

BUSINESS-TO-BUSINESS MARKETING

FIFTH
EDITION



Ross Brennan, Louise Canning & Raymond McDowell



BUSINESS-TO-BUSINESS MARKETING

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PREFACE

As the latest edition of our book goes to print, some observers might say that industry and B2B marketing are on the cusp of a new world order. Developments in digital technologies, computer systems and data handling promise a future in which industry value chains are connected from end to end and in which machines share information, perform tasks and make decisions without the need for human intervention – whether that is deciding on, and actually undertaking cleaning services at an airport, designing and supplying packaging materials to a beverage producer, or providing personalized marketing content that matches precisely the interests of an R&D manager in the aerospace industry.

Organizations and entire industry sectors might well use technology to simplify processes and increase productivity, but improved performance also has to be responsible: economically, socially and environmentally. With regard to the latter, reduced environmental impact is afforded different priorities around the world. Yet, in some markets, circular economy principles have gained quite a foothold and there is considerable effort amongst companies to design out waste and pollution, keep products and materials in use, and regenerate natural systems.

If you are studying B2B marketing or are planning a career in the domain, then these are arguably two phenomena which will frame your understanding and your professional life. Market structures are shifting, what and how organizations transact is evolving, and the work of the B2B marketer with it. Yet, human insight, judgement and empathy will remain important to sound business decisions and inter-firm relationships.

In revising the text, we continue to feature topics as these emerge or evolve in the business world. And while headline themes such as digital technology and responsible business have been present since the first edition, in this latest version they are further integrated throughout the text: related to particular B2B concepts, illustrations or indeed theories. For example, responsible business features in new snapshots that touch on bribery (in Chapter 4) and circular economy (in Chapter 11), while AI appears as part of product offers (Chapter 10) and communication campaigns (Chapter 7).

Our development of the book content continues to be based on the same principles as earlier versions: we integrate conventional approaches to B2B marketing (such as market segmentation and impersonal market communication) with more relational approaches (relationship portfolio analysis and key account management). Our logic in doing so is the recognition that depending on the situation, either (or indeed a mix) of these approaches can be most effective for the B2B marketer.

In this edition, B2B snapshots, scenarios and case studies have either been replaced or updated with new content, and chapters revised. Our aim is not only to provide you with a text which is current and engaging, but also provides you with the understanding and insight necessary for a future career in B2B marketing.

Thank you to the readers and reviewers who have told us what they think of previous editions of this book. We are always happy to receive constructive feedback from our readers.

Ross Brennan
Louise Canning
Ray McDowell

ONLINE RESOURCES



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LIST OF ABBREVIATIONS

ARA	actor bonds, resource ties and activity links
ARPU	average revenue per user
B2B	business-to-business
B2C	business-to-consumer
BRIC	Brazil, Russia, India, China
CRM	customer relationship management
CRP	continuous replenishment programme
CSR	corporate social responsibility
DMU	decision-making unit
EBIT	earnings before interest and taxes
EDI	electronic data interchange
EPOS	electronic point of sale
ERP	enterprise resource planning
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
ICT	information and communications technology
IMP	Industrial Marketing and Purchasing Group
ISIC	International Standard Industrial Classification
JIT	just-in-time
KAM	key account management
MRO	maintenance, repair and operating supplies
NACE	Nomenclature statistique des activités économiques dans la Communauté Européenne
NAICS	North American Industrial Classification System
OEM	original equipment manufacturer
PR	public relations
R&D	research and development
RFID	radio frequency identification
RFQ	request for quotations
SBU	strategic business unit

SCM	supply chain management
SIC	standard industrial classification
SWOT	strengths, weaknesses, opportunities, threats
TCO	total cost of ownership
UK SIC	British Standard Industrial Classification
US SIC	United States Standard Industrial Classification
VAR	value-added reseller
WTO	World Trade Organization

FUNDAMENTALS OF BUSINESS-TO-BUSINESS MARKETING

PART
I



1

BUSINESS-TO-BUSINESS MARKETS AND MARKETING

LEARNING OUTCOMES

After reading this chapter you will:

- know what are the defining characteristics of business-to-business markets;
- be able to differentiate between business-to-business markets and consumer markets;
- understand how the characteristics of business-to-business markets affect the practice of marketing management;
- appreciate the changing balance between the agricultural, manufacturing and service sectors in the world's major economies;
- understand the nature and significance of derived demand in business-to-business markets;
- be able to explain the significance of an industry concentration ratio;
- understand the nature and the significance of the accelerator effect in business-to-business markets; and
- be able to apply two complementary classification schemes to the categorization of business products.

INTRODUCTION

As consumers, we encounter thousands of marketing messages every day and so form the impression that marketing is something that is carried out by businesses with the aim of persuading consumers to buy their products and services. Perhaps, every now and then, something happens to make us contemplate the fact that consumer purchases can only be made possible if a chain of prior transactions between businesses take place. For example, many European consumers were dismayed in the hot summer of 2018 when they had difficulty in obtaining their favourite fizzy drinks. Shortages of both alcoholic and non-alcoholic drinks occurred in several countries, and most consumers were probably just annoyed that buying their beer, cola or lemonade became much more difficult than usual. However, many consumers also became aware that the production of carbonated drinks relies on a steady

supply of carbon dioxide. Rather surprisingly, the news reports quickly established that carbon dioxide is generally regarded as a by-product of the production of ammonia for use in fertiliser production. Since farmers require little fertiliser in the summer months, many ammonia production facilities had closed down for maintenance, so reducing the availability of carbon dioxide. The effects of the carbon dioxide shortage extended to some food packaging and even to meat production, since the gas is used to extend the shelf-life of some food products and for stunning animals prior to slaughter. In cases like the carbon dioxide shortage, consumers get a brief insight into the complex web of business-to-business transactions that underpin the more visible consumer economy. The brewers and the soft drink producers are only the tip of the business-to-business iceberg. This book is concerned not with the final consumer transaction – buying the beer or lemonade to enjoy on a pleasant summer evening – but with the network of business-to-business transactions, usually invisible to the final consumer, that underlies it.

In this chapter, our aims are to clarify just what is meant by *business markets*, to explain why it is considered necessary to distinguish them from consumer markets, and to show how business products and markets can be classified. We begin by discussing the nature of business markets. In order to emphasize the message that business markets involve both goods and services, we spend a little time looking at the industrial structure of modern economies, to see how influential the service sector has become. The subsequent section deals with the core idea of this chapter, namely that business markets can be differentiated from consumer markets along a number of dimensions. Those dimensions can be summarized as market structure differences, buying behaviour differences and marketing practice differences. The chapter then moves on to look at the ways in which business products can be classified. An approach based on the uses to which products are put is contrasted with an approach based on customer perceptions of the risk and the effort (including cost) involved in acquiring a product. The chapter concludes with a case study of Rolls-Royce, no longer the producer of the most famous luxury car in the world (cars bearing the Rolls-Royce name are now made by BMW), but the company that keeps many of the world's aircraft in the air. Yes, Rolls-Royce manufactures aircraft engines. However, as we will see, much of what it does goes far beyond manufacturing. It is the support services that Rolls-Royce provides to aircraft operators as much as the engines themselves that make it still one of the UK's most successful companies. Meanwhile, from Snapshot 1.1 you can get an immediate impression of the scale and breadth of B2B marketing by taking a look at Air Products, a large-scale global business operation that you may never have heard of, but which contributes critically important products and services that have applications to everything from the latest medical scanners to the flat-screen TV in your living room.

B2B SNAPSHOT 1.1 AIR PRODUCTS

The clue is in the name: Air Products (officially, Air Products and Chemicals, Inc.). This is a company that has its origins in the business of producing and manufacturing gases for industrial use (the company started out as a supplier of oxygen to large-scale users). It is a company that had a turnover of around \$9 billion in 2018, employs nearly 16,000 people and operates in 50 countries around the world. Its big competitors are

companies such as Air Liquide SA and Linde AG, and the letters after these company names reveal just how globally competitive this industry is; Air Liquide is a French Société Anonyme and Linde is a German Aktiengesellschaft. But, unless you have a professional interest in this business, the closest you are likely to come to Air Products itself is when you order some helium from them for your party balloons – something that you really can do!

