CHAPTER
2

The Business Market: Perspectives on the Organizational Buyer

The business marketer must understand the needs of a diverse mix of organizational buyers drawn from three broad sectors of the business market—commercial enterprises, government (all levels), and institutions—as well as from an expanding array of international buyers. After reading this chapter, you will understand:

1. **the nature and central characteristics of each of these market sectors.**
2. **how the purchasing function is organized in each of these components of the business market.**
3. **the dramatic role that online purchasing assumes in the business market.**
4. **the need to design a unique marketing program for each sector of the business market.**

Cisco Systems, Inc., provides the networking solutions that are the foundation of the Internet and of most corporate, education, and government networks on a global scale. Today, the Internet and computer networking are a fundamental part of business, education, personal communications, and entertainment. Virtually all messages or transactions passing over the Internet are carried efficiently and securely through Cisco equipment. Cisco provides the hardware and software solutions for transporting data, voice, and video within buildings, across campuses, or around the world.

Rather than serving individuals or household consumers, Cisco is a leading-edge business-to-business firm that markets its products and services to organizations: commercial enterprises (for example, corporations and telecommunications firms), governmental units, and institutions (for example, universities and health-care organizations). Marketing managers at Cisco give special attention to transforming complex technology products and services into concrete solutions to meet customer requirements. For example, when Pep Boys, the leading automotive aftermarket and service chain in the United States wanted to connect its 593 retail store locations across 36 states, Cisco provided the network solution.[1] Likewise, when Procter & Gamble (P&G) wanted to launch a major Internet initiative to meet its aggressive growth targets, the firm turned to Cisco.[2] The sales team from Cisco described how an efficient Internet strategy could improve the way companies interact with employees, suppliers, and customers. Working with Cisco, P&G implemented several initiatives, including an online system called “Web Order Management” that enables retail customers, like Target, to connect to P&G any time to place and manage orders on the Web. In working with Cisco, P&G Chief Information Officer (CIO) Steve David commented: “We like to hook our wagon to people who are the best so they can help us be the best at creating that all-important competitive advantage.”[3]

Each of the three business market sectors—commercial firms, institutions, and governments—has identifiable and unique characteristics that business marketers must understand if marketers wish to grow their client bases. A significant first step in creating successful marketing strategy is to isolate the unique dimensions of each major business market sector. How much market potential does each sector represent? Who makes the purchasing decisions? The answers provide a foundation on which managers can formulate marketing programs that respond to the specific needs and characteristics of each business market sector.

Commercial Enterprises: Unique Characteristics

Commercial enterprises include manufacturers, construction companies, service firms (for example, hotels), transportation companies, selected professional groups (for example, dentists), and resellers (wholesalers and retailers purchasing equipment and supplies to use in their operations). Manufacturers are the most important commercial customers: The 100 largest ones purchase more than $1 trillion of goods and services annually.[4]

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[1] Customer Success Story: “Cisco Helps Pep Boys Improve Point-of-Sale Applications, Security Posture, and Future Flexibility,” http://www.cisco.com, accessed June 6, 2008, pp. 1–4.

[2] “Cisco Customer Profile: Procter & Gamble,” http://www.cisco.com, accessed July 23, 2002, pp. 1–3.

[3] Ibid., p. 3.

[4] Anne Millen Porter, “Containing Total Spend,” *Purchasing* 132 (November 6, 2008): pp. 18–25.

Distribution by Size

A startling fact about the study of manufacturers is that so few of them remain. Available evidence suggests that there are approximately 350,000 manufacturing firms in the United States.[5] And although only 30,000 manufacturing firms (fewer than 10 percent) employ more than 100 workers each, this handful of firms ships more than 75 percent of all U.S. manufactured products. Because manufacturing operations are so concentrated in the United States, the business marketer normally serves far fewer but far larger customers than does a consumer-product marketer. For example, Intel sells microprocessors to a few large manufacturers, like Dell and Hewlett-Packard, who, in turn, target millions of potential computer buyers. Clearly, large buyers are generally vitally important to business marketers. Because each large firm has such vast buying power, business marketers often tailor particular marketing strategies for each customer.

Smaller manufacturing firms also constitute an important business market segment. In fact, more than two-thirds of all U.S. manufacturers employ fewer than 20 people.[6] In addition to small manufacturers, more than 5 million small businesses in the United States employ fewer than 6 people each. Based on sheer numbers, small businesses represent a dominant category of business market customers—but a market that is often difficult to serve.[7] Because the organizational buyer in smaller firms has different needs—and often a very different orientation—astute marketers adjust their marketing programs to this market segment's particular needs. To illustrate, FedEx wanted to increase its share of the small shipper market but recognized that picking up packages at many small businesses is more expensive than picking them up at one larger location.[8] To cost-effectively reach these customers, FedEx encourages small shippers to bring their packages to conveniently located FedEx drop-off points. The strategy has been successful.

Geographical Concentration

Size is not the only concentration factor important to the business marketer: Manufacturers are also concentrated geographically. More than half of all U.S. manufacturers are located in only eight states: California, New York, Ohio, Illinois, Michigan, Texas, Pennsylvania, and New Jersey. Most large metropolitan areas are lucrative business markets. Geographical concentration of industry, however, means only that a large potential volume exists in a given area; each buyer's requirements may still vary significantly.

Geographic concentration has important implications for formulating marketing strategy. First, firms can concentrate their marketing efforts in high-market-potential areas, making effective use of full-time personal sales forces in these markets. Second, distribution centers in large-volume areas can ensure rapid delivery to a large proportion of customers. Finally, firms may not be able to tie their salespeople to specific

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[5] U.S. Department of Commerce, Bureau of the Census, *2005 County Business Patterns*, accessed at www.censtats.gov, June 6, 2008.

[6] Ibid.

[7] Arun Sharma, R. Krishnan, and Dhruv Grewal, "Value Creation in Business Markets," *Industrial Marketing Management* 30 (June 2001): pp. 391–402.

[8] Thomas H. Davenport, Jeanne G. Harris, and Ajay K. Kohli, "How Do They Know Their Customers So Well?" *MIT Sloan Management Review* 42 (Winter 2001): p. 65.

geographic areas because many large buying organizations entrust the responsibility for purchasing certain products and materials for the entire company to a single individual. For example, Wendy's International, Inc., operates a centralized purchasing system from its Dublin, Ohio, headquarters that supports the entire Wendy's network—all corporate and franchise restaurants on a global basis. The centralized staff purchases all direct materials for all of the restaurants—food, packaging, and supplies. Judith Hollis, vice president of supply chain management at Wendy's, notes:

> We view our job as developing supplier partnerships that are going to assist Wendy's with maintaining our competitive advantage. We look to . . . companies that are involved in technological innovation in quality, food, safety, and preparation efficiency.[9]

By understanding how a potential buyer's purchasing organization is structured, business marketers are better equipped to identify buying influentials and to develop responsive strategy.

Classifying Commercial Enterprises

Marketers can gain valuable strategy insights by identifying the needs and requirements of different types of commercial enterprises or business customers. The **North American Industrial Classification System (NAICS)** organizes business activity into meaningful economic sectors and identifies groups of business firms that use similar production processes.[10] The NAICS is an outgrowth of the North American Free Trade Agreement (NAFTA); it provides for standard economic data reporting among Canada, Mexico, and the United States. Every plant or business establishment receives a code that reflects the primary product produced at that location. The new system, which includes traditional industries while incorporating new and emerging-technology industries, replaces the Standard Industrial Classification (SIC) system that was used for decades.

Figure 2.1 illustrates the building blocks of the system. Observe that the first two digits identify the economic sector and that as more digits are added, the classification becomes finer. For example, all business establishments that create, disseminate, or provide the means to distribute information are included in the Information sector: NAICS Code 51. Nineteen other economic sectors are included in the system. More specifically, U.S. establishments that produce paging equipment are assigned an NAICS Code of 513321. Individual countries customize the six-digit codes for industry subdivisions, but at the five-digit level they are standardized across the three countries.

Using the NAICS If marketing managers understand the needs and requirements of a few firms within a classification category, they can project requirements for other firms that share that category. Each group should be relatively homogeneous in terms of raw materials required, component parts used, and manufacturing processes employed. The NAICS provides a valuable tool for identifying new customers and for targeting profitable segments of business buyers.

