CHAPTER TWO

2. UNDERSTANDING INDUSTRIAL MARKETS AND ENVIRONMENT

The industrial market is composed of customers whose purchasing decisions vary with the type of industrial goods or service under consideration. Effective marketing programs thus depend upon a thorough understanding of how marketing strategy should differ with the type of organization being targeted and the product being involved.

2.1. Who are Industrial Customers?

One way to understand the diversity of industrial customers and products they purchase is to begin by examining the various types of customers. Customers in the industrial market normally fall into three basic classifications:

1. Commercial Enterprises
2. Governmental organizations and
3. Institutions

They buy a variety of products that in one way or another are important to the functioning of their business activities knowing how these vast group of industrial customers purchase and use products and what criteria's are important in the purchasing decision is the essential aspect of industrial marketing strategy. This is because buying motives and reasons of purchase are quite different with each type of customer group. However, these groups of customer exclusive to each other. The same company can be all types of the same normally not for the same supplier.

A. Commercial Enterprises

This group includes any type of business enterprises purchasing industrial goods and services for use other than selling directly to the ultimate consumers. They purchase a variety of products for different uses. They are basically three types, original equipment Manufacturers (OEMs), user customers, and industrial distributors or dealers. These categories are useful to the industrial marketer because they point out how products and services are used by buying firms.

- ***Original Equipment Manufacture (OEMs):*** OEMs buy products to incorporate into the products they produce and sell either into the products they produce and sell either into the industrial or ultimate consumer markets. The purchased products of the industrial marketer becomes an integral part of the customer's final product. If an electronics company, for example, sells component parts to TV set manufacturer, the TV set manufacturer would be considered as OEM customer where as the electronics company is supplier of component parts to the TV set manufacturer, the TV set manufacturer would be considered as OEM customer where as the electronics company is supplier of component parts to the TV set producer.
- ***User Customers:*** are those commercial enterprises purchasing industrial goods and services for use in the production of other goods and services that are then sold into the industrial or consumer markets. The industrial products purchased by users, as opposed to the products purchased by OEMs, never end up /incorporated/ in the final product being produced by the user customer. They are used in the production process to produce other goods and services by recycling.

  The user customers purchases products that support their manufacturing process or facilitate the operation of their business. Products used to produce output and purchased by user customers include: drilling, smoothing, punching, bending, and forming machines, grinding wheels, lathes, axe, etc. There are also products that facilitate the operation of a buyer's business such as computers, type, writers, and adding machines.
- ***Industrial Distributors*****:** These are marketing intermediaries who purchase products from manufacturers and then sell these products, often in the same form as purchased, to commercial, government and institutional customers. They take title to goods and act in a similar capacity to whole salers and retailers. In strict sense, they are not actual customers of industrial goods rather they are resellers. They generally serve other business enterprises, governmental agencies, private and public institutions.

It should be, however, noted that, at times, the three groups of commercial enterprises tend to overlap each other. For example, a manufacturer of forlift can be a user purchasing metal cutting machine tools to support the manufacturing machine tools to support the manufacturing process, or an OEM purchasing years and transmissions to incorporate into the forklift being manufactured.

Thus, OEM purchasers must be more concerned with the impact that the purchased products have on the quality and dependability of the end products they produce. User customers should center their emphasis on prompt, predictable delivery, and maintenance. And industrial distributors purchase products based on how these products match the needs of their customers.

B. Governmental Organizations

Governmental agencies are the largest purchasers that represent a huge market for industrial goods and services in almost all countries. They purchase virtually every kind of goods ranging from the smallest dollar amount to the largest dollar values. As a result of volume purchasing, procurement administration and practices are highly specialized. Government buyers negotiate directly with vendors or carefully develop detailed specifications and invite qualified suppliers to submit a price bid in writing and award the bid to the lowest, qualified supplier.

Governmental customers of industrial goods and services range from the smallest to the largest organization. These variations occur in

- Their buying power or the volume of purchase
- Their purchasing/buying patterns
- Their purchasing procedures, not often

Based on these criteria, governmental customers are basically classified into three groups local governments, state governments, and federal governments.