Once you go beyond party balloons, Air Products is involved in the manufacture, distribution and marketing of a wide range of gases, equipment and services, and performance materials that play critical roles in many industries that are tremendously important for both human welfare and human pleasure. What sort of industries use Air Products? Adhesives, aerospace, cement, chemicals, electronics, glass, healthcare, metal fabrication, mining, oil extraction, paints, pharmaceuticals, rubber ... that's just a brief and very incomplete list. What do these customers get from Air Products? Gases, like argon, helium, hydrogen, nitrogen, oxygen (and others); equipment and services, like cryogenic business applications (that is, ultra-low-temperature technology), heat exchangers and business services; and performance materials, like epoxy resins, polyurethane products, amines, surfactants, and a whole lot else. What does all of this mean for you? Just three examples follow. At the heart of those fabulous MRI (magnetic resonance imaging) scanners in hospitals are extremely powerful magnets that rely on liquid helium: Air Products provides the helium and the specialist low-temperature services (the KeepCOLD® MRI magnet filling and cryo-shielding maintenance services) that keep MRI scanners running. Semi-conductor production relies on the availability of specialist gases provided in extremely high levels of purity: Air Products supplies a wide range of these gases. Meanwhile, the electronics division of Air Products provides essential products and services to manufacturers in the TFT (thin-film transistor) and photovoltaic markets – meaning that they are heavily involved in the process of making your flat-screen TV or computer monitor, and in facilitating the production of solar panels.

But, if all you want is the helium for your party balloons, check out the Air Products party balloons service at www.airproducts.co.uk/industries/leisure-recreation.aspx!

Sources: Air Products (2012); MarketLine (2019); www.airproducts.com.

THE NATURE OF BUSINESS MARKETS

The key distinguishing feature of a *business-to-business market* is that the customer is an organization rather than an individual consumer. Organizations and consumers often buy the same products. For example, both organizations and individual consumers buy smartphones, laptop and tablet computers, cleaning services, automobile repair services and light fittings. Therefore, one cannot distinguish unambiguously between a business market and a consumer market on the basis of the nature of the product. It is true that there are certain products that are often bought by organizations and never by individual consumers, such as management consultancy services for a corporate merger, or – more prosaically – industrial cranes. On the other hand, it is difficult to think of anything that an individual consumer buys that would not be bought by some organization.

A brief observation on terminology may be helpful at this point. The generally accepted term for the marketing of goods and services to organizations is 'business-to-business marketing'. This gradually superseded the older term *industrial marketing* in the 1980s and 1990s. Industrial marketing is often considered to be a term that is exclusively applied to primary and secondary industries; primary industries include agricultural and the extractive industries such as coal and iron-ore mining, while secondary industries are those that manufacture tangible products such as cars, planes and furniture. In many modern economies, the primary and secondary industries account for a relatively small share of economic activity, and it is the tertiary sector of the economy (the service industries) that contributes most to measures of national income (of which gross domestic product (GDP) is probably the best known).

The expression business-to-business marketing is synonymous with 'business marketing'; these will be the two terms that we use throughout this book to refer to our subject matter. However, two other expressions are worth mentioning: 'B2B' and 'organizational marketing'. The term B2B is clearly just a contraction of business-to-business. What makes it important in its own right is that it is the ubiquitous term on the internet for business-to-business marketing and selling, to be contrasted with B2C, which stands for 'business-to-consumer'. The term 'organizational marketing' has been advocated by some authors (Wilson, 1999) as being superior to 'business marketing' because it explicitly includes *all* organizations, while 'business marketing' seems to exclude organizations that are not 'businesses'. This may be a legitimate distinction, since charitable organizations, other non-profit organizations and governmental organizations have different fundamental objectives from private enterprise businesses. However, the expression 'organizational marketing' has not yet proved popular, and we will stick to the conventional terms 'business-to-business marketing' and 'business marketing'.

It is important to understand that business-to-business marketing is *not* synonymous with marketing goods and services to the manufacturing industries. Taking the United Kingdom as an example, there has been a prolonged and prominent trend away from manufacturing employment and towards service sector employment. In 1980 there were over 6.5 million people employed in UK manufacturing industries, and by 2013 this had declined to around 2.6 million. Over the same period, service sector employment increased from 15.5 million to around 23 million – service sector employment is now over 80 per cent of total UK employment. The absolute number of jobs created in the service sector considerably exceeded the number of jobs lost in manufacturing, so that total employment in the UK increased over the period (Rhodes, 2015).

In itself this trend is a matter of widespread debate for UK economists and politicians (Hadjimatheou and Sarantis, 1998; Julius and Butler, 1998). In particular, an unresolved debate revolves around the question of whether manufacturing industry is especially important (for example, because it has a high propensity to export and exhibits more rapid productivity growth than the service sector), or whether it is a normal part of the developmental process for an advanced economy to see a shift of activity away from manufacturing and into the service sector. This has important economic policy implications: should the government

try to slow down or reverse the decline in manufacturing? However, from the perspective of marketing professionals, the trend away from manufacturing industry and towards the service sector should be seen as an important element of the marketing environment, which suggests that opportunities to market goods and services to the UK manufacturing sector may decline, and will certainly grow more slowly than opportunities in the service sector of the economy. In passing, it is worth observing that the decline in manufacturing employment in the UK has also been associated with a decline in the manufacturing share of GDP (Hartley and Hooper, 1997); although manufacturing productivity has grown faster than service sector productivity, it has not grown fast enough to compensate for the very substantial decline in manufacturing employment seen over the last few decades. The trend away from manufacturing and towards the service sector is much more than just a UK phenomenon. In recent decades, virtually all of the world's major economies have seen a decline in employment in agriculture and manufacturing, and an increase in service sector employment. From a marketing point of view, it is interesting to observe not only these trends, but also the different structural characteristics of these economies. While the UK has seen a rapid decline in manufacturing and has an economy that is very heavily dependent on the service industries, Germany has retained a large, if declining (as a share of GDP), manufacturing sector. Understanding such trends in the economic environment is a useful foundation for the more complex research and analysis that goes into preparing an international marketing *strategy*.

However, while this analysis of the basic structure of several of the world's major economies probably strikes the reader as both plausible and relevant, it suffers from at least two important deficiencies: first, the analysis is based on the idea that the distinction between manufacturing and service activities is meaningful and, second, we have so far ignored the emerging *BRIC economies* – that is, Brazil, Russia, India and China (sometimes known as BRICS, with the addition of South Africa). In a moment, we will turn to the importance of the BRIC economies, but first let's pause to question the validity of the manufacturing/services dichotomy in marketing. Recent years have seen growing prominence for 'service-dominant logic' in marketing (Ballantyne and Varey, 2008; Vargo and Lusch, 2004, 2008). The underlying idea behind service-dominant logic is that whatever it may be that customers buy – tangible goods, intangible services or a combination of the two – in all cases it is services that generate the value that customers desire (the customer's 'value-in-use'). Whether they are buying cranes, computers, cleaning services or consultancy, business buyers are in all cases seeking value-in-use, which in all cases is provided by the services delivered by the various things procured (for example, businesses don't want cranes, they want the ability to move heavy objects around, which is a service delivered by cranes). Hence, according to proponents of service-dominant logic, in the end all marketing concerns services, and the distinction between the marketing of goods and services is artificial, summarized as 'All economies are service economies' by Vargo and Lusch (2008: 7).

Finally, before moving on to the differentiating characteristics of business markets, it is important to emphasize for the reader the importance of the BRIC and other emerging economies to the global economic system. The global financial and

economic crisis of 2008/9 clearly affected these emerging economies badly, with lower economic growth than for many years previously and lower inward flows of capital (foreign direct investment). However, even in times of recession, the more robust BRIC economies, namely Brazil, India and China, were still growing, while advanced economies such as the USA, Germany and the UK were experiencing zero or negative growth. (Russia is a slightly different case from the other BRIC economies because it is heavily dependent on oil exports, so that its economic fortunes are strongly influenced by oil price fluctuations.) The long-term trend, observed for over two decades now, shows emerging economies, particularly China, India and Brazil, growing much faster than the advanced economies, exporting much of their output to those advanced economies, and rapidly increasing the average income of their populations. While in relative terms these economies can be expected to continue to grow faster than Europe or North America, it is likely that their economic growth rates will be slower than in the peak years at the end of the twentieth century and in the early years of the twenty-first. Much marketing attention has focused on the huge consumer market potential in these countries, as incomes grow and consumers demand many of the goods and services that are common in rich countries. For our purposes, however, it is important to appreciate that these economies are fast-growing industrial powerhouses where much of the world's manufactured output is produced, so that their potential as business-to-business markets is virtually limitless. For example, 56.5 per cent of Chinese workers were employed in the manufacturing and agriculture sectors in 2016 (CIA, 2016), which is a much larger proportion of a much larger workforce than the major North American and European economies. This is why the BRIC economies generally, and China in particular, have become the focus of a great deal of attention in B2B marketing, with several special issues of major academic journals in the field devoted to them (*Industrial Marketing Management*, vol. 40, issues 1 and 4, and the *Journal of Business & Industrial Marketing*, vol. 22, issue 2 and vol. 27, issue 3).