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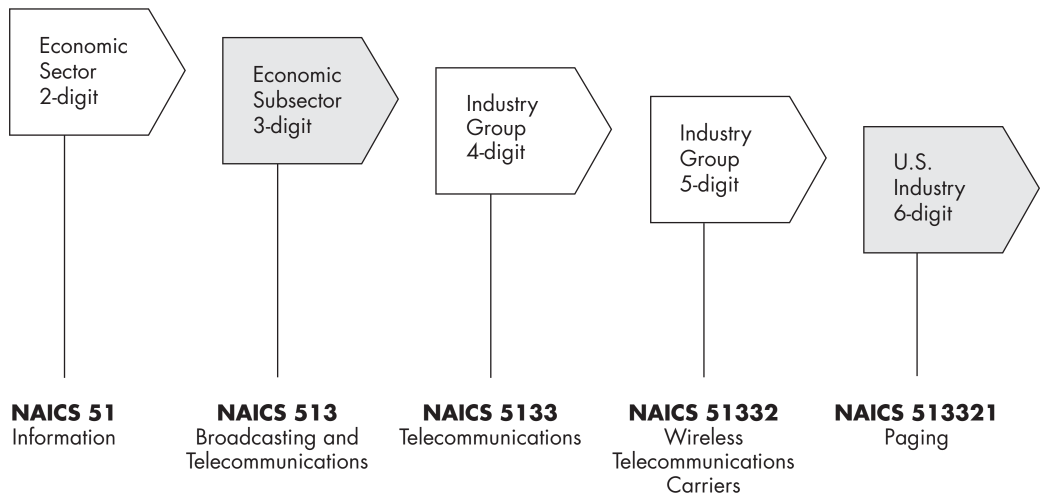
[9] Michael Fredette, "An Interview with Judith Hollis," *Journal of Supply Chain Management* 37 (Summer 2001): p. 3.

[10] www.naics.com, "History of SIC/NAICS," accessed June 15, 2005.

FIGURE 2.1 | NORTH AMERICAN INDUSTRIAL CLASSIFICATION SYSTEM



SOURCE: Reprinted from K. Douglas Hoffman et al., *Marketing: Best Practices* (Mason, Ohio: South-Western/Thomson Learning, 2003), p. 171.

The Purchasing Organization

Regardless of its organizational characteristics, every firm must procure the materials, supplies, equipment, and services it needs to operate the business successfully. "Spending on purchased goods and services can represent 70 percent of a company's costs, so business leaders have long known that purchasing improvements can directly improve the bottom line."[11] How goods and services are purchased depends on such factors as the nature of the business, the size of the firm, and the volume, variety, and technical complexity of items purchased. Rarely do individual departments in a corporation do their own buying. An individual whose title is director of purchasing or director of procurement usually administers procurement for all departments. Indeed, a decade marked by fierce global competition and rising energy and commodity costs opened the eyes of executives everywhere to the strategic benefits that can be achieved through a best-in-class purchasing and supply management function. So the stature and visibility of corporate buyers has risen in the organization. Alcoa Inc., IBM, and Sarah Lee Corporation, along with a growing list of others, have created chief purchasing officer (CPO) positions, often reporting directly to the chief executive or chief operating officer.[12]

The day-to-day purchasing function is carried out by buyers, each of whom is responsible for a specific group of products. Organizing the purchasing function in this way permits buyers to acquire a high level of technical expertise about a limited number of items. As products and materials become more sophisticated, buyers must

[11] Chip W. Hardt, Nicholas Reinecke, and Peter Spiller, "Inventing the 21st Century Purchasing Organization," *The McKinsey Quarterly*, 2007 (4): p. 116.

[12] Timothy Aeppel, "Global Scramble for Goods Gives Corporate Buyers a Lift," *The Wall Street Journal*, October 2, 2007, p. A1; and Shelby D. Hunt and Donna Davis, "Grounding Supply Chain Management in Resource-Advantage Theory," *Journal of Supply Chain Management* 44 (January 2008): pp. 10–21.

TABLE 2.1 | **THE GOALS OF PURCHASING**

Goals	Description
Uninterrupted Flow of Materials	Provide an uninterrupted flow of the materials, supplies, and services required to operate the organization.
Manage Inventory	Minimize the investment in inventory.
Improve Quality	Maintain and improve quality by carefully evaluating and choosing products and services.
Developing and Managing Supplier Relationships	Find competent suppliers and forge collaborative relationships with supply chain.
Achieve Lowest Total Cost	Purchase required products and services at lowest total cost.
Reduce Administrative Costs	Accomplish the purchasing objectives at the lowest possible level of administrative costs.
Advance Firm's Competitive Position	Improve the firm's competitive position by reducing supply chain costs or capitalizing on the capabilities of suppliers.

SOURCE: Adapted with modifications from Michael R. Leenders, Harold E. Fearon, Anna E. Flynn, and P. Fraser Johnson, *Purchasing and Supply Management*, 12th ed. (Chicago: Irwin, 2002), pp. 40–43, and Andrew Bartolini, "CPO Rising: The CPO's Agenda for 2008," Aberdeen Group, February 2008, accessed at http://www.aberdeen.com on June 7, 2008.

become more knowledgeable about material characteristics, manufacturing processes, and design specifications. Frequently, a sizable group is employed to conduct research, evaluate materials, and perform cost studies.

Goals of the Purchasing Function

To address the needs of business customers of all types, the marketer has to understand the purchasing manager's goals and how the purchasing function contributes to the organization's objectives (Table 2.1). The purchasing decision maker must juggle a number of different objectives that often clash. For example, the lowest-priced component part is unacceptable if it does not meet quality standards or is delivered two weeks late. In addition to protecting the cost structure of the firm, improving quality, and keeping inventory investment to a minimum, purchasing assumes a central role in managing relationships with suppliers. Here purchasing assumes a central role in supply chain management.

Supply chain management is a technique for linking a manufacturer's operations with those of all of its strategic suppliers, key intermediaries, and customers. The approach seeks to integrate the relationships and operations of both immediate, first-tier suppliers and those several tiers back in the supply chain, in order to help second-, third-, and fourth-tier suppliers meet requirements like quality, delivery, and the timely exchange of information. Firms that embrace supply chain management also solicit ideas from key suppliers and involve them directly in the new-product-development process. By managing supply chain costs and linking supplier capabilities to new product development, the purchasing function is advancing corporate performance in many organizations.

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The Supply Chain for McNuggets

Purchasing managers at McDonald's Corporation have worked closely with suppliers to develop a sophisticated model to reduce the cost of chicken. The model isolates how various feed mixes affect weight gain in chickens, and suppliers are able to optimize chicken weight gain in response to changing food prices.

McDonald's also closely manages and tightly coordinates its supply chain from hatchery to processor and into the restaurants. "McDonald's explicitly orders hatcheries to place eggs in anticipation of the sales forecast for chicken products. Product movement through the supply base is so well orchestrated that a supplier can confidently place the eggs in the hatcheries seventy-five days before McDonald's expects to sell the chicken as McNuggets."

SOURCE: Timothy M. Laseter, Balanced Sourcing: Cooperation and Competition in Supplier Relationships (San Francisco: Jossey-Bass, 1998), p. 14.

Strategic Procurement[13]

Leading-edge organizations like Dell Computer, GE, and Honda demonstrate the critical role that purchasing can assume in creating profit opportunities in their industries. To illustrate, Honda, long recognized for purchasing excellence and its ability to sustain customer loyalty, was able to reduce by 20 percent the costs of external purchases that are embodied in the current Accord. A senior purchasing executive at Honda described how it was done:

> The first thing we did was compile a big list of every possible way we could remove costs from the Accord; most of them, in fact, came from suppliers' work with purchasing and engineering. We studied each idea, prioritized them according to their likelihood of success, and then just started focusing our work on developing them.[14]

Understanding the Total Cost To unlock savings and growth opportunities, the purchasing function must develop a keen understanding of the total cost and value of a good or service to the firm. Such an approach requires purchasing managers to consider not only the purchase price but also an array of other considerations:

- the factors that drive the cost of the product or service in the supply chain, such as transportation;
- the costs of acquiring and managing products or services;
- quality, reliability, and other attributes of a product or service over its complete life cycle;
- the value of a product or service to a firm and its customers.

[13]This section is based on Matthew G. Anderson and Paul B. Katz, "Strategic Sourcing," *International Journal of Logistics Management* 9 (1, 1998): pp. 1–13.

[14]Timothy M. Laseter, *Balanced Sourcing: Cooperation and Competition in Supplier Relationships* (San Francisco: Jossey-Bass, 1998), p. 224.

Fundamental to this total-system cost perspective is the concept of total cost of ownership. "**Total cost of ownership** considers both supplier and buyer activities, and costs over a product's or service's complete life cycle."[15] For example, a firm can justify buying a higher-quality product and paying a premium price because the initial purchase cost will be offset by fewer manufacturing defects, lower inventory requirements, and lower administrative costs. The total cost of ownership means understanding a range of cost-value relationships associated with individual purchases.

Levels of Procurement Development In capturing cost savings through improved procurement, Matthew Anderson and Paul Katz of Mercer Management Consulting suggest that firms operate at different levels of development and emphasize different pathways to cost reduction and revenue enhancement (Figure 2.2). Ranging from the least to the most developed, these approaches include (1) Buy for Less; (2) Buy Better; (3) Consume Better; and (4) Sell Better. Note that the most developed strategy—Sell Better—ties purchasing activities directly to strategy. Here procurement builds supplier relationships that ultimately enhance the growth and the market strength of the organization.