- ***Local Government:*** These are the lowest administrative units of the government. They serve specific populations in defined areas and are typically responsible for many local government functions. They include municipalities, districts, peasant associations, and kebeles.
- ***State Governments:*** These are organization, which make major expenditures in various projects for many individual goods and services.
- ***Federal Governments***: are large buyers of good and services. There are many functional areas within federal government organizations. They include both civilian and military buying units such as agencies, boards, commissions, departments etc.

Effective marketing strategy for reaching government customers involve thorough understanding of each group and the complex purchasing procedures. The marketer is primarily faced with widely dispersed markets at federal, state, and local levels. Compounding this fact is the large number of influencers in the purchasing process. Government buyers are responsible to and influenced by numerous interest groups who specify, legislate, evaluate, and use the goods and services purchased.

C. Institutional customers

Institutions do not fall into a clear-cut classification. Rather their practices lay somewhere between government and private commercial enterprises. Institutional buyers are a mixture of government and private organs and industrial marketers must consider them on an individual basis to respond successfully according to their unique characteristics, purchasing practices, and policies. They include schools, colleges and universities, churches, hospitals, non-profit organ, etc.

Some of these institutions follow rigid rules and purchasing procedures while others follow for more casual procedures. On the one hand, public institutional buyers are quite similar to government buyers due to the constraints of political considerations and the dictates of law. On the other hand, private institutions are managed very much like commercial enterprises.

Effective marketing rests on the industrial marketer's ability to recognize the way in which each institution purchases its goods and service. This distinction enables the marketer to know customers explicitly and perform detailed research into market segmentation, original behavior, purchasing policies and practices, and informal buying influences appropriate for each institution.

2.2. Classification of Industrial Products

There are many types of products that can be sold into the industrial market. They are generally grouped into three broad grouped:

1. Material and parts
2. Capital items
3. Supplies and services

1. Materials and Parts

Goods that enter the product directly consist of raw materials, manufactured materials, and component parts. The cost of these items are treated by the purchasing company as part of manufacturing cost.

- ***Raw materials*:** These are the basic products that enter the production process with little or no alterations. They are products generated by the extractive industries.

  Example include coal, iron ore, lead, field crops copper etc. They may be marketed as either OEM or user products. For examples when large bakery purchases natural gas to fire the ovens which are used to produce cakes, it is a use customer but when the same firm purchases fruits for processing Juice, it is an OEM. Given the undifferentiated nature of raw materials, price becomes a key selling factor.

- ***Manufactured /processed/ Materials*:** These include all type of raw mateirials that are subjected to some amount of processing before entering the manufacturing proass. They under go series of further processing before

becoming part of the finished product. Typical of these products include chemicals, glass, sheet metal, leather, yarn, etc. Copper can be formed into wire, leather can be further processed into shoe etc. Since they are standardized products, price, quality, and availability are the primary purchase considerations.

- ***Components parts:*** These are products purchased for the purpose of inclusion into the final product of the industrial customer. They can be installed directly into products with the product of the purchaser. Example include switches, motors, batteries, tires etc.

2. Capital Items

Capital items are those which are used the production processes and they wear out over a certain time frame. They are normally treated as "user product". Capital items are further classified into three groups:

1. Heavy equipment/Installations
2. Accessories/high equipment, and
3. Plan and building

- ***Heavy Equipments/Installations:*** these are basic ally capital items used in the production process and wear out overtime. They are major long-term investment or installation items. They can be purchased outsight or leased by user customers. In cases where capital equipments are purchased, it is treated as an asset by the purchasing firm and depreciated for tax purposes. When capital equipment is leased, the purchaser treats the cost as expense. It includes metal cutting machines, metal forming machines, cranes, factories, generators, etc.

  The marketing strategy for heavy equipment's, therefore, is direct manufacturer to user distribution because of the extensive interaction involved. Negotiations often take many months and may involve top executives in both buying and selling firms. Personal selling becomes the primary promotional effort.

- ***Light Equipment/Accessories:*** These are products whose transition values are considerably lower than heavy equipment. They are generally less expensive and not considered part of the fixed plant. They may be leased or purchased outright by the industrial customer. It includes hand tools, typewriter, fax machines, drills, calculators etc.