Recent years have seen striking evidence of the growing influence of the BRIC economies in the shape of corporate mergers and acquisitions that would once have been unthinkable; for example, Chinese computer-maker Lenovo acquired the personal computer business of the American firm IBM in 2005, and the Tata Group of India acquired the Anglo-Dutch steel producer Corus (formerly British Steel) in 2006 and British vehicle manufacturer Jaguar Land Rover in 2008. There can be no doubt that the emerging economies, already important to many B2B marketers, will feature ever more prominently in B2B marketing plans in the future. However, marketers must be aware that deals involving the emerging economies, and those involving China in particular, may have political overtones. For example, in 2019 a fierce political debate arose in America and Europe concerning whether or not the Chinese technology firm Huawei should be allowed to participate in the development of 5G mobile networks in Western economies. In April 2019, the *Financial Times* reported that the US government regarded Huawei as a threat to global cyber-security and had warned allies that it may not share intelligence with them if they used Huawei technology in their 5G networks (Yang, 2019). This is a reminder that political matters can have a profound and direct influence on international business deals, and therefore on the environment within which business-to-business marketing strategy is developed. In this case, Western firms that were planning to partner with Huawei, because of its

acknowledged technological excellence, would need to factor in the political risk raised by the warning from the US government.

BUSINESS MARKETS: DEFINING CHARACTERISTICS

Having established that it is not the nature of the product that is bought and sold that differentiates business markets from consumer markets, we move on to examine what are regarded as the defining characteristics of business markets. Many authors have sought to identify the *dimensions* by which business markets can be distinguished from consumer markets, and then the specific *characteristics* of business markets and consumer markets on each of these dimensions. Table 1.1 provides a synthesis of these dimensions and characteristics. The table is organized into three columns. The first column identifies the dimension against which business and consumer markets are thought to differ, the second column provides the characteristic expected of a business market, and the third column provides the characteristic expected of a consumer market.

Table 1.1 is also divided into three major sections, entitled respectively market structure differences, buying behaviour differences and marketing practice differences. In general, it is underlying structural differences between business and consumer markets that bring about important differences in buying behaviour. Marketing practice in business markets differs from that in consumer markets because of the underlying differences in market structure and because of the differences in buying behaviour. For example, it would be wrong to assert that business markets differ from consumer markets because the most frequently used promotional tool in the former is *personal selling*, while in the latter it is advertising. The extensive use of personal selling in business markets can be traced to the market structure and buying behaviour characteristics commonly found in business markets, which are usually not found in consumer markets. Specifically, in many business markets, demand is concentrated in the hands of a few powerful buyers (market structure), who employ teams of purchasing professionals to do their buying (buying behaviour). In most consumer markets, demand is dispersed widely throughout the buying public and no single consumer has any real buying power (market structure), and buyers are not trained professionals (buying behaviour). Personal selling makes sense in the first set of circumstances (concentrated demand, powerful buyers, trained professionals), since organizational buyers expect to hear a well-argued case specifically tailored to the needs of their organization, and the costs associated with employing a sales executive are justified by the high potential value of each order. Advertising makes sense in the second set of circumstances (dispersed demand, no powerful buyers), primarily because the relatively low value of a typical transaction only justifies low selling costs. Of course, specifically tailoring the message to the needs of the individual consumer, which was once effectively impossible, is becoming more and more feasible with the deployment of sophisticated IT and customer relationship management (CRM) software (Evans et al., 2004). Indeed, such technologies may bring about a degree of convergence between marketing practices, based around the internet and CRM, between consumer markets and those business markets that have relatively dispersed demand.

You will find that the word ‘relationship’ is used in Table 1.1, and then widely elsewhere in this book (see the titles of Chapters 3, 8 and 9, for example). Before you go

any further, it would be a good idea for you to think about what this term means in the context of B2B marketing. To help you think about this, take a look at the dilemma facing new sales and marketing executive Magnus in B2B Scenario 1.1.

B2B SCENARIO 1.1 ADVISE MAGNUS!

Magnus Johanson, only newly arrived as a sales and marketing executive at the engineering consultancy firm ENG Projects, had a problem and was looking for some advice from his boss, Petra Wend. He listened carefully to what Petra had to say:

Even people who don't know much about business-to-business marketing will often say that 'it's all about relationships'. This is one of those phrases that is both true and yet can be misleading. First, there's the matter of what 'relationship' means. This is not just a dull, academic question. There are relationships between people, and there are relationships between organizations. The two are not the same thing, and shouldn't be confused. Second, the bottom line is that business-to-business marketing is about business (the clue is in the name). So when we talk about relationships between people in B2B we are almost always talking about professional relationships rather than personal relationships. Don't confuse the two. While you may like the people you have professional relationships with, even enjoy their company, the purpose of the relationship is to deliver business results for all parties. Professional relationships have to deliver tangible business results. In this case, Magnus, let's be honest, you have failed to deliver what the client wanted. You have wasted their time and their money. In these circumstances you have to decide on the best strategy to manage the professional relationship. Now, go away and sort this mess out!

Magnus could not disagree. He had, indeed, wasted the client's time and money, by suggesting that ENG Projects would be able to deliver a technical solution that was beyond the capabilities of this fairly small consulting firm. The client really needed one of the big firms for this kind of project (such as Arup; see arup.com). Magnus had made a mistake by suggesting that ENG could take the project on, and then another mistake by ignoring the advice of his colleagues and stringing the client along, so that the (organizational) relationship between the two firms was now under some strain. He had already decided that the best thing to do, to soften the blow, was to spend some of his client entertainment budget on taking two of the key people from the client firm to watch Arsenal play football at the Emirates stadium, and then to an expensive restaurant for dinner after. Since his future at ENG probably depended on mending fences with this client, he was pretty sure that arranging a great day out was the best way of repairing the damage he had done. And Petra had emphasized the importance of professional relationships. At least that was how he interpreted her words.

Do you agree with Magnus's approach? Has he understood what Petra was saying? What would you do in Magnus's position?

Source: Inspired by Oakley and Bush (2016).

TABLE 1.1 Differences between business and consumer markets

Market structure differences		
Dimension	Business marketing	Consumer marketing
Nature of demand	Derived	Direct
Demand volatility	Greater volatility	Less volatility
Demand elasticity	Less elastic	More elastic
Reverse elasticity	More common	Less common
Nature of customers	Greater heterogeneity	Greater homogeneity
Market fragmentation	Greater fragmentation	Less fragmentation
Market complexity	More complex	Less complex
Market size	Larger overall value	Smaller overall value
Number of buyers per seller	Few	Many
Number of buyers per segment	Few	Many
Relative size of buyer/seller	Often similar	Seller much larger
Geographic concentration	Often clustered	Usually dispersed
Buying behaviour differences		
Dimension	Business marketing	Consumer marketing
Buying influences	Many	Few
Purchase cycles	Often long	Usually short
Transaction value	Often high	Usually small
Buying process complexity	Often complex	Usually simple
Buyer/seller interdependence	Often high	Usually low
Purchase professionalism	Often high	Usually low
Importance of relationships	Often important	Usually unimportant
Degree of interactivity	Often high	Usually low
Formal, written rules	Common	Uncommon
Marketing practice differences		
Dimension	Business marketing	Consumer marketing
Selling process	Systems selling	Product selling
Personal selling	Used extensively	Limited
Use of relationships	Used extensively	Limited
Promotional strategies	Limited, customer-specific	Mass market
Web integration	Greater	Limited
Branding	Limited	Extensive, sophisticated
Market research	Limited	Extensive
Segmentation	Unsophisticated	Sophisticated
Competitor awareness	Lower	Higher
Product complexity	Greater	Lesser

Sources: Chisnall (1989); Dwyer and Tanner (2002); Ford et al. (2002); Lilien (1987, 2016); Simkin (2000); Webster (1991); Wilson (1999, 2000); Wilson and Woodside (2001).

One of the conclusions that academics and professionals interested in B2B marketing draw from the kind of analysis presented in Table 1.1 is that interpersonal networking is a particularly important aspect of business marketing. An important recent development in interpersonal networking is the use of *social media*. Perhaps surprisingly, social media are an important marketing communications medium not only in consumer markets, but also in business markets (Drummond et al., 2018). We explore this in more detail in subsequent chapters of the book.

