The underlying factors that influence the demand

• Derived demand

The demand for business products is called **derived demand** because the demand for industrial products is derived from the ultimate demand for consumer products. As a result, business marketers must carefully monitor fluctuating trends and patterns in consumer markets.

• Fluctuating demand

Because demand is derived, an increase or decrease in consumer demand can create a fluctuating demand for many industrial products.
Example:

• An increase in mortgage rates can quickly stifle new home sales. This slows down the need for new household products. Businesses react by decreasing their inventory of materials or putting off buying new machinery.
• This action explains why the demand for many industrial products tends to fluctuate more than the demand for consumer products.
• A decrease in interest rates has the opposite influence.

• Stimulating demand

Sometimes, business marketers need to stimulate demand for consumer goods which either incorporate their products or are used to make consumer products.

• Pharmaceutical manufacturers advertise on television by presenting various ailments followed by offering their products as solution to the ultimate consumer. ("Ask your doctor if XYZ is right for you!")
• Sometimes manufacturers offer deep price discounts that influence members of the supply chain to lower their prices, in the hope of influencing the ultimate consumer to buy their product.

• Price sensitivity / demand elasticity

Inelastic demand is demand without regard to price. An increase or decrease in the product price will not significantly affect the demand for the product.

• Example: Price for gasoline.

Supply chain

Marketing's Cross-Functional Relationships

Rather than operating in isolation from other functional areas, the successful business marketing manager is an integrator—one who understands manufacturing, research and development (R&D), and customer service and who applies these strengths in developing marketing strategies that respond to customer needs.21 Close and tightly integrated cross-functional relationships underlie the strategy success stories of firms such as Hewlett-Packard and 3M. As firms adopt leaner and more agile structures and emphasize cross-functional teams, the business marketing manager assumes an important and challenging role in strategy formation.

Working Relationships A day in the life of a business marketing manager centers on building relationships with customers *and* in forging one-to-one relationships with managers in the firm's other functional areas. By building effective cross-functional connections, the marketer is ideally equipped to respond to customers' changing needs. Business marketing success depends to a large degree on such functional areas in the firm as engineering, R&D, manufacturing, and technical service. Planning in the industrial setting thus requires more functional interdependence and a closer relationship to total corporate strategy than planning in the consumer-goods sector. B. Charles Ames points out that "changes in marketing strategy are more likely to involve capital commitments for new equipment, shifts in development activities, or departures from traditional engineering and manufacturing approaches, any one of which would have companywide implications."22 All business marketing decisions—product, price, promotion, and distribution—are affected, directly or indirectly, by other functional areas. In turn, marketing considerations influence business decisions in R&D and in manufacturing and procurement, as well as adjustments in the overall corporate strategy. Business marketing planning must be coordinated and synchronized with corresponding planning efforts in R&D, procurement, finance, production, and other areas (Figure 1.3).

Managing Buyer-Seller Relationship

Transactional Exchange

Customers are more likely to prefer a **transactional relationship** when a competitive supply market features many alternatives, the purchase decision is not complex, and the supply market is stable. This profile fits some buyers of office supplies, commodity chemicals, and shipping services. In turn, customers emphasize a transactional orientation when they view the purchase as less important to the organization's objectives. Such relationships are characterized by lower levels of information exchange and are less likely to involve operational linkages between the buying and selling firms.

Collaborative Exchange

Buying firms prefer a more **collaborative relationship** when alternatives are few, the market is dynamic (for example, rapidly changing technology), and the complexity of the purchase is high. In particular, buyers seek close relationships with suppliers when they deem the purchase important and strategically significant. This behavior fits some purchasers of manufacturing equipment, enterprise software, or critical component parts. Indeed, say Cannon and Perreault,

the closest partnerships . . . arise both when the purchase is important and when there is a need—from the customer's perspective—to overcome procurement obstacles that result from fewer supply alternatives and more purchase uncertainty.

Moreover, the relationships that arise for important purchases are more likely to involve operational linkages and high levels of information exchange. Switching costs are especially important to collaborative customers.

Switching Costs

In considering possible changes from one selling firm to another, organizational buyers consider two **switching costs**: investments and risk of exposure. First, organizational buyers invest in their relationships with suppliers in many ways. As Barbara Bund Jackson states:

They invest *money;* they invest in *people,* as in training employees to run new equipment; they invest in *lasting assets,* such as equipment itself; and they invest in changing basic business *procedures* like inventory handling. Because of these past investments, buyers may hesitate to incur the disruptions and switching costs that result when they select new suppliers. Risk of exposure provides a second major category of switching costs. Attention centers on the risks to buyers of making the wrong choice. Customers perceive more risk when they purchase products important to their operations, when they buy from less established suppliers, and when they buy technically complex products.