  In the marketing of less costly and more standardized accessory equipments, it is necessary to use industrial intermediary, advertising in trade journals to reach final users, the development of missionary salespersons who provide selling support to intermediaries.
- ***Plant and Buildings:*** These are the real estate property of a company. It includes the firm's offices, plants (factories), warehouses, housing, parking lots, and so on.

3. Supplies and Services

Supplies and services support the operation of the purchasing organization. They do not become part of the finished product.

- ***Consumable Supplies*****:** These are products of any kind that are used up or consumed by the customer firm in the normal business operation since these goods do not become part of the finished product, they are treated as operating expense item for the period in which they are consumed. Typical of such products include: soaps, typing papers, business forms, fluids, cleaning materials, etc.

  They are generally standardized, marketed to broad section of industrial users, and are not very different from the types of supplies that consumers purchase. In selling supplies, the marketing strategy is to use a wide variety of intermediaries to reach broad users and large markets. This is because most supplies are marketed to many organs in all most all industries. Thus, in the purchase pf supplies, purchasing agents dominate the market. They evaluate and choose suppliers on depend ability of delivery, convenience, price, and

breadth of assortments. Personal selling is not cost effective for supplies. Thus, the firms should limit their direct selling effort to major resellers and users. Advertising through catalog and trade journals are the primary means to reach most users.

***Industrial Services*:** Many companies also operate in the service market and organs require a wide variety or range of services. Industrial services are of great variety and difference considerably interms of cost and sophistication. Common examples of services include janitorial or cleaning services, repair and maintenance, installation services, delivery and warehousing service, protective services, consulting, computer, advertising, leasing, accounting services, etc.

However, some organs lack internal capabilities to give such services as legal counsel, marketing research ads, and field and product development since buying firms usually contact professionals on the basis of their words of mouth reputations the marketing strategy for professional service is to use a more consultative selling effort aimed at helping the customer to develop an objective and relevant definition of the problem so that the implemented solution will be effective and beneficial.

2.3 Industrial Market Environmental Analysis

Industrial buyers and sellers operate in a dynamic environment which change continuously. There are three types of environment.

1. Physical (cological) environment
2. Internal environment and
3. External environment

1. ***Physical (Ecological environment:*** industrial organizations manufacturing chemicals and pesticides pose serious threats to environment due to disposal of untreated waste. The governments in most of the countries have tightened safety and environment regulations to force the defaulting organizations to make corrective measures. Therefore, the corporate and marketing strategies have to be developed obased on the demands of the ecological environment.

2. ***Internal Environment:*** The purpose of carrying out the internal environment analysis (that is, internal company analysis) is to identify periodically the specific strengths and weakness of a company. This involves an analysis of all the factors of a firm, including marketing, finance, R and D, manufacturing, organizational structure, and human resource.
3. ***External Environment:*** successful companies recognize the importance of continuously scanning /monitoring/ the external factors. Both micro and macro environmental factors change continuously. These changes spin out new opportunities and environmental factors and the resulting opportunities and threats, industrial firms determine their objectives and strategies.

The time-horizon for environmental scanning is approximately twice the duration of a company's planning period. For example, if an industrial firm is developing a short term plan of one year, the environmental scanning period is two years. The source of information on environment factors are business press, government publications, trade journals, professional, publications, customers, dealers, sales representatives etc.

- ***The micro environmental factors:*** They include customers, competitors, and suppliers. These factors/forces affect individual firms differently since each firm has different set of customers, competitors, and suppliers. It is important for industrial marketers to understand the changes in their customers' needs and goals, competitive well as changes taking place in the environmental factors of customers. An industrial marketer also needs to gather information on competitors' strategies, objectives, strengths and weaknesses, and reaction patterns. Raw materials, components parts, and capital goods are supplied by supplier firms as inputs for the use in the production of goods and service. The survival and success of both supplier and buyer firms depend on their interdependent relationship, commitment to quality and service, and knowledge of external environmental.
- ***The Macro environmental factors:*** they include economic, technological, political and legal and demographic factors that affect/influence the activities of industrial marketer.

2.3.1 Strategies for Managing Industrial Environment

Effective use of marketing mix variables such as product, price, place, and promotion are not adequate for the survival and success of industrial firms in a dynamic environment. The first step is the continuous gathering monitoring of information on the relevant external environment. The following three strategies are available to respond productively and creatively for managing the opportunities and threats presented by external environment.

