*Demand analysis* includes estimation of demand schedule and cost-benefit analysis. Business marketers must measure the relationship between price and demand for their products. For an effective price-setting, understanding how business customers evaluate cost/benefit is important.

Business marketers must understand the various types of costs and how the costs can be reduced by using the concepts of *economies of scale* and *experience curve*. The *break-even analysis* is a useful financial technique to consider the effect of different prices on the sales volume and profits.

Information on the competitors' prices and other parameters is useful in evolving pricing strategy and product positioning. A firm must study the competitors in order to predict their responses to the price changes initiated by the firm.

After analysing the five factors which influence the pricing decisions, the first pricing decision made by the business marketer is setting the basic price of a product. For this, there are three major pricing methods: (1) cost-based, (2) value-based, and (3) competition-based.

The *pricing strategies* vary depending on product and market situations, such as competitive market, new products, and product life-cycle. In competitive bidding, pricing strategy used is probabilistic bidding. For new industrial products, firms can use *skimming* or *penetration strategy*. Different pricing strategies are used when the product moves across growth, maturity, and decline stages.

Sometimes business marketers use flexible pricing strategy when marketing environment indicates less demand, intense competition, and unused production capacity. Besides, business market managers adopt different pricing strategies for different types of customer relationships.

Online auctions and reverse auctions are popular in business marketing with the following types: English auctions (ascending bids), Dutch or reverse auctions (descending bids), and sealed-bid auctions.

Pricing policies are evolved to adjust the basic price of a product to different types of customers who buy different quantities, and are at various geographical locations. Business customers are given

different types of discounts on the basic prices (or list prices). These are trade, quantity (cumulative and non-cumulative), and cash discounts. *Geographical pricing* decides how to price the products to customers in different geographical locations.

Discussion on the various commercial terms and conditions prevailing in business market would help the marketers in bidding and negotiating with business customers. The role of leasing is important for capital items when business buyers examine the alternatives of buying versus leasing. In such situations business marketers should respond with appropriate pricing strategies.

### KEY TERMS

- Auctions
- Break-even volume
- Demand analysis
- Economies of scale
- Ex-factory pricing
- Financial leases
- Flexible pricing
- FOR destination pricing
- Geographical pricing
- Hard and soft benefits
- LD clause
- Learning/experience curve
- Life-cycle costing
- List price
- Operating leases
- Penetration strategy
- Price elasticity of demand
- Reverse auction
- Risk-purchase clause
- Skimming strategy
- Value-based pricing

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. Can a company achieve profitable operations by following a strategy of market dominance through low prices? Discuss.
2. Is it a good strategy for a capital goods manufacturer to use “life-cycle costing” concept? Explain.
3. The concept of learning (or experience) curve states that as experience is gained, the costs decline. Does this happen automatically?
4. Why price determinants must be analysed by business marketers before making pricing decisions? What types of price decisions are generally made by business market managers?
5. Mention the major methods used for price-setting in business marketing. Describe any one of these methods.
6. Under what situations skimming pricing strategy is appropriate?
7. Explain the differences between closed and open bidding methods. Why closed or sealed bidding method is more commonly used by government organisations?
8. How can business marketers justify use of trade, quantity and cash discounts? Which legal issues they should be aware when discounts are administered?
9. Why leasing is gaining importance in business marketing for capital goods?

**OBJECTIVE TYPE QUESTIONS**

1. The highest customer perceived (or delivered) value is the difference between overall perception of benefits and the total: (a) benefits, (b) cost, (c) attributes, (d) all of them, or (e) none of them.
2. The factors which influence pricing decisions include: (1) pricing objectives, (2) demand analysis, (3) cost analysis, (4) competitive analysis, and one of the following: (a) external environment, (b) internal environment, (c) government regulations, or (d) none of these factors.
3. If the price of a product is reduced by five per cent, and the quantity of the product demanded increases by eight per cent, the demand is said to be: (a) elastic, (b) inelastic, (c) either elastic or inelastic, or (d) none of the above.
4. The concept of life-cycle costing is increasingly used by buying organisations typically for: (a) materials and parts, (b) capital items, (c) supplies and services, or (d) all of them.
5. The decline in the costs in the concept of learning curve happens due to: (a) large size of the plant, (b) superior planning, (c) accumulated production, or (d) none of the above.
6. Predatory pricing aims at: (a) achieving profitability, (b) driving out competitors, (c) adherence to government regulations, or (d) giving superior value to customers.
7. Skimming pricing strategy is used in the: (a) introductory, (b) growth, (c) maturity, or (d) decline stage of product-life cycle.
8. List price of a product indicates: (a) net price, (b) basic price, (c) lowest price, or (d) maximum retail price.
9. When a supplier quotes the price basis as FOR destination, it means that the cost of transportation (or freight) is to: (a) the buyer's account, (b) the distributor's account, (c) the seller's account, or (d) transport carrier's account.
10. Financial leases have: (a) short-term, (b) medium-term, or (c) long-term agreements between a lessor and a lessee.

**APPLICATION QUESTIONS**

1. A tyre manufacturing company finds its sales performance substantially below the targeted sales at the end of the half-yearly performance review. The head of marketing proposes a price reduction of seven per cent. What factors should the firm consider before deciding to reduce the price?
2. A power transformer manufacturing company wants to quote in response to a closed (sealed bid) tender notice from a state electricity board, valued at ₹ 50 million. If you were working in the company's sales office and your senior asks you to recommend a strategy to win the contract and also to make a profit, what will be your response? (You can make suitable assumptions, if needed).
3. A machine-tools manufacturing company wants to give a choice to its business customers of outright buying or leasing its newly developed CNC (computerised numerical control) machines. What are the different ways the company can make leasing arrangements for the CNC machines? What should be the pricing strategy for these new machines for (a) setting the price for selling, (b) determining the relationship between sale rate and lease rate?

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**CASE 12.1****SL Business Systems (India) Limited: Pricing a High Quality Product\***

The marketing manager of SL Business Systems (India) Limited wondered why the sales of the printer had not achieved the sales target for the first quarter of the financial year 2006–07. The company had adopted the pricing strategy of pricing its printer at ₹ 1,50,000, which was double the prices of its major competitors like HP and Canon, who had priced their printer at ₹ 75,000.

SL Business Systems (India) Limited was a joint venture company between a leading Japanese Corporation and a well-known Indian engineering corporation. The marketing manager of the company thought that the customers knew about the superior quality of their printer as compared to other suppliers' printers and hence, the existing and prospective customers would pay for the higher initial price. He felt that there was no time to carry out a market survey as that would have taken about 5–6 months, which would have delayed the introduction of the printer in the market.

The company realised the importance of communicating to the current and potential customers about the superior quality of the company's printer and the long-term monetary benefits of the printer over other printers. The cost per print out copy of the company's printer (including consumables like toners, developers, drums, etc.) was ₹ 0.35, and that of other printers was ₹ 1.00.

The distribution channels included personal selling through the company's ten branches established at major industrial cities, online marketing, as well as authorised distributors to sell and service to business customers and household consumers all over India.

The marketing manager was not sure if the sales would pick-up in case the company made an effective communication to its present and prospective customers about its superior quality and higher initial price of the printer.

**Question**

If you were the marketing manager what would you do and why?

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Navdeep Kaur Grewal, Niloy Rajbangshi, and Nitanshi Gupta, MBA students of Alliance Business Academy, Bangalore.



# 13

## Planning, Implementation, and Control in Business Marketing

*After studying this chapter you should be able to:*

- Understand the characteristics of market-oriented firms.
- Examine the role of marketing in strategic planning.
- Learn strategic planning at corporate and business unit levels.
- Know the role of strategic alliances.
- Understand implementation of business marketing plan.
- Examine the marketing control process and types of marketing control.
- Know ethical aspects in business marketing.

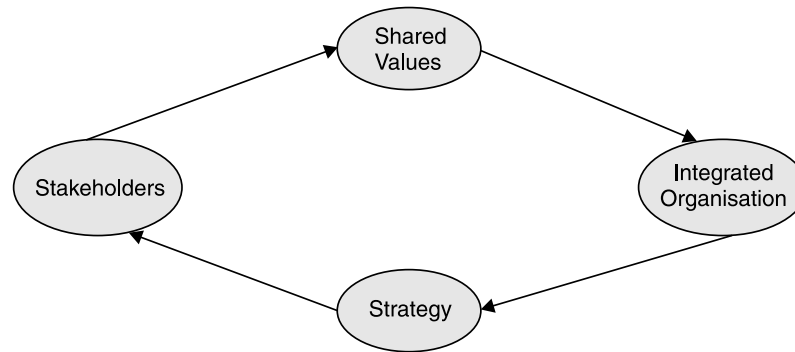
The challenges faced by today's business marketers are growing domestic and global competition, and rapidly changing markets and environment. To meet these challenges, business firms are recognising the importance of strategic planning. As a result of unexpected upsets in American industry, conventional long-term planning was converted into strategic planning in the 1970s. The **aim of strategic planning** was and even today is to keep the organisation successful in the face of changing markets and environment. An effective strategic planning includes market-oriented strategies in which marketing function has an important role.

### CHARACTERISTICS OF MARKET-ORIENTED ORGANISATIONS

Market-oriented organisations stay close to the customers and ahead of the competitors. They understand the basic principle that the purpose of a business is to attract and satisfy customers at a profit. As shown in Fig. 13.1, companies achieve market orientation by managing the following factors: (i) Shared values; (ii) Integrated organisation; (iii) Strategy; and (iv) Stakeholders.

#### Factors Affecting the Market Orientation

**Shared Values** The market-oriented organisation understands clearly customers' needs and preferences. It also identifies and understands major competitors' strengths, weaknesses, strategies and capabilities. The market-oriented organisation then offers superior value (more benefits at less cost than competitors) to its target customers. The shared value of customer first or **customer focus** is effectively implemented by deploying the skills and resources of the entire organization to satisfy customers. **For example**, Dell company's built-to-order process enables it to understand clearly the specific features needed by the buyer. It, therefore, offers superior value to its customers.



**Figure 13.1** *Factors of Market-oriented Integrated Organisations*

**Integrated Organisation** Market-oriented companies are effective in integrating all functions to provide superior customer value. These organisations are successful in understanding multi-functional nature of business marketing decision-making. **For example**, Zara, the Spanish apparel producer and marketer, is very effective in overcoming the hurdles of getting people from different functions to share information about the market and to work together to develop innovative products. The speed of Zara's new product introduction and inventory turnover highlights the importance of all business functions working together towards a common purpose.

**Strategy** The organisation's market orientation helps the management to identify and target customer segments whose value requirements provide the best match with the organisation's distinctive capabilities. "Today's customer wants solutions that can improve business" says Natrajan, CEO, Mind Tree Company that has decided to focus on IT and product engineering services. Market driven strategy and its successful implementation leads to consistently good performance. **Examples** can be given of many organisations: Hero cycles, Hero Honda, Bajaj Auto, TVS, TCS, Dell, IBM, and so on.

**Stakeholders** Traditionally, many firms looked after the needs of their shareholders. Today's firms have recognised the importance of understanding and sustaining the needs or expectations of its stakeholders consisting of customers, employees, shareholders, suppliers, and intermediaries. To achieve its objectives, a company must satisfy at least the minimum expectations of each group of stakeholders. **For example**, if a company creates a high-level of employee satisfaction, it results in superior quality of products and services, which in turn creates high customer satisfaction (or customer delight). High customer satisfaction leads to repeat purchase, and hence, higher sales and profits. This delivers high shareholder satisfaction.

Market-oriented strategic planning is the managerial process of developing and maintaining a viable fit between the organisation's objectives, skills, and resources and its changing market opportunities. The aim of strategic planning is to shape and reshape the company's business and products so that they achieve target profits and growth.<sup>1</sup>

## THE ROLE OF MARKETING IN STRATEGIC PLANNING

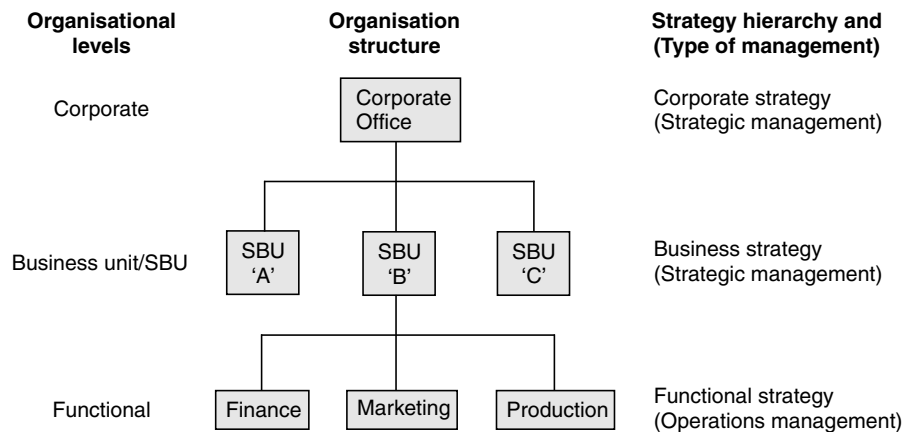
The role of marketing will be better understood, if we examine the hierarchy of strategies.

## Hierarchy of Strategies

In most large and multi-product organisations, strategies are developed at three levels: (i) Corporate strategy, (ii) Business-level strategy, and (iii) Functional strategy.

**Corporate Strategy** This deals with corporate level strategic planning. It includes defining the corporate mission, managing the business portfolio (i.e. deciding which businesses to retain, divest, and enter), and dealing with issues that have company-wide impact (such as allocation of resources to business units, government regulations and capital market access).

The role of marketing at the corporate level is (a) to provide information on competition and customer, (b) to advocate customer orientation and basic value of putting the customer first for long-term corporate strategy.



**Figure 13.2** Strategy Hierarchy and Organisational Levels

Figure 13.2 shows a typical organisation structure of a large business firm. Strategic planning (or strategic management) takes place at two levels of the organisation, viz. at corporate, and strategic business unit (SBU) levels. The third level is functional and it is a part of operations management.

*Strategic management* gives a direction to the firm and focuses on developing strategies to achieve long-term objectives and goals.

*Operational management* maintains the direction given by strategic management and concentrates on day-to-day (short-term) issues of costs, revenue, and profits. It includes all the functions like finance, marketing, production, human resource, R&D, and so on.

A *business strategy* is evolved at a business unit or strategic business unit (SBU) level. A business strategy concentrates on (a) achieving and maintaining the competitive advantage, and (b) deciding the long-term mission, goals, and strategies in a given or changing environment. A *strategic business unit* (SBU) consists of an independent product or a product line that has its own competitors and a specific market. It is a relatively independent business unit, although it may share certain resources with other SBUs to achieve economies of scale. **For example**, in Fig. 13.2, three SBUs are shown for a business firm. Each SBU is headed by a senior executive, and each undertakes its strategic planning process to evolve the business strategy.

The *role of marketing* at business unit or SBU level is to **(i)** help in developing long-term business strategy, including competitive advantage by providing analysis of customers and competitors, **(ii)** develop segmenting, targeting, and positioning strategies, **(iii)** take product-line decisions.

**Table 13.1** Role of Marketing in an Organisation

<i>Organisational Level</i>	<i>Role of Marketing</i>	<i>Formal Name</i>
1. Corporate	<ul style="list-style-type: none"> <li>• Provide information on competition and customer, and advocate customer orientation for developing long-term corporate strategy</li> </ul>	Corporate marketing
2. Business unit/SBU	<ul style="list-style-type: none"> <li>• Provide competition and customer analysis for developing long-term business strategy, including competitive advantage</li> <li>• Develop segmenting, targeting, and positioning strategies</li> <li>• Take product-line decisions</li> </ul>	Strategic marketing
3. Functional	<ul style="list-style-type: none"> <li>• Evolve and implement marketing-mix strategy in short-term to achieve business unit objectives</li> <li>• Coordinate marketing activities</li> <li>• Allocate resources</li> </ul>	Marketing management

**Functional Strategy** This includes efficient utilisation of resources allocated to the various functional areas. It is derived from the business-level strategy. It is a short-term (generally up to only one year) strategy and is a part of operations management, as mentioned earlier. The role of marketing is to focus on evolving and implementing marketing-mix strategy, to coordinate the marketing activities, and to allocate the resources to marketing elements to achieve the business unit's objectives.

As shown in Table 13.1, it is in relationship with strategic management that marketing activity takes on strategic nature and becomes strategic marketing. Strategic marketing focuses on long-term marketing strategy at business unit level. Marketing management deals with developing a marketing-mix strategy in short-term.

## STRATEGIC PLANNING AT CORPORATE LEVEL

The corporate office of a business organisation has the responsibility to set up a strategic planning process. It prepares the time schedule, the formats, and the guidelines for business units or SBUs to prepare their strategic plans including business strategies. We shall first examine the strategic planning process at corporate level, and thereafter, study the strategic planning at business unit level. The major steps involved in carrying out the strategic planning at corporate level are: **(i)** Developing corporate mission and objectives; **(ii)** Defining strategic business units (SBUs); **(iii)** Allocation of resources to SBUs; and **(iv)** Developing corporate strategies to fill the strategic planning gap.

### Corporate Mission Statement

A mission or purpose is defined as the chief executive officer's (CEO's) conception (or vision) of the company's existence or what it should work towards. Sometimes it is also referred to as corporate

concept, vision, or aim. According to Jack Welch, former CEO of General Electric Company, mission statement should say where exactly the company is going how the company intends to win in the business.

An organisation must define its mission or its purpose of existence. Successful organisations develop mission statements for: (a) providing company's employees with a shared sense of purpose, direction, and opportunity; (b) guiding geographically dispersed employees to work independently and yet collectively towards realising the company's business mission; and (c) providing a vision and direction for the company.

### Factors Shaping a Company's Mission

According to Philip Kotler, a company's mission is shaped by five factors: (i) Company history, (ii) Current preferences, (iii) Market environment, (iv) Company's resources, and (v) Company's core competence.

**Company History** Each organisation has a history of objectives, strategies, and achievements. In redefining its business mission or purpose, a firm must not depart too much from its past history.

**Current Preferences** Personal goals and visions of the management and owners should be considered. **For example**, if the owners of an engineering company want to diversify into textile industry, this is going to influence the company's mission statement.

**Market Environment** A company's mission statement is also influenced by the market/business environment. An analysis of the major opportunities and threats faced by a company, as a part of the appraisal of the market environment, should be considered. **For instance**, with the change in business environment after the start of liberalisation and reforms in India since 1991, many marketing research firms had tied up with the world leaders after analysing the opportunities and threats prevailing in the marketing research industry.

**Company's Resources** The organisation's resources determine which missions are possible. **For example**, a small company manufacturing distribution transformers would be deceiving itself if it adopted the mission to become the world's largest transformer manufacturer.

**Company's Core Competence** A chief executive needs to find a creative answer to the most important question of all that can be asked about an organisation: What is the company's core competence? A core competence may be found in any area of a firm's operations, such as R&D, engineering, production or marketing. It may come from not only one area but also from the synergy of the several areas of operations. The firm's core competence is that set of capabilities that translates into a product-market strategy, distinguishing the firm from its competitors in a way that is important to its customers.<sup>2</sup> C K Prahalad and Gary Hamel<sup>3</sup> have defined core competence as one that provides a potential access to a wide variety of markets, makes a significant contribution to the perceived customer benefits, and is difficult for the competitors to imitate.

Another approach to defining the company's core competence is to focus on the customers served, the nature of the needs that are satisfied and the role of the company's product and service offering in satisfying that set of needs. This is generally reflected in the question posed by Peter Drucker: What is

our business? The answer should be phrased in terms of customer's need satisfaction. Theodore Levitt stated that any business must be viewed as a customer-satisfying process and not as a goods-producing process. To elaborate, let us consider some **examples**: companies manufacturing and marketing air-conditioning units, instead of making product-oriented business definition of "we make air conditioners" would like to make market-based business definition of "we provide comfortable climate in the homes and offices". Similarly, a fertiliser company would like to say "we help improve agricultural production" instead of saying "we sell fertiliser", in response to the question—What is our business?

The definition of the firm's core competence not only answers the question—what is our business but also helps in defining corporate strategy (i.e. product-market opportunities) and business strategy (i.e. positioning of the company in the competitive market place). Besides, the definition would commit the company resources to the continued development of its competence and protect itself against the competitive inroads. The core competence may relate to any areas of the company's operations, such as:

1. Basic scientific knowledge in the R&D group which gives the ability to invent effective solutions to customers' problems.
2. Access to critically important raw materials or components.
3. Production skills relating to machinery or processes that allow better quality or cost savings.
4. Technology that produces unique product characteristics or cost savings.
5. Distribution and customer relationships that provide access to specific markets and customers not so readily available to competition.

The definition of core competence must be fitted to the changed competitive market environment. It will be of no use to maintain an internal core competence that is no longer desired by the customers. It requires the management's creativity and insight.

Writing a formal statement of the company's mission after analysing the five elements mentioned above is not easy. Some organisations spend considerable time to prepare a satisfactory statement about the purpose or mission of their companies. However, at present, the company's vision and mission statements are replaced by the purpose and core values.

## Corporate Objectives and Goals

Corporate objectives indicate general statement of the company's outlook with respect to shareholders (such as profitability and growth), and environment (e.g. keeping the environment clean or control the water pollution in the factory). There are no universally accepted procedures for setting objectives. It can be set by a series of executive meetings. However, the basic inputs required to set objectives at corporate level are: (i) expectations of corporate public consisting of owners, employees, customers, suppliers, banks/lenders, government, and community/society; (ii) value system of top management; (iii) corporate resources; (iv) performance of SBUs; and (v) external environment.

The corporate objectives should be translated into specific goals. An **objective** is a broad statement of intent that is not quantified and not limited by a time period. A **goal** is a measurable or quantifiable objective at a specific time period. **For example**, a company may state its corporate objective as "to improve its profitability". The company can translate this objective into a goal by stating that "the company wants to increase return on investment (ROI) to 20 per cent in two years".

Most companies pursue more than one objectives. The objectives may include profitability, growth in sales, environment, technological leadership, innovativeness, and company image. In such cases, the objectives should be arranged hierarchically, that is from the most important to the least important. The objectives and goals must be realistic, consistent, and unambiguous. In the final analysis, setting objectives and goals is a creative exercise.

### Defining Strategic Business Units (SBUs)

Many large companies have several businesses. Some companies define their businesses in terms of products. **For example**, the companies may say that they are in passenger car business or in electric motor business. A better way to define a business is in terms of market (i.e. customer needs and customer groups), rather than product. **For instance**, Xerox company may define its business as “we help improve office productivity” (market definition) rather than “we make copying equipment”. The market definition of a business, helps a company to expand its business into other customer needs and customer groups. Take **for instance** a transformer manufacturing company which defines its business as “supplying power systems to industrial users”. The company can expand its business into supplying power control systems (such as switch gears of various types, depending on customer needs) and expand its customer groups to state electricity boards, manufacturing units in private and public sectors, and international markets.

The purpose of defining the businesses is to manage them strategically. Companies call their business units as strategic business units (SBUs). A SBU has the following characteristics:

1. It has an independent product or product lines (i.e. related business) with a set of competitors and markets.
2. It can have a separate business strategy (or strategic planning).
3. It is headed by a senior executive responsible to achieve long-term and short-term business objectives and goals.

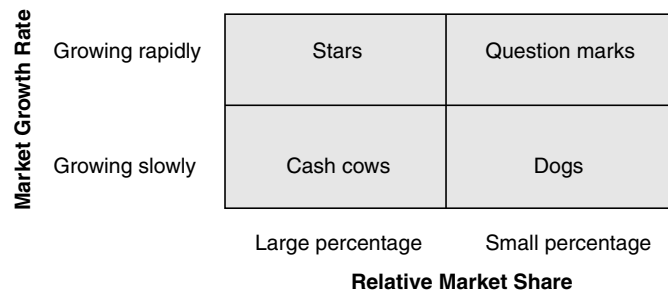
### Allocation of Resources to SBUs—Portfolio Analysis

Strategic plans of SBUs are reviewed at corporate office and decisions are taken on which of their SBUs should be maintained (or continued), expanded, phased out (or divested), and new businesses to be pursued. Based on these decisions, the corporate headquarter allocates its resources. To assist corporate office to make these decisions, certain analytical models or tools are used. Two widely used portfolio analysis models are: (i) Boston Consulting Group (BCG) Model, called Growth-Share Matrix and (ii) General Electric (GE) Model, called Business Screen Matrix.

**BCG Model: Growth-Share Matrix** The Boston Consulting Group (BCG), a leading management consulting group, developed a model called Growth-Share Matrix. Products or businesses are classified according to market growth rate and a product’s relative market share, compared to the market share of the largest competitor. Figure 13.3 shows the Growth-Share Matrix.

The products or businesses are classified into one of the four cells or quadrants that are given colourful names like “question mark”, “star”, “cash cow”, and “dog”.

A **question mark** is a product or business that has a small relative market share in a rapidly growing market. The corporate management has to think hard whether to invest money into this business or not. That is why it is called a question mark.



**Figure 13.3** BCG's Growth-Share Matrix

The **stars** are market leaders in rapidly growing markets. Although these businesses are profitable, they require substantial investment to keep up leadership position in highly competitive markets.

A **cash cow** is a product or business with the largest relative market share in a slow-growth market. These products generate considerable positive net cash flows for the company. These are well-established products in the maturity stages of the product life-cycle. The cash cow businesses do not need heavy investments. The excess cash generated can be used to support other products/businesses.

The **dogs** describe those businesses that have a small percentage of relative market-shares in slow-growing markets. They generally make losses or may be breaking-even. The company must consider whether it is holding on to the dog products for sentimental reasons or for expectations of turn-around in future. If not the latter, it should get rid of such loss making businesses.

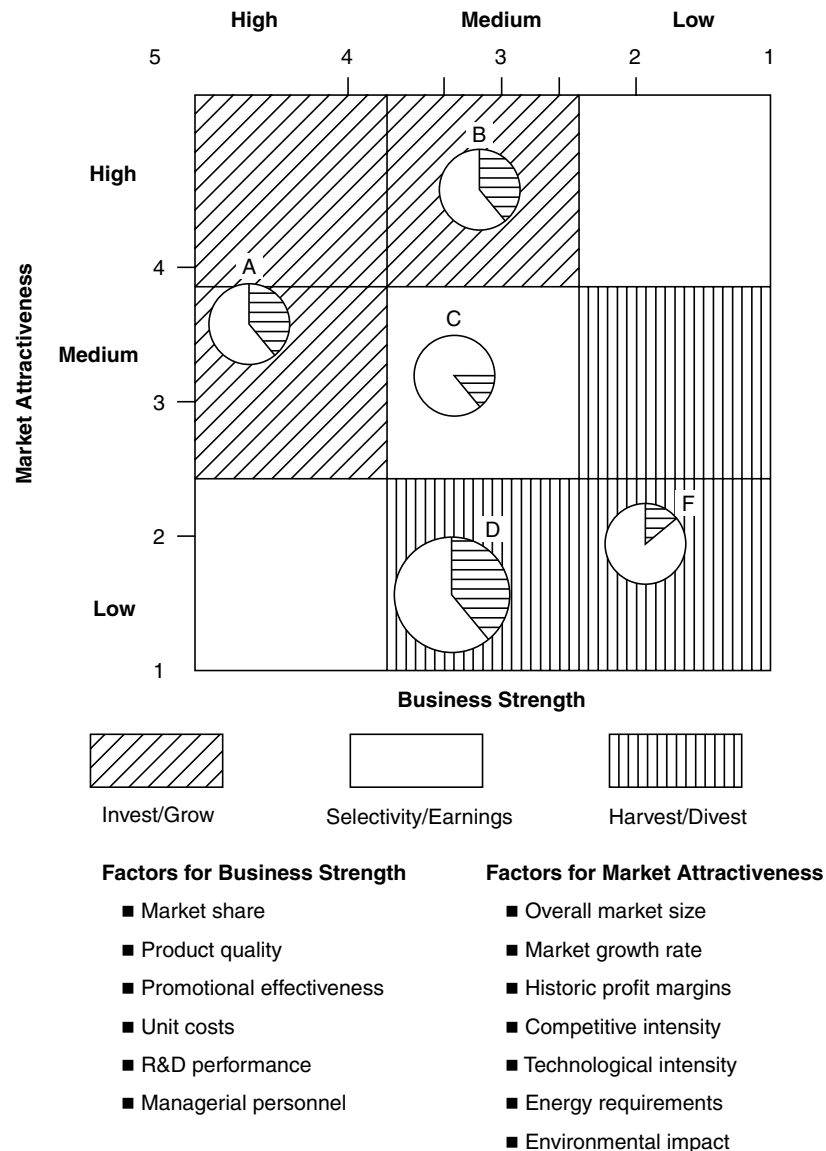
The company should plot its various products or businesses on the Growth-Share Matrix. The company can then do its business portfolio analysis to determine whether it has a healthy portfolio with many stars and cash cows, and a few dogs and question marks. The company can thereafter decide to allocate its financial resources to stars (to keep up the market share) and question-mark businesses (to increase the market shares if they have potential to become stars). The emphasis in the BCG's Growth-Share Matrix is the effective utilisation of resources amongst the businesses or products of a company. However, there is an alternative model developed by General Electric Company.

**GE Model: Multifactor Portfolio Matrix** A more elaborate and multi-factor portfolio analysis was developed by General Electric (GE), as shown in Fig. 13.4. In this model, each business is rated by using two major dimensions—(a) market attractiveness and (b) business strength. The model uses three-by-three matrix, permitting an average (or medium) category. Each circle is a distinct business or product and the size of the circle represents size of the market. The pie-shaped shaded area within each circle represents the market share of that business.

The company measures the two dimensions of market attractiveness and business strength by identifying the factors responsible for each dimension. These factors may vary from company to company.



According to Table 13.2, the company decides the factors relevant to measure market attractiveness for each of its businesses. It then determines the importance of each factor by assigning weights which add up to 1.00. Each business or product is evaluated on each factor by using five-point rating scale. The weights (A) are multiplied by rating (B) to arrive at scores which are added to determine the overall score of 3.05. The same process is repeated for the market strength dimension. The company then arrives at the position of various products or businesses as shown in Figure 13.4. The three cells in the



**Figure 13.4** Multifactor Portfolio Matrix by GE

upper left-hand corner of Figure 13.4 indicate strong businesses in which the company should invest or grow. The diagonal cells stretching from the lower left to the upper right indicate medium priority in terms of investment, and hence, the company should be selective in its investment. The remaining cells in the lower right corner indicate businesses with low attractiveness, and hence, they should be considered for harvesting or divesting.

### Developing Corporate Strategies

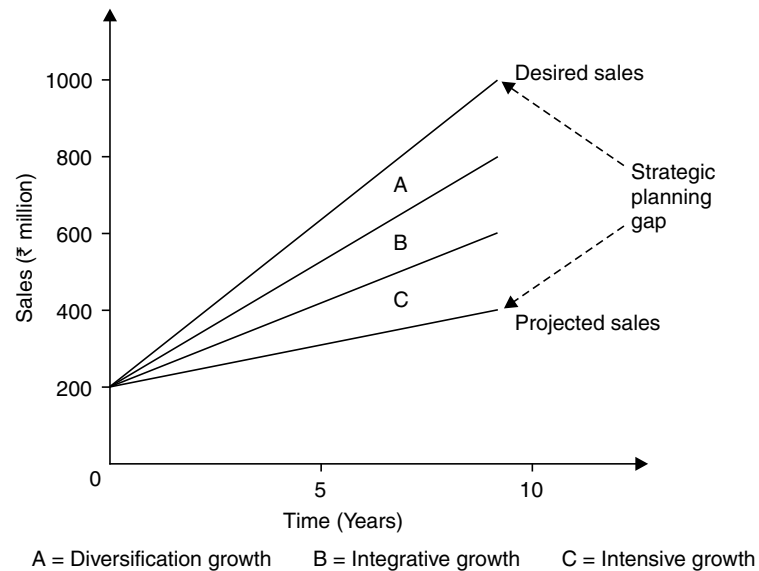
Once a company determines its mission, long-term objectives and goals, defines its strategic business units (SBUs) at the corporate level, and allocates resources to SBUs, the next step is to develop appropriate strategies to achieve the projected sales and profit goals. Sometimes the total sales of all the SBUs put together is less than what the corporate management wants to achieve. If there is a substantial gap between the future (5 to 10 years) desired sales and the projected sales over the same period, such a gap is called *strategic planning gap*, as shown in Fig. 13.5.

In Fig. 13.5, the lowest curve represents the company's projected sales over the next 10 years (from ₹ 200 million to ₹ 400 million) from its current portfolio of businesses. As described earlier in "portfolio analysis", the current portfolio of businesses will include divesting some businesses and these will need replacement. The highest curve represents the company's desired sales (of ₹ 1000 million) over the next 10 years. The company desires to grow much faster than its existing businesses will permit. This strategic planning gap (of ₹ 600 million) can be filled in by three alternative strategies: (1) Intensive growth; (2) Integrative growth; and (3) Diversification growth.

**Table 13.2** Weighted Factor Score for Market Attractiveness

<i>Factors</i>	<i>Weight (Importance) (A)</i>	<i>Rating (1–5) (B)</i>	<i>Score (A) × (B)</i>
• Overall market size	0.20	3.00	0.60
• Market growth rate	0.20	4.00	0.80
• Historic profit margins	0.15	3.00	0.45
• Competitive intensity	0.15	2.00	0.30
• Technological intensity	0.10	4.00	0.40
• Energy requirements	0.10	2.00	0.20
• Environmental impact	0.10	3.00	0.30
	1.00		3.05

Rating scale:      1            2            3            4            5  
                          Excellent    Very      Good      Fair      Poor  
    good



**Figure 13.5** The Strategic Planning Gap

### ***Intensive growth strategy***

In this the corporate management reviews whether there are any further opportunities to achieve growth with the company's current businesses. The new intensive growth opportunities could be identified by using a product-market expansion grid. Figure 13.6 shows three major intensive growth strategies: (i) market-penetration strategy; (ii) market-development strategy; and (iii) product-development strategy.

**Market-Penetration Strategy** Here a company examines different ways to increase the market share of its current products in the markets. One alternative is to encourage its existing customers to buy more by offering attractive quantity discounts, increasing advertising, and/or stepping up selling efforts through more sales calls. Another alternative is to attract competitors' customers by attacking competitors' products and marketing weaknesses. In this strategy, a company uses its aggressive marketing efforts.

	Current products	New products
Current markets	1. Market penetration strategy	3. Product development strategy
New markets	2. Market development strategy	(Diversification strategy)

**Figure 13.6** Product-Market Expansion Grid

**Source:** Igor Ansoff, "Strategies for Diversification", *Harvard Business Review*, p. 114, September–October 1957.

**Market-Development Strategy** In this strategy, a company looks for new markets for the existing products. *Firstly*, the company tries to identify potential customers in its existing sales areas. **For example**, if a manufacturer of ceiling fans is selling the fans only to consumer markets (i.e. households), it can offer the ceiling fans to business markets like offices, hotels, schools, colleges, and factories. *Secondly*, the company can develop new markets through regional, national or international markets. Many Indian fan manufacturers operating in domestic markets are opening markets in Europe, South Africa, or Gulf countries.

**Product-Development Strategy** The company management should consider developing improved products for present markets. This can be done by developing new product features, developing additional sizes/models, or developing different quality levels for different markets. **For instance**, a leading electrical engineering company developed, for the first time in India, a new electrical equipment, called “Flame-proof Transwitch Unit” for underground applications for the existing market in coal mines in India.

If the corporate management finds that the three alternatives of intensive growth strategies are not enough to achieve its desired sales goals, it should examine the integrative growth strategy.

### ***Integrative growth strategy***

A company’s sales and profits can be increased by integrating backward, forward, or horizontally within that industry. In backward integration strategy, a company acquires the business of its one or more suppliers or sets up its own manufacturing plant to supply the material to its other plants.

The second alternative is to go for forward integration strategy in which a company discontinues business with some of its distributors or agents and sets up its own sales offices (particularly if it is profitable), **for instance**, as done by MMM company for material handling equipment.

The third alternative is the horizontal integration strategy in which a company acquires the business of one or more of its competitors. **For example**, VIP industries acquired its competing firms in luggage manufacturing industry.

### **Diversification Strategy**

When a company discovers that both the intensive growth strategy and the integrative growth strategy are inadequate to achieve the desired sales growth, it considers diversification strategy. This strategy is considered when good opportunities are found outside the present businesses (i.e. product-markets). Good opportunities are the ones which are not only attractive but also are related to a company’s business strengths or core competence.

**Types of Diversification Strategies** There are three types of diversification strategies: (i) *Concentric diversification strategy*, which consists of searching for new products that have technological and/or marketing synergies (relationships) with the company’s existing products, though the new products will have new customers; (ii) *Horizontal diversification strategy*, which consists of adding new products technologically unrelated to the existing products, but appealing to the existing customers; (iii) *Conglomerate diversification strategy*, which consists of seeking new product-markets (businesses) that are unrelated to the firm’s existing products, technology, or markets. **For instance**, if an engineering company, with several business groups or strategic business units (SBUs) such as engineering, cement, heavy equipment, construction and oil exploration, discovers that the long-term projected sales and profits will not be possible with the existing businesses, it selects one or more strategies from intensive and interactive growth strategies. However, when the company finds highly attractive

opportunity outside its present businesses, such as acquiring or setting up an alumina project, it is a conglomerate diversification strategy. The responsibility for diversification strategy is that of corporate planning department.

## STRATEGIC PLANNING PROCESS AT BUSINESS UNIT LEVEL

After describing the strategic planning at corporate level, we can now study the strategic planning process at business unit or SBU level. The head of the business unit evolves the business strategy by developing long-term mission, goals, and strategies in changing environment. For developing the business strategy, the business-unit head follows the following steps:

1. Defining the business unit's mission.
2. Scanning the external environment (for opportunities and threats analysis).
3. Analysis of the internal environment (for assessment of strengths and weaknesses).
4. Developing objectives and goals.
5. Formulating strategies for achieving the goals.
6. Preparing programme or action-plan from the strategies.
7. Implementing the strategies and action-plans.
8. Monitoring results and taking corrective actions (i.e. control).

We shall now examine these steps.

### The Business Unit's Mission

We had earlier defined company (or corporate level) mission or purpose of an organisation. Within the corporate mission, each business unit or SBU is required to define its mission which is called the business mission.

A business mission should specify what activities the organisation or the business unit intends to pursue, and how differently it intends doing these activities, so as to distinguish it from the competitors'. A business mission statement should have the following components:

1. It should state (a) *what business the company is in*, and (b) *what business it intends to be in*.
2. What methods would be uniquely followed (which are different from the competitors') in pursuing the business activities?
3. What is the social standing of the organisation as a business entity?

To answer *what business the company is in*, a business unit should answer the following questions.

- Customer groups (or segments): Who are being satisfied? Which customer groups an SBU intends to satisfy?
- Customer needs or functions: What needs of the customers are being satisfied?
- Technologies used: How the customer needs are satisfied?

Let us consider an **example** of a thermometer manufacturer who answers the above questions as follows:

*Customer groups:* (i) Households, (ii) Restaurants/Hotels, (iii) Healthcare facilities, (iv) Doctors, (v) Factories.

*Customer needs:* (i) Body temperature, (ii) Cooking temperature, (iii) Atmospheric temperature, and (iv) Process temperature.

*Technologies used:* (i) mercury-base, (ii) alcohol-base, (iii) Electronic or digital.

The manufacturer of the thermometer can define its business either narrowly or broadly. It can say: The firm is in the business of supplying superior quality mercury based thermometer at competitive prices to health care facilities in India to measure body temperature. The company intends to expand its markets to include other customer groups (such as restaurants and factories) to satisfy the needs of accurate measurement of cooking temperature and process temperature by using state-of-the-art digital technology. The company wants to pursue all its activities by giving due importance to the welfare of the society in terms of environmental aspects and other regulations.

### Scanning of External Environment (For Opportunities and Threat Analysis)

An analysis or scanning of the external environment is useful to a business unit or a company for recognising opportunities and threats. Scanning or monitoring the external environment on a continuous basis is necessary since the external environment changes continuously. To achieve its objectives and goals, a company must develop a systematic approach to scanning the external environment.

An environment scanning can be done at the three different levels in the organisation—(a) corporate; (b) strategic business unit (SBU); and (c) product/market. At the corporate level, environment monitoring is done broadly. The focus is on the trends which have company-wide implications. At the SBU level, the emphasis is given to those changes in the environment that may influence the SBU business in future. **For instance**, the SBU in electronic industry may decide to monitor the changes in technology. At the product/market level the analysis of external environment is limited to short-term aspects, like the impact of government policy of excise duty and import duty on the consumer durable product/markets such as TVs, refrigerators, and so on.

#### *Types of external environment*

A business unit has to monitor important and relevant macro-environmental factors and micro-environmental factors. The major types of macro-environmental factors or forces which affect all the firms in business marketing are: (i) Technological, (ii) Political, (iii) Economic, (iv) Regulatory or legal, and (v) Social. We have not considered demographic and cultural factors as these are more relevant for consumer markets.

The external environment, as discussed earlier in Chapter 2, also includes customers, competitors and suppliers, which are called “**micro-environmental factors (or forces)**”. The major purpose of scanning external macro- and micro-environmental forces for a company is to have insight into marketing opportunities and threats.

A **marketing opportunity** is an area of buyer need or potential interest in which a company can perform profitably. A company determines attractiveness and success probability by asking the following questions to each opportunity:

- Does the company possess the capabilities and resources to deliver the benefits to the target market(s)?
- Can the target markets be reached with cost-effective media and marketing channels?
- Can the company deliver benefits better than competitors?
- Will the sales revenue and profits meet the company’s expectations or objectives?

Based on the responses to the above questions, an opportunity matrix (as shown in Fig. 13.7) is developed.

		High	Low
Attractiveness	High	A	B
	Low	C	D
		Success Probability	

**Figure 13.7** *Opportunity Matrix*

Some external environmental developments represent threats to an organisation. An **environmental threat** is a challenge posed to a company by an unfavourable trend or development that may lead to reduction in sales and or profit, if a company does not take a corrective action. Environmental threats are determined based on probability and seriousness of occurrence, as shown in Fig. 13.8.

		Probability of Occurrence	
		High	Low
Seriousness	High	A	B
	Low	C	D

**Figure 13.8** *Threat Matrix*

A company should identify major opportunities and threats faced by a specific business unit. It can then determine the business unit's overall attractiveness out of the following four alternatives:

1. An ideal business unit is high in major opportunities and low in major threats.
2. A speculative business unit is high in both major opportunities and threats.
3. A mature business unit is low in both major opportunities and threats.
4. A troubled business unit is low in opportunities and high in threats.

### ***Technological Environment***

This is relevant to those SBUs or business units, which face rapid changes in technology such as computers and electronics. Such business units should (a) recognise limits to their existing technologies, (b) know which new technologies are emerging, and (c) decide when to incorporate the new technology in their products or processes.

### ***Political Environment***

This can affect business goals and strategy. **For example**, uncertain political situation in India during 1996–1998 affected the performance on sales and profits of many companies. During this period,

investments in new projects went down substantially. Due to globalisation of economies of many countries, it is necessary to monitor and forecast the political trends not only in domestic market but also in international markets.

### ***Economical Environment***

The economic environment affecting the businesses include various economic parameters such as fiscal policies, interest rates, industry-wise production and capacity utilisation, stages of economy (like recession, depression, revival or prosperity), money supply, and others. These economic parameters are analysed and used for long-term and short-term decisions. **For example**, the economic trends and consumer-spending patterns could indicate whether the demand for consumer durables, such as cars, TVs, refrigerators, will go up substantially in some of the developing economies such as India and China compared to the growth in demand in Western Europe and North America.

### ***Regulatory Environment***

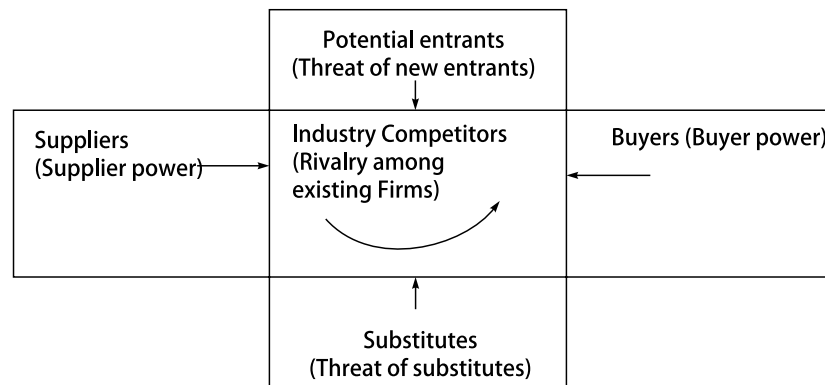
This includes government policies and statutory requirements. A business firm needs to study the impact of existing laws and the pending legislations with the law-making body. The company needs legal assistance to understand the prevailing laws in the countries where it is carrying out its business. **For instance**, Norway bans several forms of sales promotion as unfair.

### ***Social Environment***

The social environment for industrial products mainly includes pollution control and environmental safety. The deteriorating condition of natural environment is one of the major issues facing businesses that will call for social, political, and legal actions. **For example**, a World Bank report has asked the Indian Government to take urgent action on small and medium enterprises (SMEs) as these firms contribute 70 percent of the total industrial pollution.

After the major macro environmental forces, most business units consider the major micro environmental factor as competition. The profit performance of the industry in which a business unit is operating is impacted by five competitive forces, as recognised by Michael Porter.

**Competitive Forces:** The five competitive forces that have an impact on the industry's profit potential are shown in the Fig. 13.9.



**Figure 13.9** *Five Competitive Forces*

**Source:** Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*.



1. **Rivalry among existing firms:** The first force recognises active competition among existing firms in the industry. Rivalry may occur within a market segment or across all segments of the industry. The nature and scope of competition may vary according to type of industry structure. **For example**, a mature industry like personal computers includes many firms competing in segments like home, business and education. High competition in a stable or declining market will lead to frequent price wars, high expenditure and lower profitability.
2. **Threat of new entrants:** The second force draws attention to the possibility of new competitors entering the market of an industry. The profit potential is good in an industry in which entry barriers are high and exit barriers are low. Here, a few new firms can enter the industry and poor-performing firms can easily exit. When both entry and exit barriers are high, like steel industry, profit potential is high, but risk is also high because poor-performing firms cannot exit easily and, therefore, they stay in and fight it out. When both entry and exit barriers are low, the industry profitability is low and stable. Lastly, when entry barriers are low and exit barriers are high, companies enter during good times but find it difficult to exit during hard times. The profitability is low for all firms due to overcapacity.
3. **Threat of substitute products:** An industry's profitability is affected when there are existing or potential substitutes for its products. The company has to monitor price trends of the substitute products as they may bring down the prices, sales and profits of the company's product. **For example**, a company manufacturing and marketing Aluminium extruded products like door and window frames monitors prices of substitute products such as wooden and steel frames, which satisfy the same customer need. Any changes in the prices of wooden and steel door and window frames will affect the prices, sales and profits of the company's products.
4. **Bargaining power of suppliers:** An industry's profit potential is affected, if its suppliers are able to increase prices or reduce quantity supplied. **For instance**, steel component manufacturing industry's major and important input is steel, which is supplied by a few suppliers who are powerful. To reduce the bargaining power of suppliers, manufacturers use multiple supply sources or build collaborative relationships with suppliers.
5. **Bargaining power of buyers:** Profit potential of an industry is influenced by the buyers' strong bargaining power. Buyers' bargaining power increases when their purchase volume is large, when the product is undifferentiated, or when the buyers' switching costs are low. To minimise bargaining power of buyers, the supplier should develop a superior offer that strong buyers cannot ignore.

### ***Environment Scanning Procedure***

This should link environment analysis and future trends to identifying opportunities and threats. Some business units have set up marketing intelligence systems. Other business units have set up environment scanning committees. These committees or systems consider the following steps: (i) review the broad trends in the macro- and micro-environmental factors, (ii) select the relevant trends for its business-es, (iii) carryout in-depth analysis of relevant trends, (iv) forecast the new opportunities and threats, (v) relate the outcome to long-term objectives and strategies.

In most companies the responsibilities of scanning the external environment is shared by the strategic planning executives and the line managers. The time horizon for environment scanning is approximately twice the duration of a company's strategic plan. If, **for instance**, the company has strategic planning for five years, environment scanning period should be for 10 years. The major problems faced

by firms on environment scanning are lack of knowledge of theoretical framework, lack of formal system, ignorance of managers on trends in environment, and difficulties in forecasting environmental trends. However, it is important to forecast the major opportunities and threats faced by a business unit to ensure its long-term survival and success.

### **Analysing the Internal Environment (for Assessment of Strengths and Weaknesses)**

We have seen that a company should determine opportunities in the external environment. Attractive opportunities need to be matched with the strengths of the company to ensure success. An assessment of strengths and weaknesses is, therefore, an essential task that is performed at different levels of an organisation—corporate, SBU, and product/market. **Strengths** are the competitive advantages which a company can use to gain leverage in the marketplace. **Weaknesses** are constraints that hinder movements in certain directions. **For example**, a business unit, which is short of cash or liquidity, cannot undertake large-scale market development efforts.

*Assessment* of strengths and weaknesses should be done by a firm in comparison to its competitors. The company should also consider the key (success) factors, based on the importance given by the customers. The success factors will be different for different businesses. **For instance**, for the photocopying machines and diesel generating sets, after-sales-service is the success or key factor. There are many ways to measure a company's strengths and weaknesses relative to competitors. These are: (i) current marketing strategy; (ii) past performance; (iii) marketing effectiveness or orientation; and (iv) marketing environment.

**Current marketing strategy** will answer questions like what are our target markets and how each target market is served. It will also indicate which of the marketing-mix elements (4Ps) dominate in the current marketing strategy and how the company's marketing strategy compares with that of competitors.

To measure **past performance** three types of analysis should be undertaken: (i) *Product performance* such as contribution of each product-item, product quality and features that give superior customer benefits in comparison to that of the competitors and utilisation of production capacity; (ii) *Market performance* in terms of relative market share, growth and contribution of each target market segment, and customer service; and (iii) *Financial analysis* such as sales growth rate, return on investment (ROI), and profit as a percentage of sales of the company and its major competitors.

*Marketing orientation* or *effectiveness* indicates to what extent the company is market- or customer-oriented. Some companies are production-, sales- or product-oriented, which may work in markets that are not competitive. In a competitive market, the business marketing firm must keep in touch with changing needs of the target customers and satisfy those needs (of excellent product quality and service or other benefits) better than competitors.

*Marketing environment*, as discussed earlier includes macro- and micro-external environmental factors. Not all the environmental factors are relevant to a business unit. The company should first select those environmental factors that are relevant to its business and then monitor the impact of those factors on its business.

### **Matching Strengths with Opportunities**

Matching strengths with opportunities is called **opportunity analysis**, which is useful in developing objectives, as shown in Table 13.3, for a company in air-conditioning and refrigeration industry.

The external environmental analysis, as discussed earlier, assists in identifying the opportunities available to the company. An internal environmental analysis indicates the strengths and weaknesses of the company. By matching the strengths with the opportunities, the company can develop the objectives that would indicate future direction or course of action.

