

## LECTURE NOTES

### CHAPTER OPENING EXAMPLE

#### STRATEGIC PROCUREMENT IN FUJITSU

- Fujitsu is the world's fourth largest and Japan's largest provider of IT products and services.
- The company spends about US\$21.5 billion annually on components and materials and seeks to reduce its spending on these items by approximately US \$3.85 billion over two years. They seek to achieve this through centralized purchasing and have set up international procurement offices in various parts of Asia to implement centralized purchasing.
- Fujitsu uses more standardized parts and strives to have 100 percent of these standardized parts delivered to the company on a just-in-time basis.
- Fujitsu conducts its procurement under basic policies such as fair and proper evaluation and selection of suppliers, close partnership with suppliers, and promotion of corporate socially responsible (CSR) procurement activities. Fujitsu promotes green procurement and aims to have 99 percent of all procured parts worldwide to be ecofriendly.

#### I. THE NATURE AND SIZE OF ORGANIZATIONAL MARKETS [LO1]

- **Business marketing** is the marketing of goods and services to companies, governments, or not-for-profit organizations for use in the creation of goods and services that they can produce and market to others.
- **Organizational buyers** are those manufacturers, wholesalers, retailers, and government agencies that buy goods and services for their own use or for resale.
  - a. Manufacturers buy raw materials and parts and reprocess them into finished goods.
  - b. Wholesalers and retailers resell the goods they buy without reprocessing them.
  - c. Organizational buyers include all buyers except ultimate consumers.
  - d. Organizational buyers are divided into industrial, reseller, and government markets.

### **A. Industrial Markets**

- There are over 200,000 firms in the industrial, or business, market in Singapore alone, and many more in other Asian countries.
- *Industrial firms* in some way reprocess a product or service they buy before selling it again to the next buyer.

### **B. Reseller Markets**

- *Resellers* are wholesalers and retailers that buy physical products and resell them again without any reprocessing.
- There were 41,711 wholesalers and retailers in Singapore in 2006.

### **C. Government Markets**

- *Government units* at the respective levels, such as national or federal government, state or provincial government, and city, county or local government make purchases in order to sustain their operations.
- An example of government spending, the Singapore government had an operating expenditure of S\$19.936 billion in 2004. Its development expenditure for 2004 was S\$8.482 billion.

### **D. Global Organizational Markets**

- Industrial, reseller, and government markets also exist on a global scale. The largest exporting industries in the U.S. focus on organizational customers, not ultimate consumers.
- The majority of world trade involves exchange relationships that span the globe.

## **II. MEASURING DOMESTIC AND GLOBAL INDUSTRIAL, RESELLER, AND GOVERNMENT MARKETS**

- Though there is no uniform standard industrial classification system used globally, the United Nations uses the International Standard Industrial Classification (ISIC) system, consisting of one letter to classify industries into 21 sections; these sections are then categorized as divisions, groups, and classes.
- Different Asian countries use slight different industrial classification systems.
- It is important to understand the industrial classification systems used in the different Asian countries, because national statistical bodies, research institutions and market

research firms often use these systems as a basis for collecting market and statistical data.

- Limitations of the industrial classification system:
  - a. An organization may only be assigned one code, even if it engages in many different activities that can involve many sectors that are identified by many different codes.
  - b. Different countries in Asia and around the world use different classification systems, so a firm may have different codes in different countries.

## **LEARNING REVIEW**

### **1. What are the three main types of organizational buyers?**

Answer: industrial firms; resellers; government units

### **2. What are industrial classification systems?**

Answer: Industrial classification systems provide common industry definitions for certain countries, which makes easier the measurement of economic activity in the member countries.

## **III. CHARACTERISTICS OF ORGANIZATIONAL BUYING [LO2]**

Unique objectives and policies of an organization put special constraints on how it makes buying decisions. Key characteristics include:

### **A. Demand Characteristics**

- Consumer demand for products and services is affected by their price, availability, as well as consumers' tastes and discretionary income.
- **Derived demand** means that the demand for industrial products and services is driven by, or derived from, demand for consumer products and services.