Level 1—Leveraged Buy (Buy for Less) Many firms demonstrate Level 1 procurement practices and achieve cost savings by centralizing decision-making authority, which permits the consolidation of volume and by selecting suppliers that provide the best prices and terms.

Level 2—Linked Buy (Buy Better) The next level of procurement development is triggered when the procurement organization takes an external view of the supply chain and develops mutually beneficial relationships with suppliers. It achieves cost savings by streamlining the bidding process, optimizing delivery and information flows, and making stable commitments to enable efficient production by suppliers. Incremental cost savings of 5 to 25 percent result from moving from Level 1 to Level 2.

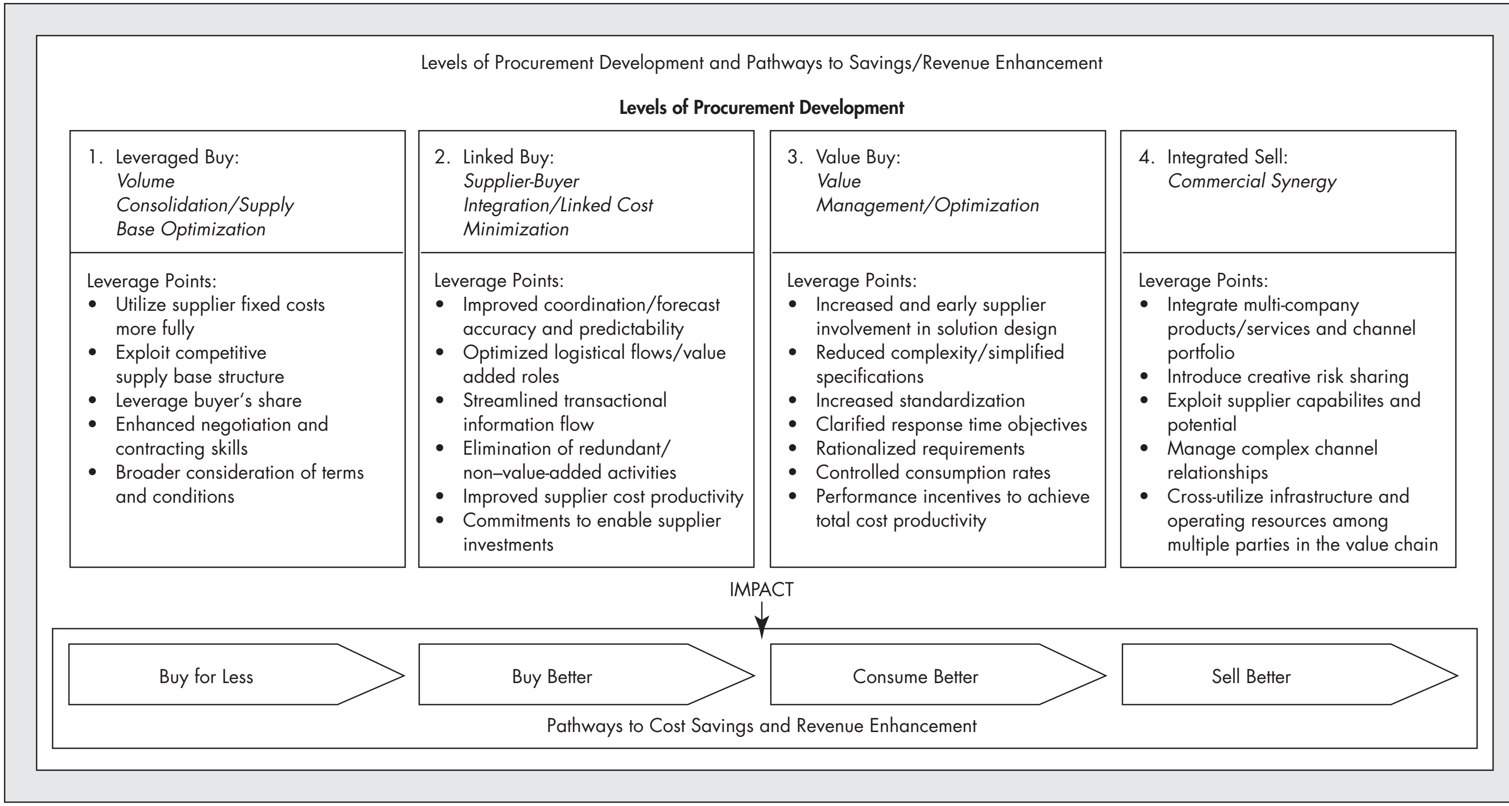
Level 3—Value Buy (Consume Better) The goal of Level 3 is to advance the performance of the procurement function by optimizing the life cycle costs and value of products and services. Value analysis, complexity management, and early supplier involvement in product design allow buyers and suppliers to uncover added value.

- **Value analysis** is a method of weighing the comparative value of materials, components, and manufacturing processes from the standpoint of their purpose, relative merit, and cost in order to uncover ways of improving products, lowering costs, or both. For example, Ferro Corporation developed a new coating process that allows Whirlpool to paint a refrigerator cabinet in 10 minutes compared with the old process, which took 3 hours.[16] The new process provided significant cost savings for Whirlpool.
- **Complexity management** seeks cost reductions by simplifying the design of products or by using standardized component parts in products and across product lines. Complexity management can also involve the outsourcing of

[15] Anderson and Katz, "Strategic Sourcing," p. 3. See also, James Carbone, "Using TCO to Rate Suppliers," *Purchasing* 133 (February 19, 2004): pp. 30–34.

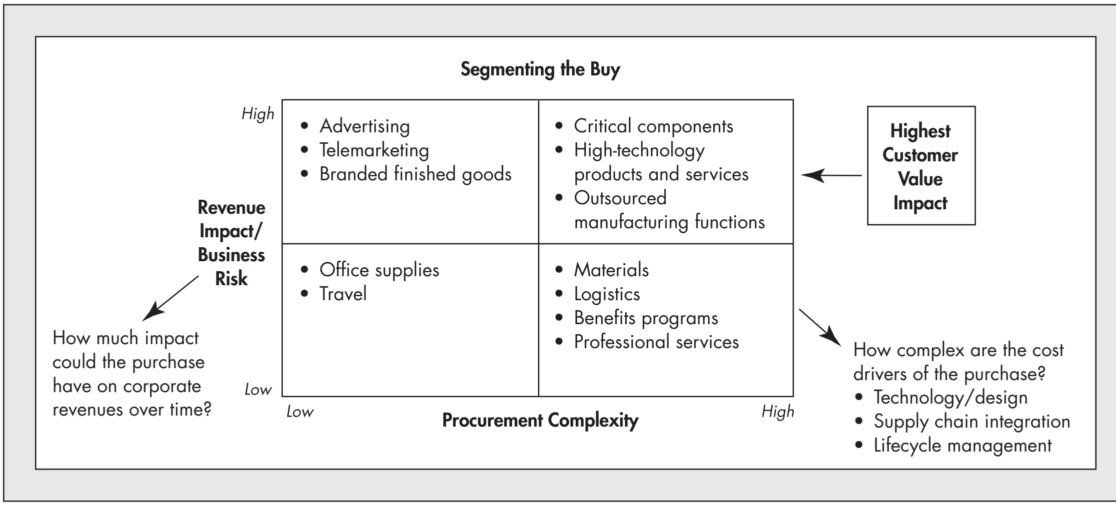
[16] Elizabeth Baatz, "How Purchasing Handles Intense Cost Pressure," *Purchasing* 127 (October 8, 1999): pp. 61–66.

FIGURE 2.2 | LEVELS OF PROCUREMENT DEVELOPMENT AND PATHWAYS TO SAVINGS/REVENUE ENHANCEMENT



SOURCE: Reprinted with permission from Matthew G. Anderson and Paul B. Katz, "Strategic Sourcing," *International Journal of Logistics Management* 9 (1, 1998): p. 4, Figure 3. Website at http://www.ijlm.org.

FIGURE 2.3 | SEGMENTING THE BUY



SOURCE: Reprinted with permission from Matthew G. Anderson and Paul B. Katz, "Strategic Sourcing," *International Journal of Logistics Management* 9 (1, 1998): p. 7, Figure 8. Website at http://www.ijlm.org.

production or assembly tasks to supply chain partners. For example, Boeing is taking the concept of supplier collaboration to new heights in the development of the 787 Dreamliner. Rather than integrating supplier parts and materials in its own features, key suppliers assume that responsibility and provide complete subsystems to Boeing. To illustrate, Rockwell Collins provides the major avionics systems—displays, communications, and more—to Boeing for the 787.[17]

- To capture fresh ideas, technologies, and cost savings, leading purchasing organizations emphasize **early supplier involvement in new product development.** At firms like Boeing, Harley-Davidson, Apple, and Honda, key suppliers actively contribute to the new-product-development process from the design stage to the product's introduction, often spending months on-site collaborating with the development team.

