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DISCOVERING A NEW B2B APPROACH TO SUCCESSFUL CUSTOMER PROFITABILITY ENHANCEMENT

The case of Formica-PSM

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Abstract

Profitability of businesses is a very interesting area to study, as this is the key to survival and development for all companies. Despite its crucial importance, many companies are managing profitability by using rather restricted and short-term measures. This thesis presents an alternative way to obtain profitability, which implies a focus on customer relationship management.

Our aim is consequently to determine which relationship characteristics are related to customer profitability in order to focus on the most promising prospects. To accomplish this purpose and to increase the knowledge in our area of research, a theoretical model will be developed. Based on these findings we will further suggest implications for tailored customer management.

The subject of customer profitability was approached from a quantitative perspective and in the context of our case company Formica-PSM in Sweden. The company is active in the high pressure laminate industry, which is characterised by maturity and overcapacity. This further emphasises the need for innovative ways to enhance profitability.

The results of our research allowed us to identify six relationship characteristics that are directly influencing customer profitability and six additional determinants of these direct factors that indirectly affect customer profitability. Once the customer base was segmented in terms of their level of profitability, they were evaluated on the basis of these identified factors. Finally, conclusions and recommendations were drawn for customers to be targeted in a way that corresponds to their current or potential contribution to profit.

Key words: Profitability, relationships, B2B, relationship characteristics, relationship duration, switching costs, interdependence, perception of value, loyalty, trust and commitment.

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1 Introduction

This chapter has the objective to familiarise the reader with the area of study by presenting a background to the area of Relationship Marketing and customer profitability. The most interesting aspects of this discussion are presented in the problem statement together with a presentation of the research questions. Thereafter, the purpose of our thesis is stated, followed by the delimitations of the research. Finally, the disposition of the thesis is outlined.

1.1 Background

Profitability has and will always be a main concern to all companies, as this is the key to their survival and development. Striving for profitability means of course managing costs and revenues, but there are more innovative ways of doing it. Historically, short-term financial measures such as annual sales and profits, expenses and the balance sheet have been considered as key indicators of a company's current and future performance. The present situation is, however, that many managers are using rather outdated measurement systems that do not always correspond to the business strategies. As a result, a CEO function can be compared to a pilot flying an aeroplane with nothing but an air speed indicator to tell him how he is doing, implying that *"with almost total reliance on measures of current period profits, today's managers are flying blind."*¹ With this in mind, we argue that there is the need for a more holistic and innovative way of obtaining a high profitability. Why not look closer at the present customer relationships and evaluate how these can be managed to nurture a higher profitability?

"An innovative way to obtain profitable customer relationships"

With this perspective on profitability, customer relationship management becomes an important area to consider. Previous studies on relationships from a profitability perspective are e.g. Grant and Schlesinger (2000) article *"Realise your customers full profit potential"* which stresses maximisation of long-term value of relationships with customers that have the potential to generate high returns, and the Reinartz and Kumar (2003) study on the impact of customer relationship characteristics on profitable lifetime duration. Apart from these studies, research has mainly focused on a Business-to-consumer (B2C) setting or in the perspective of large customers that want to enhance profitability in their relationships with

¹ Reichheld *et al* (2000)

suppliers. Hence, there is a growing need to expand the knowledge on profitable customer relationships to the business-to-business (B2B) setting as well, particularly from the supplier's perspective. De Burca (1995) argues that “*B2B marketing has remained underdeveloped as a consequence of the application of the traditional marketing concept, developed in a consumer goods context, to B2B problems.*”² Further, Morris *et al* (2001) suggests that both suppliers and industrial customers do not know how to manage their relations; instead their knowledge is derived from the day-to-day interaction process. This lack of knowledge and experience in relationship management includes issues such as the types and amounts of investments made in the relation, shared information and established linkages.³

Studies regarding customer relationship management are usually found within the area of Relationship Marketing (RM), which developed from dissatisfaction with the traditional marketing management approach in terms of the four P's⁴. An important reason for this was that the traditional perspective became outdated and did not adequately address the needs of B2B and services marketing, where researchers within the Nordic School were important contributors.⁵ Additionally, the IMP⁶ Group provided an industrial perspective on marketing by defining the major marketing problem of firms as the establishment, development and maintenance of lasting business relationships with customers, suppliers and other important actors. The insights generated by this research contributed to the development of RM by increasing the understanding of important elements in relationships and interaction. The network perspective contributed to the RM concept as it stresses relationships as the primary unit of analysis, and its holistic view by bringing into play a direct relationship through its emphasis on interaction, contextuality and time.⁷

The impact of RM is however not agreed upon among theorists. Gummesson (1995), among others, considers RM to be a paradigm shift abandoning the transactional approach of marketing to anonymous masses for the management of relationships with more well-known identifiable customers.⁸ On the other hand, there are authors that consider RM as a complement to the already established marketing management, e.g. Morris *et al* (1997). We believe that although the RM

² De Burca in Gummesson (1995)

³ Morris *et al* (2001)

⁴ 4 P's stands for Product, Price, Place and Promotion

⁵ Gummesson (1995)

⁶ IMP stands for Industrial Marketing and Purchasing

⁷ Gummesson (1995)

⁸ Gummesson (2002) Grönroos (1997), Morgan & Hunt (1994), Gummesson (1994)

school of thought might not be new, its modern application represents a major directional change that has influenced marketing in both theory and practice. Still, RM is a rather broad and fragmented area of study in a state of evolution, resulting in a series of sometimes confusing concepts and theories describing similar or interconnected phenomena. An example of this is that there is no single and commonly accepted RM definition.

Although the RM approach has marked the emerging importance of managing customer relationships, as companies need to be aware of who their customers are to approach them in a successful way, many companies implement so-called RM strategies without a real understanding of what they entail, and in cases where a transactional approach could be more suitable. The current theoretical framework of RM consequently needs to be further developed to gather the findings of the academic research within this area and make it available to the everyday management, particularly in areas such as customer management based on the dynamics of the relationships and customer behaviour.

Accordingly, Zolkiewski and Turnbull (2002) point out that *“the importance of effective planning and management of an organization's array of customer and supplier relationships is self-evident, yet relatively little research has been published which develops our academic or managerial understanding of the conceptual and practical problems inherent in this issue.”*⁹ Ford (2001) adds that despite that *“buyer-seller interdependence is a crucial characteristic of industrial marketing, meaning that industrial firms establish buyer-seller relationships which are often close, complex and frequently long-term, the nature of these relationships has until recently received scant attention in the literature.”*¹⁰ The need of research in this domain has become a high priority. For instance, the Marketing Science Institute in the USA has elevated the topic of customer management and the analysis of surrounding issues (e.g. value of loyalty, measuring lifetime value) to one of its main research concerns.¹¹

Each company is characterised by its own array of transactional and relational exchanges, which stresses the importance of having a customer management orientation to approach each customer in a way that the benefits are maximized for both parties.¹² This is especially evident in a B2B setting, where the customer base normally consists of a rather small number of customers compared to a B2C

⁹ Zolkiewski & Turnbull (2002)

¹⁰ Ford (2001)

¹¹ Reinartz & Kumar (2003)

¹² Ford *et al* (1998), Morris, *et al* (2001)

setting. Yet, this task can be particularly difficult since relationship investments and benefits are not always financial and therefore may not be always easy to quantify. Furthermore, we would like to stress that an understanding of each customer is important as research by Reinartz and Kumar (2003) has demonstrated that long-term customers are not necessarily profitable and that companies can also obtain profit from short-term customers when detecting the opportunities on time.

B2B companies tend to have a heterogeneous customer base where the largest proportion of profits is accounted by a relative small number of customers. In this respect it is vital to understand the structure and characteristics of profitable relationships at the customer level since it is very difficult to provide equal service to each customer. This will help managers to decide which customers to focus on and when to do so, according to each relationship orientation. Having this integrated approach in mind, companies can assure the accurately implementation of relational strategies to become truly customer driven.

Also, in an increasingly globalised world where competition is much more intense and with tougher economic conditions, innovative ways of managing customer profitability are especially valuable. The successful management of the customer relationships will set the grounds to build a competitive advantage, acting at the same time as powerful barriers for newcomers to enter the market.¹³

This discussion implies that companies of today are not only required to build relationships with their customers in order to differentiate from their competitors in the current tough markets, but additionally managers need to evaluate the profitability of each individual account in order to invest resources in the most rewarding prospects. Thus, the question is what factors make a customer profitable?

1.2 Problem statement

With the background discussion in mind, we believe that management of customer relationships is vital for the success of companies, especially in B2B markets. There are indications that companies are using outdated measurement systems or applying relationship management superficially to one-fit-all situations. Therefore, we believe is important to increase the awareness of what characterises

¹³ Ford *et al* (1998), Zolkiewski & Turnbull (2002)

profitable customer relationships, since it can lead to a positive development of profitability. Since few studies have been conducted from a supplier perspective, we have chosen to take this perspective in our study. The supplier is represented by Formica-PSM, which was chosen as a case company. Consequently, the main problem is:

Main Problem

Which relationship characteristics impact customer profitability and in what ways can a supplier develop and manage successful B2B relationships in terms of these aspects?

When we refer to “in what ways” we mean that once these characteristics are identified we aim to use these findings as a basis to successfully manage a customer base, focusing on customers with the most promising profit potential.

In order to answer the main problem, it has been divided into two research questions presented in the next section.

1.2.1 Research questions

The first research question will explore the way in which profitable industrial customers may be distinguished based on their relationship characteristics. Consequently:

Research Question 1

Which relationship characteristics impact profitability?

The second research question is based on the information obtained from research question one, and aims to determine future strategies from a supplier perspective by creating different customer categories to manage these B2B relations in a successful way. Hence, our second research question is:

Research Question 2

What are the different strategies that can be implemented to manage the customer base in terms of the identified relationship characteristics?

The implications for these strategies will be presented with regards to Formica-PSM and its customers, but the ideas are thought to contribute to the general knowledge as well. It should also be mentioned that our two research questions will be analysed and answered by using hypotheses based on our theoretical findings. These are presented in Chapter 3.

1.3 Purpose

The purpose of this thesis is to create a framework on how to develop and manage B2B relationships from a supplier-customer point of view, in terms of profitability. It is, to our knowledge, common that most studies of B2B relationships undertake the view of large customers that aim to develop or improve relations with its suppliers. In turn, our approach takes a supplier perspective to upgrade the current status of its customers based on relationship characteristics to develop the level of profitability. In this respect the results are expected to contribute to the current theoretical background but also to benefit the day-to-day managerial application of industrial customer management.

1.4 Delimitations

In order to answer the main problem, this study will use Formica-PSM and its customer base as a case study. The company has three customer segments; direct-buying customers, distributors and indirect customers. However, only the business relationships with the direct-buying group will be considered in this study. Formica-PSM also has different products in the surface materials, but we will only refer to the high pressure laminates (HPL) as this is the main area of business.

Although we are aware that dyadic relationships do not provide a holistic view of B2B relationships, we will be concentrated on supplier-customer relationships without considering other relations that might exist across customers, between Formica-PSM and its suppliers or other indirect relationships within the Formica-PSM network. Moreover, we are mainly taking a supplier perspective, even if the customer perspective was considered to describe the results from the customer survey.

A quantitative study was conducted in order to determine main customer characteristics throughout the whole base of direct-buying customers. Furthermore, customer profitability is restricted to the direct purchases and its related costs, as a division of indirect costs proved too complex to apply.

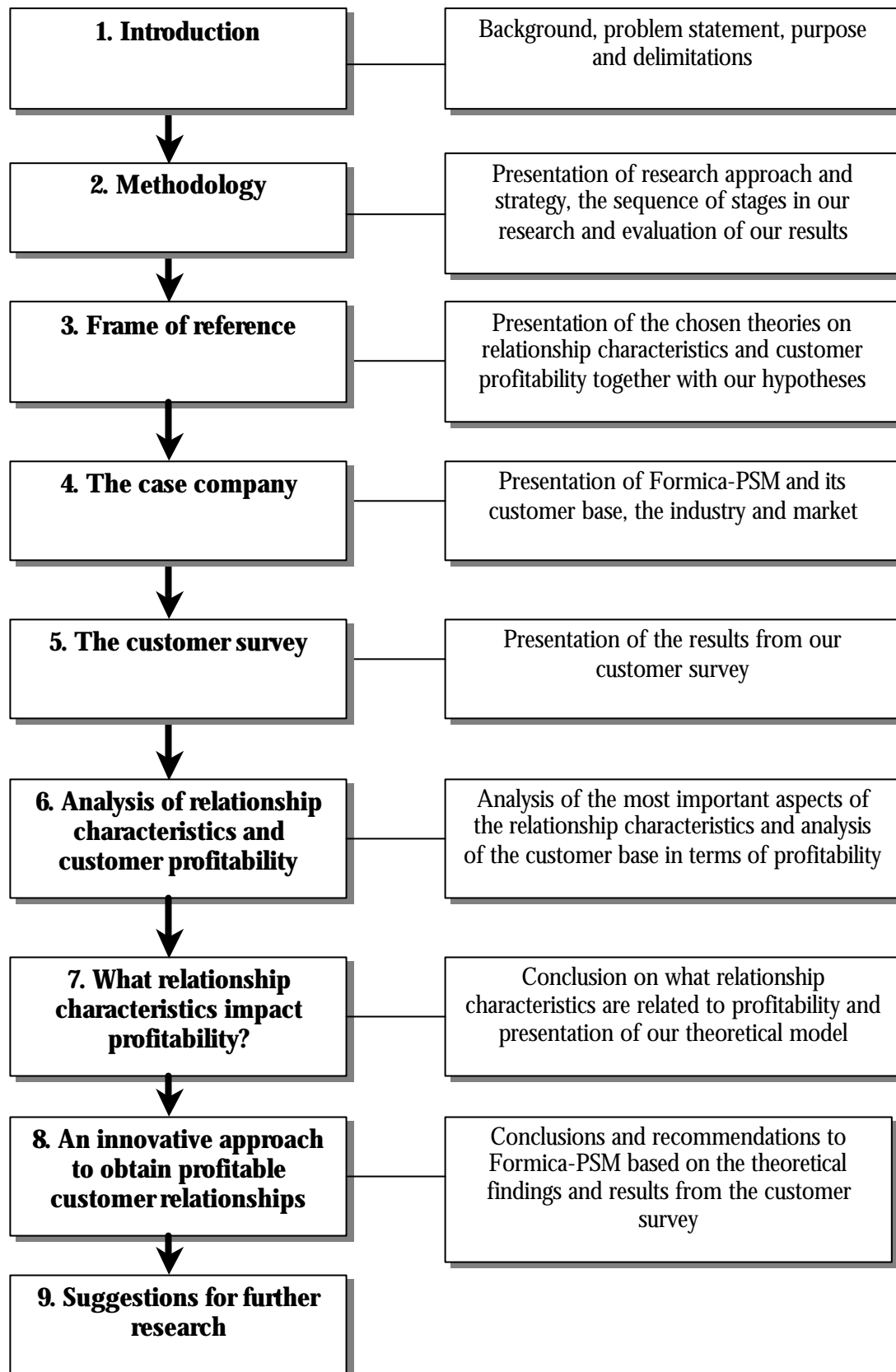
The study was conducted only in Sweden due to time constraints and because Sweden represents an important market for the company's success in the rest of Scandinavia and Eastern Europe.

Relationship marketing is an extensive school of thought incorporating a wide area of concepts, where each of these could be subject for a thesis. Therefore, we have chosen to focus on the concepts of loyalty, commitment and trust as these were recurrently referred to as important when developing relationships in the articles we revised when formulating the main problem. Also, we will consider the customers' perception of value but only in terms of price fairness, perceived quality and satisfaction. A further delimitation is to only apply the aspects of social exchange theory that concerns switching costs and interdependence as we consider these as important aspects of dyadic relationships. All the presented concepts are analysed from a supplier perspective and with specific focus on their contribution to profitability.

1.5 Disposition

The first chapter of this thesis presents the background to this study, the related problem statement and purpose. Further, the delimitations on our research are stated. The second chapter outlines the methodological aspects that were applied during the process of thesis writing. The frame of reference follows in chapter three, where the chosen theories on relationships and customer profitability are presented, discussed and motivated. These theories constitute the basis for the hypotheses presented in the final section of the chapter. In chapter four we present the case company in terms of business, industry and market, followed by the results from the customer survey in chapter five. Chapter six presents the analysis and discussion of our empirical findings in a theoretical context. Conclusions related to the first research problem are drawn in chapter seven, followed by conclusions and recommendations regarding managerial implications for the case company, which are presented in chapter eight. Finally, areas for future research are suggested in chapter nine. The disposition of this thesis is illustrated in Figure 1.1.

Figure 1-1 Disposition



Source: Own construction

2 Methodology

This chapter will outline the sequence of stages by which this thesis has been developed. The research strategy and approach are discussed initially in order to establish the conditions for conducting the study. Further, the project formulation phase is presented, followed by the designing phase which concerns the creation of a framework to the study. Thereafter, the completion phase describes how the study was carried out and the analysis phase illustrates how the collected data was interpreted. Finally, an evaluation of our research is discussed.

2.1 Research strategy

The problem statement should determine the research strategy to apply.¹⁴ This thesis concerns the identification of relationship characteristics that impact customer profitability and in what ways suppliers can develop and manage successful profitable customer relationships.

Five main types of research strategies that can be applied to exploratory, descriptive or explanatory investigations were evaluated on the basis of our problem statement. Each strategy represents a different approach to treat a problem and consequently each one has advantages and disadvantages. Furthermore, we considered the type of research questions that are posed; the extent of control the researcher has over actual behavioural events and the contemporary or historical nature of the event.¹⁵ A case study approach was regarded as most appropriate, as we aim to further develop the existing theoretical framework. Hence the remaining strategies; experiments, surveys, histories, archival analysis were excluded.

2.1.1 Case study

As the actual relations between suppliers and industrial customers and their effects on profitability can be seen as contemporary events that cannot be manipulated by the investigators, we found that a case study approach is most suitable for this research. Case studies require the application of a particular theory in the description of a specific real situation and it can be conducted either to further develop the existing theoretical framework, or contradict it and develop a completely new one. This is in line with our intention to test and further develop

¹⁴ Merriam (1998), Yin (1994)

¹⁵ Yin (1994)

present theories, as well as analysing different aspects of a phenomenon and its interrelations, maintaining a broader perspective while retaining the key characteristics of a real-life situation.

Authors such as Aaker *et al* (2000) refer to case studies in these terms, whereas Gummesson (1991) adds that case studies provide a holistic view of the process examined.¹⁶

The case study can be defined as “*an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between the phenomenon and the context are not clearly evident.*”¹⁷ Case studies have been used as a research strategy within diverse disciplines for a long time, and are applied in many different situations. Among them are thesis and dissertations and in other professional fields such as business administration and management. When undertaking a case study it is important that the limiting boundaries are well established, otherwise the strategy chosen will not be a case type. This can be done by limiting the data collected or the number of interviewees.¹⁸ In our case, we considered this by only studying one company, and a further limitation is to only study a selected group within the whole customer base.

Case studies are normally applied when the research questions posed are “how” and “why”, when the researcher has little control over the events or when contemporary events in a real life context are in focus. Furthermore, Yin (1994) affirms “in what ways” questions have an exploratory purpose and therefore case studies may be conducted.¹⁹ This is in accordance with our main problem, as it considers in what ways suppliers can manage their customers profitably. The focus of our study is on events that take place in a real life context, which is something that we can not control, exploring and explaining the present situation.

Additionally, it is necessary to determine the type of unit in which the study will be based on. Within the literature, it is possible to find single or multiple-case designs, which can be analysed from a holistic or embedded perspective. A holistic design will concentrate on a single unit of analysis in order to evaluate the global nature of the event, while, on the other hand, the embedded design will evaluate several units or subunits of the same phenomenon.²⁰

¹⁶ Aaker (1991)

¹⁷ Yin (1994)

¹⁸ Merriam (1998)

¹⁹ Yin (1994)

²⁰ Ibid

Initially, we discussed whether a multiple-case design could be applicable to compare profitable customer relations in different companies and industries. Later on we realised that such a study would require more resources than the ones available, especially with regards to time, running the risk of making a superficial analysis of several customer bases. Therefore, it was determined that a single-case design was more suitable, as it would allow us to concentrate on one single unit of analysis gaining deeper understanding of one company's customer base to draw more thorough conclusions.

There are three main rationales to undertake a single case study. The critical case, when the objective is to test a well-formulated theory in order to confirm, challenge or extend that particular theoretical framework. The extreme case which investigates a unique or rare event and the revelatory case that refers to events that have not yet been scientifically studied.²¹ This thesis follows the critical and revelatory rationales. As stated in our purpose, it is our goal to contribute to the current theoretical framework by providing a more integrated view of this topic. In addition, the topic of B2B relationships is still under investigation, particularly from the supplier-customer approach. Moreover, it is to our knowledge that the particular research on customer management in terms of profitability based on relationship characteristics has not been previously assessed.

2.2 Research approach

Our case study is a combination of exploratory, explanatory and descriptive applications, since the objective is to explore and explain the ways in which supplier-customer relationships may be developed and managed in terms of profitability, as well as to describe the characteristics of these relationships.

Exploratory cases are applied when a deeper insight into a particular problem is desired. This approach does not require extensive prior knowledge, rather it aims at exploring subjects that are somehow unknown and therefore tries to increase knowledge in that particular topic.²² In addition, exploratory cases have a flexible and unstructured nature which provides the possibility to develop new ideas and follow new clues about a problem.²³

²¹ Yin (1994)

²² Ibid

²³ Aaker *et al* (2000)

At the beginning of the investigation the subject was relatively unknown; therefore the exploratory approach was used in order to gain deeper understanding that would help us to formulate our research problem by revising diverse journals, tracking references and literature. Once the problem was defined, this approach was also implemented for the definition of the theoretical framework to be used.

Explanatory case studies use the available data to explain a particular phenomenon and aim at determining what the possible causes are for an event to occur involving some degree of interpretation.²⁴ The explanatory approach was undertaken when the empirical findings were analysed, as we were able to draw our own conclusions based on our understanding of the theoretical approach, finding interesting issues to suggest strategies to manage each category of Formica-PSM customer base.

Descriptive research concentrates in providing detailed descriptions of a particular phenomenon without any interpretation.²⁵ However, as Gummesson (1991) does, we argue that in order to make a description it is necessary to have a certain prior understanding of the matter meaning that there is no real description without analysis and interpretation.²⁶ We moved to a descriptive phase in the stage where we described the identified relationship characteristics.