### **B. Size of the Order or Purchase**

- The size of the purchase in organizational buying is much larger than that in consumer buying. The dollar value of a single purchase often runs into the thousands or millions of dollars.
- Most organizations place purchasing constraints on their buyers, who must get competitive bids from at least three prospective suppliers if the order is above a specific amount.

- The size of the order determines who participates in the purchase decision and the time required to negotiate a purchase agreement.

## **MARKET MATTERS >> Global**

### **The Airbus A380 Superjumbo Jet Takes Flight**

- Rapidly expanding demand for intercontinental passenger air traffic and the growth of the global air freight industry have resulted in the creation of Airbus's A380 Superjumbo Jet.
- The demand for the A380 will depend on prospective buyers' expectation of future air transport traffic.
- Airbus has orders for the A380 from buyers on five continents, including Singapore Airlines, Qantas Airways, Lufthansa, Virgin Atlantic Airways, Air France, Emirates Airlines, and Fedex.

#### **C. Number of Potential Buyers**

- Firms selling consumer products and services try to reach thousands or millions of individuals or households.
- Firms selling to organizations usually have far fewer buyers.

#### **D. Organizational Buying Objectives**

- For business firms, the buying objective is usually to increase profits through reducing costs or increasing revenues.
- The objectives of nonprofit firms and government agencies are usually to meet the needs of the groups they serve.
- Firms have broadened their objectives to emphasize buying from minority- and women-owned suppliers and vendors.
- Other companies include environmental initiatives in their buying objectives.

### ***[SLN 6-1: How Organizations Can Improve Their Purchasing]***

#### **E. Organizational Buying Criteria**

- **Organizational buying criteria** are the objective attributes of the supplier's products and services and the capabilities of the supplier itself. These criteria serve the same purpose as the evaluative criteria used by consumers.
- Seven commonly used buying criteria are:

- a. Price.
  - b. Ability to meet the quality specifications required for the item.
  - c. Ability to meet required delivery schedules.
  - d. Technical capability.
  - e. Warranties and claim policies in the event of poor performance.
  - f. Past performance on previous contracts.
  - g. Production facilities and capacity.
- Organizational buyers who purchase products and services in the global marketplace often supplement their buying criteria with supplier ISO 9000 standards certification.
  - **ISO 9000** standards, developed by the International Standards Organization (ISO) in Geneva, Switzerland, refer to for registration and certification of a manufacturer's quality management and assurance system based on an on-site audit of practices and procedures.
  - **Reverse Marketing** involves the deliberate effort by organizational buyers to build relationships that shape suppliers' products, services, and capabilities to fit a buyer's needs and those of its customers.
  - With many Asian manufacturers using a *just-in-time* (JIT) inventory system that reduces the inventory of production parts to those to be used within hours or days, on-time delivery is becoming even more important buying criterion and, in some instances, a requirement.

## **MAKING RESPONSIBLE DECISION >> ETHICS**

### **Scratching Each Other's Backs – The Ethics of Reciprocity in Organizational Buying**

- Reciprocity is prohibited by anti-competitive laws in many countries because it restricts the normal operation of the free market.
- Reciprocity buying practices exist in a variety of forms and the extent to which reciprocity is viewed as an ethical issue varies across cultures.

### **F. Buyer-Seller Relationships and Supply Partnerships**

- Organizational buying involves complex and lengthy negotiations concerning delivery schedules, price, technical specifications, warranties, and claim policies.

- **Reciprocity** is an industrial buying practice in which two organizations agree to purchase each other's products and services.
  - a. Anti-competitive laws in many countries limit reciprocal buying because it restricts the normal operation of the free market.
  - b. However, the practice exists and can limit the flexibility of organizational buyers in choosing alternative suppliers.
  - c. Long-term contracts are also prevalent.
- A **supply partnership** is a relationship that exists when a buyer and its supplier adopt mutually beneficial objectives, policies, and procedures for the purpose of lowering the cost or increasing the value of products and services delivered to the ultimate consumer.