- ***Independent Strategies:*** These are the independent efforts of an industrial firm by using its own resources (strength). There are several examples of independent strategies depending up on an organization's initiative and strengths. To overcome a competitor's strategy of price cuts, on firm pursues an aggressive pricing by undercutting the competitor's price or differentiates its product superiority through product development. To meet public concern for ecologic environmental protection, a firm carries out environmental controls and creates awareness through corporate image advertising. If the demand for its product is too inadequate in a certain geographical area in relation to the cost of marketing, a firm may decide to demarket (not to market) in that area.
- ***Cooperative Strategies:*** In these strategies, an industrial firm cooperates with other firms, industries, or groups in the environment. For example, industry associations such as association of shoes manufacture, association of Banks and Insurance, and Ethiopian chamber of commerce protect the Ethiopian industries from unfair political or legal regulations of the government.
- ***Strategic Planning:*** An industrial firm carries out strategic planning by identifying long term product/market based on its forecasts of external environment, analysis of its strengths and weaknesses, and its long term objectives and goals. This would help an industrial firm to take strategic decisions on diversifying through "backward", "forward" or "horizontal" integrations or by expanding its markets from domestic to international markets.

- ***In backward integration,*** a company seeks ownership of its supply system. For example, Kangaroo shoe may set up its manufacturing plant for leather, which was earlier supplied by Ethio tannery or Awash Tannery.
- ***In forward Integration,*** a company seeks ownership or increased control of its distribution systems.
- ***In horizontal Integration,*** a company seeks ownership or control of some of its competitors.

2.4. The Nature of Demand in Business Marketing

2.4.1 Demand defined

Definition: Demand can be defined as the volume of a specific product a defined customer or customer group in particular geographic area buys during a specified period of time. Thus, demand is a single number.

Types of demand

According to Gross (Business marketing scholar), there are two major types of demand: direct and derived demand.

Direct demand

Direct demand is generated by individuals who buy goods and services to satisfy their own personal needs. The end objective of the purchase is personal gratification in one way or another. In this role, we are known as "Consumers". We are not buying to further the ends of a business or to make a profit. Even in our purchases for gift giving, the end result is our personal gratification at seeing the pleasure of the gift recipient. Consumer direct demand is the origin of all other demand.

Derived demand

Purchases made by business buyers, institutions and organizations are expressions of derive demand- that is, they are derived from the demand generated by the customers or clients of the organization. Thus, the demand for plastic bottles to be sold to CoCa- Cola would be directly related to the demand by consumers for the soft drink.

Example:-the demand for business goods and services. Business goods and services are purchased to produce goods and services needed/ demanded by its clients. If the firm had no clients or customers; it would have no need to buy anything.

Business buyers buy goods and services for use in the products and services that they, in turn, produce for facilitating the operation of the enterprise or for sale.

Inelastic demand:-

Because of the derived demand for business products, there is less opportunity for business marketers to stimulate primary or direct demand through price cuts than there is for consumer goods marketers to do so. Therefore, the primary or direct demand for business is more price inelastic than that for consumer products. **Inelastic demand** takes place if price changes have little impact on the quantity of goods or services demanded. For example, automobile manufacturers purchase headlights as component parts for automobiles. If the price of headlights goes down, the automobile manufacturers are not very likely to greatly increase their purchase of headlights.

Fluctuating demand

The demand for industrial goods and services tends to be more volatile than the demand for consumer goods and services. This fluctuating demand is especially true of the demand for new products and equipment. A given percentage increase in consumer demand can lead to a much larger percentage increase in the demand for plant and equipment necessary to produce the additional output. This phenomenon is referred to as the **acceleration principle.** An increase in consumer demand of only 10 percent can result in as much as a 200 percent increase in industrial goods demand in the next period.

Joint demand

Joint demand exists in situations where two products are used together and are demanded together. The demand for a number of business products, such as raw materials and components part, is affected by joint demand. Joint demand occurs when two or more items are used in combination to produce a product. For instance, a firm that manufactures hammers needs the same number of handles as it does hammer heads; these two products are demanded jointly. If the supplier of handles cannot furnish the required number, and the hammer producer cnnot obtain them elsewhere, the producer will stop buying hammer heads.