2.3 The formulation phase

The idea behind our research problem emerged during our attendance in the course “Post modern marketing” as a part of our Masters studies. We decided to do further research on relationships and profitability to be able to formulate an interesting research problem, and after a continuous process of scanning previous research and discussing with our supervisor, the research problem was established. After that, we contacted companies of interest and presented our ideas. Two companies, Pioneer and Formica-PSM were visited, where we had the opportunity to present our proposal and determine whether the companies would fit as cases. After that, we decided to choose Formica-PSM as our case company.

²⁴ Aaker *et al* (2000), Yin (1994)

²⁵ Aaker *et al* (2000)

²⁶ Gummesson (1991)

2.3.1 Objectives

Our research objectives are empirical as well as theoretical. The empirical objectives relate to the desire to extend previous research of subjects such as buyer-seller relationships, buying behaviour and customer relationship profitability. The theoretical objectives originated from the aim to integrate several theoretical perspectives into a unified model, which would serve to evaluate B2B relationships based on customer profitability. Our initial scanning of previous research indicated that this area is rather unexplored, with fragmented perspectives not very well linked. Nevertheless, we found the Reinartz and Kumar (2003) model on profitability in B2B relationships to provide a framework for analysing this area. Consequently, our theoretical objective became to test the factors proposed in this model and to develop it further. The purpose of our thesis is to develop knowledge of supplier-customer relationships in industrial markets, which means that relationships are of central importance. Furthermore, two subordinate research problems were identified, which concern the characteristics of a profitable customer relationships and implications on how to manage relationships profitably.

As few studies are yet conducted from the chosen research approach, the results are expected to contribute to the current theoretical background. Additionally, the results will benefit the day-to-day managerial application of customer management based on relationship characteristics.

2.3.2 Research design

When setting the grounds for our research, we initially considered a qualitative approach; however we decided to focus on a quantitative method and conduct a thorough statistical analysis. We believe that this would provide information on the relationship between Formica-PSM and its direct-buying customers, which would help us to find linkages between relationship characteristics and profitability by being able to statistically test the significant relation. This would provide us with a deeper understanding of relevant characteristics of profitable relationships. It is important to mention that we complemented the quantitative study with interviews at Formica-PSM in order to understand their procedures, organisation and present situation, which we refer to a somewhat qualitative part of our study. Also, the population and sample frame were determined in this stage.

Quantitative Method

Quantitative methods investigate the conforming elements of a particular phenomenon as variables to be tested later on, stressing the importance of descriptions and hypothesis demonstration. In line with this, we base our study on hypotheses that captures the essence of our problem statement, which were tested by a comprehensive statistical analysis. The nature of this method is mainly deductive using statistical techniques. The main characteristic of this type of research is that a phenomenon is observed from outside assuming that there is only one objective reality to be observed. Therefore, the focal point is on the outcomes by using objective measures, in order to reach reliable and valid conclusions.²⁷ For example, our interpretations of the relation between the variables of relationship characteristics are based on statistical tests that provide us with a value that determine what conclusions to be drawn.

However, we intend to generalise some of the main results to a B2B setting in order to enrich the present theory. Because of these characteristics, the information obtained through this method is more likely to be generalised to greater situations. The major strength of the quantitative method is that it can explain a variety of events with a higher degree of control and structure while extending the results to other situations.²⁸

The quantitative approach was undertaken in order to determine main customer characteristics throughout the whole base of direct-buying customers of Formica-PSM, to later on categorise them into segments. Furthermore, we obtained a deeper knowledge of the characteristics of different customer groups so we could develop different strategies to manage each category.

The population

According to Aaker *et al* (2000), a population can be defined as “*the set of all objects that possess some common set of characteristics with respect to a particular research problem.*”²⁹ It is not always necessary to study the whole population; sometimes a sample can be more appropriate. Nevertheless, is important to keep in mind that the sampling process is extremely delicate since approaching the wrong sample can lead to useless and equivocate results.³⁰

²⁷ Merriam (1998)

²⁸ Magne & Solvang (1991)

²⁹ Aaker *et al* (2000)

³⁰ Magne & Solvang (1991)

Initially, we intended to include Formica-PSM customers in Norway or Denmark, as these companies belong to the headquarters in Sweden. The purpose was to test whether the results in Sweden differed from other countries or if the same conditions prevailed among countries. However, as the mail survey in Sweden required considerable time, we decided to prioritise the Swedish direct-buying customers. In this way we would achieve better results both for the company and our study, as we could allocate more time to the analysis rather than collecting data from the additional countries.

We decided to focus on B2B relationships, as this area of research is rather unexplored. The Formica-PSM customer base consists of distributors, indirect customers such as architects and direct buyers. The distributors are very few and also specific in their characteristics, which makes it difficult to study them together with direct buyers. There are also around 5 000 architects to consider, but as they only prescribe the Formica-PSM products to other companies they do not have a direct relationship with Formica-PSM that we could study. The direct-buying customers purchase material from Formica-PSM, produce themselves and sell to their own customers and incorporates all purchasing companies that are industrial producers dedicated to carpentry, balcony production, kitchen production, transport, furniture production and office interiors. We decided to study the direct-buying customer base as this would provide us with a manageable number of customers of the same type, which would allow us to draw general conclusions on the base.

In order to construct a theoretical model on which we could make generalisations of our results, we aimed to analyse a large number of customers. We did not want the company to decide what customers to analyse, as this could have too much impact on our results. Therefore, we decided to study the total population of direct-buying customers as it was considered a manageable number (97). Consequently, a sample procedure was not necessary.

2.4 The designing phase

This section outlines the phase of designing the study and the development of our research instrument, which is the questionnaire. As our research concerns the analysis of B2B relationships from a supplier perspective emphasising relationship characteristics and customer profitability, the concepts setting the dimensions for

the data collection are *Profitability, Relationship- and Customer Characteristics*, which are further discussed in the frame of reference in chapter three.

2.4.1 Questionnaire design

The questionnaire included topics that were identified during the process of theory selection that would help us to gain insight into the opinions, knowledge, attitudes, motives and possible future behaviour of the participating customers. In order to capture the different factors influencing profitable and valuable relationships, the questions had very different characteristics. Different types of questions were designed in order to obtain the best possible interpretation, including two-choice, multiple-choice and rating questions, particularly the Likert scale. These rating questions were included in the final section of the questionnaire where a series of positive or negative statements were presented in order to measure the customer attitudinal position towards certain issues. The questionnaire is available in Appendix 1.

The questionnaire consisted of 33 questions and embraced the following main areas:

- Customer data: establishment year, year as customer, industry and turnover 2002
- Purchasing characteristics: cross-buying, frequency of buying
- Adaptations to the relationship in terms of different types of investments
- Relationship: time orientation, overall perception, contact frequency
- Perception of Formica-PSM
- Trust, commitment, loyalty and satisfaction

In order to avoid any misinterpretation and to increase the neutrality of the questions so they did not guide or influence the responses, the questionnaire was reviewed by our supervisor, one representative at Formica-PSM and one person working as a purchaser at an industrial company to identify possible sensitive questions. Furthermore, guided questions were avoided by incorporating positive and negative questions and statements.

2.5 *The implementation phase*

This phase contains the data collection, the application of the questionnaires described in the previous section and the problems that arose during this process.

2.5.1 *Data collection*

To make the most of the sources from the data collection we followed Yin's (1994) recommendations on three principles. The first principle is to use multiple sources of evidence, as it will guarantee more valid and reliable results gaining a broader range of facts, attitudes and behaviours. This is also known as triangulation and it is possible to find four types: data sources triangulation, different evaluators, theory and methodological triangulation. We employed data sources triangulation by analysing the results from interviews at Formica-PSM, data on customer purchasing obtained from the company, and the information from the customer survey in order to grasp the different views of the ongoing relationships. Moreover, diverse sources of secondary data were employed, adding to the theory triangulation. Diverse journals, literature and specialised articles were revised in order to evaluate different perspectives on the same subject, specifically regarding supplier-customer relationships from a profitability perspective.

The second principle is to create a case study database in which the data is organised and documented. We have used diverse databases to organise different sources of information. Initially, one database was created on all direct-buying customers where we noted who returned the questionnaire, who did not participate and the reason for this. In a later stage, we created one database with information on the purchase-related information of each customer. The database mainly used did however contain the coded data from the customer survey.

Finally, a chain of evidence that allows the reader to trace the steps followed throughout the whole case in any direction can be secured by using an external observer, which in our case has been our supervisor and our contact at the statistical institution.³¹

³¹ Yin (1994)

Secondary data

Secondary data is relevant information already available for the researcher originally collected by other agencies or organisations in order to solve a different problem than the one at hand. This information is normally consulted in the initial stages of the research process as it helps to gain deeper understanding of the area of study besides functioning as the grounds for the problem formulation. Moreover, it is relatively easy to obtain and more economic than primary data collection.³²

On the other hand, there are a number of limitations when using this type of information. Firstly, problems of fit are likely to occur since the information was originally gathered to accomplish different purposes. Secondly, it is necessary to make a series of assumptions when using this data since the level of accuracy is unknown and difficult to evaluate. Thirdly, this information may be outdated. Finally, the amount of secondary data can be overwhelming and may require considerable time to be scrutinised.³³

In our case, external secondary data was collected in terms of relevant articles, specialised journals, academic literature and to some extent, the Internet. Initially, this information helped us to gain deeper knowledge of previous work related to the field of our study. However, later on, these sources functioned as a basis for the theoretical framework and the empirical study presented in this thesis.

Additionally, internal information such as brochures, company reports, presentations, marketing information system and other documents were reviewed to gain a better understanding of the company as well as its situation in relation to its customers.

Primary data

Secondary data provides a good basis for understanding a particular research problem, however it is normally necessary to complement it with primary data.³⁴ Consequently, a considerably share of the data collected consists of primary data.

³² Aaker *et al* (2001)

³³ Ibid

³⁴ Ibid

There are several methods for primary data collection: mail-surveys, personal interviews, telephone surveys, self-administered surveys, omnibus studies, focus groups, interactive research and observation.³⁵ In our study, we have mainly focused on the mailing survey and interviews at the case company.

Mailing surveys are often used, but it is not always the easiest or the best technique to apply. This is very dependent on the objectives and nature of the problem in question.³⁶ To determine the characteristics of profitable and unprofitable supplier-customer relationships, we decided to apply this method as it would allow us to gather a great amount of data at relatively low costs avoiding any kind of interviewer bias. Furthermore, as we needed to cover a rather wide range of topics, we consider the mail survey convenient as the respondent do not need to interrupt his work activities for a certain appointment and could respond to it at a convenient time.

Two personal interviews were conducted with the marketing director of Formica-PSM in Helsingborg. Furthermore, we spent three days at the company in Helsingborg, conducting interviews with different departments to capture all dimensions of the customer relationships, as each department has their specific information that adds to the overall view. In addition to the information we received from the marketing director, primary data was attained from the managers of sales, logistics, finance and customer service. Further, we maintained continuous communication via telephone and email.

2.6 *The analysis phase*

The data analysis is an examining, categorising, tabulating or recombining procedure that will provide the basis to give meaning to the collected evidence, where the level of interpretation depends on the type of the study and the type of results expected. This is a very sensitive and critical stage within the research process, since misinterpretation or over-interpretation is always a risk.³⁷ The characteristics of the collected data will determine the method to be used for the analysis.³⁸ The analysis of information is a continuous process, however the final

³⁵ Lehmann *et al* (1997)

³⁶ Ibid

³⁷ Magne & Solvang (1991)

³⁸ Håkansson (1982)

goals it to achieve reliable conclusions and generalisations that are based on the empirical evidence.³⁹

The data analysed was obtained from the mail survey sent out to customers and from an extensive excel file of invoice-related customer data. The questionnaires from the mail survey were continuously coded using the SPSS data program as we received a varying number of answers per day. In order to increase the quality of the analysis and to gain a better understanding of the statistical program applications, the statistical institution at Gothenburg School of Economics and Commercial Law was contacted on a regular basis. The results from the mail survey were organised according to the theoretical framework, which is presented in Chapter 3. Initially, each question was analysed by using a *frequency count analysis* where the amount of observations per question are presented together with the corresponding percentage. This information allowed us to grasp the general characteristics of the customer base which would function to conduct the overall analysis in the following stages.

The relation between the topics in the questions was crucial to our research. This provided insight into what relationship characteristics are important to consider in the theoretical model we aimed to create. By statistically testing our statements on important determinants of relationship characteristics and profitability that are found in the frame of reference, we were able to determine which of these aspects are significant determinants of the identified relationship characteristics in our study. Therefore, the analysis followed a discussion of the results by comparing the relationship between pairs of variables, where each variable represented one question in the questionnaire.

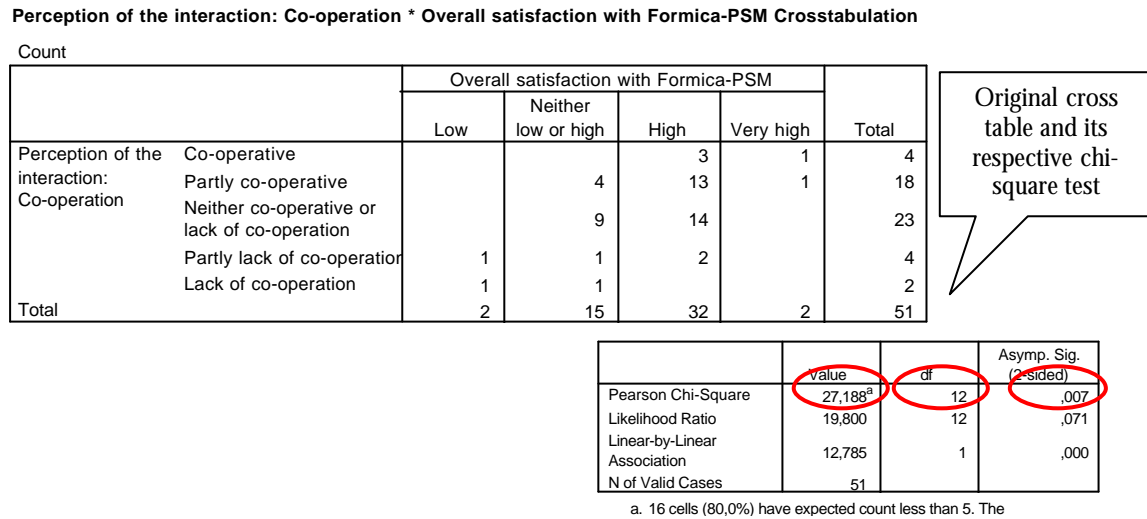
To conduct this analysis *cross-tabulation* in SPSS was used, and the significance of the relation between the variables was confirmed by running a Pearson chi-square test (X^2). For two variables to be significantly related, we used a significance level of $p=0.05$, as it is generally accepted that if the p-value is less than 0.05 the result is considered to be statistically significant.⁴⁰ This means that the value of X^2 needs to exceed the critical value given at the level of $p=0.05$ and the degrees of freedom presented in the chi-square test in Figure 2.1. The critical value was obtained by the statistical table of the X^2 distribution which is normally found in statistics textbooks. We used Lehman *et al* (1997) and Johnson and Wichern (1997).

³⁹ Merriam (1998)

⁴⁰ Ingvar Holmberg (2003), George & Mallery (2001)

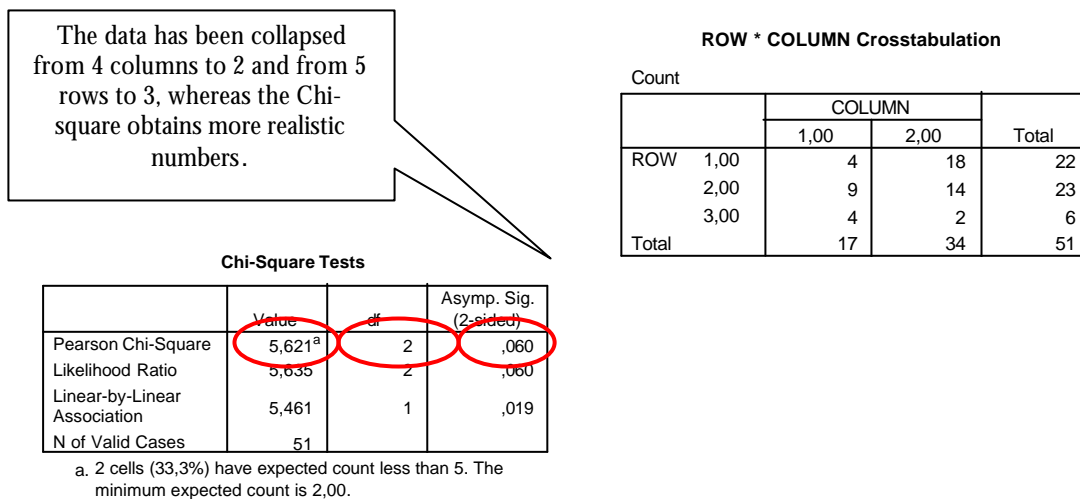
It is important to mention though that cross-tables can create problems when there are not enough observations or when there are many missing cases in a certain category. When this occurs it is required to “collapse”⁴¹ (summarise) categories together in order to get sufficient representation and trustable conclusions regarding the relation between certain variables. An example of this procedure is presented in Figure 2.1 and 2.2:

Figure 2-1 Original Cross-Table and Chi-Square Test



Source: Own construction

Figure 2-2 Collapse Procedure and Collapsed Chi-Square



Source: Own construction

⁴¹ Collapse refers to the process of reducing the number of columns and rows (e.g. from 4 to 2) by summing the number of observation in each one. A collapsed table should have at least 2 rows and 2 columns.

However, the chi-square test does not allow crossings of continuous variables such as years as customer and turnover. What distinguish these variables from the others is that they are coded by adding a continuous range of numbers (years as customer and turnover for each individual customer), while the additional questions from the questionnaire are coded by scales such as 0 for “no” and 1 for “yes”, which means that we obtain grouped data for each question. Consequently, chi-square tests allow cross-tabulation of grouped values only, and when adding continuous variables to the analysis we need other alternatives for data analysis.

For the purpose of cross-tabulation of a continuous variable with a grouped variable, a t-test is appropriate.⁴² The t-test functions similarly to the chi-square test, where two variables are crossed and a cross-table is produced. However, it measures the means in the population and we obtain a table with t-test variables instead of the chi-square table. The significance is determined in the same manner as previously, by using the degrees of freedom presented in the t-test output and the condition that $p=0.025$ we obtain the critical value.⁴³

However, a limitation with the t-test is that it only allows us to analyse questions that have two options such as *yes* and *no* together with a continuous variable. As many of our questions gave up to five options, we needed to refine our analysis even more. In these cases we used cross-tabulation with ANOVA test of significance as it allows cross-tabulation of continuous and grouped variables with several options for answers.⁴⁴ It is worth mentioning that in this test it was also necessary to “collapse” the results when the number of observations was considered too low.

In addition to this, we decided to run a factor analysis with the purpose of complementing the amount of data obtained from the 18 statements included in the mail survey. We contacted Ingvar Holmberg to determine whether this type of analysis could be employed in our research and he stated “*with 5 levels of each variable, factor analysis may be employed although the number of observations is quite small and conclusions must be considered with some caution, but since you are not making any statistical test of significance of factors it is possible to go on with the analysis and regard it merely as an explorative evaluation.*”

⁴² Ingvar Holmberg (2003), George & Mallery (2001)

⁴³ $p= 0,025$ as we use a two-tailed test of significance for t-test and ANOVA test

⁴⁴ Ingvar Holmberg (2003), George & Mallery (2001)

Formally, the factor analysis is a multivariate statistical procedure with the objective being to reduce the set of variables used into a more efficient amount through grouping highly correlated variables in a number of factors each measuring a unique bundle of ratings.⁴⁵ The KNO and Bartlett's test, which indicates the adequacy of the selected variables to be used in a factor analysis, proved to be fair in our study. In our case, the value 0.701 was obtained, which is referred to as “middling” and indicates a high level of applicability.

Thereafter, we followed the advice of Ingvar Holmberg, and excluded four less significant variables from the rotation since they were lower than 0.45 (*The relation with Formica-PSM is trustworthy, switch supplier implies major costs for the customer, the price paid in relation to quality is fair, customer is proud of doing business with Formica-PSM*). The rotated component matrix available in Appendix 2, presents the variables that were extracted and rotated (question 16 to 33) using the Varimax with the Kaiser Normalisation method in relation to the factors obtained.

The analysis generated five factors, where the first three account for the majority of the variation. It was possible to observe that certain variables loaded high onto two different factors. However, we decided to allocate them to the factor in which they presented the higher correlation. Factors four and five can be considered as *trivial*, since they only loaded one variable each. Accordingly, there are only three relevant factors that we decided to use.

The next step in the analysis was to determine what aspects were significantly related and important to relationship characteristics by the described statistical procedures, and to summarise them into a table to obtain an overview.

Thereafter, the objective was to determine which of these aspects were significantly related to customer profitability. This was done by crossing these variables with a variable of profitability, which was based on the invoice-related data obtained from the company.

The invoice-related customer data included the purchases of all customers of Formica-PSM in an excel sheet of 65 000 rows performed in the last one and a half year. The data consisted of company name, the date when the invoice was placed to Formica-PSM, the standard product cost, product revenue, product quantity, product category, order number, delivery location and the payment

⁴⁵ Lehmann *et al* (1997)

conditions. The first task was to sort out the data concerning the customers that were included in our study. After this first screening, we continued with summarising the detailed data into more manageable numbers. Since all orders were presented on a daily basis, we summarised them into orders, costs and revenues per month. This provided us with information on customer profitability for the last 16 months. However, the detailed data was important to analyse in order to understand the frequency of purchase, as looking at a monthly amount would not tell us whether the customer bought once that month or if it made several purchases.

Also, we intended to add the indirect costs of each department at Formica-PSM on each customer, which we weighted by an estimated percentage given by Formica-PSM. A standard cost was calculated based on these assumptions and added to each customer. However, we realised that this division was too rough as most customers ended up with a negative profitability, which would make our analysis of profitability very difficult. Hence, we decided not to consider these costs in the customer analysis and only focus on the costs and revenues obtained from the purchasing. Appendix 3 provides an overview of the calculated indirect costs.

When the relationship characteristics related to profitability were identified, we used this information to create a theoretical model. Thereafter, the customers were grouped into 4 different categories according to their level of profitability. Each category was assessed in relation to each factor (one factor corresponds to one question in the questionnaire) to determine what factors characterises profitable and unprofitable relationships. The final recommendations were established by presenting a portfolio of the customer base and different strategies to manage the current base of customers in terms of the relationship characteristics linked to profitability.