**G. The Buying Center: A Cross-Functional Group [LO3]**

- A **buying center** is a group of people in an organization who participate in the buying process and share common goals, risks, and knowledge important to a purchase decision.
- In large multi-store chain resellers, the buying center is highly formalized and is called a *buying committee*.
- Four questions to provide guidance in understanding the buying center in these organizations include:
  - a. Which individuals are in the buying center for a particular product or service?
  - b. What is the relative influence of each member of the group?
  - c. What are the buying criteria of each member?
  - d. How does each member perceive the firm, its products, and its salespeople?

**1. People in the Buying Center.**

- a. The composition of the buying center in a given organization depends on the specific item being bought.
- b. The purchasing manager is almost always a member.
- c. Individuals from top management and other functional areas are included depending on the purchase.

**2. Roles in the Buying Center.** There are five specific roles that an individual in a buying center can play:

- a. *Users* are people in the organization who actually use the product or service.
- b. *Influencers* affect the buying decision, usually by helping define the specifications for what is bought.
- c. *Buyers* have formal authority and responsibility to select the supplier and negotiate the terms of the contract.
- d. *Deciders* have the formal or informal power to select or approve the supplier that receives the contract.
- e. *Gatekeepers* control the flow of information in the buying center.

**3. Buying Situations and the Buying Center.**

- a. The number of people in the buying center largely depends on the specific buying situation.
- b. There are three types of organizational buying situations, called **buy classes**, which vary from the routine reorder to the completely new purchase:
  - *Straight rebuy*, where the buyer reorders an existing product or service from the list of acceptable suppliers.
  - *Modified rebuy*, where users, influencers, or deciders in the buying center want to change the product specifications, price, delivery schedule, or supplier, although the item purchased is largely the same.
  - *New buy*, where the firm is a first-time buyer of the product or service. This involves greater risks, so the buying center is enlarged to include all who have a stake in the new buy.

- c. The marketing strategies of sellers facing each of these three buying situations can vary greatly because the participation of personnel from functional areas, such as purchasing, R&D, engineering, and production, often varies with  
(1) the type of buying situation and (2) the stage of the purchasing process.

## LEARNING REVIEW

3. **What one department is almost always represented by a person in the buying center?**

Answer: purchasing department

4. **What are the three types of buying situations or buy classes?**

Answer: straight rebuy, modified rebuy, and new buy

## IV. CHARTING THE ORGANIZATIONAL BUYING PROCESS

**Organizational buying behavior** is the decision-making process that organizations use to establish the need for products and services and identify, evaluate, and choose among alternative brands and suppliers.

### A. Stages in the Organizational Buying Process

Consumers and organizations use the same five stages of the purchase decision process: (1) problem recognition, (2) information search, (3) alternative evaluation, (4) purchase decision, and (5) postpurchase evaluation.

### B. Buying a Machine Vision System

- The stages of the buying process can be applied to the purchase of components and assemblies for machine vision systems, which are used for product inspection.
- The buying process for machine vision components and assemblies is frequently a new buy because many machine vision systems contain elements that require some custom design.

#### 1. Problem Recognition.

- a. Sales engineers canvass industrial automation equipment users for leads on upcoming industrial automation projects.
- b. After a contract is won, project personnel must often make a **make-buy decision**—an evaluation of whether components and assemblies will be purchased from outside suppliers or built by the company itself.

## 2. Information Search.

- a. Companies employ a sophisticated process for identifying outside, such as a purchasing databank, which contains information on suppliers and products.
- b. Many products in the company's purchasing databank have been assessed using **value analysis**—a systematic appraisal of the design, quality, and performance of a product to reduce purchasing costs.
- c. New developments in product technology are often found in technical journals, industry magazines or at international trade shows where suppliers display their most recent innovations. In some instances, supplier representatives might be asked to make presentations to the buying center.

## 3. Alternative Evaluation.

- a. The main buying criteria used to select suppliers are: price, quality, delivery, assurance that a supplier will not go out of business, and service during the contractual period.
- b. Typically, a few suppliers for each standard component and assembly are identified from a **bidder's list**—a list of firms believed to be qualified to supply a given item.
- c. Firms selected from the bidder's list are sent a quotation request from the purchasing agent, describing the desired quantity, delivery date(s), and specifications. Suppliers are expected to respond within 30 days.

