International Marketing and Purchasing of Industrial Goods

An Interaction Approach

By IMP Project Group

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Preface

This book presents a new approach to industrial marketing and purchasing based on a research project carried out in five European countries. The book, however, is not a complete and final report of the project. It will be followed by others.

The book ought to be of interest both to researchers and managers. It presents an alternative theoretical approach but is also highly empirical. The main part of it consists of descriptions and analyses of actual marketing and purchasing problems.

The research work has been made in collaboration between researchers in France, Italy, Sweden, West Germany, and Great Britain. In writing this book there has, however, been a certain division of labour. The three first chapters have mainly been written by Malcolm Cunningham, David Ford, Lars Hallén, Jan Johanson, and the editor. The authors to the company cases and the themes are named in the book. The introductions to the different sections of company cases and themes as well as the final chapter have been an editorial task. The whole volume has been checked by the English group from a language point of view.

A research project like this could not have been accomplished without support from many different persons and organizations. There are especially three groups that we would like to mention. Firstly, we have benefited from the encouragement and advice of our colleagues at the six different research institutes that have been involved. Secondly, we are deeply indebted to all the companies that have helped us with the data collection by giving us permission to interview their personnel. Thirdly, the project could never have been carried out without the support from the following foundations and organizations:

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As we will continue to work with the approach presented here we are very interested in getting in contact with researchers or managers involved in the same type of problems. Please, feel free to contact any of us.

Uppsala
January 1981

On the behalf of the IMP Project Group
HÅKAN HÅKANSSON

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Chapter 1

Introduction

A CHALLENGE

This book is based on an approach which challenges the traditional ways of examining industrial marketing and purchasing. This approach can be outlined as follows:

Firstly, we challenge the concentration of the industrial buyer behaviour literature on a narrow analysis of a single discrete purchase. Instead we emphasize the importance of the *relationship* which exists between buyers and sellers in industrial markets. This relationship is often close. It may also be long term and involve a complex pattern of interaction between the two companies.

Secondly, we challenge the view of industrial marketing as the manipulation of the marketing mix variables in order to achieve a response from a generalized, and by implication passive market. We believe it necessary to examine the *interaction* between individual buying and selling firms where either firm may be taking the more active part in the transaction.

Thirdly, we challenge the view which implies an atomistic structure in industrial markets. This view assumes a large number of buyers and sellers, with ease and speed of change between different suppliers for each buyer and ease of market entry or exit for those suppliers. Instead, we stress the *stability* of industrial market structures, where those present as buyers or sellers know each other well and are aware of any movements in either the buying or selling market.

Fourthly, we challenge the separation which has occurred in analysing either the process of industrial purchasing *or* of industrial marketing. In contrast, we emphasize the similarity of the tasks of buyers and sellers in industrial markets. Both parties may be involved in a search to find a suitable buyer or seller, to prepare specifications of requirements or offerings and to manipulate or attempt to control the transaction process. This means that an understanding of industrial markets can only be achieved by the simultaneous analysis of both the buying and selling sides of relationships.

MARKETS FOR INDUSTRIAL GOODS

The market is the place where supply meets demand. Suppliers and customers meet, discuss and evaluate the conditions for exchange of goods and services, and exchanges take place. The conditions under which these exchanges occur, especially that of price, are influenced by the characteristics and structure of the market, for example, the number and market power of suppliers and customers. Traditional economic analysis of markets presupposes that they are characterized by certain basic features;[1] firstly, there is an assumption of free movement in the market, and thus a customer will always buy where he obtains the best terms of exchange at that moment; similarly, the assumption is that suppliers will move to and from the market freely.[2] Thus, the market is portrayed as atomistic. Each unit in the market is free and independent to do as it wishes. Also, as a result of this free movement, the market is characterized by change, and stability is an exception. Underlying these two assumptions is the further assumption that there is little or no cost of transaction.[3] In other words, it is assumed that there are no costs in obtaining accurate information, or in negotiations, etc. One effect of this assumption is that production costs are considered central and that sellers can be simply represented by a production function. The traditional economic theory of the market has of course been subject to challenge and modification. However, it has influenced the models and principles used in marketing management. The basic model that most of the literature in marketing is built on is the marketing mix model. The key problems in marketing, according to that model, are:

(a) to allocate resources to different competitive means or mix elements,
(b) to design each mean as well as possible within the firm's resource limitations.

The market is often described in terms of response curves, each defined in relation to a certain 'marketing decision variable' or to the whole mix of a company. The assumption is of course that the market consists of many individual customers that are affected by the marketer's variables in accordance with a certain statistical distribution.