**Table 13.3** Opportunity Analysis of an Air-conditioning Company-An Example

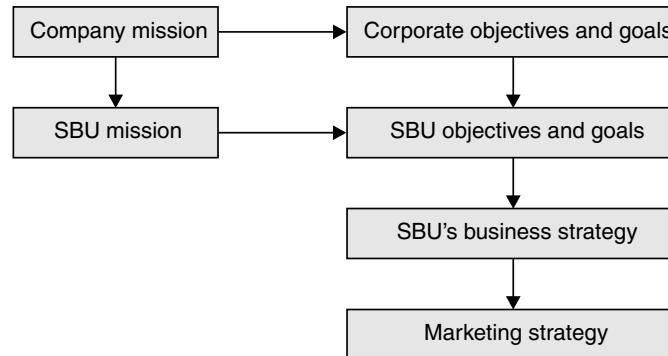
<i>Strengths</i>	<i>Likely Impact</i>	<i>Opportunity (From External Environmental Analysis)</i>	<i>Objectives</i>
1. Superior sales and service network in air-conditioning industry	Helpful in new product introduction in air-conditioning industry, particularly making compressors instead of buying from suppliers	Replacement market for air-conditioning compressors neglected by the industry	To manufacture compressors for air-conditioning applications by having a tie-up with one of the world leaders in the industry
2. Market leader in central air-conditioning plant	Defend market share in target markets of commercial enterprises who need central air-conditioning plants	Trends indicate that service industry and retail stores want to make their customers comfortable by having central air-conditioning plants	To focus on commercial enterprises, particularly service firms and retail stores by promoting central air-conditioning plants

In the process of analysis of the strengths, the weaknesses of the Air-conditioning company should also be identified. Some of the *marketing weaknesses* are: (a) after-sales-service policies are not clear, in terms of “warranty clause” or frequency of warranty service; (b) the field sales people do not have an adequate technical knowledge; and (c) decision-making process is slow due to too many levels of reporting in the organisation structure. Corrective actions should be taken by the company wherever the weaknesses are identified, either at SBU level or product/market (or functional) level.

### Developing SBU’s Objectives and Goals

We discussed earlier the corporate objectives and goals. We shall now discuss development of objectives and goals at business unit or SBU level. To understand the relationship between corporate level mission objectives and goals, and SBU level mission, objectives and goals, we should look at the framework shown in Fig. 13.10.

The framework in Fig. 13.10 is applicable to large companies who have many SBUs. Each SBU may have one or more product(s)/market(s). However, for a small company with a few related products, corporate and SBU mission, objectives and goals may be the same. Let us consider an **example** of a large firm. Blue Star Ltd. had three SBUs—air-conditioning and refrigeration, testing and measuring instruments, and computer hardware and software. A small company, such as Sangam Aluminium Ltd., had only one product line—Aluminium extruded products. In this company, all the three levels, such as corporate, SBU, and product/market, are merged into one.

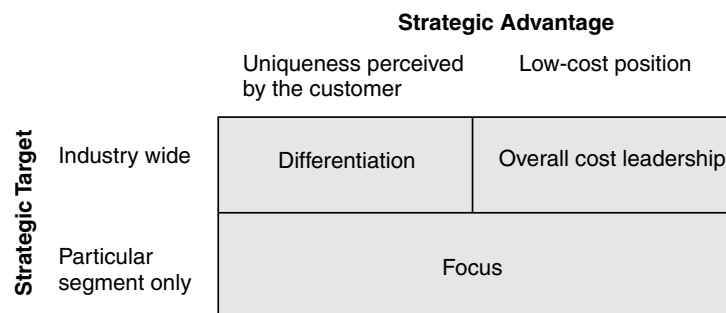


**Figure 13.10** Framework of Relationship between Corporate and SBU Level Mission, Objectives and Goals

As mentioned earlier, an objective is a broad statement of intent that is not quantified and not limited by a time period. A goal is a measurable or quantifiable objective of a business for a specific time period. An SBU has (a) financial objectives and goals; (b) growth (or survival) objectives and goals; and (c) constraint objectives and goals. To elaborate, the **survival objective** of an SBU or a business unit with single product may be to increase the sales volume above break-even level and the goal can be to reach 400 metric tons of production and sales per month in two years time. The **growth objective** can be to ensure stable growth of business, say, in terms of achieving ₹ 1,000 million sales goal in five years. The **constraint objective** is with reference to the internal environment (strengths or weaknesses) and how it interacts with outside world. Like, if the workers are not adequately educated or skilled, the SBU objective is to conduct training programmes to improve the skills of the work force.

### Formulating Strategies at Business Unit Level

The objectives and goals indicate what a business unit wants to achieve. A strategy answers the question—How to achieve the objectives and goals? Each business unit should formulate its business strategy. There are many types of strategies available. These are summarised by Michael Porter into three generally-applicable (i.e. generic) strategies in Fig. 13.11. They are: (a) overall cost leadership; (b) differentiation; and (c) focus. Porter's choice of strategy is based on two factors: (a) the strategic target the business unit aims at, and (b) the strategic advantage that the business unit has in aiming at the target.



**Figure 13.11** Porter's Generic Strategies Framework

**Overall Cost Leadership** Here the firm decides and achieves the lowest cost of production and distribution by adopting a number of policies such as economies of scale, cost reduction through learning curve, value analysis, and cost control. The firm with overall cost leadership can price the products lower than its competitors and win a large market share. The high margins can be reinvested in equipment to maintain cost leadership. **For instance**, the Reliance Industries practise this strategy with its large scale manufacturing plants, superior engineering, purchasing and physical distribution skills.

**Differentiation** Here, a firm differentiates its product or service in such a way that a large segment of customers perceive the product as a provider of those superior benefits which are valued by them. Differentiation can be achieved in many ways such as customer service, product quality, distribution network, and so on. **For example**, Otis Elevator Company has differentiated its products with superior quality, backed-up by superior customer service. This differentiation strategy gives good profit margin and protects the firm from competitive forces.

**Focus** In this strategy, a company focuses or concentrates on one or more narrow market segments such as a particular customer group, a geographic market segment, or a distinct segment of a product line. The firm understands the needs of these narrow segments better than the competitors and serves them more efficiently and effectively than the competitors. **For instance**, Mercury International company focuses on training salespersons working in business marketing firms. Generally, companies with focus strategy earn above average profits.

Today, business firms or business units are recognising the importance of *strategic networks*. In this strategy, firms join together in strategic alliances and joint ventures in order to leverage or complement their capabilities and resources.

## Strategic Alliance

Strategic alliances are beginning to have an important role in the strategy of leading companies. Strategic alliances include a formal long-term linkage, funded with direct co-investments by two or more companies, that pool complementary capabilities and resources to achieve generally agreed objectives.<sup>4</sup> Organisations are becoming aware that they need strategic partners if they want to be effective. Even large companies like IBM and Siemens cannot achieve leadership without forming alliances with domestic or international companies.

In the new global environment, with substantial increase in competition, alliances are not an option but a strategic necessity. The traditional management thinking that “old fences make good companies” is now changing to a new concept—viz. “create strong alliances with other firms by stretching the company’s boundaries.”<sup>5</sup> The compelling reason for arrangement of a strategic alliance is the strong need of an organisation to use its core competencies by having alliances with other firms who have complementary expertise. This results in making the organisations’ geographic and product opportunities larger. Some of the **examples** of strategic alliances are between Microsoft and Xerox for integrated office products, and between Lockheed Martin, Northrop Grumman, and BAE Systems for designing and producing fighter and attack aircrafts.

Some of the strategic reasons for the partnering companies to enter into alliances are: (1) fill gaps and have access to markets and technology; (2) achieve economies of scale by combining manufacturing, marketing, or R&D activities; (3) reduce risk and entry costs into new markets; (4) move quickly to introduce new products to markets; (5) overcome legal and trade barriers.<sup>6</sup> Because of these reasons strategic alliances are booming across various products and services. The major factors that determine

successful alliances are: **(a)** trust between partners, **(b)** encouraging communications at various levels of the partnering firms; **(c)** agreements on goals and strategies.<sup>7</sup> Some companies like Corning Glass Works have managed strategic alliances successfully by focusing on a few major points: **(1)** choosing partners carefully by evaluating their strengths and/or strategic fit in terms of reputation, capabilities, culture, resources, and relationships; **(2)** creating conditions for mutually beneficial relationships, by institutionalising the partnership and flexible approach; **(3)** focusing on long-term gains.<sup>8</sup>

The role of marketing, as discussed earlier, at SBU or business unit level is to provide information on customers and competitors for developing strategic plan (or business strategy) which includes deciding on the competitive advantage. In addition, marketing decisions taken on a long-term basis (i.e. more than one year) are considered as a part of strategic marketing, that is, segmenting, targeting and positioning, (STP), and product line strategies. These are also a part of marketing plan at the functional level.

## DEVELOPING A BUSINESS MARKETING PLAN

After the corporate and the business unit (or SBU) strategy, the marketing plan (which includes marketing strategy) should be developed at the functional level. A guide to business marketing plan is shown in Table 13.4.

The marketing plan is normally prepared by the head of the marketing function in the business firm. A marketing plan is an output of marketing planning process which includes the following steps: **(a)** Analysing marketing situations (Chapters 2 to 5); **(b)** Segmenting, targeting and positioning in business marketing (Chapter 6); **(c)** Developing marketing strategies (Chapters 7 to 12); and **(d)** Implementing and controlling the marketing plan (Chapter 13). A marketing plan is a written document that is prepared after a business marketer goes through the four steps of the marketing planning process. Ideally, to prepare an effective marketing plan, the head of marketing may need five to six months. But sometimes, in practice, lesser time is given to the marketing head due to certain prevailing situations. For this, the marketing head has to depend on the information obtained from the company's past data on sales, prices, existing customers, and also, on business magazines, journals and the internet.

**Table 13.4** Guide to Business Marketing Plan

<i>Section</i>	<i>Contents</i>
1. Situational analysis	<ul style="list-style-type: none"> <li>▪ <b>Market situation</b> includes data on market size, growth, sales, market share and profits (or contributions) for the past 3/5 years, current position and future projections for total market and each target market segment. It should also indicate target customer needs, buying behaviour, buying stages, and buying situations.</li> <li>▪ <b>Competitive situation</b> consists of identifying, ranking, market share, objectives and strategies, strengths and weaknesses, and reaction patterns of major competitors.</li> <li>▪ <b>Product situation</b> includes data on sales, unit prices, profits (or contributions) for each major product item in the product line for the past 3/5 years.</li> <li>▪ <b>Macro-environmental situation</b> consists of first identifying relevant macro-environmental factors (e.g. economic, political, legal) and then forecasting the future trends and the impact on the product.</li> </ul>

*Contd.*

2. SWOT and issues analysis	<ul style="list-style-type: none"> <li>▪ <b>SWOT analysis</b> includes identifying major strengths, weaknesses, opportunities, and threats faced by the product.</li> <li>▪ <b>Issues analysis</b> consists of determining major issues faced by the firm, based on situational and SWOT analysis.</li> </ul>
3. Objectives and goals	<ul style="list-style-type: none"> <li>▪ Determine sales, market share, and profit goals considering the environmental and issues analysis done earlier.</li> </ul>
4. Marketing strategy	<ul style="list-style-type: none"> <li>▪ Selection of target market segments.</li> <li>▪ Positioning strategy relative to competitors.</li> <li>▪ Marketing mix strategy consisting of product, price, distribution, and promotion as well as branding strategy.</li> <li>▪ Customer service and marketing research strategy.</li> </ul>
5. Action plan	<ul style="list-style-type: none"> <li>▪ Each marketing strategy element is broken down to specific actions to answer: who will take the specific action, by when and at what cost?</li> </ul>
6. Marketing budget	<ul style="list-style-type: none"> <li>▪ Building the revenue and expenditure budget. Revenue budget includes forecasted sales in units, average unit price, and sales revenue. Expenditure budget includes estimated marketing expenses on personal selling, promotion, distribution, and so on.</li> </ul>
7. Implementation and control	<ul style="list-style-type: none"> <li>▪ Building marketing organisation to implement the marketing plan. Control includes periodic review of actual performance against goals and taking corrective actions, if required.</li> </ul>
8. Contingency plans	<ul style="list-style-type: none"> <li>▪ Some firms prepare contingency plans in case uncertain situations arise.</li> </ul>

## IMPLEMENTING AND CONTROLLING MARKETING PLAN

### Implementation of Business Marketing Plan

We shall now answer the question: how the business market manager can effectively implement the marketing plan. An excellent marketing plan cannot achieve its objectives, if it is not implemented properly<sup>9</sup>. Although the dividing line between strategy and execution (or implementation) is not clear, it is usually not difficult to recognise difference between strategy short-comings and implementation problems. When both strategy and implementation are proper, the organisation is likely to achieve its objectives. However, excellent implementation of a poor strategy may give marketing managers time to correct the problem.<sup>10</sup> Consider the following **example**:

A capital goods manufacturing company decided to increase the prices of its products by ten per cent, assuming that quality of its products was superior to its competitors. This resulted in the decline of orders from business customers. A subsequent market survey revealed that customers perceived its quality inferior to two of its major competitors. The company immediately took the corrective action of bringing its prices down, in line with competition.

Many marketing plans fail because they are poorly implemented. Implementation of marketing plans includes converting the marketing strategy into action plans and ensuring these action plans are properly and timely executed with continuous monitoring. The action plan often includes persons *who* would be responsible for execution of the various actions, by *when*, and at *what* cost.

In order to better understand implementation of a marketing plan, including linkages between marketing objectives, strategy, and action plan, let us consider the following **example**:

In 1994, Chief Executive Officer (CEO) of Materials Equipment Manufacturing Company Private Limited (MEM) asked his Chief Marketing Officer (CMO) to set the marketing objective of 100 per cent sales growth for the year 1994–95 over the previous year. After doing situational and SWOT (strengths, weaknesses, opportunities, and threats) analysis, the CMO prepared the marketing strategy and the action plan, as shown (partially) in Table 13.5. The analysis showed that two of the company's branches, located at Mumbai and Hyderabad, managed (or controlled) by agents (or manufacturer's representatives) have not been performing well in terms of sales and customer service for the past two years, despite adequate counselling and warnings. It was, therefore, decided to replace them with the company's sales and service employees. It was also decided to open two new branches at Baroda and Coimbatore with the company's employees. The responsibility for the action of locating a place for the branch offices, on rental basis, and hiring of branch heads, sales and service engineers, and the needed office equipment, was given to the CMO, who could take the help of H.R. and Finance heads whenever required. However, all the four employee-managed branches should be in operation by 1-07-1994, including training for newly recruited persons. The costs of various activities were to be approved by the CEO. Second strategy of introducing and implementing the relationship management (RM) with key accounts needed actions of conducting training programme for branch sales and service heads, identifying key accounts, and formation of relationship teams. The training was to be conducted twice—once for the existing sales and service people in April 1994 and again in June 1994 for the newly hired people for the four branches, along with product, application, and other aspects of training.

**Table 13.5** Implementation of Marketing Plan—An Example

Marketing Objectives	Marketing Strategies	Action Plan	
		What Action & Cost, By Whom	By When
100% sales growth in 1994–95.	(1) Improve distribution	(a) Replace agent-managed branches at Mumbai and Hyderabad with employee-managed branches at the cost of ₹ 3,00,000 p.m. Action by CMO.	3-months (July 1994)
		(b) Open new branches at Baroda and Coimbatore at the cost of ₹ 2,50,000 p.m. Action by CMO.	July 1994
	(2) Introduce relationship marketing with key customers	(a) Conduct 2-day training for sales and service heads from all branches at the cost of ₹ 3,00,000. Action by CMO.	April 1994
		(b) Decide key customers and relationship teams. By CMO.	June 1994

While implementing various activities of the action plan, the CMO had to involve various functional heads. For instance, the H.R. head was involved in staffing and training sales and service people. R&D and production people participated during the training programme, and finance and accounts persons were needed for releasing funds required for various activities. The CMO needed organising and interacting skills when he was implementing the action plan.

In case of business marketing, the challenges of implementation are much more because of the involvement of various functions such as R&D, production, advertising and industrial engineering.

### Implementation Skills

According to Thomas Bonoma, there are four skills that are important for effective implementation of marketing plans: (i) Allocating, (ii) Monitoring, (iii) Organising, and (iv) Interacting.



**Allocating skills** are needed by marketing managers for allocating resources such as time, money, and people, depending on where they are effective. **For example**, how much money should be allocated to the various elements of promotional mix, or who should be asked to perform which activities of the action plans, are the problems that require allocating skills.

**Monitoring skills** need intelligence and systematic approach in dealing with the company's management information and control system. Regular monitoring of the progress on action plan, evaluating the results of actions taken, and taking corrective actions are important skills needed by marketing heads.

**Organising skills** are used to develop an effective organisation and to work with both formal and informal networks within the organisation.

**Interacting skills** are required to get the implementation done by interacting both within and outside the organisation. Within the firm, the marketing manager deals with peers such as production and R&D managers, over whom he has little authority. Outside the organisation, the marketing manager interacts with customers, intermediaries, advertising agencies, and so on. Good implementers have motivating and negotiating skills.

Successful companies have both, appropriate strategy and excellent implementation. However, marketing strategy and its implementation affect each other. It is, therefore, difficult to diagnose whether the poor sales are due to an inappropriate strategy or a poor implementation. The marketing managers need to have *diagnostic skills* to distinguish implementation problems from the strategy's deficiencies.

## Marketing Control

After a business marketer develops and implements the marketing plan, the next task is to control the marketing performance.

### Control Process

The process of marketing control consists of four steps:

**Setting Goals** The management sets yearly, quarterly, and monthly goals, budgets, or targets for the company, SBUs, divisions, regions, branches, and individual salespersons. These goals are quantified and have time periods.

**Performance Measurement** The management measures the actual performance against the planned performance (i.e. against the goals set). The information on actual performance is obtained through business marketing intelligence system.

**Performance Analysis** Business marketer analyses the deviations between the planned and actual performance, and determines the causes of major deviations.

**Taking Corrective Actions** To bridge major gaps between the goals and the actual performance, the marketer takes corrective actions. These could be change of strategy, action plans, or even the goals.

The marketing control process is illustrated with the following **example**:

A steel component manufacturing company had set the sales goal of ₹ 500 million (i.e. ₹ 50 crores) for the year 1985–86, after discussions on the marketing plan presented by the marketing head. At the end of the first quarter, the actual sales performance was lower than the budgeted (or planned) sales

figure by about 30 per cent. The sales analysis showed that major unfavourable difference between planned and actual sales happened in two branches—viz. Ludhiana and Sonapat. When the marketing head talked with the two branch managers, he was told that there was a recession in bicycle segment. Most of the sales were planned from major Bicycle manufactures like Hero, Atlas, and Avon cycles in these two branches. The marketing head thereafter discussed with his senior sales and marketing managers on how to bridge the gap between the budgeted and actual sales, and decided to take the following corrective actions, with the approval of the management, in the balance nine months of the financial year: (1) concentrate marketing efforts on other market segments, such as automobile, boiler, furniture, and bus body-builders, (2) export to countries in Asia and (3) improve customer satisfaction by superior quality of product and service.

### Types of Marketing Control

It was found in a study that many companies do not have adequate procedure to evaluate their performance and that the importance given to measurement tools varies across cultures<sup>12</sup>. **For instance**, U.S. companies give importance to profitability as the major performance measurement tool, but Japanese firms emphasise employment. The control system should work under different cultures and situations. Table 13.6 shows four types of marketing controls needed by organisations. These are: (1) strategic control, (2) annual-plan control, (3) efficiency control, and (4) profitability control. We will discuss each of these controls briefly hereunder:

**Table 13.6** Types of Marketing Control

Type of Control	Aim of Control	Main Responsibility	Major Tool Used
1. Strategic Control	To review long-term marketing goals and effectiveness	Top management	Marketing audit
2. Annual-Plan Control	To examine if planned annual goals are being achieved	Top and middle management	<ul style="list-style-type: none"> <li>▪ Sales analysis</li> <li>▪ Market share analysis</li> <li>▪ Financial analysis</li> </ul>
3. Efficiency Control	To find out how resources are used in the elements of the marketing strategy	Middle management	<ul style="list-style-type: none"> <li>▪ Key efficiency indicators</li> <li>▪ Promotional effectiveness</li> </ul>
4. Profitability Control	To review where the firm is making and losing money	Marketing controller/ Head of marketing	<ul style="list-style-type: none"> <li>▪ Marketing Cost and Profitability analysis</li> </ul>

**Source:** Adapted from Philip Kotler, Marketing Management, 11th edition, Indian reprint, Prentice-Hall Inc., p. 685.

**Strategic Control** Companies should periodically review their long-term marketing goals (e.g. market share), strategies, and marketing effectiveness. The technique used for this is called *marketing audit*, which examines major issues, such as (a) the firm's marketing opportunities and strategies; (b) use of information technology; (c) impact of changing environment; and (d) Strategy implementation. The audit should also recommend plan of action to improve the firm's marketing performance.

**Annual Plan Control** The major goals in an annual plan of a firm are sales (in volume and value), market share, expenses, profit, and customer satisfaction. These yearly goals or budgets are broken down to quarterly and monthly goals for the firm and also for each lower levels of management, such as regional and branch managers. The actual results are compared with the goals on monthly or quarterly basis. If there are any major deviations, their causes are determined and corrective actions are taken to close the gap between the goals and the actual performance. The tools or techniques used by managers to analyse the causes or reasons for deviations are: **(a)** sales analysis, **(b)** market share analysis, **(c)** expense-to sales ratios, **(d)** profit/contribution analysis, and **(e)** customer satisfaction monitoring.

**Efficiency Control** If a firm does not achieve the goals in annual plan, it may become necessary to examine whether the resources are used efficiently in each element of the marketing-mix strategy. The control system provides information on the resources like money and manpower used in product, promotion (including advertising, sales promotion, and sales force), distribution, and pricing strategies and tactics. **For instance**, it examines the marketing logistics cost for each distribution channel, advertising effectiveness of each media used by the firm, discount structure in the pricing policy, and contribution of product items. Efficiency control can be combined with profitability control, and this responsibility, in some companies, is given to the marketing controller, or it could be the responsibility of the head of marketing.

**Profitability Control** The purpose of profitability control is to find out where the company is making or losing money. Hence, companies measure the profitability (or contribution to fixed costs and profits) of each product-line and product-item, each market segment (or customer groups), each branch (or territory), and each distribution channel. Based on this analysis, companies take corrective actions.

Out of the various tools used for marketing control, as seen in Table 13.6, we shall examine four tools in greater details: **(1)** marketing audit tool used for strategic control, **(2)** sales analysis used for annual-plan control, **(3)** marketing cost and profitability analysis for profitability control, and **(4)** key efficiency indicators for efficiency control.

## Marketing Audit

Marketing audit is a tool that is used for strategic control of an organisation's marketing activities. It is an in-depth and comprehensive analysis of all aspects of the company's marketing activities. Philip Kotler defines marketing audit as a comprehensive, systematic, independent, and periodic examination of a company's or business unit's marketing environment, objectives, strategies, and activities with a view to determining problem areas and opportunities, and recommending a plan of action to improve the firm's marketing performance. He also gives a list of major questions asked in the marketing audit<sup>13</sup>.

A comprehensive marketing audit includes all the major marketing activities and is often more effective than functional audit of sales or promotional activities. Marketing audit can be conducted by the company's auditing office, outside consultants, or self-audit by the marketing department, but the best audits usually come from independent, outside consultants. Many firms conduct marketing audits, when they face with some marketing problems like declining market share or turnover of salespersons. However, it is beneficial if companies conduct marketing audits on regular basis to ensure consistent good performance.

A marketing audit begins with discussions between the company's marketing professionals and marketing auditors for working out an agreement on the audit's objectives, coverage, depth, data sources, report format, and time frame. Auditing time and cost are also discussed along with preparation of a plan which includes persons to be interviewed, the questions to be asked, time and place of contact, and so on. A good auditor not only interviews the firm's marketing professionals, but also outside groups such as customers, intermediaries, and advertising agencies.

The marketing audit examines six major marketing areas of the company: (1) environment, (2) strategy, (3) organisation, (4) systems, (5) productivity, and (6) specific function or decision areas. Some of the current issues that need to be added to the six areas mentioned earlier are<sup>14</sup>:

- Globalisation (i.e. international opportunities and strategies considered by the firm).
- Information Technology (I.T.) (i.e. the firm's existing I.T. practices).
- Changing Environment (i.e. the firm reviewing changing environment).
- Communication Technology (i.e. the firm's use of new media and communication technology, such as telemarketing, sports marketing, and video discs).
- Analytical Tools (i.e. the firm's use of analytical tools, including online databases).
- Implementation (i.e. involvement of the firm's managers in the implementation of the marketing strategy and the recommendations of the audit report).

## Sales Analysis<sup>15</sup>

Sales analysis is an important factor or element for evaluating the effectiveness of a sales organisation, because the purpose of a sales organisation is to generate sales. Sales analysis detects strengths and weaknesses of the sales organisation of a company.

**Sales analysis** is described as a detailed inspection of a company's sales data, which includes assimilating, classifying, comparing, and drawing conclusions. All companies collect sales data in the form of customer sales invoices or cash register receipts, which are needed for maintaining their accounting records.

Definition of what is meant by a sale is necessary before starting a sales analysis. The company must decide when a sale takes place—whether at the time an order is received, shipped (and invoiced), or paid for. Most companies define a sale when an order is shipped or transported. The sales organisation should develop an information system based on whatever definition of sale is decided.

Another point companies have to decide is whether to concentrate on sales value (that is, Rupees or Dollars), or sales units (numbers, tonnes). It is often useful to include both sales value and units in a sales analysis, because each one gives different types of evaluative information.

### **Framework for sales analysis**

There are many alternatives available to a company for evaluation of effectiveness of a sales organisation as shown in Fig. 13.12. These alternatives are grouped in three important decision areas: (1) all levels in the sales organisation, (2) different type of sales, and (3) different type of analysis.

**All levels in the Sales Organisation** Sales analysis should be done at all the levels of the sales organisation. There are two reasons for this—(1) For evaluation and control purposes, sales managers at various levels need sales analysis. At higher levels, that is national sales managers and regional sales managers, sales analysis is needed not only at their levels but also at the next level(s) below

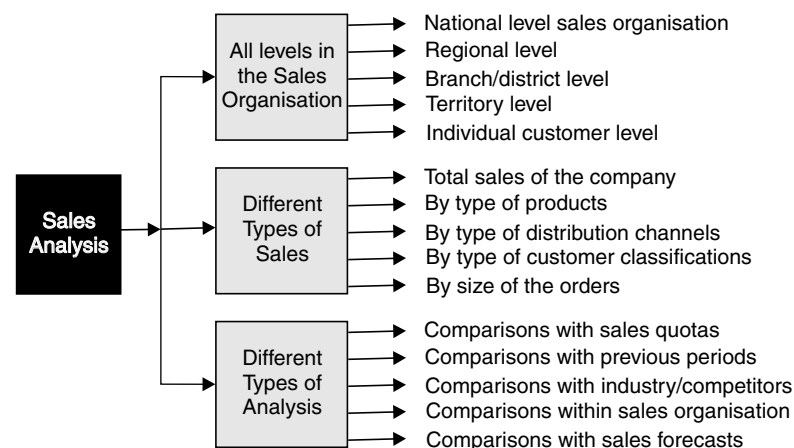
for evaluation and control, and (2) for identifying problems (or strengths and weaknesses), companies use a *hierarchical sales analysis*. This includes evaluation of sales performance from the company level down to the last level. **For instance**, the sales analysis is first done at total organisation level, by comparing the actual sales with the sales budget of the company, both in value (Rupees or Dollars) and units (numbers, tonnes, or litres). If the actual performance is not up to the budget level, the sales analysis of the next level, say, regional level is done to identify which region(s) are having problems in reaching their sales quotas.

Next, sales analysis are done for all the branches (or districts) reporting to those problematic (or weak) region(s). This would identify low sales in specific branch(es). Further sales analysis is done for all territories in those low sales branches. This would point out territories which are not achieving their sales quotas. Further analysis is needed to find out why these territories are not achieving their sales quotas by an analysis of customers in the territories, talking to customers, salespersons, and the branch manager(s). Corrective actions can then be taken to increase sales from these problematic territories. Thus, the hierarchical sales analysis method is a systematic way to carry out a sales analysis, to identify strengths and weaknesses (or problems) in the sales organisation.

**Different Types of Sales** The analysis of different types of sales, shown in Fig. 13.12, at different organisational levels definitely increases the sales manager's ability to detect problem (or weak) areas in the company's sales performance.

But it makes the evaluation process confusing. A better way is to extend the hierarchical sales analysis, by focusing different type of sales on to the problematic territories. This would help understand the sales problems of the territories completely, by knowing which products and customer types are having low sales as compared to the sales quotas. Additional analysis would be needed for these products and customers to find out why sales are low and what needs to be done to improve sales performance.

**Different Types of Analysis** In Fig. 13.12, different types of analysis are mentioned. Out of these, comparisons of actual with sale quotas are widely used by companies because it gives interesting information. Comparisons of actual performance with sales forecast are done at the company level. Based on the company sales forecast, sales quotas are set at regional, branch or district, and territory levels. As



**Figure 13.12** A Framework for Sales Analysis

shown in Table 13.7, an effectiveness index can be calculated by dividing the actual sales by the sales quota and multiplying by 100. This index helps to compare the sales effectiveness at different organisational levels. As shown in an **example** in Table 13.7, sales growth of this year sales over last year sales is another useful analysis for the four regions of the company. Market share analysis is also done for the four regions of the company, by dividing the (actual) sales by the industry sales and multiplying by 100.

**Table 13.7** An Example of Different Types of Analysis

	<i>Northern Region</i>	<i>Eastern Region</i>	<i>Western Region</i>	<i>Southern Region</i>
Sales (₹ Million)	23	22	28.5	27
Sales Quota (₹ Million)	25	20	30	25
Effectiveness Index	92	110	95	108
Sales Last Year (₹ Million)	22.5	19	28	24
Sales Growth (%)	2	16	2	12
Industry Sales (₹ Million)	250	200	300	250
Market Share (%)	9	11	9.5	11

Most companies use sales analysis for evaluating the effectiveness of sales organisations. However, sales data should be available at different organisational levels and also for different type of sales.

### Marketing Cost and Profitability Analysis<sup>16</sup>

While sales analysis is useful as one of the factors for evaluating the effectiveness of a sales organisation, for comprehensive evaluation other factors like cost analysis and profitability analysis should also be considered.

Sometimes called as “distribution cost analysis”, marketing cost analysis is the analysis of costs that affect sales volume. The purpose of marketing cost analysis is to determine the profitability of sales (or marketing) control units, like market segments, sales territories, and products. This is done by subtracting the marketing costs from the sales revenue, associated with the sales control units. Marketing cost is a managerial tool that is used for planning and control of a company’s future operations. Often, an analysis of past financial events helps as a guide for future operations. **For example**, a study on a bank’s profitability found that 30 per cent of the bank’s branches were unprofitable, and 60 per cent of their accounts (meaning customers) generate losses.

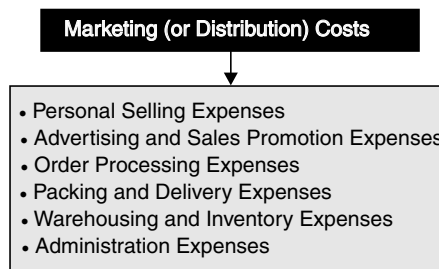
Companies need to measure the profitability of their territories, customer groups (or market segments), products, distribution channels, and customers. This information will help the management to decide whether any sales and marketing activities or products should be expanded, reduced, or eliminated in future.

#### ***Procedure for marketing cost and profitability analysis***

The procedure followed for conducting a marketing cost and profitability analysis for a sales organisation includes the following steps: (1) state the purpose of the analysis, (2) identify functional (or activity) expenses, (3) convert (or change) natural accounting expenses into functional expenses, (4) allocate functional expenses to market segments, products, or other marketing/sales units, and (5) prepare the profitability of the marketing/sales units.

**State the purpose of the analysis** Before starting the marketing cost and profitability analysis, the sales manager should decide the purpose. Whether the purpose is to find the profitability of sales territories, market segments, products, branch offices, or sales representatives? Depending upon the answer, the marketing costs are classified as either direct or indirect costs. **For instance**, a salesperson's salary is a direct cost with respect to an allocated territory, but an indirect cost with regard to various products or customer groups. By stating the specific purpose of the analysis, the costs can be classified.

**Identify functional (or activity) expenses** Each company should prepare a list of major activities (or functions) that are relevant to its own marketing programme. A manufacturer of material handling equipment, **for example**, performs different activities compared to a retail chain. However, a typical list, as shown in Fig. 13.13, includes: personal selling expenses, advertising and sales promotion expenses, order processing expenses, packing and delivery expenses, warehousing and inventory expenses, and administration expenses. Administration expenses consist of costs of sales offices, including salaries of sales managers and staff, travelling, and office maintenance costs. Order processing expenses include costs of processing sales and purchase orders and billing.



**Figure 13.13** Major Functional/Activity Expenses List

**Convert natural accounting expenses into functional expenses** In typical accounting records, expenses are classified according to the object of expenditure. The natural (or traditional) ledger accounts may classify marketing expenses as office rent, sales salaries, and advertising costs. However, for an effective marketing cost analysis these accounting expenses are converted (or changed) into functional (or activity) expenses. A more accountable method for allocating costs is **activity-based costing (ABC)**, which allocates costs to marketing/sales units on the basis of how the units actually spend or cause these costs (or expenses). Costs are gathered and then allocated to the units by suitable factors that drive costs up or down.

We shall take an **example** of Saragam Aluminium Company's simplified profit and loss statement, presented in Table 13.8. We take each natural expense and allocate it to various activities (or functions). Salaries are dispersed to the functional areas where the recipients work, as shown in Table 13.9.

Travel expenses include food, and travelling expenses incurred in personal selling and are therefore allocated to personal selling expenses. Similarly, entire natural expenses on advertising and sales promotion are allocated to the functional expenses of advertising and sales promotion. However, the expenses on supplies and telephone are allocated to each function (or activity group) that incurs this expense. Rent is allocated to the various functions in proportion to the floor space used by them. Allocations of natural expenses to functional expenses are shown in Table 13.9.

**Table 13.8** Saragam Aluminium Company's Profit and Loss Statement

Sales		75,00,000
Less Cost of goods sold		52,00,000
Gross Margin		23,00,000
Less Sales expenses		
Salaries	11,00,000	
Rent	3,50,000	
Supplies and Telephone	1,50,000	
Travel	1,20,000	
Advertising and Sales Promotion	80,000	
Total Sales Expenses		18,00,000
Net profit		5,00,000

**Note:** All figures are in Rupees.

**Table 13.9** Saragam Aluminium Company: Natural Expenses Allocated to Functional Expenses

Natural Expenses	Total	Functional Expenses				
		Personal Selling	Advertising and Sales Promotions	Warehousing Inventory	Order Processing	Administration
Salaries	11,00,000	6,00,000	1,50,000	1,00,000	1,00,000	1,50,000
Rent	3,50,000	1,00,000	40,000	1,40,000	35,000	35,000
Supplies and Telephone	1,50,000	40,000	25,000	35,000	30,000	20,000
Travel	1,20,000	1,20,000	—	—	—	—
Advertising and sales promotion	80,000	—	80,000	—	—	—
Total	18,00,000	8,60,000	2,95,000	2,75,000	1,65,000	2,05,000

**Note:** All figures are in Rupees.

**Allocate functional expenses to marketing units** To find the marketing costs and profitability of marketing units, such as branches, regions, market segments, products, or channels, the functional expenses should be allocated to the marketing unit under study. There are several bases for allocating functional expenses to different marketing units, which are presented in Table 13.10.



**Table 13.10** Bases of Allocation of Functional Expenses to Marketing Units

<i>Function</i>	<i>Bases of Allocation of Expenses</i>
• Personal selling	<ul style="list-style-type: none"> <li>• Direct to sales territories</li> <li>• Selling time given to each product and marketing segment</li> <li>• Number of sales calls multiplied by average time per call to customers and distribution channels</li> </ul>
• Advertising and sales promotion	<ul style="list-style-type: none"> <li>• Direct or by circulation of media to sales territories</li> <li>• Direct or media space given to each product and market segment</li> <li>• Direct for sales promotion or equal charges to customers and distribution channels</li> </ul>
• Warehousing and inventory	• Physical unit of goods handled, shipment, or orders received (applicable for all marketing units)
• Order Processing	• Number of customer orders (applicable for all marketing units)
• Administration	• Equal charges to each salesperson, or selling time (applicable for all marketing units)

**Prepare profitability of marketing units** Profitability analysis of marketing units (that is, regions, branches, channels, products, or customer groups) can be developed by preparing profit and loss (or income and expense) statements for marketing units. However, the question comes how to allocate indirect or shared expenses to various marketing units. There are two approaches in allocating marketing costs for profitability analysis: full-cost (or net profit) approach, and contribution (or contribution-margin) approach.

In the **full-cost approach**, all marketing expenses, both direct and indirect, are allocated to the marketing unit under study. By allocating all marketing costs, the company is trying to find the net profit of each marketing unit. This is presented in Table 13.11. In the **contribution approach**, only the direct expenses are allocated to each marketing unit, for which profitability analysis is being done. The indirect or shared expenses are not included. After deducting the direct costs from the gross margin, the amount that remains is the contribution that is available to cover the overhead (indirect) expenses and a profit. An **example**, which includes both approaches, is shown in Table 13.12.

**Table 13.11** Full-Cost versus Contribution Approaches

<i>Full-Cost Approach</i>	<i>Contribution Approach</i>
Sales	Sales
<u>Minus: Cost of goods sold</u>	<u>Minus: Cost of goods sold</u>
Gross margin	Gross margin
Minus: Direct selling expenses	<u>Minus: Direct selling expenses</u>
	Contribution (available to cover overhead expenses and profit)
<u>Minus: Allocated indirect expenses</u>	
Net profit	

**The example** presented in Table 13.12 uses full-cost approach for evaluating the profitability of western region and the contribution approach for assessing the profitability of the three branches within the western region. The profitability calculations of branches include branch sales, cost of goods sold and branch selling expenses. This generates profit contribution for each branch. The profitability calculations for the western region include branch selling expenses, western region direct selling expenses (that are not allocated to the branches), and allocated portion of indirect expenses. This gives a net profit figure for the profitability evaluation of the region.

**Table 13.12** An Example of Profitability Analysis

	<i>Full Cost Approach</i>	<i>Contribution Approach</i>		
	Western Region	Branch A	Branch B	Branch C
Sales	400	150	130	120
Cost of goods sold	300	112.5	97.5	90
Gross margin	100.0	37.5	32.5	30
Branch selling expenses	12.7	4.5	4.2	4
W. Region direct selling expense	12.0	—	—	—
Profit Contribution	75.3	33.00	28.3	26
Allocated indirect expenses	36.3	—	—	—
Net profit	39.0			

**Note:** All figures are in Rupees million.

There is a considerable argument over the relative merits of contribution and full-cost approaches. Supporters of full-cost approach state that the purpose of a marketing cost study is to decide the net profitability of the marketing units under study. They think that contribution approach does not satisfy this purpose. Besides, full-cost supporters think that a contribution approach may be misleading, because a product or market segment may show a positive contribution, but after deducting allocated indirect expenses, the product or market segment may show a loss.

Supporters of contribution approach argue that it is very difficult to arrive at a satisfactory procedure for allocating the indirect costs. Therefore, contribution approach is more objective in evaluating the profitability of a marketing unit. Further, these advocates point out that a full-cost approach may show that a product or a branch has a net loss, whereas, this marketing unit may be contributing positively to the overhead costs.

In reality, both approaches are useful in profitability analysis. A full-cost approach is useful when making a long-term study of the profitability of different products or market segments. The contribution approach is useful for short-term marketing decisions, such as evaluation of profitability of branches and regions, when only direct costs are allocated to them. There seems to be a trend towards the contribution approach, for a short-term analysis.

### Key Efficiency Indicators

Efficiency control, as mentioned in Table 13.6, finds out how resources are used in the elements of marketing strategy. Some companies like DuPont and Johnson & Johnson have set up the position of a

marketing controller to improve marketing efficiency.<sup>17</sup> They monitor key efficiency indicators, some of which are shown below:

**Product Efficiency Indicators** Product managers need to monitor the following key indicators of efficiency for their respective products.

- Sales growth rates for the product
- Market share
- Return on investment or contribution margin

If the performance of the product on the above key indicators is not satisfactory, further analysis should be done based on customers' perceptions about the product quality and features, service, and pricing in relation to competition. Thereafter, the company can take corrective actions.

**Distribution Efficiency** Business marketers should focus on profit contributions by different channels as well as cost of logistics, with the help of the following key efficiency indicators:

- Sales, expenses, and contribution by each channel
- Logistics cost as a percentage of sales
- Percentage of orders completed correctly (or delivery service)

The company should bring down the logistics cost (which mainly includes inventory, transportation, and warehousing) and at the same time improve the delivery service, to improve distribution efficiency.

**Communication/Promotion Efficiency** This includes all the elements of communication—viz. advertising, sales promotion, personal selling, direct marketing, and public relations. The key indicators of efficiency are:

- Advertising effectiveness by each media type
- Sales per sales call
- Before and after measures of customers' awareness, attitude, and purchase action
- Number of inquiries or sales leads generated by ads, trade-shows, and the internet

Based on above indicators, the company can take corrective actions to reduce cost and improve promotional impact.

**Pricing** A study of general pricing strategy and policy can help in identifying key indicators of efficiency. These are as follows:

- Discount structure (trade, quantity, and cash) as related to sales volume and competition
- Changes in prices in relation to sales volume and costs

Pricing strategies and policies are to be seen in relation to product strategy and customer service levels, as perceived by the target customers. It is difficult to analyse the pricing efficiency in isolation.

## ETHICAL ASPECTS IN BUSINESS MARKETING

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Consider the following **instances** of unethical behaviour of some organisations, which appeared as news items in a business newspaper.

- **“EU fines Siemens, Areva, Alstom for price fixing”** European authorities fined Siemens, Areva, Alstom, Schneider Electric, and six competitors 750.7 million euros (\$976.6 million) for fixing prices of electricity transmission gear. The commission has put an end to a cartel which has cheated public utility companies and consumers for more than 16 years<sup>18</sup>.
- **“Former Siemens managers to pay \$51 million fine”** Siemens beset with at least three corruption investigations, was ordered by a German court to pay 38 million euros (\$51 million) as two former managers were found guilty in a bribery case<sup>19</sup>.
- **“Government suspects cartel among cement makers”** The Health Ministry of Government of India got suspicious after all the five private companies and a public sector company, Hindustan Latex, quoted ₹ 25 for single piece of intra-uterine contraceptive device, called Copper-T, while bidding for the 80 lakh (8 million) units contract in 2004–05. This is ₹ 16 higher than the price at which it was procured a year earlier. The government has asked the director-general of investigation and registration (DGIR) attached to the Monopolies and Restrictive Trade Practices Commission to investigate the issue<sup>20</sup>.

These are some of the **examples** of ethical issues in business marketing.

Companies need to evaluate whether they are practising ethical and socially responsible marketing. The most admired companies in the world abide by a code of serving people's interests, not only their own.

Some of the examples of marketing-related practices that raise ethical dilemmas are as follows:

- Providing free trips, luncheons, or gifts
- Seeking information about competitors' quotes or other competitive information from customers
- Exaggerating claims regarding product quality, reliability, or service life
- Downgrading competitors to get a customer's business
- Refusing to accept returns of products that are clearly defective
- High pressure selling tactics used in persuading prospective customer to buy

The issues raised above are not easy to draw a line between normal marketing practices and unethical behaviour. At the same time, certain business or marketing practices are unethical or illegal. These include bribery, stealing trade secrets, price-fixing, and false warranties. Thanks to the internet, companies today are at greater risk of being exposed. Today, a disgruntled customer can reach thousands of people on the internet. **For instance**, Microsoft had attracted over 100 anti-Microsoft sites, including Hate Microsoft and Boycott Microsoft.

Ethics is a company-wide responsibility. Sales and marketing managers are sometimes caught in the middle by senior managers, who pay lip service to responsible behaviour. Unless senior management explicitly includes ethical performance in the formal performance measurement system, it is perhaps unrealistic to expect sales and marketing persons to follow ethical standards.

On a broader view, there is a need to take the following steps to ensure ethical behaviour from organisations: **(1)** Society should use the law to define those practices that are illegal, antisocial, or anti-competitive; **(2)** Companies must adopt and spread the information on a code of ethics, build a tradition of ethical behaviour, and hold its people fully responsible for observing ethical and legal guidelines; **(3)** Individual sales and marketing persons must practise ethics in their dealings with customers and other stakeholders.

## SUMMARY

An effective strategic planning should have market-oriented strategies. Companies achieve market orientation by managing the four factors: shared values, integrated organisation, strategy, and stakeholders. The role of marketing in strategic planning is at corporate and business unit levels. At corporate level, marketing function provides information on customer and competition for development of a corporate strategy. At business unit (or SBU) level, marketing helps in the development of business strategy which includes competitive advantage and long-term marketing strategies such as segmenting, targeting, positioning, and product-line decisions. In relationship with strategic planning at the business unit level, marketing activity takes the form of strategic marketing. At the functional level, marketing management is a part of operations management. It deals with developing short-term (i.e. up to one year) marketing plan.

Strategic planning is done at corporate and business-unit levels in large organisations. At the corporate level, strategic planning process includes developing corporate mission and objectives, defining strategic business units (SBUs), allocation of resources to SBUs and developing corporate strategies to fill the strategic planning gap.

For allocation of resources, two widely-used models or techniques are *Boston Consulting Group (BCG) Model*, and *General Electric (GE) Model*. To fill the strategic planning gap between the desired sales and the projected sales, firms use three alternative strategies at the corporate level: intensive growth, integrative growth, and diversification growth.

*Strategic planning at business unit level* includes the following steps: (i) Defining the business unit's mission, (ii) Scanning the external environment (including opportunity matrix, threat matrix and competitive forces analysis), (iii) Analysing the internal environment, (iv) Developing objectives and goals, (v) Formulating strategies, (vi) Preparing action plan, (vii) Implementing strategies and action plans, (viii) Monitoring results and taking corrective actions.

There are three generally applicable strategies at business unit level, as identified by Michael Porter. These are *overall cost leadership*, *differentiation*, and *focus*.

Strategic alliances are becoming a necessity in the new global environment. In a strategic alliance two or more companies pool their complementary capabilities and resources to achieve agreed objectives.

After formulating a business strategy, the next logical step is to develop a marketing plan at the functional level. The contents of business marketing plan consists of (a) *situational analysis*, (b) *SWOT and issues analysis*, (c) *objectives and goals*, (d) *marketing strategy*, (e) *action plan*, (f) *marketing budget*, (g) *implementation and control*, and (h) *contingency plan*.

For effective implementation of marketing plans four skills are important: *allocating*, *monitoring*, *organising*, and *interacting*. The process of marketing control consists of four stages: *setting goals*, *performance measurement*, *performance analysis*, and *taking corrective actions*. There are also different types of control: *strategic*, *annual plan*, *efficiency*, and *profitability controls*.

Business organisations use marketing audit as a tool for strategic control, sales analysis for annual-plan control, marketing cost and profitability analysis for profitability control, and key efficiency indicators for efficiency control.

Companies need to evaluate whether they are practising ethical and socially responsible marketing. Unless senior management includes ethical performance in the formal performance measurement system, ethical standards may not be followed.

**KEY TERMS**

- Competitive forces
- Diversification strategy
- Efficiency control
- Integrative growth strategy
- Intensive growth strategy
- Marketing control
- Mission
- Operational management
- Portfolio analysis
- Shared values
- Strategic alliance
- Strategic Business Unit (SBU)
- Strategic control
- Strategic management
- Strategic planning
- Strategic planning gap
- SWOT analysis

**Note:** Glossary of the key terms is given at the end of the text.

**CONCEPTUAL QUESTIONS**

1. How do the companies achieve market orientation?
2. Explain the role of marketing at corporate, business-unit, and functional levels.
3. Describe how the strategies differ at corporate and business-unit levels.
4. Why are increasing number of companies entering into strategic alliances? Which factors contribute to successful alliances?
5. Explain briefly the components of a business marketing plan.
6. How can business market managers effectively implement a marketing plan?
7. Describe the process of marketing control.
8. Explain briefly the types of marketing control, their aims, and the major tools used.
9. What should the company management do to ensure ethical behaviour from sales and marketing professionals?

**OBJECTIVE TYPE QUESTIONS**

1. The role of strategic marketing includes developing strategies on: (a) pricing, (b) promotion, (c) segmenting, targeting, and positioning, (d) all of the above, or (e) none of the above.
2. A goal is: (a) quantified objective, (b) long-term objective, (c) short-term objective, or (d) none of the above.
3. BCG model is used as a tool for decisions on: (a) pricing, (b) resource allocation, (c) distribution channels, or (d) promotion.
4. Strategic planning gap is a gap between the projected sales and: (a) budgeted sales, (b) actual sales, (c) desired sales, or (d) past sales.
5. In horizontal integration strategy a company acquires the business of its: (a) suppliers, (b) distributors, (c) agents, or (d) competitors.
6. Monitoring of external environment is useful for a business organisation for analysing: (a) strengths and weaknesses, (b) objectives and goals, (c) opportunities and threats, or (d) sales and marketing strategies.

7. According to Thomas Bonoma, four skills are required for implementing marketing plans. These are: allocating, monitoring, organising, and one of the following: (a) planning, (b) controlling, (c) interacting, or (d) supervising.
8. There are four types of marketing control: strategic, annual-plan, efficiency, and one of the following: (a) cost, (b) sales, (c) profitability, or (d) market share.
9. In marketing cost and profitability analysis, the full-cost approach is useful for making: (a) short-term, (b) medium-term, or (c) long-term decisions.

### APPLICATIONS QUESTIONS

1. Product manager of Cool Star company finds that at the end of the first quarter, customer orders of central air-conditioning plants sold to business customers like hotels, hospitals, cold storage plants and other commercial organisations, are 25 per cent below target. Explain the process the product manager can use for analysing this performance deviation.
2. Assume you are the regional manager of eastern region. You would like to evaluate the profitability of the branches (viz. Kolkata, Gauhati, and Patna) reporting to you. Explain what information you would seek from the company's marketing information system and which approach you would follow in allocating marketing costs for profitability analysis.
3. Suppose you are a branch manager and one of your salespersons asks you if the company can pay two per cent of the total value of ₹ 50 million order as bribe to get the order from a government organisation. Your company has no specific guidelines on ethical behaviour. This order will help not only to exceed your branch sales target, but also to earn incentives from the company. What would you do?

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### CASE 13.1

#### **Autotech Pvt. Ltd.: Deciding Business Strategy\***

Sunil Shetty, Director, Autotech Pvt. Ltd., was not sure what kind of competitive strategy the company should adopt in the face of growing competition. The company was one of the leading manufacturers of service station equipment for two-wheeler service stations in southern region of India. Autotech started its operations in 1995 in Bangalore and by 2007, it had become a dominant player in Southern India.

The company adopted a focus strategy, by concentrating on superior quality of the equipment to the geographic segment of the four southern states of India—viz. Karnataka, Tamil Nadu, Andhra Pradesh, and Kerala.

Sunil Shetty discussed with the other two directors to invest in the new three-wheeler service station equipment and to launch the product in the market by end 2008. The company had the advantage that the new equipment would be needed by the existing two-wheeler service stations. This would minimise the cost of launching the new product.