The chain of derived demand

A company manufactures ball-point pens. Its customers are consumers. Thus, the demand for these pens is a direct demand. The pen company buys metal ball-tips, plastic barrels, and ink to make the pen. Each supplier to the pen manufacturer is supplying into a business market and faces a derived demand. If consumers buy more pens (direct demand), then the suppliers are called upon to deliver more plastic barrels, ink, and so on (derived demand).

Note that each of these suppliers, in turn, purchases materials and supplies from other firms, thus, **a chain of derived demand** is established, with suppliers several times removed depending on the initial consumers' direct demand for pens to generate derived demand for their products.

2.4.2 The implication of derived demand

The concept of derived demand is perhaps the most important idea in business marketing-one with many significant implications for the marketing mix. Changes in the business marketer's price may shift market shares among competitors but are not likely to affect over all industry demand. Price elasticity of demand (relative price sensitivity) depends on how crucial reliability is to the buyer and the profit impact on the buyer of the price change. The business marketer's promotional efforts may benefit from use of telescopic marketing strategy. In distribution, changes in demand may be magnified by the acceleration effect, the whiplash effect, inventory policies, speculation, and discontinuities associated with capital goods purchased.

1. **Price and profit impact**

Derived demand carries three implications for the pricing of business products and services: difficulty in expanding overall demand, relative price insensitivity, and in certain situations, relative price sensitivity.

a. **Difficulty in expanding overall demand: -** generally speaking, some rule of thumb ratio can be established to stimulate overhead, administration and sales costs of goods.If we assume that these components amount to 50% of the price of any finished product, the other 50% would be the cost of materials. However, in most cases the cost of material is much lower than the cost of 50% of the cost of the finished product. Consequently, if the business marketer is able to reduce the cost of purchased materials the cost of saving that can be passed to the end market consumer will be very small. Thus it is virtually impossible to expand total market demand by lowering the price of a component sold in the business market.

b. **Relative price insensitivity(industrial buyer): -** industries in which industrial products feed production lines, the customer is likely to view price as relatively unimportant in comparison with such supplier attributes as assurance of stability in product specifications and reliability in consistently meeting delivery dates. The buyers will pay more to prevent break down capital equipment and to keep the assembly line moving. A slightly higher cost of suppliers in such a case is a small price to guarantee

against down time (the period during which equipment cannot be used) and to avoid the cost of paying workers who cannot produce output.

c. **Relative price sensitivity (Industrial marketer):-**In comparison with the direct demand consumer market, in which personal gratification and even whim may lead to purchases without great concern for price, derived demand tends to respond more often to pressure on price. One reason for this is the profit- generating potential of any cost reduction the business buyer can achieve. E.g. if for example, Sony earns a return of 5% on sales revenue, the company must sell $100 worth of radios to earn $5 profit. On the other hand, if the company can cut its costs by $5, this represents immediate profit. Often it is much easier to find cost savings than to increase sales by twenty fold. Because of this immediate impact on profits, business buyers often place greater pressure on their suppliers.

2. Promotion

Because of derived demand, business marketers must direct promotional efforts to more targets than just their immediate customers. They may need to use pull promotion to increase derived demand by stimulating their customer's customers to specify the marketer's specific material, component, or service- thus pulling the product through the distribution channel from a lower level.

Thus a manufacturer of florescent lighting fixtures, such as general electric, might send sales people to visit architects to specify General Electric fixtures rather than those of competitors, even though the actual buyer, the immediate customer, is the contractor, or the architect.

What this means is that the multiple buying influences at the customer level (production, finance, quality control, plant managers) all of whom may be recipients of promotional message may be joined by another layer of multiple buying influences at the customer's customer level. Given a sufficient promotional budget and demonstrable results from effective pull strategies, the business marketer's task may be extremely complex.

Telescopic marketing strategy:-is somewhat more sophisticated technique using promotion to increase derived demand for business marketer's product or service. In this case, the marketer stimulates direct demand for an end product containing the marketer's product. This in turn increases derived demand for business goods or services. Thus telescopic marketing is something more than a simple pull promotion strategy.