The same kind of influence can also be identified in the purchasing management literature. The focus here is largely on the management of a single purchase. This does not give full consideration to the factors which have contributed to the way this purchase takes place, or to the effects of this purchase on the subsequent dealings with the supplying company.[4]

Results from empirical studies into industrial markets indicate a quite different picture from that given above.[5] For example, relationships between sellers and customers are more often highly stable, than in a state of flux. Also, the long lead times before many industrial purchases take place are a time of complex interaction during which a relationship is established. Furthermore, changes in the composition of the customer and supplier markets are few and occur relatively slowly. Stability is, in other words, a clearer, stronger characteristic of industrial markets than is change.

These features can, of course, be seen as signs of inefficiency and if so it could be argued that the markets and the firms should be influenced in order to be made more efficient. However, there are many reasons for the development of such characteristics as stability and lasting relationships between suppliers and customers and these are now elaborated below.

BENEFITS OF STABILITY AND OBSTACLES TO CHANGE IN INDUSTRIAL MARKETS

We may firstly consider the purchasing firm and the benefits to it of stability and its unwillingness to change suppliers. It is possible to distinguish three different groups of explanatory factors:

Firstly, the firm faces problems of search and evaluation. A purchasing firm must be well informed about a potential supplier's technology, administration and commercial skills, and its trustworthiness. The costs of making a mistake in supplier selection by using a supplier which, for example, delivers an unsatisfactory product or allows delays in delivery, can be enormous. Thus the firm has to be very sure of an alternative before it is prepared to change suppliers. This means that in order to reduce the risk of incurring such costs the buying company will make supplier changes relatively rarely. When the buyer does decide to make a change then a number of purchasing procedures will be used. For example, they may visit the new supplier as part of an established vendor rating scheme. Furthermore, in the case of frequently purchased products the buyer will probably start with small orders. If the new supplier meets their requirements then they will gradually increase the order level. Thus, the purchasing firm will, in such a situation, have two or more suppliers during this period with associated cost increases. The problems of search and evaluation also occur in the case of infrequently purchased products. Here, the buying firm will also require considerable information about any potential vendor from whom it has not purchased in the past. Here again, the buyer is likely to value the experience he has of those companies from whom he has purchased before.

Secondly, the buying company can face problems in product use which centre on its internal routines and the experience of its staff. These can be reduced by stability of supplier. For example, some products may require special handling whilst others may need specialized service and maintenance systems. The cost and work load consequences of a change of supplier for such products are often prohibitive. Furthermore, the purchasing firm usually buys a large range of products. Thus, buyers may have to simplify their work by dealing with existing suppliers rather than incur the extra work load (and costs) associated with searching for and evaluating new suppliers' offering.

The third problem area in supplier change is that of the technological adaptation in the buying firm's machinery and its knowledge which may be incurred. Many of the products purchased for use in production are intimately related to the production process itself or to the fundamental characteristics of the firm's end product. Thus, a change in one purchased product can influence the whole production process and/or the firm's end product itself. As a result of this, other components or machines may have to be changed. Furthermore, a purchasing firm needs to have extensive technical contacts with its suppliers' personnel in order to be able to use their resources and knowledge. These contacts may have taken several years to develop. A change in suppliers means that they are lost and that new contacts have to be established with associated costs and personal implications.

Fourthly, if the market consists of a small number of buyers and sellers then action by any one company will be observable by all others and counteractions may be taken. This makes it necessary to plan any actions with regard to the possible response of other companies. These probable responses will militate against change by any one company.[6]

In summary, there exist arguments for believing that the purchasing firm may seek to reduce its costs and increase its benefits by developing stable relationships. Further, the more developed a relationship is, the more attractive an alternative has to be in order to get attention from the purchasing firm. Finally, the value of stability emphasizes the importance of events in an existing relationship in determining whether new suppliers will be considered.

The purchasing firm's unwillingness to change involves a potential seller in several kinds of problems and costs in the process of establishing itself as a new supplier. It must search for and evaluate customers and decide how much it is prepared to invest in establishing a relationship with them. Costs are involved in developing the technical and informational contacts – the selling process. The seller also has internal costs of change which are similar to those of the buyer. Examples of this are in special product design or new administrative routines which may have to be established to meet the delivery requirements or quality standards of the new customer. Therefore, new relationships are expensive to establish. Existing relationships on the other hand, can save costs in the short term. They are more predictable in that the seller can expect better information about the purchasing plans of old as compared to new customers. Another benefit can be in the suggestions and ideas which can come from the purchasing firm about product development or product use.