MARKET STRUCTURE DIFFERENCES

Derived demand

Bread satisfies man's wants directly: and the demand for it is said to be direct. But a flour mill and an oven satisfy wants only indirectly, by helping to make bread, etc., and the demand for them is said to be indirect. More generally: the demand for raw materials and other means of production is indirect and is derived from the direct demand for those directly serviceable products which they help to produce. (Marshall, 1920: 316)

It is the convention in marketing to treat demand by consumers as *direct* and demand from businesses as *derived*. This idea originated with the economist Alfred Marshall (Eatwell et al., 1987). At its simplest, it is supposed that consumers only buy goods and services to satisfy their wants, whereas businesses only buy things to facilitate the production of goods and services. In this case, consumer demand is wholly *direct* while business demand is wholly *derived*. The word derived indicates that the demand for something only exists so long as there is a demand for the goods or services that it helps to produce. Businesses do not 'want' forklift trucks or computerized logistics systems in the same way that consumers want fashion clothing or computer games. The demand for forklift trucks and logistics systems is derived from the demand for the products that they help to deliver. Of course, many industries have no contact at all with the final consumer. For example, aero-engine manufacturers (see the case study at the end of this chapter) sell their products only to other businesses, aircraft manufacturers; steel manufacturers sell their products and services to a wide range of industries, such as car manufacturing, shipbuilding and the construction sector. So, we have a chain of *derived demand*. For example, final consumer demand (*direct demand*) for cars and diesel fuel creates a derived demand for steel (to manufacture cars), ships (to transport crude oil), and many other goods and services besides. The derived demand for ships in turn creates a derived demand for steel, as well as a whole range of other products and services. The derived demand for steel creates many more forms of derived demand, including raw materials, transport services and general business services such as accountancy and management consultancy. The whole chain of derived demand is driven by the direct demand of consumers. The metaphor of a river is often used to describe the chain of derived demand, where 'downstream activities' are those that take place in close proximity to the consumer and 'upstream activities' are those that take place far away from the consumer. Take a look at B2B Snapshot 1.2 to get some additional insight into the concept of derived demand. In this snapshot, the final consumer demand for products like chocolate desserts and chocolate croissants creates the derived demand for chocolate, much of which is supplied by a company called Barry Callebaut, who do not themselves market chocolate to consumers.

While it is convenient to think of consumer demand as direct and business demand as derived, the stark dichotomy is probably a little misleading (Brennan, 2012; Fern and Brown, 1984; Simkin, 2000). Consumers do not generally buy washing machines because they 'want' a washing machine; rather, it is because of the valuable services the machine provides. The consumer may 'want' clean clothes, or to be accepted socially by sending out their children looking smart, or to look good in a clean white shirt for a job interview. The machine is a means to an end, not the end in itself, so that, arguably, the demand for the machine is derived. Equally, one can envisage a manager in a business organization using company funds to buy a particularly attractive painting for the office; while this would no doubt be justified in terms of creating the right ambience for effective working, it is easy to see it as a direct demand based on the intrinsic merits of the painting. Nevertheless, there is little doubt that the great majority of business expenditure represents derived demand. Firms do not buy such things as office buildings, factories, warehouses, raw materials, logistics support, cleaning services, lubricants and backhoe loaders for the pleasure that they give, but for their ability to facilitate the delivery of goods and services to customers.

B2B SNAPSHOT 1.2 BARRY CALLEBAUT

Barry Callebaut claims to be 'the heart and engine of the chocolate and cocoa industry' (Barry Callebaut, 2018), and it is certainly the biggest chocolate company that you have (probably) never heard of. Depending on where you come from, your favourite chocolate brand might be Lindt, Hershey, Guylan, Nestlé, Cadbury, or any one of a dozen other well-known consumer brands. It will not be Barry Callebaut, because it is an entirely business-to-business chocolate supplier. Its customers are businesses that use chocolate as an input to their manufacturing or service process, such as food manufacturers, confectionery manufacturers and catering companies. The 2017/18 Annual Report showed a sales volume of over two million tonnes of chocolate, a sales revenue of 6,948 Swiss Francs (€6,095 million) and a net profit of 357 million Swiss Francs (€313 million). In fact, profits were up nearly 9 per cent in 2017/18, and, despite facing a few challenges, Barry Callebaut was in great financial shape.

Perhaps the biggest challenge facing Barry Callebaut is the slowdown in demand in the historically important markets of Europe and North America. Of course, demand for Barry Callebaut products is entirely derived demand, created by the downstream demand for chocolate products from consumers. Manufacturers of chocolate cakes, chocolate croissants and chocolate desserts, for example, only buy chocolate so long as there is consumer demand for those products. Europe and North America are slow-growth markets because they are already relatively heavy consumers of chocolate so that there is little room for growth, and because of public health campaigns and growing consumer concern to reduce the amount of fat and sugar in the diet (a very good example of this is the UK change4life campaign; see www.nhs.uk/change4life). Sadly, for chocolate-lovers, chocolate is perceived to be a high-sugar, high-fat and relatively unhealthy foodstuff.

In contrast to the mature markets of Europe and North America, the Asia Pacific region is so far a relatively small part of Barry Callebaut's business (about 5 per cent

(Continued)

of sales revenue), but is regarded as a major opportunity for business growth. Sales volume grew by over 16 per cent in this region in 2017/18. Heat-resistant chocolate is a key product innovation that Barry Callebaut has developed to cope with the warmer climates of many countries in the Asia Pacific region. In fact, if you think it over for just a minute, you can see why heat-resistant chocolate is such a tricky innovation to achieve. The chocolate has to remain firm in a warm shop, but then melt deliciously in the mouth of the consumer. As things stand, Barry Callebaut seems to be the only business-to-business chocolate company that can offer this clever combination, giving it a valuable competitive advantage.

While heat-resistant chocolate is a particularly important innovation aimed at developing markets (notably countries where supply chains are relatively unsophisticated so that temperature control is problematic), Barry Callebaut also has a not-so-secret weapon to unleash on the mature markets: ruby chocolate. The aim is to expand the current three types of chocolate (milk, dark and white) to four, with the addition of ruby chocolate, which is made from ruby cocoa beans grown in countries including Ecuador, Brazil and the Ivory Coast, and then manufactured by a process known only to Barry Callebaut. Ruby chocolate: coming soon to a store near you (but not under the Barry Callebaut brand).

Sources: Atkins (2015, 2017a, 2017b); Barry Callebaut (2018); MarketLine (2018a).

The accelerator effect

The most straightforward implication of derived demand in business markets is that marketers must be aware of developments, both upstream and downstream, that may affect their marketing strategy. In particular, it is downstream demand that influences the level of derived demand in a specific business market. Of course, this is intuitively obvious – if the demand for new housing increases then clearly, perhaps after a time lag, the (derived) demand for housing materials such as steel and wood will also increase. In due course, and probably after a longer time lag, the (derived) demand for capital equipment used in the construction industry, such as backhoe loaders and cement mixers, may well also rise. However, what is less obvious is that the percentage change in derived demand may be much larger, or much smaller, than the percentage change in original demand. This is a phenomenon that can occur in capital equipment industries, and is known as the *accelerator effect*. The illustration in Snapshot 1.3 shows the basic arithmetic of the accelerator effect.

B2B SNAPSHOT 1.3 AN ILLUSTRATION OF THE ACCELERATOR EFFECT

Suppose that a house-building firm knows that it needs to own one backhoe loader for every 50 houses that it builds per year. Each backhoe loader is depreciated over five years. The company usually builds around 500 houses per year, and so owns a stock of

ten backhoe loaders. This means that it buys two new backhoes each year to replace machines that reach the end of their economic life.

Now, suppose that, because of a house-building boom, the firm experiences a growth in demand to 600 houses per year. Let us assume that the managers of the house-building firm expect this increase in production to be permanent. They need to increase their stock of backhoe loaders to 12, as well as replace two worn-out machines. Rather than buying two backhoe loaders, this year they buy four.

The increase in demand for houses experienced by the building firm was 20 per cent (that is, $100/500$), but the increase in purchases of backhoe loaders by the firm was 100 per cent (four instead of the usual two).

The accelerator effect in this case is five (the 100 per cent increase in demand for capital equipment divided by the 20 per cent increase in demand for houses).

Notice that if the managers of the house-building firm expect the demand for housing to remain constant from now on, this will then be a one-time-only increase in the demand for backhoe loaders. The long-term demand for backhoe loaders will increase by 20 per cent, exactly in line with the permanent increase in demand for houses. In subsequent years, the firm will replace, on average, 2.4 ($12/5$) machines each year.

What if the managers of the building firm expect their sales of houses to return to their previous level of 500 per year? The firm would temporarily own two more backhoes than it needed, and for one year only its demand for backhoes would fall to 0.4. The accelerator then works in reverse, and is entirely symmetrical, since sales of houses have declined by 16.7 per cent, and demand for backhoes has declined by 83.3 per cent, giving an accelerator of five (after allowing for rounding error).

The example in Snapshot 1.3 is hypothetical. It illustrates the principle of the accelerator only. A purely hypothetical example is needed because, in practice, things are never so clear-cut, and the underlying acceleration principle can be difficult to discern. In practice, managers will be cautious about investing in new equipment at the first sign of an increase in demand for their own products, since they cannot be sure that the new demand will be enduring. In the short term, managers are very likely to spend a little more on maintaining old equipment (so continuing to use equipment even though it has been fully depreciated on the balance sheet), rather than investing in new equipment, to get a better picture of the trend in demand. Naturally, managers can choose to lease equipment rather than buy it new – although this in itself does not make the accelerator principle incorrect, since the equipment-leasing company has to get its equipment from somewhere. For the accelerator principle to work to full effect, we have to assume that the capital equipment is being worked to full capacity; otherwise, the building firm in our illustration could have chosen to work its existing backhoe loaders more intensively rather than buy new machinery.