## 4. Purchase Decision.

- a. The period from supplier selection to order placement to product delivery can take several weeks or even months.
- b. Even after bids for components and assemblies are submitted, further negotiation concerning price, performance, and delivery terms is likely.
- c. Sometimes two or more suppliers might be awarded contracts when large orders are requested.
- d. Suppliers who are not chosen are informed why their bids were not selected.

### **5. Postpurchase Behavior.**

- a. Companies such as Siemens employ a formalized and sophisticated process for evaluating the products and services purchased from suppliers.
- b. A supplier's performance is monitored and recorded, and will determine its chances of being asked to bid on future purchases. Poor performance may result in a supplier being dropped from the bidder's list.
- c. Four lessons for marketers striving to sell products and services to organizations are:
  - Understand the organization's needs.
  - Get on the right bidder's list.
  - Find the right people in the buying center.
  - Provide value to organizational buyers.

## **LEARNING REVIEW**

### **5. What is a make-buy decision?**

Answer: An evaluation of whether components and assemblies will be purchased from outside suppliers or built by the company itself.

### **6. What is a bidder's list?**

Answer: A list of firms believed to be qualified to supply a given item.

## **V. ONLINE BUYING IN ORGANIZATIONAL MARKETS [LO4]**

- Organizational buyers account for 80% of the total worldwide value of all online transactions, both in volume and dollar value.
- U.S. organizational buyers account for about 60% of these online purchases.

### **A. Prominence of Online Buying in Organizational Markets**

- Online buying in organizational markets occurs for these reasons:
  - a. Organizational buyers depend heavily on timely supplier information that describes product availability, technical specifications, application uses, price, and delivery schedules.

- b.** Internet technology has been shown to substantially reduce buyer order processing costs.
- c.** Business marketers have found that Internet technology can reduce marketing costs, particularly sales and advertising expense, and broaden their potential customer base for many types of products and services.
- Organizational buyers can purchase directly from suppliers, through a reseller, or via e-marketplaces and online auctions.

## **Web Link**

### **eBay Means Business Too**

eBay, Inc., is a true Internet phenomenon. By any measure, it is the predominant person-to-person trading community in the world. eBay recently introduced a trading platform for the nearly 23 million small businesses in the U.S. and even greater numbers around the world. Transactions on eBayBusiness exceed sales of \$20 billion annually.

### **B. E-Marketplaces: Virtual Organizational Markets**

**E-marketplaces** are online trading communities that bring together buyers and supplier organizations to make possible the real time exchange of information, money, products, and services. Also called *B2B exchanges* or *e-hubs*.

- E-marketplaces can be independent trading communities.
  - a.** Independent e-marketplaces act as a neutral third-party, provide an Internet technology trading platform and a centralized market that enable exchanges between buyers and sellers, and charge a fee for their service.
  - b.** E-marketplaces exist in settings that have the following features:
    - Thousands of geographically dispersed buyers and sellers.
    - Frequently changing prices caused by demand and supply fluctuations.
    - Time sensitivity due to perishable offerings and changing technologies.
    - Easily comparable offerings between a variety of suppliers.
  - c.** Small business buyers and sellers benefit from independent e-marketplaces, which offer them an economical way to expand their customer bases and reduce costs.
- E-marketplaces can be private exchanges.

- a. Large companies tend to favor private exchanges, which streamline their purchase transactions by linking them with their network of qualified suppliers and customers.
- b. Private exchanges are not a neutral third party, but represent the interests of their owners.
- c. Private exchanges have saved their members billions of dollars due to efficiencies in purchase transactions.