The major players in the three-wheelers market were Bajaj Auto (65 per cent market share) and Mahindra & Mahindra (17 per cent market share). However, TVS and Hero Honda were also planning to launch their three-wheeler commercial vehicles in 2008.

Autotech did not find it necessary to have a marketing department. The company did not have any promotional strategy. The directors thought the company could not afford the marketing expenditure. The relationships with the existing customers were built by their service engineers. Sunil Shetty felt there was no need to develop new customers, since the existing customers were giving adequate business.

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Nandan Mallesh and Mohit Kumar, SBS-ABA MBA students of Alliance Business Academy, Bangalore.



However, in the three-wheeler service station equipment there was already a dominant competitor and also there was a possibility of new players from other parts of India entering the southern regional market. Therefore, the question uppermost in the minds of Sunil Shetty and the other two directors was what kind of competitive strategy the company should now adopt in the changing marketing environment?

### Questions

1. Do you agree to the company's existing business strategy?
2. Should the company continue with the existing strategy in future or not? Give reasons.
3. Assuming the company should change its strategy to meet growing competition, what strategy do you suggest and why?

## CASE 13.2

### Star Engineering Company Ltd\*

In January 1993, the Chairman and Managing Director (CMD) of Star Engineering Company Ltd (SECL) encountered a problem of deciding how to allocate the funds to various products. The company had limited financial resources, and to maintain a growth in sales and profits he thought that it was important to allocate the available funds in a balanced manner. The general managers of each of the five product-groups were asking for funds for the expansion of their operations. The CMD asked Mr. Anant Kumar, who had joined the group as an executive in the corporate planning cell, to study the problem and give his recommendations. Mr. Kumar, who had completed his MBA in May 1992, thought that it was a good opportunity to apply what he had learnt at the business school.

As the report was to be given to the CMD within a month, Mr. Kumar immediately started collecting the information about the various products.

*Product "A" was the transformer coils*, sold to the manufacturers of equipment used in telecom exchanges. The total market for the transformer coils was growing at an average rate of 25 per cent per annum. The company's product was well accepted by the customers in terms of quality, and it was considered as the market leader with a market share of 20 per cent. To keep pace with the growth and to maintain leadership, the General Manager wanted to increase the production capacity with an additional investment of ₹ 2 crore (i.e. ₹ 20 million) in plant and equipment.

*Product "B" was the cable jointing kits*, for jelly-filled cables used in telecom industry. Although telecom industry was growing at the rate of 15 per cent per annum, the jelly-filled cables and jointing kits were getting slowly substituted by fibre-optic cables and suitable jointing kits. The information on the rate of substitution was not available from the Department of Telecommunication (DOT). Due to growing competition, the market share of the company had come down from 100 per cent in 1988 (when the company had introduced this technology in India) to about 20 per cent in January 1993, but it was still the market leader among the seven players. Out of the total group sales of ₹ 25 crore (i.e. ₹ 250 million), the turnover contributed by this product was ₹ 15 crore (i.e. ₹ 150 million). This product,

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\* This case was prepared by Prof. Krishna K. Havaladar for classroom discussion. It does not indicate an effective or an ineffective handling of a business situation.

which was contributing to the expansion and diversification projects of the company, had faced with the problems of substitution and competition.

*Product “C” was the electric point machines*, used by railways for changing tracks electrically instead of the old method of mechanical track changing. The demand for this product from the Indian railways was growing at the rate of 7 to 8 per cent per year and the company was exploring export markets. Since the company’s market share of 40 per cent was the highest amongst the three manufacturers, including a multi-national company, the General Manager was confident of getting business from international markets if he was allowed to expand the production capacity by investing ₹ 2.50 crore (or ₹ 25 million).

*Product “D” was the steel forgings*, required by diverse industries. The unit which produced this product was sick and was located at Mangalore. The company acquired the management of the unit in 1990 with an objective of turning it to a healthy unit in about two years. Despite investing ₹ 3 crore (₹ 30 million) and giving the best management attention for more than  $2\frac{1}{2}$  years, the unit continued to make losses. The market share of the product was only five per cent. The domestic market for steel forgings was growing at the rate of about 8–10 per cent but there was a tremendous demand in international markets. The basic problems faced by the unit was poor product quality and high rejection rate. The General Manager wanted to improve the quality and try for ISO-9000 certification, for which certain equipment needed replacement. An investment of at least ₹ 1.50 crore (₹ 15 million) was required for this.

*Product “E” was the switch mode power supply (SMPS)*, required by electronic industry. The total market for SMPS was growing at the rate of 20 per cent per annum. This was a new product to the company, introduced about six months earlier, in July 1992. The production capacity could not be increased as the company could not meet the funds requirement of ₹ 5 crore (₹ 50 million) due to financial constraints. There were only four suppliers of SMPS. Although the market share of the company was only 6 per cent, it had a good potential to become a market leader.

The total requirements of funds for all products was at least ₹ 11 crore (₹ 110 million). However, the management could arrange for only ₹ 5 crore (₹ 50 million).

### Question

1. If you were Anant Kumar, what would be your recommendations to the CMD of the company?

# 14

## Business-to-Business Marketing Through Electronic Commerce

*After studying this chapter you should be able to:*

- Know how traditional business environment is changing to e-Commerce revolution.
- Understand the forms of business-to-business marketing through e-Commerce.
- Learn to create electronic markets using the Internet.
- Learn to create a business site on World Wide Web (WWW) portion of the internet.
- Analyse how electronic markets and the internet will evolve in future.

Commerce is a process of the exchange of goods or services, where buyers and sellers come together in a marketplace. e-Commerce is buying and selling of products and services by businesses and consumers through an electronic medium, particularly using Internet. It also enables intra- or inter-organisational activities that facilitate the exchange of products and services.

e-Commerce uses the digital technology for trading and transmitting information between individuals and organisations as well as business-to-business (B2B).

We have defined business-to-business (B2B) marketing in Chapter 1 as marketing of products and services to business organisations. Business-to-business marketing is also referred to as industrial marketing or business marketing or organisational marketing. Today the cutting edge for business is electronic commerce (e-Commerce). e-Commerce is generally divided into three segments: business-to-consumer (B2C), consumer-to-consumer (C2C), and business-to-business (B2B). Here, we focus on conducting business-to-business marketing through e-Commerce.

### WHAT IS E-COMMERCE?

E-commerce is buying and selling of products and services by businesses and consumers through an electronic medium, particularly using Internet. It also enables intra or inter organizational activities that facilitate the exchange of products and services.

E-commerce uses the digital technology for trading and transmitting information between individuals and organizations as well as B2B.

Conducting business-to-business marketing through e-Commerce represents a basic shift or change in the manner firms are interacting with buyers and suppliers.

**The Role of e-Commerce** It should be understood as a new communication tool, which can be used to achieve a company's objectives like increase in customer service, customer satisfaction, and sales. It cannot replace an effective marketing strategy, nor can it remove a marketing or sales function.

e-Commerce is an instrument that improves the effectiveness and efficiency of the marketing or sales function.

**Application of e-Commerce** It is important to understand that e-Commerce can be applied to all functions of the business. We shall identify here some of the important marketing applications of e-Commerce. These are: (i) communicating with customers, intermediaries, and suppliers; (ii) online marketing and advertising; (iii) getting and processing customer orders, and informing customers about delivery or dispatch positions of their orders; (iv) effective managing of finished-goods stocks; (v) receiving payments from customers by using electronic payment systems; and (vi) gathering useful information about existing and prospective customers.

e-Commerce is generally classified into the following types:

- **Business-to-Business:** Business-to-Business (B2B) transactions conducted electronically between two businesses or organisations.
- **Business-to-Consumers:** Business-to-Consumers (B2C) transactions conducted electronically between companies and consumers over the internet.
- **Consumers-to-Consumers (C2C):** A consumer sells product or service to other consumers electronically.
- **Collaborative Commerce (c-Commerce):** Business partners collaborate along the supply chain electronically.
- **Intra-organisational Commerce:** e-Business transactions within an organisation.
- **Mobile-Commerce (m-Commerce):** e-Commerce through wireless mobile devices.
- **Location based-Commerce (l-Commerce):** Delivers the information about the goods and services based on their positions or location.
- **e-Government:** The delivery of public services electronically.
- **Government-to-Citizens (G2C):** Government provides services to its citizens.
- **Government-to-Government (G2G):** Government do business with other governments.
- **Government-to-Business (G2B):** Government does business with other business organisations.

## CHANGING BUSINESS ENVIRONMENT

The traditional business environment is changing rapidly as business firms want to increase the efficiency of business communications, expand market share, and maintain long-term viability. In B2B e-Commerce both sellers and buyers are business organisations. B2B covers a broader spectrum of applications that enable an enterprise or business firm to form digital relationship with their distributors, suppliers and other partners.

The aim of web-enabled B2B marketing is to help the companies to establish and accomplish its goals on the internet. The internet presence establishes the companies as a player in the new age and puts them ahead of the game, establishing the company in an emerging e-Commerce market. The customers can shop or access product information's 24 hours a day 365 days a year. This is enabling to deliver information, product and services around the world or within the country. The B2B marketing technique is the one that:

- Is an on-line brochure that introduces the company to potential customers, channels or distributors.

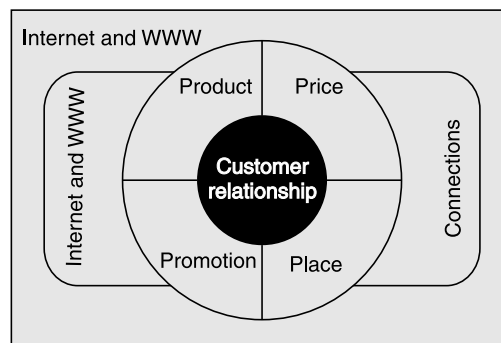
- It supplements the company's off-line operation and talks to the audience, offering customers and sales services and support.
- Displays an electronic catalogue for on-line shopping and sells the products and services directly on the web.
- Connects the companies operation with its suppliers to increase efficiency and streamline delivery systems.

The Marketing Mix Model (four P's) can be used by marketers as a tool to assist in implementing the marketing strategies. These four most important P's are generally accepted as in Fig. 14.1. to be Price, Product, Promotion and Place. These P's are still useful in considering e-Business. The resulting marketing space model which identifies the three key features of e-Business that are enabled through technology as an extension of the tradition four P's marketing model. In this model the customer relation is rightly placed at the centre which enables the e-Business system to provide a customised or personalised service.

Due to the real-time, on-line nature of the Internet, relationship between organisations at customers is becoming more interactive. This enhances the richness of customer relationship and gives rise to new paradigm of product design and customer services.

Let us see some of the **examples** to understand the changing business environment;

- In 1996, Boeing Airplane Company launched an e-Commerce site on the World Wide Web (WWW) to help its global customers in getting spare parts. Customers were in a position to check the prices and availability of the spare parts, place orders and monitor the progress of their orders. More than 50 per cent of Boeing customers were using the site within one year, and spare parts business of Boeing grew by over 20 per cent, without increasing its manpower.
- Many business firms, including Boeing and Motorola, have warned their suppliers that they must develop the ability to conduct business through e-Commerce within one year. If not, such suppliers will not be considered for any business in the long-term.



**Fig. 14.1** *The Marketspace Model*

**Source:** Amoni et al., 2000.

- Prior to 1996, Microsoft used a variety of manual, paper-based processes for purchasing goods and services. The process was slow, costly, and error prone. In the summer of 1996, Microsoft Corporate Procurement Group implemented an innovative new procurement method that was on Microsoft's Intranet. It was an easy-to-use system that provided online forms for ordering

office supplies, PCs, catering, and so on. The new method validated pricing and availability. It ensured that each order had the correct accounting code and automatically routed the order to managers for approval. The results were impressive. In less than two years order processing costs dropped from \$60 to \$5 per order, and manpower costs were reduced by about \$3 million. (Source: Microsoft IT showcase, at [www.microsoft.com](http://www.microsoft.com)).

**For example, Dell B2B Business model:** The B2B business model used by Dell has been enabled by information technology. In this model, more order for purchasing computers and laptops are placed with Dell by telephone or through internet, through a process called Just-in-Time (or lean) manufacturing, waste is reduced and productivity improved by only having the required inventory on hand when it is actually needed for manufacturing. This reduces both lead time and set-up time for building a computer. Using JIT technique, Dell only orders the parts for computers when it has a corporate order (or non-corporate orders). As a result, Dell operates with little in-process and no finished goods inventory; products are shipped as soon as they are manufactured. This approach also enables Dell to forgo having brick and mortar store fronts with inventory that must be kept on the books or that might become absolute, thereby significantly reducing the over-head. In addition, items that are not built by Dell are shipped directly to the customer by the manufacture. These features help Dell to reduce the cost of production and sales. Far from being inflexible, however, this process also allows Dell to customise design systems for its customer within certain parameters as well as to offer a range of items rather than a single system.

The e-Commerce revolution is taking place in India too with e-Business paper, educational portal for youth ([www.edurite.com](http://www.edurite.com)) and many business firms adopting e-Commerce for business-to-business marketing. One such example from Indian business situation is Tata BP which adopted e-Commerce to market their solar products by establishing a web site. The company's marketing executives felt that marketing solar products to industrial customers through the Internet was easier, less time consuming, and less costly, compared to the traditional methods of conducting business.

Let us compare the traditional (old) order-taking process and the new (web-based online) order-taking process:

**Traditional Order Taking Process** This typically involves the following steps.

1. The company's industrial (or business) customer sends the purchase order by fax. The order mentions the price that is outdated, product's specifications do not match, and the product is out-of-stock.
2. The company's sales representative contacts the customer on phone or visits personally to explain the problems. With great difficulty he makes the customer issue an amendment to the purchase order indicating change in product specifications, prices, and delivery period.
3. The sales clerk types the work order for the production department as a part of order processing system. He makes mistakes!
4. Mistakes made in the work order show up at the final inspection before despatch. The sales rep again spends time with the customer requesting amendment to delivery time. The frustrated customer decides to cancel the order.

**New (Web-based online) Order-taking Process** This involves the following steps.

1. The customer accesses the company's web site at any convenient time.

2. The customer looks at the product specifications, prices, and availability from the company's current online catalogue and selects the product. If complex technical specifications are involved, the supplier company presents a simple interface that offers valid combinations of components. A customer can compare various suppliers' products with respect to quality and price. After which the customer can ask for customisation of the product and place the order online thereafter.
3. The purchase order is checked online by the supplier company including a credit approval before the customer releases it. Once the order is released by the customer, the order confirmation from the supplier company is immediate.
4. After the placement of the order, the customer can monitor the delivery status of the order on the computer.

Compared to the traditional method, the customer in the new process spends only half of the time in placing the order. The customer enjoys ordering through e-Commerce because it is easier and faster. The supplier firm likes the new method because the order processing costs are 50 to 75 per cent less than those orders processed through traditional method.

In B2B e-Commerce, the business alliances (collaborations) with the different entities will offer enterprises to access the following informations:

1. **Product details:** Specification, price, vendor's details, and supplier details, sales history, comparison of the product with the competitor's products.
2. **Customers:** Sales history and forecasts.
3. **Suppliers:** Suppliers' locations, mode of supply, product line and lead-time, sales terms and conditions.
4. **Shipping mechanisms:** Carriers, mode of transportation, cost and time.
5. **Inventory:** Inventory levels, inventory carrying cost, location.
6. **Service:** After sales services, customer care, frequently asked questions (FAQ).
7. **Sales and marketing:** Promotions, customer relationship.
8. **Supply chain process and performance:** Process descriptions, performance measure, quality, delay time, customer's satisfaction.<sup>6</sup>

**For Example:** Bharti Airtel and Cisco - Strategic Alliance:

Bharti Airtel leading integrated telecom service provider and Cisco's strategic alliance help to drive the growth for Indian enterprises. This alliance combined the strengths of Airtel's network service provider leadership and Cisco's Internet protocol (IP) technologies and also the expertise to work together to create and sell in a phased manner a set of unique products and services including managed data services, hosted unified communications, connected branch services and Cisco Telepresence. This alliance is to support the Indian B2B growth after achieving leadership in the B2B segment of Airtel.

### How B2B e-Commerce Benefits Small Businesses:

B2B e-Commerce is one of the fastest growing segments of the small business marketplace. As businesses flock to the internet to find vendors for essential products or services, B2B e-Commerce is rapidly expanding, both in terms of total revenue and the number of small B2B firms in the digital space. Consumers are drawn to e-Commerce because it allows them to provide digital connections with the leading brands and businesses that are important to them and offer opportunities for seamless customer

experiences. In addition to connecting with e-Commerce providers via Internet connections, the consumers are also provided with sophisticated array of tools and resources, integrating mobile and social channel into their online shopping behaviours.

In response to consumers demand, large and small e-Commerce companies are ramping up their multi-channel strategies. Familiar e-Commerce giants like Amazon, eBay and shop.ca are major players in the consumer's e-Commerce market space and a number of brick-and-mortar retailers, including Best buy, Home Depot and Wall-mart have captured consumer's attention in the digital space.

The way in which large B2B e-Commerce brands gained the marketplace, for small and medium business organisations can also find an opportunity to market their products and services to the consumers. By adopting B2B e-Commerce strategies small businesses gain several important advantages as;

- **Operational efficiency:** B2B small businesses have historically struggled with labour intensive process that are inefficient and hinder organisational growth. E-Business channel help B2B small businesses save time and resources through the automation of on-line and off-line transactions. B2B e-Commerce also allows these companies to streamline warehouse, call centre and other functions that have the potential to become choke points in the company's efforts to achieve targeted growth objectives.
- **Market scale:** In B2B e-Commerce, the multi-channel tactics, solid media campaigns and other strategies allow small businesses to appear like large business organisations. By scaling up market presence, B2B e-Commerce makes it easier for small companies to reach global network, mobile audience and the extended on-line community. As a result, small business gains the ability to react more quickly to market trends and to leverage a more professional industry presence.
- **Sales cycle:** The e-Commerce technology helps B2B small business streamline the sales process and generate higher return on investment (ROI) from their sales programme investment. Conventional B2B sales cycles are labour-intensive and require sales teams to guide customers through a series of mundane tasks. In e-Commerce, these tasks can be automated enabling sales teams to reallocate time towards new customer acquisitions.
- **Cost saving:** B2B e-Commerce has the potential to create substantial cost savings for small businesses. Implementation of e-Commerce initiatives has resulted in lower operational cost saving in the areas like; customer set-up, order management, payment processing, shipment tracking and e-Mail campaigns. It otherwise requires the attention of sales or customer support personnel.
- **Customer experience:** It is important to note that by leveraging e-Commerce strategies, B2B small businesses gain the ability to capture cost reduction and other benefits without sacrificing the quality of customer's experiences. The multi-channel e-Commerce strategy typically results in vastly improved customer experiences by allowing prospects and leads to connect with the company using their preferred channel and technologies.

### Size of e-Commerce Economy

Forrester Research Institute predicted that the revenue generated by web based B2B and B2C e-Commerce in US market is estimated that by the end of 2013, customers facing from end B2B e-Commerce will reach \$559 billion. This figure includes transactions placed on-line. By comparing US B2C e-Commerce will be \$256 billion market which would make B2B e-Commerce fully twice the size of the



B2C e-Commerce. In addition to sizing the US B2B e-Commerce key trends in B2B e-commerce for 2013 explore three important trends in B2B e-Commerce for the coming years:

- *Ever growing demand for B2C e-Commerce, like B2B e-Commerce experiences:* The popular B2C sites having set a high standard for what constitutes a compelling online customers experience, B2B e-Commerce companies are now actively retooling their existing B2B sites or building whole new sites to deliver B2C like e-Commerce experiences.
- *Increased channel conflict between direct sales organisation and e-Commerce operations:* As the e-Commerce option becomes a more viable alternative to a traditional direct sales model, companies are increasingly migrating through off-line customers to more cost-effective self service, on-line only environment.
- *Rising demand for scarce B2B e-commerce talent:* With the demand for B2B e-Commerce talent continuing to greatly outstrip the supply of qualified and competent workers. B2B e-Commerce leaders are now taking unconventional e-Commerce applications.

In 2013, business in B2B e-Commerce will be in the same from B2C commerce selling. New business policies, especially **bring-your-own-device (BYOD)**, have had a big impact on the B2B market. As personal smart phones and tablets are used more frequently in the work place, the immediacy of being able to compare B2B product price and specifications means that competition will inevitably increase. It's vitally important for business organisations to keep their platform ready for this transition and ensure that, they establish a loyal B2B customer base by providing a seamless and helpful on-line service.

## BUSINESS-TO-BUSINESS FORMS OF E-COMMERCE

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The function of B2B e-Commerce (EC) is usually based on the internet. This works as an interconnecting mechanism. The entire activities of B2B EC are happening on the internet. The B2B EC can contribute to lower purchase costs, reduced inventory, enhanced efficiency of logistics, as well as to increased sales and lowered sales and market cost.<sup>1</sup>

The key components of B2B EC and their functions are:

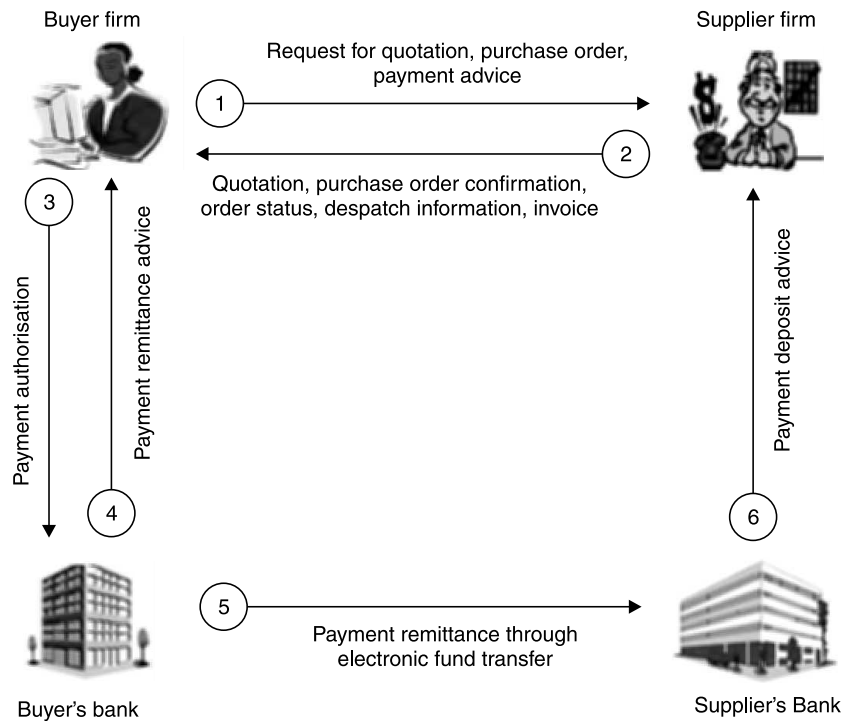
- **Buyer company**—with procurement management perspective or orientation (*see* Fig.2.3).
- **Selling company**—with marketing management perspective (i.e., superior customer value).
- **Electronic intermediary**—this also considered an informediaries,<sup>9</sup> which replaces traditional intermediaries, a third party service provider who performs which activities?
- **Deliverer**—who performs the Just-In-Time (JIT) delivery.
- **Network platform**—Intranet, Internet and Extranet.
- **Protocols and communication**—these are the rules and guidelines used for data communication and message passing, such as Electronic Data Interchange (EDI).<sup>5</sup>
- **Backend information system**—Integrated system (Enterprises Resource Planning) in the organisation interconnected by the help of Intranet and this intern is interconnected to the collaborators' or partners' Intranet (by using Extranet).

There are two forms of B2B marketing through EC:

1. Inter-organisation system
2. Electronic market

### Inter-organisational Systems

Inter-organisational systems emerged due to the business needs of interconnecting business partners to streamline business processes. The buyers and sellers arrange for routine exchange of business transactions over communication networks like Electronic Data Interchange (EDI) by using pre-arranged format as shown in Fig. 14.2.



**Figure 14.2** *Inter-organisational System for EDI*

### Cisco and Intel Alliance

Cisco and Intel collaboratively focused on improving the business impact of technology. The Cisco Intel ([www.cisointelalliance.com](http://www.cisointelalliance.com)) made a common platform to collaborate in specific technology area for the benefit of their mutual customers.

The alliance provides:

- Tangible business value for technology adoption.
- Business class wireless networking solutions that seamlessly combine Intel Centrino mobile technology clients with the Cisco unified wireless network.
- Lower complexity of deployment and total cost of ownership (TCO) for business implementing and managing a pervasive wireless network.

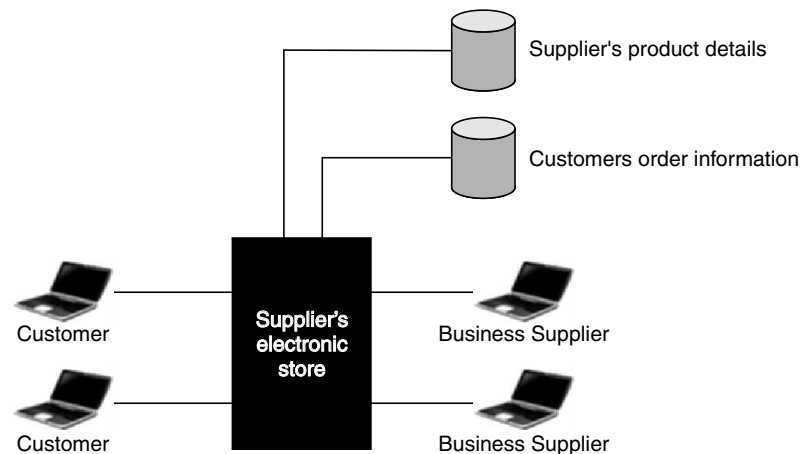
## MODELS FOR B2B EC

B2B EC Models are classified as:

1. Supplier oriented marketplace
2. Buyers oriented marketplace
3. Intermediary oriented marketplace
4. Virtual corporation<sup>10</sup>
5. Networking between headquarters and subsidiaries
6. Online services to business.

### Supplier-oriented Market Place

It is also called as sell-side market place. In which organisations attempt to sell their products or services to other organisations over the internet. The connectivity is as shown in Fig. 14.3. This model is identical to that of B2C e-Commerce model in which the buyers are expected to visit the sellers' websites; search the required product in the electronic catalogue, which is shareable to others and then place the purchase order. A buyer in this model is an organisation that may be regular customer of the seller. The seller in this model can be a manufacturer, a distributor or retailer. This model is used by thousands of companies. Few of the reputed companies belong to this category are Cisco, IBM, Intel and Dell.

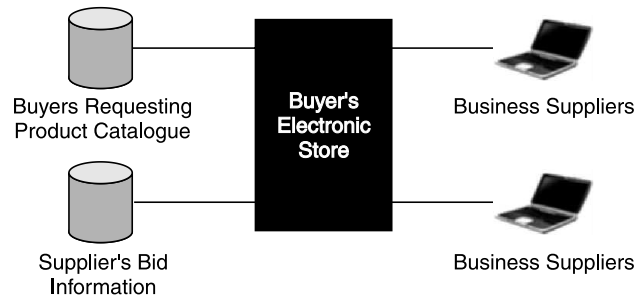


**Figure 14.3** Architecture of the Supplier Oriented B2B Market Place

### Buyer Oriented Marketplace

In this model, e-Commerce is used to streamline the purchasing process in order to reduce the cost of the items purchased, the administration cost of procurement and the time duration needed for purchasing. This mode is also known as e-Procurement (electronic procurement) is a reverse auction. Organisations want to buy the materials place a Request for Quotation (RFQ) on their website or in a bidding marketplace. Suppliers bid these RFQ electronically and also it is later processed and the winners are also communicated by e-mail. The architecture for interconnecting the business suppliers and buyers is as in Fig. 14.4. These types of reverse auction helps to attract larger pool of suppliers and also a major

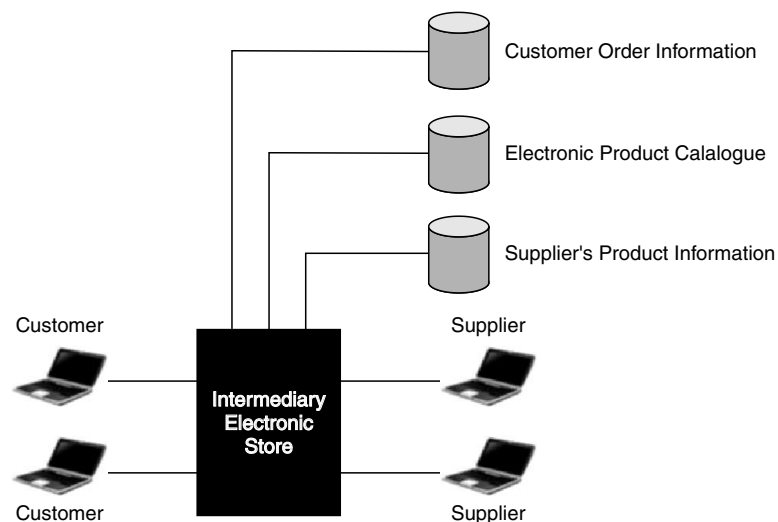
administrative cost can be minimised. e-Procurement will help to small companies in the form of group purchasing. In which the requirements of many small buyers are consolidated so that they make up a large volume. This order is now placed on a reverses auction. A third party website like shop2gether.com will help to consolidate all these small buyers purchase order.<sup>8</sup>



**Figure 14.4** *Architecture of Buyers Oriented Market Place*

### Intermediate Oriented Marketplace

In this model an electronic intermediary company runs a marketplace. Where the buyers and sellers can meet and do the business. Figure 14.5 shows the architecture of intermediate oriented marketplace.



**Fig. 14.5** *Architecture of Intermediate Oriented Marketplace*

### e-Procurement

The terms procurement and purchasing has been quite often mixed with each other or used interchangeably. However, they differ significantly in their scope. Purchasing refers to buying materials and all activities associated with the buying process. Procurement on the other hand, is broadly defined to include a company's requisitioning, purchasing, transportation, warehousing, and in-bound receiving processes.

Electronic purchasing addresses only one relatively minor aspect of the procurement problems faced by companies. Electronic procurement is generally referred to as e-Procurement; potentially enable the procurement process to unfold in a faster, more efficient manner, and with fewer errors. These methods include electronic data interchange (EDI), online marketplaces or e-marketplaces, and various blends of the two. Besides varying from industry to industry, different companies use different blends of traditional and electronic procurement methods and individual e-Procurement systems themselves may incorporate traditional capabilities like telephone or fax.

e-Procurement is a technology solution that facilitates corporate buying using the internet. It is an important part of many B2B sites. e-Procurement is also sometimes referred to by other terms, such as supplier exchange. Typically, e-Procurement websites allow qualified and registered users to look for buyers or sellers of goods and services. Depending on the approach, buyers or sellers may specify prices or invite bids. Transactions can be initiated and completed. Ongoing purchases may qualify customers for volume discounts or special offers. e-Procurement software may make it possible to automate some buying and selling. Companies participating expect to be able to control parts inventories more effectively, reduce purchasing agent overhead, and improve manufacturing cycles. e-Procurement is expected to be integrated with the trend toward computerised supply chain management in the organisation. It has the power to transform the purchasing process because it pervades all of the steps identified by the supply manager.

For a buying organisation this integrated solution offers great benefit of purchase control, monitoring and preventing maverick purchasing within the context of large organisation. The on-line nature of the application allows for easy purchasing with a few button clicks while adhering to aspects such as approvals and departmental budgetary control.

There are components facilitating web-enabled work flow to allow for management approvals over several layers for a given purchase requisition, notification on delivery, ability to split shipments based on geographical or cost-based parameters, and integration with third party secure payment channels. Procurement solutions allow the organisation to consolidate widely distributed database of users and data into one comprehensive repository that can be easily maintained and applied to several other applications including time card, reimbursements, vacation approvals and other personal related aspects.

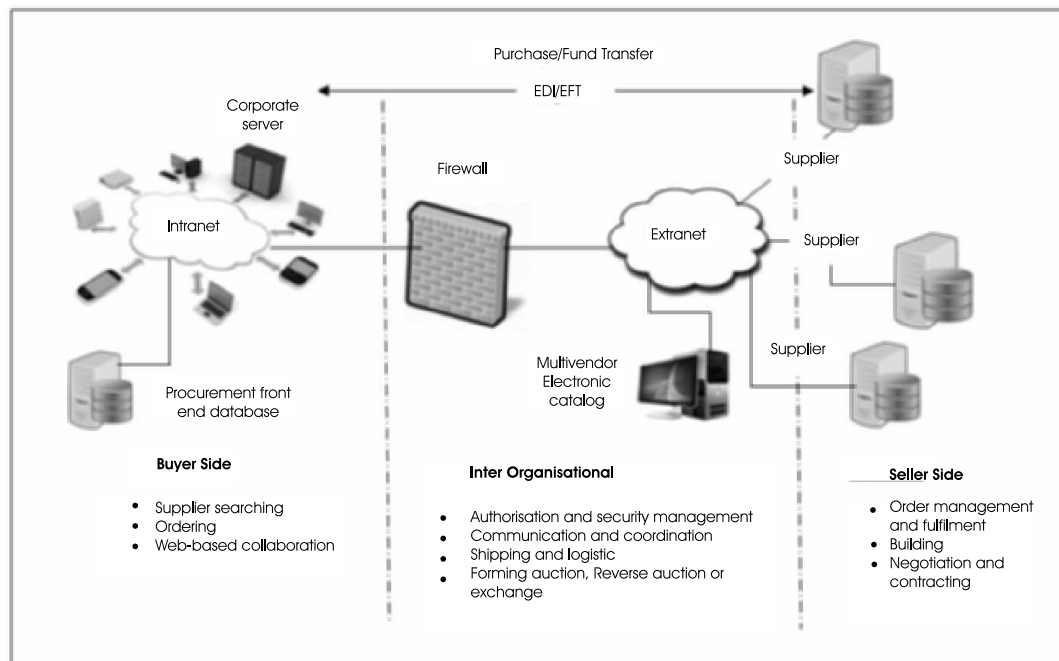
Now-a-days procurement strategies focus on restructuring the entire order-to-delivery process rather than on specific tasks within the process. Thus, e-Procurement is not just an addition of technological aspect to traditional procurement. e-Procurement system in essence, mirror the procurement process through the provision of two distinct, but connected infrastructures, internal processing (using intranet) and external communication processing (through internet). The architecture of a web-based e-Procurement system is as shown in Fig. 14.6. The critical difference is that these systems allow individual employees to order goods directly from their personal computers through their website on real time. Requests and orders are channelled through various forms of hubs or database. It also allows individual employees to search for items, check availability, check the location of the supplier, and check the mode of delivery, place and track orders, compare the cost, and initiate payment of delivery.

### ***Benefits of e-Procurement***

e-Procurement's benefits fall into two major categories as efficiency and effectiveness;

e-Procurement's efficiency benefits include lower procurement costs, faster cycle times, reduce maverick or unauthorised buying well organised reporting information, and tighter integration of the procurement functions with key back-office systems.

The effectiveness includes increased control over the supply chain, proactive management of the key data, and higher-quality purchasing decision within organisations.



**Fig. 14.6** e-Procurement Architecture

The other benefits of e-Procurement are:

- Shorter purchasing cycle
- Improvement data accuracy
- Access to real-time information
- Reduced paperwork
- Reduction in off-contract buying.

### Types of e-Procurement:

There are seven main types of e-Procurements:

1. *Web-based ERP (Enterprise Resource Planning):* Creating and approving purchasing requisitions, placing purchase orders and receiving goods and services by using a software system based on internet technology.
2. *e-MRO (Maintenance, Repair and Overhaul):* The same as web-based ERP except that the goods and services ordered are non-product related MRO supplies.
3. *e-Sourcing:* Identifying new suppliers for a specific category of purchasing requirements using internet technology.
4. *e-Tendering:* Sending requests for information and prices to suppliers and receiving the responses of suppliers using internet technology.

5. *e-Reverse Auctioning*: Using internet technology to buy goods and services from a number of known or unknown suppliers.
6. *e-Informing*: Gathering and distributing purchasing information both from and to internal and external sources.
7. *e-Market Sites*: Expands on web-based ERP to open up value chains. Buying communities can access preferred suppliers' products and services, add to shopping carts, create requisition, and seek approval, receipt purchase orders and process electronic invoices with integration to suppliers' supply chains and buyers' financial systems.

### ***e-Procurement Risks***

In addition to the common problems, the following risks related to e-Procurement are to be considered:

- (i) Good procurement principles are forgotten when information technology gets in the way.
- (ii) Information security and negative impact on business reputation should not be seen as barriers to e-Procurement.
- (iii) Avoid one size fits all approach. Be pragmatic about the real risks and build checks and controls to identify and manage them. The benefits of buying online and using procurement cards lead to the potential issues of card misuse.
- (iv) Suppliers will be reluctant to be included if security of their commercial information cannot be granted.
- (v) Corporate policies and procedures are not revised to reflect the changes in culture, such as exception management and risk-based processing.

### **Virtual Corporation**

To perform certain business activities several partners or organisations sharing the cost and resources for the purpose of producing a product or service is known as *Virtual Corporation* (VC).<sup>10</sup> The developments of VC are mainly dependent on the B2B EC platform. Modern VC can be viewed as a network of creative peoples, resources and idea connected by online services. For this the business partners can use Electronic Data Interchange, Sharable Knowledge Base, Desktop Video Conferencing, e-mail and Electronic Fund Transfer systems.

The main objectives of VC are:

1. Understand the core competences of the partners and use the same in the VC.
2. Utilise the resource of the business partners more profitably.
3. VC can find and meet the market requirements better than an individual player.

### **Networking between Headquarters and Subsidiaries**

In a networked B2B EC communication and information sharing between headquarters and subsidiaries or franchises by means of e-mail message, discussion forums or chatrooms. Intranet of the headquarters and the franchiser are interconnected for information sharing by means of extranet.

### On-line Services to Businesses

Many online services are available for businesses and individual customers. The commonly available on-line services in B2B EC are:

- Travel and tourism service
- Personal services
- Electronic trading
- Electronic payment
- Real Estate
- Electronic auction<sup>8</sup>
- On-line training
- On-line publishing

One of the outgrowths of Information Technology that has enabled the development of new B2B model is electronic data interchange (EDI), a standard format used in exchanging business data including the price or product specifications. EDI technology is very essential for international commerce where paperwork required for international trade creates the costs that can be up to seven per cent of the value of the items being traded. With EDI on the other hand suppliers, carriers, customers channel partners and customs agents can send and receive documents electronically, thereby saving both time and money for international transactions.

### ELECTRONIC DATA INTERCHANGE (EDI)

EDI is the communication between the applications running in two or more number of computers. It communicates specially formatted standard business information like purchase orders, invoices, approvals of credit, shipping notices and confirmation between the computer systems of companies, banks, government agencies and logistic companies. Its main purpose is to transfer the repetitive business transactions electronically. EDI translator converts business data into a standard format. The EDI architecture has four layers (as shown in Table 14.1) the semantic (or application) layers, the standard (or standard business form) translation layer, the transport layer and physical network infrastructure layer.<sup>5</sup>

**Table 14.1** Layered Architecture of EDI

<i>EDI layers</i>	<i>Description</i>	<i>Examples</i>
Semantic	Business Application on level	Purchase applications
Universal standards	Standard business forms	EDIFACT standards, ANSIX12 standards
Transport (or Transmit)	Sending or transmitting business forms from company A to company B electronically (e-mail and Point-to-point)	WWW, FTP, TELNET, HTTP, MIME, X5
Physical	Network Infrastructure	Internet, Information Highway (I-Way, Value Added network (VAN)

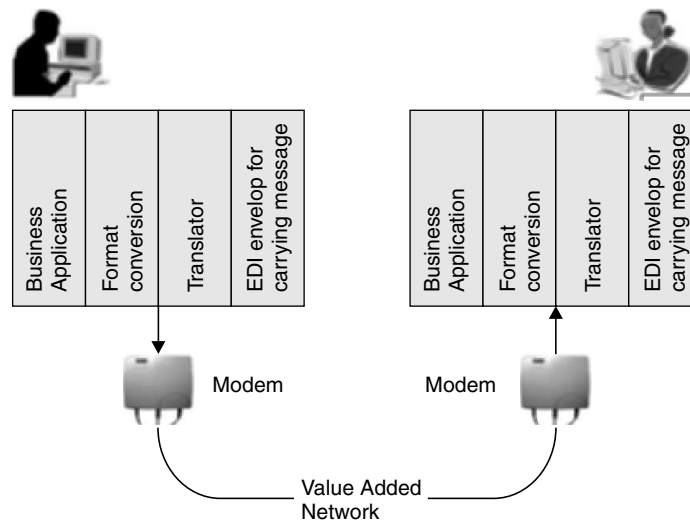


### EDI Communication Architecture

A Semantic layer is specific to a company and the software they use for representing their business applications. **For instance**, the purchase application, a company may have its own specific forms of request for quotations, purchase order and payment advices.

During message transmission the company specific format is translated into a universal form to send various trading partners and made it to accessible in their system in their specific format. The Universal Standard layer does this. However there are two universal forms—one developed by American National Standard Institute (ANSI), called as ANSI X12 standard, and the other developed by United Nations Economic Commission for Europe UN-EDIFACT.

The transport layer transmits business forms from company 'A' to company 'B' electronically by means of e-mail or by means of point-to-point communication protocols. Wherever using Simple Mail Transport Protocol (SMTP) cannot transmit the signals in the form of multimedia messages such as spreadsheets and word processing attachments, in such cases MIME (Multipurpose Internet Mail Extension) will support to transmit these non-textual messages. The business information between the trading partners is communicated in the Internet. To secure the transmission and to exchange the EDI message Value Added Network (VAN) is typically used. The message communication between the users in EDI using VAN (communication channel) is shown in Fig. 14.7.



**Figure 14.7** Message Communication between the Users in EDI on a Value Added Network

There is a difference between the message transmission by EDI and e-mail system. An e-mail message is composed and interpreted by the users, whereas EDI is composed by software for interpretation by another software. E-mail data are not necessarily structured, whereas the messages created by EDI are structured and in software understandable form. In addition EDI messages have certain legal status. That is if a buying firm sends an EDI purchase order to the supplier firm, the purchase order indicates the product specifications and the delivery periods. If the supplier firm fails to fulfil this buyers firm can then take the issue to the court of law. E-mail is a communication tool, it makes use of textual messages and it cannot support the non-textual message for transmission.

## ELECTRONIC FUND TRANSFER (EFT)

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An electronic fund transfer (EFT) is an application that electronically routes the funds, debits and credits and charges and payments between the banks and customers using telecommunication networks. The traditional methods of payments such as using cash, *cheques*, *money order* or giving *credit card* number over the telephone have its own limitations. To process these payments it will take its own time. In case the payment denomination is very low (micropayment) the cost of making micropayments off-line is too high. Considering all these reasons the best solution identified for fund transfer in e-Commerce is Electronic Payment System (EPS). The most common and acceptable methods of payments in e-Commerce are *electronic cheque*, *electronic fund transfer* (EFT), *e-wallet*, *electronic credit cards*, *electronic cash*, *smart cards*, *person-to-person payments* and *purchasing cards*. These payment mechanisms are broadly classified into two types:

1. Token based payment systems (or electronic token), which are of three types:
  - (a) Electronic cash (e-Cash)
  - (b) Electronic Cheques
  - (c) Smart cards
2. Credit card based payment systems are of the following types:
  - (a) Plain credit cards
  - (b) Encrypted credit cards
  - (c) Electronic wallet

### Electronic Cash (e-Cash)

It is a new concept in online payment system. It combines the conveniences of computerisation with security and privacy, which is an improvement over paper money. e-Cash appears in two forms:

#### 1. *Electronic Cash in a Personal Computer (PC)*

How does it work in practice? The use of this approach involves the following steps:

- The customer opens a bank account with a bank and receives payment processing software for his or her PC.
- Customers buy “electronic money” from this bank by using the software. The customer bank account is debited accordingly.
- The bank sends a secured electronic money notes to this customer.
- This money which is stored in their PC can be spent in any electronic store that accepts e-cash.
- The same software can also be used to transfer the e-Cash from the buyers computer to sellers computer.
- The seller can deposit the e-Cash in a bank crediting his or her regular or electronic account or the seller can use the e-Cash to purchase the items elsewhere.

#### 2. *Electronic Payment Cards with e-Cash*

This type of payment mechanisms are in practice for several years. The most commonly used one is the credit cards. It contains a magnetic strip to store limited information's like the card ID's. A more

advanced form of electronic payment card is known as stored value (pre-paid) money cards which is used to pay for buying petrol for local transportation, or for internet and mobile charges. In which a fixed amount of pre-paid money is stored and whenever a business transaction is made the respective charge is deducted.

### Smart Cards

Smart cards are also a type of stored value cards. A smart card is a debit or credit card with embedded microprocessor, that can store a considerable amount of information (up to 128 KB), and can perform processing. These smart cards are used for paying bills, transfer funds, buy from vending machines, etc.

Smart cards are being used since early 1980s and have a potential to secure transactions by using the existing infrastructure of credit and debit cards. Smart cards are of two types:

- (a) *Relationship based smart card*: It is an enhancement of existing card services and/or the addition of new services that the financial institutes deliver to its customers. It provides an option for accessing multiple financial accounts.
- (b) *Electronic purses*: It is a wallet sized smart card embedded with programmable microchip that stores the information of money for the users. The user can use this for any purchasing activities

### Electronic Cheques (e-Cheques)

Electronic cheque is a digital version of the traditional cheque. It contains the same information as a paper cheque. However an electronic cheque is much less expensive to process than a traditional cheque. This is one of the most popularly used modes of payment. The steps involved in the usage of electronic cheque are:

- The buyer approaches the seller, buys a product or service and makes the payment by e-mails or by on-line electronic cheque.
- The seller presents the cheque in his or her account; money is deducted from the buyers account and credited to the sellers account. For authentication an e-cheque bears the digital signature of the payer (or account holder). The e-cheque will need to be endorsed by the payee, using another electronic signature, before the cheque is paid. Properly signed and endorsed cheques can be electronically exchanged between financial institutions through electronic clearing houses. However in spite of development of many prototype systems for electronic cheque (e.g. net cheque), we are a long way from a universal payment system. In the mean time, sellers of electronic commerce services are looking for alternative methods of payment.

In Fig. 14.8 below, the payer receives bill or invoice from payee. The payer then issues an electronic cheque, and sends it to the payee's bank. The payer's bank sends it to the payee's bank for processing. Once the cheque is cleared, the payee's bank sends account receivable information to the payee.

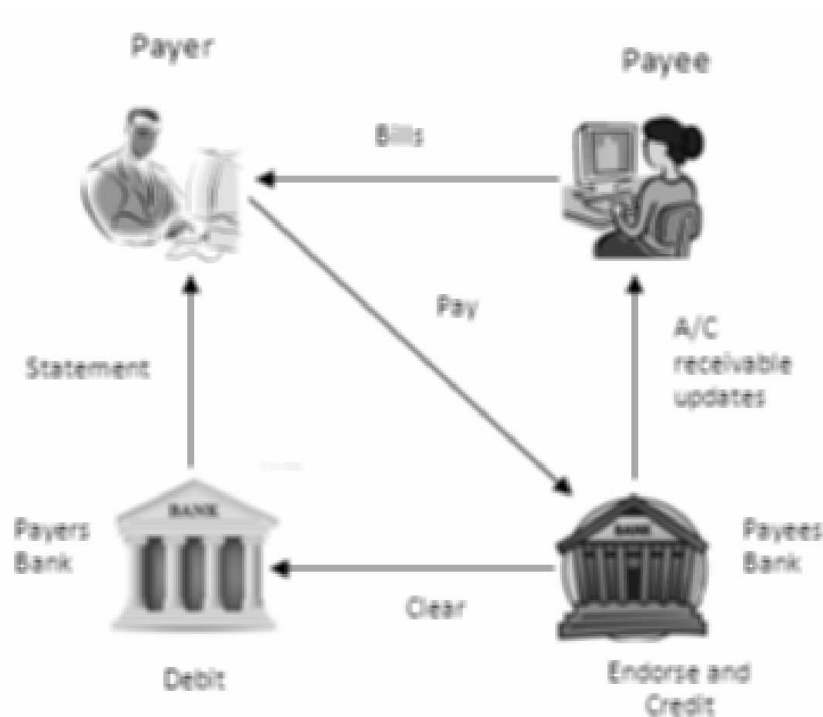


Fig. 14.8 e-Cheque transfer system

### Credit Card Based Electronic Payment Systems

On the internet, they are time tested alternatives for consumers and suppliers. If consumers want to purchase a product or services, they send their credit card details to the services provider who handles the payment like any other payment. Using credit card it is possible to charge online payments to one's credit card account. For the payment the buyer can just e-mail his or her credit card number to the seller. But this is vulnerable for security threat. Hackers can read your credit card number. Also the sender authentication is difficult. Therefore, secured transaction only with encrypted information should be used. Here only the intended receiver with the key for decryption can retrieve the data. Credit card details can be encrypted by using the Secured Socket Layer (SSL) protocol in the buyer's computer; it is a component of standard browser.

Online electronic credit card payments are classified into three types:

- (i) *Plain credit cards*: The easiest method of payment is by using plain (unencrypted) credit cards using telephone lines or the internet. However it has a low level of security, and hence encryption of a card is a must.
- (ii) *Encrypted credit card*: An encryption of credit card details is required to be done by the credit card holder before sending the details in the internet. Encryption is mutation of information (i.e. Text, video, and graphics) into a format that is unreadable by anyone without a decryption key. However, the cost of credit card service may go up substantially.

- (iii) *Third party verification:* In this system a buyer registers with a third party on the internet to verify electronic micro-transactions, and get an account number. The buyer requests an item for purchase online from the supplier and authorises the supplier through browser settings to access the account number and bill. The supplier contacts the third party processor with their buyer's account number. The third party payment server verifies the buyer's account number and checks for adequate funds availability. The third party payment server sends an electronic message to the buyer. The buyer responds by agreeing or not agreeing. If the third party payment server gets as "yes" from the buyer, the supplier is informed. Only after the buyer receives the purchased material, the buyer's account is debited. Both the buyers and the sellers are charged certain amount of service charge by the third party.

### Electronic Wallet

This is also called as e-Wallet or digital wallet. It is encryption software that stores payment information like a traditional wallet. The e-Wallet software component is downloaded to a user's PC and in which the user stores credit card number and other personal information. When the user is shopping, he or she uses this e-Wallet at merchant, he accepts the e-Wallet as in Fig. 14.9; the user can perform one click shopping, with the e-Wallet automatically filling in the necessary information. Credit card companies like VISA and Master Card offer e-Wallet services.