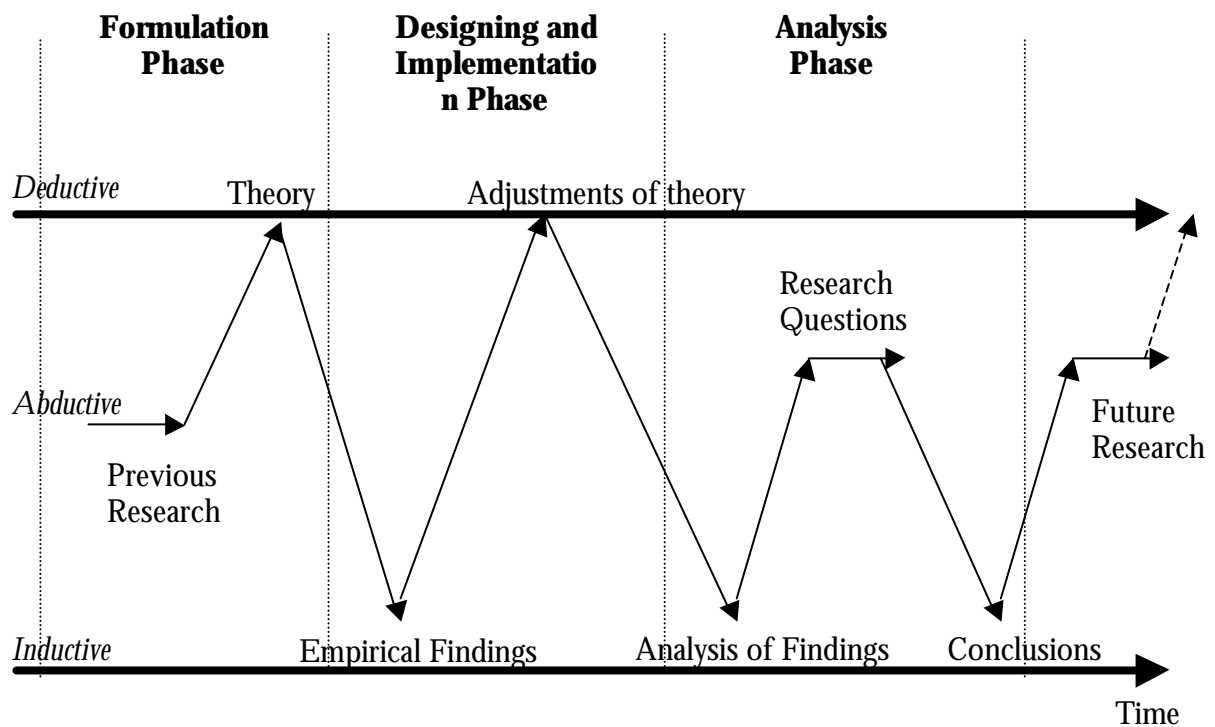
2.7 Scientific reasoning

In order to approach a problem the researcher has the possibility to start from either a theoretical or an empirical level. In this respect, there are three ways of reasoning: the deductive, inductive, and abductive reasoning. The theoretical level is the point of departure of the deductive reasoning, meaning that by using general principles and theories that are later on tested in an empirical study in the form of hypothesis, it will be possible to produce logical conclusions regarding a particular phenomenon. Contrary, the inductive approach begins from the empirical level by

first gathering empirical data to thereafter produce conclusions and develop theories. However, it is possible that the starting point comes from previous ideas, concepts or preliminary hypotheses.

The combination of these two approaches derives into what is known as an abductive approach. This is considered to be a rather convenient and effective reasoning, since by making use of both established theories and empirical evidence the researcher is able to construct his own theoretical models.⁴⁶ The stages in the process of thesis writing can be related to different levels of scientific reasoning, which is illustrated in Figure 2.3:

Figure 2-3 Scientific Reasoning



Source: Adapted from Schweizer seminar 2003

In the initial stage of this research, an abductive approach was used, as we initiated the process by reviewing previous studies in order to determine the area of study to focus on. Thereafter, several articles and journals were revised in order to establish the specific interest as well as to gain deeper knowledge of the subject. The current theory within B2B relationships, supplier-customer relationships, profitability and relational factors showed us that there was a lack of an integrated theoretical framework, and therefore, as stated in our purpose, this thesis would

⁴⁶ Merriam (1998)

concentrate on obtaining such a result. In this respect, the next reasoning employed was an inductive one where the theories presented served as the base to create our own theoretical model that was applied in an empirical situation. Nevertheless, throughout the whole writing process we alternated from the theory and empirical level, therefore using an overall abductive approach that would lead us to solve the research questions to draw conclusions ending again in an abductive level as grounds for future research.

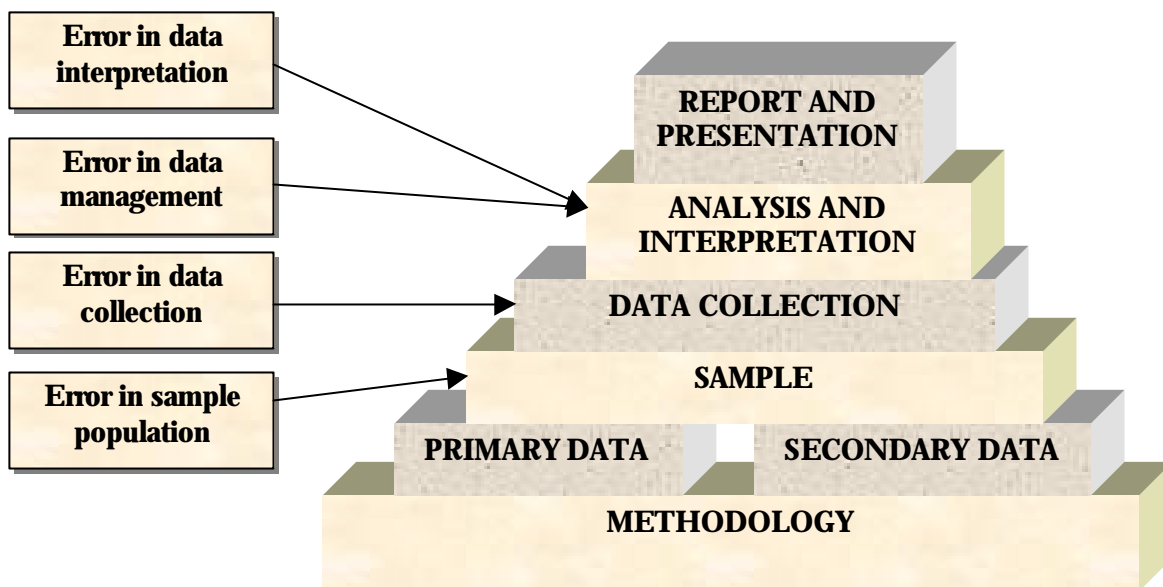
2.8 Evaluation

The evaluation is an ongoing process as errors can be present in any stage of the research process, which can affect the reliability and validity of the study.⁴⁷ Therefore, we have carefully revised the potential errors that can have affected the obtained results.

2.8.1 Sources of error

There are various sources of errors that need to be considered to obtain a convenient validity and reliability. Figure 2.4 illustrates how these can occur during the research process.

Figure 2-4 Sources of Error



Source: Christensen et al (2001)

⁴⁷ Aaker et al (2000)

Error in sample population

Errors of this kind are errors in the sample definition and sample frame, which means that respondents that should not have been included in the survey were considered, or respondents that should have been included were not considered. Further, there is normally a non-response error, which requires a non-response analysis.⁴⁸

Our sample definition was the direct-buying customers of Formica-PSM, which were clearly distinguished from the customer categories of distributors and architects. Nonetheless, we found that the customer information obtained from Formica-PSM contained companies that were not direct-buying customers. Consequently, in most cases, these companies did not answer the questionnaire as they thought they did not have the required knowledge. In some cases there were customers that should not have been in the population, as they were buying through their parent company, but we included them in the study as they were having a relationship with Formica-PSM, which was the target of our study. This is discussed further in the non-response analysis, which is presented in the next section.

Follow-up and Non-response analysis

Formica-PSM provided us with a list with company names, telephone numbers and addresses. However, we did not receive any contact information to enable us to address the survey to a person at the customer company. This implied that when following up the responses, we needed to track the person that actually received the questionnaire, which normally was in the purchasing department.

Once these persons were identified we could confirm whether they had received a questionnaire, if they had sent it or not and if they wanted to participate or not. In the cases where they had not received the questionnaire, we had to confirm if the addresses were correct, which in many cases were not, and whether we could send a questionnaire directly to these persons. This was done continuously each time we got hold of a person, which means we were sending out questionnaires almost every day.

⁴⁸ Christensen *et al* (2001)

In total, this ongoing process of sending out and collecting questionnaires lasted for one month. It resulted in 57 replied questionnaires and 24 customers that did not want to participate, which meant 81 answers. However, three of the answered questionnaires did not have any company name and were impossible to track in a correct manner; hence we decided to exclude them from the survey as we could not guarantee the accountability of these answers. Additionally, 16 customers agreed to return the questionnaire but did not do that. As we had to set a deadline to be able to start running the data analysis, these 16 customers consequently had to be excluded. Finally, 3 customers were never reached. This means that we managed to contact 94 out of 97 customers on the list. The results are presented in Table 2.1.

Table 2-1 Rate of Response

	<i>Yes</i>	<i>No</i>	<i>Not returned</i>	<i>Total</i>
<i>Direct buying customers</i>	57	24	16	97

There were various reasons for why 43 customers were not included in our research, most often, due to the lack of time (15 customers). Three companies were not customers anymore, and in two cases we found that two companies from the same group were on the list, which meant that the persons at the parent company only placed the orders to Formica-PSM that they received from their subsidiary, who consequently also had a relation with Formica-PSM. In these two situations, the person at the parent company was not able to answer our questionnaire which referred to specific questions about the relationship with Formica-PSM. Even if the subsidiary hence was not the direct-buying customer, we included them in the survey as they still were the ones who had a relationship with Formica-PSM. Furthermore, one company was not a direct-buying customer and claimed that they were a “special case” unable to answer our questions. One customer turned out to be bankrupt. Additionally, two customers said they had sent the questionnaire, but as we have not been able to identify their questionnaires among the unknown we decided to exclude these from the survey.

Errors in data collection

One source of error is that respondents do not want to participate in the survey. Also, questions can be interpreted in other ways than we intended and quick answers by uninterested respondents can lead to very random results.⁴⁹ As

⁴⁹ Christensen *et al* (2001)

mentioned previously, to avoid misinterpretation in the questionnaire, external readers were asked to read it before sending it out, which made us able to revise some questions.

Errors in data management

When managing the data and coding the answers, there is a risk for errors that are more connected to the human factor, such as mistakes in coding and manual calculations.⁵⁰ The coding of questionnaires in SPSS represents a potential source of error. With this in mind, we have double-checked the coded data to track errors that have been corrected. Also, we have had continuous contact with the statistical institution at the School of Economics and Commercial Law in Gothenburg where we have been able to get feedback on our coding procedure.

Error in data analysis and interpretation

There is a risk for interpreting the results in the wrong way, and hence it is important not to make too generalised conclusions.⁵¹ Being aware of this, we have tried to only draw conclusions that the results allow us to do, and also received support from our contact at the statistical institution in the School of Economics and Commercial Law in Gothenburg, which has confirmed the correct interpretation of the results.

2.8.2 Validity and reliability of the study

In order for the results to be credible, it is important to evaluate the reliability and validity of our study which is related to the absence of errors described in the previous section. Reliability and validity are not independent concepts; instead they are related to each other in the form of a continuum.⁵² Consequently, for a quantitative measurement to be considered as valid, the reliability must be high. For a measurement to be reliable, the same results should be obtained if the investigation was undertaken in another case following exactly the same procedures.⁵³ For obtaining *validity* we should, regardless of the measurement method, obtain similar results, which means that it refers to the accuracy in which a certain theory, model or category is able to describe reality with a good fit. In

⁵⁰ Christensen *et al* (2001)

⁵¹ *Ibid*

⁵² Trochim (2003)

⁵³ Yin (1994)

other words, validity is a term measuring the quality of a case.⁵⁴ *Reliability* concerns the ability of measurement methods to resist random errors, hence a measurement that is completely reliable does not have any random errors.⁵⁵

Validity

According to Yin (1994), there are three design-tests when referring to validity: construct validity, internal validity and external validity.⁵⁶

Construct validity refers to the establishment of correct operational measures when selecting and dealing with the concepts studied and the use of objective judgements. The use of multiple sources of evidence, the establishment of chains of evidence, and having the case study reviewed by key participants are tactics to increase the construct validity.⁵⁷

As mentioned in section 2.5.1 *Data collection*, in order to increase the construct validity of our thesis we used multiple sources of evidence both for the collection of primary and secondary data. In addition, we secured the establishment of a chain of evidence with help of external readers, mainly our tutor Dr. Eva Ossiansson, student peers and representatives at Formica-PSM.

Internal validity refers to whether the research results correspond to reality and if the concepts measure what they were intended to. In order to secure the internal validity of this study several techniques were employed. First, data source- and theory triangulation allowed us to have a thorough comparison and corroboration of the concepts to measure exactly what was desired. Second, working in close cooperation with Formica-PSM and customers helped us to balance the supplier and customer perspective. Finally, in two seminar occasions our classmates as well as our tutor provided their constructive criticism in order to give results that fit reality and the purpose stated.

External validity deals with the problem of whether the current case study results can be generalised to other situations.⁵⁸ Since this case study is based on statistical results it can be generalised to a certain extent. Nevertheless, we are aware that the customers studied belong to a certain company and industry; therefore a careful

⁵⁴ Gummesson (1991), Christensen *et al* (2001)

⁵⁵ Christensen *et al* (2001)

⁵⁶ Yin (1994)

⁵⁷ Ibid

⁵⁸ Merriam (1998)

generalisation must be made as the results can be affected by certain conditions in the specific industry. We argue although that our results can provide a basis for future research to be conducted in similar cases and that the results provide valuable analytical generalisations. According to Richard Normann in Gummesson (2001):

“ If you have a good descriptive or analytic language by means of which you can really grasp the interaction between various parts of the system and the important characteristics of the system, the possibilities to generalise also from very few cases, or even one single case, may be reasonably good. The possibilities to generalise...are founded in the comprehensiveness of the measurements...to reach a fundamental understanding of the structure, process, and driving forces.”⁵⁹

According to the above extract, it is possible to assume that by having high levels of construct and internal validity it is possible to draw valid external generalisations through case studies. Our goal is to contribute to the current theoretical background by testing the applicability of our own theoretical model in a real life situation that will serve to develop and manage supplier-customer relationships. Considering this, as long as the construct and internal validity are met and the conducted survey is exhaustive enough, the basis for future valid generalisations is established.

Reliability

This concept refers to the extent to which the findings of our study can be replicated, meaning the likelihood of having equal results if the study was repeated.⁶⁰ Considering that this is a quantitative study, we would argue that the reliability of our research is high as our interpretations are based on statistical measures that allow us to determine the interdependence between variables. Therefore, if another researcher would make use of our collected data he or she would obtain very similar results to ours. Furthermore, the procedures in which this research was undertaken are carefully described in this chapter, which also increases the possibilities for others to obtain similar results.

Nevertheless, it should be mentioned that since we are measuring human perceptions and attitudes towards a supplier at a particular point in time, we would

⁵⁹ Gummesson (1991)

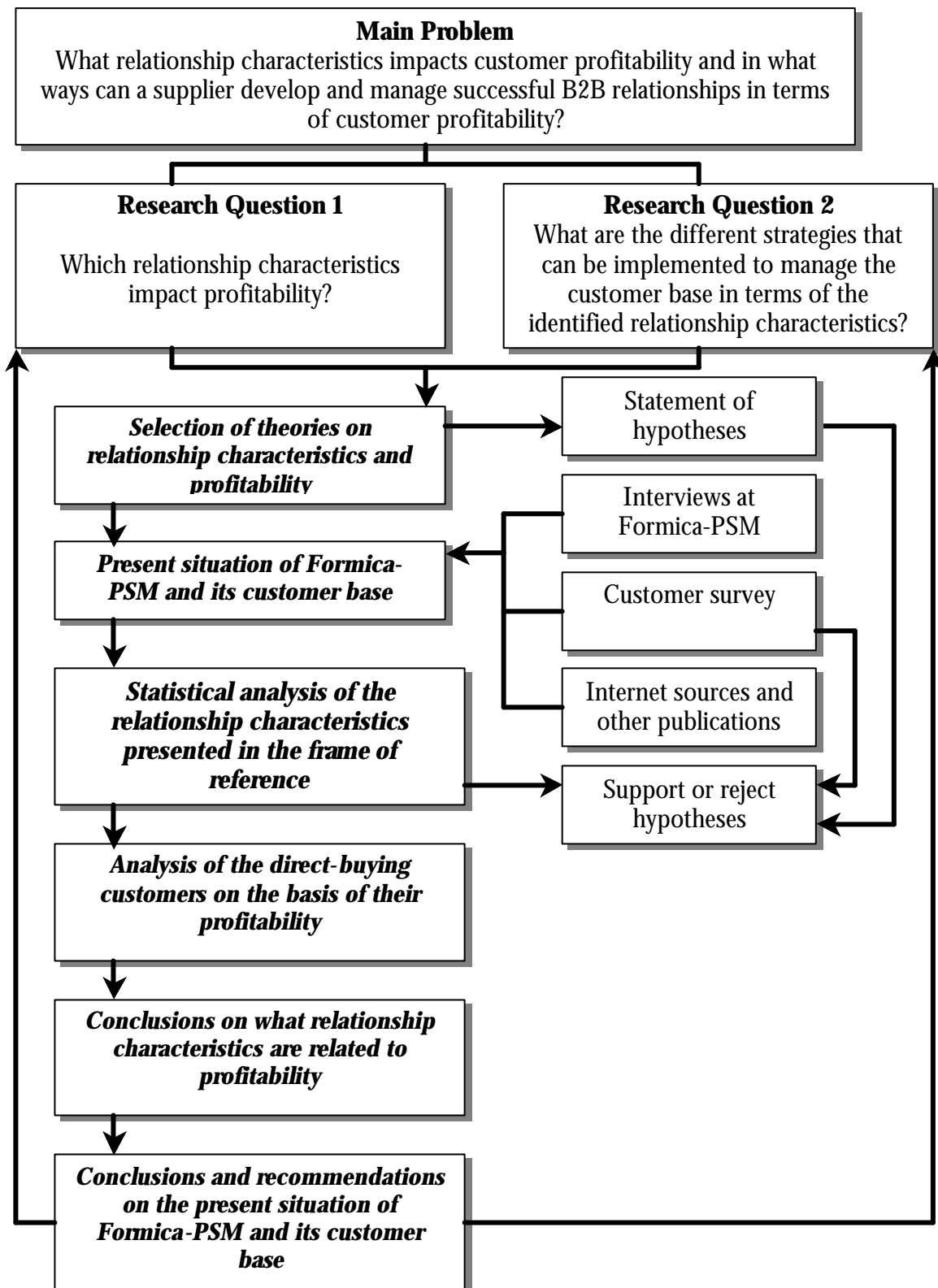
⁶⁰ Merriam (1998)

not guarantee that if conducting this study from scratch the results would be the same since human behaviour changes through time and among individuals.

2.9 Research model

To answer the stated main problem and the two research questions, a research model was designed in order to visualize the different stages that were required to approach the subject of study. As illustrated in the Figure 2.5, it is possible to observe that the research started by first selecting the theories on relationship characteristics and profitability which led to the statement of 19 theoretical hypothesis that were answered in the analysis phase. By collecting information from the company, the customer survey and other secondary sources we were able to present an overview of the present situation of Formica-PSM and its customer base. Further on, relationship characteristics detected in the frame of reference were statistically tested whereas the customer base was segmented and analysed in terms of profitability and relationship characteristics. Finally, conclusions and recommendations are drawn from a theoretical and practical perspective accomplishing the purpose of this thesis.

Figure 2-5 Research Model



Source: Own construction

3 Frame of reference

The frame of reference constitutes the theoretical basis for this thesis, and aims to provide further understanding of the main problem and research questions. To identify what characterises B2B relationships and how these can be managed profitably, it is important to understand the context in which they exist, the B2B setting. After that, a discussion on relationship profitability will provide a further understanding on our relationship perspective. This is followed by a presentation of the relationship characteristics we aim to analyse, which also constitutes the basis for our proposed hypotheses presented in the end of this chapter.

3.1 The B2B setting

3.1.1 Background to B2B markets

The characteristics of B2B markets have changed considerably in the last two decades, which according to Möller and Wilson (1995) can be seen in the long-term trend of movement from market transactions towards more complicated B2B relationships. This trend can be explained by the increased global competition, the internationalisation of industries, increased complexity of products and services and the emergence of highly interdependent producers of components and processed materials. There is a move towards a significant reduction of the number of suppliers to make the relationships more manageable and hence to develop close relationships with the remaining suppliers in order to adapt techniques, for instance Just-In-Time deliveries.⁶¹ The distinctions between business markets and consumer markets are illustrated in Table 3.1.⁶²

Table 3-1 B2B vs. B2C

B2B <ul style="list-style-type: none">- Few customers- Complex products- High investments- Multiple decision-making units	B2C <ul style="list-style-type: none">- Many customers- Less complex products- Low investments- Individual decision-maker (consumer)
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Source: Peppers and Rogers (2001)

⁶¹ Möller & Wilson (1995)

⁶² Peppers & Rogers (2001)

One difference is that the industrial customer base normally consists of a few dozen customers, while consumer markets can include thousands or millions of customers.⁶³ According to Håkansson and Snehota (1997), the industrial customer base often includes a few customers that account for a major part of total sales and purchases, and these relationships are of striking importance to the performance of the company. Consequently, sales volumes, profitability and growth potential often depend on a small number of customers, forcing B2B companies to evaluate each individual customer.⁶⁴ Also, the channel complexity is normally higher in a B2B setting compared to B2C channels, as the B2B product is often more complicated and the channel members can contribute to a high degree of value adding. Due to the complexity of B2B products compared to B2C products, the selling process is more knowledge-based and implies that customers are provided with education and training to use the product.⁶⁵

Moreover, as B2B products and services often require high investments, the purchase cycle tend to be rather long, with periods of inactivity.⁶⁶ The industrial purchasing process can take several months involving a number of individuals in order to reduce the risk and uncertainty perception caused by the technical complexities of the products and the amount of money invested.⁶⁷ As a result, selling to an individual consumer means a single decision-making unit while selling to a business unit means targeting a number of different decision-making individuals.⁶⁸ Industrial buyers are also individuals and hence their buying decisions are not only influenced by tasks-objectives including price, service, quality and assurance of supply, but also other social considerations such as friendship, reputation, and mutual benefits.⁶⁹ Buyers will have different expectations as a result of their individual backgrounds, information sources, active search, perceptual distortion and satisfaction with past purchases.⁷⁰ As a conclusion, it can be said that even though there are distinctions between B2B and B2C markets, the boundaries are becoming increasingly difficult to define.