By using these methods, Level 3 savings opportunities can be substantial. Research by McKinsey & Company indicates that high-performing purchasing groups generate annual cost savings that are nearly six times greater than those of low performers.[18]

Level 4—Integrated Sell (Sell Better) Level 4 development applies when specific product and service choices the purchasing organization makes have a significant effect on revenue and also involve a high degree of business risk. For example, the investments of a telecommunications firm such as AT&T in technology products that form its infrastructure have a major effect on the future of the firm. Under such

[17] Susan Avery, "Boeing Executive Steven Schaffer is Named Supply Chain Manager of the Year for the 787 Dreamliner Project," October 18, 2007 Issue of *Purchasing*, accessed at http://www.purchasing.com on June 5, 2008.

[18] Hardt, Reinecke, and Spiller, "Inventing the 21st Century Purchasing Organization," p. 116.

INSIDE BUSINESS MARKETING

Respond with Value-Based Selling Tools

Astute B2B marketing strategists use value-based selling to vividly demonstrate the superior value that they provide compared to rivals. For example, Microsoft provides an online tool that potential business customers can use to cost, configure, and compare the Microsoft Windows Server to the whole universe of options, such as Linux. In 5 minutes or less, a business customer can estimate the total cost of ownership of the Microsoft option and then undertake a more detailed business-value study that provides a comprehensive analysis of costs and benefits—tailored to their organization.

To illustrate, when the Linux-based high-performance computing cluster at Callaway Golf reached the end of its useful life, key decision makers decided to examine two options: (1) another Linux-based system or (2) a solution based on Windows Compute Cluster Server running on Hewlett-Packard hardware. Callaway Golf chose the high-performance computing solution based on the Windows server because it offered significant advantages, including manageability, ease of use, and cost. John Loo, design systems senior manager at Callaway Golf, observed: "What really surprised us was the difference in software licensing and maintenance costs. A Linux solution would have been more expensive because we would have needed a separate job scheduler, which is something that Windows Compute Cluster Server provides." Microsoft used value-based selling to demonstrate the points of difference.

SOURCE: "Microsoft Customer Case Study: Callaway Golf," April 11, 2008, accessed at http://www.microsoft.com on June 12, 2008.

conditions, choosing the right technologies and sharing the risks with important suppliers are crucial to the success of AT&T's corporate strategy. Highly skilled and knowledgeable purchasing professionals are required to achieve this advanced level of procurement development, which unites purchasing decisions with corporate growth strategies.

Segmenting Purchase Categories Each firm purchases a unique portfolio of products and services. Leaders in procurement are giving increased attention to segmenting total purchases into distinct categories and sharpening their focus on those purchases that have the greatest effect on revenue generation or present the greatest risk to corporate performance. From Figure 2.3, observe that various categories of purchases are segmented on the basis of procurement complexity and the nature of the effect on corporate performance (that is, revenue impact/business risk).

Which Purchases Affect Performance? Procurement complexity considers factors such as the technical complexity, the scope of supply chain coordination required, and the degree to which life cycle costs are relevant. The revenue impact/business risk dimension considers the degree to which a purchase category can influence customers' perceptions of value. For example, purchasing managers at Ford decided that some components are important to brand identity, such as steering wheels, road wheels, and other highly visual parts.

Purchasing managers can use a segmentation approach to isolate those purchase categories that have the greatest effect on corporate revenues. For example, advertising services could have tremendous risk implications relative to customer perceptions of value, whereas office supplies remain a cost issue. Or, in the high-tech arena, the procurement of a new generation of semiconductor technology may essentially be a bet on the company's future.[19]

Business marketers should assess where their offerings are positioned in the portfolio of purchases a particular organization makes. This varies by firm and by industry. The revenue and profit potential for the business marketer is greatest in those purchasing organizations that view the purchase as strategic—high revenue impact and high customer-value impact. For example, in the auto industry, electronic braking systems, audio and navigation systems, as well as turbochargers, fit into this category and represent about one-quarter of a passenger vehicle's cost.[20] Here the marketer can contribute offerings directly tied to the customer organization's strategy, enjoying an attractive profit margin. If the business marketer can become a central component of the customer's supply chain, the effect is even more significant: a valuable, long-term relationship in which the customer views the supplier as an extension of its organization. For categories of goods that purchasing organizations view as less strategic (for example, office supplies), the appropriate marketing strategy centers on providing a complete product assortment, competitive pricing, timely service support, and simplified ordering. By understanding how customers segment their purchases, business marketers are better equipped to target profitable customer groups and develop customized strategies.

E-Procurement[21]

Like consumers who are shopping at Amazon (http://www.amazon.com), purchasing managers use the Internet to find new suppliers, communicate with current suppliers, or place an order. While providing a rich base of information, purchasing over the Internet is also very efficient: It is estimated that purchase orders processed over the Internet cost only $5, compared with the current average purchase order cost of $100. For example, IBM has moved all of its purchasing to the Web and has created a "private exchange" that links its suppliers. A **private exchange** allows a company like IBM to automate its purchases and collaborate in real time with a specially invited group of suppliers.[22] By handling nearly all its invoices electronically (some 400,000 e-invoices a month), IBM saves nearly $400 million per year using its more efficient Web purchasing strategy.

Everyone Is Getting Wired

Less than a decade ago, pioneering enterprises like IBM, GE, and United Technologies began testing Internet-based negotiations as part of their strategic purchasing programs. Today, more than 80 percent of *Fortune* 1000 enterprises have adopted e-procurement software, and new low-cost, hosted options are driving the adoption of e-procurement solutions among medium-sized enterprises. Leading suppliers of

[19] Anderson and Katz, "Strategic Sourcing," p. 7.

[20] Srikant Inampudi, Aurobind Satpathy, and Anant Singh, "Can North American Auto Suppliers Create Value?" *The McKinsey Quarterly*, June 2008, accessed at http://www.mckinsey.com on June 8, 2008.

[21] Tim A. Minahan, "Best Practices in E-Sourcing: Optimizing and Sustaining Supply Savings," September 2004, research report by Aberdeen Group, Inc., Boston, Massachusetts; accessed at http://www.ariba.com on June 15, 2005.

[22] Nicole Harris, "'Private Exchanges' May Allow B-to-B Commerce to Thrive After All," *The Wall Street Journal*, March 16, 2001, p. B4.

e-procurement software include Ariba, Inc. (http://www.ariba.com), Emptoris (http://www.emptoris.com), and Oracle Corporation (http://www.oracle.com). To compete effectively in this information-rich environment, business marketing managers must develop a firm understanding of the e-procurement tools that customers are embracing.

Enhancing the Buyer's Capabilities

Rather than a strategy, e-procurement is a technology platform that enables information to be exchanged efficiently and processes to be automated. E-procurement is "the use of Web-based applications, decision support tools, and associated services to streamline and enhance strategic sourcing processes and knowledge management."[23] Included among the distinguishing components of e-procurement solutions are the following capabilities:

- *online negotiations* that enable the buyer to query suppliers with a request-for-proposal (RFP), request-for-quote (RFQ), or request-for-information (RFI), and to conduct reverse auctions (discussed below);
- *collaboration tools* that enable the purchasing manager to (1) collaborate with internal stakeholders (for example, departments) to develop detailed specifications and priorities for goods or services to be purchased and (2) provide a detailed description of requirements to suppliers through an RFP;
- *knowledge management* capabilities that provide the procurement function and senior management with a central repository of valuable data and information on supplier performance, material and component costs, process flows, and best practices;
- *analytical tools* that support detailed analysis and modeling of purchasing costs and total spending by category across the enterprise.

Delivering Measurable Results

Why are purchasing organizations embracing online purchasing technologies? Because they "deliver measurable benefits in the form of material cost savings, process efficiencies, and performance enhancements" according to Tim Minahan, a supply chain consultant at the Aberdeen Group.[24] Studying procurement processes at sixty companies, including American Express, Motorola, and Alcoa, Aberdeen found that e-procurement cut purchasing cycle time in half, reduced material costs by 14 percent and purchasing administrative costs by 60 percent, and enhanced the ability of procurement units to identify new suppliers on a global scale.

Buying Direct and Indirect Goods

In the United States alone, organizations spend more than $1.4 trillion annually on *indirect* goods or operating resources—items that organizations of all types need to run day-to-day operations. Examples encompass everything from personal computers

[23] Minahan, "Best Practices in E-Sourcing," p. 3.