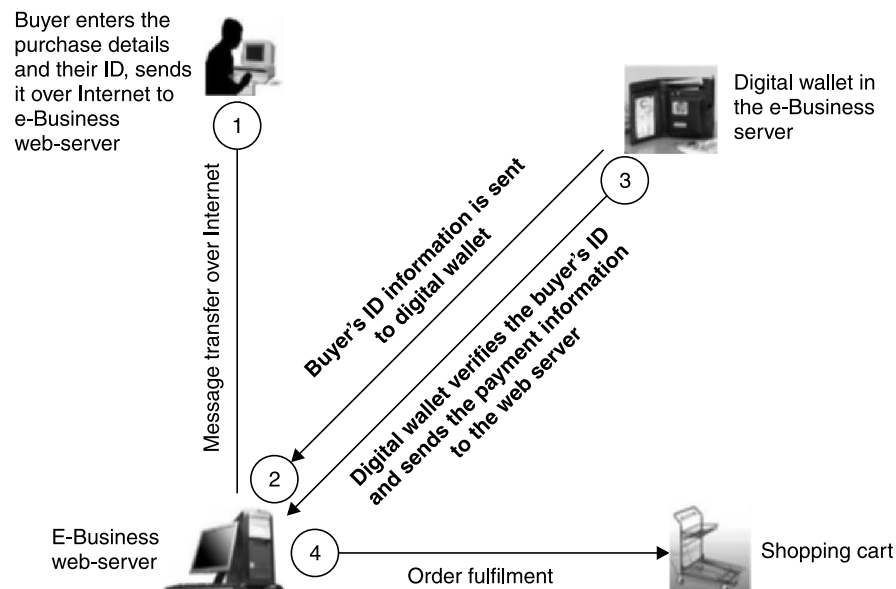


Fig. 14.9 Electronic Fund Transfer using Electronic Wallet

### Advantages of Electronic Fund Transfer Systems

1. EFT (or electronic payment) system is faster and real time.
2. It reduces the problem in sending the paper based documents and processing time.
3. Applicable for large volume of financial transaction generated daily in the banking industry.

4. Electronic Fund Transfer, based Point of Sale (POS) and ATMs are available in most of the shopping centres and business areas.
5. Transaction is available 24/7.

### ***Disadvantages***

1. Frauds and mistakes.
2. Shops should select an appropriate set of electronic payment systems. Until electronic payment methods become popular among customer it is necessary to offer traditional payment methods as well.
3. Technical limitations like availability of telephone connections and desired internet Band width.

### **Electronic Fund Transfer Systems in Indian Banks**

National Electronic Fund Transfer Systems (NEFTs) and Real Time Gross Settlement (RTGS) allow the individuals and firms to transfer funds from one bank to another.

### **National Electronic Fund Transfer Systems (NEFTS)**

NEFT and RTGS facilities can only be used to transfer money within the country. To enable NEFT service, the payers need to fill a form providing their beneficiary's details – name of the bank branch where the account is held and the Indian Financial System Code (IFSC), a unique code for identifying the branch and the account number and type.

The remitting branch prepares a Structured Financial Messaging Solution (SFMS) message and sends it to its service centre for NEFT. The service centre forwards the same to the local RBI (national clearing cell) to be included for the next available batch of settlement. NEFT has eleven batches of settlement on week days and five batches on Saturday.

*Weekdays:* 09.00, 10.00, 11.00, 12.00, 13.00, 14.00, 15.00, 16.00, 17.00, 18.00, 19.00 hours.

*Saturday:* 09.00, 10.00, 11.00, 12.00, 13.00 hours.

The RBI at the clearing centres sorts the transactions bankwise and prepares accounting entries of net debit or credit for passing on to the banks participating in the systems. Therefore, bankwise remittance messages are transmitted to banks. The receiving banks process the remittance message received from RBI and effect the credit to the beneficiary's accounts.

NEFT uses the public key infrastructure (PKI) technology to assure end-to-end security and the Indian Financial Network (INFINET) to connect bank branches for electronic transfer of funds.

### **Real Time Gross Settlement System (RTGS):**

In these systems, the processing of funds transfer instructions takes place at the time they are received (real time). Also the settlement of funds transfer instructions occur individually on an instruction by instruction basis (gross settlement). RTGS is the fastest possible interbank money transfer facility available through secure banking channel in India.

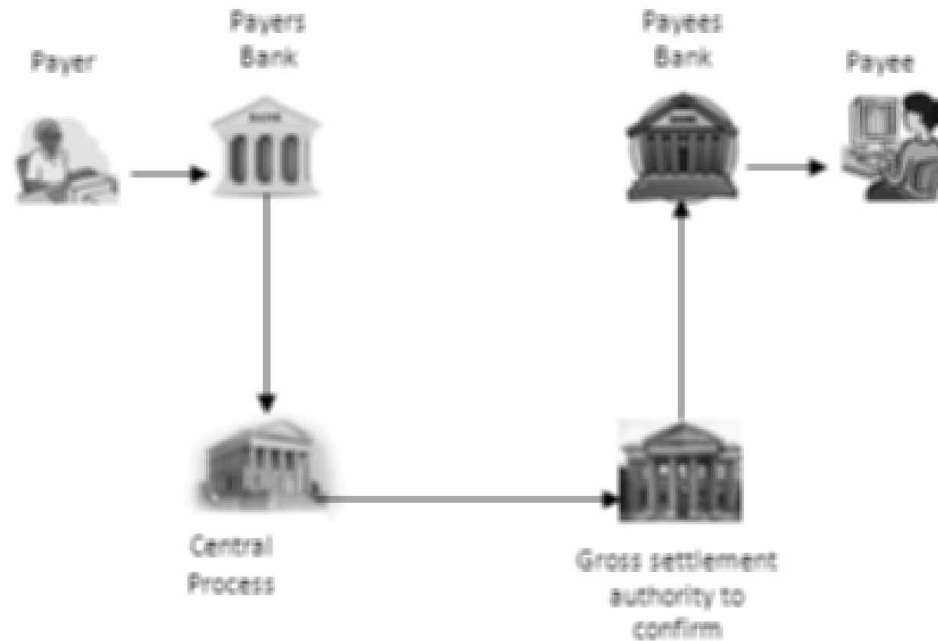


Fig. 14.10 RTGS transaction processing

### Risks in Electronic Payment System

There are three major risks involved in the electronic payment systems:

- (i) Fraud and mistakes
- (ii) Privacy issues
- (iii) Credit card risk

Preventing mistakes require an improvement in legal framework. Privacy and fraud issues can be dealt with an improved security framework. Managing credit risk requires development of policies and procedures to restrict credit and reduce float in the market. Many of these technical problems can be resolved through an improved technology and a better experience.

Security issues are the main threats for EFT. Four essential security requirements for safe electronic fund transfer are:

1. **Authentication:** It is a method to verify the buyer's identity before payment is authorised.
2. **Encryption:** It is the transaction of data into a secret code called cipher text.
3. **Integrity:** In Electronic Commerce it is necessary that the messages transmitted are not accidentally or purposefully altered or destroyed during transmission.

4. **Non-Repudiation:** It is the protection against customer's denial of order placed and against merchant's denial of payment made.

**Electronic Forms** These are online completion and transmission of business forms, such as purchase orders, contracts, and claim forms. It includes electronic signature on the business forms. These business forms are routed to the appropriate in-house destination by the recipient for proper handling.

**Integrated Messaging** Consider a familiar business situation: The marketing manager hands over an urgent fax message through his secretary to the fax operator on, say, a Wednesday and finds that the fax was not transmitted even on Friday morning. Why? Because the line was busy. The solution to these common problems is found by integrated messaging. This includes a group of computer services that send, receive, and combine faxes, electronic mail (e-mail) and electronic data interchange (EDI).<sup>5</sup> This is done by using networks or electronic transmission systems. Messaging services offer solutions for communicating structured data (e.g. purchase orders, invoices) and unstructured data (e.g. reports, letters, memos). Structured document messaging includes EDI. Unstructured messaging consists of e-mail and fax.

Messaging is gaining momentum in electronic commerce. The major *advantages* of messaging are: (i) It supports both immediate (synchronous) and delayed (asynchronous) processing and delivery of messages, (ii) It is not associated with any specific communication protocol, and (iii) It is more effective in communicating and working for people despite their diverse locations. However, the main *disadvantages* of messaging are the issues of security, privacy, confidentiality, and legality that need to be resolved.

**Shared Databases** Trading partners develop data warehouses (or repositories) that are accessible and shared by both the partners. These data warehouses are often used for faster communication and for arranging cooperative activities. **For instance**, Federal Express allows their customers to access their system through their Web sites. A customer can enter an air-bill number and can see the route a particular package has taken, the time at which it was delivered, and the name of the person who signed for it.

## Scope and Characteristics of Inter-organisational Systems

Companies build inter-organisational systems with buyers or sellers when business activities take place on regular basis and information is also exchanged regularly. There are some common characteristics between all inter-organisational systems, as shown in Table 14.2.

Inter-organisational systems are well-established in business-to-business marketing, and are growing at a rapid rate. Many companies use EDI to conduct their business with buyers or suppliers if business activities are regular in nature. **For example**, the suppliers of steel and components (such as tyres, and spark plugs) to automobile manufactures (e.g. motorcycles, scooters, cars and trucks) have regular business activities, and hence, inter-organisational systems by use of EDI for regular exchange of information is more appropriate.

However, for certain types of businesses such as marketing of capital items (e.g. furnaces, CNC machines), customers are not regular. Only when firms decide to set up expansion or diversification projects, such capital items are purchased. In these business-to-business marketing activities, electronic markets may be the appropriate method.



**Table 14.2** Common Characteristics of Inter-organisational Systems

<i>Activities</i>	<i>Particulars</i>
1. Main activities	▪ Business-to-business (i.e. from business firm 'A' to business firm 'B') marketing on regular (or recurring) basis
2. Relationships	▪ Buyer and seller relationship is established in advance, based on anticipated multiple transactions
3. Agreements	▪ Agreements or contracts are arrived in advance on the terms and conditions of the relationship between a buyer and a seller ▪ Agreements take place on the nature and format of business documents that will be exchanged ▪ Expectations and responsibilities of each party are decided so that each party knows how to use the system and when transactions will occur
4. Networks	▪ Whether private or public networks are used depends on the situations

### Electronic Markets

Along with the inter-organisational systems, electronic markets are also emerging for business-to-business marketing through e-commerce. A **market** is a place where information, products, services, and payments are exchanged. When a market place is electronic, the business centre is not a physical building, but is a network-based location where business transactions take place.

In electronic markets, buyers and sellers hardly know each other. They are also located at different locations. The characteristics of electronic markets are shown in Table 14.3.

Apart from the buyers and sellers, the other participant in the electronic markets is the transaction handler who handles all the business transactions that take place between the buyers and the sellers. These transactions are managed by a range of IT applications.

A business (or business-to-business) marketer should evaluate the potential of electronic markets based on the following benefits:

1. Advertising
2. Customer service and support
3. Effective alternatives to traditional distribution channels
4. Extending reach to potential buyers.

**Table 14.3** Characteristics of Electronic Markets

<i>Activities</i>	<i>Particulars</i>
1. Main activities	▪ Business-to-business marketing that is not recurring or predictable in nature
2. Relationships	▪ Buyer and seller relationship may be for one purchase transaction or multiple transactions spread over a seller agreeing to deliver products/services to a buyer for specific time periods
3. Agreements	▪ No agreements or contracts are drawn in advance ▪ Sellers decide, in consultation with transaction handler, which business transactions they will provide
4. Networks	▪ Typically, public networks are used ▪ Buyers and sellers independently decide which communication networks they will use when they participate in the electronic market

## Electronic Exchanges

It is a marketplace where many sellers and buyers gather to do the business. It is also referred to as e-market place, e-hub or portal. There are four types of electronic exchanges;<sup>4</sup>

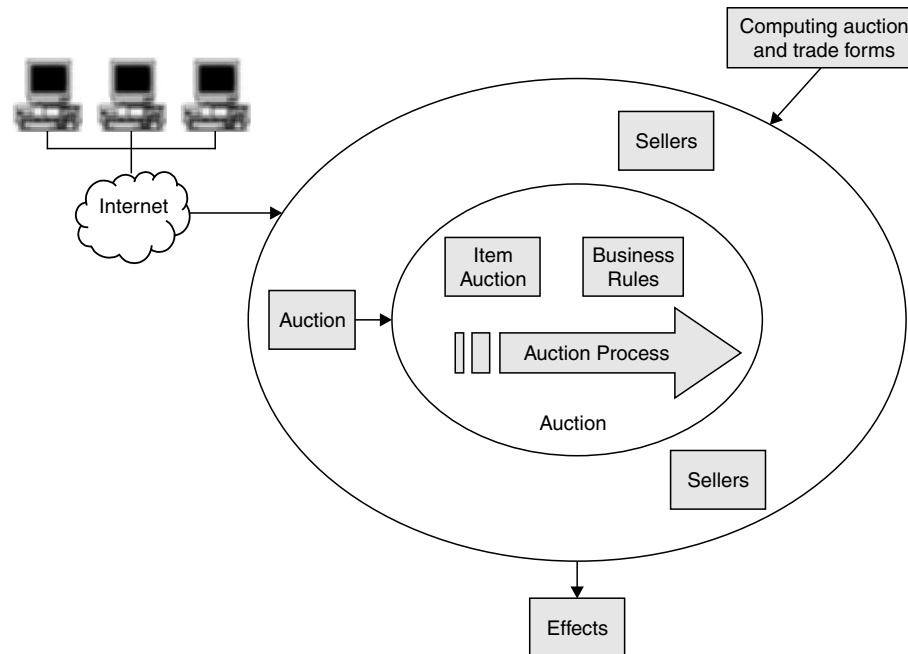
1. *Vertical distributors*: It is a B2B marketplace where direct materials (like the raw materials used for manufacturing) are marketed in an environment of long-term relationship.
2. *Vertical exchange*: Here unknown sellers and buyers do the business. In vertical exchange the price is continuously changing based on the matching of supply and demand? Auctions are typically used in this kind of B2B marketplace.
3. *Horizontal distributors*: This is a many-to-many B2B marketplace for indirect materials. Material prices either fixed or negotiable.
4. *Functional Exchanges*: This e-marketplace provides the needed services like temporary help or extra space. The prices of the product or service are negotiable, which is dependent on the supply and demand.

## Online Auctions

B2B auction is a mechanism which enables multiple buyers or sellers to make competitive bid on a contract. On-line auctioning becomes more popular due to the following two reasons:<sup>8</sup>

1. Low barrier to entry in the auction market
2. The opportunities to earn good commission on the sales without maintaining any inventory.

The internet provides a platform or infrastructure for executing auction at a minimum cost and with many more involved sellers and buyers. Individual consumers and corporation can participate in this extensively growing B2B e-Commerce. The on-line auctioning process is as in Fig. 14.11.



**Figure 14.11** On-line Auction Process

B2B auctions are divided into two types; *forward auctions* and *reverse auctions*. In forward auction method, a single seller auctions materials to multiple potential buyers, whereas in reverse auction a single buyer wants to buy products or services from multiple suppliers. Here he or she will call the suppliers to submit the bids. The buyer then finds the lowest bid to select the supplier.

### Electronic Catalogues

It is vendor's catalogue containing the details and specifications of all the products and services offered in an internet (e-Commerce website). This, also known as on-line catalogue, is to advertise and promote the products and services. Using an electronic catalogue customer can search the information about their required product and services, which they want to buy. The electronic catalogue creation process is as in Fig. 14.12. Some of the e-Commerce websites also contain customised and dynamic catalogue integrated with selling and buying features such as electronic order taking by adding the product to the shopping cart and also an on-line payment system.

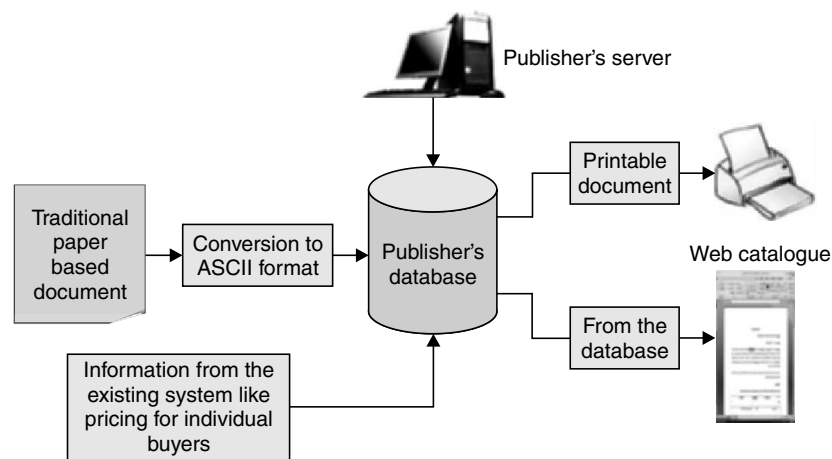


Figure 14.12 Electronic Cataloguing Process

### Just-In-Time (JIT) Delivery

Inventory approach scheduling system that attempts to minimise in process inventory, reduce inventory space and costs and improve work flow by scheduling materials and parts to arrive at a workstation exactly when they are needed minimising inventory and idle production facilities. The manufacturing units run their factories according to JIT manufacturing principle critically need JIT delivery. Here the delivery of components and materials on time is a must. B2B Electronic Commence is a promising mechanism to assure JIT delivery of materials, which are supported by the delivery service systems of the logistic companies and supplier's inventory policy. The system for the quick delivery is the backbone of JIT delivery. For B2B EC environment the advanced confirmation of the delivery date at the contract stage is very important which has not yet been emphasised in the B2B EC environment. Using the advanced technology like package tracking system and RFID (Radio Frequency Identification) the courier company employees can track and record the progress of the package electronically.

**Benefits of JIT delivery** The benefits of just-in-time delivery system to the customers are;

1. It reduces inventory carrying expenses.
2. Electronic commerce based JIT delivery system reduces the administrative expenses.
3. Lowers the storage space required.
4. Reduces the material handling expense.
5. Reduces the insurance cost for the materials.
6. Reduces the inventory tax ramification
7. It reduces the valuable capital.

### **Limitations of JIT Delivery**

Regardless of the benefits of JIT delivery there are few limitations in the following cases:

1. The organisations, cultures vary from firm to firm. There are some cultures that tie to JIT's success, but it is difficult for an organisation to change its cultures within a short time.
2. Also manufacturers that use the traditional approach which relies on storing up large amounts of inventory for backing up during bad times may have problems with getting used to the JIT system.
3. Also JIT is quite different for workers, in the sense that due to the shorter cycle time, lots of pressure and stress is added on the workers.
4. Also the JIT system throws workers off in the sense that if a problem occurs, they cannot use their own method of fixing the problem, but use methods that have been previously defined. Moreover, the JIT system only works best for medium to high range of production volume manufacturers, thus leaving a question whether it might work for low volume companies.

### **E-Commerce Support Services**

For the successful e-Business system it is necessary to provide them with all the needed support. Because a large number of issues to be addressed and the large number of companies and government agencies may be involved. EC infrastructure is one of the main requirements. It comprises online services, internet, intranet, extranet, websites, web portals, domain names, web spheres and integration with back end information systems.

### **Online Services to Business**

The delivery of services by on-line is growing very rapidly. In an online delivery system internet can reduce the vendor's selling cost by 20 to 40 per cent. The delivery cost can be further reduced for the digitised products. But only few products can be digitised and delivered online for saving the cost. The major online services to be considered for travel and tourism, employment placement and job market, real estate, trading stock, cyber banking, insurance, electronic bill payment (electronic clearing system) and auctions. These online services can be used both by commerce and by business.

### **Online Advertising**

A relatively unknown company can create an impact about the company and its products by a carefully chosen listings in online catalogues and databases. Electronic links make it possible for the interested buyers to jump from advertising spot to the company's location in the market. Colourful demonstra-

tions, and product visibility made possible electronically, are effective methods of gaining customer attention and developing business.

Advertising is the hottest area of business activity on the web. Through web advertising, a company links a customer to an in-depth product information and encourages the customer to make the purchase. This is different from the traditional advertising which creates an awareness about the product and sells on its benefits. Like a salesperson, a marketer's website should try to provide customer service, and get sales.

Marketers should try to promote their websites by (a) mentioning their addresses in the traditional print media, brochures, direct mails, and other promotional media, (b) purchasing banner advertisements and hyperlinks on the popular sites, (c) trading hyperlinks with other sites on the web, and (d) getting "free" coverage in newspapers or magazines through cyberspace reporters. The marketers on the web have to use these alternative strategies to generate traffic to their website.

It is difficult to have personalised advertising and marketing in a traditional advertising method. Internet advertising redefines the process by making it media rich, dynamic and interactive.

The key features of Internet advertising are:

1. It is a dynamic and interactive method of advertising and is targeted to a specific interest group.
2. The content of advertisement in Internet advertising can be updated any time at a nominal cost and always be timely.
3. It can reach a very large number of potential buyers around the world.
4. On-line advertising are sometime cheaper compared to the traditional advertising methods.
5. The multimedia based internet advertising method is always media rich and attracts large pool of internet users.

Most common on-line advertising methods are:

1. *Banners*: Internet Banners are the electronic billboards. Banners contain short text or graphical images to promote a product or vendors. A multimedia banner contains audiovisual clips.
2. *e-Mail advertising*: e-Mail is a cost-effective advertising and marketing channel. The marketing agencies develop or purchase a list of e-mail addresses, place them in a customer database and then send advertisement via e-mail. A major issue related to this is unsolicited e-mail advertising is considered as spamming.

### Online Advertising Issues and Approaches

There are many issues related to the implementation of on-line advertising; how to design it and implement. The key issues are:

- (a) Permission marketing
- (b) Viral marketing
- (c) Customised advertisement
- (d) Interactive marketing.

1. *Permission marketing* It is an Internet marketing strategy to grab the attention of the customers. Permission marketing offers consumers initiatives to accept advertising and e-mail voluntarily.  
*Example*: [www.microstrategy.com](http://www.microstrategy.com) uses a range of incentives and then asks initially for the relationship with the customers, before leading to more details.

2. *Viral marketing* It is also known as advocacy marketing. It is online word of mouth marketing where people forward messaging to friends.

*Example:* www.hotmail.com its e-mail practices of appending advertising for itself in outgoing mail from their users.

3. *Customising advertisements* Internet is a pool of information. Relevant information can be obtained by filtering out irrelevant information. It will provide customised advertisement to the customers.

*Example:* Yahoo!, the process of adding custom keyword setting.

4. *Interactive advertising and marketing* An interactive advertising and marketing present customised one-to-one advertisement. Interactive points to the ability to address an individual to gather and remember that person's response and to serve that customer based on his or her previous unique responses. Interactive marketing becomes very effective and competitive when the marketing database is combined with internet technologies.

*Example:* www.e-storm.com is an interactive marketing and advertising agency.

## Online Customer Service and Support

Excellent quality of customer service is critical for keeping customers happy and get repeat orders. The important part of customer service is to have right answers to customers' questions and solutions to customers' problems. Getting timely answers and solutions for customers is the crucial point. This can be achieved electronically by using various tools:

**A. e-Mail** Provides a detailed and specific information to the customer at a very fast pace. It gives customers one more method of corresponding that is faster and less expensive. While using e-mail, a company should emphasise clarity and professionalism.

**B. FAQ** The most helpful resource on a website is often the “**frequently asked questions**” (FAQ) page. The most common questions and their answers are collected and made available for electronic retrieval. At any time, customers can find solutions to the problems they are facing. Some of the frequently asked questions are as follows:

- How long is the warranty period?
- Where is your nearest after-sales-service centre located?
- Are you charging anything extra for delivery and installation?
- Do you recommend a list of standard spares to be in stock with us?

**C. Online services** Can be delivered 24 hours a day. Information on the company's product or services can consist of narrative explanations, photographs, drawings, animated discussions, and full multimedia presentations.

Well organised, frequently updated, and easily accessible customer service and support allow customers to help themselves to relevant information by clicking through product and service reference sections. Superior customer service and support can serve as an important marketing strategy and is a source of competitive advantage.

**D. Tracking services** Customers can check the status of their purchase orders, services (banking, passport, insurance claims, etc.) or job applications.

**E. Web based Call Centre** It is an online web based customer care centre, which accepts the customer queries and replies them quickly and automatically. This service is provided to the customers 24/7.

**F. Virtual Assistant** The virtual assistant is a business assistant always ready to work for the B2B organisations, but only when they need them. It provides secretarial services to the customers. The virtual assistant system frees the valuable time of the managers, so that the organisations can concentrate more on the important things relating to their business.

The basic tools included in virtual assistant systems are:

1. **e-Mail:** Set up an e-mail address when you and your virtual assistant can send and receive interactions and documents.
2. **Chat client:** Being able to communicate in real time is valuable in a virtual work environment. Make sure you and your virtual assistant have at least two chat clients available; so there will be a backup client in case one of the client is out of service.
3. **Voice and web cam communication (VoIP):** This tool helps to make calls to reach others directly and interact with the customers on the internet channel.

### Effective Alternative to Traditional Channels

Increasing number of companies are trying to deal directly with the existing and potential business customers through online electronic markets. If the services of traditional distribution channels such as distributors, manufacturer's representatives, or brokers do not add value, companies will bypass them. This will reduce the costs, minimise delays, and eliminate other inefficiencies.

Many firms dealing directly with customers through electronic markets offer lower prices to customers due to the savings from elimination of traditional channels. Some of the effective electronic market alternatives are:

**Direct Service Centres** These are electronic locations from which customer service, marketing, and technical support are provided.

**Direct Sales Outlets** These are electronic storefronts where customers deal directly with the supplier to carry out sales transactions.

### Extending Reach to Buyers

Reach is defined as the ability of a company to interact with its existing and potential customers. Often, the ability of a firm to reach its customers is limited by the size and location of the sales force, distribution network, or the mailing list. The major objective of a firm is to reach its existing and potential customers despite its locational disadvantage. This objective can be achieved by creating innovative communication networks for electronic markets anytime and anywhere.

## USING THE INTERNET

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The internet is a massive public and global electronic network connecting the computers of business organisations, customers, government agencies and other organisations world wide by means of tele-

communication networks. It exchanges information seamlessly using non-proprietary standards and protocols.

The Internet provides direct connectivity to the local area network (LAN) of the business organisations and interconnected to the other part of the internet through Internet Service Providers (ISP) and backbone networks. Internet targets not only electronic commerce applications (on-line shopping and trading online) but also computer based services like; EDI, information publishing, information retrieval, and video conferencing. The services provided by Internet is classified into four types; communications, information retrieval, web services and World Wide Web (WWW).

Communication services includes—e-mail, USENET newsgroups, LIST SERVs, chatting, TELNET, Internet Telephony, and Internet Fax.

An information retrieval service includes—gophers, Archives, WAIS, File Transfer Protocol and veronica.

Web services provide software applications over Internet.

WWW is used for information search and retrieval.

Internet is viewed as a prototype of emerging information super highway (I-way). The number of computer and networks connected to the internet continues to grow rapidly. These computer and networks have been voluntarily set up to confirm the internet's set of nonproprietary standard protocols. Internet Society (ISOC) estimates doubling of subscribers annually. Since access to the internet is open to all, there is a lack of control that may result in an unreeling proliferation of information.

The ability of internet is providing immediate access of information. It is also an infrastructure to store, retrieve, filter and distribute information. These capabilities greatly enhance the value of the information itself by making it practically useful in business. The benefit of internet is in many folds, on one hand it is a resource for delivery mechanism or packaging for many products and services and on the other hand it is also powerful in reducing costs or increasing the value of the product or services.

### Features of the Internet that are Important in e-Commerce

- (i) Internet's capability to link firms.
- (ii) International reach of the internet.
- (iii) Shared ownership of the internet.
- (iv) Accessibility on the internet.
- (v) Flexibility in the use of system platforms.
- (vi) Low cost of conducting business on the internet.

**International Reach** International reach of the internet means business access to individuals, households, and companies who are the worldwide internet user population. It is, therefore, a truly international network. This itself is sufficient reason for many companies to integrate e-commerce over the internet into their businesses.

**Linking Firms** Many industrial (or business) users of the internet consider it as a communication tool like e-mail and accessing of information. Very few business users have discovered the internet's capability to link firms and to capitalise on its vast capabilities. Several types of business-to-business transactions can be passed through the internet, using EDI documents. Using the internet as a communication medium for the transfer of EDI data transactions has been pioneered by the US government



and the education community. Today, several organisations are exchanging EDI transactions over the internet.

**Shared Ownership** The internet is not owned by an individual, a company, or a society. Thousands of independently owned and operated networks are interconnected to form the internet, which is a shared ownership. Today, most major cities in the world have the internet service providers (ISPs). This means that all individuals and firms, small or large, have the opportunity to participate. Shared ownership of the internet has certain positive aspects like collaboration and public participation. It has also certain negative areas concerning security and reliability.

**Accessibility on the Internet** Majority of business firms are aware of the widespread accessibility of the internet and the most distinguishing aspect of its public participation. Potential customers and business partners expect companies to be accessible on the internet. That is why many business firms such as Motorola and Boeing Airplane have asked their suppliers to develop the ability to conduct business through e-Commerce. Even a small firm can depict its presence to the global market by making only a small start-up investment. There are tremendous opportunities to reach potential customers or business partners and also to launch new products and services.

**Flexibility of System Platforms** The firms have freedom to choose the system platforms from various alternatives like UNIX, Linux, Windows NT, and Macintosh. The networking and applications software compensates for the differences in systems computing and communications platforms. Thus, there is a flexibility on the nature of the computing and communications that can be interconnected with the internet.

**Low Cost** The cost of conducting business on the internet is relatively low. The main requirement is to create a business site on World Wide Web (WWW) portion of the internet. Low cost tools are available to construct the required features such as online catalogues, communication links, and home pages.

### Marketing on the World Wide Web (WWW)

World Wide Web (WWW) has done a great deal to promote the use of the internet. Its ability to transmit images, video, and sound has captured the imagination of the world. WWW is presently the most popular internet “navigation” tool for finding and getting information in a multimedia format (i.e. colour graphics, video, and audio). WWW has three elements: (i) Hyper Text Markup Language (HTML) for creating and formatting documents, (ii) Uniform Resource Locator (URL) for finding documents, and (iii) Hyper Text Transfer Protocol (HTTP) for transferring documents among different types of computers and networks.

At the Web World Conference in February 1995, the audience was asked as to why they wanted to learn more about using the Internet and the World Wide Web. The benefits the audience at the conference said they wanted were to:

- Improve corporate image
- Improve customer service
- Find new prospects

- Expand markets through international reach
- Meet customer expectations
- Reduce costs

Some of the above benefits were discussed earlier in this chapter, viz. customer service, expanding market through international reach, and reducing costs (or low costs). The other benefits are described hereafter.

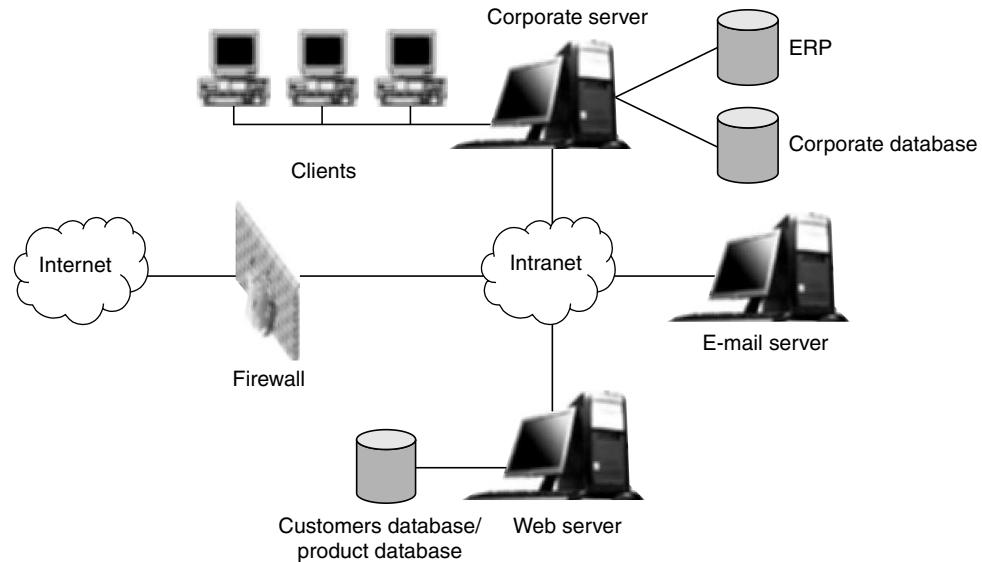
**Improve Corporate Image** If a company creates an image of a leading-edge company, it creates an image that it cares about its customers. The company should be the first to build a robust website in its industry, or first with a unique service. Today, a company can get away without a website, if its customers are not on the Internet. However, this will change soon. If a company starts creating a website today, it will be ready to meet the computer user's expectations. If a company has a well-positioned website, it will get a good publicity in the trade journals and newspapers. The journalists and the editors will visit the company's website for the latest news and to put together a story, and that means, the company's name appears in the print media more often.

**Finding New Prospects** The marketing costs of finding new customers by traditional methods of advertising, sales promotion, direct marketing, and personal selling are too high. For a sophisticated industrial product such as furnace, or a computerised numerical control (CNC) machine, a prospective business customer will need a good deal of information about the product specifications, applications, and performance parameters before buying decision is made. The prospective customer can visit the company's website and retrieve the required information, including the answers to the most frequently asked questions. If required, the salesperson can spend time towards the end, for closing the sale. Thus, marketers use websites to attract qualified and interested potential customers.

**Meeting Customer Expectations** The best way to meet the customers' expectations is to get frequent feedback from customers on what they want. Marketers must take e-mail feedback and suggestions from customers and respond to their questions and complaints. Like a salesperson, a marketer's website must learn about a customer's requirements and provide customer service. The customer relationship is then built with assured sales in the long-term. For example, an Indian exporter finds it difficult to respond quickly to the international customers' queries on the delivery status of various orders placed. The problem gets serious when the senior marketing executives are away from the office. Today, companies are seriously thinking of meeting the expectations of the customers through an appropriate electronic commerce system.

## Intranet

Intranet is a private network that uses internet software and TCP/IP protocol in essence with an organisation network (corporate LAN). Intranet interconnects various servers, clients, database programs like ERP and other devices in the entire organisation as in Fig. 14.13. Only authorised employees of the organisation can access the resources and services in an Intranet. This protects the sensitive corporate information from malicious users. A firewall protects the Intranet system from the intruders. The corporate intranet can be used to enhance the communication and collaborations among authorised employees, customers, suppliers and other business partners, i.e., it acts as an infrastructure for many Intra-business Commerce applications. Intranet provides the following functions to the organisation:



**Figure 14.13** *Architecture of Corporate Intranet*

1. As an interactive communication media and provides chatting, audio and video conferring service.
2. It provides corporate/department or individual web pages.
3. It provides a channel for accessing the web based databases.
4. Keyword based information searching and mining.
5. It is a perfect conduit for computer based telephony.
6. Using intranet we can link the geographically dispersed customers and business partners intranets to exchange information's.

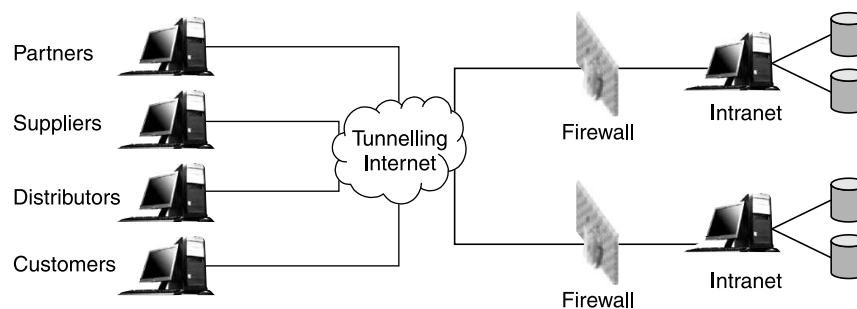
Some of the applications of intranet are:

1. Information management
  - Strategic decision support
  - Enterprises resource management
  - On-line analytical processing for data analysis
  - Financial data reporting
  - Time and leave systems
  - Procurement and supply chain
  - HRM and metadata development
2. Marketing
  - Promotional presentation (multimedia)
  - Customer support
  - Market survey

3. Workflow
  - Process control
  - Process monitoring and data collection
  - Production monitoring
  - Business process improvement and support
4. Communication enhancement
  - Secure communication
  - Internet telephone
  - Video and teleconferencing
  - Chat-server
  - Groupware
  - Documentation
  - File server
  - Search tools
  - Research support by using intelligent agents
5. Training
  - On-line training
  - On-line test and certifications
  - Collective training

## Extranets

It is a secure network that links the business partners and intranets over the internet by providing access to areas of each others corporate intranets. It is otherwise also called as *Extended Intranet*. Figure 14.14 shows the connectivity of the intranets of the different business entities. It combines the privacy and security of intranet with the global reach of the internet, granting access to outside business partners, suppliers and customers to a controlled portion of the enterprises network.



**Fig. 14.14** Interconnection of Intranets in an Extranet

The intranets are interconnected by using TCP/IP protocol. Extranet service is provided through the less secured internet channels. Therefore when using an extranet, it is necessary to improve the security of the connecting portions of the internet. This is done by secured data flow, and data encryp-

tion techniques. For secured business data transaction between the corporate Intranets of the business partners to secure the channel, Virtual Private Network (VPN) is used. Access to the corporate Intranet is usually limited by agreements of the collaborating parties is strictly controlled and it is only available to authorised personal. The protected environment of the Extranet allows groups to collaborate, sharing information exclusively and exchanging it securely.

### Features of Extranet

***Strengthen Relationships with Existing Clients*** Provide clients with instant web access to important information, and collaborate with tools, notes, notices, documents, training materials, product catalogue, product design, news, and so on.

***Increase Quality*** Easily manage documents and data in a shared workspace. Track the history of the work process with user action logs, shared notes, and document review.

***Enhanced communication*** Extranet improves the internal communication and provides an effective marketing, sales and customer support.

***Enhanced productivity*** Extranets provide JIT information delivery, which reduces the problems of information overload and productive collaborations between work groups

***Scalability*** Manage small or large amounts of information and provide a browser-based interface to accommodate large numbers of simultaneous users.

***Seamless information delivery*** Compress event-to-action response times through event notification and efficient email and portal information delivery.

***Leverage your existing security*** Enable secure information transactions within the firewall and beyond to internet and extranet deployments.

***Reduces the cost*** Extranet reduce the travelling, meeting, administrative, and operational cost. It eliminates the paper publishing cost and error.

### Extranet Applications

Some other popular uses of an extranet include:

- Post warranty information that clients can access at their convenience.
- Build a database of sales leads from recent promotions that can be accessed by sales partners.
- Provide key sales and marketing partners access to a complete library of company artwork and literature for downloading.
- Offer customer discussion forums for reporting known problems or product suggestions.
- Grant access to a knowledge database of FAQ's and other support related material.
- Provide key suppliers access to discussion forums, knowledge base articles and opportunities to update their skills.
- Establish an extranet to coordinate financial, research and product development projects with outside partners.
- Provide each supplier with a private workspace to post deliverables, check status, and view on-going performance.
- Consolidate contracts, relative performance, current issues and activities with a supplier for a total strategic view of the relationship.

## B2B e-Commerce and Cloud Computing

B2B integration with trading partners is critical for many companies. It is 24×7, 365 days a year and as such it is integral to a company and its successes. Many business organisations are now revisiting their in-house solutions in case they could become a single point of failure for the company in the event of IT outage or disaster such as flooding, earthquake, tsunami or tornado. Companies are realising that they have to be able to do B2B e-Commerce and a functioning B2B platform is of vital importance.

Initially IT departments in the companies look at the requirements and it appears easy for them to establish and maintain robust IT infrastructure, but they omit to consider the ongoing, continuous nature of B2B e-Commerce and gradually find the on-boarding of suppliers and customers become more and more distracting from their core strategic objectives.

To overcome these problems, the companies are looking at cloud computing as a key driver of IT productivity. The cloud computing is a technology that uses the internet and central remote server to maintain data and applications. Cloud computing allows consumers and businesses to use applications without installation and access their personal files at any computer with internet access. This technology allows for much more efficient computing by centralised data storage, processing and bandwidth. In B2B e-Commerce there is an increased use of cloud based infrastructure. These clouds may be developed to serve a different requirement or service that a particular industry needs. The companies need to be connected to a central B2B hub as well as ERP systems such as SAP and oracle and sharing the data to other organisations. Business collaboration can make the decisions to switch to the B2B cloud easily without considering the constraints like management applications, current hardware systems data security issues, architecture and integration investment.

The cloud computing solution from B2B cloud solution can provide:

1. **Greater flexibility:** In B2B businesses, cloud solution will grow and change as the B2B business changes.
2. **Customer Configuration:** Cloud solution can be designed based on the companies specific business needs.
3. **Availability:** Connected to the applications and data from any web-enabled devices for doing business on the go.
4. **Cost-effective technology:** Optimise the applications it is already developed and get a new solution that will pay for itself.

B2B cloud computing solution for an enterprise includes:

- (i) Infrastructure as a Service (IaaS)
- (ii) Platform as a Service (PaaS)
- (iii) Software as a Service (SaaS)
- (iv) Network as a Service (NaaS)

### Infrastructure as a Service (IaaS)

Most B2B cloud service provides IaaS. It offers physical or virtual machines (server, storage facility, load balancers, and networking devices). IaaS provides a large number of virtual machine with the ability to scaling services up and down according to the consumers varying requirements. IaaS cloud also offers the additional resources such as; file based storage, load balancers, virtual local area network (VLAN), IP addresses and firewalls. These pools of resource are accessible from the data centres of the cloud service provider.

### **Platform as a Service (PaaS)**

It is a category of cloud computing service that provides a computing platform as a service to the customers. Using PaaS, the application can be deployed to the customers without the additional cost and complexity of buying and managing the underlying hardware and software and provisioning deliver a computing platform typically including operating systems, programming language execution environment, and web servers. Application developers can develop and run their software solutions on a cloud platform without the cost and complexity of buying and managing separate hardware and software.

### **Software as a Service (SaaS)**

It is also referred as “on-demand software” is a software delivery model in which software and associated data are centrally hosted on the cloud. Using SaaS, the customers can access their applications using thin-clients, via a web browser. SaaS become a common delivery model for many business applications including accounting, collaboration, customer relationship management (CRM), management information systems (MIS), enterprises resource planning (ERP), invoicing, human resource management (HRM), content management (CM) and service desk management (SDM).

### **Network as a Service (NaaS)**

These categories of cloud services provide network or transport connectivity service and/or inter cloud network connectivity services. NaaS involves the optimisation of resource allocations by considering network and computing resources as a unified whole. Traditional NaaS service includes flexible and extended virtual private network (VPN), and bandwidth on demand, also providing virtual network services by the owners, of the network infrastructure to a third party.

### **Examples of Cloud Computing**

- ICICI's Insurance arm has used Zoho's web-based applications to develop innovative services such as a personalised insurance for diabetes. Premiums are adjusted depending on how well policy holder sticks to a fitness plan.
- Infosys partnered with its major client in cloud research to provide cloud computing based service for the auto sectors.
- In China, Alibaba group planned to develop cloud computing centres that provide SaaS to its customers especially SMEs at a cost of US\$146 million. Alisoft, Alibaba's software subsidiary had captured more than 60% of Chinese SaaS market.

## **MARKETING STRATEGY FOR THE ELECTRONIC MARKET PLACE**

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Many firms are not clear as to what changes are required in the marketing strategy when they plan to change from a non-electronic (or traditional) world to an electronic platform. We shall focus our discussions on business-to-business marketing, and short-term (up to one year) marketing strategy, that is normally considered when annual marketing plans are developed by business marketers. It may include some of the strategic (long-term) marketing issues, such as segmenting, targeting, and positioning. The major components of a marketing strategy are:

1. Segmenting and targeting

2. Product differentiation and positioning
3. Marketing-mix strategies, that is, product, price, promotion, and distribution strategies.

## Segmenting and Targeting

As discussed in Chapter 6, the procedure of segmenting and targeting includes carrying out marketing research to collect information from the existing and potential customers. In traditional marketing, segmentation of the total market is then carried out by using one of the variables such as type of industry (or customer), size of customer (i.e. volume of usage), geographical location of customer, or end-use (application) of the product. In the new interactive marketing, industrial buyer's behaviour will be used as one of the key variables, for segmenting the market. e-Commerce will enable marketers to capture behavioural data and update the database.

**Marketing Research** As mentioned in Chapter 5, in industrial (or business-to-business) marketing research, more emphasis is placed on secondary research (i.e. the data collected by others). The secondary data is available not only from traditional sources of government and non-government publications, but also from computerised online databases through search engines. At present, availability of secondary data on the Internet is not well organised in India. However, there is no doubt that the Internet will be a major source of secondary data soon. Primary research can be conducted by survey method by mail, telephone, or personal interviews in traditional ways. However, more effective way of collecting the primary data is by creating a questionnaire and sending it out over the internet to the customers, or through an online interactive data collection. Customers' purchase decisions generate behavioural data that should be captured, fed into marketing database, updated, and only then the customers' profiles be recreated. The new customer profiles may conform to the existing segments or generate new segment classifications. Effectiveness of conducting marketing research through e-Commerce is measured in terms of the lower cost and time, compared to the traditional methods used for collecting the data. In future, the sources of databases may include multimedia information. Many marketing researchers are in a position to collect market data in electronic commerce, but very few have the ability to organise customer information for developing a meaningful marketing strategy. This area of electronic commerce needs to be developed in future.

After segmenting the market into various potential segments, a company should evaluate the potential segments by using criteria indicated in Chapter 6, and select the target segments. The target market strategy (niche, concentrated, differentiated, or undifferentiated) is then decided.

## Product Differentiation and Positioning

The steps involved in product differentiation and positioning are: (i) Identifying the target customers' wants in terms of major benefits, through marketing research; (ii) Selecting one or more benefits or niche for differentiation, based on the company's strengths or distinctive competences; and (iii) Communicating the company's positioning to the target market.

There is some confusion about what differentiation means in electronic markets, and how to find a niche or benefit. Early internet pioneers set up successful web servers (e.g. Hot-wired and Global Network Navigator—GNN). However, as their distinctiveness got blurred due to arrival of many players in electronic markets, it became a question of survival. It is, therefore, important for the survival and success that a company should first identify accurately the target customers' needs and wants and then satisfy those needs by creating superior products or value-added services (in comparison to competi-



tors'). Differentiation can be done by being different or superior with respect to several variables such as product, service, personnel, and image of the company.

Marketers should use the new method of interactive marketing to position their superior customer service in the minds of their target customers. **For instance**, let us consider two companies who have large amount of information available about their products on the Internet. Firm 'A' exercises no control over the flow of information and hence, potential customers view general information and then go elsewhere. Firm 'B' guides the potential customer on how the company's product can solve the customer's problems, comparative analysis with competitors' products, and price justifications. Firm 'B' has better chances of getting orders from prospective customers due to its superior pre-sales service, although both the firms have websites.

Business marketers should ensure that while communicating their positioning strategy, they should use the power of *integrated marketing communication* by conveying the same message or theme through different media. The business marketers may select different promotional media such as direct mail, trade journals, and electronic media through the internet, but the communication message which conveys the firm's positioning strategy should remain the same. This improves the customers' recall of the company's distinctiveness and avoids confusion (if different messages are conveyed through various media).

## Marketing-mix Strategies

**Promotion (or Communication) Strategy** Advertising in traditional marketing is one-way communication. Business marketers communicate information about their products and services to the target customer groups through several promotional media such as advertising in trade journals, direct mail, trade-shows, and personal selling. Some of these media have an advantage of face-to-face communication with customers (e.g. trade shows and personal selling). But other mass media such as advertising through trade journals and business magazines cannot get immediate feedback or results on customers' reactions. However, advertising can be used effectively for promoting the firm's website. Promotion of products and services through websites on the Internet allows marketers to react to individual buying-firm's needs. Each industrial or business customer can be served in their preferred way. *One-to-one marketing* has become a standard method of dealing with customers over the internet. Communication is, therefore, tailored to individual customer's needs. Marketing has become much more customer centric.

**Web-design** The marketer's website is the basic marketing message on the internet. The web offers immediate rewards if the contents are interactive and value-laden. It is also more dangerous than other media if it is not done in right way. The design of the website is very important since that is what a firm's customers will see. Copying the existing paper document will not work because the traditional paper documents are linear (or one-way communication). Documents on the Web are non-linear (interactive). The website should be attractive to the firm's customers, with well-produced content, nice graphics, and should be user-friendly. Information on the website should give an adequate information about the company's products and services. It should also answer the potential questions of the customers. To have a successful business online, the website should be designed in the right way.

The websites designed for a particular business activity should have a clear, established and measurable goals and objectives. It helps to determine whether the website:

- Allow customers to order product and services online.
- Provide technical support for product and services
- Advertise product and services
- Collect information about current and potential customers
- Provide links to the related web pages
- Provide industry informations.

**WebPages** Document that can contain text, graphics, and video, audio and help links stored on a web server and viewed in a web browser. A collection of these related web pages is called a website. The web pages are linked by hyperlinks. If a website offering a wide array of services such as search engines, directory services, electronic catalogues and shopping services it is called as a web portal.

**Domain Name** A domain name identifies a website on the internet including the server that handles web browser requests the specific organisation associated with the domain name, and the general category in which the organisation operates.

**For example:** www.alliance.edu.in identifies alliancebschool.org website located on a particular web server. Alliancebschool portion of the domain name identifies the organisation or entity associated with the domain name. The 'www' identifies the server that handles internet requests. The '.org' portion is called the top-level domain (TLD) and identifies the general catalog in which the domain name is registered.

**Table 14.4** Some of the Top-Level Domains (TLD's)

<i>Type of the organisation</i>	<i>TLD Name</i>
Commercial	.com
Educational	.edu
Government	.gov
International Treaty organisation	.int
Network Provider	.net
Non-profit	.org
Military	.mil

**Distribution Channel** Traditional marketing use intermediaries (or middlemen) such as distributors, dealers, manufacturer's representatives, and brokers as a part of the distribution strategy. The new distribution strategy with electronic technology is direct distribution (or direct channel). In recent years, companies have started adopting *multi-channel marketing* instead of single-channel marketing that was followed in the past. A multi-channel marketing has advantages of (a) higher market coverage, (b) more customised selling, and (c) lower channel costs. Direct channels used in business-to-business marketing are direct sales through the company's sales force, and direct marketing through direct mail, telemarketing, and the internet. If critical functions or services (e.g. promotion, selling, warehousing, transportation, and technical services) are performed efficiently and cost-effectively by the manufacturer, there is no need to have intermediaries. Each business marketer should decide which functions

are important and whether the company can perform those functions effectively without the services of the intermediaries. This analysis should also include the tasks of physical distribution (or marketing logistics) so that the products and services are available to the customers, when required.

**Pricing Decisions** In traditional marketing, industrial marketers set the prices of its products or services based on (i) pricing objectives; (ii) demand analysis; (iii) cost analysis; and (iv) competitive analysis. In the new interactive marketing, the customer is likely to set the price based on the comparative price information available on the internet. With *one-to-one marketing* method that is followed on the internet, each business customer will ask for the specific product and the price to meet the individual needs. This will force the companies to have a pricing strategy that is flexible enough to meet the specific pricing needs of individual customers. To ensure profitable business, each business marketer will have to first find out ways and means of bringing down the costs and then draw a line below which the company cannot accept the prices set by the customers.

**Product Strategies** Product strategies include deciding as to which of the existing products should be continued, modified, or dropped, and which new products need to be developed. Marketers should review the existing products and choose those products that are suitable for online business. These products should be first put on the company's web page.