In a **pull promotion strategy**, the marketer sells a product through the distribution channel, with no interviewing manufacturing or processing stage.

In telescopic marketing strategy, the marketers sell to an intermediate manufacturer or processor. Consequently, the product, component, or material undergoes an intervening manufacturing or processing stage before it is purchased by the end customer.

Factors permitting use of telescopic marketing- Note every business marketer can use a telescopic marketing strategy. Since the company is promoting something other than the identifiable product it manufactures, competitors can also benefit from its efforts. Thus a company that is considering telescopic marketing should have a high market share in the product. The major factors that permit the use of telescoping marketing are the following:

a) Telescopic marketing is a feasible strategy for products or process that are patentable or that have high entry barriers.
b) Telescopic marketing is made much easier if the business marketer's customers represent a high market share in the industry. The end market must be sufficiently large to generate enough derived demand for the product to warrant the investment in telescopic promotion.
c) Telescopic marketing is likely to bring the greatest derived-demand benefits if current penetration of the end market is small. But the shrewd marketer also must consider the availability of direct and indirect substitutes and how long they will take to eat into the new market. For example, aluminum cans have now displaced most tin plate cans in the carbonated beverage business.
d) The state of the economy is another variable affecting the feasibility of a telescopic marketing strategy. Since in telescopic marketing the product or service is not immediately identified with the business marketer, the marketer receives no spin-off benefits, which it would in the case of institutional advertising. Since the marketer's benefits depend solely on the sale of other companies; products, telescopic marketing is more risky in a poor economy.
e) Finally, the marketer should weigh the advantage and disadvantages of the item to be promoted from the perspective of the manufacturers, processors and other channel members intervening between the marketer and the end user. The new item should have obvious advantages to these channel members or, at the very least, lack negative attributes. It is extremely difficult to use telescopic marketing effectively if the transition costs to channel members are high.

3. Distribution

The chain of derived demand forms a chain of distribution characterized by dramatically wide swings in inventories and expectations. This **boom and bust volatility** can be caused by shifts in tastes and preferences at the customer direct demand level, by inventory policies, by technological developments, or by changes in economic conditions. It is exacerbated at times by the speculative purchasing of organizational buyers.

a. **The acceleration effect: -** a change in direct demand at the customer level has an **acceleration** effect on the business market. For example, assume it takes Br 300 worth of raw material, which undergo processing, to make Br500 worth of processed material, which in turn undergo a fabrication stage to become Br 600 worth of finished product-one hundred units all. These one hundred units sell at Br 10 each to yield total sales of Br 1000. If demand drops 10%, from one hundred to ninety units, the demand for fabricated product is reduced to Br 540[Br 600x.9]. Similarly, the demand for processing is reduced to Br 450, and the demand for raw materials to Br 270. Thus the ten-unit, or Br 100, reduction in demand at the customer level has had the effect of reducing the demand for goods in the business market by Br 140.

   Not only is the overall business demand decreased by a larger absolute amount than the decrease in consumer demand, it is also likely that distributors, jobbers, and retailers which base their inventory level on some multiple of current sales, will further reduced their inventories. This will have an accelerating or multiplying effect on inventory levels back through the channel.

b. **The whiplash effect: -** the small fluctuations in retail demand are reflected in inventory patterns at each level of the channel are called the whiplash effect. For example, assume that the typical retailer figures inventory requirements on the basis of sixty days supply of goods to meet the current sales level. The retailer might check inventories every two weeks after the order is placed. With relatively stable demand, adequate cycle quantities are on hand, and there is sufficient safety stock to cover delivery delays. Distributor and manufacturer inventories would be managed in a similar fashion.

c. **Volatility in longer channels: -** when organizational buyers are trying to assure adequate supplies of components and material for production in their company, they too will establish an inventory objective for each item they buy. This is usually sufficient for a particular production in the short run or, on the long runs, for some time period, for sixty or ninety days. The inventory objective is based on forecasted sales of

the particular products, perhaps for the next six or twelve months. Increased demand for the consumer or business end product and optimism and decreased sales reduces these objectives considerably. Thus, demand volatility for supplies and components in longer distribution channels is the result not only of shifts in demand, but also of inventory policies and expectation.