[24] Ibid., p. 3.

and spare parts for factory equipment to office furniture and employee travel, including airline tickets, hotel rooms, and car rental services.[25] Powered by software from Ariba, Motorola has used its global e-requisitioning system to reduce procurement costs and control indirect purchasing, yielding more than $300 million of cost savings in a recent year.[26] During the Internet-boom years, companies invested heavily in e-procurement systems but used them primarily to buy indirect goods. As adopters reaped huge cost savings and began to trust Internet-based purchasing systems, many firms began to use e-procurement to buy *direct* materials or entering goods—the raw materials or component parts that are core to a firm's manufacturing process. As e-procurement systems become more affordable, some experts predict that small and medium-sized firms will soon adopt the purchasing practices of the industry leaders. To illustrate, many suppliers apply what they learn from best-practice firms, like Toyota, to their own purchasing processes and relationship management programs.

Reverse Auctions

One online procurement tool that sparks debate in the business market is the reverse auction. Rather than one seller and many buyers, a **reverse auction** involves one buyer who invites bids from several prequalified suppliers who face off in a dynamic, real-time, competitive bidding process. Reverse auctions are most widely used in the automobile, electronics, aerospace, and pharmaceutical industries. Proponents claim that reverse auctions can lower the cost of procuring products and services by 20 percent or more. A case in point: Sun MicroSystems saved 30 percent on the commodities it purchased through reverse auctions.[27] Critics counter that reverse auctions can inflict real damage on supplier relationships and that the realized savings are often overstated.[28] For example, during the recent economic downturn, many firms used reverse auctions as a tactical weapon to drive supplier prices down but often found that the winning bidder delivered less value—lower quality and poorer service than existing suppliers.

Reverse auctions are best suited for commodity-type items like purchasing materials, diesel fuel, metal parts, chemicals, and many raw materials. On the other hand, reverse auctions are generally *not* appropriate for strategic relationships, where suppliers have specialized capabilities and few suppliers can meet quality and performance standards. Rob Harlan, senior director of e-procurement for Motorola, aptly states: "We pride ourselves on strong supplier relationships. We are not going to jeopardize these for short-term gains with online auctions. You need to ensure the integrity of the bidding environment, educate suppliers on how best to compete, and clearly communicate your intentions and requirements."[29]

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[25] Mark Vigoroso, "Buyers Prepare for Brave New World of e-Commerce," *Purchasing* 127 (April 22, 1999): pp. S4–S12; and Mylene Mangalindan, "As Times Get Tough, Firms Buy Online," *The Wall Street Journal*, June 3, 2008, p. B10.

[26] James Carbone, "Motorola Leverages Its Way to Lower Cost," *Purchasing* 133 (September 16, 2004): pp. 31–38.

[27] James Carbone, "Sun's e-Auction Evolution," September 13, 2007 issue of *Purchasing*, accessed at http://www.purchasing.com on June 10, 2008.

[28] Mohanbir Sawhney, "Forward Thinking About Reverse Auctions," June 1, 2003 issue of *CIO Magazine*, accessed at http://www.cio.com on June 20, 2005, pp. 1–6.

[29] Minahan, "Best Practices in E-Sourcing," p. 52.

Ethical Business Marketing

Gift Giving: "Buy Me These Boots and You'll Get My Business"

Greg Davies, director of sales for Action Printing in Fond du Lac, Wisconsin, encountered this awkward situation. Leaving a restaurant after taking a potential customer to lunch, the prospective client stopped to examine the window display of a country-and-western store located nearby. That's when Davies's prospect turned to him and said very slowly: "I have always wanted a pair of boots like this." "There was no mistaking it: He expected me to buy him the boots," recalls Davies, who simply smiled and began walking again. He declined because company policy, as well as his personal value system, forbids the exchange of expensive personal gifts for business. As you would imagine, from that day forward, Greg felt awkward around the prospect.

Sales experts suggest that Greg made the right business decision, as well as the right moral decision. He stood behind a well-conceived company policy. In turn, Jacques Werth, a sales consultant, agreed with the decision to walk away. "If your relationship is based on extravagant gifts, entertainment, and other perks, you're likely to lose the business when a bigger bribe comes along, anyway."

SOURCE: Melinda Ligos, "Gimme, Gimme, Gimme!" *Sales & Marketing Management* (March 2002): pp. 33–40.

How Organizational Buyers Evaluate Potential Suppliers

E-procurement systems provide purchasing managers with a rich information environment and a sophisticated set of analytical tools they can use to evaluate the performance of suppliers. Many criteria may be factored into a buyer's ultimate decision: quality, price, delivery reliability, company image, and capability. Buyer perceptions are critical. When products are perceived as highly standardized or commodity-like, price assumes special importance in the purchasing decision and the business marketer faces the intense competitive pressure that reverse auctions impose. On the other hand, when the value offerings of the business marketer are perceived as unique, other criteria dominate and the opportunity exists to develop a strategic relationship with the customer. At a fundamental level, customers in the business market are interested in the total capabilities of a supplier and how those capabilities can assist them in advancing their competitive position—now and in the future.

To this point, the discussion has centered on one sector of the business market—commercial enterprises—and the role the purchasing function assumes. Attention now turns to the government market.

Governments: Unique Characteristics

Federal (1), state (50), and local (87,000) **government units** generate the greatest volume of purchases of any customer category in the United States. Collectively, these units spend more than $1.5 trillion on goods and services each year—the federal government accounts for $400 billion, and states and local government account for the rest.[30] Governmental units purchase from virtually every category of goods

[30] U.S. Census Bureau, *Statistical Abstract of the United States: 2008*, accessed at http://www.census.gov on June 12, 2008.

FIGURE 2.4 | HEWLETT PACKARD'S e-GOVERNMENT STRATEGY

As customers have become adept at shopping online, managing their bank accounts, and requesting services, Internet-savvy citizens now expect the same from their governments. Enabled by information technology, public agencies are giving citizens new tools to access information and services while, at the same time, introducing new efficiencies in government operations.

Hewlett Packard (H-P) has developed a complete portfolio of services tailored to e-government goals:

- Improving quality and ease of access for citizens
- Reducing the cost of service delivery
- Simplifying the implementation of government directives
- Advancing economic growth by stimulating the development of a digital economy

H-P offers targeted solutions that allow citizens to:

- Test for and renew drivers' licenses online
- Purchase decals and permits online
- Access information and services around the clock from public agencies and government departments

H-P has also developed a suite of solutions that governments require for efficient and effective Homeland Security. Included here are:

- Mission-focused technology solutions that protect borders and public transportation systems
- Supportive technologies to enhance the capabilities of law enforcement agencies, firefighters, and emergency response teams
- Security solutions to protect critical infrastructure assets and defend against catastrophic threats.

H-P Success Story:

- Government Customer: Chicago Office of Emergency and Communications (OEMC)
- Mission: The Chicago OEMC is responsible for all 911 communications and emergency operations and for responding to emergency incidents of all types in the city.
- Customer Solution: H-P technologies were applied to support an integrated emergency operation center and are deployed in a Unified Communications Vehicle, which enables city personnel to continue operations from any location. The OEMC also uses surveillance cameras to increase situational awareness when responding to 911 calls.
- Results: The Chicago city government can sustain operations in an alternate location in the event that activities at any of its government buildings are disrupted.

SOURCES: "HP Services: A Comprehensive Managed Services Portfolio," "Homeland Security," and "Public Sector, Health, and Education," accessed at http://www.hp.com on December 4, 2008 and "Securing a City: Chicago Takes a Unified Approach to Emergency Management," accessed at http://www.hp.com on December 26, 2008.

and services—office supplies, personal computers, furniture, food, health care, and military equipment. Business marketing firms, large and small, serve the government market. In fact, 25 percent of the purchase contracts at the federal level are with small firms.[31]

E-Government

Across all levels of government, public officials are embracing the Internet as the best means of delivering services to constituents. E-government, then, involves transferring traditional government operations to an integrated Internet environment to improve public-sector accessibility, efficiency, and customer service. For example, www.govbenefits.com now provides users with access to information about 200 special government benefit programs, and www.recreation.gov provides a description of all publicly managed recreation sites in the United States. Many states, such as Texas, Arizona, Michigan, and Illinois, are launching creative e-government initiatives to deliver service to citizens. For business marketing firms like IBM and Hewlett-Packard that sell information technology products and services, e-government initiatives are sparking a large market opportunity (see Figure 2.4).

Influences on Government Buying

Another level of complexity is added to the governmental purchasing process by the array of influences on this process. In federal, state, and large-city procurement, buyers report to and are influenced by dozens of interested parties who specify, legislate, evaluate, and use the goods and services. Clearly, the range of outside influences extends far beyond the originating agency.