New product introduction process<sup>1</sup> on the internet includes the following steps:

1. Segmenting and targeting potential customers is done through marketing research by the use of WWW servers and news groups.
2. Communicating product positioning, product information, and ordering procedure through attractive web page, with emphasis on interactive and value-laden contents.
3. Carrying out interactive marketing by interactive discussions with customers on the internet, answering customers' questions, giving online pre-sales, during-sales, and after-sales services to customers.
4. Using customer feedback for continuous improvements in products, services, and marketing strategies.

## OUTLOOK INTO THE FUTURE

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Electronic markets, the internet, and other emerging technologies are in the introduction stage at present. It is uncertain how they will evolve in future. However, they represent a basic shift in the ways business firms are interacting with their customers and suppliers. One thing is certain that in future much more business-to-business marketing will be conducted online with the help of the internet, WWW sites, and other digital technologies.

Some of the predictions and concerns of present and emerging technologies and their impact on marketers and customers are as follows:

- *From Bill Gates of Microsoft Corporation:* "I happen to think that, even as you move into the internet world, software will be more valuable. Somebody could take the position that because of low-cost connectivity, software is not important anymore. But I don't."
- *From Paul Saffo Institute for the Future:* "The biggest change taking place due to the internet is from mass-media age to the personal-media age. The Web will evolve to a place where it

connects people to people in information-rich environment, and the people who construct those information-rich environment will get rich in 3 to 5 years from now.”

- *From Amanda North, Studio Archetype:* “What is really going to be exciting in creating the buyer/seller relationship is the way in which technology will make it possible to track individual preferences. So the website is going to become very customised and very targeted.”
- *From the e-Business (R) Evolution by Daniel Amor:* “Two types of new entrepreneurs will be around for the next few years—service developers and service providers ... it gives start-up companies the chance to take away market share from traditional service providers as they may be slow to move the next generation of services.”  
“... The new paradigm connects all sorts of devices and integrates them into the internet ... Instant private business networks will become more important in the future, where most of the business will be conducted over the internet.”
- *From World Wide Web Marketing by Jim Sterne:* “It’s much more difficult for companies that come late to the internet marketing game ... So go surf the web. Assemble a team. Read some books. Get some tools. Write a style guide. Get started. Get started soon. It will be much harder to catch up later.”
- *From Frontiers of Electronic Commerce, by Ravi Kalakota and Andrew B Whinston:* “In sum, the rules for regulating cyberspace marketing, advertising and sales are still in the early stages. This is a grey area that will without doubt continue to be the focus of heated exchange.”
- *From Walter Forbes:* “The Web has low barriers to entries, but huge barriers to profit.”

## SUMMARY

Traditional business environment is changing rapidly due to the advent of e-Commerce. Businesses and individuals use e-Commerce to minimise the transaction cost, speed up the flow of goods and information, improve the level of coordination of actions among manufacturer’s suppliers and customers. By e-Commerce the customers and companies gain access to each other in a market space. In a B2B EC both sellers and buyers are business organisations. This model is an effective media for inter organisational activities, and collaborative commerce for managing supply chain, procurement, JIT delivery and other online services. The organisations can buy the product or services at a lower cost. The major applications of B2B e-Commerce is selling form catalogs and by forward auctions, buying in reverse auctions and in group purchasing, and trading in exchanges. In addition most organisations employ collaborative commerce, usually along the supply chain.

Compared to traditional method of conducting Business-to-Business marketing, the new method of marketing on the internet is easier, less time consuming, and less costly. e-Commerce is a new communication tool, which improves the effectiveness and efficiency of marketing function. The important components of e-Commerce are the Internet, WWW, Intranet and Extranet. The growth of Internet is one of the influencing factors to the development of global e-Commerce in general and B2B e-Commerce in particular. The internet is also created many operations for on-line banking, on-line stock trading and electronic auctions, where geographically dispersed buyers and sellers can come together.

There are two forms of B2B marketing through e-Commerce: inter-organisational systems and electronic markets. Inter-organisational systems create smooth business process between business partners (buyers and sellers) by exchanging business transactions through Electronic Data Interchange (EDI). The major types of inter-organisational systems are: (i) Electronic Data Interchange (EDI), (ii) Electronic Fund Transfer, (iii) Electronic forms, (iv) Integrated messaging and (v) shared databases.

In e-Commerce whether an organisation is selling to organisations or to individuals, in many cases a competitive edge is gained by providing superb customers service. Electronic markets have certain benefits to market such as advertising, customer support services, alternative to traditional distribution channels, and extending reach to potential customers.

Marketing strategies in B2B marketing in the new electronic environment will change. The major changes will occur in segmenting and targeting (including marketing research), promotional strategy, distribution channel, pricing decisions, and new product introduction process. Electronic markets and the Internet are in their infancy. It is not clear how they will evolve in future. But business marketers must get started on the Internet; otherwise it will be very difficult to catch up later.

### KEY TERMS

- |                                  |   |
|----------------------------------|---|
| • Bring-your-own-device (BYOD)   | • Infrastructure as a Service (IaaS)              |
| • Business to Business           | • Intranet  |
| • Business-to-Consumers          | • ISP (Internet Service Provider)                 |
| • Cloud Computing                | • Knowledge Base                                  |
| • Collaborative Commerce         | • I-Commerce                                      |
| • Consumers-to-Consumers         | • m-Commerce                                      |
| • Domain names                   | • MIME (Multipurpose Internet Mail Extension)     |
| • EFT (Electronic Fund Transfer) | • National Electronic Fund Transfer system (NEFT) |
| • e-Commerce                     | • Network as a Service (NaaS)                     |
| • E-Government                   | • Platform as a Service (PaaS)                    |
| • Electronic catalogue           | • Real Time Gross Settlement system (RTGS)        |
| • Electronic Data Interchange    | • Software as a Service (SaaS)                    |
| • Electronic Fund Transfer       | • VAN (Value Added Network)                       |
| • e-Procurement                  | • VPN (Virtual Private Network)                   |
| • Exchange                       | • WWW (World Wide Web)                            |
| • Extranet                       |   |
| • Informediaries                 |   |

**Note:** Glossary of the key terms is given at the end of the text.

### CONCEPTUAL QUESTIONS

1. What are the major categories of communication service provided by the internet?
2. Define e-Commerce and distinguish it from e-Business.
3. What are the different types of e-Commerce?
4. Compare B2C and B2B e-commerce.
5. Explain the functions of electronic storefront and malls.
6. What are the benefits of cyber banking?
7. Describe electronic securities trading.
8. Describe the working of electronic auctions. Mention their benefits.
9. Briefly describe the sell-side and buy-side marketplace.
10. What are the roles of exchanges in B2B EC?
11. Describe the various electronic payment mechanisms.
12. List the security requirements for Electronic Commerce.
13. Describe methods involved in buyer's protection in e-Commerce.

**OBJECTIVE TYPE QUESTIONS**

1. Software, music, digitised images; electronic games can be revenue sources for the B2C e-Commerce by: (a) selling services, (b) doing customisation, (c) selling digital products, or (d) selling physical products
2. Which e-commerce category is the largest in terms of revenue? (a) Business to Business (B2B), (b) Intra-Business (B2E), (c) Business to Consumer (B2C), or (d) Consumer to Consumer (C2C)
3. Which of the following items is used to protect your computer from unwanted intruders? (a) A cookie, (b) A browser, (c) A firewall, or (d) A server
4. For selling physical products on the internet, what is the key to profitability? (a) A. Hook, (b) Cost Control, (c) Brand Recognition, or (d) Customisation
5. Which of the following B2C companies is the best example of achieving its financial success through controlling its cost? (a) Yahoo, (b) Amazon, (c) e-Bay, (d) Google, or (e) None of the above
6. Which of the following is the least attractive product to sell online? (a) Downloadable music, (b) Software, (c) A PDA, or (d) electronic stock trading
7. Which is more significant for web based advertisers: (a) Impressions, (b) Page Views, (c) Click Though, or (d) Hits
8. The differences between B2B and B2C exchanges include: (a) Size of customer set, (b) Transaction volume, (c) Form of payment, or (d) Level of customisation on products/services (a) a and b, (b) a, b, and c, (c) b and c, or (d) All of the above
9. Security-and-risk services include: (a) Firewalls and policies for remote access, (b) Encryption and use of passwords (c) Disaster planning and recovery, (d) All of the above, or (e) a and b only
10. On which forms of e-Commerce does Dell Computer Corporation rely in conducting its business? (a) B2E, (b) B2C, (c) B2B, or (d) All of the above
11. The internet: (a) is providing the infrastructure for electronic business because its technology and technology standards can also be used to make information flow seamlessly from one part of the organisation to another, (b) Provides a much lower cost and easier to use alternative for coordination activities than proprietary networks, (c) Reduces agency costs, or (d) does all of the above
12. A system with universally accepted standards for storing, retrieving, formatting, and displaying information in a networked environment best defines: (a) a website. (b) A web location. (c) The World Wide Web, or (d) An intranet.
13. eBay is a type of e-Commerce? (a) B2B, (b) B2C, (c) C2C, or (d) All the above
14. Which is a on-line stock trading site: (a) www.marketerporter.com (b) www.transwave.com (c) www.elitetrader.com, or (d) www.visa.com
15. Which one is not a search engine: (a) Google, (b) eBay, (c) ask.com, (d) baidu, or (e) bullguard.

**APPLICATION QUESTIONS**

1. Discuss various types of e-Business models. Based on what factors they are classified?
2. Why the electronic payment system is popular even if it is vulnerable for all kinds of security threats?
3. Find out the various opportunities provided in the leading e-Business portals (www.amezon.com, www.google.com, www.fedex.com etc.) for establishing B2B e-Commerce.

### ONLINE (WEBSITE) EXERCISE

Visit the following websites and understand the services provided by them:

1. [www.citybank.com](http://www.citybank.com)—find the net-banking and mobile banking services.
2. [www.emarketer.com](http://www.emarketer.com)—to find the survey reports on different verticals
3. [www.amazon.com](http://www.amazon.com)—for finding a unique gift item and the procedure involved in sending the same to a destination address.
4. [www.cisco.com](http://www.cisco.com)—study the supplier oriented marketplace.
5. [www.paypal.com](http://www.paypal.com)—for payment and money transfer mechanisms.
6. [www.freemarkets.com](http://www.freemarkets.com)—study the business model for B2B EC.
7. [www.dell.com](http://www.dell.com)—study the process of placing an order for a customised Dell product.
8. [www.fedex.com/in/](http://www.fedex.com/in/)—on-line package tracking systems
9. [www.verisign.com](http://www.verisign.com)—security services provided for financial transactions
10. [www.dellauction.com](http://www.dellauction.com)—on-line auctions methods of Dell computers.

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**CASE 14.1****Traveloworld.com<sup>\*</sup>**

Traveloworld.com is a tour operator, providing limited services to tourists. Unfortunately, they are unable to provide customised services to tourists. This resulted in high customer attrition. The company wants to have a networked system to provide the required services to their customers within India, and also to explore possibilities outside India.

Traveloworld.com wants to network the community of major Travel Service Providers (TSP) specialising in one or more travel services, such as package tours or airline reservations within and outside India. This TSP's, operating from different places and providing specific services to customers, can only meet a portion of the customer requirements. If a tourist needs to visit Shimla, travel agents may be able to manage the airline reservation for the traveller, but perhaps not a hotel reservation. Similarly other travel agents may provide hotel booking services and car rental services, but they may not be affordable for the tourist. Tourists face difficulties in getting adequate information about the various travel destinations, hotels, restaurants, airports and other services. They need an option for searching multiple travel agents to plan a tour, and information about the different services provided by them with the pricing structure.

After analysing these problems in the tourism and travel industry, the managers at Traveloworld.com want to develop a single point contact solution for the tourists. Their idea is to provide customised services and updated information in a single click.

**Questions**

1. What are the capabilities of online travel service system?
2. Why is this e-Commerce model considered as a B2B2C e-Commerce?

**CASE 14.2****Sunrise Spices Ltd.,<sup>†</sup>**

Sunrise Spices Ltd. has over 100 years of experience in the food industry. The company is a leading manufacturer and exporter of a wide spectrum of spices, blended spices and allied products in India. With modern and advanced infrastructure, they also specialise in tailor made spices as per the client requirements. All spices are organically cultivated, making them free from any form of chemical exposure.

**Business Challenge**

The need of the company was to create a brand image online and also enhance its presence on the major search engines. Major challenges faced are:

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<sup>\*</sup> B2B2C (Business-to-Business-to-Consumer) e-Commerce model—In which a Business provides some product or services to a client Business that maintains its own customers.

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<sup>†</sup> Source: [www.indiamart.com](http://www.indiamart.com)



- Offer an attractive and systematic showcase of the entire range of products.
- Project the client as an industry leader.
- Facilitate online processing of queries.
- Enhance online promotion and visibility to increase responses globally.
- Create a user-friendly interface for visitors seeking the company's products.

### **B2B Solution**

IndiaMART leveraged its expertise in online business promotion to offer comprehensive solutions to Sunrise Spices Ltd. IndiaMart.com founded in 1996 serving as a Business-to-Business (B2B) electronic marketplace. Its function is to provide an on-line business portal to link Indian exporter and the buyers around the world. This helped Sunrise Spices Ltd., to introduce to the large pool of buyers in the Internet.

Value addition by developing a website with;

- Extensive details about the company in terms of quality, infrastructure and clients.
- Convenient and easy to navigate website.
- Search bar on the homepage making the site more user-friendly.
- Brief description of the major product categories on the homepage along with their high resolution images.

### **Result**

- The Sunrise Spices Ltd., received a large number of business queries.
- The well-designed website helped in creating a strong online presence for the client.
- The company ranked well on major search engines.
- Sunrise Spices Ltd. was made visible as an international brand, for its quality and customised blend of spices.

### **Questions**

1. What is the role of IndiaMART.com B2B portal?
2. What are the services provided by IndiaMART.com to the customer?

## **CASE 14.3**

### **AuctionIndia.com\***

Chennai based Cyber Commerce Pvt. Ltd. has launched India's first web based auction site. It auctions and sales the industrial assets, such as plants and machinery, total factories and business. AuctionIndia.com offers free listing and access to buyers and sellers. Customer having computers and Internet facility can directly involve in the bidding process, whereas the customers do not have computers and internet connections can also make use of the service by authorising Cyber Commerce Pvt. Ltd., to make bids on their behalf. The company communicates with buyers upon request when particular machinery desired by the buyers gets listed on the site. Cyber commerce maintained certain level of norms related to the bidding process. It also tied up with Industrial and Technical Consultancy Organisation of Tamil

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\* Source: [www.auctionindia.com](http://www.auctionindia.com)

Nadu (ITCOT) to act as the appraiser agency. ITCOT can upon request of the buyers inspect the goods physically and come out with the independent evaluation, which could help the buyers to negotiate a better deal. The report will remain confidential with the buyer.

The site consists of an easily navigating and a search mechanism to facilitate buyers to choose a particular type of machinery. For the user convenience the internet auction will be kept open on site for a few days for buyers to place competitive bids. The bid history and the current highest bids will be always displayed. AuctionIndia narrowed on the B2B auction market opportunity that focuses on industrial assets recovery.

### **Question**

1. Identify the issue(s) involved and find appropriate solutions.

## **CASE NO. 14.4**

### **ACOM'S EZConnect EDI Solution for Continental Airlines to Carry the Mail\***

#### **The background**

When Continental Airlines jets lift off from the various 200 airports the company serves, ACOM Solutions, Inc. is present on board -- not in the cabin and not in the electronically tricked out environment of the flight deck, but in the spacious cargo hold, where tons of U.S. Mail share space with merchandise of every description and sometimes, even a beast or two.

The airlines are critical to the operations of the U.S. Postal Service (USPS), which has aggressively pursued the implementation of Electronic Data Interchange (EDI) communications with aviation business partners for several years, in order to speed the two-way flow of shipping, manifest and carrier information and correspondingly, the flow of the mail itself. According to Senior Technology Analyst, Wally Mensing, Continental Airlines began working with USPS, its biggest cargo customer, four years ago to develop means to exchange information electronically. The development work continues, as both trading partners expand the amount and kind of data being exchanged. And for the past year, ACOM's EZConnect EDI/XML solution has formed the basis of much of Continental's development work.

#### **The problem**

Until the EDI initiative began, all of the information flow between the USPS and Continental (and other airlines) followed a paper trail -- and in fact, paper copies remain the "official" documents in the process by which the postal service ships its mail. The paperwork accompanies shipments to the airport.

#### **Why the extensive and expensive EDI initiative?**

The answer is efficiency. Exchanging information on cargo commitments and space availability ahead of the paperwork enables the postal service to optimise the scheduling of its shipments, and at Continental's end, enables allocation of personnel and equipment resources for the greatest efficiency and effectiveness. A device used by the postal service computerises information generated when the shipping labels are prepared, and when enough mail is assembled for a shipment, an EDI message goes out.

\* Source: Adapted from - [www.acom.com](http://www.acom.com)

“We receive some 15,000 of these EDI messages per day from the postal service, and we send the USPS about 60,000 to 80,000 EDI messages per day, with transmissions in every 30 seconds,” Senior Technology Analyst says. “We provide flight schedules one week in advance, and in the interim, furnish a stream of constantly updated information about every flight such as time changes, cancellation, insertions, and cargo space available, and so on. Everything they need to know for their own planning. Their information provides details about how much mail to expect, whether the shipments are bulk or containers, the type of mail – priority, first class, parcels, express, letters, boxes, etc. If they have information in place early enough, they even designate the flight they want the shipment to move on.”

The EDI solution has proven to be immensely valuable in load planning – coordinating the passenger, cargo and fuel factors with the personnel and equipment requirements. **For example**, Mensing says, if you have 8,000 kilograms of bulk mail, it requires more people for handling it than if you have a container, which requires different handling equipment.

“If you can have the information before the shipment arrives at the airport, you can make the necessary arrangements ahead of time and get the job done faster and better,” he says. “Thirty minutes of lead time makes a vast amount of difference.”

Continental first began its EDI initiative with the postal service by developing an EDI system and maintains the entire data related to business transactions in SQL Server database. This obtains streaming information from the various operations applications and populates other elements of the database structure with the information. It also forwards the relevant information about the USPS’ activities to the shipper. A reverse process is followed with the information arriving from the USPS.

The information exchange is automatic and transparent, with both Continental and the postal service operating their proprietary TCP/IP (Transmission control protocol/Internet protocol) networks. The postal service maintains a server at Continental’s IT facility, where essentially it operates as a limited access, and password protected node on the Continental network. Both incoming (to Continental) and outgoing (to USPS) traffic move through the server with little or no manual intervention.

### **The solution**

Continental decided it was time to replace or bypass the problem code. Mensing looked at several EDI solutions; among them was Sterling and ACOM’s EZConnect, which he had considered for implementation. It’s a fully saleable and flexible EDI solution compatible with all VPNs, VANs and proprietary networks and supports EDI standards. The solution includes translation and mapping software, a trading partner management tool, security module and a documentation tool – with an SQL database server.

### **The implementation**

Mensing purchased EZConnect and asked ACOM Professional Services to implement “Add a Message,” the Cardit message that conveys the cargo information electronically to Continental. Cardit is an EDIFACT document format developed by the Universal Postal Union that is similar in principal to the X12 document types used for domestic EDI. It is a versatile, internationally acceptable document format that communicates cargo routing, transfer and destination information from the postal service to its carriers.

Initially, EZConnect deals only with incoming Cardit traffic, polling the USPS server every 10 minutes and relaying the collected data to the SQL database server. Different applications then examine the data and pass it on to the field operations sector that handles postal service cargo -- instantaneously.

Continental's own data will remain on the old system until the company changes the way the data streams come in from operations, at which time outgoing message traffic will also be handled by EZConnect. Meanwhile, Mensing and his colleagues have mapped the data for international mail and are developing methods for providing the postal service with comprehensive reports from intermediate points. Mensing has also collected operations data on international shipments and has mapped the response portion of that process.

**Result**

"This is the first airline company to be certified for this EDI activity, and we try to be the front-runner," Mensing says. "The postal service is a tremendously important part of our cargo division operations, and they are such an immense organisation that it is difficult for them to inaugurate changes, so we strive to lead the way as much as we can." With its power and flexibility, Mensing says, ACOM's EZ-Connect makes that job easier.

**Questions**

1. What are the challenges for Continental Airline using paper based transactions?
2. What type of EDI system is planned to implement?
3. How is the new system streamlined the business process in Continental Airlines?

# 15

## International Business Marketing

*After studying this chapter you should be able to:*

- Appreciate the nature and importance of international markets.
- Learn how to gather information about the target market.
- Understand how to choose the markets to enter.
- Learn the economic, legal and cultural aspects of international marketing environment.
- Understand the risks involved in doing international business.
- Know the entry strategies for international markets.
- Understand pricing, financial terms and payment methods used in international markets.
- Learn about building international marketing channels.

The past two decades has seen a number of changes in the global situation, important among them being the opening up of Russia, India and the eastern European countries and the emergence of China as a major market. The emergence of WTO has opened up many new areas to freer trade such as agriculture, textiles and services.

What this means for most companies is enhanced opportunities while at the same time increased competition and risk. In this chapter we will try and understand the implications of these momentous changes.

### THE NATURE OF INTERNATIONAL MARKETS

International markets vary in terms of their level of development. At one end, we have affluent and highly developed markets such as the US and the western countries while on the other there exist markets which are very poor and undeveloped such as certain countries in Africa. Each of these offer opportunities for different reasons—highly developed markets due to their high levels of consumption and also because of their high cost of manufacture, the poor and undeveloped countries due to their lack of industries and infrastructure. The types of products which will sell in each of these markets will differ depending on the level of development.

Today, countries such as the US and even Japan and Korea have started outsourcing manufacture of products to countries like India due to the lower cost of production. **For instance**, India has become a global manufacturing base for many automobile manufacturers like Hyundai, Suzuki and Ford which are marketing their products made in India globally. Many other manufacturers like GM, Volvo, etc. are sourcing components for their global operations from India. Many international pharmaceutical companies are using India as a source for many of their drugs. India is also a global source for many leading garment brands.

The main feature that should be noted in this context is that global manufacturers and traders will move to outsource products to areas where there is a definite cost advantage without loss of quality.

A recent study has shown that the majority of international trade is in industrial products like machinery, chemicals, transport equipment and other manufactured goods. It is therefore important that any study of business marketing should include the study of international business marketing as well.

## Product

Products sold in international markets have to conform to local laws on a variety of issues ranging from safety to pollution to design etc.

Business products can be standard, i.e. the same product is used in many industries and there is very little variation in the specifications or they may be customised to suit the design of a particular product.

Fasteners, Components, Chemicals, etc. can be both standard type or customised to suit a client. Obviously, a customised product would require direct and greater interaction between the buyer and sellers.

Very often, companies vary the specifications between countries to ensure there is no trade in these products between markets.

## MARKET INTELLIGENCE AND RESEARCH

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This is an important activity for any exporter. Collecting primary data through market surveys is very expensive and hence not feasible for most companies. Secondary data is available from a number of sources which can be collected and compared to get a clear understanding of the market.

The sources of secondary data include:

- Embassies/consulates of the importing country
- Indian missions in the host country
- Trade and industry organisations like CII, FICCI, Assocham, EEPC, AEPC, CAPEXCIL and many others
- Chambers of commerce and industry in the importing country
- Commercial banks
- EXIM bank
- Export Credit Guarantee Corporation (ECGC)
- Trade journals and publications
- Internet websites

In addition, many of the chambers of trade and industry frequently host business delegations from various countries and also sponsor delegations of Indian businessmen to those countries. Such meets can be very useful in gathering a lot of information apart from establishing contacts with prospective businessmen in those countries.

## CHOOSING THE MARKET

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This is a very important element in international marketing. Some of the factors to be borne in mind while choosing the market to enter are:

1. The size of the market
2. The language and culture of the market
3. The competition in the market
4. Proximity of the market
5. Political and financial stability of the country

While size of the market is an obvious attraction, the manufacturer must bear in mind that all large markets will inevitably be more competitive as every manufacturer wants to get a slice of the market. The US and more recently India are good **examples** of large markets which are very competitive. Smaller manufacturers may find it difficult to service larger markets, but may be more comfortable choosing small markets.

Language and cultural affinity is very important in international markets. Indian companies will find it easier to do business in neighbouring markets like Sri Lanka, Bangladesh, Nepal and the Middle East, due to the ease of communication and similarity in cultures.

For India, doing business with neighbours like Sri Lanka, Bangladesh, Nepal and the Middle East is preferable due to the low cost of freight, travel and communications. One could travel to Bangladesh by bus from Kolkata and the fare from Bangalore or Chennai to Colombo is approximately the same as that to Delhi. For US companies, it is easier to do business in Canada or Mexico than India, due to the proximity and similarity in cultures.

Political and financial stability of target countries is a very important factor to be considered while choosing markets. In today's context, doing business in Iraq or Afghanistan is probably very risky as the countries are very unstable both politically and financially. The same would hold true, though to a lesser extent, with Pakistan.

## CULTURE AND INTERNATIONAL BUSINESS

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Culture is a very **important** factor in international marketing. Culture encompasses everything from the way of thinking and doing business to the consumption patterns of the population. Understanding the culture is important as it gives vital clues on how best to do business in these countries.

In some countries, there is a natural hostility to foreigners and foreign business. Although we are open to foreigners doing business in India, we can still be hostile towards them as we have seen in the case of McDonald's and more recently to the METRO stores. It is important to understand this when doing business overseas. Pakistan, though next door to India, maintains a hostile political attitude to India and Indian business and hence although both countries can gain substantially, Indian companies do not do direct business across the border. Contrast this with Bangladesh, where the business environment is marked by the presence of several Indian companies.

Culture dictates the mode of dealing; for example in the US and western countries, they are forthright in communicating their inability to accept the products, whereas in eastern countries they are more circumspect. Aspects such as punctuality, the formalities and courtesies in doing business, the negotiation process and even dressing vary from culture to culture and these factors should be understood in order to succeed in such an environment. In eastern countries, people are not always punctual and this can be an irritant to many westerners. There have been instances of software engineers sent for on site work being sent back due to their inability to observe the basic dress code in the client's office.

Language is a very **important** aspect of international business. In several countries knowledge of the local language is a must for doing business. It is important to bear in mind that meanings of terms and words vary with the language and culture. This is very important in communications, including mass communications like advertisements, sales promotions and brand names. When TATA was selling trucks in Africa, most people were very fond of the name as it meant “grandfather” in many local languages and hence was easily recalled.

Also **important** is the way in which culture influences consumption. In western markets, there is a tendency to use and throw most items, whereas in less developed countries, the tendency is to make a product which could last for a longer period of time. The practice of repairing a product when it is broken is also a characteristic feature of the latter markets. The Indian market too tends to be very cost conscious—people tend to weld and repair broken parts of automobiles, which in the West would have been scrapped.

Culture also influences the usage of a product—a motorcycle or a bicycle in the West is a recreational product while in India it is a means of transport. This, naturally, will influence the way the product has to be positioned and marketed.

## LEGAL ASPECTS OF DOING INTERNATIONAL BUSINESS

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Whenever business is transacted between two companies in different countries, one important aspect that should be taken into consideration is the type of law that would prevail in case of a dispute. Generally, these are clearly spelt out in the contract document, but even so, it can tend to be messy and expensive at times.

Some countries insist that in any dispute their local laws and courts will have the final say. Sometimes the contracts may also be written in the local language and translated into English or some other language. In such cases too, the contract may specify that the version in the local language will be treated as the original and authentic version. The TATAs faced a similar situation when they signed a contract for supply of buses with a French speaking North West African country. Considerable amount of time and money had to be spent to hire international lawyers familiar with the French and local laws and the languages.

An **important** aspect of business these days is the protection of intellectual property rights. Many countries including Thailand, India and China have laws which are either lax or not well enforced resulting in infringement of copyrights and losses to the original manufacturer. The Indian Patent Act is being amended and will soon protect product patents rather than process patents which it has protected so far. The amendment, by and large, has been welcomed by large MNC drug manufacturers who claim that they have suffered greatly due to the lack of this facility. Designs, trademarks and copyrights are all protected under international laws and infringements can invite heavy penalties. Selling copycat products and passing them off as originals will no longer be viable.

Yet another legal aspect of doing business internationally is the method of doing business in the destination country—a company could choose to have a representative, a branch office or a subsidiary depending on cost/benefit analysis. A local presence always offers a level of comfort to the buyer. Sundaram fasteners, **for instance**, have their own office and warehouse in Detroit from where they supply their products to General Motors. Others may choose to have only a representative or even a subsidiary depending on considerations such as the level of service required in the market, tax benefit and cost considerations. Generally, a branch office’s income is added to the parent company’s income and taxed



in the parent company's home country. A subsidiary is technically an independent local entity and is subject to all the local laws and taxes.

The recent case involving an employee of a software company in a law suit pertaining to sexual harassment shows the liability of a vendor in foreign countries.

The US in particular has very stringent regulations for safety, pollution and other aspects. Violation of these can result in very heavy penalties. The laws in the US require that every component should be traceable back to the manufacturer and the raw material supplier, including the date of manufacture, batch number, etc. and may require all components from that manufacturer or the particular batch to be recalled in case of any incident involving safety or health. There have been many instances of product recalls on these counts involving automobiles, drugs, baby food, etc.

**Product liability insurance** is available, but is expensive and requires the manufacturer to be certified by an approved quality certification agency like Underwriter's Laboratory (UL). The cost of such insurance must be built into the cost of the product when it is sold. **For instance**, the TATAs had considered the possibility of exporting trucks to the US and even had discussions with some manufacturers, but eventually gave up the idea due to the risks involved because of these laws.

## RISKS INVOLVED IN DOING BUSINESS INTERNATIONALLY

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The two main risks involved in doing business internationally are: (a) Political risks, and (b) Commercial and Financial risks.

### Political Risks

Political risks are those which involve disruption of contracts or payments due to sudden political developments such as coups, wars, etc. As a consequence, contracts may be cancelled, payments withheld, businesses disposed of or taken away. There are **examples** of some companies having faced situations where, after having supplied goods as per contract, payments were delayed due to coups. In some instances, the goods supplied were looted in the political upheaval, but due to documentary evidence available and some persuasion, the payments were released. A number of Indian companies which had contracts with Iraq before the Gulf war had to abandon the contracts half way through due to the outbreak of war. They were subsequently compensated by the Government of India through the Export Credit Guarantee Corporation (ECGC).

### Commercial and Financial Risks

Financial risks involve the failure of the buyer company to pay as per contract due to bankruptcy. Commercial risks involve the sudden change in the situation in the buyers' country like a sudden shortage of foreign currency to pay the invoices, although the equivalent local currency may be available.

**For example**, a trader/importer in an African country faced a situation of being unable to pay for his imports and release of the goods from customs due to the sudden failure of the Bank of Credit and Commerce International (BCCI) in the 1980s. The importer had his account with BCCI and the documents from the seller were sent to the bank which had suddenly closed. The money in his account was also frozen. While such situations may not be common, these risks are higher when dealing with foreign countries where one may not have all the information about various developments.

In **another instance** involving some exports to Uganda, an Indian exporter could not be paid despite the importer having deposited the local equivalent money in the bank, due to the Central Bank's restrictions on release of foreign exchange for the transaction. In many countries, such occurrences have happened with letters of credit issued by local banks—recent **examples** being Nigeria and Iran. In such cases, it is safer for the exporter to ask the buyer to open a letter of credit confirmed by a prime international/European bank, so that the liability for payment is with the international/European bank.

Many such risks are covered by agencies like the ECGC (Export Credit Guarantee Corporation) which has offices in all the main cities and state capitals in India. The willingness to cover such risks will depend on the value of the transaction and the credit exposure to the country/company as well as the country credit rating which is frequently reviewed and updated by internationally renowned credit rating agencies.

## ENTRY STRATEGIES FOR INTERNATIONAL MARKETS

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An important element of international marketing is determining the entry strategy.

Having determined the business prospects in various potential markets and chosen the target markets to enter, it is always safer to start business by trading to determine the acceptability of the product in the market. Usually for many small companies, a break into the international market is by chance—a meeting with a friend or a relative who lives in the destination country and feels the product compares well with those in the market and can be sold. They can at times even provide some basic facts like the competitors prices, likely importers, different brands or products available, and so on.

### Fairs and Trade Shows

A good way to at least assess the sales potential at low cost and risk is to exhibit the product in international fairs or India trade shows. Many of these shows are industry- or product-specific. **For instance**, BangaloreIT.com is a computer software show. The Las Vegas, Nevada computer show is an annual event with participation by global leaders in computer hardware and software. The India Engineering Trade Fair in New Delhi is an engineering and automotive show. Such shows attract large numbers of people who have an interest in the industry and contacts can be developed in one place. Similarly, a show in Singapore or London attracts not only locals but also people from neighbouring countries and even some from countries far away. The Trade Fair Authority of India frequently holds India Trade shows in various countries, especially in developing countries. The contacts developed at these shows can then be followed up and commercial relationships built up.

Initially, business could be started by appointing an *indenting agent* to solicit customers and business. Once some volume of business is achieved, a distributor could be appointed. In case the market potential is seen to be very large, the company could set up its own warehouse and stock products for sale locally. As mentioned earlier, Sundaram Fasteners and TTK have set up their own warehouses in the US, to stock and supply to distributors and/or OEMs. Such facilities lend credibility to the supplier.

### Tie-up with a Larger Company

The other strategy is to become a supplier to a larger company which is interested in outsourcing the supplies/components. Mention has been made in the earlier part about the interest shown by many companies overseas in auto, pharmaceutical and garment industries to outsource manufacture to India.

In order to achieve this, one needs to be persistent and should follow the best practices in manufacturing and quality. One of the major considerations of buyers overseas in choosing suppliers is the ability of a supplier to deliver quantity and quality required at short notice, at competitive prices and in time. One of the major drawbacks of some Indian suppliers is their inability to offer short delivery times compared to Chinese and SE Asian suppliers. A number of companies are now addressing these issues by re-engineering their operations and better management of supply chains to achieve lower costs and faster deliveries.

### **Tie-up with a Local Company**

Sometimes, a tie-up with a local company is preferable to enter a market, because of the local company's knowledge of the market, ready availability of a distribution network and a reputation in the market. **For example**, Ford entered the Indian market in a joint venture with Mahindra and Mahindra. This offered them the access to a ready network of dealers and made the product acceptance easier. Daewoo, Honda, Toyota, etc. followed similar strategies for entering the Indian market. More recently, TATA motors has tied up with Rover of UK for marketing the TATA Indica, branded as the "City Rover", across the UK and in mainland Europe.

In some markets, the law mandates a local partner to do business. **For instance**, in Saudi Arabia or the Emirates, care must be taken to choose the right partners, because if differences arise, breakups can be very costly and painful.

### **Licensing and Franchising**

There are newer strategies used in products like garments, hotels, etc., where the brand name/design is permitted to be used for payment of a royalty. This model works best when a product with an internationally accepted brand image is franchised. **Examples** are Radisson hotels, McDonald's restaurants, Pierre Cardin merchandise and Disney characters.

Each product market is unique and must be individually studied before strategies are crafted. Whatever strategy is adopted, it must be calibrated so that the company becomes comfortable with all aspects of doing business and does not undertake any high risk transactions.

### **e-Commerce**

With the rapid spread of the internet, businesses are now able to reach out to customers and suppliers dispersed across the globe at a negligible cost. Buyers can get to see the photographs, specifications, etc. to prima facie judge the suitability of the products being offered. For products such as software, online demonstrations can help persuade buyers of the suitability. While merely reaching out or knowing about buyers or suppliers is not sufficient to get business, it at least helps to connect with potential partners who can then be targeted and evaluated before ordering.

The internet also helps in getting suppliers to quote online so as to reduce time and costs of obtaining and evaluating every purchase transaction. Some companies adopt online reverse auctions for prequalified suppliers and this helps save costs to a large extent.

The internet also has facilitated the rapid communication between suppliers and buyers. In some cases, buyers have linked their computers to the suppliers' computers and this has helped in rapidly updating changes in the marketplace and constant monitoring and replenishment of inventories. Many companies are using social media platforms to closely connect with and resolve customer problems.

The major automobile and engineering companies like Tata Motors have implemented Dealer Management Systems where the dealers can access information on the status of their orders, payments, inventory management, etc.

GE regularly conducts reverse auctions for their purchases by having online bidding by approved suppliers.

Product and commodity exchanges have facilitated monitoring of the marketplace trends and helped companies liquidate excess stocks.

The usage of the internet is still evolving and we can expect new developments in the future.

## Branding

In the developed markets, branding of B2B products becomes very important. Many small companies will find it useful to sell the products under the distributors' "private labels" or brands to gain acceptance by end users. This could be an entry strategy which could then be followed up with gradually establishing the suppliers brand in these markets in parallel. Many large international manufacturers of B2B products market under their own as well as distributor/retailers' private labels.

### Pricing and Payment Terms in International Trade

Pricing of products for international markets can be done on various terms. Some of the commonly used terms are:

#### Pricing Terms

**Ex Works** Price of the product at the manufacturer's factory gate.

**FOT (Free on Truck)** Price of the product, packed, palletised and containerised (where applicable) and loaded on a truck at the manufacturer's factory gate (including the loading charges).

**FAS (Free alongside)** Price of the product at the quay (place for loading or unloading ships) beside the ship, including the port charges and not including the loading charges.

**FOB (Free on Board)** The price of the product, packed, palletised and containerised (where specified) and loaded on the ship (including all the shipment port charges and loading charges).

**C&F (Cost and Freight)** FOB price of the product plus the cost of the freight to the destination (it could be a port or an inland warehouse/factory premises), but not including the charges at the discharge port and import duties and local taxes which may be applicable.

**CIF (Cost, Insurance and Freight)** C&F price plus the insurance charges from the manufacturer's factory to the final destination (either a port or the importers warehouse inland) including marine insurance (but excluding import duties and local taxes).

Many times, importers who have an establishment in the exporting country may choose to buy on FOT/FAS or FOB terms, as this can give them the leverage to negotiate the freight with known shipping companies and also to consolidate the cargoes from various suppliers into larger consignments. The risk for the manufacturer is that the buyers may delay picking up the consignment depending on the other supplies and availability of shipping space.

Some countries have regulations which require import consignments to be either shipped on their flag vessels or be insured with their local insurance companies only. This is to facilitate easier and faster processing of any claims that may arise.

Freight rates vary with the loading port and destination as well as availability of services between the ports and the time of the year. Usually freight brokers can help negotiate better freight and insurance rates. There are many companies which can handle the entire logistics involving picking up the cargo from the manufacturers' warehouse to delivery at the importers' warehouse including storage in the destination country, if required.

Certain high value products (jewellery, leather garments, electronic components, etc.) are shipped by air as it is safer and the delivery is faster, which ultimately works out to be economical when considering all the costs.

## Payment Terms

**Payment by Cash in Advance** This is a widely preferred mode of payment. But importers will rarely agree to this as it will mean locking up their funds and taking risks in case manufacturers or suppliers default on deliveries.

**Payments against Documents** This mode of payment sent through the bank is another method of payment—Here the supplier sends the documents to the buyers bank with a demand draft payable at sight. The risk here is if the importer (or buyer) refuses to pay because the local market conditions have changed.

**Documents against Acceptance** In this mode of payment, the importer accepts the documents sent to his bank by the exporters bank and the bank releases the documents for clearing the consignment from customs. The danger here is if the importer collects the consignments and does not pay as agreed.

Usually, the above two methods are used when relationships between the importer and exporter are well established and there is mutual trust. These methods enable saving of considerable sums in bank charges, especially when the business is regular and considerable in size.

**The Letter of Credit (LC)** This is the most preferred method of payment as it ensures safety and comfort to both the exporter and the importer.

The LC is a document which is sent by the importer's or buyers' bank to the seller's or exporter's bank promising payment of the agreed amount on submission of the documents evidencing shipment of the goods being traded. The terms could be payment at sight (i.e. immediately on presenting the shipping documents) or usance (at an agreed time after presenting documents say like 60 days or 120 days, etc.). Various terms can be specified in the LC including the last date for shipment and the last date for receiving the documents, etc. This ensures that the seller maintains his commitments.

Banks usually offer "**Packing credit**" against letters of credit. This is like a working capital advance for manufacture of the export goods and is usually at a rate lower than the normal borrowing rate as an incentive to exporters.

Some products of a capital nature like equipment which are of high unit value and when contracts are of large value may require longer term financing extending up to seven years. In such cases, agencies such as the Export Import Bank (EXIM bank) offer financing with payments in

regular instalments. They may extend the finance to the seller who in turn extends it to the buyer and assumes the risk of collection from the buyer or may directly finance the buyer against suitable guarantees. In the former case, it is referred to as suppliers' credit and in the latter case as buyers' credit. The terms will vary depending on the credit rating of the buyer, the destination country and the guarantees available.

EXIM Bank and the Government of India often extend credits to foreign banks and governments respectively for import of Indian products. These credits are in turn passed on to local buyers against firm offers and contracts from suppliers. This is a safe arrangement for the sellers as the Exim Bank and the Government of India assume the responsibility of collection of the payments.

### Currency of Pricing

Exports are normally priced in any hard currency—the most common being the US dollar. Exports can also be priced in Euros or Japanese Yen or even Indian Rupees.

One of the risks involved in international business is the fluctuation of the currency of pricing with respect to the local currency. A depreciation of the local currency benefits the exporters as they realise more for their export, but hurts importers. Since the main business of traders is not currency speculation, it is best to seek professional advice from either bankers or foreign exchange dealers on the future trends in the exchange rates and building suitable safeguards in the pricing. It must be borne in mind that the time from making the offer to conclusion of order can take anywhere up to three months and thereafter execution of the order could take up to six months—a total of nine months or more from the time of soliciting the business. Exchange rates can vary widely in this time period and cause considerable distress to exporter in case they are not hedged (or secured against loss).

Banks offer various instruments like forward contracts and options on future transactions to hedge the risks of adverse movements of foreign exchange rates.

In addition, where the exporter needs cash immediately, banks offer “forfaiting” facilities where they effectively discount the receivables and take the risk of collection on themselves. This, however, could be an expensive proposition and the cost can vary with the country of import, importer's credit rating, and varies from time to time.

**Transfer Pricing** Transfer price is the price a company charges for a product, when it is transferred from one unit (division, department, or subsidiary) to another unit of the same company. The main purpose of transfer pricing is to (a) help improve economic performance of the units and ensure their competitiveness, (b) help measure performance of unit managers, (c) provide information to top management on strategic decisions like make or buy.

In today's globalised world, 40 per cent of world trade takes place between units of multinational companies (MNCs). These MNCs have units (subsidiaries or strategic business units—SBUs) located in different countries. They buy and sell products and components made in different units. The question then arises how these transactions are to be priced. Transfer pricing is the answer to such a question.

Many countries including India, have transfer pricing laws, which are strictly implemented.

The fundamental point is that transfer pricing should be based on “arms length” principle, i.e. pay the same price to the unit as to an external supplier of the same product.

**Dumping** If a company charges a very low transfer price for a product to its subsidiary unit in a foreign country, it may invite charges of dumping. Dumping takes place, when a company sells its products in a foreign country at prices that are either less than their full costs or less than home market. The objectives of dumping are to enter a foreign market or to sell excess production. Customs department in many countries keep a watch on corrupt practices followed by firms. When they get information to establish fact of dumping, they collect a dumping tariff from the guilty company. Many times, customs departments force companies to charge the “*arms-length price*”, which is the price charged by competitors for the same or similar product. For example, a steel manufacturer in Canada claimed dumping of steel products by steel manufacturers in India, Brazil, and Indonesia. The Canadian tribunal (or court of justice) upheld the claim and levied a dumping tariff on the imported steel from these countries.

### Packing and Shipping

Packing goods for export is a very important element of marketing. The packing should be light, strong and must be appealing for the end customers. Usually, the buyers tend to specify the type of packing required. **For example**, some importers of shirts ask them to be hanger packed so that they can be readily put up at the retailers on arrival. They may further ask them in cartons of certain numbers each so that they may allocate them to various stores. They may even specify the size mix per carton, colour mix and weight of the carton for easy handling.

An exporter has experienced situations where the Canadian importer demanded that Ceramic Floor tiles be packed no more than 10 per box and each box not to weigh more than 10 kg. so that an individual tile layer could handle the entire job himself. Likewise, in the case of fasteners, it was specified that no more than 10 kg. should be packed per box for easy handling. These requirements vary with the buyers and the country to which the goods are destined. In other cases, the buyers wanted packages of specific sizes to fit the store shelves.

It is also mandatory that the packing should show the contents, specify the origin, weight and quantity of the item inside. Canada insists that the labelling should be in both English and French.

In view of the long sea voyage and handling, the packing must be waterproof and should have suitable rust and fungus prevention measures.

Since most of the goods are mechanically handled, especially in western countries, they must be palletised for handling by fork-lift-trucks in warehouses and stores.

Most shipments these days are done in containers which are safer and easier to handle. Many inland container depots (ICDs) have been set up in India such as Bangalore, Guwahati, etc. where the cargo can be cleared by customs prior to shipment. Similarly, the import cargoes can also be cleared at inland ports.

A very important aspect to be borne in mind is that due to pressures of competition, most industrial buyers would like goods to be delivered just in time (JIT) so that their inventory is minimised. A supplier would therefore have to integrate his production schedules to those of the buyer's supply chain and ensure adequate stocks are maintained in the destination country to enable prompt delivery. While deciding stock levels, the long shipping time will have to be considered.

## SUMMARY

International marketing of business products involves many other factors to be taken into consideration, which do not apply to domestic markets. These factors include (a) the political and economic relationships between the two countries, (b) the standards applicable in the destination country, and (c) the distance, language, culture and legal system of the country.

Secondary data on the international markets can be collected from a variety of sources like embassies, chambers of commerce, banks, internet, etc. It may be preferable to choose markets which are physically closer and culturally similar in the initial stages, before venturing into markets which are physically and culturally far away. Trade shows in India and in the foreign country are very cost effective ways of establishing contacts with potential buyers. Entry into a new market may be done initially through an indenting or sales agent and once the market demand grows, distributors could be appointed. In some markets, it may be advantageous to have one's own office and warehouse to supply goods to buyers at short notice.

e-Commerce is growing extremely fast and companies are realising the benefits of using e-Commerce for procurement, communications and quick resolution of issues between suppliers and buyers. It also enables a global reach economically and is particularly valuable to small businesses. Branding of products is essential to provide assurance and recall. Since the buyers in countries feel more comfortable with local businesses/distributors, it is preferable that the products are branded as per the wishes of the distributor.

Care must be taken to price the products in foreign currencies as any variations in the exchange rate can favourably or adversely affect the profitability of the deals. Pricing for exports could usually be done in any hard currency, the US Dollar being the most common. The terms of the supply can also vary depending on the buyer. It could range from ex-works in India to be delivered at the buyer's warehouse inland in the country of destination.

Packing and Shipping are important elements of cost in the final price and these must be optimally negotiated. The payment method must be agreed upon so that there are no undue risks to either buyer or seller. Credits, where necessary, will have to be suitably insured to reduce the risk of default.

## KEY TERMS

- |                 |                                |
|-----------------|--------------------------------|
| • Branding      | • Indenting                    |
| • Copyrights    | • Intellectual Property rights |
| • Culture       | • Licensing                    |
| • Dumping       | • Outsourcing                  |
| • e-Commerce    | • Patents                      |
| • Force Majeure | • Trademarks                   |
| • Franchising   | • Transfer Pricing             |

**Note:** Glossary of the key terms is given at the end of the text.

## CONCEPTUAL QUESTIONS

1. Can the pricing of a product vary between two countries? If so, Why?
2. What problems can a company encounter if there are price differentials for the same product in two countries?



3. Research the Internet and list the differences in distribution of business products in developed markets and developing markets.
4. Many companies are now outsourcing manufacturing to India. Examine the risks involved in this decision for both the buyer and seller.
5. Indian and Chinese companies are now in a race to buy resource companies worldwide. Examine the logic.

### OBJECTIVE TYPE QUESTIONS

1. Industrial products are normally: (a) Standard, (b) Customised, (c) both, or (d) none of the above.
2. The specifications of Industrial products vary from country to country: (a) Yes, or (b) No.
3. In case of disputes in International business, the laws which apply are: (a) home country laws, (b) host country laws, (c) both, or (d) none of the above.
4. Pricing of Industrial products in International markets for the same product is the same on: (a) CIF basis, (b) Retail selling price, (c) FOB basis, or (d) all of the above.
5. Pricing of products in International contracts are done in: (a) US Dollars, (b) Euros, (c) Indian Rupees, or (d) all of the above.

### APPLICATION QUESTIONS

1. Examine if export companies based in India should switch to quoting and billing in Indian Rupees.
2. Examine why many products sold in SE Asia are different in specification to those sold in India?
3. Examine the impact of currency fluctuations on a company whose import content is large—say 30 per cent of the final price or more.
4. Companies with operations in many countries may make the same product in more than one of these countries. Since they market these through large distributors, are there any risks the companies face?

## CASE 15.1

### Precicomp Industries Ltd.

Sharad Kumar established Precicomp Industries Ltd (PIL) in 1975 in Peenya near Bangalore. PIL was set up to manufacture a range of precision components for various industries like Automobile, Engineering equipment, Oil industry equipment manufacturers, etc. Sharad Kumar had earlier worked in some companies manufacturing similar products after his graduation and gained considerable expertise and experience in the field of manufacturing.

In 1990, after 15 years of existence, Sharad decided it was time for PIL to look for avenues beyond the Indian market. Since he had no experience in Export and International business, Sharad decided to enlist the help of Anand Rao, a person with a proven track record with many large companies, who at that time was a freelance consultant in the field.

After some initial success in the markets of the Middle East and South East Asia, Sharad felt PIL could compete with companies from across the globe in terms of quality, price and delivery. He felt it was time to take PIL global in a big way.

Sharad Kumar himself handled the Indian market with the assistance of Raghuram, who was his Sales Manager. Since most of the sales came from large **corporate institutions**, Sharad was able to keep a close track of the business and interact with the clients himself.

Sharad realised that managing the global business would have to be handled differently. For one, the clients were far flung and travel and interactions with them would be difficult and time consuming. Besides, each market was different. Developed markets in Europe and North America involved dealing with OEMs and large distribution chains that supplied components to small and medium size industries across the continents. The distribution chains had their own brands under which they marketed products manufactured by various companies globally.

In many countries in Africa and Asia, the market was mainly for the replacement parts for maintenance and repair of equipment. Volumes were small compared with the developed markets. Also the distribution channels were not very well organised.

While the developed markets offered large volumes, their margins were much lower and terms more stringent. Developing markets on the other hand offered lower volumes, but the margins were higher and terms more comfortable.

Some of the questions that came to Sharad's mind were:

1. Which markets should he take up first—what should be his criteria for choosing markets?
2. How should his sales be organised—should it be separate from the domestic sales organisation?
3. Should PIL export the products directly or should they use other channels?
4. Should he use an Indian sales force for overseas sales? What should be the profile of the personnel—would they be the same for all markets?
5. What should be the criteria for selection of distributors?
6. Should PIL brand their products under their own brand or use a distributors brand?

### Question

1. If you were a consultant, recommend a course of action with reasons for your suggestions.

## CASE 15.2

### SUKHOI SUPERJET\*

The Sukhoi Company, a joint stock company (JSC) of Russia, was founded in 1939 by Pavel Sukhoi as the Sukhoi design bureau. The Sukhoi Company is well known for design of fighter jets which are used by the Air Forces of India, China, Vietnam and many countries in Asia and the Middle East.