Despite these various objections, there is considerable evidence that the acceleration principle plays a substantial role in explaining the demand for capital equipment. Almost all macro-economic models of the economy include a version of this principle to explain capital investment, indicating that the principle is valid (Eatwell et al., 1987). The key implication of the principle for business marketers is that, in capital equipment markets, the future trend in demand cannot be predicted straightforwardly from forecasts of demand in downstream markets. Changes in downstream demand

can lead to much larger percentage changes in demand for capital equipment. The fact that this is very unlikely to happen with the simple arithmetic precision of our illustration, for the various practical reasons discussed, makes the forecasting job much harder. One task for the business marketer working in such an industry is to understand both the scale of the underlying accelerator principle for the industry, and the moderating influences on the accelerator exerted by the conditions in the market and the behaviour of managers in customer organizations.

Market concentration in business-to-business markets

Business-to-business markets in general are characterized by a higher concentration of demand than consumer markets. However, the degree of demand concentration varies from market to market, and it is important to have some means of comparing markets to establish just how highly concentrated they are. The standard measure that is used is the **concentration ratio**. A concentration ratio is defined as the combined market shares of the few largest firms in the market – what is known as the ‘oligopoly group’ in the market. Quoted concentration ratios are usually based on the top three, four or five firms; that is to say, the concentration ratio is the sum of the market shares held by the top three, four or five firms. For purposes of economic analysis and economic policy, concentration ratios are important because it is supposed that the higher the concentration ratio, the more likely it is that firms in an industry will collude to raise prices above those that would be found in a truly competitive market. Economists also theorize that where concentration ratios are relatively high, industry will be less innovative and production volumes less stable. Empirical economic research has generally shown that prices do tend to be higher, and innovation less dynamic, in highly concentrated industries (Eatwell et al., 1987).

The perspective taken by economists, when studying concentration ratios, is generally that of the *customer* of the industry in question and the *economic efficiency* of the structural conditions of the industry. To the business marketer, it is the perspective of the industry *supplier* that is generally most relevant, along with the implications of the industry structure for *sales and marketing strategy*. While economists are generally most concerned about the *monopoly power* that businesses have over their customers because of the concentration of market share, business marketers are usually more interested in the *monopsony power* that businesses have with respect to their suppliers because of the concentration of buying power. The degree of monopsony power in the supply market is symmetrical with the degree of monopoly power in the customer market; those firms that control large shares of the customer market are also the largest customers for suppliers to the industry. So, we can use the concentration ratio (concentration of market share) as a proxy for the concentration of buying power within an industry.

Illustrating concentration ratios

The concentration of market power in consumer markets is widely known and understood. For example, anyone who has studied consumer marketing in the UK knows that, although there are many *brands* in the laundry detergent market, the market is in fact dominated by just two producers: Procter & Gamble and Unilever. The brands owned by Procter & Gamble have a combined share of 50 per cent of the UK market, while Unilever brands have a combined share of over 30 per cent.

At the company level, this market is highly concentrated, since two firms control over 80 per cent of the market, and can be reasonably referred to as a *duopoly*. Clearly, any business wanting to supply products or services to the UK laundry detergent market must take this factor into account when developing a sales and marketing strategy. If your aim is to obtain a substantial share of the business to supply the UK laundry products market, then it is essential to do business with at least one of the industry leaders. To have any chance of achieving this, you must become very familiar with the business of those companies and adapt your products and services so that they exactly match their requirements, which may well involve specific investment in new technology or new systems. Throughout this book, we will frequently return to the implications of this for the theory and practice of business marketing.

In order to understand business-to-business marketing, it is helpful to understand the degree of industry concentration that can be found in B2B markets. In some industries, market concentration is very high; for example, the global market for heavy electrical equipment is dominated by the GE Company (over 30 per cent share), Alstom (around 20 per cent share), Siemens and Mitsubishi (both of these firms have over 12 per cent share). However, other industries are less concentrated; for example, in the global wireless telecommunications market, the top four firms worldwide have relatively small market shares – China Mobile (13.8 per cent market share), Vodafone (6.3 per cent), Airtel (5.1 per cent) and China Unicorn (4.4 per cent) (MarketLine, 2018c). The heavy electrical equipment market is much more concentrated than the wireless telecommunications market. Business marketers aiming to develop a marketing strategy to supply products or services to either of these industries clearly need to be aware of the buying power of the top companies, particularly in very highly concentrated sectors like heavy electrical equipment. However, in many markets there is also scope to develop sales and marketing strategies based on other segments of these markets, rather than simply focusing on the major players.

Other market structure differences

An understanding of derived demand, the accelerator effect and concentration ratios provides a basis for analysing many of the structural differences between typical consumer and business markets. Table 1.2 listed a number of other dimensions, along which lines experts have proposed that there are systematic differences between business and consumer markets. *Demand elasticity* is one of these dimensions. First, it is argued that businesses have less freedom simply to stop buying things than consumers, so that business demand is likely to be less price elastic (that is, less responsive to price changes) than consumer market demand. Second, and for similar reasoning, it has been suggested that there will be more instances of reverse (or 'perverse') price elasticity of demand in business markets than in consumer markets. Both of these hypotheses about demand elasticity arise from the nature of derived demand and assumptions about the availability of substitutes for the inputs to critical business processes. Businesses need critical inputs if they are to continue trading.

For example, if a firm manufacturing laptop and tablet computers cannot gain access to the latest generation of microprocessors, then it cannot build machines that will sell, and the very existence of the company is at risk. Should the purchasing professionals

at this company see the price of microprocessors rising, then they may take this to mean that there is a shortage of supply (price tends to rise in markets where demand outstrips supply) and may therefore *increase* their orders in the short term in the hope of guaranteeing a sufficient supply of microprocessors to keep the business functioning. In effect, this is a case of reverse elasticity, where a rise in price triggers an increase in demand. Even if the purchasing team at the computer firm does not believe that there is likely to be a shortage of microprocessors, price changes are unlikely to affect the volume that they purchase to any great extent. The volume of microprocessors that the company buys is primarily driven by their computer sales forecasts, and not so much by component prices. The expectation is that demand for microprocessors will be inelastic with respect to price.

From Table 1.2 we can see that business markets have been described as more heterogeneous, more fragmented and more complex than consumer markets. All of these characteristics are reflections of the enormous diversity of organizational forms found in business markets. Of course, the point is not that consumers are all alike; consumers are people, and each individual person is unique! Rather, it is that organizations are even more diverse than consumers. For example, most private firms employ fewer than ten people, while global businesses, such as those we discussed earlier in the chapter – for example, Alstom, GE and Air Products – employ tens of thousands of people at multiple locations across several continents. A local decorating business employing three or four people has almost nothing in common with, say, a global electrical equipment manufacturer.

BUYING BEHAVIOUR DIFFERENCES AND MARKETING PRACTICE DIFFERENCES

In this section, we will discuss these aspects of the differences between business markets and consumer markets only briefly. The reason for this is that buying behaviour and marketing practice are the subject matter of the remainder of the book, and we wish to avoid repeating ourselves excessively! In the following chapters, you will find detailed discussions of organizational buying behaviour and business-to-business marketing practice.

In essence, organizations tend to have more professionalized buying processes than consumers, often involving formal procedures and explicit decision-making practices, which in many organizations are implemented by managers who are specifically employed as purchasing professionals. Transaction values can be very high. As a result, sellers tend to tailor their product offerings to the needs of the buyer, seeking to offer complete solutions to their business problems rather than just selling them a product. The conventional tools of consumer mass marketing are not very appropriate under these circumstances. Promotional messages must be tailored to the specific needs of the customer. Sales executives (and, for the most important customers, key account managers) are employed to develop and manage the relationship between the buying and selling organization. All of these aspects of buying behaviour and business marketing practice will be explained in much greater detail in subsequent chapters of the book.

As we approach the end of Chapter 1, it is time to check in again on new B2B sales and marketing executive Magnus, in B2B Scenario 1.2.

B2B SCENARIO 1.2 MAGNUS AND THE ENGINEERS

Despite upsetting an important client (a situation where his boss Petra eventually had to step in and sort it out herself), Magnus Johanson still has his job at engineering consultancy firm ENG Projects (see B2B Scenario 1.1). In fact, after a sticky start he has settled in nicely and is definitely starting to make a good impression on the senior team at the firm. As a recent marketing graduate, he is familiar with a great many marketing techniques that were previously unheard of at ENG. The company is now leading the way in its sector in the application of social media marketing. Magnus has developed an excellent ENG blog, using material sourced from the highly qualified technical staff that the company employs. This blog is generating a lot of traffic and quite a few enquiries from prospective new clients.