### C. Online Auctions in Organizational Markets

Many e-marketplaces offer online auctions. Two types are:

- In a **traditional auction**, a seller puts an item up for sale and would-be buyers are invited to bid in competition with each other. As more would-be buyers become involved, there is an upward pressure on bid prices. The auction ends when a single bidder remains and wins the item with its highest price.
- In a **reverse auction**, a buyer communicates a need for a product or service and would-be suppliers are invited to bid in competition with each other. As more would-be suppliers become involved, there is a downward pressure on bid prices for the buyer's business. The auction ends when a single bidder remains and wins the business with its lowest price.
  - a. Some suppliers favor reverse auctions because they give them a chance to capture business that they might not have otherwise had because of a long-standing purchase relationship between the buyer and another supplier.
  - b. Other suppliers say that reverse auctions put too much emphasis on prices, discourage consideration of other important buying criteria, and threaten supply partnerships.

## LEARNING REVIEW

### 7. What are e-marketplaces?

Answer: E-marketplaces are online trading communities that bring together buyers and supplier organizations to make possible the real time exchange of information, money, products, and services.

### 8. In general, which type of online auction creates upward pressure on bid prices and which type creates downward pressure on bid prices?

Answer: traditional auction; reverse auction

## APPLYING MARKETING KNOWLEDGE

### 1. Describe the major differences among industrial firms, resellers, and government units.

Answers:

- a. **Industrial firms**, which account for the majority of all organizational buyers, in some way reprocess a product or service they buy before reselling it again to the next buyer.
- b. **Resellers**, the second largest group of organizational buyers, consist of wholesalers and retailers that buy physical products and resell them again without any reprocessing.
- c. **Government units**, the smallest of the three groups, consist of federal, state, and local agencies that buy goods and services for the constituents they serve.

### 2. Explain how industry classification systems might be helpful in understanding industrial, reseller, and government markets, and discuss the limitations inherent in these systems.

Answers:

- a. **Advantages of industry classification systems.** Industry classification systems such as the International Standard Industrial Classification (ISIC) system provide common industry definitions for its member countries, which makes easier the measurement of economic activity in these countries. It consists of letter to classify industries into 21 sections; these sections are then categorized as divisions, groups, and classes.
- b. **Disadvantages of industry classification systems.** Such breakdowns allow one to identify firms within categories and to monitor growth or decline with industries. These systems have two important limitations: (1) often, an organization may be assigned only one code, even if it engages in many different activities that can involve many sectors that are identified by many different codes. and (2) the different countries in Asia and around the world use different classification systems, so a firm may have different codes in different countries.

### 3. List and discuss the key characteristics of organizational buying that make it different from consumer buying.

Answers: Although the buying processes organizations go through when making a purchase also apply to consumer buying, there are some key differences:

- a. Organizations buy products and services to help them achieve organizational objectives, namely, to increase profits through reducing costs or increasing revenues.

- b. Demand for products and services from organizations is derived from the demand for consumer products and services.
  - c. The size (\$ or #) of organizational purchases is much larger than consumer purchases.
  - d. There are fewer organizational buyers than consumer buyers.
  - e. The buying criteria for organizational buyers generally focus on three critical factors: (1) ability to meet quality standards, (2) ability to deliver the product on time, and (3) past performance on previous contracts.
  - f. Several people, typically in a buying center, get involved in an organizational purchase.
  - g. The postpurchase evaluation is often more formalized.
4. **What is a buying center? Describe the roles assumed by people in a buying center and what useful questions should be raised to guide any analysis of the structure and behavior of a buying center.**

Answers:

- a. **Buying center.** A buying center consists of a group of individuals within an organization who participate in the buying process and share common goals, risks, and knowledge important to a purchase decision.
- b. **Buying center roles.** Individuals in a buying center perform one or more roles:
  - *Users* are people in the organization who actually use the product or service.
  - *Influencers* affect the buying decision, usually by helping define the specifications for what is bought.
  - *Buyers* have formal authority and responsibility to select the supplier and negotiate the terms of the contract.
  - *Deciders* have the formal or informal power to select or approve the supplier that receives the contract.
  - *Gatekeepers* control the flow of information in the buying center.
- c. **Questions.** Four questions guide an analysis of a buying center:
  - Which individuals are in the buying center for the product or service?
  - What is the relative influence of each member of the group?
  - What are the buying criteria of each member?

- How does each member of the group perceive our firm, our products and services, and our salespeople?