Factors that influence customer profitability

Managing High- and Low-Cost-to-Serve Customers

What causes some customers to be more expensive than others? Note from Table 4.2 that high-cost-to-serve customers, for example, desire customized products, frequently change orders, and require a significant amount of presales and postsales support. By contrast, low-cost-to-serve customers purchase standard products, place orders and schedule deliveries on a predictable cycle, and require little or no presales or postsales support.

Look Inside First After reviewing the profitability of individual customers, the business marketer can consider possible strategies to retain the most valuable customers and to transform unprofitable customers into profitable ones. However, managers should first examine their company's own internal processes to ensure that it can accommodate customer preferences for reduced order sizes or special services at the lowest cost. For example, a large publisher of business directories reduced the cost of serving its customer base by assigning key account managers to its largest customers

(that is, the 4 percent of customers who accounted for 45 percent of its sales) and serving the smallest customers over the Internet and by a telephone sales force. These actions not only cut costs dramatically but also gave each group of customers what they had wanted all along: Large customers wanted a central point of contact where they could secure services customized to their needs; small customers preferred minimal contact with a direct salesperson but wanted the assurance that they could receive advice and support if required.

A Sharper Profit Lens Business marketing managers can view their customers through the lens of a simple 2 3 2 diagram (Figure 4.4). The vertical axis shows the net margin earned from sales to a particular customer. The **net margin** equals the net price, after all discounts, minus manufacturing costs. The horizontal axis shows the **costs of serving the customer**, including order-related costs plus the customer specific marketing, technical, and administrative expenses.

Identifying Profitable Customers Observe from Figure 4.4 that profitable customers can take different forms. To illustrate, a customer like Honda of America would be at the lower left corner of the diagram: demanding low prices, so net margins are low, but also working with its suppliers to streamline activities so that the cost-to-serve is also low. High-cost-to-serve customers who occupy the upper right corner of Figure 4.4 can also be profitable if the net margins earned on sales to them more than compensate the company for the cost of the resources used in serving them. A company is indeed fortunate if several of its customers occupy the upper left hand quadrant of the diagram: high margins *and* low cost-to-serve. Because these customers represent a valuable asset, marketing managers should forge close relationships with them, anticipate their changing needs, and have protective measures (for example, special services) in place in case competitors attempt to win them away.

Managing Unprofitable Customers

The most challenging set of customers for marketing managers is found in the lower right-hand corner of Figure 4.4: low margins and high cost-to-serve. First, the marketing manager should explore possible ways to reduce the cost of activities associated with serving these customers. For example, perhaps postsales support could be shifted to the Internet. Second, the manager should direct attention to the customer actions that contribute to higher selling costs. To illustrate, the high cost-to-serve may be caused by the customer’s unpredictable ordering patterns or by the large demands it places on technical and sales personnel. By detailing the costs of these activities and openly sharing this information with the customer, the business marketing manager can encourage the customer to work with the company more efficiently. From the earlier example, recall that Kanthal used this approach not only to restore profitability but also to help one of its largest customers, General Electric’s Appliance Division, refine its internal processes and reduce its costs.

Firing Customers

By improving processes and refining pricing strategies, business marketing managers can transform many, but not all, customers from unprofitable to profitable. What should we do with those unprofitable customers that remain in the high-cost- to-serve quadrant of Figure 4.4? To answer this question, we have to dig deeper into the customer relationship and assess the other benefits that certain customers may provide. Some customers are new and the initial investment to attract them will ultimately be repaid in higher sales volume and profitability. Other customers provide an opportunity for learning. For example, some firms that serve Toyota or Honda incurred initial losses in serving these demanding customers but secured insights into management processes and technology they could effectively apply to all their customers.

Suppose, however, that a customer is unprofitable, not new, and offers little or no opportunity for learning. Furthermore, suppose that the customer resists all attempts to convert the unprofitable relationship into a profitable one. Under these conditions, Robert S. Kaplan and Robin Cooper observe that we might consider firing them, but a more subtle approach will do: “We can, perhaps, let the customer fire itself by refusing to grant discounts and reducing or eliminating marketing and technical support.” Customer divestment is a viable strategic option, but one that must be exercised sparingly and only after other options have been thoroughly examined.