After the collapse of the Soviet Union, many of the aircraft manufacturing companies in Russia including Sukhoi were merged to form the United Aircraft Corporation. Since the aircraft industry in Russia was starved for orders from the militaries, they decided to take a look at the civilian aircraft market.

\* This case was prepared by Prof. B S Sachidanand with information from the company's website and articles published in the media and on the internet. The case was written for classroom discussion. It is reprinted with his permission.

Sukhoi in partnership with Boeing started the development of the Sukhoi Superjet 100 in the year 2000. The Superjet 100 was to be a modern fly by wire regional jet with a passenger capacity of 75 to 95. Its main competitors would be the Airbus 318, Boeing 717, Bombardier CRJ and the Embraer E jet. The Superjet 100s are fitted with SaM engines manufactured by a French Russian joint venture and are marketed by an Italian Russian joint venture.

After extensive ground and flight tests on 3rd February 2012, the Sukhoi Superjet 100 received the airworthiness certificate from the European Air Safety Agency (EASA). The certification makes it possible for airlines operating in countries using EASA rules to accept and operate the aircraft. The company hopes to manufacture and sell 70 aircraft each year.

Malev Hungarian Airline was the first airline to order 30 Superjets valued at over US \$1 bn. It has also received orders from Aeroflot and the Indonesian airlines are also considering buying the aircraft.

Although priced considerably lower than its main competitors, the Superjet faces major marketing challenges in selling to airlines.

### Questions

1. Identify the segments in the aircraft markets in the world.
2. Identify the challenges in selling the Superjet 100 to airlines across the world.
3. What criteria would airlines use to decide on the purchase of aircraft?
4. What offers by Sukhoi other than price could make it interesting for airlines to consider the aircraft for their fleet?

## CASE 15.3

### SKANRAY TECHNOLOGIES LTD\*

Skanray Technologies Ltd is a leading international medical equipment manufacturing company based in Mysore, India. Skanray is specialised in High Frequency X-Ray Imaging Systems, Critical Care Devices and Primary Healthcare & Telemedicine compatible devices. It was set up in 2007 by a group of engineers and technologists who left their jobs in many well-established companies. It is fully owned by the promoters and a group of Angel investors.

The company's vision is to aid Primary Healthcare with products of international quality and performance at an affordable level to the rural population of the world. Skanray does that by combining the latest in technology with simplicity of design, innovation and high performance for efficient patient care. Skanray's products are designed to comply with international quality and safety standards such as UL, CE, FDA, ISO 13485, ISO 9001 and AERB. The products have been CE certified. (It means the product's compliance with European Union (EU) legislation.)

The company aims to tap the global market for medical primary healthcare and diagnostic devices. The Indian market for such devices is estimated by Frost & Sullivan to be around US \$2.5 bn per year and the global market to be around US \$50 bn.

The main competitors for these devices will be the larger well-established players such as Philips, Siemens and GE and a host of small and medium players from Japan, Korea and the West. In addition, there are many small players in India in the organised and unorganised sectors.

\* This case was prepared by Prof. B. S. Sachidanand with information from the company's website and articles published in the media and on the internet. The case was written for classroom discussion. It is reprinted with his permission.

After an initial rough few years in setting up the facilities, the company is now hoping to achieve a turnover of ₹ 100 crore by 2014. In addition, the company recently acquired the medical devices division of L&T in Mysore. The acquisition has expanded the product portfolio with complementary products which has saved a few years of development time. Also, it has provided Skanray access to a distribution network across India.

This could help Skanray considerably as it exports about 50% of its products to overseas markets and has not been able to make much headway in the local market. It has, however, been able to acquire Narayana Hrudayalaya in Bangalore and Manipal Hospital in Manipal as its clients. Both seem pleased with their prompt after-sales service and support. In addition, Skanray is also open to contract manufacture and also manufactures for private labels of others.

### **Question:**

Examine the situation of Skanray and recommend strategies for them to scale up and grow.

## **CASE 15.4**

### **Hindustan Engineering and Automotive Products Ltd\***

Hindustan Engineering and Automotive Products Ltd (HEAP) was established in the early 50s in a joint venture with a leading European company to manufacture engineering and automotive components for the growing Indian market. By the mid-80s, the company established three plants in eastern, western and southern India to cater to the growing demand. The company was managed by Jayant Kumar, a long time company employee, as Managing Director.

During this period, the company absorbed considerable technology from JV partners and was able to commence exporting its products to various markets in Africa, the Middle East and SE Asia under its own brand in direct competition with the partner. This led to a situation where the partner had to review its relationship which eventually led to a withdrawal from the JV agreement they had with HEAP, by mid-90s. It was, however, agreed as a part of this process that the partner would be free to establish its own operations and market its products in India under the prevailing liberalised conditions.

Foreseeing increased local competition, HEAP was now considering exporting its products to the developed markets in Europe, Japan and USA. Guru Prasad was recruited from an MNC to head the international operations and was asked by the top management to work out a strategy for growing the exports rapidly.

Meanwhile, a top management strategy planning group identified a lack of expertise in design and certain manufacturing technologies as key constraints to the company for entering the highly competitive and large market for engineering and auto components in Europe, America and Japan. The prevailing market situation was such that no major competitor was willing to offer their designs or technology to avoid potential competition.

On the marketing front, Guru Prasad carried out a study and recommended that HEAP establish its own representative offices in these countries to have direct customer contacts and to gradually build a local distribution network. Each market had its own peculiar channels of distribution and to create

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\* This case was prepared by Mr B.S. Sachidanand, for classroom discussion. It is reprinted with his permission.

confidence, it became necessary to have the company offices in these countries. He also recommended that the company focus on the replacement market rather than on the Original Equipment (OE) segment. Traditionally, the OE market offered large volumes, but at very low margins. The replacement markets in these countries were dominated by large chains of distributors with their own brands. These chains usually bought components from companies who were Tier 2 OE suppliers and often marketed the products under their own brand names.

Due to varying market conditions, HEAP had to price its products differently in different markets, leading to a situation where the same products could be bought from a distributor in one country and transported and sold in another country in a profitable manner. Besides, since HEAP had established its products in these markets, many copycat products manufactured by some of the smaller non-OE players with similar brand names and packaging, but of very much lower quality and significantly lower prices, entered the markets. The dealers of HEAP complained to the management about their eroding market share and margins by unauthorised players and threatened to quit if not resolved. Guru Prasad was asked to look into the problem and find a solution quickly.

The company had a good R&D team headed by Krishna Rao who was well qualified and had a PhD from a leading British university. Krishna Rao advised the management to seek a collaborative relationship with some leading Italian design bureaus, which had considerable expertise and were acknowledged leaders in the field, as a medium-term measure. In the long-term, it was necessary to build in-house expertise, he opined.

The management of HEAP was concerned about the following:

- (a) What short-term and long-term strategies should HEAP follow in order to achieve a position where at least 30 per cent of revenues could be from exports.
- (b) Whether it should agree to sell its products under the distributor's brand and what impact this could have in the long run.
- (c) What channels of distribution should they use? Should they be the same in all markets?
- (d) How should it tackle the menace of low priced competition from spurious manufacturers?
- (e) What would be the most effective organisation structure for export marketing? Should they employ local individuals for manning their offices or should they send their own employees from India?
- (f) Whether it should outsource its design and R&D?

### **Question**

1. Discuss and offer your solutions to the management with reasons.

## **INTEGRATED CASES**

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**Case-Chapter Selection Matrix for Integrated Cases**

<i>Case No</i>	<i>Page No</i>	<i>Case Title</i>	<i>Relevant Chapter Numbers</i>														
			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	517	Sigma Telecom Company		✓	✓			✓			✓		✓		✓		
2	522	Plastic Technologies (India) Ltd					✓	✓	✓	✓				✓	✓		✓
3	529	Alfa Networks					✓			✓	✓						
4	534	ROBO KNON			✓		✓								✓		
5	538	Electrical Equipment Ltd				✓						✓		✓			
6	541	Saragam Aluminium Limited					✓	✓		✓				✓			
7	545	Information Solutions, Inc					✓		✓	✓	✓	✓	✓	✓	✓	✓	
8	547	Karnataka Gears Ltd			✓	✓				✓		✓		✓			✓
9	550	Structural Engineering Consultants Ltd	✓	✓			✓	✓	✓			✓			✓		
10	553	4S India Ltd					✓	✓		✓	✓		✓		✓		
11	558	IMS Company Ltd						✓		✓			✓		✓		
12	560	Optotech Systems Pvt. Ltd					✓			✓			✓				
13	563	BT Technologies			✓							✓			✓		✓
14	566	Nammura Hotel Ltd		✓				✓		✓		✓					
15	569	TNM Systems, Inc						✓	✓	✓		✓					✓
16	571	NM Technologies Ltd			✓	✓						✓					

# 1

## Case

# Sigma Telecom Company\*

In February 1999, the Managing Director of Sigma Telecom was concerned about the downward trend in the net profits of the company. He felt this was because the industry had been passing through a slowdown since mid-1996 and also because the company was facing an increased competition from large and established companies as well as from new entrants.

## COMPANY BACKGROUND

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Sigma Telecom was a public limited company manufacturing, marketing and installing telecom equipment in medium and large sized organisations. It was one of the largest producers of EPABX (Electronic Private Automatic Branch Exchange) systems in India and had developed a reputation for high quality telecom equipment. Sigma Telecom was the market leader with highest market share in the EPABX market in India. The company's major task was to develop and implement an effective marketing plan so as to maintain and strengthen their market leadership position in the face of growing competition in the higher and middle end of the market.

## Strategic Alliances/Joint Ventures

Sigma Telecom had technical collaboration with MIKI of Japan in manufacturing EPABX systems. It had a joint venture with Alfa Communication Technologies for providing business communication systems, key telephone systems, multimedia messaging, and response systems. The company had also collaborated with a Japanese company for transmission products such as point-to-point digital radios. Thus, Sigma telecom was an established supplier of a broad range of telecom products and services.

## Manufacturing and R&D

The company had two modern manufacturing units, one each at Mumbai and Bangalore. Its manufacturing unit at Mumbai was fully equipped with modern manufacturing and test facilities for advanced automated electronic assembly. This unit was ISO 9001 certified. The other manufacturing unit at Bangalore was ISO 9002 certified and handled the mass production of terminal equipment and mini EPABXs. This plant was also equipped with advanced manufacturing facilities for producing world class telephones.

Sigma Telecom had invested heavily in infrastructure and manpower for Research and Development (R&D). The R&D activities included harnessing the foreign technologies to make them suitable

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\* This case was prepared by Prof. Krishna K. Havaldar, based on the case study data provided by MBA students, Ms Manjari Sinha and Mr Vibhu Kapoor of IFIM, Bangalore.



for the Indian environment, plug-on feature development, new product design, and switching software development.

### **Distribution Channel**

The company sold its products through its sales force. It had four regional offices in the four metros (Delhi, Kolkata, Mumbai, and Chennai) which covered northern, eastern, western, and southern zones of India, respectively. With the company growth, each of the regional offices had several branch offices and service centres for a wider and faster reach to the customers. Sigma Telecom had 45 branch offices and service centres across length and breadth of India manned by trained and experienced engineers. This well-spread network of offices and service centres ensured prompt customer service. It had several service packages to offer to customers and included 24-hour service, after-office hour service, and remote maintenance. These service centres took care of pre-sales and post-sales services.

The company invested heavily on the in-house training infrastructure and had its own residential training centre near Mumbai.

### **Promotion**

The promotional activities were planned at the company's corporate office at Mumbai. The promotional elements included advertising, trade shows and personal selling through the company's sales force. A central advertising agency was contracted to evolve a suitable advertising message and to release advertisements in selected business magazines and trade journals.

### **Market Segmentation**

The total market size for EPABX systems was estimated at ₹ 220 crore (or ₹ 2200 million), and equipment of six lakh (6,00,000) lines in 1998–99 in India. The total market was segmented into low-end, medium-end, and high-end markets. The description of these market segments is given below:

**Low-end Market Segment** This segment had products (or equipment) with less than 48-line configuration. It was a low-priced, low-technology, and high volume market. The market size was estimated at ₹ 40 crore (₹ 400 million). Sigma Telecom was not a player in this market. Companies like Accord, Syntel, L&T, Ruchi, and Star targeted this segment.

**Middle-end Market Segment** This segment consisted of products in the 48–100 line configuration. Digital and ISDN (Integrated Satellite Digital Network) technologies were prevalent in these products. The customer group included medium and large sized business firms. The prices varied depending upon the configurations and applications. The key players were Siemens, Accord, Alcatel, BPL Telecom, and Sigma Telecom. The suppliers in low-end market segments were planning to enter this market segment whose size was estimated at ₹ 80 crore (₹ 800 million).

**High-end Market Segment** Products above 100-line configuration formed this market segment whose size was the highest of the three market segments at ₹ 100 crore (₹ 1000 million). The customers in this segment were demanding in nature in terms of product features, applications, and after-sales service support. The customers like five-star hotels, multi-national companies (MNCs) and call centres demanded quick service support from the suppliers of EPABX equipment. The applications such as video conferencing, voice mail, and interactive voice response were the drivers of this market segment. The products supplied were customised in line with the requirements of the customers. The major players were Siemens, BPL Telecom, and Sigma Telecom. Alcatel and Usha Electronics were the late entrants.

## COMPETITION

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Apart from slowdown in the economy, the other problem faced by Sigma Telecom was an increase in competition in the middle and higher ends of the market. There were two types of competitors. The existing competitors like Siemens, BPL Telecom, and Alcatel, and new competitors like Accord in middle-end market segment and Alcatel and Usha Electronics in the high-end market segment. All the major competitors had absorbed the technologies from their foreign collaborators. Siemens and Alcatel had their own technologies. Superior technologies, which gave value-added features, were the key success factors in the high-end segment. **For example**, when Siemens introduced ISDN technology, customers started preferring Siemens EPABX system. Another factor that influenced the buying decisions was the after-sales-service support system. The added advantage to the EPABX supplier was the steady income generated due to service contracts from customers. Sigma telecom decided to focus on its service support system.

The competitors targeted different industry segments, depending upon their strengths. **For instance**, Siemens concentrated on MNCs and hospitals. Usha Electronics focused on medium size corporates, small hotels, and government organisations. Sigma Telecom targeted hospitality industry (five-star hotels), MNCs, defence, energy, and government organisations.

## DECLINING TRENDS IN THE INDUSTRY

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The EPABX industry had been passing through a declining trend due to slowdown of the Indian economy since 1996–97. Foreseeing development in the telecom, energy, financial, and hospitality sectors, EPBAX industry had forecasted a growth rate of 25 per cent per annum but the actual growth rate was around 16 per cent. This trend led to an aggressive price competition to gain a new customer or to make an entry into a new market segment. Inadequate telecom infrastructure, that is, inability of Department of Telecommunication (DOT) and private basic service providers to release as many Direct Electronic Lines (DELs) as expected, affected the growth of EPABX market. This was particularly true for the low-end and middle-end market segments. It was expected that the value added features would play its own part in the growth of EPABX market.

The Indian national elections in 1996 did not provide any clear mandate to any single political party. This led to the formation of a coalition government. This factor, coupled with the imposition of financial sanctions by the US (as a result of Pokhran nuclear tests) had resulted in reduction of investment plans for India. With this background, the value of Indian rupee was continuously eroding. These environmental factors affected the profitability of Sigma Telecom as shown in Exhibit I.

## INDUSTRY BACKGROUND

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The development of EPABX came about as a result of increasing needs for telephones, and demand for reducing the logistics cost associated with adding new telephone lines. In telecom technology, EPABX is designated as customer premise equipment and has been designated to simplify the tasks of providing communication access from the desk. The EPABX enables organisations to share the available telephone lines between a number of users. It provides for operator services. A typical EPABX system offers basic services, such as handling internal and outside calls, call holding and transfer, conference

calls, and auto call back. In addition, modern EPABX system have facilities like auto-dial, cost call calculations in rupees, computer connectivity, fax homing, call forwarding, voice guided direct inward station access, ISDN compatibility, and inter-party conferencing.

Over the years the EPABX market has undergone many changes. In the early years, Department of Telecommunication (DOT), a Government of India undertaking, supplied ITI (Indian Telephone Industries) made small exchanges to users. Then came the boards, based on C-DOT's (Centre for Development of Telematics) low-cost, path breaking, switchboard designs in collaboration with international suppliers. With the liberalisation of Indian economy since 1991, many new brands came into Indian market. Small local players served low capacity needs at low cost. Key Telephone Systems (KTS) from major international suppliers such as Siemens and Panasonic, began competing with low-end EPABX systems to meet the emerging needs of the market.

### Composition of Market Segments

The total market in 1998 for EPABX was segmented into four segments, as shown in Exhibit 2. "Others" included paging industry, networking, and call centres. Experts from the industry predicted that the composition shown in Exhibit 2 was expected to change in a period of two to three years. The corporate sector (i.e. private sector) and "others" segments would have larger market potential than government and public sector units. Hospitality industry, which included 5-star hotels, would maintain its position.

### Factors Influencing Business Customers' Buying

The major factors that influenced the business buyers of EPABX, based on a marketing research study (see Exhibit 3), were technology and performance. After-sales service support was becoming a strong influencing factor, overshadowing pricing factor. This was not the case about two years earlier. The changes in the buying behaviour of business customers were due to the high rate of penetration of more features-led middle-end and high-end products.

The basic problem facing the industry was that of economic slowdown. The market size of office communication products, including the three product categories of communications, viz. EPABX, fax and modem, was ₹ 610 crore (or ₹ 6100 million) in 1998. While each product category had distinct features and market dynamism, only modem could live up to the expectations. The other two categories performed badly. The EPABX (including KTS) industry witnessed a growth rate of 16 per cent from ₹ 2660 million (in 1997) to ₹ 3100 million (in 1998), as against the expected growth of 25 per cent. Out of ₹ 3100 million, EPABX market size was ₹ 2200 million and the balance was for Key Telephone Systems (KTS).

#### Exhibit 1 Profitability of Sigma Telecom

<i>Year</i>	<i>Profit before tax (₹ in million)</i>
1994–95	22.40
1995–96	50.20
1996–97	25.60
1997–98	12.20
1998–99	7.50

**Exhibit 2** Market Segment Composition of EPABX in 1998

<i>Market segments</i>	<i>Percentage of total market</i>
▪ Government and public sector	38
▪ Corporate (private) sector	27
▪ Hospitality industry	20
▪ Others	15

**Exhibit 3** The Influencing Factors for Buyers of EPABX

<i>Influencing factors</i>	<i>Respondents (percentage)</i>
Technology	74.8
Performance	73.3
Service support	55.8
Pricing	30.0
Advertising/marketing	19.3
Others	0.5

**Note:** Total number of respondents = 1836. They indicated multiple influencing factors.

**Questions**

1. What steps would you suggest to the company management for reversing the downward trend in the profits?
2. Which segments should the company target and what kind of target market strategy should it follow to maintain its leadership position?

## 2 Plastic Technologies (India) Ltd\*

### Case

Vikram Parikh, Business Manager of Plastic Technologies (India) Ltd (PTIL), was worried about the performance on sales of the new company. Vikram had received a lot of drubbing from his seniors due to wide deviations between actual sales and forecasted sales for the year 1997. Besides, he had to make an upward price revision in January 1998 due to:

- An increase in local material cost on account of steep hike in petroleum prices.
- An increase in imported material cost because of an increase in US dollar prices.
- An increase in cost of finance because of increased interest rates.
- A higher apportioned value of overheads due to lower volume of the total sales than the original plan.

### INDIAN OPERATIONS

Plastic Technologies Inc (PTI) was a leading manufacturer of injection-moulding machines, blow-moulding machines, extrusion systems, and mould-making equipment in USA. It had over 100 years of rich manufacturing experience and was the first plastic machinery manufacturer in the world to receive ISO 9001 certification for both machinery and ancillary equipment.

As a part of PTI's global strategy, the new company, PTIL, started its Indian operations in September 1995 to serve the following markets.

- Domestic sales to Indian manufacturers (i.e. plastic processors) who were interested to raise their productivity and product quality;
- Export sales to new markets previously untapped by PTI, such as African and Gulf countries.

PTIL was a joint venture between PTI and the Patel family, which formerly managed India's leading domestic plastic machinery manufacturer—Windsor. This relationship allowed fast-track introduction and market acceptance of Indian-made PTI machines. The new Indian manufacturing unit was strategically located at Baroda (Gujarat)—the heart of India's plastic industry with the availability of critical local vendors. Vikram Parikh was appointed as Business Manager of Indian operations.

### Product-Mix

PTIL had planned to introduce the entire range of PTI's plastic machinery product lines such as injection-moulding, blow-moulding, and extrusion systems. By 1997, the company had built the following two families of injection-moulding machines:

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\* This case was prepared by Prof. Krishna K. Havaldar, based on the case data provided by MBA students, Mr. Milind and Mr. Vinayan, of IFIM, Bangalore.

**Sigma Range** These injection-moulding machines (IMMs) came in 30 to 400-ton models, specially engineered for simplicity, reliability, and affordability.

**Magna Range** These injection-moulding machines (IMMs) were larger in size and were created by PTI's engineers as "global machines". Magna IMMs were made in 550, 660, 775 and 910-ton sizes by PTIL in India.

### Design, Manufacturing and Branch Offices

PTIL had a collaborative design process that allowed a new design to originate from PTI's Indian, American, or European engineering groups. The new design was then evaluated by the other groups to ensure global appeal and manufacturability. To achieve the objective of global collaboration, all PTI's design and manufacturing centres used common design tools, manufacturing methods, and quality systems. PTI's manufacturing facility included the following:

- Same manufacturing methods as followed by PTI's USA plant.
- Fully equipped production unit practising total quality approach.
- Own CNC (Computerised Numerically Controlled) machine shop to ensure quality of manufacturing.
- Pre-painted components and cellular manufacturing techniques.

*Branch offices of PTIL* in India were located at all the major cities—Delhi, Kanpur, Kolkata, Bangalore, Hyderabad, Chennai, Pune, Mumbai, and Ahmedabad.

## INDUSTRY PROFILE

The injection-moulding machines were classified by "clamp force" ranging from 10 tons (for making finished items like buttons) to 6000 tons (for making car bumpers). All the suppliers of plastic machinery made the machinery in the range of 30–1000 tons, which accounted for 95 per cent of the injection-moulding market in India. The types of plastic machinery and some of the end-uses are shown in Exhibit 1 and Exhibit 4 for total picture.

### Exhibit 1 Usage and Types of Plastic Machinery

<i>Plastic machinery</i>	<i>Some of the end-uses of plastic</i>
1. Injection moulding	TV/PC monitors, cellular phones, CD
2. Blow moulding	Bottles, Jerrycans
3. Extrusion	PVC pipes, cables, window and door frames

The industry segmented the total market by the end-users as shown in Exhibit 2.

**Exhibit 2** Market Segments

<i>Market segments</i>	<i>Some of the end-uses</i>
1. Automotive	Gear links, upholstery
2. Household consumers	Chairs, buckets, PET bottles
3. Technology intensive	Cassettes, switch-gears, connectors
4. Packing	Shampoo bottles, containers
5. Research and education	Products required for training, seminars, and scientific research.

Although per capita consumption of plastic in India had been growing steadily, it was much lower compared to worldwide per capita consumption, as shown in Exhibit 3.

Growth of plastic consumption in India was driven in large part by automotive and consumer products. Automotive and household consumer segments were expected to grow rapidly in the period from 1998 to 2005. Further, it was estimated that middle class in India would grow from ₹ 250 million to ₹ 400 million over the same period.

**Exhibit 3** Plastic Consumption in India and in the World

<i>Year</i>	<i>Plastic consumption per capita</i>	
	<i>India</i>	<i>Worldwide</i>
1989	0.5 kg	NA
1992	1.5 kg	NA
1998	3.5 kg	15 kg

## COMPETITION

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The leader in injection-moulding machines, in terms of numbers, was DGP Windsor. Other major competitors were Battenfeld and L&T. Exhibit 5 gives the prices of PTIL and its comparison with major competitors.

**DGP Windsor** Promoted by a British firm, Windsor entered into India in 1960 through a joint venture with an Indian partner. The parent Windsor changed hands from the British firm to a German steel manufacturer. In 1994, the parent company, German steel manufacturer, underwent major losses internationally and hence, sold their stake in Indian operations to Piramals group, who renamed the company as DGP Windsor. Windsor had, over the years, nurtured the plastic industry in India. Until 1990, Windsor had a monopoly in the market with their proven and cheaper machinery. A major part of Windsor's machinery were hydraulic and non-microprocessor based, while the major competitors had microprocessor range of machinery in 1998. The company's plants were located at Ahmedabad (in Gujarat state) and Thane (in Maharashtra state).

**Battenfeld** This German machinery manufacturer, competing in European market, entered Indian market in 1991 with a joint venture with the Mafatlal group. The initial launch, with production of 40 machines, was not successful. However, subsequently the company improved its performance, taking away Windsor's market share. The German parent increased its stake in the company considering the substantial growth prospects of plastic in India. The plant was located at Ahmedabad and the machinery used were toggle (non-hydraulic) and microprocessor based.

**L&T** Plastic product's machinery business formed a small part of the huge engineering division of L&T. In 1989, a German company, DEMAG, had a tie-up with L&T to sell its range of machinery in India. Subsequently, L&T established a manufacturing unit at Chennai (in Tamil Nadu state) with technical know-how from DEMAG. The company adopted "closed loop" technology, resulting in high price and high quality positioning strategy. However, this strategy resulted in the sale of only 50 machines in five years, and hence L&T had to change its strategy. The company introduced "open loop" technology to reduce its costs and offered competitive prices. It had positioned itself as a high technology manufacturer with microprocessor controlled (hydraulic and toggle) machinery. Due to a change in technology and marketing strategy, the company started performing considerably well.

## FUTURE

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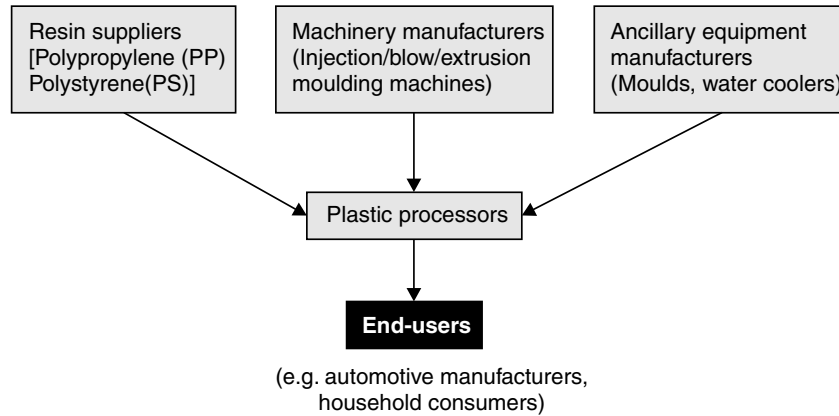
Vikram Parikh wondered whether the sales forecasting method adopted by PTIL was good enough to forecast the sales more accurately. The procedure adopted was that the sales estimates were initially made by the front-line salespersons, depending on the market intelligence. The regional managers from the four regions discussed the sales estimates with their respective sales teams and arrived at consensus forecasts, keeping in mind the company's growth plans. Thereafter, the top management team made further adjustments in the sales forecast before Vikram Parikh reported the same to his seniors at PTI, USA. **For example**, in 1997, the sales team had initially estimated the sale of 185 machines, which was scaled down to 170 machines by regional managers. Thereafter, General Manager submitted the sales forecast of 165 machines to Vikram, who himself scaled the figure down to 150 machines while reporting to the parent PTI company. The actual sales was 131 machines, and Vikram was told that such a large deviation was definitely unacceptable. Exhibit 6 shows the details of domestic and export sales.

PTI, USA, had recognised a swing in market demand towards electric injection-moulding machines (EIMM). To stay in the lead, PTI had formed a new business unit, Keltron Technologies, within its group. Keltron Technologies was dedicated solely to the development, manufacture, and marketing of a new generation of EIMMs and associated equipment.

"Our goal is to create a global electric machine platform that can be manufactured and sold anywhere to maintain high local market sales appeal" said Director of Sales and Marketing of Keltron Technologies. "The first step towards this goal would be taken at Germany's K-Show trade fair in October 1998", he added.

Major Indian moulding machinery manufacturers visited K-Show trade fair. Vikram Parikh wondered whether any sales potential existed for EIMMs in Indian market, which was very diverse and that the cost was considered as the key factor by the customers.



**Exhibit 4** The Total Picture*List of Companies*

<i>Resin suppliers/ Manufacturers</i>	<i>Machinery Manufacturers</i>	<i>Ancillary equipment Manufacturers</i>
Reliance	DGP Windsor	DME
IPCL	PTIL	L&T
LG	L&T	Kobe
DCM Shriram	Battenfeld	Prashant

**Exhibit 5** PTIL's Price List Effective January, 1998

<i>Machine Model</i>	<i>Injection frame size</i>	<i>Ex-works (₹)</i>
30	22	11,47,000
	28	11,70,000
50	22	12,16,000
	28	12,70,000
	32	12,96,000
80	28	14,90,000
	32	15,45,000

*Contd.*

<i>Machine Model</i>	<i>Injection frame size</i>	<i>Ex-works (₹)</i>
110	32	17,48,000
	40	18,18,000
150	40	21,00,000
	45	21,70,000
200	40	24,64,000
	45	25,38,000
	50	26,90,000
275	50	34,72,000
	55	35,72,000
	70	38,80,000
400	55	44,66,000
	70	48,36,000
	80	52,10,000

Comparison of (average) prices as a percentage of all ranges of machinery

DGP Windsor	< 15%
Battenfeld	> 5%
L&T	> 15%

The average discount rate was about 10 per cent for the industry.

## Exhibit 6

### *Domestic Sales 1997*

	<i>Plan</i>		<i>Actual</i>	
	<i>No.</i>	<i>Value (₹ million)</i>	<i>No.</i>	<i>Value (₹ million)</i>
Up to quarter II	60	114.50	45	92.95
Quarter III	43	86.20	42	86.20
Quarter IV	27	69.64	27	69.60
Total	130	270.34	114	248.75

*Afro-Gulf Sales 1997*

	<i>Plan</i>		<i>Actual</i>	
	<i>No.</i>	<i>Value (₹ million)</i>	<i>No.</i>	<i>Value (₹ million)</i>
Up to quarter II	0	0	0	0
Quarter III	8	11.46	3	12.70
Quarter IV	12	28.63	14	28.35
Total	20	40.09	17	41.05

**Questions**

1. What should the company do to improve the accuracy of sales forecasting?
2. What should be the company's marketing strategy to achieve its sales goals?

# 3 Case

## Alfa Networks\*

In January 1998, Suresh Kumar, Marketing Manager of Alfa networks was seriously considering how to overcome the problems in the existing distribution channel and achieve the channel objective of focusing on customers' needs of effective after-sales, and debugging services. He was considering the options of continuing with the existing distributors but ensuring better management of the channel members, setting up the company's direct sales and service offices, replacing the existing distributors with new distributors, or a combination of the above alternatives.

### COMPANY BACKGROUND

Alfa networks, which was incorporated in the US in the year 1973, pioneered the development of affordable networking solutions. The company's products had been saving a lot of money of its customers by integrating voice, data, fax, LAN (Local Area Network) and WAN (Wide Area Network) traffic over a single circuit. The company started its operations in India in 1996 by opening their offices at Mumbai and Bangalore.

The focus of Alfa Networks was to provide multimedia access networking solutions to large, medium, and small-sized companies with the following benefits:

- Substantial cost savings while integrating communication traffic.
- Choice of the most economical WAN connection.

The companies in virtually all types of industries could benefit from Alfa Networks solutions. Some of these industries are indicated in Exhibit 1. Alfa Network customers were located all over the world, which gave the company a tremendous advantage.

#### Exhibit 1 Industries Using Networking Solutions from Alfa Networks

<i>Industry</i>	<i>Percentage of total company sales</i>
Software	24.0
Telecom	16.0
Electronics	14.0

*Contd.*

\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by MBA students, Mr Sukhendu Rautela and Mr Nilotopal Nayak, of IFIM, Bangalore.

<i>Industry</i>	<i>Percentage of total company sales</i>
Airlines	10.0
Hotels	8.0
Pharmaceuticals	7.2
Construction	6.4
Iron and steel	5.0
Petrochemical	4.4
Textiles	2.0
Others	3.0
	100.0

## MARKET GROWTH

The total size of the market in 1996 was estimated at \$500 million. It was forecasted that the total market would grow substantially over the period 1997 to 2001, as shown in Exhibit 2.

### Exhibit 2 Projected Market Growth Worldwide

<i>Year</i>	<i>Market demand (\$ million)</i>
1996	500
1997	700
1998	920
1999	1080
2000	1250
2001	1360

The factors that influenced the market growth were identified as follows:

- Savings in costs by integrating voice/fax traffic with LAN/WAN data.
- Establishment of official standards such as G.729, for improvement of low voice quality.

## MARKET SHARE

Alfa Networks was the leader in the worldwide market of network solutions. Out of the estimated total market demand of ₹ 500 million in 1996, Alfa Networks occupied number one position with 37 per cent market share. Motorola, which had occupied number one position in 1995, had fallen to number two position in 1996 with 22 per cent market share. The market share of the major players is indicated in Exhibit 3.

**Exhibit 3** Market Shares and Rankings of Major Players in 1996

<i>Company</i>	<i>Market share (%)</i>	<i>Ranking</i>
Alfa Networks	37	1
Motorola	22	2
ECI Telecom	09	3
Ascom Timeplex	09	3
Others	23	
	100	

**INTEGRATING COMMUNICATION NETWORK**

Most companies around the world were discovering that integrating voice, fax, LAN, and legacy data over a single circuit not only saved money but also simplified management and improved corporate communication. The objectives of integrating communication network were:

- Reducing the number of required communication circuits and the associated costs.
- Eliminating monthly toll charges for inter-company telephone and fax calls.
- Allowing economical access to a variety of wide area network service.
- Providing a cost-effective path for network expansion.

**DISTRIBUTION CHANNEL**

Alfa Networks had appointed some of the well-known software companies of India as distributors for voice and data integration products. These were Microland, Wipro, Digital, and Datacraft RPG. Alfa Networks imported the voice and data integration equipment from their factory at Malaysia and sold them to the four distributors in India. These distributors offered networking solutions to their customers, providing the necessary hardware and software support.

**MARKET SURVEY**

Alfa Networks conducted a market survey to evaluate the effectiveness of their distributors and to know the perceptions of the companies using networking solutions. The objectives of the survey were to know:

- The prices at which the distributors supplied Alfa Networks equipments as a part of their total offer.
- The perceptions of the users about the quality of after-sales service provided by the distributors.
- The extent of the software and hardware support provided by the distributors.

The major findings of the market survey were as follows:

1. The quality of after-sales and debugging services provided by the distributors were generally rated as “poor”. The time taken to send the engineers after receiving complaints was more than two days, which was not acceptable to the customers.
2. The distributors quoted much higher prices, in comparison to the competitors, for the networking and integration although Alfa networks supplied the integration equipment at much lower prices to the distributors.
3. The software and hardware support systems provided by the distributors were “highly efficient”. However, sometimes the distributors supplied lower version of the software to the customers to save the costs.
4. The distributors did not market Alfa Networks’ equipment as properly as their own products, and their priorities were for their own products.

## ALTERNATIVES

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Sukesh Kumar was considering the various options available to him for toning up the marketing channel: If the company opted for new distributors in place of the existing distributors, would the new distributors have adequate hardware and software support system to solve any problems faced by the customers? Would the new distributors provide superior debugging and after-sales services that were acceptable or satisfactory to customers?

The marketing manager of Alfa Networking was also considering the costs involved in establishing the company’s own personal selling network. These costs should include the salaries, perks, and travelling expenses of new engineers, establishing new offices and the territories to be covered by these offices, training and other systems to provide adequate hardware and software support. Sukesh Kumar wondered how much time it would take to establish the personal selling network.

Another alternative which Sukesh Kumar thought pertained to improving the management of the existing channel members. He wondered as to what methods would be effective in motivating the channel members? He was not sure whether Alfa Networking had communicated clearly what was expected from the distributors. Would it be possible to plan a vertical marketing system that incorporated the needs of both the Alfa Networks and the distributors? Should he change the compensation package of the distributors to provide incentives for superior customer service and sales volume?

Another option that was possible was “multi-channel marketing”. Sukesh Kumar thought that instead of depending on the four distributors only, he should consider different channels to effectively reach different segments of the market, particularly because the number of industries using networking solutions were many (Exhibit 1). Alternatively, he thought, the allocation of customer organisations could be based on geographic proximity of Alfa Networks as well as that of distributors’ sales and service offices. Alfa Networks could set up a small personal selling network, and also appoint independent representatives (or agents) with required qualifications and experience on commission basis for customers dispersed in far flung areas. The third channel, he concluded, would be the existing distributors to serve their current customers with whom they had established good relationship.

Mr. Sukesh Kumar was not sure which alternative was the most appropriate to meet the company's objectives. He thought it might be a good idea to involve his marketing executives and to obtain their views, before taking a final decision.

***Questions***

1. What should Sukesh Kumar do with the existing distribution channel to achieve channel objectives?
2. How should the channel members be managed or administered effectively?



# 4

## Case

## Robo Knon\*

### BACKGROUND OF THE CASE

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ROBO KNON is a joint venture between the Indian based \$40 million ROBO group and the \$7 billion KNON—an industrial power group of the US, which is one of the most comprehensive provider of advance power systems. KNON has been at the hub of making available protection and control solutions for power systems for over 80 years and has developed a portfolio of specialist products and services. The KNON industrial power group, through its joint venture ROBO KNON, provides the world's most comprehensive systems for power generation and transmission in India.

ROBO KNON (RK) is a forerunner in the field of power system protection and control for past 28 years, with a wide spectrum of products that caters to the protection and control of generators, motors, transmission lines, transformers, sub-stations, and power distribution networks.

The company, presently with a 20 per cent market share, is poised to challenge the other multinational giants like Mac Iver of UK, Simpson of US, Roland and Smith of Germany, through its enhanced product range and multiple technology options. The company's capability ranges from conceptual design through systems integration to supply of major turnkey projects.

The company is having four manufacturing units with a strong distribution network spread over 10 states at 12 locations with four regional offices, eight branch offices and one project office.

Further, it is having a sales turnover of \$12 million in 1998–99, recording a consistent annual growth rate of 40 per cent for the previous four years. It has been ranked fifth in the growth rate in market capitalisation among its competitors, and ranked 20th in terms of earnings per share.

The products mainly aim to reach the customer groups such as state electricity boards, power utilities, power corporations, industries, captive generation plants, original equipment manufacturers (OEMs), railways, process industries, and so on.

The company is also having exports division, catering to customers and subsidiaries of KNON at U.K., South Africa, Gulf, Australia, and Far East.

Apart from the various products the company markets, their main focus is on “Relays”, one of their key products. Relays are generally used to protect and control primary equipment like generators, transformers, feeders, motors, etc. in all the power plants and sub-stations.

Three types of relays are manufactured: (a) Electromechanical, (b) Static, and (c) Numeric.

These relays are used depending upon their suitability for the system. Its estimated market in India during 1998–99 is ₹ 60 million.

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\* This case was prepared by Dr Ashok Kumar Madhav for classroom discussion. He has permitted to print this case.

The major competitors in the relay market and their market share are:

	<b>% Market share</b>
(a) Mac Iver (market leader)	32
(b) Roland	27
(c) ROBO KNON	20
(d) Smith	10
(e) Simpson	6
(f) Others	5

## THE OBJECTIVES AND STRATEGIES

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The major objectives of the company are:

1. To become the market leader in 'relay' market segment.
2. To challenge the market leader Mac Iver.

The marketing department developed strategies, keeping the company's objectives in mind.

The strategies are:

- (a) Offering multiple technology options and single window solutions.
- (b) Identifying new market opportunities.
- (c) Strengthening the dealer network.

The company intends to make an organised move in achieving its objectives. Initially it entrusted the task of getting information for developing marketing policies and strategies to its Marketing Research (MR) wing. The main responsibility of the MR wing is to study the market and give the findings to the marketing department to develop its strategies. The MR wing identified the buying process of its customers to start with their study.

## HIGHLIGHTS OF RESEARCH

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The industry which intends to set up its power plant initially gains approval from Central Electricity Authority, and depending upon its capacity of the power project, it entrusts the responsibility to its technical consultant and Original Equipment Manufacturers (OEM's) or Erection, Procurement and Construction contractors (EPC's).

The choice between the OEM or the EPC's options will be decided by the industry, based on the recommendations of a technical consultant. In case of small power plants, the OEM also acts as EPC since the cost of the equipment covers the major project cost. In case of large power plants, EPC contractors will be responsible for engineering, procurement and commissioning of the power plants. The EPC further tries to coordinate with project consultant and OEM.

Hence power system manufacturers need to pass through these business stages.

**Case I** If OEM takes the responsibility of the project, the major decision making for purchase of power systems will be

- A. Industry: Final customer.  
(Ultimate decider: Refers his needs to his consultant and OEM)

- B. Consultant: Recommender  
(Responsible for design, specifications of equipment and coordinates with the OEM)
- C. OEM: Initial decider (may or may not be involved)  
(Responsible for supply of primary equipment, engineering, procurement and construction materials)

**Case II** If the industry appoints EPC to undertake the responsibility of the project, the major decision makers are:

- A. Industry: Final customer  
(Ultimate decider refers his needs to his consultant and EPC contractor)
- B. Consultant: Recommender  
(Responsible for design, specifications of equipment and coordinates with EPC and OEM)
- C. OEM: Initial decider (may or may not be involved)  
(Responsible for supply of primary equipment and associated products)
- D. EPC: Immediate customer or acts as a subsidiary customer.  
(Responsible for engineering, project and construction materials)

After this initial exercise, they basically identified important objectives that need to be achieved by conducting research.

The identified objectives for the study purpose are:

- (a) To assess market potential for power generation equipment
- (b) To evaluate the preferences and identify the perceptions and technology trends of power systems protections users.
- (c) To measure the brand equity for ROBO KNON (RK) products and to make a comparative assessment with its competitors.

After a detailed research study, they came out with the following findings. These findings are used to modify their existing marketing strategies.

The highlights of their findings are:

- (a) On an average there are about 60–70 power plants that are commissioned in the market and they are with a capacity ranging up to 500 mw.
- (b) The transmission and distribution projects are in the capacity range of 33–132 kv.
- (c) There is more or less equal participation by EPC's, OEM's, and consultants in both generation and transmission and distribution of power areas.
- (d) The major captive power plants are set up by fertiliser, petroleum, steel, cement and sugar industries.
- (e) RK relays are not preferred for generation projects that are less than 4 mw.
- (f) OEM's and EPC's, for both generator and T&D (Transmission and Distribution) projects, consider price and delivery as the major criteria for brand decision.
- (g) OEM's and EPC's are doubtful about the effectiveness of numeric relays but consultants generally recommend numeric relays.
- (h) RK stands in 3rd position regarding brand preferences where the 1st and 2nd positions are shared by Mac Iver and Roland respectively.

***Questions***

1. What are the major issues involved and how has the company resolved the same?
2. What marketing strategy and action plan the company should follow to achieve the leadership position?

# 5

## Case

# Electrical Equipment Ltd\*

In February 2010, Suresh Kumar, Regional Marketing Manager—Eastern Region (RMM-E) of Electrical Equipment Ltd (EEL) was reviewing the company's offer with his sales engineer, Pradeep Dasgupta, before meeting General Manager (Materials) of Voltas Ltd. EEL had earlier submitted a quotation for the supply of 10 numbers of flame-proof motors to the Kolkata branch of Voltas Ltd. Voltas had secured an order for supplying and installing 10 numbers of industrial pumpsets from Eastern Coalfields, against a tender at a competitive price. Voltas had also agreed for a penalty clause for delay in supply and installation of pumpsets beyond May 31, 2010, at the rate of 0.5 per cent per week with a ceiling of 10 per cent on the undelivered portion of the order.

## PREPARATION FOR THE MEETING

Pradeep Dasgupta informed Suresh Kumar that General Manager—Materials (GM-M) of Voltas was known as a tough negotiator. Suresh Kumar realised that apart from competitive price, faster delivery, past performance, and supplier-buyer relationship would play an important role in bagging the order worth ₹ 4 lakh (₹ 400,000). Pradeep Dasgupta had established a good relationship with purchase, finance, and project people working at Kolkata office of Voltas, considering the fact the Voltas was a key (or major) OEM (Original Equipment Manufacturer) customer to EEL for electric motors, with a sales potential of ₹ 50 lakh (₹ 5 million) per year. Pradeep had met Murli Bhasin, GM (M) of Voltas only once earlier as Mr. Bhasin was transferred to Kolkata from Delhi office of Voltas in January 2010.

Pradeep informed Suresh Kumar that against EEL's offer of 10-weeks delivery, Voltas may insist on eight weeks. Regarding the specifications of flame-proof motors and the past performance, all the suppliers were almost on par. The competing firms were Siemens, ABB, and Kirloskar, all of whom had a good reputation on quality and performance of motors.

EEL had quoted the basic price of ₹ 50,000 for a 40 HP, 1,400 rpm, flame-proof motor, to work in underground coal mines, coupled to the centrifugal pump of Voltas. The pumpsets were to be installed before 31.05.1990, before the onset of monsoon rains, for removing the accumulated water in the underground mines. The designs of flame-proof motors were made special to avoid any explosion that might take place if the inflammable gases came in contact with a spark. These motors were to be designed and manufactured as per relevant Indian standards. The market for flame-proof motors was served by the reputed manufacturers such as EEL, Siemens, ABB, and Kirloskar. There was no competition from small-scale motor manufacturers.

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\* This case was prepared by Prof. Krishna K. Havaladar for classroom discussion.

EEL had given a volume discount of 20 per cent on the basic price, in the quotation, to Voltas. In addition, Kumar was allowed a discretionary discount of up to five per cent for negotiation by the Marketing Manager of EEL. Kumar felt that he might need further 7 to 8 per cent discount during negotiation with Voltas and hence, he talked to the Marketing Manager at Mumbai. The Marketing Manager agreed to give further 7 per cent discount and assured to improve on delivery from ten weeks to eight weeks despite the application of the penalty clause.

## NEGOTIATION

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Armed with the necessary authorisation from the Head Office, Kumar and Pradeep arrived at the Voltas office five minutes before the appointed time for the meeting with the GM (Materials) who was accompanied by the Project Manager and the Purchase Executive.

Kumar sent in his visiting card and after receiving the nod from Murli Bhasin's secretary, he entered the meeting room along with Pradeep. With a smile on his face, he said "Good afternoon, Gentlemen, I am Suresh Kumar from Electrical Equipment Ltd and this is my colleague, Pradeep Dasgupta". Murli Bhasin extended his hand to welcome Kumar and Pradeep and introduced his Project Manager and Purchase Executive. "Well, you have been one of our regular suppliers of electrical equipment, and we value the long-term relationship between our organisations. This is the reason we have called you first amongst the various suppliers of flame-proof motors. We have received the order for the supply and installation of 10 numbers of industrial pumpsets from Eastern Coalfields, despite a stiff competition on price and delivery. I would like to know what best can you offer, which should be better than your quoted price and delivery", said Murli Bhasin coming straight to the point. There was a pause after which Kumar responded, "Thank you for considering EEL as one of your regular suppliers. We too value our long-term relationship and we assure you to work together to resolve the problems, not only for this order, but also for all future orders, so that both the organisations are benefited. Now, coming to the present issue of Eastern Coalfields order, I would like to know what are your expectations on price and delivery. However, before we come to the important issue on price, may I suggest we discuss other matters related to delivery, freight, transit insurance, installation, warranty, and after-sales service."

Murli Bhasin looked at his Project Manager and after getting his nod, remarked, "OK, let us first discuss other issues and then come to the pricing matter. We want delivery to commence in four weeks from the date of the order at the rate of two or three motors per week, and completion in eight weeks, failing which a penalty will be applicable at the rate of 0.5 per cent per week. The freight is to be borne by you from your Mumbai factory to our factory at Kolkata, and transit insurance will be covered under our open policy. Is this acceptable to you?" Kumar responded, "Well, we shall meet your delivery completion date of eight weeks and also penalty clause of 0.5 per cent per week with a ceiling of five per cent on undelivered value of the order. Delivery will commence in six to seven weeks and we will deliver all the 10 motors in one or two full truck-load to avoid any damage or delays that may take place if we dispatch part truck-load consisting of two or three motors only. I hope you appreciate the problem of part truck-load and the long distance between Mumbai and Kolkata. As regards bearing the freight cost, we have to incur an additional cost that would be about 3 to 4 per cent of the sales revenue. We agree to your proposal of bearing the freight cost, but keeping in mind its impact on the price. I hope, you understand our point of view."

“Yes, yes. We understand and appreciate your points, but at the same time you should also appreciate that we have bagged this order in the face of tough competition at a very low price and low margins. Now, tell us about warranty period, after-sales service, and the installation service arrangement for the motors,” said Murli Bhasin. Kumar observed the body-language of the GM paused for a moment, and responded slowly, “Well, we are aware that your margins are low and we would like to assure you that we will also keep our margins thin, so that both of us make some profits in this order. We shall give you 12 months warranty from the date of installation or 18 months warranty from the date of dispatch of motors, whichever is earlier. If you need any help in installation, we shall give it free-of-charge, although we quoted for only supply of motors. During the warranty period our service will be free, but later on, Eastern Coalfields will have to pay for any services or repairs. I hope this is okay.”

“Yes, it is acceptable to us”, said Murli Bhasin, “and now let us discuss how much discount you can give us. You have already given us 20 per cent discount on the basic price. We need further 15 per cent discount to make your prices competitive. If you agree to our proposal, I will finalise the order now on you. If not, I shall negotiate with other reputed motor manufacturers and then take appropriate decision.” Kumar looked at Pradeep and then requested the Voltas team to give a break for about 15 minutes to discuss the matter before conveying their decision. The Voltas team agreed.

Kumar asked Pradeep’s opinion on the discount particularly because he had the approval of his boss to give a maximum of 12 per cent discount, whereas Voltas had asked for 15 per cent. Pradeep said he was not sure whether the GM (Materials) was telling the truth about competitive prices. However, Pradeep was keen to get this order in view of long-term relationship with this important OEM. After the break, Kumar informed the Voltas team that EEL could give further a maximum of 12 per cent discount if the entire order for 10 number motors was placed on them. Murli Bhasin remarked, “Well, you are forcing us to negotiate with others. We shall inform you about our decision in about 3 to 4 days. Thank you for coming over and the meaningful discussion.” Suresh Kumar and Pradeep shook hands and thanked all the negotiating members of the Voltas team.

While driving back to their office, Kumar wondered whether they would get the order, and remarked to Pradeep whether they could have employed any other alternatives while dealing with a key or major account like Voltas.

### **Questions**

1. Are you satisfied with the way Suresh Kumar has conducted the negotiation with a key account like Voltas?
2. If you were the regional marketing manager (RMM-E), of EEL, how differently you would have conducted the negotiation?

# 6

## Case

# Saragam Aluminium Limited\*

Mr. Krishna Kumar, Vice-President, Marketing, of Saragam Aluminium Limited was considering the type of pricing strategy and policy that would be effective for the new aluminium extruded products that were to be launched in the Indian market in December 2011.