Understanding Government Contracts

Government purchasing is also affected by goals and programs that have broad social overtones, including compliance, set-asides, and minority subcontracting. The **compliance program** requires government contractors to maintain affirmative action programs for minorities, women, and the handicapped. Firms failing to do so are barred from holding government contracts. In the **set-aside program,** a certain percentage of a given government contract is "set aside" for small or minority businesses; no others can participate in that proportion of the contract. The **minority subcontracting program** may require that major contractors subcontract a certain percentage of the total contract to minority firms. For example, Ohio law requires that 7 percent of all subcontractors on state construction projects be minorities. The potential government contractor must understand these programs and how they apply to the firm.

Most government procurement, at any level, is based on laws that establish contractual guidelines.[32] The federal government has set forth certain general contract provisions as part of the federal procurement regulations. These provisions include stipulations regarding product inspection, payment methods, actions as a result of default, and disputes, among many others.

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[31] Stephanie N. Mehta, "Small Firms Are Getting More Government Contracts," *The Wall Street Journal*, April 27, 1995, p. B2.

[32] Michael R. Leenders and Harold E. Fearon, *Purchasing and Supply Management*, 11th ed. (Chicago: Irwin, 1997), pp. 537–566.

Without a clear comprehension of the procurement laws, the vendor is in an unfavorable position during the negotiation phase. The vendor particularly needs to explore the advantages and disadvantages of the two basic types of contracts:

1. **Fixed-price contracts.** A firm price is agreed to before the contract is awarded, and full payment is made when the product or service is delivered as agreed.
2. **Cost-reimbursement contracts.** The vendor is reimbursed for allowable costs incurred in performance of the contract and is sometimes allowed a certain number of dollars above cost as profit.

Each type of contract has built-in incentives to control costs or to cover future contingencies.

Generally, the fixed-price contract provides the greatest profit potential, but it also poses greater risks if unforeseen expenses are incurred, if inflation increases dramatically, or if conditions change. However, if the seller can reduce costs significantly during the contract, profits may exceed those estimated when the contract was negotiated. The government carefully administers cost-reimbursement contracts because of the minimal incentives for contractor efficiency. Contracts of this type are usually employed for government projects involving considerable developmental work for which it is difficult to estimate efforts and expenses.

To overcome the inefficiencies of both the cost-reimbursement contract (which often leads to cost overruns) and the fixed-price contract (which can discourage firms from bidding because project costs are uncertain), the government often employs incentive contracts. The incentive contract rewards firms when their actual costs on a project are below target costs, and it imposes a penalty when they exceed target costs.

Telling Vendors How to Sell: Useful Publications

Unlike most customers, governments often go to great lengths to explain to potential vendors exactly how to do business with them. For example, the federal government makes available such publications as *Doing Business with the General Services Administration*, *Selling to the Military*, and *Selling to the U.S. Air Force*. Government agencies also hold periodic seminars to orient businesses to the buying procedures the agency uses. The objective is to encourage firms to seek government business.

Purchasing Organizations and Procedures: Government

Government and commercial purchasing are organized similarly. However, governments tend to emphasize clerical functions because of the detailed procedures the law requires. Although the federal government is the largest single industrial purchaser, it does not operate like a single company but like a combination of several large companies with overlapping responsibilities and thousands of small independent units.[33] The federal government has more than 15,000 purchasing authorities (departments, agencies, and so on). Every government agency possesses some degree of buying influence or authority. Federal government procurement is divided into two categories: defense and nondefense.

[33] Ibid., pp. 552–559.

Defense Procurement The Department of Defense (DOD) spends a large proportion of the federal government's total procurement budget. The DOD's procurement operation is said to be the largest business enterprise in the world. The era of declining budgets for the DOD was quickly reversed with the terrorist attacks on the United States in September 2001. Defense and homeland security became funding priorities in the federal budget.

Each DOD military division—Army, Navy, and Air Force—is responsible for its own major purchases. However, the Defense Logistics Agency (DLA) procures billions of dollars worth of supplies used in common by all branches. The DLA's budget for procurement exceeds $35 billion annually.[34] The purposes of the DLA are to obtain favorable prices through volume purchasing and to reduce duplication of purchasing within the military. Defense-related items may also be procured by other government agencies, such as the General Services Administration (GSA). In fact, the DOD is the GSA's largest customer. Under current agreements between the GSA and the DOD, the military purchases through the GSA many items such as vehicles, desks, office machines, and hand tools.[35] Also, many supplies for military-base operations are procured locally.

Nondefense Procurement Nondefense procurement is administered by a wide variety of agencies, including cabinet departments (for example, Health and Human Services, Commerce), commissions (for example, the Federal Trade Commission), the executive branch (for example, the Bureau of the Budget), federal agencies (for example, the Federal Aviation Agency), and federal administrations (for example, the GSA). The Department of Commerce centralizes the procurement of supplies and equipment for its Washington office and all local offices. The Department of the Interior, on the other hand, instructs each area and district office of the Mining Enforcement and Safety Administration to purchase mine-safety equipment and clothing locally.

Like the DLA, the GSA centralizes the procurement of many general-use items (for example, office furniture, pens, lightbulbs) for all civilian government agencies. The Federal Supply Service of the GSA is like the purchasing department of a large diversified corporation because it provides a consolidated purchasing, storing, and distribution network for the federal government. The Federal Supply Service purchases many items commonly used by other government agencies, including office supplies, small tools, paint, paper, furniture, maintenance supplies, and duplicating equipment. In some cases, the GSA operates retail-like stores, where any federal buyer can go to purchase equipment and supplies. The GSA has enormous purchasing power, managing more than one-fourth of the government's total procurement dollars.[36]

Under the Federal Supply Schedule Program, departments within the government may purchase specified items from an approved supplier at an agreed-on price. This program provides federal agencies with the sources of products such as furniture, appliances, office equipment, laboratory equipment, and the like. Once a supplier has bid and been approved, the schedule may involve an indefinite-quantity contract for a

[34] Defense Logistics Agency, "Facts and Figures," accessed at http://www.dla.mil on June 10, 2008.

[35] U.S. General Services Administration, "Doing Business with the GSA" (Washington, D.C., 1996).

[36] U.S. General Services Administration, "GSA Details FY09 Budget Request," accessed at http://www.gsa.gov on June 10, 2008.

term of 1 to 3 years. The schedule permits agencies to place orders directly with suppliers. Like corporate purchasing units, the GSA is using the Internet to streamline purchasing processes and to facilitate communication with suppliers (see http://www.gsa.gov).

Federal Buying

The president may set the procurement process in motion when he signs a congressional appropriation bill, or an accountant in the General Accounting Office may initiate the process by requesting a new desktop computer. Business marketers can identify the current needs of government buyers by consulting *FedBizOpps (FBO)* at http://www.fbodaily.com. The *FBO*, published by the Department of Commerce, lists all government procurement proposals, subcontracting leads, contract awards, and sales of surplus property. A potential supplier has at least 30 days to respond before bid opening. By law, all intended procurement actions of $10,000 or more, both civilian and military, are published in the *FBO*. Copies of the *FBO* are available at various government field offices, as well as local public libraries.

Once a procurement need is documented and publicly announced, the government follows one of two general procurement strategies: formal advertising (also known as open bid) or negotiated contract.

Formal Advertising **Formal advertising** means the government solicits bids from appropriate suppliers; usually, the lowest bidder is awarded the contract. This strategy is followed when the product is standardized and the specifications straightforward. The interested supplier must gain a place on a bidder's list (or monitor the *FBO* on a daily basis—which suggests that a more effective approach is to get on the bidder's list by filing forms available from the GSA Business Service Centers). Then, each time the government requests bids for a particular product, the supplier receives an invitation to bid. The invitation to bid specifies the item and the quantity to be purchased, provides detailed technical specifications, and stipulates delivery schedules, warranties required, packing requirements, and other purchasing details. The bidding firm bases its bid on its own cost structure and on the bids it believes its competitors might make.

Procurement personnel review each bid for conformance to specifications. Contracts are generally awarded to the lowest bidder; however, the government agency may select the next-to-lowest bidder if it can document that the lowest bidder would not responsibly fulfill the contract. For example, the Internal Revenue Service (IRS) held a reverse auction for 11,000 desktop PCs and 16,000 notebook PCs. The prebid pricing started at $130 million; when the auction closed, the price was down to $63.4 million.[37]

Negotiated Contract Buying A negotiated contract is used to purchase products and services that cannot be differentiated on the basis of price alone (such as complex scientific equipment or R&D projects) or when there are few suppliers. There may be some competition because the contracting office can conduct negotiations with several suppliers simultaneously.

[37] Richard Walker and Kevin McCaney, "Reverse Auctions Win Bid of Acceptance," *Buyers.Gov* (December 2001): p. 1.

Obviously, negotiation is a much more flexible procurement procedure; the government buyers may exercise considerable personal judgment. Procurement is based on the more subjective factors of performance and quality, as well as on price. The procurement decision for the government is much like that of the large corporation: Which is the best possible product at the lowest price, and will the product meet performance standards?