⁶³ Peppers & Rogers (2001)

⁶⁴ Håkansson & Snehota (1997), Peppers & Rogers (2001)

⁶⁵ Peppers & Rogers (2001)

⁶⁶ Ibid

⁶⁷ Reeder *et al* (1987)

⁶⁸ Peppers & Rogers (2001)

⁶⁹ Reeder *et al* (1987)

⁷⁰ Webster (1991)

3.1.2 B2B relationships

B2B relationships are important to understand in order to identify the characteristics connected to profitability. Webster and Wind (1991) even argue that a failure to understand the nature of B2B relationships can lead to poor value delivery and unsuccessful strategy development.⁷¹ Hence, we aim to define B2B relationships and discuss their development and duration.

Defining B2B relationships

The concept “*relationship*” can be defined in many different ways, which depend on what perspective you have. Ford (2003) use the term “*relationship*” to describe the pattern of interactions and mutual conditioning of behaviours *over time*, between a company and a customer, *a supplier or another organisation*.⁷² We argue that this definition suits our perspective as it considers both interactions and behaviours, which determine the type of relationship as well as it considers the time perspective.

B2B relationships are not only complicated to define, we have also understood from previous studies that they are rather complex to measure.⁷³ Håkansson and Snehota (1997) suggest that a B2B relationship can be viewed in isolation from the broader context, or as a part of a network. This means that B2B relationships can be explained in terms of company characteristics and the buying and selling process, or by factors in the relationship context. As our research problems entail a focus on relationship characteristics in the dyadic supplier-customer relationship, the isolated view is preferable. Despite the argued complexity of relationship measures; product and process technologies, buyer and seller market structures and the availability of alternative buyers and sellers have been suggested as important determinants of the nature of buyer-seller relationships.⁷⁴ Accordingly, these areas are interesting to consider when we analyse the customer relationship characteristics.

A further understanding of relationship characteristics can be derived by viewing relationships to range from discrete transactions to relational exchanges.⁷⁵ The Relationship Marketing (RM) – Transactional Marketing (TM) continuum

⁷¹ Webster (1991)

⁷² Ford (2003)

⁷³ Håkansson & Snehota (1997), Wyner (1999)

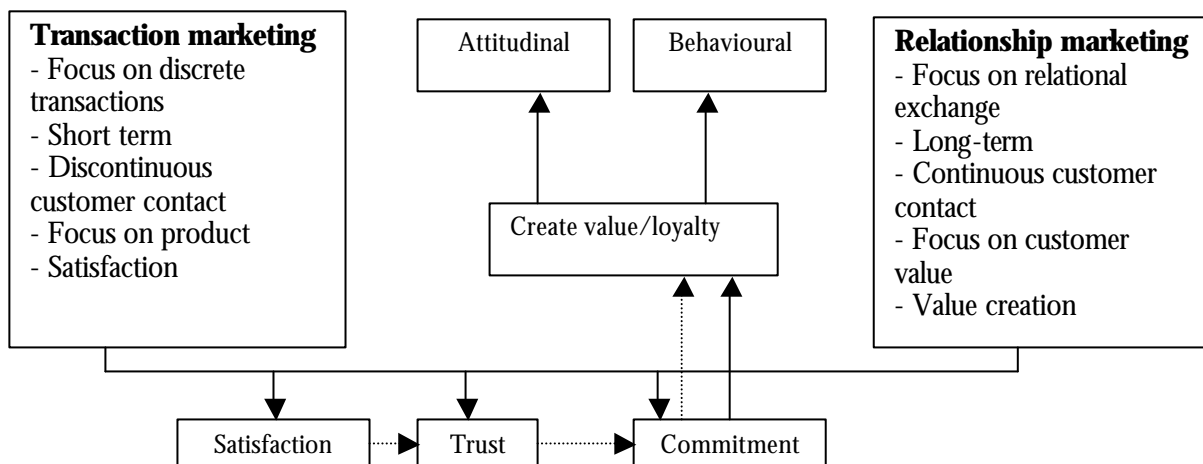
⁷⁴ Ford (2001)

⁷⁵ Dwyer *et al* (1987)

provides an understanding of what characterises these types of relationships, as this means that in some cases a transactional marketing approach is preferable, while in others a relational marketing approach is needed.⁷⁶ The RM and TM continuum refers to the movement between discrete transactions which has a “distinct beginning, short duration and sharp ending by performance”, and relational exchange which “traces to previous agreements (and)...is longer in duration, reflecting an ongoing process.”⁷⁷

Discrete transactions are characterised by very limited communications and narrow content, with minimal seller recognition of the buyer. In contrast, relational exchanges transpire over time and view each transaction in terms of its history and its anticipated future. Relational exchange partners can be expected to derive complex, personal and non-economic satisfactions and engage in social exchange.⁷⁸ The RM – TM continuum is illustrated in Figure 3.1.

Figure 3-1 RM-TM Continuum



Source: Adapted from Egan (2001) Ossiansson Seminar (2003)

Discrete transactions involve an occasional deal, alternatively repeated deals independent of the previous one. On the contrary, relational exchanges aim to create a long-term interactive relationship between providers and customers.⁷⁹ Also, RM stresses that sellers need to be knowledgeable about their customers’ requirements and needs as it allows customization of selling efforts to better fit

⁷⁶ Reicheld & Sasser (1990), Grönroos (1997)

⁷⁷ Dwyer et al (1987)

⁷⁸ Ibid

⁷⁹ Gummesson (1995)

the customers' specifications.⁸⁰ Furthermore, successful marketing requires an appropriate solution for the customer. In TM this solution is a product in the form of a physical good, while in RM the solution is the relationship itself and how it functions and leads the need to satisfaction for the customer.⁸¹

In the RM – TM continuum, satisfaction, trust and commitment are considered relationship drivers where satisfaction is seen as a prerequisite for trust, which in turn will lead to commitment and loyalty. Trust and commitment are important antecedents to relationship establishment, where the relationship outcomes are value creation and loyalty. In discrete transactions, satisfaction is normally enough, while relational exchanges emphasises further value creation.⁸² We consider satisfaction, trust, commitment and loyalty as important relationship characteristics, which will be further discussed in this chapter.

Transactional relationships have been the historical focus of marketing, maximising transactions by price, product, promotion and place. It typically relies on a stimulus-response approach and a short time horizon and involves a one way flow of activities from the marketer to the customer.⁸³ However, a relational oriented view on the customer has been developed in the last decades, which considers the customer as the primary asset to achieve business growth by creating, developing and maintaining committed, interactive and profitable customer relationships over time.⁸⁴

Relational oriented interactions are often found in a B2B setting, as B2B relationships are often close, complex and frequently long-term oriented with characteristics such as mutual commitment, adaptations, trust-building and social exchange over time. Close B2B relationships can be developed when benefits in terms of cost reduction or increased revenues can be obtained, e.g. by transaction specific investments for a certain buyer or seller which indicate a willingness to adapt to the relationship. This can be seen as a sign of commitment by the buyer or seller to the relationship, as the specific investment would be less valuable in another transaction.⁸⁵

⁸⁰ Frankwick *et al* (2001)

⁸¹ Håkansson (1982)

⁸² Egan (2001)

⁸³ Frankwick *et al* (2001), Wyner (1999)

⁸⁴ Wyner (1999), Frankwick *et al* (2001)

⁸⁵ Ford (2001)

Relationship development and duration

The development of relationships can be described from different views, which can be classified into stages and states perspectives.⁸⁶ Li (1995) and Dwyer *et al* (1987) have applied the stages perspective which emphasises an evolutionary, sequential development of relationships over long periods of time that are determined by the level of resource commitment and the degree of interdependence.⁸⁷ In accordance with this, common models applied are lifecycle and growth stage models.⁸⁸

The stages perspective sees relationship development as a process of increasing experience, reduction of uncertainty and distance, growth of commitment and formal/informal adaptations to each other. We partly agree with this view as close and committed relationships in many cases are developed along with the increasing relationship duration.

However, it is not given that relationships will develop in this manner only because the relationship has lasted for several years. We think that the relationship development is very dependent on the beliefs and actions of each party involved in the relationship, and some relationships might revert to an earlier stage of the relationship or even remain in a certain state over the years if it suits both parties.

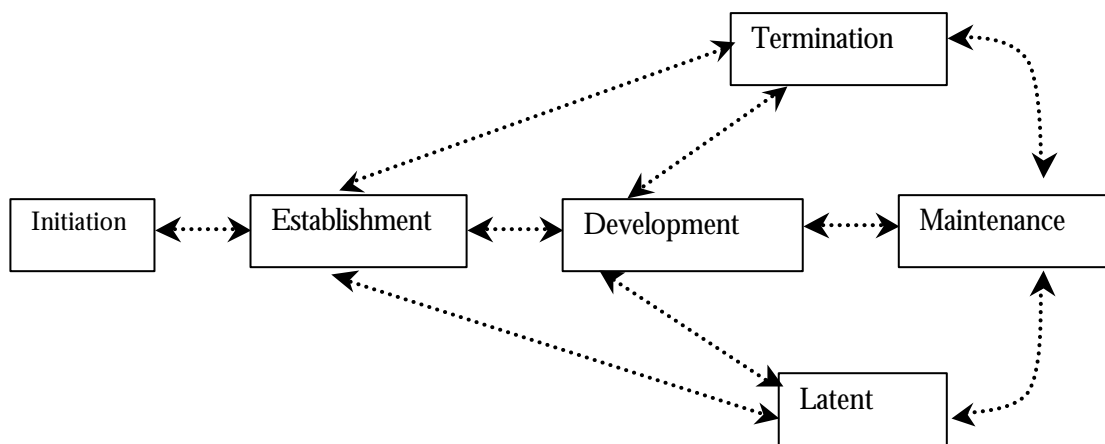
In line with this, it is necessary to introduce the states perspective which emphasise that the context of exchange is rather unstructured and difficult to predict. This means that a relationship does not necessarily evolve into stages determined by time and the fulfilment of a set of conditions. According to Rao and Perry (2002), relationship development is determined by the circumstances and opportunities at a certain point of time. Due to these circumstances, we conclude the states theory to be an important complement to the stages theory.⁸⁹

⁸⁶ Rao & Perry (2002)

⁸⁷ Ford (2001), Dwyer *et al* (1987)

⁸⁸ Rao & Perry (2002)

⁸⁹ Ibid

Figure 3-2 Stated Model of Relationship Development

Source: Rao and Perry (2002)

Figure 3.2 illustrates the complexity of relationship development, meaning that it will not evolve in the same structured manner proposed in the stages theory. Rather, relationship development can move forward and backward or remain at the same state for an undetermined period in its development process.⁹⁰ Authors supporting this view are Hakansson and Snehota (1995), Rao and Perry (2002), among others.

The two different perspectives are presented in order to illustrate how different relationships can be depending on the degree of development, which is important to be aware of when analysing relationship characteristics and formulating customer strategies. This means that a manager can attempt to develop customer relationships by showing commitment and create trust, and hopefully with time this will develop into long-lasting valuable relationships.

However, old customers might still be found to be in an early stage of relationship development and then it is important to identify the reasons for this. Also, there can be customers with very short-term oriented objectives that do not aim to develop a relationship with the existing supplier, and hence terminate the relationship after the state of establishment. Hence, the stages and the states perspective are considered as complementary for the analysis of the empirical results.

In addition to determining relationship development, the time dimension is important as it is related to relationship duration. A focus on relationship duration

⁹⁰ Rao & Perry (2002)

requires managers to shift their emphasis away from each single, discrete transaction towards tracking the relationship over time and changing it when appropriate.⁹¹ This can be connected to the earlier presented RM-TM continuum, which illustrates the hierarchy of single transactions to relational exchanges over time.

An analysis of the customer's time orientation enables a supplier to select and use marketing tools that correspond to the time horizon of the customer.⁹² Otherwise a relational marketing approach might be applied when a transactional marketing approach would be more appropriate.⁹³ For example, a short-term tool such as price could be most appropriate for a customer with short-term orientation, whereas technological investments and technical capabilities could be appropriate for long-term oriented customers. A second benefit of analysing a customer's time orientation is that the insight from the analysis can be used to change the customer's position along the spectrum of long- to short-term orientation.⁹⁴

A long-term orientation in a buyer-seller relationship is determined by mutual dependence and the degree of trust in the relationship. Antecedents to these two factors are environmental uncertainty, transaction specific investments, reputation and satisfaction in the buyer-seller relationship.

Profit maximisation is the focus of both long-term and short-term oriented customers, however customers with a short-term orientation tend to rely on efficiencies in market exchanges to maximise profits in a transaction, while customers with a long-term orientation rely on relational exchanges to maximise profits of over a series of transactions.⁹⁵ Relationships that have lasted a long time are more likely to continue than relationships that are younger because over time adjustments have been made, unsatisfactory and unalterable dyads terminated, while the surviving dyads achieve high degree of fit.⁹⁶ Additionally, older dyads continue since experience breeds trust.⁹⁷

⁹¹ Ford (2003)

⁹² Ganesan (1994)

⁹³ Wyner (1999)

⁹⁴ Ganesan (1994)

⁹⁵ Ibid

⁹⁶ Anderson & Weitz (1989)

⁹⁷ Ibid

3.2 Profitability and B2B customer relationships

The aim of this section is to establish a perspective on customer profitability that can be applied when analysing what relationship characteristics determine customer profitability. Kotler and Armstrong (1996) define customer profitability as “*a person, household, or company whose revenues over time exceed, by an acceptable amount, the company costs of attracting, selling, and servicing that customer*”⁹⁸. At the end of the day, revenues will be translated into economic terms and companies will strive to maximise that profit.

However, it is important to highlight that profitability is not the only value that a customer can bring to a company. Looking solely to profitability may ignore other relationship benefits that may be source of hidden value and that through the continuance of the business relationship the economic revenue can be increased. In addition, customer purchase characteristics can have opposite effects on the gross margin and service costs, therefore focusing on customer revenue as a driver of profitability can be misleading.⁹⁹

In the last two decades the development and management of B2B relationships has become the focus of marketing research on the basis that the interaction between customers and suppliers are valuable assets.¹⁰⁰ As with other assets, customer relationships need investment and therefore the importance in knowing how much a relationship is worth becomes a major concern.¹⁰¹

From the financial perspective, “*the value of a customer is the present value of the future profits that can be expected from it.*”¹⁰² However, this approach has several limitations since current or past actions are not always a good indicator for the future. In addition, economic assessment of the value of a relationship is based on the correct measurement of revenues and costs incurred in it. This can be a complicated task since many of the costs and benefits derived from a relation are intangible, meaning that some can be directly assigned to the relation while there are others that are more difficult to estimate and allocate.¹⁰³

⁹⁸ Kotler & Armstrong (1996)

⁹⁹ Ryal (2002) & Niraj *et al* (2001)

¹⁰⁰ Zolkiewsky & Turnbull (2002)

¹⁰¹ Ford, *et al* (2003)

¹⁰² *Ibid*

¹⁰³ *Ibid*

We consider both concepts of profitability and value important as we believe these are closely related. We think that a customer can be valuable but not profitable, which means that there is a future potential of this customer to become profitable. Hence, it is important not to solely focus on the customers that are profitable at present as a business needs to be concerned about its future profitability as well.

3.2.1 *The pyramid of profitability*

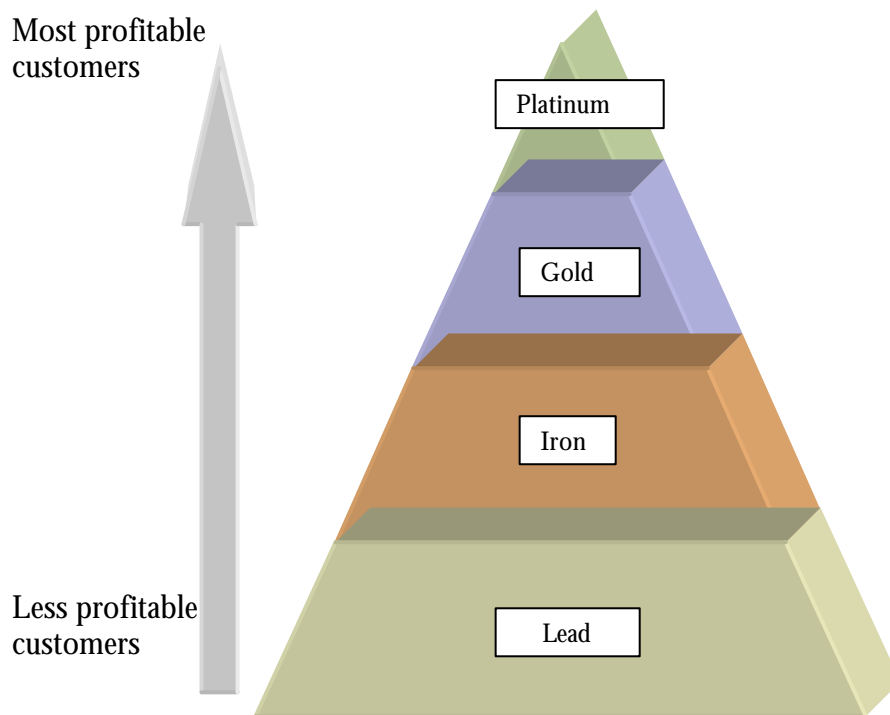
Companies do not need to market all customers in the same way, since some of them can be too costly to serve or may not have the potential to become profitable. Zeithaml, *et al* (2001) customer pyramid in Figure 3.3 presents four groups of customers based on their profitability.

On the top, we find the *platinum customers* that are normally the most profitable ones as they are heavy users, less price sensitive, willing to invest and are committed to the firm. The next level is represented by the *gold customers*, which are profitable but not as high as platinum customers are. As they are more interested in price discounts they are considered less loyal, trying to minimise risk by working with several suppliers. The *iron customers* refer to those who conform the volume needed to operate and use the capacity of the firm. However, their level of expenditure, loyalty and profitability does not justify special treatment. Finally, the *lead customers* are those costing money and resources to the company demanding more than what they provide to the firm and are normally considered to be “problem customers” as they complain to others.

The authors argue that profitability differs among customers and suggest that it can be managed and increased. The customer pyramid provides companies with the possibility to upgrade or eliminate unprofitable customers depending on the resources and goals of the firm.¹⁰⁴

¹⁰⁴ Zeithaml *et al* (2001)

Figure 3-3 The Pyramid of Profitability



Source: Zeithaml *et al* (2001)

We consider the pyramid to be an excellent tool for identifying profitable customer relationships as it is based on customer profitability, which is our main concern. Additionally it enables the identification of what relationship characteristics are found in profitable and unprofitable customer groups. We would like to add that customers that have the potential to develop into a higher level in the pyramid should be recognised as valuable, even if they may not be profitable at present, which is not mentioned by Zeithaml *et al* (2001).

The ideas of the pyramid can be linked to the arguments of Grant and Schlesinger (1995), who state that achieving the full profit potential of each customer relationship should be the fundamental goal of every company since they are the means to support the business. There are three basic ways to do it: acquire new customers, enhance the profitability of existing customers or to extend the duration of customer relationships.¹⁰⁵ Yet, in order to fulfil the potential of a relationship, suppliers need to be able to convince customers about that potential and to secure the necessary investment from the customer and company's side.¹⁰⁶ According to Niraj, *et al* (2001), the decision to acquire, retain and even divest customers is based on present profitability and future profit potential which

¹⁰⁵ Grant & Schlesinger (1995)

¹⁰⁶ Ford, *et al* (2003)

should be calculated considering the possibility to induce favourable behaviour in terms of service characteristics, future revenue, and expected lifetime duration.¹⁰⁷

Following the Zeithaml *et al* (2001) customer categorisation, we will segment the customer base of our case company and draw conclusions on the relationship characteristics affecting profitable customers. With the additional arguments in mind, it is possible to generate ideas about which customer relationships should be prioritised and developed and which not.

Normally profitability is the only criterion used for analysis and management of relationships when profitability rather should be the final aspect to consider. The issue is what aspects or factors make a relationship valuable to later on become profitable.¹⁰⁸ Value can be regarded as the trade-off between benefits and costs that implies all monetary and non-monetary revenues, such as competence, market position or social rewards that are derived from the relationship between customers and suppliers.¹⁰⁹

A company may seek to achieve a range of non-financial objectives through customer and supplier relationships, such as technical development, network access, reference sites, etc.¹¹⁰ This means that profitability can be enhanced by creating co-operation, incorporating technologies or by becoming intimately involved with the customer's organisations in order to identify needs and opportunities for value creation.¹¹¹

Activity co-ordination has the potential to affect the productivity of both suppliers and customer firms. Shared resources can motivate R&D innovations and other shared benefits, while social bonds can facilitate the transfer of knowledge and information through extensive interaction leading to higher levels of trust. Activity links, resource ties and actor bonds in a relationship can provide value to both companies in several ways, such as lower operational costs and development expenses, better flow of material and information, reduced inventory costs, better delivery, quicker and cheaper problem solving, reduced administration costs, shared knowledge, network access, and so on.¹¹²

¹⁰⁷ Niraj *et al* (2001)

¹⁰⁸ Ford, *et al* (2003)

¹⁰⁹ Walter, *et al* (2001)

¹¹⁰ Ford, *et al* (2003)

¹¹¹ Morris *et al* (2001)

¹¹² Ford, *et al* (2003), Håkansson (1982)

Yet, the value derived from the relationship is not always the same for both parties as it will be rated depending on the arrangements and outcomes derived from these bonds, links and ties. Therefore, it is vital for the supplier to communicate these values to the customers, especially when setting prices since a failure in this aspect may harm the relationship, jeopardising past investments and future benefits. In addition, long-term relationships need investments and should not be taken for granted nor exploited for short-term profitability. On the other hand, it is important to remember that the higher the benefits derived from the relationship to the customers the higher the switching costs they will create.¹¹³

3.3 Relationship characteristics

With the discussion on profitability in mind, this section will move on to presenting the relationship characteristics that we think can be important determinants of profitability.