## THE COMPANY

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Saragam Aluminium Limited (SAL) had invested ₹ 10 crore (₹ 100 million) for manufacturing and marketing of aluminium extruded products. The factory was located at Hosur in Tamil Nadu, and the marketing head-office was located 38 km away from factory at Bangalore. The managing director (MD) of the company had visited various countries in the late 1990s for selection of the extrusion press and its accessories, which were critical equipment for the manufacture of aluminium extrusions. The order was finally placed with a French supplier for the supply and installation of the press and accessories at a cost of ₹ four crore (₹ 40 million). The MD had earlier recruited the works manager, design engineer, materials executive, financial controller, and personnel manager—all of whom were reporting to the MD directly. In May 2011, Mr Krishna Kumar, Vice-President (Marketing) was recruited, reporting to the MD.

## MARKET SURVEY

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Mr. Krishna Kumar felt it necessary to carry out a market survey to understand consumer buying behaviour, market potential and competitors' analysis to make more effective marketing decisions. Aluminium extrusion was a new industry for Mr. Krishna Kumar, who was basically an electrical engineer and a management graduate with 15 years of experience in electrical, air-conditioning and refrigeration industries. He decided to carry out a market survey in southern and western regions of India, where he decided to focus the company's marketing efforts initially. The two marketing executives, who were recruited by the company, were involved in carrying out the field work of data collection, under the guidance of Mr. Krishna Kumar. The major findings of the market survey, carried out in-house, are outlined below:

### Customer and Demand Analysis

The Customer (market) segments, which require aluminium extruded products were household consumers, commercial enterprises, government organisations, and institutional customers. Business buy-

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\* This case is prepared by Prof. Krishna K. Havaldar for classroom discussion.



ers considered aluminium extrusion products as “capital items”, when these products were used as door, window, and partition frames. However, extrusions were also used as “component parts” in the manufacture of electrical control panels, water purification equipment, computers and electronic equipments (as heat sinks). The household consumers, who used aluminium extruded products mainly for window and door frames, were extremely price-sensitive. Aluminium frames for doors and windows, although costlier compared to wooden and steel frames, were more elegant looking, rust-free, but less strong than steel. The business customers like commercial enterprises and institutional customers were less sensitive to prices. However, government organisations had a policy of purchasing from the lowest priced suppliers. The market potential of various market segments as a percentage of total market demand is shown in Exhibit 1.

**Exhibit 1** Market Segments, Market Potential and Price Sensitiveness for Aluminium extruded products in Southern and Western Regions

<i>Market Segments</i>	<i>Market Potential (%)</i>	<i>Price Sensitiveness</i>
Household consumers	50	High
Commercial enterprises	20	Medium
Institutions	10	Medium
Government organisations	15	High
Cooperative societies	05	Medium
	100	

## Competitive Analysis

There were seven players, manufacturing and marketing aluminium extrusions in India. None of them was an MNC, but the market leader was Jindal Aluminium, with its manufacturing unit located at Bangalore. Jindal Aluminium was a national player serving all the markets in India. Other large scale national players were primary aluminium manufacturers of ingots and billets, like Hindustan Aluminium Ltd. (Hindalco), National Aluminium Company (NALCO), and Bharat Aluminium Company (BALCO), who also manufactured small quantities of aluminium extruded products. However, their major concentration was on primary products like ingots and billets. The secondary manufacturers (i.e. manufacturers of secondary products like aluminium extrusions) were four, out of which only Jindal Aluminium was a national player and others were local players.

The findings of the market survey indicated that based on consumers’ perceptions, Jindal Aluminium ranked first in product quality, followed by Hindalco and Nalco. On delivery/availability, the rankings were as shown in Exhibit 2. However, there was a difference in the pricing, based on total cost of various suppliers.

**Exhibit 2** Competitive Analysis

<i>Competitors</i>	<i>Primary/ Secondary Manufacturer</i>	<i>Quality Ranking</i>	<i>Delivery/ Availability Ranking</i>	<i>Relative Price Comparison</i>
1. Jindal Aluminium	Secondary	1	1	110
2. Hindalco	Primary	2	5	105
3. Nalco	Primary	3	6	105
4. Balco	Primary	4	7	105
5. Man. Aluminium	Secondary	4	2	107
6. Bangla Aluminium	Secondary	5	4	107
7. MP Aluminium	Secondary	5	3	107

The Secondary manufacturers focused more on household consumers with thinner (less thickness of 0.8, 0.9 and 1 mm) aluminium sections, which were purchased on weight basis of ₹ 80,000/- per ton by the dealers, but sold on rupees per metre basis. Business buyers preferred thicker aluminium sections as these were considered as stronger and superior in quality. Primary manufacturers mainly concentrated their marketing efforts with commercial enterprises, and government organisations.

However, the company's France made extrusions could not produce thinner sizes below 1.2 mm thickness.

**Cost Analysis**

The basic problem of all the secondary manufacturers was higher cost of aluminium billets (i.e. small aluminium bars as basic material used for extrusion), which was purchased from the primary manufacturers, who were also their competitors for extruded products. The minimum difference in the cost of aluminium billet between primary and secondary manufacturers was six to seven per cent (i.e. four per cent CST + two to three per cent transportation and handling costs).

The fixed costs (overheads) of primary manufacturers were considered to be higher than secondary manufacturers, and hence, the difference in prices, as shown in Exhibit 2, was much less as compared to the difference in the cost of aluminium billets. The information on other costs like marketing, direct labour, factory supplies, etc. of various extrusion manufacturers was not available.

**Pricing Objectives**

Saragam Aluminium company's pricing objectives were derived from the corporate and marketing objectives, which included (a) achieving long-term profits, and (b) maximising sales volume and market share, respectively. The pricing objective as stated by Mr. Krishna Kumar, was to achieve market penetration through low initial price strategy. He justified a low initial pricing strategy to the management by pointing out to the market survey findings and these included: (i) various market (customer) segments were medium to high levels of price sensitive; (ii) competition was severe from primary and secondary

manufacturers; and (iii) as the production and sales volumes increase, the unit cost will come down leading to achievement of long-term corporate and marketing objectives.

On receiving the recommendation from Mr. Krishna Kumar, the managing director called a meeting of key executives including works manager and financial controller to decide on the pricing strategy. In the meeting, after Mr. Krishna Kumar explained his proposal of market penetration strategy, the financial controller argued in favour of “skimming strategy” through high initial price, which would give advantage of recovering the investment sooner by generating larger profits. The works manager said that the workers and production supervisors were new to the extrusion technology and the concept of experience (or learning) curve will be applicable, in terms of decline in cost per unit, after accumulated experience of production over a period of 6 to 12 months.

The finance manager pointed out that the break-even volume was estimated at 350 tons of production and sales per month, and wanted to know when would it be achieved. The managing director intervened to observe that all these points were important, but it was necessary to take a decision on the company’s pricing strategy and policy immediately to enable Mr. Krishna Kumar to plan marketing efforts.

### **Questions**

1. Which market segments should be targeted by the company? What should be the target market strategy?
2. What should be the pricing strategy and policy of the company?

# 7

## Case

# Information Solutions, Inc\*

Indu Sharma, Sales Manager of one of the verticals—viz. water—for North American market was concerned about achieving her sales target of \$50 million for the year 2007–08. Her anxiety was mainly due to the management expectations of higher sales growth of 30 per cent, as compared to the previous year's 20 per cent sales growth.

## ABOUT THE COMPANY

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Information Solutions Inc. was an American based online information distribution solutions company, incorporated in 2005. It facilitated information sharing amongst buyers, suppliers, and information seekers. The company developed online conferences, trade shows, exhibitions, and information resource centres. Online information resource centres (IRCs) had important elements like white papers (government reports on various issues), case studies, news, product information, and buyers' guides. The main benefit offered by Information Solutions Inc. was to increase the business of the participants like buyers, suppliers, and information seekers by sharing the online information with a large number of individuals and organisations.

The company had seven verticals such as water, healthcare, packaging, environment, emergency management, power and energy, and plastics. Each vertical dealt with a specific group of products that were needed by a group of customers or market segments. Water was one of the verticals that dealt with specific products like pumps, valves, water treatment equipment, storage tanks, and so on.

## THE INDUSTRY

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Online water business had a high market potential in North America and Europe, as compared to other markets like Asia and Africa. It was estimated that the online water industry was growing at 30 per cent per annum in North America and was expected to reach \$20 billion by 2010. The information on main players (suppliers) in this industry in the North American market with their market share is shown in Exhibit 1. Some of the online water information suppliers also used offline promotion tools like trade shows and publications related to water industry to improve the brand awareness.

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Neha Tripathi and Onkith Dutta Choudhury, students of SBS-ABA-MBA programme of Alliance Business Academy.

**Exhibit 1** Market Share of Major Suppliers of Online Water Industry

<i>Major Suppliers</i>	<i>Market Share (in percentage)</i>
www.globalspec.com	25
www.thomasnet.com	20
www.wateronline.com	18
www.awwa.com	15
www.idswater.com	10
others	12
Total	100

**MARKETING EFFORTS**

Indu Sharma knew that the company's marketing efforts needed to be increased substantially in order to achieve the challenging sales growth of 30 per cent. The company's promotional efforts included sending e-Newsletters to its customers and delegates (i.e. customers' customers), as well as sponsoring a newsletter of American Water Works Association (AWWA). Telemarketing was done by a group of trained employees, who also interacted with prospective and existing customers in North America on the internet. Indu felt that the quality of service provided by her team members, with the search engine optimisation that was built into the company's solutions, was superior to competitors. Besides, the pricing strategy was to offer lower prices (i.e. 15-month tariffs) compared to the competitors. The distribution channels used were the internet and telemarketing. However, she thought that the conversion ratio from sales leads to prospects to customers was somewhat lower than the expectations of the company's management. One of the reasons, Indu felt, could be lower brand awareness of the company, as it was relatively new compared to the competitors. She, therefore, thought that the company should consider building the brand. Indu Sharma wondered how to go about preparing a marketing plan, as well as brand building plan, keeping in mind the importance of achieving the company's sales and profit goals.

**Question**

1. If you were the management consultant, what would you advise Indu Sharma and why?

# 8

## Case

# Karnataka Gears Ltd\*

In December 2004, all the buyers of “alloy steel” (a mixture of steel with other metals) were surprised and upset due to a large increase of 20 per cent in the prices of alloy steel, mainly due to a huge gap in demand and supply. The global demand for alloy steel had gone up substantially and the Indian manufacturers of alloy steel increased their exports due to higher profitability in the international markets. This resulted in shortage of alloy steel in domestic market. Suresh Mehta, Director of Karnataka Gears, was one of the persons who was shocked at this increase in the prices of alloy steel. He wondered whether his customers would give the price increase for Gears which needed alloy steel material.

## NEGOTIATION WITH A MAJOR CUSTOMER (KEY ACCOUNT)

Phoenix Limited, a textile machinery manufacturer, was one of the major customers of Karnataka Gears, which supplied 30 per cent of the total requirements of gears of Phoenix for over 4 years. GL Company supplied the balance 70 per cent of gears to Phoenix, which perceived the quality of gears supplied by GL company better than those supplied by Karnataka Gears. When Suresh Mehta approached the purchase manager of Phoenix for a price increase, he was told “no increase in current prices”.

Suresh Mehta, in all humility, requested the purchase manager of Phoenix to find a way out in the difficult situation of 20 per cent increase in the cost of alloy steel, which contributed 50 per cent of the total cost. The purchase manager, considering the long-term relationship between their two organisations, confided with Suresh that GL Company had already submitted a letter to Phoenix asking for 15 per cent increase in the prices of gears with immediate effect. GL company had further stated in the letter that supplies of gears would continue only if Phoenix agreed for 15 per cent price increase. Chief executive officer (CEO) of Phoenix perceived the behaviour of GL company as arrogant and gave instructions to the purchase manager to look for a new supplier (or suppliers) in place of GL company, before leaving for overseas visit. The purchase manager asked Suresh Mehta to rework his cost structure to convince the CEO of Phoenix for a price increase of about 5 per cent, after his return from the overseas tour in about a week’s time.

Suresh Mehta, after returning to his office, discussed with his accounts manager and industrial engineer on the cost structure and different methods that could be used for cost reduction. The impact of

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Sukumar J. and Sumeet Saluja, students of SBS-ABA-MBA programme of Alliance Business Academy, Bangalore, for class discussion.

increase in the cost of gears due to increase in alloy steel prices was about 10 per cent. By reducing the wastage in oil and other materials, better negotiations of purchased items with suppliers, and reduction of inventory of raw material, work-in-process, and finished goods, there was a scope to reduce the total costs by about 2 to 3 per cent. Suresh was informed by his industrial engineer that, if the company could buy a new fully-automatic machine from France in place of three existing and old semi-automatic machines, it would improve the quality and reduce the production time of gears substantially. However, the breakeven volume of the new machine would be double of the existing volume. Suresh thought that with the new machine, the quality of gears supplied by his company would be equal to or better than that of GL Company and therefore, he could aim at about 70 to 80 per cent share of the total number of gears required by Phoenix. This would improve the company's sales volume. However, the profitability would improve, if Phoenix agrees for a price increase of over 7 per cent.

Suresh was thinking how to convince the CEO of Phoenix, when he received a call from the purchase manager of Phoenix: "Mr. Mehta, could you please come to our office to meet with our CEO today at 4.00 pm for discussion on prices of gears?"

"Yes, I will be at your Office at 4 pm," responded Suresh.

Suresh Mehta entered the office of the CEO of Phoenix, Arvind Mittal, and gave his visiting card to the secretary of the CEO. After getting a nod from the secretary, Suresh entered the meeting room. With a smile on his face, he said, "Good evening, Mr. Mittal, I am Suresh Mehta of Karnataka Gears". Arvind Mittal extended his hand and said, " Good evening, Mr. Mehta; Nice to meet you. You have been one of our regular suppliers of gears and we value the long-term relationship between our organisations. I was recently transferred from our head-quarter at Mumbai to this unit at Bangalore, which is one of our strategic business units, manufacturing textile machineries. The recent increase in the prices of steel and alloy steel has affected all of us. We have to put extra efforts to ensure that the price increase to our customers would be as minimal as possible, so as to remain competitive in the market. Do you agree with this approach, Mr. Mehta?" asked Arvind Mittal.

"Yes, I fully endorse your views, Mr. Mittal. We have been your suppliers of gears for over 4 years and we have excellent relations with your people. Although the total impact of 20 per cent price increase of alloy steel is 10 per cent, we have thought of taking a number of steps to reduce the cost of manufacture. Therefore, we are requesting for a price increase of only 8 per cent. Besides, we can give you improved product quality and faster delivery by installing a fully automatic, imported machine. For this, we need more than double of the existing volume of business in order to breakeven. I, therefore, request you to give us 80 per cent share of your total volume, with a price increase of 8 per cent," responded Suresh Mehta.

"You seem to have done your home-work well. But, it would be difficult to give you more than 60 per cent volume, and a price increase of over 7 per cent. We have to justify to our customers, when we ask for price increase for textile machines", said Arvind Mittal, in a thoughtful manner.

"Considering our long-term relationship, may I make a request of 70 per cent share of your total purchase of gears and a price-increase of 7.5 per cent" pleaded Suresh Mehta. After a pause, Arvind Mittal responded,

"OK, I would agree to your request, provided your organisation keeps up to our expectations of performance standards on quality, delivery, and technical support" and extended his hand to Suresh Mehta.

"Thank you very much, Mr. Mittal. We will ensure that we come up to your performance expectations," said Suresh Mehta with a broad smile.

***Questions***

1. Discuss the approach of the two suppliers towards price increase.
2. Are there any other aspects of buyer–seller relationship that need to be looked into?
3. What style of negotiation was used by Suresh Mehta and Arvind Mittal?



# 9

## Case

# Structural Engineering Consultants Ltd\*

Bramha Sharma, Marketing Manager, Structural Engineering Consultants Ltd (SECL), was not sure how to resolve the problem of stagnant list of customers and increase the number of customers. The company, which started its operations in April 2005, had not increased its customer list of eight numbers for about two years. The eight customers were also acquired due to the excellent contacts and relationships developed by SECL's chief executive officer (CEO), Anand Yelvigi.

## THE COMPANY BACKGROUND

Three well-qualified engineers, with post-graduation in management, came together to start the company in 2005. They had good experience and expertise in structural design and execution of projects in steel structures. Within a short period of time, the CEO, Anand Yelvigi secured good project orders. Although the company's registered office was in Bangalore, it took orders for projects to be executed all over India.

SECL specialised in taking up turnkey projects, which included designing, fabricating, and executing steel and other structures, in the areas shown in Exhibit 1.

### Exhibit 1 SECL's Specialised Areas of Operations

<i>Type of Specialisation</i>	<i>Examples</i>
Polycarbonate and glass skylights	Domes, pyramids, walkways
Tensile fabric structures	Amphitheatres, sunshades
Space frame structures	Airplane hangars, cantilever structures

## SEGMENTING AND TARGETING

The company identified the market segments, based on the segmenting variables of 'type of customer' and 'end-use or application'. The target segments were selected by using the criteria of profitability and extent of scope for steel structures. These are presented in Exhibit 2.

\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Abdul Majeed and Ashish Chauhan, students of SBS-ABA-MBA students of Alliance Business Academy, Bangalore.

Bramha Sharma, who joined the company recently, wondered why the company did not use some other criteria like market potential (or size of the market and its future growth) and competitive analysis for each of the market segments.

### Exhibit 2 Market Segments and Target Segments

<i>Market Segments</i>	<i>Target Segments</i>
▪ Residential apartments	▪ Shopping malls
▪ Commercial buildings	▪ Business applications (e.g. Prefabricated structures for factories)
▪ Shopping malls	
▪ Educational institutes	
▪ Business applications	

## COMPETITIVE ANALYSIS

The company was faced with seven competitors, out of which the major players were Polyklad Structures Ltd, Kurby Constructions Ltd, and Macoy Structurals. The company had not done any market survey to obtain information on competitors' strengths and weaknesses based on target customers' perceptions. Bramha Sharma was also not sure about the market share of the various players, as well as the value propositions of the competitors, and the expectations of the target customers. When he proposed to the management to conduct a market research to get information on customers and competitors, the management rejected the idea on the grounds of time and financial constraints.

## MEETING

In the meeting, called by the CEO, Anand Yelvigi, which was attended by the other two co-founders and the marketing manager, Bramha Sharma, the problem of stagnant list of customers was discussed. Anand asked other members to express their views frankly, since the project orders obtained in the past two years were nearing completion and the same customers might not have any new projects in the next few years. This would mean that the company had to develop some new customers to get new projects. His personal contacts and relationships had helped to get business in the past, but this could not be continued indefinitely.

Sidharth Sen, one of the co-founders said that the company should focus on the prospecting activity, which would help in identifying prospective customers. He further added that different methods of prospecting should be explored, including cold canvassing with architects and builders by recruiting sales engineers.

Vikas Deshmukh, the third co-founder, expressed his opinion about the importance of brand strategy for the company. "The products and services marketed by the company might change over a period of time, and hence, branding the products and services, particularly the projects of steel structures handled

by the company, might not provide continuity of brand identity. It would, therefore, be advisable to develop the 'company brand', like what L&T, Infosys, and Wipro have done," he said thoughtfully.

Bramha Sharma agreed to what Vikas Deshmukh said earlier, and added, "however, the company brand had to be positioned in the minds of the target customers, based on the most important benefits (or value) they look for. Do our customers value superior quality of work and timely completion of projects or some other benefits should be researched. All these concepts are a part of marketing and brand building plans, which we have not developed so far".

"Ok, all of us have expressed our opinion. I suggest Sharma should prepare a proposal on what the company should do to resolve the problem of stagnant customer base, and circulate the proposal to all the members of this group. We, shall, then take a final decision", said Anand, and then adjourned the meeting.

### ***Questions***

1. How effective were the company's marketing efforts?
2. If you were Bramha Sharma what would be your proposal?

# 10

## Case

## 4S India Ltd\*

Pradeep Dasgupta, Product manager of 4S India Ltd was anxious about low sales of a new product, MP1000, in India, although it was a success in other markets like U.S.A. and Europe. The new product was a photo printer with instant printing feature of photos. It was an innovative product and first of its kind when the product was launched in February 2006 in India.

### THE COMPANY BACKGROUND

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4S India Ltd was a subsidiary of 4S Japan Ltd., with the main businesses focused on information-related equipment (such as computers, printers, scanners and projectors), electronic devices (like semi-conductors, displays and quartz devices), and precision products (such as watches, plastic corrective lenses, and factory automatic equipment).

The company's vision was to provide imaging solutions that would bring colour to everybody's life. It was reputed as a innovative organisation, with a commitment to develop breakthrough products, using radical or breakthrough technologies. MP1000 photo printer was one such product, which had the ability to take printouts directly from digital cameras and mobile phone cameras.

The company had a global network with manufacturing facilities in 30 locations, as well as 60 marketing and servicing bases around the world.

### PHOTO PRINTER MARKET

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The photo (that is photography) industry market size was about ₹ 30 billion (or ₹ 3000 crores) in India in 2006. Out of this total market size, digital cameras and photoprinters were estimated at only three per cent and the balance was for analogue. Photo studios' conversion from analogue to digital was rather slow. The change was taking place for those functions or activities which needed quick turnaround, like passport photos. Photo printing market could be segmented into the following market segments.

**Market Segments** Although photo printing market was broadly divided into (i) home users, (ii) business users, and (iii) professional users, Pradeep Dasgupta, the Product Manager of the company, decided to carry out brainstorming sessions with management students to identify specific segments which might buy the new MP1000 photo printer, with possible applications, as shown in Exhibit 1.

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\* This case was prepared by Prof. Krishna K. Havaladar based on the case data provided by Sunil Mir, Shravan Krishna, Shweta Sinha, and Shabad Hussain, students of SBS-ABA-MBA programme of Alliance Business Academy, Bangalore.

## MARKET SURVEY

The brain-storming sessions had listed some more market segments, such as modelling agencies, detective agencies, and educational institutions. But these segments were ruled out, after discussion, as low probability and low volume of buying MP1000 photo printer. The management students were asked to carry out market survey on the segments listed in Exhibit 1, so that the company could decide suitable marketing strategy.

**Exhibit 1** Specific Market Segments with Application for MP1000 Photo Printer

<i>Market Segment</i>	<i>Application</i>
Automobile Dealers	Taking photos while handing over the keys and giving instant photo print to the automobile owner.
Police Department	Taking the instant photo prints of criminals.
Tourist Spots	Taking the instant photo prints of tourists.
Photo Studios	Instant photos as required by customers.
B.P.O. (Business Process Outsourcing)	For instant photos of picnics, training programmes, and other events carried out by the BPO organisations.
RTO (Regional Transport Office)	Taking instant photos of the vehicle owners with the vehicles.
Insurance Agency	Instant photo for insurance claim purpose.
High Income Individuals (Home Users or Home Segment)	These individuals take instant photos during family get-to-gethers and functions.

The objectives of the market survey were:

1. To identify market segments who would buy the new product—MP1000 photo printer.
2. To understand prospective customers' requirements about the product features, and the needs of photoprinting.
3. To know the opinion of prospects on the prices decided by the company for MP1000.
4. To get information on direct and indirect competition for the new product.

The management students prepared a synopsis, including the research design and after getting the same approved, carried out the field work at Bangalore and Mysore, with a structured questionnaire.

After the tabulation and analysis of the data, the major findings of the study were as follows:

## MAJOR FINDINGS OF THE MARKET SURVEY

1. 73 per cent of high-income individuals (home segment) used digital cameras, but only four per cent used non-dedicated photo printers like MFDs (Multi Functional Devices), which were also

used for other purposes like scanning, printing, and as a copier. Nobody had used dedicated photo printer like MP1000, but the price of ₹ 11,000/- of MP1000, plus the battery cost of ₹ 4000/-, as well as the running costs of cartridge, glossy sheets, and maintenance at ₹ 20 per photo print were considered very high by the prospective high-income customers or home users.

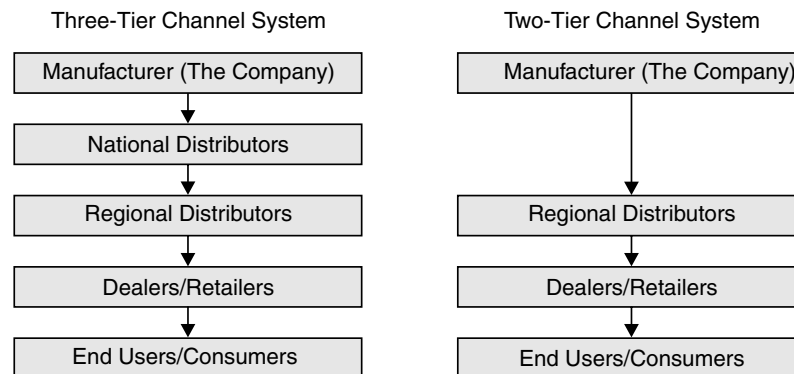
2. 27 per cent of high-income segment prospective customers used normal (analogue) cameras, but they could not use instant photo printers unless and until they used digital cameras.
3. Automobile dealers were interested in MP1000 product, as they thought they could delight their customers by giving instant photo prints of the photos taken while handing over the keys of the vehicles to their customers. They were prepared to pay for a running cost of up to ₹ 10 per photo print, instead of ₹ 20 per photo print with MP1000 photo printer.
4. Police departments and regional transport offices (RTOs) were not interested in the instant photo print from MP1000 photo printer, as the cost of traditional method of taking photo prints at about ₹ 5 per photo was very much lower.
5. Most insurance agents, who took photos for the claim purpose, mailed the soft copies of the photos to the insurance companies, and hence, there was no need of taking instant photo prints.
6. At the tourist spots at Mysore almost all photographers were interested to buy MP1000 photo printer, as they were charging ₹ 50 to ₹ 60 per photo with Polaroid camera. The quality of photo prints with MP1000 was far superior with long life (of 100 years). Besides, MP1000 photo prints were water and smudge resistant. The cost of ₹ 20 per photo print of MP1000 compared favourably with ₹ 30/- cost per Polaroid photo print, and per photo print charge of ₹ 50 to tourists. However, these tourist photographers felt the cost of ₹ 15,000 for MP1000 with the battery was on the high side. They were prepared to pay about ₹ 10,000. It was interesting to find that the photographers at tourist spots of Bangalore found the running cost of ₹ 20 per photo print of MP1000 was high because they were charging ₹ 25 to ₹ 30 per photo print to tourists due to high level of competition.
7. Photo studios also found that the running cost of MP1000 photoprints were high as they were charging about ₹ 5 per photo print to their customers for instant photo prints by using Multi Functional Devices and Computers. Besides, MP1000 could print out only one size of 4"X6", which accounted for 73 per cent of the sizes sold. The requirements of passport size photos were 18 per cent and balance 9 per cent was for other sizes.

**Inadequate Information** Pradeep Dasgupta went through the project reports of the management students, but could not find any information on distribution channels and promotion, which could be used for developing the distribution and promotional strategies.

## CHANNEL LEVELS

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For selling its existing products the company used two and three levels (or tiers) of channels, as shown in Exhibit 2.

**Exhibit 2**

The company used either three-tier or two-tier channel system depending on the product and the market segment. Pradeep wondered which of the two systems the company should use for MP1000.

## COMPETITION

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Pradeep noted from the market survey report that except Polaroid brand, no other product was in direct competition to MP1000, although there were rumours in the market that Hewlett-Packard (HP) and Canon might launch similar kind of photo printers soon. As mentioned earlier, the cost of photo prints from Polaroid camera was higher than that of MP1000, and the quality of Polaroid photo prints were not as good as that of MP1000. Polaroid photo prints were possible only during the daylight. Non-dedicated photo printing by using MFDs (Multi Functional Devices) was another form of competition to MP1000, although not directly.

## PROMOTION

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The company thought of directing the limited promotional budget to high-income group in home segment, as this market segment accounted for major sales of MP1000 in USA and Europe. Hence, promotional efforts were directed at social clubs, which had members of high-income families. Due to cost constraints, advertising in newspapers, magazines, TVs and radios were not considered. Ads in photo-magazines and participation in trade-shows were considered favourably.

The new product, MP1000, which was launched in February 2006, continued to show poor performance on sales till mid June 2006, when the market study was completed. Pradeep wondered how he should go about, as his boss, the General Manager, asked Pradeep to submit a proposal on the marketing plan by the end of June 2006 to achieve the sales and profit goals for MP1000.

**Questions**

1. How were the marketing efforts of the company in launching the new product, MP1000, in India?
2. What kind of information on distribution channel and promotion could be collected by the management students for developing distribution and promotional strategies?
3. If you were Pradeep Dasgupta, what would be your proposal on the marketing plan for MP1000?



# 11

## Case

# IMS Company Ltd

Sunil Kumar, Business Analyst, IMS Company, was concerned that the business for managed services, which included mainly “IT (Information Technology) infrastructure outsourcing” was not increasing up to the expectations of the top management. Whatever decisions and actions that were taken by the company in the past one year had not yielded desired results.

## COMPANY BACKGROUND

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IMS Company started its operations in November 2012 at Pune, in India. The company had two areas of operations—viz. managed services and professional services.

**Managed Services** mainly consisted of IT infrastructure outsourcing or remote IT infrastructure management. The company had a unique model, that was cost-effective and user-friendly.

**Professional Services** included providing training to get ITIL (Information Technology Infrastructure Library) certification and implementing ISO 20000 certification. The company was doing reasonably well in this area of business with customers like Infosys, Sun Microsystems, and Wep.

## INDUSTRY ANALYSIS

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Remote IT infrastructure global market size was estimated at about \$100 billion, growing at about 20 per cent per annum. It was interesting to note that the Indian companies, which started satisfying the needs of the remote IT infrastructure market in recent years, were growing at 30 per cent per year, perhaps due to smaller base of business in the initial years.

The domestic market for infrastructure management service was growing at a lower rate of about 10 per cent per annum. The reasons for this might be due to lack of awareness about availability of such services and lack of systematic approach towards management of information technology by most firms.

## TARGET MARKET SEGMENTS

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Based on internal discussions and knowledge of the market, IMS Company decided to target the market segments (or verticals, as often referred to in IT industry) such as banking, insurance, retailing, finan-

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\* This case was prepared by Prof. Krishna K. Havaladar for classroom discussion.

cial services, educational institutes, and BPOs (Business Process Outsourcings). The company thought that in this technology driven market, there could be many organisations interested in outsourcing their IT infrastructure, not only abroad but also in India.

## PROMOTION

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The company participated in the IT trade-show and conference held in Bangalore in October, 2013. This, Sunil Kumar thought, created a good awareness about the company and its services among target customers, IT companies, and general public. The trade-show generated about 180 sales leads from those individuals who had visited the company stall and had made efforts to enter details of their addresses and contact numbers in the register kept at the stall. In addition, the promotion included sending personalised e-mails to the prospective business customers, informing them about the company and its services. The response for personalised e-mails was far better at about 18–20 per cent, compared to that of generalised e-mails sent to about 7000 prospects, which was about 2 per cent only. As a start up company, it could not spend more on promotion due to financial constraints.

## COMPETITIVE ADVANTAGES

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Sunil Kumar, who completed a management programme from a reputed management institute in Pune, India, discussed with his seniors in the company about the competitive advantages it could offer to the prospective customers, as compared to its competitors like HCL Technologies, Tata Consultancy Services (TCS), and Wipro.

IMS company executives came up with three areas of competitive advantages in remote IT infrastructure management services. These were: First, ‘Selective Sourcing Model,’ as compared to ‘Total Sourcing Model’ offered by most competitors. In selective sourcing, the customer was given a choice of selecting the hardware and software, if the customer had any particular preference. Thus, the customer’s specific needs of infrastructure were considered when the offer was prepared by IMS company. Flexibility during negotiation and final agreement, keeping in mind interests of both the buyer and seller, was the second advantage provided by the company. The third benefit was being economical, in terms of penetration pricing strategy, compared to many large competitors.

There were about 15–16 firms in India who were offering services in remote IT infrastructure market. Sunil Kumar thought that this service was in growth phase of its life-cycle, and wondered why the sales were not up to the management’s expectations despite good economic conditions and certain advantages the company had over its competitors.

### Questions

1. How is the company’s approach to segmenting, targeting, and positioning?
2. Are the promotional efforts of the company adequate?
3. What strategy and actions would you suggest to the company to improve the sales performance substantially?

# 12

## Case

# Optotech Systems Pvt. Ltd

Arvind Kumar, Director of Optotech Systems was concerned about the stagnating sales of the company. The company had been the distributor (or partner) of NeuroDimension, Inc., a US based firm, marketing neural network software products for various applications.

## COMPANY OVERVIEW

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Optotech systems was established in the year 2000, with its corporate headquarters located at Hyderabad, India. It was a technology-driven design and development company. Neural network technology had been successfully applied to a wide range of real-world applications, such as:

- Cost Management,
- Portfolio Management,
- Medical Diagnosis,
- Quality Control,
- Targeted Marketing,
- Target Recognition,
- Signal Processing,
- Sales Forecasting,
- Fraud Detection,

And many more.

The target market segments identified by Optotech Systems were financial sector, defence, aerospace, and research institutes. The names of some of the customers were Indian Space Research Organisation (ISRO), Aeronautical Development Agency, National Academy of Agricultural Research Management and S.V. National Institute of Technology.

## PRODUCTS AND SERVICES

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Optotech marketed two major products of Neuro Dimension Inc. These were: Neuro Solutions and Trading Solutions.

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Amit Kumar and Amit Shirke, students of SBS-ABA-MBA programme of Alliance Business Academy, Bangalore, for class discussion.

**NeuroSolutions** It was a software product that was used for solving data modelling problems, such as prediction, classification, function approximation, and data mining. The software, costing ₹ 63,000 plus value added tax (VAT), shipping and handling charges, had state-of-the art neural network technology. NeuroSolutions for Excel was another form used with a Microsoft Excel, costing ₹ 1,02,000 plus VAT, shipping and handling charges. The advantages of NeuroSolutions were flexibility, genetic optimisation, and probing tools as integral part of the software package.

**Trading Solutions** It was a software package that helped to make better trading decisions in stock markets. The software, costing ₹ 7,50,000 plus VAT, shipping and handling charges, combined traditional technical analysis with state-of-the art artificial intelligence technologies. Trading Solutions' user-friendly interface and flexibility allowed the user to create effective models in a volatile stock market, and perform complex financial forecasting.

In addition to the above products, Optotech marketed the following services:

- Application software development.
- Embedded product prototyping, product design, and development.
- Neural networks and knowledge based systems.
- Image processing, pattern recognition and machine vision.
- Mathematical modelling and simulation.
- Application security, identity, and access management solutions.

## MARKETING RESEARCH

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As said earlier, despite having good products and services, Arvind Kumar wondered why the sales had not increased to expected levels, during the year 2004–05. He thought marketing research would help in identifying the reasons for the same. The major findings of the marketing research, which was carried out subsequently, were as follows:

Only 100 (or 20 per cent) out of 500 respondents (consisting of existing and potential customers) were aware about the company, and its products and services. Out of these 100 respondents, only 30 respondents had favourable perceptions about the company and its products/services. Only 10 respondents (out of 30) had purchased the company's products/services. Therefore, only 2 per cent of the total sample size of 500 had purchased the company's products and services.

Based on the marketing research findings, Arvind Kumar took a decision to increase substantially the awareness level as well as favourable attitude of potential customers towards the company's products and services, through an effective promotional/communication programme.

## EFFECTIVE COMMUNICATION PROGRAMME

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In order to generate ideas for developing an effective communication programme, Arvind Kumar called a meeting of sales, marketing, and technical persons. The discussions were mainly on selection of media. Some of the ideas were on the use of the following promotional tools: advertisements, seminars, direct marketing, personal selling, public relation, and sales promotion. The criteria used for selecting the appropriate promotional media were cost-effectiveness, technical nature of the company's products and services, and achievement of communication objectives. After a lot of discussion, it was decided

to focus on conducting a seminar for target market segments. Other aspects of effective communication programme, that is, identifying target audience, determining promotional budget, developing the message strategy, and integrating the promotional programme were not specifically discussed in the meeting.

### **Seminar**

A group of sales people worked out the details of the seminar plan, which included identifying the target audience, determining the dates and duration of the seminar, preparing brochures containing information about the company's products and services, contents of the seminar, and so on. Invitations were sent for the seminar on "Artificial Neural Networks and Applications" to be held on 4<sup>th</sup> and 5<sup>th</sup> February 2006 to business organisations and technical/research institutions. 35 out of 65 participants were from business organisations like Computer Associates and Genpact, representing industries from embedded systems to financial forecasting. Balance 30 participants were from technical and research institutes, such as Indian Institute of Technologies (IITs) and Regional Engineering Colleges (RECs).

On the first day of the seminar, professors from the Indian Institute of Science (IISc) and Siddaganga Institute of Technology (SIT) delivered lectures on the basic and theoretical aspects of neural network technology. Thereafter, the technical team of Optotech Systems demonstrated the company's products. On the second day, problem-solving operations (algorithms) and applications like image processing and control were discussed. These interactive sessions generated a lot of interest, and the participants enjoyed the learning experience. In addition, NeuroDimension Inc. arranged a web conference from U.S.A. The seminar generated increased awareness and positive perceptions about the company's products and services. Some of the findings of the seminar were as follows:

- The current customers were satisfied with the company's products and services and were willing to give repeat business.
- Optotech Systems should focus on certain target segments like financial sector, defence, aerospace, and research institutes.
- Stock markets (financial sector) and research institutes (in agricultural sector) were specific target markets that should be contacted by the company for direct usage of its software products.
- General perceptions of Optotech System's products and services were high quality and high price.

After the seminar, the company implemented some of the action areas of the seminar.

### **Questions**

1. How effective was the overall approach of the company in solving its sales related problem?
2. Comment on the communication programme of the company.
3. How was the seminar conducted? If you are asked to conduct another seminar, how would you plan it?

# 13

## Case

# BT Technologies\*

In July 2006, Pradeep Gupta, Asst. General Manager-Exports of BT Technologies (BTT) Ltd., was studying the RFQ (Request for Quotation) received from a high sales potential, prospective international customer in Europe. The quotation was required for hydraulic gear pumps used in the manufacture of machine tools. Before submitting the offer, Pradeep had a brief telephonic interaction with the prospect, when he understood that the prospective customer was seriously considering the possibility of changing the existing sole supplier of hydraulic gear pumps. The reasons were unsatisfactory after-sales-service and non-co-operative attitude of the current supplier. However, Pradeep found that the landed cost of BTT's Indian product at the prospect's factory was higher by about 4 per cent, compared with the present European manufacturer's product, mainly due to cost of freight and import duty.

## COMPANY BACKGROUND

BT Technologies Ltd., a private sector Indian company, produced highly engineered products, for the following applications:

- Automotive Sector
- Aerospace Sector
- Agricultural Equipment Industry
- Construction Equipment Industry

The company had four strategic business units (SBUs), as mentioned hereunder:

**BT Hydraulics** This SBU manufactured largest number of hydraulic gear pumps in Asia and one of the top five worldwide. It also produced hydraulic valves and custom-made hydraulic products and offered solutions.

**BT Metal** The SBU made use of the latest metallurgical technologies to produce high quality non-ferrous alloy castings for industrial, automotive, and aerospace applications.

**BT Power** The SBU was a world-class design centre for product and system designs in structural, thermal, and dynamic engineering for analysis, validation, and optimisation.

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\* This case is prepared by Prof. Krishna K. Havaladar, based on the case data provided by Ms. Swetha V.C., Ms. Sayantani Gupta, and Mr. Varun Kumar, Students of SBS-ABA-MBA programme of Alliance Business Academy, Bangalore, for class discussion.

**BT Aerospace** Produced airframe structures and precision components for aircrafts, including India's Pilotless Target Aircraft and Sukhoi Fighter-Bomber.

Over 85 per cent of all agricultural tractors and construction equipment produced in India were powered by BT hydraulics. The Nation's borders were secured by products and technologies developed by BT Technologies Ltd.

## RESEARCH AND DEVELOPMENT (R&D)

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The company had transformed itself into a knowledge-based organisation through its sustained R&D efforts. BTT was awarded the status of "Recognised in-house R&D unit" by Government of India in 2001. The Company created new products and services, with the efforts of R&D, for many internationally reputed customers like General Electric, Volvo Renault and John Deere, as well as for critical national establishments such as the Indian Air force.

## MARKETING STRATEGY FOR INTERNATIONAL MARKETS

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BTT had a long-term objective of becoming the largest manufacturer of Hydraulic Gear Pump in the world by the year 2010. In order to achieve this objective, the company had developed the following strategies.

To focus on target market segments of agricultural sector (particularly the three large tractor manufacturers) and industrial sector with machine tool applications. The product strategy consisted of designing the product as per the customer's specific application and specifications or standards. High quality of the product was ensured with ISO: 9001:2000 quality certification.

The pricing strategy was to offer competitive prices to customers and to position Hydraulic Gear Pump as superior quality product at reasonable price. Effective after-sales-service was made possible with marketing tie-ups with internationally located distributors like ATOS spa, Italy. The company did not carry out any promotional activities for international markets, which contributed 15 per cent of its total sales. Pradeep felt that word-of-mouth communication from the existing satisfied customers was adequate to get new business. "After all, international customers want a good quality product, at reasonable cost, delivered at the required time, and with adequate technical support" said Pradeep, who was responsible for developing export sales for the past few years for BTT.

## REQUIREMENTS OF AN INTERNATIONAL PROSPECT

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The high sales potential European prospect, as said earlier, wanted to replace the current sole supplier mainly because of the arrogant behaviour and poor after-sales-service of the supplier. Pradeep knew that his competitors were Europe based companies, who had a cost advantage of about 10 per cent on freight charges and also a saving of 4 per cent import duty. Although the ex-works price of BTT for a Hydraulic Gear Pump was about 10 per cent lower than that of the European Competitors, the higher costs of freight and import duty, resulted in higher landed cost at the prospective customer's factory in Europe.

On product quality, on-time delivery, and technical support Pradeep was confident to be equal to or better than the European competitors. BTT had a strong distributor in Europe to give an excellent

technical service as well stocking and delivery support, as required by the prospect. “Most domestic and international customers consider our product quality equal to or superior than competitors” said Pradeep to the European prospect. However, the biggest problem was the freight cost and import duty, which made BTT product’s landed cost higher by about 4 per cent. Pradeep decided to call a meeting of the product development team to consider further reduction in cost, so that BTT would be better placed in getting the business from this prospective customer.

***Questions***

1. Was the marketing strategy for the international markets effective?
2. What should Pradeep do to get the business from the European prospective customer?



# 14

## Case

# Nammura Hotel Ltd\*

Krishna Hegde, CEO of Nammura Hotel Ltd., was happy with the progress made by the hotel in five years from February 2002, when he started it in a small way with only three people in Bangalore. In September 2007, the hotel had over 1000 employees, ₹ 400 million revenue, a unique system of centralised food production and delivery, and catering to the needs of over 30 multi-national companies. The focus of Nammura Hotel was on the corporate customers, which accounted for 80 per cent of the revenue. Some of the major issues that needed Krishna Hegde's attention were how to retain the employees and the corporate clients.

## THE BACKGROUND

Before starting Nammura Hotel, Krishna Hegde had spent 18 years of his life in several five star hotels in various countries. "I worked very hard to save money for my own hotel. I worked, many times, continuously for two shifts, to earn more money and get experience of different functions" said Krishna Hegde. He had started the hotel in February 2002 with limited financial resources, as he came from not a well-to-do family.

Nammura hotel's business strategy was to provide quality food of international standards to local customers at reasonable prices. The innovative and unique system followed by Nammura Hotel was the centralised food production and delivery system that was meeting the needs of different market segments. Using the database of the past five years, the wastage of food was brought down to one per cent in 2007.

## SEGMENTING AND TARGETING

The various market segments targeted by the hotel were: counter sale, wholesale, home delivery, banquet, and corporate service.

**Counter sale** This was introduced to minimise wastage due to excess food which remained after providing food for business customers. The excess food was sold across the counter to individuals who wanted good food at affordable cost. The pricing policy for counter sales to individual customers was cost plus three per cent, since the hotel did not incur any extra cost and the business strategy of the hotel was to provide quality food at reasonable price.

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Krishna Joshi, Jyothi Hegde, Leena, and Mahesh Kodagi, MBA students of Alliance Business Academy, Bangalore.

**Wholesale** This segment was catering to the needs of small entrepreneurs who made money by buying quality food from Nammura Hotel at low cost and reselling the same to individuals as well as business clients. The response from small business persons was good.

**Home delivery** The needs of the household consumers were fulfilled by the hotel by providing home delivery service. This service helped to generate a favourable word of mouth communication for the hotel.

**Banquet** This market segment satisfied the needs of providing meals for many people during meetings and functions conducted by various organisations. Some of the major projects executed successfully were ‘LIC National Meet’ by serving 10,000 meals per day and ‘Bangalore Habba’ by providing lunch and dinner for 25,000 people per day.

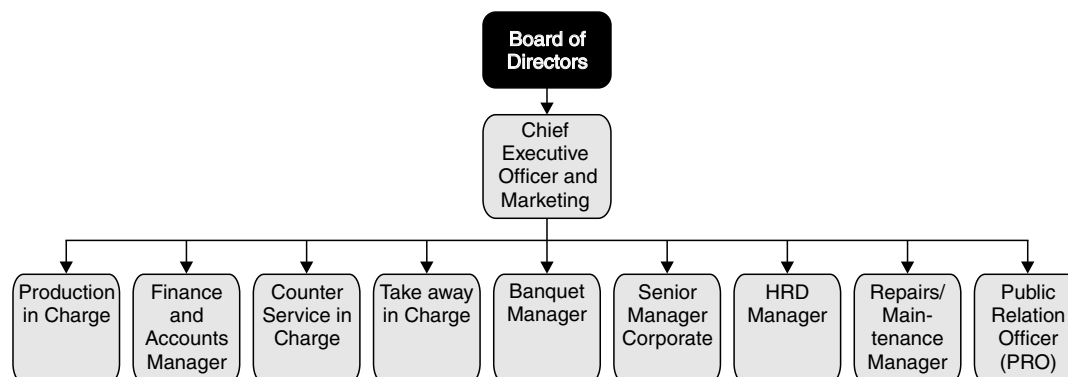
**Corporate Service** This was a major segment, generating about 80 per cent of the total revenue. It included about 30 business organisations, mainly the multinational companies (MNCs) from software, BPO, textile, and engineering industries. These MNCs needed hygienic and nutritious food. Nammura hotel responded to the corporate needs by creating a separate “corporate kitchen” under the brand name “Right Caterers” to meet HACCP (Hazard Analysis Critical Control Point) standards of NASA, USA. This gave the hotel a competitive advantage, as none of the competitors could establish these standards. “That is the reason we could substantially increase number of corporate clients from 10 to 30 in one year” added Krishna Hegde with a smile on his face.

Typically these customer organisations would have monthly review meetings to discuss and finalise the menu, food specifications and prices for the month. Krishna Hegde himself managed the relationships with the 30 MNCs, as the hotel did not have a marketing department. When asked the reason, he said, “they were not effective.”

## ORGANISATION STRUCTURE

Nammura hotel’s organisation chart was as shown below in Exhibit 1.

**Exhibit 1** Organisation Chart—Nammura Hotel



The person in charge of production was responsible for corporate services as well as other services like individual customer services. North and South Indian cooks reported to him, along with various sections like chapathi, grinder, thandoori, chats and salads. As mentioned earlier, marketing function was handled directly by the chief executive officer (CEO), Mr Krishna Hegde, with public relations officer (PRO) reporting to him. Purchase and stores departments reported to the manager finance and accounts. Interestingly, HACCP (Hazard Analysis Critical Control Point) manager and administration executive were reporting to HRD manager. All kinds of repairs and maintenance, like electrical and civil, came under repairs/maintenance manager. Food and beverage service staff reported to corporate supervisors, who reported to corporate unit managers, who in turn were reporting to the senior manager—corporate. The maximum hierarchical levels were six in the organisation structure, although the Exhibit 1 shows only two levels. “Decisions were taken in the department heads committee meeting everyday” said Mr. Hegde, suggesting a joint decision making process followed by the firm.

## COMPETITION

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There was no direct competition to Nammura hotel, considering its unique format of centralised food production and delivery system. However, other caterers did compete with Nammura Hotel’s “Right Caterers”, who had a clear advantage due to setting up of high quality standards in its “Corporate Kitchen”, for getting catering contracts from corporate clients.

In order to sustain the competitive advantage, the hotel focused on innovations like ‘corporate kitchen’ and ‘kitchen on wheels’ and training employees at all the levels. It also ensured consistency of quality and taste. No synthetic colours and additives as well as harmful chemicals were used.

## RETAINING EMPLOYEES AND CUSTOMERS

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“Nammura hotel offers free food, shelter, and medical service to its employees. It has also started offering stock options and loans without interest to its employees. Despite these measures some employees leave us, because competing hotels offer more salary”, said Krishna Hegde, showing some kind of concern on his face. “As far as corporate customers are concerned, I deal with them myself, but it is difficult to find time to meet them often,” added the CEO of Nummura hotel. The hotel did not spend on promotions, but existing satisfied customers’ word of mouth communication helped in getting new customers. In addition, the radio and T.V. programmes on cooking conducted by Krishna Hegde gave a good publicity for the hotel.

As the hotel was considering further expansion and diversification of business into lodging and restaurant, it was important to retain the existing employees and customers. Krishna Hedge was seriously thinking on further steps to be taken to resolve these issues.

### Questions

1. What are your views on the segmenting and targeting strategy of Nammura Hotel?
2. If you were the consultant, what strategy and actions would you suggest to retain the existing employees and corporate clients?

# 15

## Case

# TNM Systems, Inc\*

Ravi Kumar, CEO of TNM Systems, was anxious to establish its new software product in the US market. The company was incorporated in Texas, USA, in September 2006.

## THE COMPANY

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TNM Systems was relatively new company, founded by three well qualified and experienced professionals. Ravi Kumar, the CEO of the company was a qualified software engineer with over 20 years of experience in the telecom industry. T.S. Venkateswaran, the CTO (Chief Technology Officer), was also a qualified engineer and had 18 years of experience in telecom and network management industry. Murli Bhasin, Head-Sales and Marketing, was an MBA and had over 22 years of experience in sales, quality, customer support and training.

## THE NEW PRODUCT

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The company founders identified a specific need for a customised product for telecommunication service providers to monitor, manage and measure network operations. The company developed a new product by name TelNet, which was a high-performance NGOSS (Next Generation Operational Support System). It was designed to solve the problems of telecommunication service providers. This unique and simple GUI (Graphical User Interface) based service assurance platform provided integrated, intelligent, end-to-end solutions that could monitor and manage network operations worldwide. In addition to standard functions offered by all OSS (Operational Support Systems), TelNet presented some revolutionary features, as shown in Exhibit 1.

### **Exhibit 1:** Revolutionary Features of TelNet.

- Consolidating and monitoring multiple networks onto one cohesive system
- Proactively detecting problems and implementing solutions
- Reducing operational expenses
- Presenting an accurate view of the network
- Integrating into existing telecom infrastructure

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Prabhu S.P. and Priyanka Paul, SBS-MBA-MBA students of Alliance Business Academy, Bangalore.