For example, the U.S. Army and Marines are together planning to replace the Humvee transports used in Iraq with a Joint Light Tactical Vehicle.[38] Lockheed Martin Corporation and Boeing Company, the two largest U.S. defense contractors, are each competing for the contract, along with a formidable set of rival teams led by General Dynamics Corporation, BAE Systems, Northrop Grumman Corporation, and Raytheon Company, respectively. From this field of competitors, three development contracts will be awarded first. That will set the stage for a competition in 2011 where each of the three rivals will demonstrate the performance and reliability of its vehicle. The stakes are high: The winner will receive a $40 billion order to supply 60,000 vehicles over the next decade.

A Different Strategy Required

A marketer positioned to sell to the government has a much different marketing strategy focus than does a firm that concentrates on the commercial sector. The government seller emphasizes (1) understanding the complex rules and standards that must be met; (2) developing a system to keep informed of each agency's procurement plans; (3) generating a strategy for product development and R&D that facilitates the firm's response to government product needs; (4) developing a communications strategy that focuses on how technology meets agency objectives; and (5) generating a negotiation strategy to secure favorable terms regarding payment, contract completion, and cost overruns due to changes in product specifications.

The Institutional Market: Unique Characteristics

Institutional customers comprise the third sector of the business market. Institutional buyers make up a sizable market—total expenditures on public elementary and secondary schools alone exceed $500 billion, and national health expenditures exceed $1.9 trillion.[39] Schools and health-care organizations make up a sizable component of the institutional market, which also includes colleges and universities, libraries, foundations, art galleries, and clinics. On the one hand, institutional purchasers are similar to governments in that the purchasing process is often constrained by political considerations and dictated by law. In fact, many institutions are administered by government units—schools, for example. On the other hand, other institutions are privately operated and managed like corporations; they may even have a broader range of purchase requirements than their large corporate counterparts. Like the commercial enterprise, institutions are ever cognizant of the value of efficient purchasing.

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[38] Edmond Lococo, "Lockheed, Boeing Brains Fizzle in Humvee-Heir Bid (Updated)," Bloomberg.com June 4, 2008, accessed at http://www.bloomberg.com on June 5, 2008.

[39] U.S. Census Bureau, *Statistical Abstract of the United States: 2008*, accessed at http://www.census.gov on June 12, 2008.

Institutional Buyers: Purchasing Procedures

Diversity is the key element in the institutional market. For example, the institutional marketing manager must first be ready to respond to a school purchasing agent who buys in great quantity for an entire city's school system through a formal bidding procedure and then respond to a former pharmacist who has been elevated to purchasing agent for a small rural hospital.

Health-care institutions provide a good example of the diversity of this market. Some small hospitals delegate responsibility for food purchasing to the chief dietitian. Although many of these hospitals have purchasing agents, the agent cannot place an order unless the dietitian approves it. In larger hospitals, decisions may be made by committees composed of a business manager, purchasing agent, dietitian, and cook. In still other cases, hospitals may belong to buying groups consisting of many local hospitals or meal preparation may be contracted out. In an effort to contain costs, purchasing executives at large hospitals are adopting a supply chain focus and using sophisticated supplier evaluation methods, including e-procurement tools, like their counterparts in the commercial sector. Because of these varied purchasing environments, successful marketers usually maintain a separate marketing manager, staff, and sales force to tailor marketing efforts to each situation.

For many institutions, once a department's budget has been established, the department attempts to spend up to that budget limit. So, institutions may buy simply because there are unused funds in the budget. A business marketer should carefully evaluate the budgetary status of potential customers in the institutional segment of the market.

Because many institutions face strong budgetary pressures, they often outsource segments of their operations to specialists to enhance efficiency and effectiveness. School districts may look to third-party contractors to purchase food and supplies and to manage their meal service operations. For example, in Los Angeles, Marriott Corporation manages food service operations at the city's charter schools, and in Chicago, three different contract companies each operate 10 food-preparation departments.[40] Many universities have turned over operation of their bookstores and beverage contracts and management of their student unions to outside contractors. Business marketers must carefully analyze and understand the operational strategy of their institutional customers. Frequently, extensive sales and marketing attention must center on the third-party contract operators.

Targeted Strategy The institutional market offers some unique applications for the concept of multiple buying influences (discussed in Chapter 1). Many institutions are staffed with professionals—doctors, professors, researchers, and others. In most cases, depending on size, the institution employs a purchasing agent and, in large institutions, a sizable and skilled purchasing department or materials management department. There is great potential for conflict between those responsible for purchasing and the professional staff for whom the purchasing department is buying. Often, the salesperson must carefully cultivate the professional staff in terms of product benefits and service while developing a delivery timetable, maintenance contract, and price schedule to satisfy the purchasing department. Leading business marketers also use the Internet to provide added value to

[40] Susie Stephenson, "Schools," *Restaurants and Institutions* 106 (August 1, 1996): pp. 60–64.

FIGURE 2.5 | **GE HEALTHCARE RE-IMAGINED ADVERTISING: HOW DO YOU CAPTURE A STILL IMAGE OF SOMETHING THAT NEVER SITS STILL?**

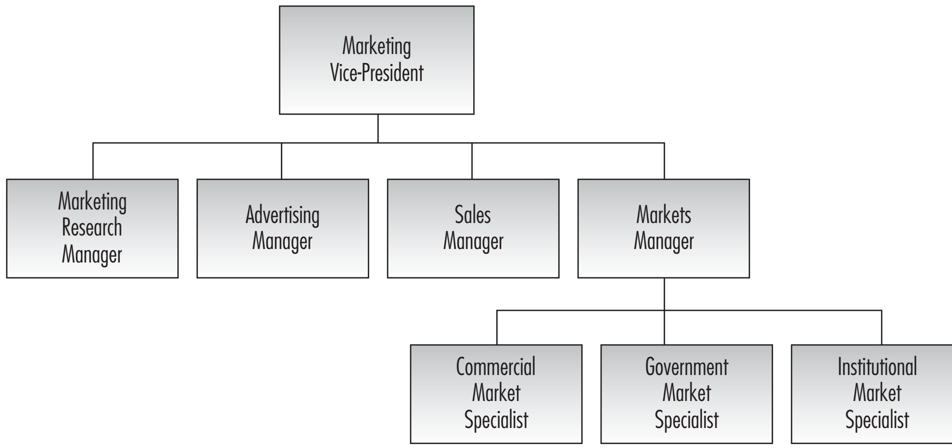
SOURCE: © 2008 General Electric Company. All rights reserved. Reprinted by permission from General Electric Company. Accessed at http://www.ge.com/company/advertising/ads_healthcare.html.

their customers. For example, GE Healthcare, a leader in medical imaging and diagnostics equipment (see Figure 2.5), has embraced e-commerce as the centerpiece of its marketing strategy and provides an online catalog, daily Internet specials, and a host of services for its customers—purchasing managers at hospitals and health-care facilities worldwide. In fact, GE and the University of Pittsburgh Medical Center have formed a company to move the laboratory analysis of human tissue into the digital age.[41] Following a routine that has changed little in the past century, the vast majority of tissue samples are viewed individually by doctors using a microscope. The goal of this new venture is to create and market a "virtual microscope" that would scan and store images electronically, improving patient care by making it easier for doctors to share information.

Group Purchasing An important factor in institutional purchasing is group purchasing. Hospitals, schools, and universities may join cooperative purchasing associations to obtain quantity discounts. Universities affiliated with the Education and Institutional Purchasing Cooperative enjoy favorable contracts established by the cooperative and can purchase a wide array of products directly from vendors at the low negotiated prices. The cooperative spends more than $100 million on goods

[41] Scott Thurm, "GE Venture to Develop 'Virtual Microscope'," *The Wall Street Journal*, June 5, 2008, p. B5.

FIGURE 2.6 | A MARKET-CENTERED ORGANIZATION



annually. Cooperative buying allows institutions to enjoy lower prices, improved quality (through improved testing and vendor selection), reduced administrative cost, standardization, better records, and greater competition.

Hospital group purchasing represents a significant market exceeding $10 billion. Group purchasing has become widely accepted: More than one-third of public-sector hospitals in the United States are members of some type of affiliated group. Most hospital group purchasing is done at the regional level through hospital associations. However, for-profit hospital chains, which are a growing factor in the health-care field, also engage in group buying. For example, a multihospital system with a $1 billion operating budget spends $300 to $500 million a year on medical supplies and purchased services. By channeling purchases through group purchasing organizations, these large buyers are reaping significant savings.[42]

Group purchasing poses special challenges for the business marketer. The marketer must develop not only strategies for dealing with individual institutions but also unique strategies for the special requirements of cooperative purchasing groups and large hospital chains. The buying centers—individual institution versus cooperative purchasing group—may vary considerably in composition, criteria, and level of expertise. For the purchasing groups, discount pricing assumes special importance. Suppliers who sell through purchasing groups must also have distribution systems that effectively deliver products to individual group members. And even though vendors have a contract with a large cooperative association, they must still be prepared to respond individually to each institution that places an order against the contract.