3.3.1 The Reinartz and Kumar study

The idea that led to the initiation of this thesis originates from the study by Reinartz and Kumar in 2003, which analyses the impact of customer relationship characteristics on profitable lifetime duration. This study is the development of previous research by the same authors in 2000, which concluded that both long-term and short-term customers can be profitable. The study in 2003 aimed to complement this result by measuring lifetime duration in a profitability context as well as identifying the factors affecting the variations in relationship duration. Furthermore, the 2003 study focused on factors that determine the characteristics of a customer-firm relationship, which are categorised into exchange characteristics, observed heterogeneity and non-contractual setting.

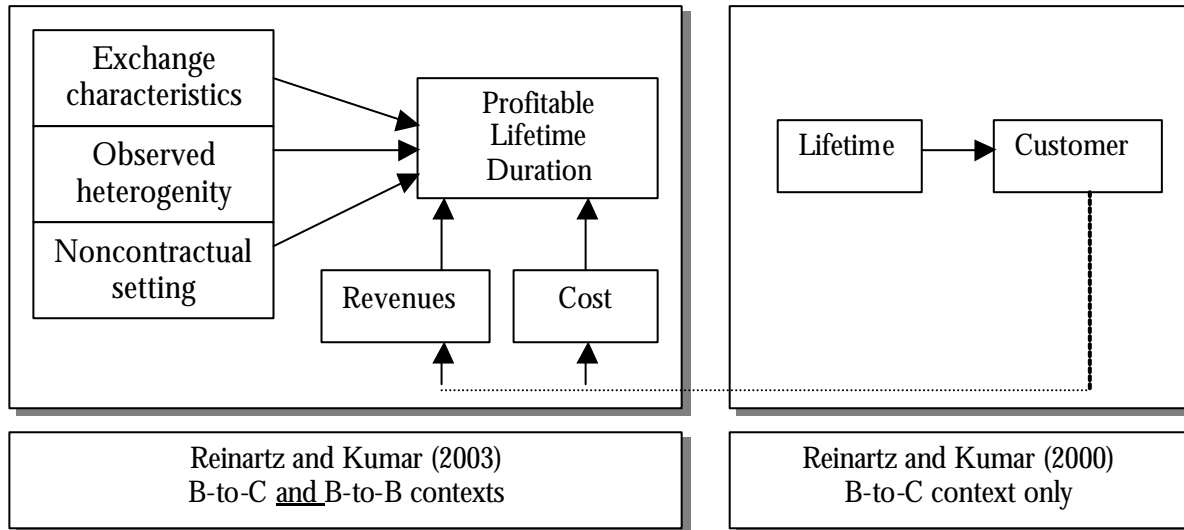
These factors are developed from the relationship marketing and the social exchange paradigm as well as from related research on loyalty and satisfaction. In conclusion, Reinartz and Kumar argue that their study in 2000 concerned the *consequences* of lifetime duration while the study in 2003 emphasises the *antecedents* of profitable lifetime duration.¹¹⁴ The research was conducted within the direct marketing industry drawing conclusions mainly to the B2C markets, but the results were also validated in a B2B setting. Figure 3.4 illustrates how the Reinartz and

¹¹³ Ford, *et al* (2003), Håkansson (1982)

¹¹⁴ Reinartz & Kumar (2000) and (2003)

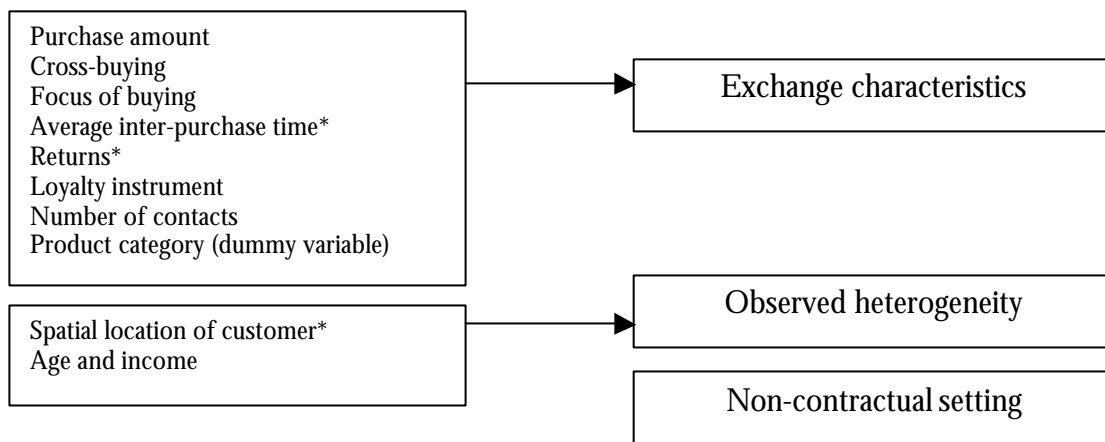
Kumar studies complement each other in a conceptual model of profitable customer lifetime.

Figure 3-4 Conceptual Model of Profitable Customer Lifetime



Source: Reinartz and Kumar (2000), (2003)

Figure 3-5 Determinant Characteristics



* Not supported in statistical validation

Source: Reinartz and Kumar (2000), (2003)

Figure 3.5 defines the exchange and heterogeneity characteristics. The importance of considering purchasing frequency, purchasing amount per incidence and purchase composition when evaluating customer relationships is emphasised, however, it is recognised that these measures needs to be complemented. According to Reinartz and Kumar (2003), the profitable duration of a customer-supplier relationship depends on the exchange characteristics in a given moment in time and customer heterogeneity. Regarding the first type of characteristics, the

authors argue that the relationship will become more durable as customers buy more, more frequently and from different categories. Their study confirms that profitable customer lifetime duration is positively related to the customer spending level (purchase amount) and to the degree of cross-buying behaviour, whereas focused buying has a negative impact in long-term profitability.

The authors argue that customer retention is enhanced with cross-buying since dependency increase as well as customer switching costs, particularly in contractual relationships. The frequency of interaction or average inter-purchase time (AIT), is significant meaning that the longest profitable lifetime should be associated with intermediate inter-purchase time, since it is impossible to sustain constant high levels of purchase frequency. Reinartz and Kumar (2003) mention that profitable lifetime duration is not affected by the proportion of merchandise return by customers.

Finally, the authors found evidence to confirm that the availability of a line of credit and the number of contacts, have a positive impact on lifetime duration. As far as customer heterogeneity is concerned, Reinartz and Kumar (2000) proved that profitable lifetime duration is positively related to the age and income of the customer firm whereas the spatial location of the customer does not have any influence.¹¹⁵

For the purpose of our research, we will only use the heterogeneity and exchange characteristics that were validated in the B2B setting and these will be treated as part of the theoretical framework that after empirical test will help us to determine which factors are the ones characterising profitable relationships between supplier and customers. Since the Reinartz and Kumar (2003) study has rather limited information of the B2B context, we believe our findings will complement it, however we will provide knowledge in the conditions of contractual settings.

We believe that the Reinartz and Kumar (2003) model constitutes a relevant basis for our research, with several important aspects that we want to further examine. However, we think that it should be complemented with aspects connected to trust and perceived values, as we believe these are important in supplier-customer relationships as well. We also intend to test additional aspects from the theories applied by Reinartz and Kumar (2003) to see if there are additional characteristics that prove to be important.

¹¹⁵ Reinartz & Kumar (2000), Reinartz & Kumar (2003)

In the following sections, we will present the main factors that we think are important to consider when analysing what aspects of a relationship that can be linked to customer profitability. These are switching costs, interdependence, the customer's perception of value, loyalty, trust and commitment.

3.3.2 *Social exchange*

Our main focus is to study dyadic B2B relationships, and there are a number of theories that are central when studying these types of two-part relationships, such as social exchange and network theory. We believe it is important to review the social exchange perspective as it enables us to understand the reasons why organisations interact with each other and the grounds for a further connection with relationship profitability patterns. Furthermore, a discussion on social exchange theory needs to be considered since the focus of this study is the analysis of supplier-customer relationships in a B2B setting. Even though B2B relationships refer to the interaction between companies, in the end it is through individuals (the purchaser and the salesman) that the relation is conducted.

The social exchange theory establishes a mainframe for the study to recognise the patterns in which mutual interaction occurs. Specifically the rationales for dyadic interaction are evaluated as it is assumed that it is through social interaction that people develop and change, and institutions and organisations evolve. In addition, the theory is also applicable to highlight the major factors for relationships to begin, grow, develop or terminate in a wide variety of contexts. This suggests that the social exchange theory can be applied to evaluate the relationships between companies and its customers and the possible sources of value creation.

For this purpose and since this theory is rather broad, we will only focus on the aspects related to switching costs and interdependence. However, for the interdependence some dimensions of the network theory will be considered, specifically some thoughts of the interaction approach that concerns dyadic B2B relationships on which network theory is based.

The central concept of social exchange theory is *the longitudinal exchange relation between two specific parts*. This dyadic focus has been one of the main constraints of

the theory. However, this focus has been used as the point of departure for the development of other theories, such as the network approach.¹¹⁶

Relationships develop or dissolve as a result of a continuous process of social exchange, which can be understood as the constant negotiation between rewards and costs between partners. Relationships will continue as long as mutual value exists and as long as the exchange creates mutual feelings of moral obligations to reciprocate benefits.¹¹⁷ Social interaction is argued to be based on the notion of mutually rewarding exchanges.¹¹⁸ Actors have different levels of rewards and costs for different activities at different occasions, and they will try to maximise their rewards and minimise their costs.¹¹⁹ Hence, the theory analyses the trade-offs between rewards and costs in order to measure the value of outcomes from different situations.

In this perspective, satisfaction is perceived as a function of the relationship outcomes and the internal comparison level. Thereafter, based on possible alternatives the individual evaluates the best and worse payoffs available outside the relationship.¹²⁰ In this respect, the comparison level of alternatives represents an external comparison standard to indicate the minimum level of relationship outcomes a person will accept in order to continue in the relationship.

The social exchange theory states that it is possible to be satisfied but not committed or committed but no satisfied. Therefore, to say that satisfaction and attractiveness of alternatives are the only determinants for the continuation and profitability of a relationship is overly simplistic. It is argued that the size of the investments also plays an important role for the decision to stay or exit. According to Rusbult (1980), investments can include intrinsic resources as emotions, time, effort and money, or extrinsic ones such as shared activities, common personal contacts and property. These resources are invested over time, and as the relationship continues, it becomes increasingly costly to leave and lose the investment.¹²¹ Consequently, the continuation of a relationship depends on the level of satisfaction and commitment, attractiveness of alternatives and the size of the investments. The higher the level of investments the greater the value of the relationship and higher the switching costs. In addition, if the level of the

¹¹⁶ Emerson (1987)

¹¹⁷ Scanzoni (1979)

¹¹⁸ Huston & Burgess (1979)

¹¹⁹ Larbes (1999)

¹²⁰ Liu (1998)

¹²¹ Yoon (1996)

investments is high and the alternatives available in the market are poor, commitment will be high whereas satisfaction will be rather low.¹²²

From a social exchange view, relationships develop from one stage to another depending on the reward-cost ratio. Thus, when this ratio declines on detriment of one or both parties, a relationship will move backwards to an earlier stage and the opposite will occur when the ratio increases.¹²³ Hence, termination is determined by impersonal and individual determinants, interpersonal determinants, network influences, declining attractions, rising alternative attractiveness, declining barriers, etc. However, not all relationships end in termination; it may be just a temporary downturn in the relationship.¹²⁴ Relationships may also continue although they are no longer rewarding because of the barriers that have been built under the development of the relationship.¹²⁵

Social exchange theory constitutes a school of thought, from which the most interesting conclusions are the ideas of mutually rewarding exchanges, the importance of investments and the determinants of relationship continuation. As a result, we have chosen to focus on switching costs and interdependence, which are further presented in the following sections.

3.3.3 *Switching costs*

The social exchange theory highlights the amount of resources invested as one of the major factors for relationships continuance or termination. In this respect and relating it to B2B relationships, it is our understanding that the decision for companies to remain in or exit a relationship is based on the barriers built during the existence of the relationships, barriers that can be examined under the subject of switching costs.

Switching costs indicate the facility or difficulty for a company to replace a current supplier, a choice that is extremely related to the level of dependency. The commencement of a relationship with a new supplier involves the sacrifice of resources invested in previous relationships and implies future investments for the establishment of a new working relationship in terms of processes, routines, activities and know-how. Therefore, investments can have a monetary and non-

¹²² Liu (1998)

¹²³ Huston & Burgess (1979)

¹²⁴ Levinger (1987)

¹²⁵ Huston & Burgess (1979)

monetary nature and such transaction specific investments normally cannot be transferred to other relations when the current is terminated. Companies able to build significant switching costs have the possibility to improve their competitive position in the market.¹²⁶

Jackson (1985) uses the switching costs term as the central determinant for the classification of customers into the lost-for good and always-a-share spectrum. Jackson argues that there are two types of switching costs. The first one is investment actions characterised by tangible switching costs that include all kinds of investments in people, lasting assets and procedures. The second type refers to the risk that organisations and buyers face when selecting a supplier and are less tangible kinds of costs. This risk is also known as exposure and can be classified into three categories: financial, performance and personal. The level of exposure changes over time and not always in the same direction.¹²⁷ For a more extensive explanation of these switching costs, refer to Appendix 4.

Further, Klemperer (1995) classifies investments into *physical*, as those undertaken in equipment or for the development of the relationship, *informational*, referring to how to use a product or its characteristics, and *artificially-created* or physiological.¹²⁸ We consider that this classification highlights the importance that “learning” plays when getting to a particular relationship derived from the interaction between the parties. This implies that if a customer has learned to use the products while undertaking investments, it is likely to continue to deal with the same supplier. These costs of learning will provide knowledge that will increase the costs of changing the supplier and therefore will be included in our study.

3.3.4 Interdependence

“When firms interact and exchange, the nature of the connection between them is contingent upon the interdependence between them and the other independent relationships they might have.”¹²⁹

Companies are interdependent units and their existence is based on the continuous interaction with other entities and individuals, creating complex networks integrating other organisations, employees, shareholders, customers and the community. Interaction between parties is based on the recognition that

¹²⁶ Klemperer (1995)

¹²⁷ Jackson (1985)

¹²⁸ Klemperer (1995)

¹²⁹ Gummesson (1995)

mutual interdependence and mutual share of resources can derive into more effective business outcomes. Thus, organisational interaction will allow partners to make better use of their capabilities and expertise.¹³⁰

Interaction will vary over time in intensity, style and scope in each relationship but does not always imply co-operation or closeness, as sometimes relationships are conflictive and hostile. However, it is possible to argue that closer relationships are likely to be more rewarding, since they are based on mutual understanding of each others goals.¹³¹ Personal contact is one of the most significant mechanisms to influence a relationship and to establish trust, loyalty and confidence. If there is lack of personal contact, limited exchange and no adaptation, the relationships will not develop trust and co-operation. As long as the roles of each party and the expected performance are clearly established, effective and satisfactory interaction can take place.¹³²

Nowadays it is almost impossible to find totally independent firms, instead they are part of greater and interrelated systems of suppliers and customers. Thus, it can be argued that this interaction will create certain degrees of dependencies or even more desirable interdependence in the relationship. The later one can be defined as the reliance of the partners within any social system or other actors within that system for valued rewards, benefits, or gratification that will provide companies with the possibility to build a competitive advantage by developing collaborative relationships with other members of the supply chain.

Interdependence research tries to determine the nature of the interaction between individuals in a relation and the ways in which they influence each other to obtain valuable outcomes, and where the level of dependence is determined through the comparison level of alternatives.¹³³ The extent of interdependence between partners is determined by how much one's outcomes are based on the resources received by the other and the degree in which one's profits exceeds potential profits in another relationship. In this respect, relationships remain superficial because the type of rewards received are widely available from another sources or because the interaction has not proven to be profitable enough to intensify the commitment. Accordingly, relationships grow closer when the parties have uncommon abilities to reward each other.¹³⁴

¹³⁰ Cunnigham (1982)

¹³¹ Ibid

¹³² Cunnigahm & Homse (1982)

¹³³ Scanzoni (1979), Bantham *et al* (2003)

¹³⁴ Huston & Burgess (1979)

The social exchange theory argues that relationships may remain superficial or may evolve to a deeper and more committed involvement due to the growth in the extent and nature of interdependence.¹³⁵ In general, the low involvement approach considers suppliers as more efficient producers of identical products. The price orientation neglects other indirect costs and other potential benefits of the purchase. Low switching costs makes it difficult for customers to routinise activities increasing the chance of “hidden” costs appearance. These types of relations require limited co-ordination, adaptation and interaction.

On the other hand, high involvement relationships are based on an alternative idea of purchasing efficiency highlighting the importance of the different roles of suppliers. These relations require co-operation, certain level of adaptation and resource investment for the development of the relationship. The aim is at improving long-term operations rather than focusing on price under the rationale that high involvement may produce costs benefits in terms of reduction of operation costs, material flows, service, share capabilities, etc.¹³⁶

Partners in relationships characterised by equity are likely to be more satisfied since their equal returns have derived from equal investments. However, as long as each actor receives greater rewards in comparison with those offered by outside alternatives, they will be less concerned about inequality issues. Inequity and equity are related to the rewards-costs history of the relationship.¹³⁷ The power each party has in the relation depends on the number of suppliers and the costs of switching. For instance, when the number of suppliers is limited and the switching costs are high, the supplier will have stronger position in terms of power relative to the customer. On the other hand, when there are numerous suppliers with standardised products and a limited number of customers but with strong links, suppliers are likely to have a weaker position.¹³⁸ Figure 3.6 illustrates the aspects of switching costs and interdependence that we will concentrate on based on the social exchange theory.

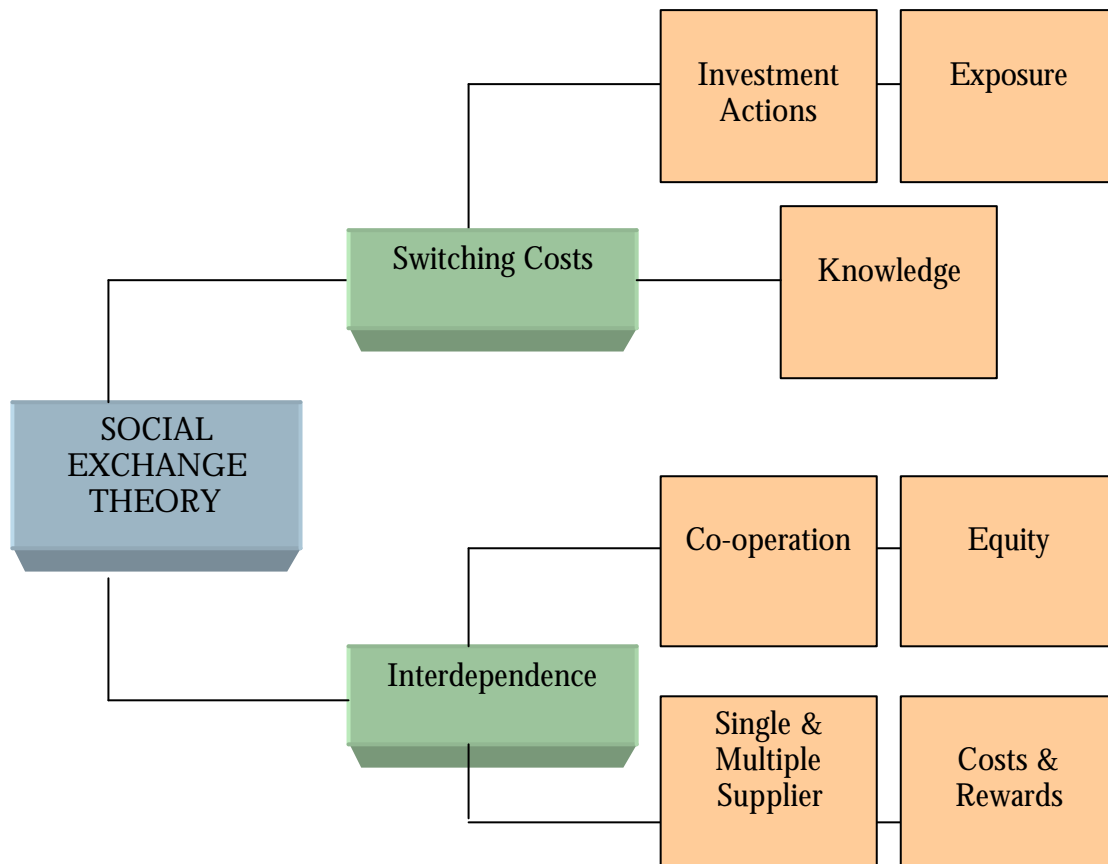
¹³⁵ Huston & Burgess (1979)

¹³⁶ Ford, *et al* (2003)

¹³⁷ Huston & Burgess (1979)

¹³⁸ Silf Competence (2003)

Figure 3-6 Aspects of Social Exchange



Source: Adapted from Jackson (1985) and Klemperer (1995)

In the figure, it is possible to observe that social exchange theory will help us to analyse B2B relationships taking into consideration switching costs and interdependence from Jackson’s (1985) and Klemperer’s (1995) classifications. The switching costs concern investment actions, exposure and knowledge, while interdependence refers to equity, co-operation, single or multiple suppliers, costs and rewards and these aspects are based on authors such as Ford (2003) and Huston and Burgess (1979).