## SALES AND MARKETING EFFORTS

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The company was doing business to business (B2B) marketing. Murli Bhasin and his team identified prospective customers based on their previous company contacts and also other databases. The prospective customers were first contacted over telephone to understand their needs and the level of interest. The qualified prospects were given a demo (i.e. demonstration) of the new product over the internet. If the prospective customers were satisfied with the product demo, they were given a free laboratory trial of the product for a period of one week. To meet the specific needs of the prospect, certain modifications were carried out to customise the product. After this, a formal quotation was given, negotiations were held, and the sales closing was done.

TNM Systems initially targeted telecom service providers in the US and Europe. Many telecom service providers in USA and Europe had shown interest in the company's new product. Both Ravi and Murli had visited Europe to introduce the new product to various telecom service providers. More specifically TNM Systems had focused on two prospective customers each from the US and UK. The company had planned to launch its product in India after establishing its brand name in the US and UK markets.

## COMPETITION

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The company faced severe competition from major IT firms like IBM and HP and also from other smaller companies like BMC Software. These companies had established their products in the market. However, TNM Systems was yet to get its first customer order as on September 2007. IBM, which offered standardised products to its customers, was the market leader. TNM Systems offered customised product to meet the needs of the prospective customers. IBM, **for example**, after selling its standardised product to its customers, released various versions at regular intervals to meet the needs of various customers.

Ravi Kumar was thinking how to establish its new product in competition with the recognised products of its competitors. He discussed this matter with the other co-founders, Venkateswaran and Murli Bhasin, and wondered if the company should do something more to acquire customers.

### Questions

1. What are your views on the company's approach towards launching of the new product?
2. If you were the consultant to this company, what would you have advised and why?

# 16

## Case

# NM Technologies Ltd\*

Deepak Mittal, Chief Executive Officer (CEO) of NM Technologies was wondering how to solve the problems of making the sales team more effective and improving the conversion ratio. He thought the conversion ratio of 50 per cent was not good enough.

## ABOUT THE COMPANY

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NM Technologies was one of the leading information technology (IT) services company in India. The company employed 40,000 software professionals in about 25 offices worldwide. The key industry segments (also called verticals) served by the company included the following:

Engineering, healthcare, financial services, manufacturing, retail, telecom, travel and leisure, media and entertainment, transportation, aviation, utilities and energy.

The company was growing above the industry growth rate of 35 per cent per year over the past few years. The strength of the company, Deepak felt, was in identifying and responding to the changing marketing environment.

The competition in IT services, solutions and consulting was intense with major multinational companies (MNCs) like IBM and Accenture, and 16 to 17 other local players.

## BUYING BEHAVIOUR

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The factors which influenced the buying decisions of most of the business organisations wanting to place orders for IT and consulting services were:

- Cost
- Quality
- Reputation

Many business buyers placed repeat orders on the existing IT service providers, indicating their satisfaction, by negotiating certain proposals for new services.

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\* This case was prepared by Prof. Krishna K. Havaladar, based on the case data provided by Chethan N.S., Deepa Raman, Gayatri and Chinthan R., MBA students of Alliance Business Academy, Bangalore.

## CUSTOMER RELATIONSHIP

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NM Technologies had a strategy of maintaining business relationships with prospective and existing customers (or accounts) depending on the size of business. If the size of business is small from a new account, then such a customer would be handled by any junior salesperson. Difficult customers, whom the company would not like to retain, were looked after by sales executives, who were also responsible for account opening (i.e. converting a prospective customer to a new customer). The important accounts, whom the company wanted to retain, were handled by senior sales managers, who were also responsible for account opening. The company directors were given the responsibility to oversee a set of very important accounts.

The company had 80 per cent of the business revenue from the retained accounts, which was a repeat business. Balance 20 per cent of the sales revenue was received from new accounts. Cross-selling (i.e. selling a new service to customers who buy an existing service) was generally adopted for the existing retained accounts.

## EFFECTIVENESS OF SALES TEAM

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Deepak Mittal was concerned about the effectiveness of the salespeople. Salespeople were organised geographically. One salesperson was placed in each geographic region, looking after all the verticals or key industry segments described earlier.

The other issue that was worrying the CEO was the low conversion ratio of prospects to new accounts. He thought that the ratio should go up from 50 per cent to minimum 70 per cent, considering the company's low cost, good quality and reputation. He wondered if the managers were adequately focused on the efforts required for opening new accounts, as they were also responsible for retaining the existing accounts.

### **Questions**

1. What should Deepak Mittal do to improve the effectiveness of salespeople and the conversion ratio?
2. What further steps should the company take to improve customer relationship?

# Glossary

**Acceleration effect** This term is used when the demand for an industrial product increases or decreases more than the demand for consumer products.

**Arbitration** Use of an independent, third party person, called arbitrator, who is legally appointed to settle a dispute between two parties. The decision of the arbitrator is final and legally binding.

**Auctions** There are three major type of auctions: English auctions have one seller and many buyers. An item offered by a seller goes to the buyer who makes the highest price bid. The other type of auction, called Dutch or reverse auction, is reverse of English auction. It has one buyer and many suppliers, with the order going to a company that makes lowest price bid. The third type is sealed-bid auction.

**Balanced scorecard** It is a framework that translates a company's mission and strategy into a set of performance measurements.

**Basic Customer Service** It is a service that accompanies a core product or service and is provided free of charge by a supplier to a customer.

**Bivariate analysis** Bivariate analysis involves the analysis of the relationship between two variables only. Some of the techniques of bivariate analysis include scatterplot diagrams, correlation, and regression.

**Brand** A brand identifies the seller. It is defined as a name, symbol, term, sign, design, or a combination of them, intended to identify the goods or services of one seller and differentiate them from those of competitors.

**Brand equity** It is the added value of a brand. Brand equity results in customers showing a preference for one product over another when they are fundamentally similar.

**Brand hierarchy** It is a part of the brand strategy in which a company decides which of the following four levels or options it should aim at: (1) corporate brand, (2) family brand, (3) individual (product) brand, or (4) a combination of the above.

**Branding** It is the process of creating a unique identity for a product. It transforms a product into a brand. It endows a product or service with the power of a brand.

**Break-even volume** It is the sales quantity at which there is nil profit. The break-even analysis is used in the pricing decisions to determine the level of sales to cover all relevant costs.

**Bring-your-own-device (BYOD)** Personal smart phones and tables used in the work places made adaptable for B2B services.



**Bull-whip effect** In this, fluctuations in orders increase as they move up the supply chain from dealers/retailers to distributors to manufacturers to suppliers.

**Business market customers** Organisations or firms buying raw materials, components, plant and equipment, and services, for consumption, use, or resale.

**Business marketing** Marketing of products and services to business organisations, such as commercial organisations, government undertakings, and institutions (like hospitals and colleges).

**Business-to-Business (B2B)** In B2B, the transactions happen between two business organisations. For example, transactions between FedEx and Cisco.

**Business-to-Consumers (B2C)** In Business-to-Consumers (B2C), transactions are conducted electronically between companies and consumers over the Internet. For instant, customers purchasing books from Amazon.com.

**Buyclasses** These are the type of buying situations, i.e. new task, modified rebuy and straight rebuy.

**Buygrid framework/model** It combines buying situations (i.e. buyclasses) with eight phases (or stages) of buying decision process (i.e. buyphases) for better understanding of organisational buying process.

**Buying centre or Decision making unit (DMU)** It includes individuals and groups who participate in the buying decision, and share common objectives and risks.

**Buying orientation** This is one of the purchasing orientations or concepts adopted by business buying firms. The purchasing firm, in this orientation, has a short-term focus and follows the practices of buying from the lowest price supplier, gaining power over the suppliers, and avoiding risks in buying.

**Buyphases** Organisational buying process consisting of eight sequential activities or phases, called buyphases, starting with problem recognition and ending with performance feedback and evaluation.

**Channel positioning** It is the process of establishing and sustaining the manufacturer's (or supplier's) reputation of delivering superior value among targeted intermediaries (or resellers).

**Closed/Sealed tender/bidding** Often government units follow closed or sealed tender or bidding process, which includes invitation to potential suppliers (typically through newspaper advertisements of tender notices) to submit written, sealed bids for supply of specified products, by particular date and time. All bids are thereafter opened, in the presence of representatives of the suppliers, and then the prices are read out. Orders are placed on the lowest price bidder, if the bidder meets with the product specifications and the delivery requirements.

**Cloud computing** The cloud computing is a technology that uses the Internet and central remote servers to maintain business data and applications. It allows consumers and businesses to use applications without installation and access their personal files at any computer with Internet access. This technology allows for much more efficient computing by centralized data storage and processing.

**Cluster analysis** Cluster analysis is a multivariate statistical technique which is used to identify similarity in perception or behaviour. It involves the grouping together of units which have similar responses on a set of variables. The clusters so obtained can then be analysed to identify behavioural profiles. In particular, cluster analysis is a common technique used in customer profiling.

**Cobranding/dual branding** When two or more well-known brands are combined in a product or a service, it is called cobranding or dual branding. For instance, IBM personal computers using Intel processors.

**Collaborative/Partnering relationship** The objectives of collaborative or partnering relationship between a customer firm and a supplier firm are to deliver superior value to the customer's customers and to have a long-term mutually beneficial relationship. These objectives are achieved by working together through joint problem solving teams to find creative solutions. This relationship is based on commitment and trust. It is a kind of strategic alliance, with agreements between selected suppliers, customers, and intermediaries.

**Collaborative Commerce (c-Commerce)** Business partners collaborate along the supply chain electronically.

**Commercial enterprises** Profit seeking companies like distributors, original equipment manufacturers, and users.

**Commission merchants** These intermediaries deal with bulk commodities like iron ore and coal. They have a short-term representation of suppliers for arranging inspection, negotiating prices, and closing the sale. They are paid commission by manufacturers or suppliers for the services provided.

**Company's sales forecast** It is calculated by multiplying the market potential by the company's estimated market share. It is also referred to as 'company's current demand,' or 'current organisational demand'.

**Competitive advantage** It is analysed from competitors' or customers' point of view. A competitors-oriented analysis compares the company's capabilities and product/service offerings with those of competitors. A customer-based analysis of competitive advantage focuses on customer benefits or needs, and how can the company offer superior value to customers in relation to competitors. A Competitive advantage can be sustained through continuous improvement. In short, competitive advantage provides superior value when compared to other suppliers' offerings.

**Competitive forces** Profit performance of an industry is impacted by five competitive forces—viz. rivalry among existing firms, threat of new entrants, threat of substitute products, bargaining power of suppliers and bargaining power of buyers.

**Concentrated marketing strategy** It means focusing all marketing effort on a single, carefully defined segment.

**Conjoint analysis** Conjoint analysis is a multivariate statistical technique which is used to determine the contribution of each attribute of a product to the total utility/satisfaction of the product. It uses the preference rankings of a set of products with different combinations of attributes to do this. It is especially used to determine which combination of attributes is most preferred (for better product design).

**Consultative selling method** Consultative salespeople or sales teams understand and analyse in-depth the customer's problems or needs, and use the resources and functions within or outside the organisation to solve the customer's problem. These salespeople create value for their customers.

**Consumer marketing** Marketing of goods and services to household consumers and individuals.

**Consumers-to-Consumers (C2C)** A consumer sells a product or service to other consumer electronically or a consumer exchanges a product with another consumer. For example, consumers auctioning in eBay.com.

**Co-operative societies** These are cooperative organisations which are owned and managed by an association of persons, who are members, with profits or benefits shared among them. Examples are cooperative sugar mills, cooperative banks.

**Core competence** A combination of most important skills and knowledge to do something successfully. C.K. Prahalad and Hamel have defined it as “a complex harmonisation of individual technologies and production skills”.

**Correlation** Correlation is a measure of the strength or degree of relatedness of two variables. The simplest form of correlation is linear correlation, as measured by Pearson’s product-moment coefficient of correlation, which measures how closely-linearly-related two variables are.

**Cross-elasticity of demand** Responsiveness of the sales (or demand) of one product to a price change in another product. For instance, demand for aluminium is related to the prices of wood and steel which are substitutes for aluminium door and window frames.

**Culture** A set of common beliefs and shared values, customs, language, music and art valued by a group of people. A consumer’s culture influences his buying decisions.

**Customer interaction management (CIM)** It is software that helps to collect and manage information to measure and optimise customer experience about after-sales efforts of a company.

**Customer lifetime value** It is an estimate of the net present value of the total current and future revenues from a customer less the cost of acquiring and serving the customer.

**Customer relationship management (CRM)** CRM is not only getting a software, but also developing customer strategy, business processes, and customer-oriented culture of the employees of the firm, for the purpose of improving the customer loyalty and corporate profitability. The CRM system integrates sales, marketing, and customer service functions and gives to all customer interacting persons and departments access to share customer data in real time.

**Customer service** It accompanies the core offering and includes basic and supplementary services.

**Customer value proposition** Difference between the benefits and costs of an offer (or proposition) made by a supplier to its target customer. It should answer the question: “why should the target customer buy from the company rather than its competitors?”

**Demand analysis** Demand analysis analyses the extent to which demand for a product is influenced by the price. The demand for industrial products are mostly inelastic and hence it is relatively less sensitive to price.

**Demand chain management** It is a broader view, which states that a company should first think of the demand of the target market and then design the supply chain backward from that point.

**Derived demand** Demand for industrial products and services are derived from ultimate demand for consumer products and services. Industrial demand is, therefore, called derived demand. For example demand for steel is derived from (or originated from) demand for cars, refrigerators, washing machines, and so on, where steel is used.

**Descriptive measures** Descriptive measures are statistical measures that describe certain characteristics of frequency distributions. **Measures of central tendency** (such as the mean, the median, and the mode) are descriptive measures that identify the average or representative value of the variable, around which the distribution seems to cluster. **Measures of dispersion** (such as the standard deviation, the quartile deviation, and the mean deviation) are measures of the spread in the data around the central values. **Measures of skewness** (such as the moment coefficient of skewness, Bowley's coefficient of skewness, and Pearson's coefficient of skewness) measure the asymmetry in the distribution around the central values. Finally, **measures of kurtosis** (such as the moment coefficient of kurtosis) measure the flatness/peakedness of the distribution around the central values.

**Differentiated marketing strategy** In this strategy, a firm decides to serve two or more segments with different or distinctive marketing strategies, avoiding other segments. The objective is to achieve higher sales volume and a stronger position in the chosen market segments.

**Diplomacy** The skill and tact used to resolve conflicts through discussion between representatives of two parties.

**Direct channel** When the manufacturer performs all the sales and distribution functions (or activities) to create sales and deliver products to the customer, it is called direct channel structure, which does not use intermediaries. Examples are the manufacturer's sales force and direct marketing channels like the internet, telemarketing, and direct mail.

**Direct marketing** Direct marketing uses direct channels to reach and deliver goods and services to customers without using intermediaries. These channels include direct mail, telemarketing, the internet (or websites), catalogs, kiosks, interactive TV, and mobile devices.

**Discriminant analysis** Discriminant analysis is a multivariate statistical technique which is used to identify the set of variables that maximally distinguish between two or more classes of units. For example, in order to identify critical performance parameters in the operation of systems, one would take performance measurements of systems that are operating well, as well of systems that are not operating well; discriminant analysis would be able to identify the performance parameters that distinguish these two classes, which would be interpreted as the critical performance parameters.

**Distribution channels** Also called marketing channels, sales channels, or trade channels, these are sets of interdependent organisations that make products or services available to customers for use or consumption.

**Distribution-fitting** Distribution-fitting is a set of statistical methods that involves identifying the probability distribution and the generation process of a given random phenomenon. This is done by comparing the distribution of sample data from the random process with the distribution of values as expected from the model.

**Diversification strategy** It is a growth strategy by which an organisation aims to serve new markets with new products that are related to the organisation's business strengths or core competencies.

**Domain name** A domain name identifies a website on the internet including the server that handles web browser requests the specific organisation associated with the domain name, and the general category in which the organisation operates. For instance, [www.allianceacademy.org](http://www.allianceacademy.org)

**Dumping** Selling products in an overseas market below the cost in the domestic market.

**Dutch auction** Also called descending bids or *reverse auction*, it involves one buyer who invites bids from several interested suppliers. The order goes to the supplier who makes the lowest price bid.

**e-Channel** Electronic channel (or e-channel) is a part of direct marketing channel and is also known as the internet. It can be used to provide information, online buying/selling, and relationship building.

**e-Commerce** e-Commerce is buying and selling of products and services by businesses and consumers through an electronic medium, particularly using the Internet. It also enables intra- or inter-organisational activities that facilitate the exchange of products and services.

e-Commerce uses the digital technology for trading and transmitting information between individuals and organisations as well as B2B.

**Economies of scale** Reduction of costs per unit due to large scale (or size) of production or operation, resulting from large capital investment in equipment and facilities.

**Efficiency control** It examines whether the resources are used efficiently in each element of marketing strategy, if the firm fails to achieve its yearly goals or targets. For instance, it examines advertising effectiveness of each media used by the firm, contribution of product items, and discount structure in the pricing policy.

**EFT (Electronic Fund Transfer)** Electronic fund transfer (EFT) is an application that electronically routes the funds, debits, credits, charges and payments between the banks and customers using telecommunication networks.

**e-Governance (or E-Government)** The use of electronic commerce to deliver information and public services to citizens, business partners and other organisations.

**Electronic catalogue** It is vendor's catalogue containing the details and specifications of all the products and services offered in the Internet (E-Commerce website).

**Electronic Data Interchange (EDI)** EDI is the communication between the applications running in two or more number of computers. It communicates specially formatted standard business information like purchase orders, bills, invoices, approvals of credit, shipping notices and confirmation between the computer system of companies, banks, government agencies and logistic companies.

**English auction** Also called forward auction or ascending bid, in this auction there is one seller and many buyers. The seller offers an item for sale to interested buyers. The item goes to the buyer who makes the highest price bid.

**e-Procurement** E-Procurement (also known as Electronic-procurement) is a way of using the Internet to make it easier, faster, and less expensive to purchase the goods and services the organisations require.

**Estimation** Estimation is a set of statistical methods that involves identifying sample statistics which are to be used as **estimators** of the population parameters. Often, rather than using point estimators, which provide a single-value estimate for a parameter, an interval estimator may be preferred. An interval estimator is a range within which the population parameter lies with certain special properties—for example, a **confidence interval** is an interval estimator of a parameter, with the property that the true value of the population parameter lies in the interval with a pre-determined probability.

**Exchange** It is a market place where many sellers and buyers gather to do the business. It is also referred as e-market place, e-hub or portal.

**Exclusive distribution** In this strategy, the manufacturer decides to have a very few intermediaries, in order to ensure superior sales and service efforts. It includes exclusive arrangements in which the intermediaries do not carry competing products. Examples are from automobiles and appliances industries.

**Ex-factory pricing** It is a part of geographical pricing, in which the freight and transit insurance costs are to the buyer's account, or that the prices are those prevailing at the seller's factory gate.

**Extranet** It is a secure network that links the business partners and Intranets over the Internet by providing access to areas of each other's corporate Intranets.

**F.O.R. destination pricing** It is a part of geographical pricing, in which the seller's quoted prices includes the freight (or transportation) costs up to the buyer's destination. F.O.R. destination means free on road up to destination.

**Factor analysis** Factor analysis is a multivariate statistical technique which is used to identify factors from a given set of variables. These factors are obtained by combining highly correlated sets of variables, and are interpreted as the underlying dimensions of the phenomenon in question. For example, the five dimensions of service quality arise as factors from the overall set of variables that look at different aspects of services quality.

**Financial leases** These are long-term contracts or agreements between a buyer and a seller, non-cancellable, and are fully amortised.

**Flexible pricing** It means adjusting the prices or profitability for certain products and services, when the firm faces dynamic marketing environment, including demand slow-down, extreme competition, and high inflation.

**Focus group** It is a method of collecting primary data from a small group of people who are invited to discuss a specific issue or topic, under the direction of a professional moderator.

**Force Majeure** A clause used in most contracts, absolving the supplier of liability/penalty due to acts beyond ones control like acts of nature, natural disasters, etc.

**Forecasting** Forecasting is the process of studying past and present data to estimate/predict/project future values of variables of interest. In particular, demand forecasting and sales forecasting are important as starting points for the entire planning process.

**Formula method** It is based on the stimulus response thinking, and is also called as formulated approach or mental states selling. The salesperson, in this method of sales presentation, assumes that most customers can be led through mental states of the buying process, which uses a well-known formula: attention, interest, desire, and action (AIDA).

**Forward auction** Also called 'English auction', it involves one seller who offers an item for sale to many interested buyers and the sale goes to the buyer making the highest bid.

**Franchising** A form of licence where the user (franchisee) uses the name and other aspects of the business of the franchisor to provide products or services as in hotels, restaurants, and other industries.

**Frequency distribution** A frequency distribution expresses the pattern of variation of a variable in a population or a sample, associating with each value or range of values of the variable the frequency with which it occurs in the data. The frequency distribution of a variable can be represented in tabular form as a frequency table, or in diagrammatic or graphical form, depending upon the nature of the variable.

**Gatekeepers** They are the individuals (e.g. purchase officers) who control the flow of information to, or salespersons' meetings with, members of buying centre.

**Geographical pricing** It means how to price the company's product to customers who are located in different geographic areas. For this, a company has two options: (1) ex-factory pricing, or (2) f.o.r. destination pricing.

**Hard and soft benefits** Benefits sought by customers are of two types: (1) hard (or tangible), (2) soft (or intangible). Hard benefits include product quality, product feature or design, production rate of a machine, or performance, which are tangible. Soft benefits consist of company reputation, customer service, warranty period, customer training, timely delivery, and payment terms.

**Hierarchy of effects** It is the individual buyer's mental stages or process of buying. There are a number of models which describe the buyer's mental stages from awareness to buying action.

**High-tech products and marketing** Major characteristics of high-technology (i.e. high-tech) products are high technological uncertainty and high-market uncertainty. It covers products from various industries, such as telecommunications, computers, software, consumer electronics, and biotech. Marketing of high-tech products is called high-tech marketing.

**Hybrid/Multi-channel/Mixed system** Hybrid channel system (or multi-channel/mixed system) includes a channel structure that is made from two or more channels, which are required to serve various market segments. For instance, a business marketing firm may use its own sales force to serve key accounts, distributors to serve small and medium-sized enterprises (SMEs), telemarketing and the internet for prospective customers.

**Hypothesis testing** Hypothesis testing is a set of statistical methods which involve the use of sample statistics to ascertain the validity of statistical hypotheses, i.e. assumptions regarding the population distribution of the variable of interest. Statistical hypotheses are usually constructed in pairs, viz. a **null hypothesis** ( $H_0$ ), representing a conservative assumption (typically of "no difference," "no change," or "no effect"), as against an **alternative hypothesis** ( $H_1$ ), which asserts some form of difference or change. Once the null and alternative hypotheses are specified, a **test statistic**, which distinguishes between the null and alternative hypotheses, and a **critical region**, which represents the range of values of the test statistic for which the null hypothesis would be rejected, are constructed. Most hypothesis tests are constructed as **significance tests**: the critical region is constructed so that the probability of **type I error** (i.e. that of rejecting the null hypothesis even though it is true) is fixed at a value, called the **level of significance**. Once the test statistic and the critical region are constructed, a random sample is taken from the population, the "calculated value" of the test statistic is computed, and the decision to reject the null hypothesis or not is taken by comparing the calculated value of the test statistic with the critical value.

**IaaS** Infrastructure as a Service (IaaS) provides a large number of virtual machine with the ability to scaling services up and down according to the consumers varying requirements.

**Indenting** The process of generating a purchase intent from a buyer.

**Indirect channel** In indirect channel structure, the intermediaries (e.g. distributors, manufacturer's representatives) are involved in sales and distribution activities or functions.

**Industrial distributors/dealers** They are the most important intermediary. They are independent business firms serving a geographic market, performing various functions or tasks, such as selling, promoting, inventory carrying, financing, delivering goods, and so on, for which they are given trade discounts (or margins) on list prices.

**Informediaries** An informediary is a computer based system that provides specialised information on behalf of producers of goods and services and their potential customers in a web.

**Ingredient branding** It is a type of co-branding that is used as a branding strategy by the manufacturers of materials or parts, which lose their identity as they enter the final or finished products of their customers. These manufactures establish ingredient brands that increase awareness and preference for their materials or parts, provided the material is an important part of the finished product. For example, Intel processors used in the personal computers.

**Innovation** It is any product, service, idea, method, or process that is perceived by someone as new. It is creation of something new, or improvement of something to make more useful.

**Inseparability** Services are typically produced and consumed (or used) simultaneously, but in case of products there is a time gap between production and consumption.

**Inside salespeople** They work from within the supplier organisation and support the efforts of outside salespersons, who visit customers. Inside salespeople are organised into customer service, tele-prospecting, and tele-selling groups.

**Institutional customers** There are organisations, such as hospitals, colleges, universities, and hotels, who buy products and services.

**Intangibility** It means "unable to be touched." Services cannot be touched. Products are tangible, as they can be touched. Most market offerings include a combination of tangible and intangible elements, like hotels, personal computers, and goods transportation.

**Integrated marketing communication (IMC)** It is a comprehensive marketing communication plan which combines (or integrates) the various marketing mix and service mix elements as well as communication tools (or elements) and messages in order to provide clarity, consistency, and maximum communications impact at a minimal cost. These communication tools are advertising, direct marketing, personal selling, sales promotion, public relations, and sponsorship marketing.

**Integrative growth strategy** An organisation achieves its strategic growth objective by integrating backward, forward, or horizontally within that industry. In backward integration strategy, the company acquires the business of its one or more suppliers, or sets up its own manufacturing to supply the material to its other factories. In forward integration strategy, the company discontinues business with some of its distributors or agents, and sets up its own sales offices. In horizontal integration strategy, the company acquires the business of one or more of its competitors.

**Intellectual Property rights** The right which enables the creator of an unique product/process to benefit by allowing the creator exclusive rights over the product/process. They could be licensed to others on agreed terms. Example: Design, Software, Music, etc.



**Intensive distribution** This strategy is used by the firms when their customers expect availability of certain products (like electric lamps and cleaning powder) near their plants. Business marketers place frequently purchased products at as many distributors or outlets as possible.

**Intensive growth strategy** A company achieves its strategic growth objective with current businesses, using intensive growth strategy (or product-market expansion grid), which includes: (1) market-penetration strategy, (2) market-development strategy, and (3) product-development strategy.

**Intermediaries** They are independent firms between the manufacturer and its customers, performing the various activities, to make a product or service available to customers.

**Intranet** Intranet is a private network that uses Internet software and TCP/IP protocol in essence with an organisation network (corporate LAN). Intranet interconnects various servers, clients, database programs like ERP and other devices in the entire organisation.

**Intrapreneurial philosophy** When sales and marketing persons, who are employees of the company, behave and act like owners of the company, they have adopted intrapreneurial philosophy, which means entrepreneur within the company.

**Inventory carrying cost** Inventory carrying cost (or inventory costs) includes (1) storage space costs, (2) cost of capital, (3) taxes and insurance, and (4) inventory risk costs (e.g. damage, pilferage, obsolescence). Inventory cost should be calculated for each product, instead of using a rule-of-thumb, as it varies from 12 to 36 per cent of the value of the product in stock for one year. Inventory costs increase at a faster rate as the customer service level approaches 100 per cent. It is computed by multiplying the inventory carrying cost percentage by the average inventory value.

**ISP (Internet Service Provider)** ISPs are the organisations whose primary business is to provide its customers with connections to the Internet. An ISP might provide dial-up service, cable, DSL, or other types of Internet access. Some ISPs are local while others are national. A national ISP will provide access throughout most of the nation, while a local ISP will only serve subscribers in a limited geographical region.

**Jobbers** They are intermediaries, who represent manufactures of typically bulk products like iron ore, coal, and chemicals. They take title to the products they sell, but do not handle, stock, or deliver the products.

**Joint demand** A situation when one industrial product is useful if other product also exists and hence, both products are demanded together. For instance, a pump can be used for pumping water only if a motor or diesel engine is available.

**Just-in-time (JIT) system** In JIT system, suppliers are required to deliver the products at the precise time, in the exact quantity, and as per the specifications needed by the customer. It minimises the inventory, increases the quality and productivity of the customer. The advantage to the JIT-suppliers is increasing share of business from the JIT-oriented customers.

**Key account** It is defined as a customer of strategic importance. It means an important customer and is also called as major account, national account, strategic account, or a house account. Key accounts have large or high sales volumes.

**Key account management (KAM)** It is defined as seller initiated type of strategic alliance. It means management of key accounts or major customers through a KAM programme. It benefits the supplier firm with increase in market share and customer satisfaction.

**Key account salesperson** The sales person to whom large or high potential customers are assigned.

**Knowledge Base** A knowledge base is a centralised repository for information; in electronic commerce a knowledge base is a machine-readable resource for the dissemination of information, generally online or with the capacity to be put online. Knowledge base is an integral component of knowledge management system, which is used to optimise information collection, organisation, and retrieval for an organisation, or for the end users.

**L.D. Clause** It is liquidated damages (LD) clause that typically a government buyer includes in the standard terms and conditions as a penalty against late delivery.

**Laggards** They are the last group of people to adopt a new product because they are traditional and suspicious of any change.

**L-Commerce** It delivers the information about the goods and services based on their position or the location.

**Learning/experience curve** It is a relationship between unit costs and volume. When cumulative volume of production and sales increase, costs per unit can be reduced through the learning or experience that has occurred. This concept can be applied to other functions of management like accounts and marketing.

**Licensing** Permission granted by a company to another to use their product design, process, know how etc in specified markets for agreed fees to be paid to the licensor.

**Life-cycle costing** This concept is used by the buyer for buying capital items, by estimating the total cost of the equipment or machine over its life span. The total cost includes the price, freight, maintenance, energy, material and labour costs over the useful life of the equipment.

**List price** It is a statement of basic or base price of a product, consisting of various sizes or specifications. It is also called price list.

**Logistics** It is design and administration of movement and storage of materials made available for manufacturing and finished products made available for customers, as they are needed. It creates value for customers, and achieves logistical objective of superior customer service at lowest cost.

**Macro and micro environment** Both macro and micro environment are parts of external environment. Macro environment includes environmental factors like economic, demographic, technological, political factors, which affect all organisations. Micro environment includes environmental factors like customers, competitors, and suppliers, which affect a particular company.

**Management by objectives (MBO)** It is a system used by managers for setting objectives, reviewing the actual performance, finding causes of performance deviations, and taking corrective actions (i.e. effective control tool).

**Manufacturers' representatives** Also called as agents, or manufacturers' agents, they are independent businesses, who represent manufacturers in particular geographic areas (or market segments). Typically they do not buy (or take title of) the products, but they promote and sell, for which they get commission.

**Market potential** The market potential of a given product or service is the best possible (or maximum) estimated sales of the product or service for the entire industry in a given market for a specific period of time. For example, the market potential for personal computers (PCs) in India for the year 2009-10 is estimated to be six million units. Market potential is also called as industry sales forecast. For a complete definition of market potential (or for any form of forecast), the following details must be provided: the product or service marketed, the forecast or sales estimated either in units or monetary value, a description of the market by a geographical area, or type of customer, or both, and the specific time period under consideration, such as a particular year.

**Market segmentation** It is a process of dividing the total market for a product into several segments or distinct group of customers. A market segment consists of a group of customers who have similar needs or characteristics. Business marketer's task is to identify the segments and decide which segments to target.

**Marketing channel** Also referred to as distribution channel, trade channel, sales channel, or channel, it is a set of interdependent organisations involved in the process of making a product or service available to customers for use or consumption. It is a link between a manufacturer and its customers.

**Marketing control** It is a system that measures actual performance against planned performance, evaluates profitability of customer segments, branches, and products, and helps marketing managers to take corrective actions, after determining the causes of major performance deviations.

**Marketing logistics (or physical distribution)** Includes planning, implementing, and controlling the physical flows of final (or finished) goods from the manufacturer to its customers, to meet customer requirements at a profit.

**Marketing network** It includes the company and its supporting stakeholders like suppliers, intermediaries, employees and the surrounding community.

**m-Commerce** The electronic commerce done in a wireless channel by using mobile devices such as mobile phones and Personal Digital Assistants (PDAs) to access the Internet.

**Mediation** It is a method of resolving the conflict between two parties by using the services of a neutral third party mediator.

**MIME (Multipurpose Internet Mail Extension)** MIME stands for Multipurpose Internet Mail Extensions or Multimedia Internet Mail Extensions. It is an encoding protocol used in EDI.

**Mission** A mission (or vision) statement expresses the purpose of existence and the course of action the firm will follow in order to realise its purpose. The statement suggests the strategic direction, which should be meaningful and motivating to employees.

**Missionary selling** A missionary salesperson provides information and assistance to customers, particularly in complicated selling situations. Missionary salespersons do not close the sale, but try to build goodwill with customers. Many companies select most effective salespersons for missionary selling. **Example:** Medical representatives in pharmaceutical industry calling on doctors.

**Modified rebuy** In a business buying situation, called modified rebuy, the buying firm wants to change the supplier due to unsatisfactory performance of the present supplier, change in product specifications, or need for quality improvement and cost reduction.

**Multiattribute decision making or multiattribute model** It is used by buying centres for evaluating potential suppliers as well as for analysing performance of current vendors, by using weights attached to different attributes.

**Multi-dimensional scaling** Multi-dimensional scaling is a multivariate statistical technique which is used to create perceptual maps from a given set of variables. The units are mapped against two dimensions in such a way that the distance between the plotted points corresponds as closely to the “distance” as defined by the variables, so that similar units are close together, and dissimilar units are far apart. The dimensions are interpreted as the critical perceptual dimensions, with which a positioning analysis may be performed.

**Multivariate analysis** Multivariate analysis involves the analysis of several variables, taking into consideration relationships between all the variables. Some of the techniques of multivariate analysis include factor analysis, multi-dimensional scaling, discriminant analysis, and cluster analysis.

**Nested approach** It is an approach to market segmentation in which five segmentation criteria are arranged as a nested hierarchy, moving from the outer nest to the inner nest. The criteria are: demographics, operating variables, customer purchasing approaches, situational factors and personal characteristics of buyers.

**Need-satisfaction method** It is a method of sales presentation, in which the salesperson first understands the prospective customer’s real needs by asking questions and listening attentively, thereafter, gives a proposal or presentation to show how the customer needs can be better satisfied by the salesperson’s product or service.

**NEFT** National Electronic Fund Transfer systems used for small denomination money transfer within the country.

**Network as a Service (NaaS)** These categories of cloud service provide network or transport connectivity service and/or inter cloud network connectivity services.

**New task** In the new task buying situation, the buying firm is buying a product or service for the first time, and hence, the buying company goes through all eight stages of buying process, due to lack of knowledge and experience of the new purchase item.

**Niche marketing** A niche is a narrowly defined customer group who have different needs. A niche can be identified by dividing a segment into subsegment. The key idea in niche marketing is specialisation.

**Objective and task method** It is one of the methods of setting marketing communication (or promotional) budget. In this method, the marketing manager first determines the communication objectives, and then decides the tasks to be performed to achieve the objectives. Thereafter, he estimates the costs of performing the tasks. The sum of these estimated costs becomes the budget. This method is also called “budget buildup” method.

**Open tender/bidding** In this tender (i.e. formal written offer) or bidding (i.e. offer) process, a buying organisation invites bids or offers from limited number of suppliers who are capable of supplying or executing nonstandard or complex products, services, or projects. Discussions are held by the buyer with several suppliers throughout the bidding process on technical matters first, and thereafter, negotiations are held on prices and other commercial terms.

**Operating lease** These are short-term contracts or agreements between a buyer and a seller, which are cancellable and not fully amortised.

**Operational management** It focuses on day-to-day (or short-term) issues like cost, revenues, and profits, and maintains the direction given by strategic management. Operational effectiveness means performing similar activities better than the firm's competitors. Operational excellence means performing different activities compared to competitors so as to provide a marketing offering at a lower total cost.

**Original equipment manufacturer (OEM)** Is a manufacturer of equipment, which includes products or components of other manufacturers. For instance, Tata Motors which manufactures trucks includes components like tyres from tyre manufacturers, who consider Tata Motors as an OEM customer.

**Outsourcing** Where a company agrees to let another agency or firm carry out a function or process—manufacturing, marketing, recruitment, etc. Outsourcing means buying goods and services from outside vendors, if they are cheaper and better.

**Partial correlation** Partial correlation is used to isolate the true correlation between two variables in multi-variable situations, where several variables may be inter-related, controlling for variation in other variables.

**Patents** Protection granted to the creators of unique products, designs, etc.

**Penetration pricing strategy** This strategy is used by a company for pricing a new product by charging relatively low initial prices to attract as many customers as possible. The pricing objective, in this case, is long-term profitability through larger market share.

**Perceptual mapping/map** It is a technique that helps in deciding positioning strategy for a company.

**Platform as a Service (PaaS)** It is a category of cloud computing service that provides a computing platform as a service to the customers.

**PIMS (Profit Impact of Marketing Strategy)** It is a data-base, consisting of a sample of over 2000 businesses, with a finding that product and service quality strategy has maximum impact on the profitability of a firm.

**Portfolio analysis** These are analytical models or tools that are used for decision making, such as BCG and GE models.

**Positioning** It is designing the company's value proposition and image in the minds of target customers, in relation to its competitors. It should answer the question: "why should target customers do business with the company rather than the competitors?"

**Price elasticity of demand** It is the ratio of the percentage change in sales (or the quantity demanded) relative to the percentage change in price. Demand is elastic if the percentage change in price brings about an even larger percentage change in the quantity demanded, and it is inelastic if the percentage change in quantity demanded is less than the percentage change in price.

**Procurement orientation** It is one of the purchasing orientations or concepts adopted by business buying firms. In this orientation, the purchasing firm has a long-term focus, and follows the practices

of collaborative relationships with major suppliers and works closely with other functions within the organisation in order to achieve the objectives of cost reductions and quality improvements.

**Product life-cycle (PLC)** Like a human being, a product has a life cycle, which is described or shown in a bell-shaped curve that is divided into four stages: introduction, growth, maturity, and decline.

**Prospecting** It means identifying or searching for prospective or potential customers. A prospect is an individual, a family, or an organisation who needs the product or the service, and also has an ability to buy.

**Reciprocity** It is the reciprocal dealing between a buyer and a seller. It is a special case of buying from one's customers and selling to one's suppliers. However, caution must be exercised to keep it at a minimum level.

**Regression** Regression is a set of statistical methods which uses independent variables to explain variation in a given response/dependent variable. The simplest of regression techniques is **simple linear regression**, in which only one independent variable is used explain variation in the dependent variable, in the form of a linear model. This can be extended to consider more complex functional forms, for example in polynomial regression, or more variables, for example in **multiple linear regression**. A regression model may be used for both explanatory and predictive purposes. However, even though regression models analyse relationships between variables, they do not test for **causality** between the variables: i.e. which of variables cause changes in the other variables.

**Relationship marketing** It focuses on collaborative or partnering relationships between customer and supplier firms. It aims to build mutually satisfying long-term relationships between key parties—customers, suppliers, distributors—in order to gain and retain business. This is achieved by building economic, social, and technical (or structural) ties for forming strong customer bond or loyalty.

**Relationship selling** It is a process which builds a long-term supplier-customer relationship that achieves mutual benefits. This is particularly important for high business potential key accounts, where the key accounts salesperson has a major role to play in relationship selling, which is a part of relationship marketing.

**Response hierarchy models** These are same as hierarchy-of-effects models, such as AIDA model, Innovation-Adoption model, and communication model. These models describe an individual buyer's mental stages of buying—from cognitive (e.g. awareness) stage, through affective (e.g. attitude or interest) stage, to behaviour (e.g. purchase) stage.

**Reverse-elasticity of demand** This is a short-term reaction, in which a price increase can cause an increase in demand, and a price decrease would be followed by decrease in the demand, which is just opposite from what we would normally expect from business customers.

**Reverse auction** Also called as 'Dutch auction', it involves one buyer who invites bids from several suppliers, with the order going to the supplier company that bids the lowest price.

**Reverse bidding** In this process, the buying firm first sets the highest possible bidding price and then asks suppliers to offer its prices below the set price.

**Risk-purchase clause** This clause is included in some government tenders. If the supplier fails to complete the order given by the government organisation (i.e. the buyer), then the buyer can cancel

the order on the supplier and purchase the same material from other supplier(s) at the risk and cost to the first supplier. That is, if the prices are higher from other suppliers compared to the purchase order prices of the first supplier, then the difference in the value of prices are recovered from the first supplier alongwith any other costs incurred, from the security deposit bank guarantee furnished by the supplier to the buyer.

**Role playing** It is a popular method of sales training, in which one trainee plays the role of (i.e. activities of) a salesperson and another trainee acts as a customer, in a business situation. It is performed live or videotaped for a group of trainee observers, who then do critical assessment of the role play. A good role-play session is learning selling skills by doing.

**RTGS** Real time gross settlement system is the fastest possible interbank money transfer facility available through secure banking channels in India.

**Sales budget** The sales budget is the estimate of expected sales volume in units or revenues from the company's products and services and the selling expenses. Sales budgets are generally set slightly lower than the sales forecast, in order to avoid excessive risk. Sales budget is used for making purchasing, production, manpower and cash flow decisions. The sales budget goes into complete details of expected sales of each product item.

**Sales forecast** The sales forecast (or company sales forecast) is the estimated company sales of a given product or service, under a proposed marketing plan, in given market, for a specific period of time. There is a relationship between the company's sales forecast and proposed marketing expenditure (or marketing plan). A company may make a sales forecast for an entire product line (such as transformer from Crompton Greaves) or a product item (such as power transformer). Sales potential and sales forecast are usually not the same. Sales potential is what a company would achieve under ideal conditions. Typically, the sales forecast is less than the sales potential, for different reasons, such as limited production facilities, and inadequate financial resources.

**Sales potential** The sales potential (or company sales potential) is the best possible (or maximum) estimated sales of a given product or service for a company in a given geographic area for a specific period of time. Sales potential is also defined as the maximum share (or percentage) of market potential that is expected to be achieved by a company. For instance, the sales potential of ICICI-Prudential is expected to be close to five per cent of the gross premium collection of life insurance industry in India in coming years.

**Sampling distribution** The sampling distribution of a sample statistic is defined to be the probability distribution of the values of the statistic taken over all possible samples of a fixed sample size. The sampling distribution of a sample statistic contains information about the population distribution/population parameters, through which it is possible to determine the properties of estimators and to construct test statistics in order to test statistical hypotheses.

**Scatterplot diagram** A scatterplot diagram is a convenient two-dimensional graphical representation used to examine the relationship between two variables. It is particularly useful in exploratory analysis of the relationships between variables, in identifying which variables may be related to a given variable, and the nature/form of the relationships.

**Selective distribution** It is the strategy used by business marketers to carefully select a few channel members in a particular geographic area, based on specific criteria.

**Selling process (Personal selling process/Sales process)** If a salesperson follows the steps involved in effective selling process, the chances of success are good. These steps are prospecting and qualifying, preapproach, approach, presentation and demonstration, overcoming objections, trial close/closing the sale, follow-up and service.

**Sensitivity analysis** Also referred to as T-groups, D-groups, and action-centered groups, it is a laboratory training method, using groups of trainees, to achieve the objectives of personal development and becoming an effective group member. The major process variables used in sensitivity training are: (1) learning how to learn, (2) growth in effective membership, (3) learning how to give help, and (4) becoming sensitive to group processes. It focuses on training of attitudes towards people.

**Service differentiation** Differentiation of services offered by several suppliers in terms of innovative features, service delivery, efficient physical environment, specifications, and experience.

**Service variability** The quality of service output may vary each time it is provided, depending on who provides, when and where the service is provided.

**Shared values (or Core values)** It means employees of the company sharing the same guiding values like respecting all individuals, and trying to achieve excellence in all activities.

**Single sourcing** Some business customers select one supplier, even though alternative suppliers exist.

**Skimming strategy** This pricing strategy is adopted by a company for pricing a high-tech or capital intensive new product by charging relatively high initial price, which is reduced later to reach other market segments that are price sensitive. The pricing objective is short-term profitability to recover investment made in product and market development.

**Software as a Service (SaaS)** Also referred as “on-demand software,” it is a software delivery model in which software and associated data are centrally hosted on the cloud.

**Source credibility** In communication theory, source credibility means the reputation of the selling company (e.g. source). It determines the credibility (or believability) of the persuasive communication from the company.

**Source effect** It is the degree (or extent) to which the effectiveness of a given message is increased or reduced by the reputation of the source (e.g. the company).

**Standard industrial classification (SIC)** The standard industrial classification is a system for classifying economic activities into industries by a coding scheme. It categorises the economy into different divisions, denoted by a letter code; within each division into major industry groups, denoted by a two-digit code; within each industry group into industry subgroups, denoted by a three-digit code; and so forth. It is used mainly as a tool for the identification of groups of businesses that produce the same type of product.

**Statistical inference** Statistical inference is a branch of statistics that is concerned with the drawing of inferences/conclusions about a population on the basis of data collected from a sample. The object of statistical inference is the **population**, i.e. the set of all units which are being studied, or, more



specifically, the **population distribution** of the variables of interest, and **population parameters**, i.e. characteristics of the population distributions, which generally tend to be unknown. Information about the population is obtained from a **sample**, i.e. a subset of the population, the set of units on which observations are taken, in the form of **sample statistics**, i.e. functions of the sample observations, which are used to extract information about the population distribution.

**Stimulus response method** Also known as canned approach, memorised or prepared sales presentation, in this sales presentation method the salesperson assumes that if he/she makes the right stimuli (e.g. sales presentation, communication), the response from the prospect could be favourable. However, this method may not be effective always, as the salesperson does not find out the prospect's needs.

**Straight rebuy** In this situation, the buying firm has continuous requirement, which is fulfilled by purchasing from the same suppliers repeatedly, with slight variations in the purchase terms.

**Strategic alliance** It is a formal long-term agreement or linkage between two (or more) parties to work together to achieve agreed objectives.

**Strategic business unit (SBU)** It is a business unit that has (1) a distinct mission, objectives, and strategic planning; (2) a set of products, customers, and competitors; (3) an executive to achieve long-term goals and objectives, and is relatively independent of other business units.

**Strategic control** It is periodical review of the firm's long-term goals, strategies, and marketing effectiveness by using tools like marketing audits and marketing effectiveness reviews.

**Strategic management** It gives a direction to the firm and concentrates on developing strategies to achieve long-term objectives and goals.

**Strategic planning gap** It is a gap between the firm's desired sales and projected sales in future. This gap is filled by the corporate management of a company by using one or more of the following growth strategies: (1) intensive growth, (2) integrative growth, and (3) diversification growth.

**Supplementary Service** It is an additional service that also accompanies a core service or product, for which a supplier may charge an extra amount to a customer.

**Supply chain management (SCM)** It is a planning and coordinating the flows of products, services and information among suppliers, manufacturers, and channel intermediaries, so as to deliver superior value to the final customer. It extends logistical integration beyond the company's boundaries to supplier's suppliers and customer's customers.

**Supply chain management orientation** This is one of the purchasing orientations or concepts adopted by business buying firms. In this orientation, the purchasing firm has a long-term view and it focuses on improving the value chain from raw materials to end products, in addition to practising collaborative relationships with major suppliers.

**SWOT analysis** The overall evaluation of a company's strengths, weaknesses, opportunities, and threats is called SWOT analysis, which is a foundation of strategic planning process. After the SWOT analysis, a company develops specific goals (i.e. quantified objectives) for the period of planning.

**Systems selling/Systems marketing** When business buyers prefer to buy total solution to their problem from one supplier, the selling firm decides to adopt the strategy of systems selling. It is used

in bidding for large and complex projects, such as steel factories, irrigation systems and sanitation systems. It is an important business marketing strategy used by firms who undertake large scale industrial projects, as it reduces the costs for both buying and selling firms. The buying firm can hold one supplier responsible, as the system may have subcomponents from several contractors or vendors. For instance, IBM includes in some of its systems, maintenance, training services, and emergency repairs.

**Target marketing** Once the company identifies various segments, the next step is evaluating and selecting the target segments, which is called target marketing or market targeting.

**Team selling** Business marketers use team selling approach to meet the needs of high potential key accounts. The team consists of a group of persons, such as a national accounts manager, outside and inside salespersons, technical support, and logistical persons. The team handles a key account with a common performance goal commitment.

**Technology adoption life-cycle** It is a modified model of new product adoption life-cycle. It indicates how individuals differ in adopting new technology products. The model shows a bell-shaped curve with five new technology adopter groups: innovators, early adopters, early majority, late majority, and laggards.

**Total quality management (TQM)** Developed by Japan, it is an organisation wide approach to continuously improve the quality of all the firm's processes, products, and services.

**Trademark** A symbol, logo, name, tagline or other such unique identifiers used exclusively by a company and its products. When a brand name or brand mark is legally protected through registration with the Patent and Trademark Office, it becomes a trademark.

**Trial close** It is one of the steps of the selling process. It is used after the salesperson makes a sales presentation and answered the prospective customer's objections. Trial close is used to check the attitude or the opinion of the prospect, before asking for the order.

**Transactional/territory salesperson** These salespersons are responsible for serving medium and/or low business potential customers, performing traditional selling activities like understanding customer needs, submitting proposals, making sales presentations, negotiating, getting orders, and making post-sales calls. They should create value to customers and profitability for the company.

**Transactional account** A customer with low and/or medium sales potential usually served by individual salesperson, who performs traditional selling activities, without any efforts to build long-term relationship.

**Transactional relationship** It is a short-term relationship between a buyer and seller, in which the supplier offers a product with basic properties at a lower price, meeting the availability requirement of the customer. Typical example is a government customer who usually places orders on lowest price bidders.

**Transfer Pricing** The price at which the products are sold from one unit of a company to another unit.

**Univariate analysis** Univariate analysis involves the analysis of a single variable at a time, without considering relationships between variables. The basic purpose of univariate analysis is to understand the distribution of variables.

**Value-added relationship** This strategy is used for customers whose business potential is medium or high value. Business marketers understand completely the needs of such customers and then satisfy those needs (e.g. product quality, delivery service) better than competitors, in order to get maximum share of business.

**Value-added resellers (VARs)** They are resellers of information technology (I.T.) products, and they add value by providing integrated systems to their customers by combining hardware and software, as per the needs of the customers.

**Value** It is the customer's perception of benefits received in exchange for the cost incurred for a product or service offering. It is measured by the ratio of benefits upon costs, or by benefits less costs.

**Value proposition/Customer value proposition** It is a statement of how the firm delivers superior value (i.e. benefits less costs) to its target customers. It should answer the question "Why should the target customer buy from the company rather than its competitors."

**Value-based pricing** In this method of price setting, the price is based on the customer's perception of the value of the product or market offering (and hence, it is also called as perceived-value approach).

**VAN (Value Added Network)** VANs are private networks that add value to the basic communication provided by common carriers by offering specialised services such as access to commercial databases, e-mail and video conferencing.

*BSNL broadband is an example of a VAN.*

**Vertical marketing system (VMS)** It is a system, in which the manufacturer and intermediaries act in a unified manner, with common goals. It minimises channel conflicts and achieves superior customer service.

**VPN (Virtual Private Network)** A VPN is a private network constructed within a public network infrastructure, such as the global Internet.

**World sourcing** It is a global, decentralised strategy that is designed to drive greater value by distributing a firm's core functions across multiple global hubs of excellence.

**WWW (World Wide Web)** It is a portion of the Internet that uses the transport functions of the Internet, via client/server architecture, to handle all types of digital information.

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