**5. Effective marketing is of increasing importance in today’s competitive environment. How can firms more effectively market to organizations?**

Answer: Firms can more effectively market to organizations by following four guidelines when designing and implementing their marketing strategy: (1) understand the organization’s needs, (2) get on the right bidder’s list, (3) find the right people in the buying center, and (4) provide value to organizational buyers.

**6. A firm that is marketing multimillion-dollar wastewater treatment systems to cities has been unable to sell a new type of system in an Asian country. This setback has occurred even though the firm’s systems are cheaper than competitive systems and meet the country’s Environmental Protection Agency (EPA) specifications. To date, the firm’s marketing efforts have been directed to city purchasing departments and the various provincial EPAs to get on approved bidder’s lists. Talks with city-employed personnel have indicated that the new system is very different from current systems and therefore city sanitary and sewer department engineers, directors of these two departments, and city council members are unfamiliar with the workings of the system. Consulting engineers, hired by cities to work on the engineering and design features of these systems and paid on a percentage of system cost, are also reluctant to favor the new system. (a) What roles do the various individuals play in the purchase process for a wastewater treatment system? (b) How could the firm improve the marketing effort behind the new system?**

Answers:

- a. **Roles played.** A number of different constituencies exist in the buying center for a wastewater treatment system for cities, and each plays one or more roles:

<u>Role</u>	<u>Constituency</u>
1. Users	City sanitary and sewer department engineers
2. Influencers	City sanitary and sewer department engineers; EPA
3. Buyers	City council
4. Deciders	Directors of the city sanitary and sewer departments; city council members
5. Gatekeepers	Consulting engineers and EPA

- b. **Marketing improvements.** The firm could improve its marketing efforts by reaching and educating the influencers and deciders (see above). Above all, the firm must circumvent or satisfy the primary gatekeepers—the consulting engineers.

These individuals are most likely detractors because the system's lower cost results in smaller compensation for them as consulting engineers.

## **BUILDING YOUR MARKETING PLAN**

**If your marketing plan involves targeting business customers, you need to carry out an analysis of the business buying behavior.**

- 1. Try to describe your target customer or customers as precisely as possible under the industrial classification system of your targeting country.**
- 2. Describe the organizational buying objectives and buying criteria of your customers**
- 3. Identify the typical buying center and buying process for your products.**
- 4. Identify opportunities for the online marketing of your products.**

If the marketing plan involves organizational markets, it is often useful first to determine the size of the market or industrial potential and then to assess the portion—or market share—that the organization might capture.

## **SLN 6-1: SUPPLEMENTAL LECTURE NOTE**

### **How Organizations Can Improve Their Purchasing**

Because savings in purchasing products and services contribute directly to a business firm's profits or allow a government agency to use the savings for other projects, effective buying is of increasing importance in today's competitive environment. Both business and government buyers have identified key steps that lead to more effective purchases:

- 1. Clarify the objectives in making the purchase.** Most purchasing departments seek some combination of six objectives on any specific purchase: (a) high quality, (b) low price, (c) no out-of-stock problems, (d) a small investment in inventory, (e) continuing sources of supply, and (f) good servicing of the order by technical and field support personnel. Because these objectives often conflict, the purchasing department must prioritize them for each purchase in establishing its buying criteria.

2. **Develop precise purchase specifications.** As a general rule, the more precise the purchase specifications, the better able the supplier is to deliver the right product or service at the right time. Precise specifications on the purchase of components and assemblies assure the buyer that suppliers understand and can deliver what was wanted.
3. **Create effective competition in the selection of suppliers.** Precise specifications make it possible to advertise a proposed purchase publicly, invite quotations from qualified vendors, and select the one or two that offer the best price and quality.
4. **Evaluate and test suppliers' products and services and inform them of the results.** These results are fed back to the supplier so it can take necessary corrective actions.
5. **Maintain a vendor-rating system.** A company's maintaining a vendor rating system permits it to drop unsatisfactory suppliers from its bidder's list and to add new suppliers that meet its standards.

When purchasing departments violate these common-sense guidelines, they usually find themselves in trouble.