3.3.5 The customers’ perception of value

Customer value has been argued as a major source of competitive advantage and functions as the grounds for all marketing exchanges.¹³⁹ We believe it is important to study customer value as part of business relationships, as customers represent the major asset organisations have.¹⁴⁰

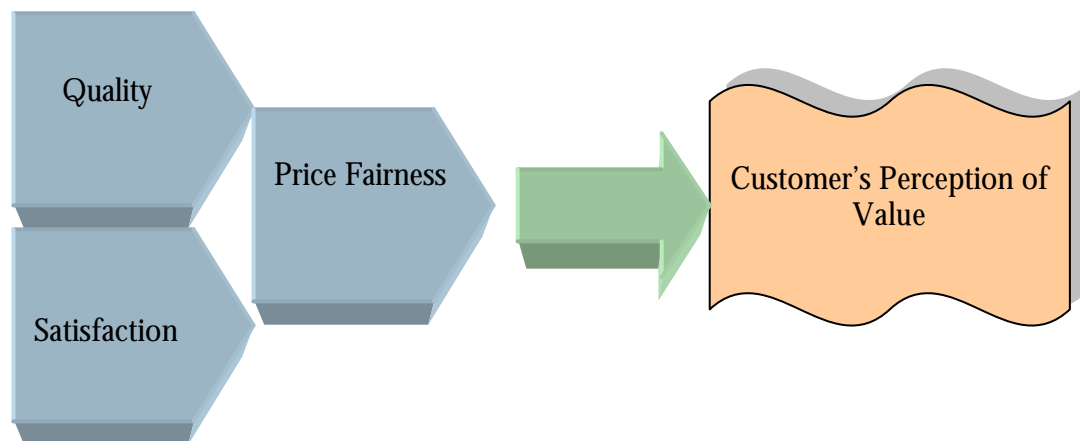
¹³⁹ Liu (1998)

¹⁴⁰ Ulaga (2001)

The concept of value within the B2B markets is related to how a supplier is able to create value for its customers and how these customers perceive superior value in a supplier's offering compared to other alternatives. In addition, Zeithaml (1988) concludes that the customer's perception of value is an interaction between price, perceived quality, perceived value and trade-offs.¹⁴¹

We would like to argue that the approach taken by Zeithaml (1988) needs to be modified as she includes *perceived value* as one of the aspects within the customer's perception of value which is confusing and difficult to apply. Therefore, we decided to use her ideas on price and quality and replaced the third one by adding the concept of satisfaction as a driver of a customer's perception of value. These aspects are presented in Figure 3.7.

Figure 3-7 Aspects of the Customer's Perception of Value



Source: Adapted from Zeithaml (1988)

Satisfaction was included based on the fact that within the articles and literature revised regarding this subject it was found that the concept of satisfaction is conceived as one of the aspects shaping a customer's perception of value, which is a view that we also share. Price is what customers pay to obtain a product or service and their perception of fairness will determine if the product is worth it or not, therefore the focus will be on price fairness. Finally, quality regards the judgement whether the product will cover the need for what it was intended to influenced by customer's expectations.

¹⁴¹ Zeithaml (1988)

Price Fairness

Price plays an important role in the customers' perception of value since it is present in all buying situations, representing the amount of money to be sacrificed in order to obtain a particular product or service.¹⁴²

The supplier's ability to charge a certain price will be determined by the price sensitiveness of the customer and the extent of word-of-mouth among them.¹⁴³ Campbell (1999) suggests that customers are concerned about price fairness, hence when a firm is perceived to charge unfair prices it will have a negative effect on value perception and profitability. Customers may resent an increase on price and consider it unfair when it results in increased profits. However, the increase on price is perceived as fair when companies do so to maintain the current level of profit and to cover increasing costs.

Consequently, customers have psychological reactions affecting their responses towards price that are intimately related to their interpretations of the motives of companies to undertake a particular market action. As mentioned before, in the eyes of the customer a company's decisions to increase prices can have good or bad motives and that will determine the perception of fairness. Therefore, companies should provide explanations behind their price strategies since the appropriate information delivered to customers may effect their perception of fairness.¹⁴⁴ In addition, several studies (e.g. Bolton and Lemon, 1999; and Bolton, *et al* 2000) have pointed out that the perception of fairness is an important factor to determining the length and depth of the relationship.¹⁴⁵

Quality

Perceived quality can be defined as the customer judgements regarding the overall superiority of a particular product or service.¹⁴⁶ From the tangible perspective, quality deals with the characteristics of the product itself. However, service factors are also determinants of perceived value, meaning that quality not only refers to physical products but it is also linked to the idea of augmented values.¹⁴⁷ These additional features may include aspects such as packaging, customer service,

¹⁴² Linchestein *et al* (1993)

¹⁴³ Kim *et al* (1995)

¹⁴⁴ Campbell (1999).

¹⁴⁵ Verhoef *et al* (2001)

¹⁴⁶ Zeithaml (1988)

¹⁴⁷ Naumann

advertising, customer advice, financing, delivery arrangements, warehousing, etc. These are concepts that conform to the value added of products and that ultimately shape customers' expectations.¹⁴⁸ Customers will also rely on the company's reputation and image to evaluate value. Corporate citizenship, community involvement, professionalism of personnel, entrepreneurship, etc. are aspects likely to affect the customer's image perception that will further help them to make decisions regarding price, product and service.¹⁴⁹ Customers balance the product and service performance in relation with the price, meaning that price can be used as a signal for product quality.

It is likely that the benefits derived from providing customer value will outweigh the costs. In this respect, value delivery will function as an antecedent for loyalty and retention. Companies will have a larger share of customer's expenditure and therefore value will have a positive impact on market share. Moreover, value delivery can increase word-of-mouth creating positive attitudes towards the company and attracting new customers. Therefore, superior value delivery relative to competitors will in the end pay-off in terms of increased profits and shareholder value.¹⁵⁰

Satisfaction

Understanding value mandates that a firm captures the voice of its customers, and customer satisfaction appraisal is an important part of this. According to Anderson and Sullivan (1993), satisfaction can be defined as “*a function of perceived quality and “disconfirmation” – the extent to which perceived quality fails to match pre-purchase expectations*”.¹⁵¹ Satisfaction implies an overall evaluation over time of the current and past purchase experiences and it is affected by quality, price and expectations, and therefore satisfaction is a determinant of customer value. As long as the current experience with a supplier provides value to customers, they are likely to be satisfied.¹⁵²

There are factors affecting customer satisfaction, such as the basic elements of the product or service that the customer expect all competitors to deliver such as support services, customer assistance, a recovery process for counteracting bad experiences. In addition to this, there are other special attributes that customers

¹⁴⁸ Payne & Holt (2001)

¹⁴⁹ Naumann

¹⁵⁰ Ibid

¹⁵¹ Anderson & Sullivan (1993)

¹⁵² Anderson *et al* (1994)

do not expect and that try to meet customers' personal preferences that make the product or service seem customized.¹⁵³

According to Matzler, *et al* (1996), customer satisfaction has been measured on a unidimensional basis of quality, "...the higher the quality, the higher the customer satisfaction". This represents a rather narrow perspective. Instead, the authors conclude that in order to gain superior customer satisfaction, companies "...must fulfil all must-be requirements, be competitive with regard...the requirements specifically demanded by the customer and stand out from the rest as regards attractive requirements that are not demanded nor expected by customers." ¹⁵⁴

Bolton (1998) among others, argues that there is a link between satisfaction and the duration of the relationship where the strength of the link is determined by prior experiences with the organisation. However, close relationships do not necessarily result in high levels of satisfaction. Accordingly, not all satisfied customers will be the most profitable. Several businesses actually achieve a large share of their profits from their transactional, opportunistic customers.¹⁵⁵ Even if customer satisfaction is a predictor of future profits, it is not enough to solely focus on assuring that customers are satisfied. Most customers who leave a supplier are satisfied, but switch for various reasons such as another supplier's marketing, better offers or to try something new.¹⁵⁶ Reicheld (1996) even argues that many organizations have fallen into a "satisfaction trap" in which managers focus on satisfaction survey scores at the expense of understanding customer retention and lifetime purchases.¹⁵⁷

It has been said that satisfaction presumably leads to repeat purchases and favourable word-of-mouth publicity and that satisfied customers are less price sensitive, more stable and are more loyal.¹⁵⁸ Although this is the subject of many controversies, there is no doubt that customer satisfaction is a vital prerequisite for the business success providing companies with great opportunities to enhance their profitability.

We have chosen to study satisfaction as one of the relationship characteristics as changes in customer satisfaction can result in important financial implications for

¹⁵³ Jones & Sasser (1995)

¹⁵⁴ Matzler *et al* 1996)

¹⁵⁵ Gummesson (2002)

¹⁵⁶ Sanzo *et al* (2003)

¹⁵⁷ Reicheld (1996)

¹⁵⁸ Markovic & Horvat (1999)

the organisation, as lifetime revenues from an individual customer depend on the duration of the relationship as well as the amount of the billing cycles.¹⁵⁹ Further, customer satisfaction is considered to be one of the most valuable assets of a company active on a mature market, as it functions as an exit barrier and thereby helps the company to retain its customers.¹⁶⁰ Investments made to increase satisfaction and value must target the customers with the highest potential value in order to be profitable. Managers also need to be aware of that not all satisfied customers are necessarily profitable. Unprofitable satisfied customers can be a result of the supplier's inability to sense the needs of the buyer, and hence offering the wrong product at the wrong price. As a result, it might be impossible to turn them into profitable customers.¹⁶¹

There is a controversy among theorists whether there is a link between customer satisfaction, retention and economic results. Some theorists assume that high customer satisfaction leads to increased loyalty, and the more loyal customers become, the longer they are likely to continue with the same supplier. Fornell *et al* (1994) support this view and argue that increased customer satisfaction leads to economic benefits.

Nevertheless, economic returns from improved customer satisfaction are not immediately realised as a long-term perspective is necessary for evaluating the efficiency of effort to improve quality and customer satisfaction. The long-term nature of the economic returns from enhanced customer satisfaction also has broad strategic implications. If increased customer satisfaction primarily affects future cash flows, resources allocated to improving quality and customer satisfaction should be treated as investments rather than expenses and loyal, satisfied customers should be regarded as revenue generating assets that are costly to acquire, retain and develop.¹⁶²

3.3.6 Loyalty

Loyalty is one of the concepts frequently occurring in the relationship literature. According to Diller (2000), the concept of loyalty has been given a new, central role as a marketing goal of the firm within relationship marketing. Yet, it remains a much debated concept among theorists, e.g. whether it leads to any economic

¹⁵⁹ Bolton (1998)

¹⁶⁰ Markovic & Horvat (1999)

¹⁶¹ Gummesson (2002)

¹⁶² Anderson *et al* (1994)

outcomes or not.¹⁶³ Therefore, we consider loyalty to be an interesting relationship characteristic to study in the context of profitability.

Reichheld *et al* (2000) mean that loyalty can function as a measure on whether superior value has been delivered, which can be assumed when customers return for additional purchases.¹⁶⁴ In this respect, it can lead to growing revenues and market share by repeat sales and referrals which we find closely related to customer profitability. Within loyalty research, authors like Diller (2000) argue that loyalty can lead to customers being more well-informed about products and processes, which means they would be less costly to manage.¹⁶⁵

On the other hand some theorists, e.g. Reinartz and Kumar (2002), question whether loyal customers are less price-sensitive, or if they will demand better prices as a reward for their loyalty and they know their value to the company and often exploit it to get premium service or price discounts.¹⁶⁶ Taking these very different perspectives into consideration, it can be argued that the effects of loyalty can either be very positive to the development of profitability or lead to considerable increases in costs. Both perspectives have relevant arguments, but we are more positive to the view of Reinartz and Kumar (2002) as we think that most customers probably will expect something in return for their loyalty.

There are two lines of thought when referring to loyalty. In behavioural terms, loyalty is determined by the number of purchases, the frequency of such purchases and by monitoring any brand switch. On the other hand, attitudinal loyalty incorporates aspects such as consumer preferences and their stance towards a brand.¹⁶⁷ To say that loyalty is measured in either behavioural or attitudinal terms implies a rather restrictive position. In this respect, we prefer to regard loyalty as a combination of both, since a purely behavioural position may tend to assume that the only reason for customers to patronize a brand is because they are loyal when in fact there may be other reasons for them to re-purchase.

Several definitions have proved to be in line with our way of thinking. Diller (2000) refers to loyalty as “*the amount and quality of the transaction between the parties*”. The transactions cover the number of contacts or the proportion of a customer’s total buying volume from a single supplier. The qualitative side of transactions

¹⁶³ Diller (2000)

¹⁶⁴ Reichheld *et al* (2000)

¹⁶⁵ Diller (2000)

¹⁶⁶ Diller (2000), Reinartz & Kumar (2002)

¹⁶⁷ Egan (2001)

refers to the atmosphere in which they take place, i.e. the climate of the relationship during the contacts with both sides.¹⁶⁸ Similarly, Jones and Sasser (1995) define customer loyalty as “*the feeling of attachment to or affection for a company’s people, products or services.*”¹⁶⁹ However, we consider that Bloemer and de Ruyters (1998) definition combines these aspects in a more comprehensive way:

*“The biased behavioural response expressed over time by some decision-making unit with respect to one out of a set of suppliers, which is a function of psychological processes resulting in brand commitment”*¹⁷⁰

Knowledge about the strength of loyalty in industrial markets is scarce as limited research has been conducted within this area. It is argued that industrial loyalty requires more time to be established since normally buyers in a B2B setting try to avoid high degrees of reliance on single suppliers. However, once established it will last longer and will be more difficult to dissolve than consumer relationships.¹⁷¹ In many cases, buyers cannot afford the risk to use only one supplier for all its needs. Therefore, a customer can still be loyal even if he purchases products from several suppliers. Moreover, remaining with the same supplier can also mean reduce risk as both parties will be familiar with each other.¹⁷²

Uncles (1994) argues that satisfaction is an antecedent to loyalty, but these two concepts do not necessarily go hand in hand, since satisfaction does not always lead to retention as well as dissatisfaction does not always result in defection. Based on Uncles’ (1994) classification, it is possible to say that there are three types of customer behaviour in terms of loyalty:¹⁷³

1. *Switching behaviour*: Either the customer stays with the supplier or turns against him.
2. *Promiscuous behaviour*: When the customers make a stream of purchases, but still remain an either/or decision in their supplier relationships.
3. *Polygamous behaviour*: Customers are loyal to the supplier brand as they are to any other.

¹⁶⁸ Diller (2000)

¹⁶⁹ Jones & Sasser (1995)

¹⁷⁰ Bloemer & de Ruyter (1998)

¹⁷¹ Morris *et al* (2001)

¹⁷² Diller (2000), Morris *et al* (2001),

¹⁷³ Uncles (1994)

Further, Uncles (1994) argues that promiscuous and polygamous behaviour are the most common since the majority of the customers are multi-brand buyers which may be also because the supplier is not able to fulfil all the requirements placed by the customer. Moreover, promiscuous or polygamous buyers may even be more profitable than completely loyal customers as it is not strange to find that frequent buyers turn to be less loyal.¹⁷⁴ From a B2B perspective, we agree with the argument of customers not being loyal to one single brand as this would mean too high a degree of dependency for many customers. Still this does not necessarily imply a low degree of loyalty.

3.3.7 Trust and commitment

Several definitions on trust and commitment are presented in the literature. Anderson and Weitz (1989) define trust as “*one party’s belief that its needs will be fulfilled in the future by actions undertaken by the other party.*”¹⁷⁵ Morgan and Hunt (1994) define relationship commitment as “*...an exchange partner believing that an ongoing relationship with another is so important as to warrant maximum efforts at maintaining it; that is; the committed party believes the relationship is worth working on to ensure that it endures indefinitely.*”¹⁷⁶ Ganesan (1994) argues that trust concerns the exchange of a partners’ confidence in exchange for a partner’s reliability and integrity, and if managed properly, trust can develop in commitment to the relationship. Trust is also necessary to a long-term orientation as it shifts the focus to future conditions.¹⁷⁷

These definitions reflect the importance that trust and commitment seem to have for the development of a relationship, and even authors such as Morgan and Hunt (1994), Håkansson (1982) and Ford (1990) in their prior studies have recognised these factors as essential for creating successful relationships. It has been suggested (e.g. Dwyer *et al* (1986), Williamson (1985), Morgan & Hunt (1994)) that trust is important to relational exchange because trustable relationships are highly valued by the parties, and therefore they will end committing to such relationships. As we are evaluating the aspects that characterise relationships and profitable customers, we believe these factors should be included in the research.

¹⁷⁴ Uncles (1994)

¹⁷⁵ Anderson & Weitz (1989)

¹⁷⁶ Morgan & Hunt (1994)

¹⁷⁷ Ganesan (1994), Morgan & Hunt (1994)

It is important to mention, on the other hand, that in the revised literature it has not been defined whether trust is an outcome of a committed relationship or whether trust is the antecedent to commitment. However, we would base our study on the assumption that these two aspects are dependent on each other where the outputs of either one will work as the inputs of the other forming a continuum. Moreover, because trust and commitment are rather broad concepts, we have decided to limit ourselves to study certain elements within these subjects.

Firstly, and following Ganesan (1994) and Sanzo *et al* (2003), trust among customers affects the desire to remain with a supplier to a large extent. Consequently, a supplier who focuses on establishing long-term relationships with customers must emphasise promotion of trust by offering assistance and support, look out for customers' interests and keep promises even though conditions may change.¹⁷⁸ On this basis the authors study the subject considering two dimensions that will be applied in this thesis. On one hand, *credibility* will help us to determine if the supplier has the required expertise to perform the job reliably, where confidence in the trusting party results from the belief that it is reliable and has high integrity, which is associated with consistency, competency, honesty, fairness and responsibility. On the other, *benevolence* will provide us with a “softer” dimension, as it is based on the customer's belief that the supplier is interested in the customer's welfare.

Secondly, on the basis that commitment implies that both parties will be loyal, reliable and stable in the relationship with one another representing the desire to maintain a given relationship, as it requires certain maturity of the relationship,¹⁷⁹ we will make use of the study of Sanzo *et al* (2003) classification of commitment into *affective* and *calculative*. This has been further supported by Morgan and Hunt (1994) and Kumar *et al* (1994), who consider this classification important “*to the development of mutual beneficial relationships.*”¹⁸⁰ The proposed division considers one “hard” and one “soft” dimension of commitment which we think are important in order to gain a more holistic perspective when evaluating this concept in practice and also because trust will be assessed in similar terms.

Affective commitment is based on emotional attachment to the relationship while calculative commitment (dependence) is based on a cognitive evaluation of the

¹⁷⁸ Sanzo *et al* (2003)

¹⁷⁹ Egan (2001)

¹⁸⁰ Kumar *et al.* (1994)

value of the relationship.¹⁸¹ A single focus on calculative commitment may only result in capturing false loyalty, as all antecedent factors of loyalty, such as trust and affective commitment are not considered.¹⁸²

In addition, for the analysis of relationship characteristics we will also use the Morgan and Hunt (1994) finding on commitment and trust on the basis that *relationship termination costs* are concluded to directly influence commitment while *shared values* directly influence both commitment and trust. In this respect, termination costs are relevant as they can be a source of sustainable competitive advantages if the supplier manages to provide resources, opportunities and benefits superior to competitive offerings and avoid taking advantage of the exchange partners. In turn, similar values are interesting to consider since it could be argued that the customer will identify with the other party making it easier to trust and commit to the relation.

We will also consider previous studies that have identified aspects such as goal congruence, negative reputation and length of the relationship to affect trust.¹⁸³ Moreover, reputation, satisfaction and perception of the supplier's specific investments in people, long-term assets and procedures and communication are also important to consider when studying antecedents to trust.¹⁸⁴

3.4 Theoretical hypotheses

As noticed the theories introduced and discussed throughout this chapter present a great amount of interesting sub-areas that require us to have some focus for the continuation of our study. The above theoretical framework has allowed us to determine six main areas which the rest of this study will be concentrated on to further be linked to profitability. The identified areas are: *relationship duration, switching costs, interdependence, perceived customer value, loyalty and trust and commitment*. Furthermore, our understanding of these theories is represented by the formulation of 19 hypotheses that will be answered in chapter 6. These theoretical hypotheses are summarised in Table 3.2

¹⁸¹ Morgan & Hunt (1994)

¹⁸² Sanzo *et al* (2003)

¹⁸³ Ganesan (1994)

¹⁸⁴ Sanzo *et al* (2003), Ganesan (1994)

Table 3-2 Theoretical Hypotheses

Relationship Characteristic	Hypotheses
1. Relationship Duration	1.1 Customers in relationships that have lasted a long time are likely to remain in the relation and repurchase
	1.2 Older dyads are likely to continue as trust is developed
	1.3 Long-term orientation in a buyer-seller relationship is determined by mutual interdependence and trust, and short-term are affected by price
2. Switching costs	2.1 The resources invested in the relationship are determinants for the duration of the relationship as they act as switching costs.
	2.2 Shared values are related to the perceived costs of changing a supplier.
3. Interdependence	3.1 Customers in relationships characterised by equity will tend to be more satisfied
	3.2 Strong influence on suppliers is negative to interdependence
	3.3 The degree of power of the customer will depend on the number of suppliers they have and the cost of switching
	3.4 Intensity and equity are related to the rewards and costs derived from the relationship
4. Perceived customer value	4.1 Customer's perception of value depends on their level of comparison with other alternatives in terms of price fairness, quality and satisfaction.
	4.2 Satisfaction is related to the duration of the relation but not related to closeness of the relation
	4.3 Satisfaction is both a driver and outcome of customer perception of value
5. Loyalty	5.1 Loyalty depends on behavioural and attitudinal aspects
	5.2 Cross-buying is affected by the duration of the relation and customer retention can be achieved through cross-buying
	5.3 Frequent buyers will tend to remain in the relation for a longer time
	5.4 Customers working with multiple suppliers are still likely to be loyal
6. Trust and Commitment	6.1 Customer's perception of the supplier's competence to perform in the industry and the supplier's fulfilment of promises are determinants of trust
	6.2 Trust is required for the development of long lasting relationships
	6.3 Termination costs and shared values are likely to affect customer's trust and commitment

4 The case company

This chapter introduces the case company Formica-PSM, which is active in the high-pressure laminate industry. Firstly, high-pressure laminates and the industry will be described with specific focus on the US and Europe to determine the present trends and market conditions since the information regarding the Swedish industry is very limited. Finally, Formica-PSM and its parent company Formica Corporation are presented.

4.1 The Industry of high-pressure laminates

4.1.1 High-pressure laminates

High-pressure Laminates (HPL) are decorative surfacing products offering high impact and scratch resistance. HPL have different applications not only in the residential sector for kitchen furniture, worktops, bathroom furniture and flooring, but also in the commercial sector for work surfaces, furniture, washroom cubicles, interior doors, counter tops and interior wall linings.¹⁸⁵



According to the Laminating Material Association in the USA, a HPL is “a decorative laminated plastic sheet which consists of papers, fabrics or other core materials that have been laminated at pressures normally between 1,000 and 1,400 psi (6895 - 9652 kPa). A typical sheet of general purpose HPL is made from a sandwich of melamine-impregnated, alpha cellulose overlay and decorative surface papers, superimposed over phenolic resin-impregnated kraft papers. The thickness, which is determined by the number of layers of kraft papers and the resulting amount of resin absorbed. When the sheet is pressed, a steel caul plate or a paper release sheet is used to create a surface finish ranging from high gloss smooth to fully textured or embossed. HPL is made in a multitude of solid colours and printed patterns.”¹⁸⁶

The production process is far from simple (treating, collation, plate, pressing, trim and sand, and variations) and requires specialised equipment (surface preparation, coating equipment, steel plates, press panels, edge laminating and post-forming

¹⁸⁵ Formica (5)

¹⁸⁶ FDM Glossary of terms

equipment) for successful lamination. Please refer to Appendix 5 for a diagram of the HPL production process. Therefore, to operate in this industry large investments in machinery and distribution are required to remain competitive, as it is necessary to exploit economies of scale. As a consequence, new comers face barriers to enter mainly due to the low return on capital, which motivates them to invest elsewhere reinforcing the trend towards dominance of large, old enterprises and conglomerates.