Unfortunately, Magnus has hit another snag. He is on the project team to develop a new service designed to audit and improve energy management systems for public sector organizations such as schools, hospitals and local authorities. This is potentially a lucrative business opportunity since governments all across Europe are keen to demonstrate that they are working hard to save energy and contribute to their commitments under international climate change agreements. The problem is that Magnus is having a hard time making his voice heard. Everyone else on the team has an engineering background and when Magnus tries to raise topics like market research, market positioning, market segmentation and marketing communications, he is largely ignored. As far as Magnus is concerned, the team seems to spend far too much time discussing unnecessarily complicated technical issues, and strongly resists the idea that the service should be built around a comprehensive understanding of customer needs. Clearly, the engineers think that they are dealing with an engineering problem, and the solution will be an engineering solution. Whereas Magnus sees the design of the new service as a business problem requiring marketing and customer information, the engineers on the team seem to see the service design process as something different. When he gets the chance to speak unguardedly to Petra, Magnus tells her:

These engineers don't seem to understand that the right solution is the solution that meets the customer's requirements, not some abstract, ideal, perfect engineering solution. They spend ages refining some minor technical point that the customer will simply not be interested in. And they have no idea at all about marketing. They seem to think that marketing is just money down the drain.

Petra ponders what advice she should give Magnus.

Source: Based on Keaveney (2008).

CLASSIFYING BUSINESS PRODUCTS AND MARKETS

We have emphasized that the key difference between business marketing and consumer marketing is the nature of the customer rather than the nature of the product. In business markets, customers are organizations. There are indeed many products that are purchased by organizations that one cannot envisage being bought by consumers, such as management consultancy services and heavy engineering equipment.

Equally, there is a vast array of products bought both by organizations and by private consumers, such as tablet computers and health insurance services. This raises the question of whether one can classify business products separately from consumer products, or whether a single classification system will function equally well for both.

The standard approach to classifying business products is to use a classification system that is quite separate from the usual consumer product classifications (Copeland, 1924; Kotler, 1972; Murphy and Enis, 1986). This classification is based on the use to which the products are put, and the extent to which they are incorporated into (or 'enter') the final product. Many things that organizations buy, such as office cleaning services, are not incorporated into the final product at all. Some things, such as the DVD drives that a computer manufacturer buys from an optical drive manufacturer, are incorporated directly and completely into the final product. The distinction between 'entering goods' and other types of purchase is based on the idea that something incorporated into the buying organization's final product contributes directly to the finished product quality and so directly to the customer's business reputation. Other purchases affect the buyer's own customer less directly, and so do not have such an immediate potential influence on the buying organization's business performance. The system of classification is as follows:

- *Installations* are major investment items such as heavy engineering equipment, which are treated as investment items by the customer, so that the costs involved in acquiring them are depreciated over their expected economic life. Customers are expected to plan such investments carefully, perhaps involving the use of extensive financial analysis, including discounted cash flow analysis and scenario planning.
- *Accessory equipment* consists of smaller items of equipment such as hand tools. Larger items of accessory equipment may be treated as investment items and depreciated on the financial statements, while smaller items will be treated as expense items. The economic life of accessory equipment is usually shorter than that of installations.
- *Maintenance, repair and operating (MRO) supplies* are individually minor items of expenditure that are essential to the running of the organization. These would include such things as office supplies (for example, stationery), lubricants and abrasives.
- *Raw materials* are unprocessed basic materials such as crude oil, coal and metal ores. These products are often traded on international exchanges (such as the London Metal Exchange, www.lme.co.uk) and are particularly prone to price fluctuations arising from the forces of supply and demand. For example, towards the end of 2015 the spot price per tonne of aluminium was below \$1,500 but just over a year earlier, at the end of 2014, the price had stood at over \$2,000 per tonne. Price fluctuations of this magnitude (in this case, a price decline of more than 25 per cent in a year) are not unusual in global commodity markets.
- *Manufactured materials and parts* include raw materials that have been processed (such as finished steel and prepared timber) and component parts (such as computer optical drives and automobile windscreens) that are ready to be incorporated directly into the finished product.
- *Business services* are often subdivided into maintenance and repair services and business advisory services.

From this classification of business products, one can easily derive a commonly cited classification of industrial manufacturing organizations into *original equipment manufacturers* (OEMs) and others. OEMs are manufacturing businesses that buy component parts from other firms to incorporate into a finished product that is then sold under their own brand name to other businesses or to consumers. Car manufacturers (such as VW/Audi, Ford and Toyota) and computer manufacturers (such as Dell, Hewlett-Packard and Lenovo) are classic OEM businesses. One can then distinguish between the OEM market (sales of component parts to OEMs for incorporation into the final product when it is first manufactured) and the *after-market* (sales of component parts to the owner of the product *after* it has been sold by the OEM). In the after-market, for example, car owners may need to replace a shattered windscreen, and computer owners may choose to upgrade the RAM capacity of their laptop machine. OEM customers are by definition business customers. They usually buy in large quantities, and are typically large and powerful buying organizations. Customers in the after-market may be either organizations or consumers. Both organizations and consumers buy vehicles and computers, for example, for which they will buy spare parts or upgrades. The OEM market is therefore an exclusively business-to-business market, while the after-market includes both businesses and consumers.

In contrast to the standard classification system for business products that we have cited above, Murphy and Enis (1986) argued that only one classification system was needed for products, and that it could apply equally well to business and consumer products. They proposed a four-fold classification of products based on the buyer's evaluation of the effort involved in acquiring the product and of the risk of making a poor decision. Effort and risk are considered to be the costs incurred by the buyer when making a decision; effort is a variable that includes the amount of money, energy and time that the buyer is willing to expend in order to acquire a given product.

- *Convenience products* involve very little effort and negligible risk for the buyer. The maintenance, repair and operating supplies described previously would generally be classified as convenience products.
- *Preference products* involve a little more effort than convenience products but substantially more risk. In general, this means that they are a little more expensive than convenience products, but that the buyer perceives a much greater chance of making the wrong decision. Minor items of accessory equipment, as described above, would generally also be classified as preference products; Murphy and Enis (1986) also mentioned business travel as a characteristic preference product.
- *Shopping products* involve a great deal more effort and perceived risk than convenience or preference products. This would include major items of accessory equipment, manufactured materials and parts (that is, products that enter the final product completely), and market research services. Buyers are willing to spend a considerable amount of time and energy on acquiring these products because of their relatively high price and the risk associated with possibly making the wrong decision.
- *Specialty products* are the highest ranked in terms of both buyer risk and effort. Installations (such as major new items of engineering plant) and highly specialized business services (such as the services of a top management consultancy firm)

would fall into this category. The main distinction between specialty products and shopping products is effort, rather than risk. Buyers are prepared to invest great amounts of time and energy in seeking to make the right choice about these high-value purchases.

The two principal classification systems described above should be regarded as complementary rather than as alternatives. The first of them concentrates on the nature of the product, the way in which products are used and whether they enter the final product or not. It is a seller-orientated classification scheme. The Murphy and Enis (1986) classification is buyer-orientated, classifying products on the basis of dimensions that are considered meaningful to buyers. Although they are logically distinct, there is clearly a degree of consistency between them. For example, 'installations' will almost certainly fall into the category of 'specialty products', and MRO supplies almost certainly into the category of 'convenience products'. The Murphy and Enis classification has the advantage of explicitly treating goods, services and ideas equally. In classifications of business products, it is all too easy to relegate services to a single undifferentiated category, with the implication that services are relatively unimportant compared to goods. However, as we saw earlier in the discussion of Table 1.1, the service sector is a much larger employer than the manufacturing sector in the world's major economies, so it is important not to think of the marketing of business services as somehow less important than the marketing of industrial products.

CHAPTER SUMMARY

- Business marketing is concerned with the marketing of goods and services to organizations. The key distinguishing feature of business marketing is the nature of the customer, rather than the nature of the product. Although there are products that are bought only by organizations and not by final consumers, there are many products that are bought by both organizations and consumers.
- Modern economies are becoming increasingly service orientated. The service industries account for close to 80 per cent of employment in countries such as Australia, Canada, the UK and the USA – and the trend is towards even higher levels of service sector employment.
- Business markets can be distinguished from consumer markets along a wide range of dimensions, but those dimensions can be conveniently grouped into market structure, buying behaviour and marketing practice. At the most fundamental level, it is structural differences that tend to drive differences in buying behaviour and in marketing practice. In particular, demand in business markets is derived rather than direct, and levels of demand concentration in business markets are typically much higher than in consumer markets. As a result, buyer power in business markets can be much greater than in consumer markets. In turn, this often means that business marketers prefer relational marketing strategies, developing solutions tailored to individual customers rather than conventional marketing mix strategies.
- A common classification for business products is installations, accessory equipment, MRO supplies, raw materials, manufactured materials and parts, and business services. A key distinction is made between products that are incorporated into the final product (entering goods) and those that are not.