Institutional Purchasing Practices In many respects the purchasing practices of large institutions are similar to those of large commercial firms, but there are some important differences. The policies regarding cooperative buying, preference for local vendors, and the delegation of purchasing responsibility for food, pharmaceuticals, and many other

[42] Timothy L. Chapman, Ajay Gupta, and Paul O. Mange, "Group Purchasing Is Not a Panacea for U.S. Hospitals," *McKinsey Quarterly*, no. 1 (1998): p. 160.

items are of particular importance. The business marketer must understand these characteristics to carefully develop effective strategies for these institutional customers.

Dealing with Diversity: A Market-Centered Organization

Because each sector of the business market is unique, many firms have built market specialization into the marketing organization. To illustrate, the industrial products area of the J. M. Smucker Company is organized around market sectors. The institutional, military, and business markets are each managed by different individuals, each thoroughly knowledgeable about one particular market.

Figure 2.6 illustrates one form of a market-centered organizational scheme. Observe that a market manager supervises and coordinates the activities of three market specialists. Each market specialist examines the buying processes, the product preferences, and the similarities and differences between customers in one sector of the business market. Such an analysis enables the market specialist to further categorize customers in a particular sector into meaningful market segments and to design specialized marketing programs for each. A market-centered organization provides the business marketer with a structure for dealing effectively with diversity in the business market.

Summary

In business-to-business marketing, the customers are organizations. The business market can be divided into three major sectors: commercial enterprises, governments (federal, state, and local), and institutions. Many business marketers—for example, Intel, Boeing, and IBM—generate a significant proportion of their sales and profit by serving international customers. Indeed, the demand for many industrial products is growing more rapidly in many foreign countries than in the United States.

Commercial enterprises include manufacturers, construction companies, service firms, transportation companies, selected professional groups, and resellers. Of these, manufacturers account for the largest dollar volume of purchases. Furthermore, although the majority of manufacturing firms are small, buying power is concentrated in the hands of relatively few manufacturers, which are also concentrated geographically.

Commercial enterprises, such as service establishments and transportation or utility companies, are more widely dispersed. A purchasing manager or purchasing agent administers the procurement process. In large firms, the purchasing function has been quite specialized. In addition to protecting the cost structure of the firm, improving quality, and keeping inventory investment to a minimum, purchasing assumes a central role in managing relationships with suppliers. In turn, leading-edge organizations like Dell Computer demonstrate the critical role that purchasing and supply chain management can assume in creating profit opportunities. Rather than devoting exclusive attention to "buying for less," leading organizations tie purchasing activities directly to corporate strategy and use a range of sophisticated e-procurement tools.

Governmental units also make substantial purchases of products. Government buyers use two general purchasing strategies: the formal advertising approach for standardized products and negotiated contracts for those with unique requirements.

Institutional customers, such as health-care organizations and universities, comprise the third sector of the business market. Depending on size, the institution employs a purchasing agent and, in large institutions, a sizable purchasing department. Across business market sectors, purchasing managers are using the Internet to identify potential suppliers, conduct online reverse auctions, and communicate with suppliers.

Diversity is the characteristic that typifies the institutional market. The characteristics, orientations, and purchasing processes of institutional buyers are somewhere between commercial enterprises and government buyers. Cooperative purchasing—a unique aspect of this segment—necessitates a special strategic response by potential suppliers. Many business marketers have found that a market-centered organization provides the specialization required to meet the needs of each market sector.

Discussion Questions

1. A small manufacturer developed a new high-speed packaging system that could be appealing to food-processing firms like Pillsbury and General Mills. This new packaging system is far more efficient but must be priced 15 percent higher than competitors' products. Because purchasing managers evaluate the "total cost of ownership" of major purchases, what selling points should the business marketer emphasize to demonstrate the superiority of this new product?
2. Honda of America relies on 400 suppliers in North America to provide more than 60 percent of the parts and materials for the Accord. What strategies could a business marketer follow in becoming a new supplier to Honda? What criteria would Honda consider in evaluating suppliers?
3. Describe the total-cost-of-ownership orientation that purchasing managers use and illustrate how you could apply it to your next automobile purchase decision.
4. Segmentation is a tool that marketers use to identify target markets. Increasingly, purchasing managers are using the segmentation approach to determine which suppliers are most critical to the goals of the organization. Explain.
5. Compare and contrast the two general procurement strategies employed by the federal government: (1) formal advertising and (2) negotiated contract.
6. Institutional buyers fall somewhere between commercial enterprises and government buyers in terms of their characteristics, orientation, and purchasing process. Explain.
7. Explain how the decision-making process that a university might employ in selecting a new computer would differ from that of a commercial enterprise. Who would be the key participants in the process in each setting?
8. Fearing red tape and mounds of paperwork, Tom Bronson, president of B&E Electric, has always avoided the government market. A recent discussion with a colleague, however, has rekindled Tom's interest in

this sector. What steps should B&E Electric take to learn more about this market?

9. General Electric (GE) has embraced e-purchasing and has saved more than $500 million per year by conducting online reverse auctions in buying a range of goods, including office, computer, and maintenance supplies. What new challenges and opportunities does this auctioning process present for business marketers who serve GE?

10. One purchasing executive observed, “Online auctioning is an appropriate way to buy some categories of products and services but it’s entirely inappropriate for others.” Agree or disagree? Provide support for your position.

Internet Exercises

1. GE Healthcare has developed an e-commerce initiative to support its marketing strategy, which targets health-care organizations on a worldwide basis. Go to http://www.gemedicalsystems.com and
   a. identify the products and services that the GE unit offers, and
   b. provide a critique of the Web site and consider the degree to which it provides access to the information that a potential buyer might want.
2. Ariba, Inc., is a leading provider of e-procurement software solutions. Go to http://www.ariba.com and
   a. describe the key products and services that the firm offers to its customers, and
   b. review a case history that describes a particular customer and how it has applied one of Ariba’s procurement solutions.

CASE

Sealed Air Corporation: Delivering Packaging Solutions[43]

Sealed Air Corporation is a global leader in providing business customers with performance solutions for food, protective, and specialty packaging. Best known for its BubbleWrap® cushioning material, the firm has pioneered a number of packaging innovations that have sustained a remarkable pattern of sales growth for more than two decades. Using a consultative selling approach, field sales and technical support specialists at Sealed Air incorporate both packaging materials and specialized equipment to provide a complete packaging solution for customers, providing superior protection against shock, abrasion, and vibration, compared with other forms of packaging. Let's explore the packaging solution that Sealed Air developed for Davis Neon Inc., a wholesale neon sign manufacturer in Heath Springs, South Carolina.

Protecting custom-made neon signs that are shipped worldwide is a challenging problem for Dave Lytle, shipping manager at Davis Neon. "We were using preformed polyethylene foam sheets, which required a lot of storage space and time to unload from the trucks," noted Lytle. "We were keeping our eyes open for an alternative packaging method which would provide comparable protection, yet reduce costs and increase productivity."

After evaluating several alternatives, Dave Lytle chose a solution proposed by Sealed Air to package the neon signs—Instapak Continuous Foam Tubes made by Sealed Air's SpeedyPacker Insight system. Using the SpeedyPacker equipment, now installed in the shipping area at Davis Neon, an operator can create numerous variations of foam bags at the touch of a button. For each neon sign, Davis Neon employees create a custom-made wooden crate with dimensions just large enough to house the sign. The packager then puts a layer of foam tubes, made-to-order by the Speedy Packer equipment, on the bottom of the crate to form a pad. BubbleWrap cushioning is used on the back of the sign, between rows, and on the side to provide surface protection and prevent abrasion of the sign against the crate. Another layer of foam tubes is added on top before the lid is attached to the crate.

Before implementing the Sealed Air solution, packagers used preformed polyethylene foam sheets, each of which had to be cut by hand to fit the crate for the bottom pad and top layer, as well as to fit in between the letters on the neon sign. "The preformed polyethylene foam sheets took a long time to cut, were expensive, and produced significant material waste," stated Lytle. "After working with the new packaging system, the actual savings are 62 percent in material costs. We have also seen productivity increase by 20 percent." Employees at Davis are now able to pack more crates in less time.

Discussion Questions

1. Given the significant value that Sealed Air can provide for a customer, like Davis Neon Inc., what approach should they follow in pricing a particular packaging solution for a customer?
2. Develop a list of other types of customers who face special packaging challenges and may represent promising customer prospects for Sealed Air to target.

[43] Case History, "Sealed Air Sheds Light on Davis Neon's Packaging," accessed at www.sealedair.com on June 6, 2008.