There are several substitutes available, depending on the segment. One of the substitutes of the HPL widely used in Europe is the Melamine. Other substitutes are low-pressure laminates, mostly saturated melamine papers, but also decorative foils, low basis weight papers and vinyl films.¹⁸⁷

4.1.2 The industry in the US

There are several firms competing in the US decorative laminates market. However, the market is dominated by Wilsonart (Illinois Tool Works) and Formica brands, which together account for 30% of the total demand. The segments includes full-line laminate producers, hard flooring manufacturers such as Armstrong, Bruce and Mannington, other floor covering makers represented by Mohawk and Shaw and laminate flooring specialists like Pergo and Witex.¹⁸⁸

Between 2000 and 2002 the furniture shipments in the US including desks, tables and office systems, categories that are more likely to use overlays, experienced a downturn resulting in a 33% decline. Moreover, it is expected that it will drop another US\$8.1 billion before it returns to a rising trend in 2004. In 2002 the desk sector managed to increase its market share accounting for 11% of the US annual office furniture shipments, meaning that more than US\$1 billion was spent in this category, although tables decreased 34% in comparison with the peak shipment volume in 2000.¹⁸⁹

Trends in North American Shipments 2002

Decorative overlays	- 0, 6%
Decorative foils	- 11%
Saturated paper	+ 5 %
Vinyl	+ 2, 7%

Looking at the North American shipments of decorative overlays in 2002, there was a decline, reaching the 1.012 billion m² (SQM). The decorative foils reported

¹⁸⁷ Infoshop

¹⁸⁸ Ibid

¹⁸⁹ LMA (1)

the largest decline while saturated papers and vinyl films increased, which may be the result of the ongoing alliances among suppliers. In the US, increases in 2002 managed to offset the losses in 2001 as the shipments of overlays increased 0.7% to 0.846 billion (SQM) whereas Canadian shipments have experienced their second annual decline to levels below the 1999 volume.¹⁹⁰ Regardless of the slowness of the market where laminate dollar sales increased less than 3% amounting US\$715 million, 2002 was a very busy year for laminating manufacturers. Armstrong replaced Formica as the third largest US producer, whereas other important players have or are planning to expand their capacity, such as Uniboard, Shaw and Homanit.¹⁹¹

According to Mr. George Carter, the President and CEO of George Carters & Affiliates and Executive Director of the Laminating Materials Association in USA, the North American production of HPL will be ranged between 1.4 –1.5 billion ft², including net imports and laminate flooring production. Mr. Carter commented that “HPL has been losing market shares due to the rapid rise of thermofused melamine or low-pressure laminate, and this trend is likely to continue”.¹⁹² George Carters & Affiliates’ industry forecast predicts a steady growth of overlays in the short-term but strong growth in the next decade, anticipating a 48% of gain for all overlays between 2001 and 2010 driven by saturated papers (76%), decorative foils (52%) and low basis weight papers (50%) which is illustrated in Graph 3.1.¹⁹³ This information has been also confirmed by the Freedonia Group, a leading research firm. However, they highlight that these gains will be driven “by the residential repair and improvement spending, particularly with regard to kitchen and bath remodelling”.¹⁹⁴

¹⁹⁰ LMA (3)

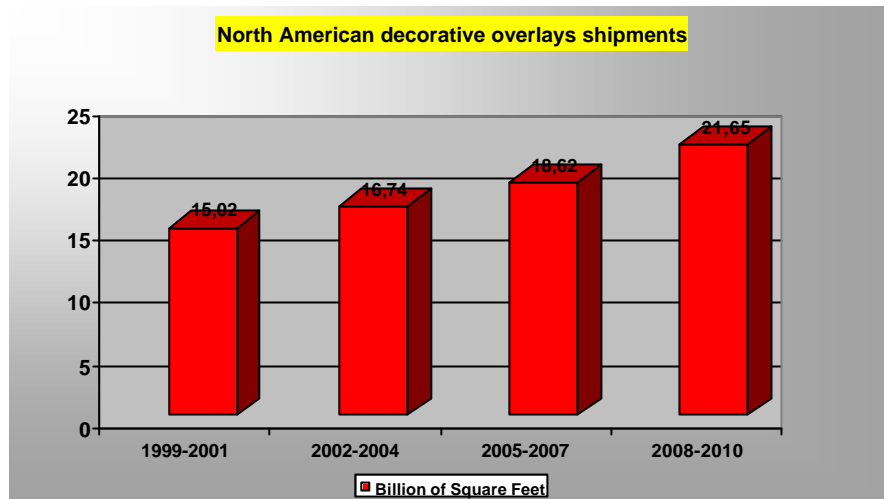
¹⁹¹ Floordaily.net (2)

¹⁹² George Carter (2003)

¹⁹³ FDM technology on laminating

¹⁹⁴ Floordaily.net (2)

Graph 4-1 North American Decorative Overlays Shipments



Source: *George Carter & Affiliates and Resource Information Systems (2003)*

In the North American industry, laminates and overlays are predicted to grow above 16% between 2002 and 2004, which means an average of 6% per year. This number is rather conservative in comparison to the 200% growth experienced back in the 90's.¹⁹⁵ The production for residential and office furniture will continue to rise in a gradual manner whereas the production of kitchen cabinets will expand as housing continues to grow and houses size trends higher.¹⁹⁶ The laminate flooring will take a considerable part of these increases. However, their impact will not be as much in absolute volumes but influencing consumers to accept surface overlays to in a greater extent. Overall, the major challenge that the industry will face is the potential impact of components and finished products coming from Asia, particularly China.¹⁹⁷



Regarding product and design development, the trend points to the “embossed in register” products, which imply that the top layers of paper are stamped with a pattern that matches the underlying décor sheet so it is possible to feel it with the hands. For these kinds of panels to be produced it is necessary to use multiple sheets of decorative overlay on the surface, which implies high costs and

¹⁹⁵ FDM technology of laminating

¹⁹⁶ LMA (1)

¹⁹⁷ Ibid

complexity. However, the companies who produce such panels are more likely to develop and enjoy first-mover advantages.¹⁹⁸

Another area of development is in digital printing, the question is to determine how to make it cost effective and production viable, since today it is mainly used for speciality effects and small run sizes. Several actors in the industry believe that digital printing has a good chance to develop and become the norm in the industry.¹⁹⁹ Applications and markets likely to experience high growth in the next few years are partitions, vertical and high-end commercial applications whereas the solid surfacing is expected to grown and become more than a decorative surface.²⁰⁰

4.1.3 The industry in Europe

The industry in Europe encompasses a large number of small suppliers and several large enterprises with important international operations. Europe has approximately 50 independent producers and within Sweden there are 10 active international strong players, where the most important actors are Wilson Art (US), Pfleiderer Group (Germany), Polyray (France), Abet Laminati (Italy), Liri Industriale (Italy) and Arpa Industriale (Italy).²⁰¹ According to Formica-PSM representatives, the company has strong market share, between 60 to 80% in traditional and mature markets such as Scandinavia and Finland, whereas in Eastern Europe, Formica's presence is about of 20%.²⁰² The Scandinavian market is "quite a static and mature business" according to the Marketing Director of Formica-PSM. He believes that "Growth is stable but rather restricted accounting for a few % each year, at around 2%. This implies that in addition to overcapacity, competition is tougher and to increase market share, sales need to be taken from competitors, mainly on price and special offers." ²⁰³

The European production of furniture components is worth about €2,900 million (2002). Italy is the leading European producer and exporter, while Germany is both the main furniture producer in Europe and the leading

Sales of leading furniture producers in Western Europe (2002)

Germany	€19.4 bn
Italy	€11.6 bn
UK	€ 9.6 bn

¹⁹⁸ LMA (5)

¹⁹⁹ FDM technology of laminating

²⁰⁰ Surfacing magazine

²⁰¹ Floordaily.net (2)

²⁰² Jörgen Bergengrip (2003)

²⁰³ Ibid

consumer and importer of furniture components.²⁰⁴ Germany is the biggest furniture market in Western Europe, followed by Italy and the U.K. Nevertheless, in the last years the furniture and building sector in Germany has experienced a weak state, and besides facing further concentration and earnings difficulties, it has suffered from low consumer demand. As a result, the German furniture industry sector has declined about 2,7% in 2001, a trend that continues at present. German kitchen furniture manufacturers reported a decline in sales of 7% in 2002. This combined with the closure of several producing facilities of kitchen furniture provides a clue of the situation of the furniture industry in the country, marking the trend for the demand of furniture components in the rest of central Europe.²⁰⁵

Europe's laminate sector is experiencing many challenges suffering from overcapacity, putting manufactures under great pressure to fulfil production capacities, which have been further aggravated by an increase in production costs in combination with price reductions. Additionally, prices of primary materials are expected to continue to rise. Although naturally this would lead laminate manufacturers to increase prices in order to secure their endurance, the market is demanding lower prices.²⁰⁶ Furthermore, Mr. Carter from the Laminating Materials Association in USA adds *“Low-pressure laminates are a cost alternative with similar performance properties to HPL. I believe the rapid rise of this product as a substitute may be a trend as well in Europe.”*²⁰⁷

For the last several years and affected by the market unification throughout Europe, the European laminate industry has gone through a process of consolidation particularly affecting smaller companies, which only operate on a regional basis. The concentration trend will continue and it will be much more evident due to the current economic downturn. According to Mike Weddington from Wilsonart International, the industry will continue to experience consolidation and alliances as a way to provide better service to a more demanding, dynamic and fluid customer base. Jean-Pierre Clement, current president of the solid surfacing division at Formica Corporation worldwide, agrees with this view in terms that small manufacturers will either disappear or be absorbed. Further closures and production relocation are expected to follow in order to reduce the overcapacity as well as to enable base material manufacturers to start making a profit again.²⁰⁸

²⁰⁴ Csimilano

²⁰⁵ Pfeleiderer (1)

²⁰⁶ Ibid

²⁰⁷ George Carter (2003)

²⁰⁸ Surfacing magazine

It is believed that the countries of Western Europe will recover from the current economic slump just to face an even greater recession in ten years derived from the difficulties to sustain an ageing population and social programs which will affect all industrial sectors.²⁰⁹ Overall these competitive conditions demand better practices in terms of cost efficiencies, international coverage, attention to emerging markets and complete product ranges to remain competitive.²¹⁰

Eastern Europe is one of the regions with the best potential for further international business. In particular, Poland is one of the most potential markets to grow. According to Euroconstruct, Polish housing construction is expected to increase by about 14% whereas in Germany it is expected to decline by about 10% between 2001 and 2005. *“Today, the Polish market is experiencing continued growth and stable prices, with increasing export activities taking place with its neighbours. The neighbouring western European markets offer further growth through increasing export opportunities.”*²¹¹

4.1.4 Main competitors

Formica-PSM’s main competitors are global players such as Wilsonart International from the US, the Pfleiderer Group from Germany, Polyrey from France, Abet Laminati, Liri Industriale and Arpa Industriale from Italy. Wilsonart International and Pfleiderer Wood-based panels are the two most important actors; hence the presentations of these companies are more extensive than for the remaining competitors. Also, the amount of information available varied considerably for the different companies.

Wilsonart International



The company was originally established in 1956 in Temple, Texas, under the name Ralph Wilson Plastics, today one of the strongest players in the laminate industry worldwide. The company is a business unit within the engineered products of Illinois Tool Works Inc. (ITW) at Glenview, Illinois, a US\$10

Wilsonart main brands

Wilsonart Custom Laminate
Wilsonart Custom Performance Laminate
Wilsonart Gibraltar
Earthstone (solid surfaces)
Wilsonart Flooring

²⁰⁹ Floordaily.net (1)

²¹⁰ Pfleiderer (1)

²¹¹ Ibid

billion diversified manufacturer of highly engineered components and industrial systems.²¹² In September 2003, ITW stated that the third-quarter net income of the North American engineered division rose to US\$ 268,9 million, which meant an increase of 1%. The division has managed to offset weaknesses in the automotive segment with the strengths experienced in the construction, laminate flooring and kitchen countertops businesses.²¹³ The engineered division in North America accounted for a operating income of US\$533,459 in 2002.²¹⁴

Wilsonart International has 16 facilities and three production plants in North America that serve to more than 200 independent wholesale distributors around the world. The largest facility covers an area of almost 47,000 m². In addition, the company acquired the Arborite Company in Canada and has a strong market position in Australia, South Africa, and South and Central America.²¹⁵

In Asia, Wilsonart International has established manufacturing facilities in Shanghai, China, with distribution centres in Shanghai, Beijing, Guangzhou, Chengdu, Shen-Zhen, and Hong Kong. The manufacturing plant in Bangkok, Thailand provides access to the ASEAN markets of Southeast Asia.²¹⁶ In Europe, the company acquired the leading German decorative brand, Resopal GmbH providing a good platform for future growth along the continent. In addition, with the recent acquisition of the British producer of residential worktops, the company has the opportunity to develop this market and further strengthen their position in Europe.²¹⁷

The company has stated that it will continue to grow through major off-shore investments both with Mergers and Acquisitions and Greenfield operations. Furthermore, they will continue to invest in Research and Development to improve the performance and aesthetic characteristics of decorative laminate as well as the creation of new surfacing products offering better performance to customers.

²¹² Annual Report 2002 ITW

²¹³ Ntlfloortrends

²¹⁴ Annual Report 2002 ITW

²¹⁵ Wilsonart

²¹⁶ Ibid

²¹⁷ Ibid

Pfleiderer Wood-Based Panels (PWP) belongs to the Pfleiderer Group in Germany. PWP manufactures raw particleboards and surface-finished products such as direct-coated particleboard, melamine faced board, decorative materials, high-pressure laminates and post-forming elements. The products are represented by well-known brands including Duropal, Thermopal, Innotec and Eltec. The company conducted a reorganisation in August 2003, launching the Wodego brand representing carrier material, surface-finished decorative panels, laminates finishes and HPL elements. The collection has about 266 decors and 200 dealers and medium-sized industrial customers. The main product within the Wodego family is the well-known Duropal brand for worktops and HPL for heavy-use surfaces.²¹⁸

The company has nine production facilities, six in Germany and two in Poland and altogether the division has 3,452 employees. A considerable amount of the total sales is generated outside Germany, and one third of the sales within the country account for chipboards and HPL. The company is market leader in the direct-coated particleboard segment with 24% of market share. In Poland, the company has 30% of market share within the

direct-coated particleboard segment, which accounts for 50% of the sales. The establishment of central warehouses in Germany has allowed the company to serve short notice orders, which has helped them to reduce costs. Industrial buyers within the furniture industry are the largest customer group in Germany, accounting for 35% of the company's sales, whereas an additional 29% of the sales are gained through exports, particularly to the Benelux countries, the UK, France, Denmark and Austria.²¹⁹

Sales

€ 723.5 Mn (2001)

€ 697.5 Mn (2002)

52% of the sales generated outside Germany

31% of the sales in Germany are HPL and chipboards

Production 20012.1 Mn m² raw particleboard61.7 Mn m² direct-coated board25.6 Mn m² HPL6.5 Mn m² post-forming elements and block board²¹⁸ Pfleiferer (3)²¹⁹ Pfleiderer (1)

In 2002, the company experienced a decline of 3.6% in comparison with last year's result. However, strong export activities helped the company to compensate the decrease, with a considerable amount of sales coming from outside Germany. Earnings before interest, taxes, depreciation and amortisation (EBITDA) were down by 33.6% to €70.6 million whereas earnings before interest and taxes (EBIT) were also down by 50% to €31.9 million. Despite all this, with rather unfavourable market conditions PWP is one of the most profitable suppliers, with a ROCE of 7.9%.²²⁰

During the first half of 2003, the PWP achieved sales of around €354.3 million, from which €88 million Euros were obtained through the Polish plants which have increased their sale by 15% and a return on sales of 10% with regards to last year performance. The German market seems to be in a downturn period that has affected the performance of the company's strongest segment, the kitchen and office furniture industry where sales decrease by around 7.7% in the first half of 2003. To offset the weak state of the German market, the company will concentrate on exports and plans to establish a foreign production in Nowgorod, Russia in 2005. Furthermore, it plans to strengthen its position within Eastern Europe, especially within the blooming construction sector in Poland through its local production sites or by greater export volumes.²²¹

Polyrey



Polyrey was founded in 1956 and has 900 employees along its six European business units located in London, Breda, Dusseldorf, Brussels, Barcelona and Vélizy. The company has three production facilities located in Couze and Ussel, France, and one in Barcelona, operating with the certification ISO 9001v2000, and a distribution network covering 80 countries around the world. The laminate line includes 300 decors, of which 253 are in the Tendance collection for creative fittings, and 42 in the Classique collection for every day fittings. These are represented by the brands Polyrey HPL, Polyform worktops, back splash and door blanks and Polyrey HPL for chipboards.²²²

²²⁰ Pfleiderer (1)

²²¹ Pfleiderer (2)

²²² Polyrey

Abet Laminati

ABET LAMINATI

The company was established in 1957 and the main brands are the Abet Collection, Print HPL, Foldline and Pral Material. The production facility covers an area of 220,000 m², with 11 soaking machines producing 270 tonnes of semi-processed materials for Print HPL and Fold-laminates. In addition, an output of 160,000 m² of high-pressure print laminate and continuous Fold-laminate is produce on a daily basis. Every year, 30 million samples of Print HPL and Fold-laminate are produced and shipped out.²²³

Albet Laminati sales organisation is arranged as follows²²⁴:

- Branches are in France, Germany, the UK, the Netherlands, Poland, Switzerland, Spain, and Italy.
- Representation offices are in Belgium, Denmark (Norway-Sweden), and Russia.
- Distributors are in Austria, Bulgaria, Croatia and Slovenia, Denmark, Finland, Greece, Iceland, Ireland, Malta, Norway, Portugal, the Czech Republic, Russia, Sweden, Turkey.

Liri Industriale

The company was found in Torino, Italy in 1955. Liri Industriale has 9 pressers producing about 79,000 m² of laminate on a daily basis. The company's is present in 60 countries around the world, offering over 500 laminates. It has sales representation in Europe located in Austria, Belgium, Belarus-Kasakistan-Kirgiztan-Russia-Ukraine, Bulgaria Cyprus, Czech Republic-Slovakia, Denmark, Finland-Lithuania, Germany, UK-Ireland, Greece, Hungary, Israel, Yugoslavia, the Netherlands, Norway, Poland, Romania, Switzerland, Turkey-Turkmenistan-Uzbekistan.²²⁵

²²³ Abet Laminati

²²⁴ Ibid

²²⁵ Liri Ameirca



Arpa Industriale

Arpa Industriale was established in Italy in 1954. The company's distribution network consists of branch offices, stores and technical agents to the customer base within the furniture industry, interior decoration, ship building, fitting, building industry. Under the Arpa brand, there are 11 collections, more than 400 decors, 30 finished and 8 different sizes, plus special production when required.²²⁶

4.1.5 The Swedish market

High-pressure laminates and other surface materials can be found in about any interior surface. Therefore, trends in the construction sector are relevant to look upon for both residential and commercial purposes.

In Sweden, it has been estimated that the volume for residential and non-residential building would decrease by 0.2 % in 2003, where the market will most likely continue developing as previously in the R&M residential market. It has been estimated that in 2004 the volume of building will increase as long as a growth rate of about 2% per year between 2003 and 2005 is preserved. This implies the construction of approximately 20,000 units of new residential buildings. The market still seems cautious in this sector, especially of new apartments.

Market trends residential building

2003	€ 13.464 Mn
2004	€ 13.898 Mn

Market trends non-residential building

2005	€ 14.171 Mn
------	-------------

Regarding the non-residential sector, investments will increase to 4.9% whereas the civil engineering sector will increase to 3.8%. In 2005 the market will continue to grow, the building sector will increase a further 2%. Non-residential investments will increase by 0.9%, the R&M residential market by 1.4% and the non-residential 1.9%, and the civil engineering sector will have a further increase of 4%.²²⁷

²²⁶ Arpa Industriale

²²⁷ Euroconstruct Conference

4.2 Formica Corporation

Formica was founded in Cincinnati in 1913. The global headquarters used to be located in Warren, N.J. but have now been relocated to the Greater Cincinnati area in September 2003.²²⁸ Today Formica Corporation, with more than 4000 employees at operations in North America, Asia and Europe, has its core business in the high-pressure laminates, solid surfacing material, laminate flooring and other decorative surfacing products.²²⁹ The founders of the company, Daniel O’Conor and Herbert Faber, former employers at Westinghouse, invented a substitute product for the layered mineral called mica used as an electrical insulator in those years, inventing in that way also the name of the company (“for mica”).

The first market was the manufacture of insulators for automotive electric starter motors, and during the World War I the business extending to insulating parts for military radio systems. Plastic laminate gears were marketed to fast growing automobile companies and textile machinery producers. The first decorative application for plastic laminates took place also in the radio industry, printing realistic wood grain patterns onto the surface of a plastic laminate and selling this for use in the production of radio cabinets. The product gained rapid acceptance due to its great resistance and lower prices in comparison with real wood panelling, but also because of its application in the construction of the New York City Musical Hall and the luxury British ship, the Queen Mary.²³⁰

A major development within the industry was the introduction of the melamine resins in 1938 as they were more transparent, durable and moisture-resistant than the resins used. Its transparency allowed the development of a much wider variety of colours and designs. The 50’s and 60’s was the golden age of Formica resulting from the possibility to post-form plastic laminates by applying heat after its manufacture, giving the opportunity to produce and adapt to different shapes.²³¹

The industry gained many important players, among them Westinghouse, Wilsonart, Nevamar and Pionite resulting in the maturity of the plastic laminate technology. Competition and market share was obtained mainly through marketing and innovation in design. As a result, costs increased considerably

²²⁸ Cincinnati.bizjournals

²²⁹ Formica (1)

²³⁰ Kbdn.net

²³¹ Ibid

whereas the product was perceived as outdated and generic. In addition, other surfaces such as solid surface materials entered the market increasing competition and forcing Formica to offer a solid surface line, which at the beginning faced difficulties and was forced to withdraw but came back by taking over Fountained from Nevamar.