Original equipment manufacturers combine components bought from other suppliers into a finished product that is sold to end-users. The after-market comprises sales of parts for repair and upgrade to products that are already owned by an end-user. Business products can also be classified using the customer-orientated categories of convenience, preference, shopping and specialty products. This classification scheme is based on the risk and the effort that buyers perceive in acquiring a given product.

QUESTIONS FOR DISCUSSION

1. Why do we not differentiate between business markets and consumer markets on the basis of the type of product purchased?
2. Draw up an elementary chain of derived demand for the laptop computer industry.
3. What is the accelerator effect and why is it important in business-to-business markets?
4. Are business markets fundamentally different from consumer markets?
5. What is a four-firm concentration ratio? What difference does it make to the business marketer whether this ratio is 30 per cent or 70 per cent?

CASE STUDY 1.1 ROLLS-ROYCE GROUP PLC

There are probably still a lot of people around who think that the famous British engineering company Rolls-Royce is a car maker, but that has not been true for many years. Rolls-Royce cars today are manufactured by a division of BMW. There will certainly be many people who believe that Rolls-Royce makes its money by manufacturing and selling aero-engines, and this is true up to a point. The company certainly does produce aero-engines, as well as power units for use in the marine and energy-generation sectors. However, if Rolls-Royce's business stopped at the point where it delivers an engine to an aircraft manufacturer (for example, a Trent 1000 delivering over 74,000 lbs of thrust, for use on the Boeing 787 Dreamliner), then the company would be much smaller and less profitable than it is. That is because around 50 per cent of Rolls-Royce revenue is generated from after-market services (Figure 1.1).

In 2017, Rolls-Royce achieved overall revenue of £15.1 billion, split almost exactly 50:50 between original equipment sales and after-market services. In Rolls-Royce's largest business unit, the civil aerospace sector (selling and maintaining aero-engines for civil airlines), 52.4 per cent of the revenue was generated by after-market services. This revenue is created by selling services such as TotalCare® to airlines who specify Rolls-Royce engines on the planes that they buy. The airline pays Rolls-Royce an agreed cost per flying hour, and in return Rolls-Royce delivers a complete engine support service for the lifetime of the engine. As a result, the airline knows exactly how

(Continued)



much to budget for engine maintenance, transfers many of the risks associated with operating an aero-engine to Rolls-Royce, improves the residual value of the engine (rather like having your premium-brand car serviced regularly by the main dealer), and allows the airline to concentrate on its core business of selling flights and getting passengers and cargo safely to their destination.

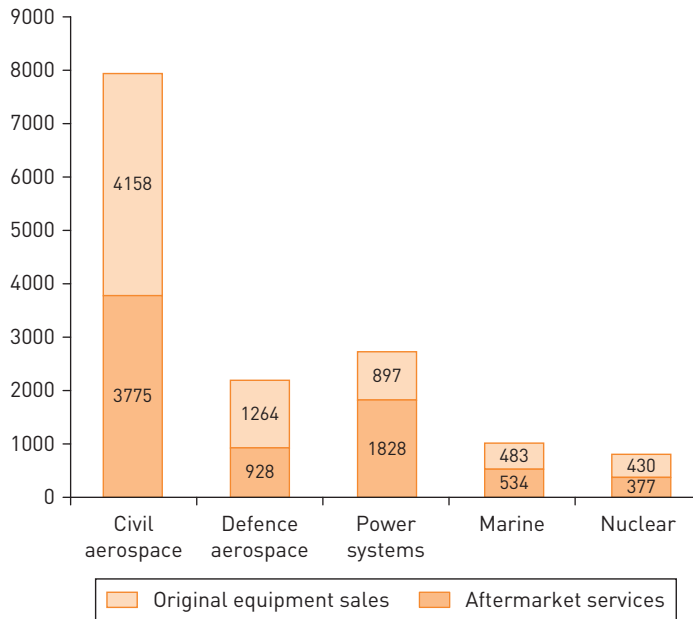


FIGURE 1.1 Rolls-Royce revenue analysis 2017 (£ millions)

Source: Based on data from Rolls-Royce (2018a).

Perhaps this rather technical description of the financial and engineering aspects of delivering after-market services is illuminated more entertainingly by a description of what this can all mean to airline operators and their passengers in practice. Imagine a long flight from Asia to America passing high over the Pacific, where the aircraft is struck by lightning. Planes are frequently struck by lightning and usually it does no harm at all, but on this occasion one of the engines loses power briefly. The passengers on the plane hardly notice, but Rolls-Royce engineers in Derby (a city a very long way from the Pacific) start analysing the problem immediately. There is no danger, since the engine is running fine again and the plane could land perfectly well without it anyway. The engineers simply need to work out whether the plane will need a full engine inspection when it touches down in Los Angeles. All of the data the engineers need is silently and automatically sent from the plane to the engineers in Derby, carefully analysed, and conclusions are drawn even before the plane has touched down. Everything is fine, and the plane will not be delayed in its subsequent departure from LA.

Although there is little publicly available financial information about the relative profitability of selling service contracts on aero-engines compared to the profit margins

made on selling the engines themselves, industry analysts believe that Rolls-Royce makes very slim profit margins on engine sales. The real money is made from the long-term partnership with the airline that is created through the sale of a service contract. The emphasis on managing long-term relationships with customers at Rolls-Royce is typical of many business-to-business companies: 'The Group places great importance on working closely in partnership with its customers to understand their operations and align the Group's service capability to meet their needs' (Rolls-Royce, 2009: 22).

So, on what basis has Rolls-Royce built its current success: excellence in engineering and manufacturing, excellence in customer service or excellence in managing customer relationships? Well, the truth is probably a combination of all three. In addition, Rolls-Royce has established a wide geographic base, including the Americas, Asia, Australia, Europe, the Middle East and Africa, with manufacturing facilities in 20 countries and customer support facilities in 50 countries. The largest geographic market is the USA, but revenues are geographically diversified. This is a particularly important consideration at a time when the world economy has experienced a slowdown, since growth in the civil aerospace market is closely tied to growth of economic output (or GDP). In particular, Rolls-Royce's strength in Asia looks like a substantial business advantage, as the Asian economies began to emerge from the global economic slowdown much sooner and more strongly than other regions of the world. On the other hand, the substantial exposure of the company to the sluggish economies of North America, the UK and Europe is certainly a matter of concern. Another concern is that, in recent years, Rolls-Royce has also been the object of an investigation by the UK's Serious Fraud Office (SFO) in respect of alleged bribery and corruption. That topic will be picked up again in Chapter 4, where we examine the Rolls-Royce/SFO case in greater detail.

CASE STUDY QUESTIONS

1. How does the concept of service-dominant logic apply in the case of Rolls-Royce?
2. Rolls-Royce has to compete against third-party maintenance operators, who also offer comprehensive service packages to airlines on both Rolls-Royce and other manufacturers' engines. What would you say are Rolls-Royce's key advantages in winning service contracts against such competitors?

Sources: Datamonitor (2009); MarketLine (2018b); Pfeifer (2018); Pooley et al. (2018); Rolls-Royce (2009, 2012); *The Economist*, 2009; www.rolls-royce.com.

FURTHER READING

Brennan, R. (2012) 'The industrial/consumer dichotomy in marketing: can formal taxonomic thinking help?', *Journal of Customer Behaviour*, 11 (4): 311–24.

This article revisits the arguments discussed by Fern and Brown (1984) in the light of developments in marketing theory over the last three decades.

(Continued)



Fern, E.F. and Brown, J.R. (1984) 'The industrial/consumer marketing dichotomy: a case of insufficient justification', *Journal of Marketing*, 48 (Spring): 68–77.

It may look a little strange to recommend a reading from the 1980s. However, it is worth taking a look at this article to understand the fundamental arguments: on the one hand that 'marketing is marketing' and B2B marketing is simply the application of general marketing principles to a B2B context, and on the other hand that B2B marketing is fundamentally different from consumer marketing. The next reading brings the arguments up to date.

Vargo, S.L. and Lusch, R.F. (2004) 'Evolving to a new dominant logic for marketing', *Journal of Marketing*, 68 (1): 1–17.

While we are on the subject of the fundamental nature of B2B marketing, now is probably a good time to take a look at this highly influential article (arguably the most influential article on marketing in the first decade of the twenty-first century). What does service-dominant logic imply for B2B marketers? Can you see any parallels between the arguments of Fern and Brown (above) and those of Vargo and Lusch? Think about it! If you want to read more about this important topic, take a look at Vargo and Lusch (2011), which addresses the topic from a specifically B2B angle.