The obstacles to change and the benefits of stability severely restrict the applicability in industrial markets of the concept of free movement within markets which is implicit in traditional economic theory. Stability, source loyalty and inertia are logical consequences of the learning process of both buyers and sellers in relation to the technical, commercial and social dimensions of the relationship. These factors are of course mediated by conscious policies of sales expansion on the marketing side and of source development by buyers. Nevertheless, a view of industrial marketing solely in terms of these policies is simplistic and unlikely to give an adequate description of market behaviour.

IMPLICATIONS FOR PRACTITIONERS

We have noted that many (but not necessarily all) industrial markets are characterized by stability and long-lasting relationships between buying and selling firms. We also know that there is a large variation in these relationships both in content and design. In some situations, they are very complex, involving many people, functions and hierarchical levels in each firm. In contrast, other markets are characterized by simple relationships involving only a buyer dealing with a sales representative. Researchers in marketing have, however, no systematic and comprehensive knowledge about these relationships. We have described earlier how one reason for this is that much of the research in industrial marketing and purchasing has been based on assumptions that are not valid in many industrial markets. Therefore, many of the models and management principles that have been developed in the area have not been applicable or especially useful for firms dealing with such markets. For this reason, it is clear that there is a need for a model which describes the nature of and the differences between buyer–seller relationships in industrial markets of varying character. We can now look at some of the implications of the inadequacy of current models and data for marketing and purchasing management and government industrial policy.

Marketing Management

As we mentioned in the first section of this chapter, the models and principles for industrial marketing management that are given by the literature are normally related to the marketing mix model. The problems identified in these are the allocation of resources and the designing of competitive means. However, marketers in for example, a highly concentrated industry may find different problems. The issues associated with the handling of ten very large customers are of totally different character from those of handling 1,000 small customers. Thus, marketers in firms in concentrated markets have a lack of accurate models for analysing their marketing problems. They have also a lack of relevant data expressed in a systematic way about the behaviour of other firms in the same situation.

Purchasing Management

The position facing purchasing management is similar to that for marketing. Their models and principles for operation are mostly developed within the context of single purchasing decisions, although there are also some examples of analysis focused more on the long term relationships.[7] Buyers have perhaps accepted the reality of stable markets more readily than marketers, because there have been obvious reasons for not changing suppliers too often. However the predominant tradition in purchasing literature emphasizes the continuous evaluation of suppliers and, by implication the frequency of decisions on new sources. This approach must be related to the differences between the short and the long term effects of a relationship. The long term benefits of a relationship are often of a non-measureable kind as, for example, access to market and technical information, technological progress through special product design, better chances for co-operative product development, security in crises, etc. The short term effects can more easily be evaluated in economic or monetary terms. However, even in the short term it is often difficult to measure costs against for example, product quality or service. Suppliers which may appear favourable when measured according to short-term criteria need not necessarily be the best in the long term. Thus we can conclude that both purchasing and marketing management have a lack of model and data for analysing and evaluating their work in these situations.

Industrial Policy

The actions taken by politicians in order to control the economic development (or regression) in a country are often aimed at influencing the behaviour of firms. These actions must be based on realistic models of the behaviour of firms. The assumptions that are frequently made and the models which are used rely heavily on a market model which assumes free and independent units on each side. In the same way, the data that is collected for policy decisions is structured and determined by these models. That means that other assumptions and other models may produce both a change in the alternatives which are considered by government as well as the consequences that are observed. The process of technological development and the means to influence this process is an example of this. Policies based on traditional micro-theory focus on individual units (i.e. companies and research units) and on the development work which is carried on within them. A policy focusing on inter-company relationships would concentrate on the combination of units and the developments which occur in the exchanges between the units.

AIM OF THE STUDY

We started this introduction by discussing some general characteristics of markets. A conclusion was that some industrial markets have features which depart quite considerably from those conventionally considered to be normal. Industrial markets are characterized by stability instead of change, long lasting relationships instead of short business transactions and closeness instead of distance.

An analysis of the benefits of stability provides a rationale for these characteristics. Analysing the relationships between buying and selling firms in greater depth leads to the conclusion that knowledge about these relationships is inadequate, and there is a need both for new theoretical models and empirical data about them.

The aim of this study is to try to generate a more comprehensive picture of these relationships. This means that we have both theoretical and empirical ambitions. On the theoretical level we want to develop concepts and models that can be used in order to describe and understand buyer–seller relationships and the factors influencing them. At the empirical level the study aims to present data about buyer–seller relationships in a form which is useful for analysis, as well as forming a reference for management. Thus, our aim is to describe the nature of buyer–seller relationships that exist in different situations, to provide evidence of the variations in these relationships, and to try to give at least some explanations of these variations.