For a change from the fairly heavy material found in the three articles suggested above, now would be a good time to become familiar with, and to bookmark, one of the most informative websites on B2B marketing practice, namely www.b2bmarketing.net. Explore the range of information about current hot topics in B2B marketing at this website.

2

BUYER BEHAVIOUR

LEARNING OUTCOMES

After reading this chapter you will:

know how the nature of a company's activities and its business strategy affect its dealings with supply markets;

understand differing purchasing orientations and their contribution to a customer's acquisition of supplier resources and capabilities;

be able to explain the buying process and reasons why this process can vary;

be able to describe the membership and characteristics of the decision-making unit;

be able to explain how and why individual needs can sometimes override rational decision-making;

know about the job of the purchasing professional;

understand how buying is evolving in an era of the digital and Internet of Things (IoT); and

understand the implications of these factors for the business marketer.

INTRODUCTION

Few customers, private or organizational, are self-sufficient, able to maintain their existence by satisfying their needs without drawing on the capabilities of suppliers, and without purchasing products marketed by those companies. To function and to achieve objectives requires an organization to have access to supply markets from which it can obtain products to support its own activities. Behaviour associated with gaining access to necessary supply markets and products is affected by a variety of factors. Some of these are external to an organization, such as general macro-environmental forces, as well as influences that are more peculiar to the sector and market in which the organization operates. In addition to these external dynamics, purchasing is affected by what goes on inside a firm. So, consideration has to be given to how organizational characteristics, as well as group and individual factors, affect purchasing behaviour and decisions (Webster and Wind, 1972). The central themes in this chapter lie in understanding what goes on inside a business and how

organizational, group and individual forces influence the purchasing behaviour of business customers, and the implications for the business marketer of the way in which organizational customers deal with supply markets as a result of these forces.

ORGANIZATIONAL FACTORS AFFECTING PURCHASING DECISIONS

Organizations are not faceless and monolithic; rather, they consist of human beings who repeatedly make decisions and take particular courses of action regarding purchasing. So, the organizational factors discussed here inform the purchasing behaviour of managers in customer companies.

The nature of company business

We can think about our customers in terms of the industry sector or market in which they operate and how the dynamics at play within these industries influence their purchasing behaviour. However, it is possible to operate at a more general level by thinking about the 'technology' associated with our customers' businesses. By this we mean the way that a customer organizes their own activities in order to perform transformation processes that represent the essential components of their value-adding activities (Woodward, 1965). A company can be categorized according to whether its activities are essentially based on unit, mass or process technology.¹ This classification system could be criticized because it is derived from the manufacturing and engineering industries, while, in the previous chapter, we saw the huge importance of the service sector. Nevertheless, the categories can be used – irrespective of whether a customer organization might be viewed essentially as a manufacturing, engineering or service business – to generate some understanding both of the nature of the key product capabilities that customer companies might purchase, and of the expectations that might be placed on suppliers.

Unit production involves the design and supply of products that are tailored to specific customer requirements. The bespoke products are typically associated with major capital investment projects, with a company's production activity being triggered by, and adapted to meet, the requirements of the individual customer. The technological complexity and scale of such projects affect the supply needs and purchasing behaviour of organizations whose business activities essentially revolve around competing for and supplying such major investment projects. A company will have the technical competence and operational capabilities both to design and produce some components/parts that are an essential piece of the final product, and to assemble/configure and install the finished product.

However, the company also has to draw heavily on the design and production capabilities of suppliers that provide the materials, components or equipment that are central to the finished project as well. The unit production company typically requires the involvement of such suppliers in its design and production/assembly phases and requires coordination among its various key suppliers to ensure the completion and financing of these major projects. Companies whose business is geared around unit production include organizations such as Mitsubishi Heavy Industries Ltd.

¹The discussion in this section is based on material from Gadde and Håkansson (2001).

The company's Energy Division competes for multi-million-dollar projects worldwide to provide power-generation installations and distribution systems, requiring it to work with a variety of subcontractors in order to assemble the finished systems. Other businesses, such as those supplying organizations with bespoke and complex information and communications technology (ICT) systems, again work in a similar way. BT, for example, installs and manages ICT systems such as that used by the Fiona Stanley Hospital in Perth, Western Australia. The system draws on BT's information communications expertise, but to assemble and operate this bespoke system it has to draw from the technological capabilities of other parties. The complexity, scale and bespoke nature of such products mean that purchasing lies within the remit of the team assembled to oversee the project, with managers that are responsible principally for the technical content of the final product assuming a key role in dealing with suppliers. (Visit www.globalservices.bt.com to learn about other complex, bespoke solutions.)

In contrast to unit production businesses, a *mass production* company is involved in the design and supply of high-volume, standard products. Operational efficiency and a low cost base are central to the ability of mass production companies to compete. This efficiency is in part determined by the equipment used and the integration of the various sections that make up the company's primary production activities. The materials and components used to make up a finished product also contribute to the company's cost base. To maximize the efficient use of its resources, a company's production activities will be characterized by a high degree of inflexibility, requiring that the supply of materials and components used in primary operational activities be precise, regular and consistent. To this end, the company would expect key suppliers to adjust logistical and administrative procedures to suit its requirements, to integrate these procedures with its own automated operations via cloud computing systems and IoT (Internet of Things) platforms. The importance attached to the stable and secure flow of materials and components to support the buying organization's primary production activities often results in the company seeking to have some influence over the behaviour and activities of businesses that are not immediate suppliers but are nevertheless part of its supply chain.

A mass production company's ability to compete is determined not only by its low cost base but also by the regular introduction of new products into its target market. The company's key material and components suppliers would be expected to contribute to the buying organization's new product development activities. When new products are being developed, a supplier will have regular contact with the buying organization's design and technical managers. However, once a supplier's material or component proposal is accepted and becomes part of the customer's product specification, the principal point of contact is then with the purchasing function. Companies that operate in this way with their supply markets are quite diverse, ranging from high-volume car manufacturers to food processors such as Kraft-Heinz and Nestlé. For food processors, efficient operations are central to the company's ability to remain cost-competitive. A key contributor to a food processor's product costs lies not in the food that it provides to consumers but in the packaging that contains and preserves that food. In addition to this, the packaging acts as an important marketing tool for the food company. So the packaging supplier makes a significant contribution to the food processor's finished product, with companies simultaneously trying to reduce packaging costs and develop innovative designs. For example, if you think about

olive oil, you might picture it in tin cans or bottles. Oil is particularly vulnerable to light and air, such that the oil's properties quickly deteriorate. So glass bottles are not ideal for olive oil. Packaging supplier Tetra Pak has worked with one of its customers, the Spanish oil producer ArteOliva, to eliminate this problem by developing a carton package for the customer's oil products. Having developed a packaging product that worked, all that remained was to convince retailers and consumers of the added value offered by the new packaging form; that is, an oil with a longer shelf life but one which retains its health-giving properties. (Visit www.tetrapak.com for other case study examples of packaging solutions provided by the company.)

While the ideas of mass production have obvious resonance when we think about companies producing tangible consumer goods, they can be extended to service businesses. If we take the retail sector, for example, large chains such as Aldi, Carrefour, Ikea, Mercadona, Sainsbury and Walmart operate on the same principles, where the key to business success is the ability to keep costs per square metre to a minimum. Supply continuity is important and retailers will, for example, work with key suppliers to maximize the efficiency of retail operations.

As with mass production, the *process production* company is involved in the manufacture of high-volume products, with low cost, operational efficiency and therefore supply continuity being central to the organization's performance. A key distinction is that the process-producing firm does not assemble finished products; rather, its business centres on the processing of raw materials for use in other supply chains. The company will typically consume high volumes of necessary materials, with those that have a standard specification being sourced via commodity markets. Others, which may be unique to the buying organization's requirements, will be purchased from specialized suppliers. Consumption volume, the importance of supply continuity and the effect of raw material prices on the processor's business performance mean that, although a company might have buyers responsible for purchasing specific commodity materials, corporate management will also have some involvement in purchasing activities. The equipment used as part of the organization's primary processing activities is central to the business's performance. Equipment purchases are infrequent, but they represent complex capital investment projects, with suppliers becoming involved with the buying company's project team at the early stages of an investment project. Businesses involved in process production include steel manufacturers such as Baosteel and utilities companies such as E.ON.

BUSINESS STRATEGY

In addition to thinking about a customer's operational 'technology', vendors might also consider the customer's business strategy as this can give some indication of the way in which the customer will deal with supply markets. A firm's generic strategy defines the organization's competitive domain and how it will position itself against competitors. Decisions made at the business level regarding a firm's competitive strategy are guided by and also inform actions and decisions at the functional level, including purchasing. So, for example, a firm that adopts a *product leadership* strategy relentlessly pursues innovation in order to offer customers leading-edge products that consistently enhance the value derived by its customers in their use of the company's products (Treacy and Wiersema, 1993). Product leadership requires that a company has excellent technical and creative abilities