Formica Corporation's greatest strength is the Formica brand name since at least in traditional markets such as the US, Latin America and in many countries in Europe, the brand name has become a generic name for all decorative laminates.²³² Moreover, the Formica brand name is one of the most frequently specified brands of HPL among architects, designers, contractors, shop fitters, home builders and manufacturers of finished products. Formica's product line includes HPL, low-pressure laminates, solid surfacing, special metallic laminates, wood veneer laminates, printed papers, foils and other related materials.²³³

Throughout the world, the Group has twenty manufacturing facilities selling its products in more than one hundred countries, being one of the largest sellers of HPL in major markets such as Brazil, Canada, China, Finland, France, Spain, Sweden, Taiwan, Thailand, the UK and the US. The Group entered Europe in 1946, where the European companies function as subsidiaries of Formica Corporation. The three main regions, North-South America, Asia and Europe, have operated very independently and with limited contact with each other.²³⁴

The Formica products are marketed to manufacturers of finished goods, as well as to architects and designers who specify the brand for commercial and residential interiors. This is performed by an international network of independent dealers and by the Formica Corporation's own sales force. The Group has approximately 350 sales representatives with 400 distributor locations and a further 10,000 sub-distributors and dealers worldwide.²³⁵

Organisational Structure

As a result of a management buy-out in May 1985, Formica Corporation became part of the Group Shearson Lehman. In 1995 the Group went through another ownership change and in 1998 Formica Corporation was acquired by a strategic

²³² Kbdn.net

²³³ Formica (1)

²³⁴ Jörgen Bergengrip (2003)

²³⁵ Formica (5)

investor group consisting of Donaldson, Lufkin and Jenrette (DLJ), CVC Capital Partners and Citicorp Venture Capital.²³⁶ In the last years, Formica Corporation has pursued and it will continue to grow by mergers and acquisitions of innovative companies whose products can be sold through the distribution channels of Formica Corporation.²³⁷

Formica Corporation has gone through three major reorganisations in 1989, 1994 and 1998, but regardless of these strategies the Group has faced losses in the past seven years. Moreover, the Group has faced serious external and internal challenges due to the economic recession in the US and the derived impacts of the September 11th tragedy. On March 5, 2002, Formica Corporation reached an agreement with its lender bank group on a credit facility to support the ongoing business operations of the Group. The credit facility augmented the Group's cash on hand of approximately US\$22,000,000 for working capital, capital improvements and restructuring expenses of the Company and its international affiliates. To conduct this restructuring the company announced a reorganisation under the Chapter 11 of the US Bankruptcy Code, allowing it to continue operations while restructuring its debts. Subsidiaries outside the US were not influenced by the filing. Regarding these actions the President and Chief Executive Officer of Formica, Frank A. Riddick III stated that:

“These actions would enable to reduce the Company's burdensome loan obligations and related interest expense, strengthen our balance sheet, invest more of the Company's resources in growing and improving the business and compete more effectively. We are confident that Formica will emerge from this process as an improved business.”²³⁸

To implement the restructuring of Formica Corporation's balance sheet and to successfully emerge from the Chapter 11, the Group signed a stock purchase agreement with an investment group sponsored by Cerberus Capital Management L.P. and Oaktree Capital Management LLC in August 2003, under which they have committed to invest US\$175 million in the company. This stock purchase agreement in combination with the proposed reorganisation plan would provide a reduction in the outstanding amount of the company's secured bank debt from over US\$300 million to approximately US\$127 million, utilising US\$173 million of the US\$175 million investment.

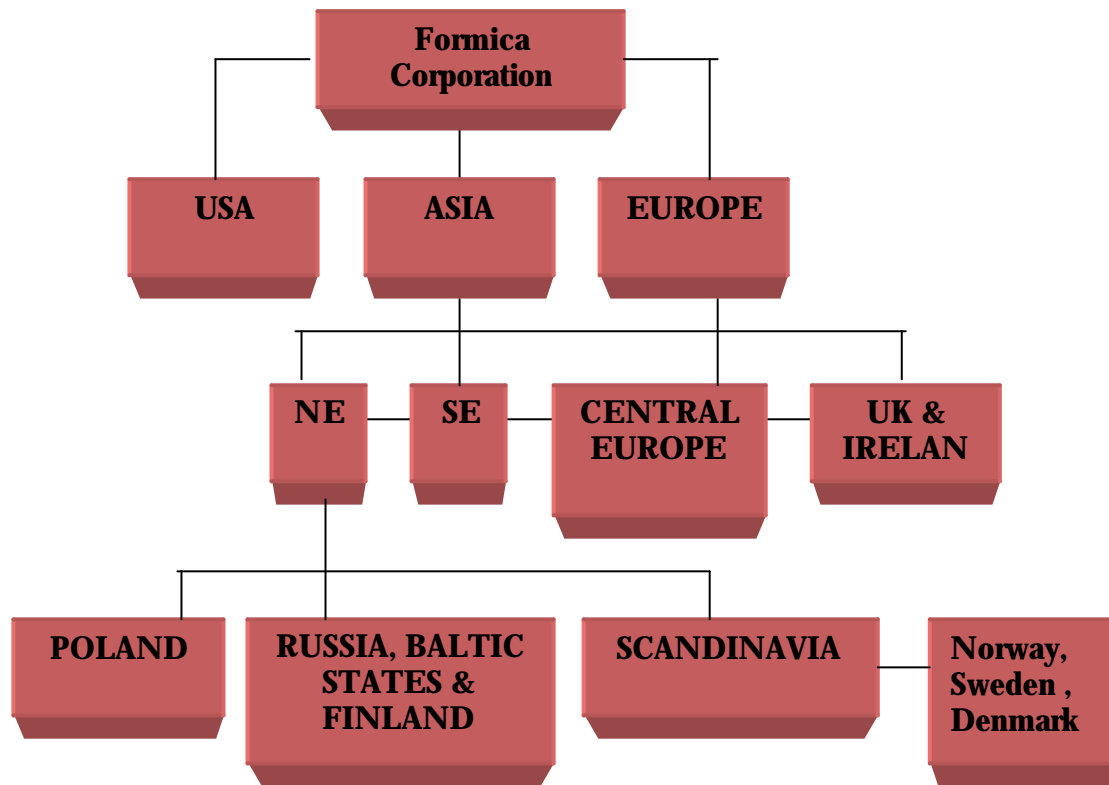
²³⁶ Formica (1)

²³⁷ Formica (5)

²³⁸ Formica (4)

The plan would also provide for the elimination of US\$215 million in pre-Chapter 11 unsecured bond debts. Formica Corporation expects to emerge from the Chapter 11 before the end of the first quarter of 2004.²³⁹ The reorganisation of the corporate structure was completed in 2003 which is presented in Figure 4.1.

Figure 4-1 Corporate Structure



Source: Jörgen Bergengrip (2003)

4.2.1 Formica-PSM

“We will be our customer’s first choice for Decorative Surfacing Solutions by having a well trained, organised and action oriented Sales Team that acts with integrity and speed so that Formica and its customers mutually meet our sales and profits goals.”²⁴⁰

In Sweden, Formica is present by its subsidiary Formica-PSM, which is the result of Formica’s acquisition of Perstorp Surface Materials (PSM) in 2000. At present, a restructuring process is taking place in order to increase the advantages derived from a better integration and intercommunication among the subsidiaries in each region.²⁴¹

²³⁹ Ntlfloortrends

²⁴⁰ Formica-PSM Befattningsbeskrivning Kundservice

²⁴¹ Jörgen Bergengrip (2003)

The Perstorp Group was founded in 1884, not entering the laminate market until 1923. Nevertheless, by 1960-1970 the company had accomplished European market leadership. In 1999 personnel within the laminate division was informed that (PSM) was to be sold as a consequence of a board decision to sell out several divisions within the Perstorp Group to solely focus on speciality chemicals as the core business. Several companies were interested to acquire PSM. However, it was Formica Corporation who acquired the company as a way to reinforce its distribution network and international presence.²⁴²

The merger was completed on paper in April 2000, however the personnel believe that in reality there was not a real integration of both companies. Operations were conducted exactly as before, but with Formica and PSM products competing against each other as two independent brands with two different product collections. During this period, several high management officials left the company. In addition, the company has faced branding difficulties as the Formica brand is not known in the North European market. Furthermore, although both brands have been merged since 2002, customers continue to refer to PSM.²⁴³

Products

Formica's HPL is made of paper and resins. These papers are saturated with resins and dried, then stacked in layers and pressed under heat. While pressed under high-pressure, the resins are cured and the separated layers are merged into one single sheet of laminate.²⁴⁴ HPL are Formica-PSM's main product, targeting both the residential sector with solutions for kitchen units, worktops and bathroom vanity units, whereas the commercial applications refers to work surfaces, furniture, countertops and interior walls used in offices, airports, hospitals, schools, restaurants, hotels, shops, buses, leisure facilities and so on. Therefore, HPL are divided into five categories according their application: public environments, furnishing and furniture, transport, doors, exteriors, kitchens and bathrooms, all represented by the Formica-PSM collection, Worktops, Exterior and Impress.²⁴⁵

²⁴² Jörgen Bergengrip (2003)

²⁴³ Ibid

²⁴⁴ Formica (3)

²⁴⁵ Formica (7)

The customer base

The Formica-PSM customer base is divided into three segments: direct-buying customers, distributors and indirect customers, such as architects that specify the product. At present there is not formal strategy for the management of the customer base. There is though a key account team directed to the attention of the top ten customers, in which individual plans, budgets, and actions plans are determined. Yet, this key account approach is not applied to the remaining customer base. There are some very small accounts in which the company is currently investing, receiving only occasional and small orders back.²⁴⁶ According to Formica-PSM, the problem that has hurt the most is the accuracy of the deliveries, particularly after the merger when the collection of products became very broad making it difficult to provide consistent service.²⁴⁷

All Formica-PSM customers are contractual buyers but there are a few special cases of customers that buy more sporadically. These customers have been heavy buyers or medium-sized customers in the past, but for different reasons they are not buying to the same extent as before. Still these customers continue buying from Formica-PSM due to their historical contact, but new customers of this kind are not been targeted.²⁴⁸ From Formica-PSM database of orders placed in the last 1½ year we determined that 48% of the customers buy one to five times a month, and 11% buys more than five times. From the remaining percentage, 33% of the customers place less than one order per month and 5% have not bought from Formica-PSM in the last 1½ years.²⁴⁹

Purchasing frequency of the direct-buying customers

11% buy more than 5 times/month

48% buy 1 to 5 times/ month

33% buy less than once a month

5% have not purchase in the last 1½ years

Formica-PSM uses two different systems to generate customer information, the marketing information system and a system with invoice-related data. The marketing system contains records on customers that have been visited by sales personnel, have received product samples or buy the Formica-PSM products. The invoice system was restructured one and a half years ago, which implies that

²⁴⁶ Jörgen Bergengrip (2003)

²⁴⁷ Ibid

²⁴⁸ Ibid

²⁴⁹ Formica-PSM system with invoice-related data (2003)

customers that have not bought since then are not included in it. As the systems work independently, a similar restructuring has not been made to the marketing information system.²⁵⁰ As a result, the marketing information system is less updated as still contains customers that are no longer contractual buyers.

Formica-PSM offer special services in terms of warehousing and packages to some major customers, two of them are included in our study, while other customers with special packaging requirements are charged extra for this service. From the direct-buying customers, B and TT have stock of compact sheets valued in US\$1 million SEK in Formica’s warehousing free of charge and this adds costs of managing the stock.

According to Formica-PSM representatives, customers are demanding more and more special packaging and that reduces efficiencies of stock. This is part of the service Formica-PSM is willing to offer to its customers, but if this is reducing the level of efficiency of the stock it may be important to determine whether the price charge for this is actually “fair” or whether the company has the resources to undertake such a responsibility.

Until October 2003, the company registered 284 finished claims at a cost of \$800,000 SEK. At the moment, there are 58 on-going claims but the cost has not yet been calculated. The complaints embrace both administration and product related issues such as errors in services, discounts and products. Each of these complaints represents a credit account that is generated to the customers, and this is measured in relation to the net sales. Table 4.1 summarises the number of claims of

Table 4-1 Direct Buying Customer Claims

Direct Buying Customers with open claims	Number of claims
P	1
BBB	1
UU	1
R	2
X	1
LL	1
PP	1
RR	1
TT	3
AAA	1
QQ	2
MM	1

Source: Lena Wehlin (2003)

each direct-buying customer with open claims. The target is to reduce the rate of complaints to 1%, and this number is based on the rate in other production industries, which is among 1.5 to 3%.²⁵¹

²⁵⁰ Leif Sigbo (2003)

²⁵¹ Lennart Nilsson (2003)

The company has approximately 800 orders per week that with today's rate of mistake of about 1.3%, implies that there would be 10 orders with the wrong specifications per week. Formica-PSM is actively targeting the sources of complaint by running different projects, where one has been to improve the order errors, orders sent from the warehouse and a current project is to analyse what generates transportation damages. An additional problem is the information system of the customer agreements, where it has been difficult for the customer service personnel to find the right discounts and agreements for each customer. This will however be improved by the new pricing strategy presented further on in this section.

There are four customers that have overdue payments one of which is 60 days late, two are 90 days late, one has been late for more than 90 days, and two customers are behind payments at 60 and 90 days. Table 4.2 presents the list of customers with bad payments.

Table 4-2 Overdue Payments

Customer	Outstanding	Current Balance	0-30	31-60	61-90	over 90
RR	61636.55	2542.26	0	-	10312.58	24 094.96
K	21446.40	-	0	-	-	21 446.40
UU	111493.12	21631.32	22796.55	3440.06	15068.03	48 557.16
AAA	302026.30	79196.65	122117.55	36344.91	64367.19	-
Total						94 098.52

Source: Urban Hector (2003)

Sales organisation

The Swedish sales force is composed of five salesmen each responsible to cover a specific geographic district: Southwest, Southeast, East, Stockholm and North. However, customers in the North region are visited every third week.

The sales force was originally composed of six persons; however, one of them was recently moved to another position in the company. The sales force works without commission and on a rather independent basis. Only one of the salesmen is located in the office at Perstorp. As mentioned previously, sales are registered in one computer system that covers all customer purchases in terms of invoice related information.²⁵² The system does not include any costs related to serving

²⁵² Hans Lindegård (2003)

each customer, for instance costs of fulfilling free of charge special order requirements nor any information related to claims.

Customer service

In 2003, Formica-PSM expanded the functions within the customer service department, which is part of the sales organisation. This restructuring was necessary as customers saw this as a condition to continue collaborating with the company. Today the department has five employees whose main purpose is to “*deliver Formica’s laminates and complementary products to customers with the best service possible.*” To achieve this, the main function of the department is to provide help and support to the sales organisation in terms of order administration. This means reception and register of orders from customers, follow up deliveries, support to the Swedish sales organisation with contractual agreements, statistics and sending out product samples, holding contact with the stock, logistic and purchasing and handling claims with help of the internal claims system SUMAC.²⁵³

Stock and transport

The functions of this department are to assure the correct level of stock for normal sales and requests and to secure lead times for on time deliveries. Therefore, the department has close contact with customer service to inform about lead times and production possibilities to cover requested orders. Furthermore, this department is responsible for adding orders to the system, packing and placing the orders to customers, as well revising that correct products, colour and quantity are placed in the right date.²⁵⁴

The department is also in charge of dealing with internal and external suppliers. The first ones refer to those forming part of Formica Corporation all over Europe. However, the company also purchases several articles and accessories from external suppliers.²⁵⁵

Formica-PSM commanded a study to a specialist consultancy agency in order to investigate potential cost savings on stock and transport, which concluded that it

²⁵³ Formica-PSM Befattningsbeskrivning Kundservice

²⁵⁴ Karin Lindh (2003)

²⁵⁵ Ibid

is not possible to save costs related to transport when compared with the level of service Formica-PSM is willing to provide.²⁵⁶

Marketing department

The marketing department constitutes of three persons, the Marketing Director and two managers, one acting as responsible for the Scandinavian market and the other responsible for advertising and sales promotion. Among their main activities are the development of marketing plans and strategies based on the product lifecycle as well as special promotions, price strategies and promotion material.²⁵⁷ Therefore, it can be said that the activities of the department are organised following the traditional marketing management based on the 4 P's.

Pricing strategy

Prior to the acquisition of PSM, the company did not work under any formal pricing strategy, meaning that prices and discounts were determined in accordance with the deal or the customer in question. The need for a clear definition of price and discount plans was noticed before, however it was delayed as a result of the restructuring process derived from the merger process. A new price strategy is to be implemented in 2004, where the amount of the discount given to customers is dependent on the annual purchasing volume they have, moving from 10% to 30%. Direct buying customers must have a minimum of \$300,000 SEK in purchasing volume in order to gain access for a discount. In addition, for individual transactions the price will be established according to the volume of the purchase, with a minimum of 100 white sheets, moving from 5% to 10%. However, this strategy is still under consideration.²⁵⁸

Currently the majority of the direct-buying customers have up to 30 days of credit, only a few customers have 45 and 60 days, respectively. However, within this there are other benefits offered to customers. For instance, the credit time may start counting from the invoice date or from the date the invoice was received, or having a credit line together with a free month of deliveries.²⁵⁹

The organisational structure of Formica-PSM is presented in Figure 4.2.

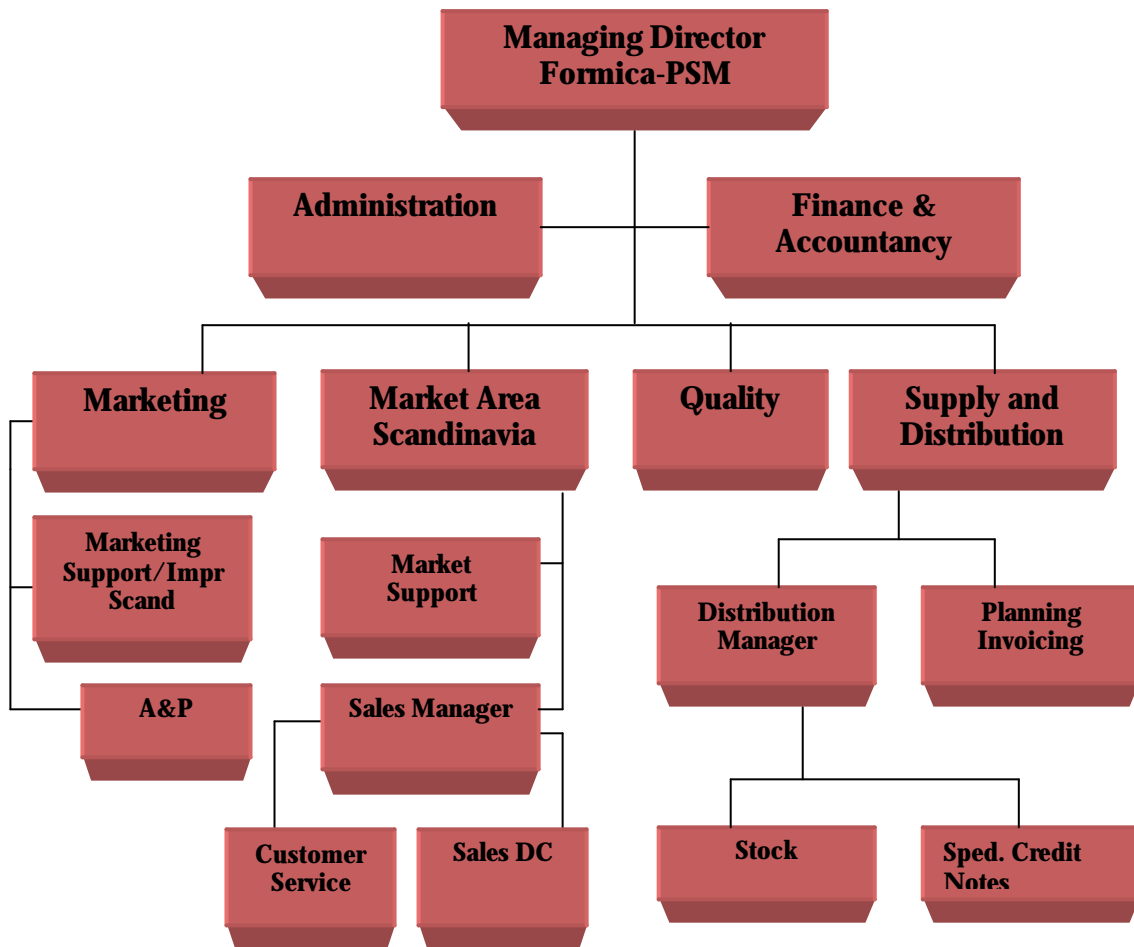
²⁵⁶ Karin Lindh (2003)

²⁵⁷ Jörgen Bergengrip (2003)

²⁵⁸ Hans Lindegård (2003)

²⁵⁹ Ibid

Figure 4-2 Formica-PSM Structure



Source: Jörgen Bergengrip (2003)

5 The customer survey

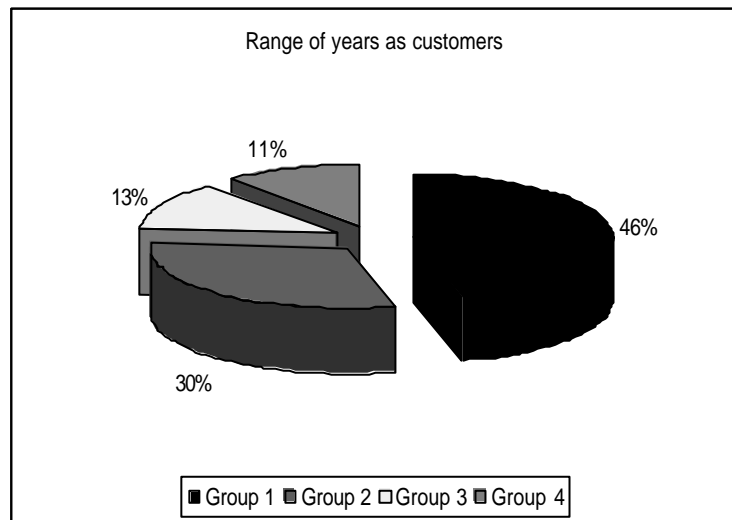
This chapter intends to present our empirical findings based on the data collected from the mail survey. The aim is to determine the main relationship characteristics, which will be tested in relation to profitability in the analysis chapter, and also constitutes a basis for categorising the direct-buying customers. The results are presented under the heterogeneity and exchange characteristics presented in the frame of reference, where the exchange characteristics are divided into the six areas of relationship characteristics that were presented in the same chapter.

5.1 Heterogeneity characteristics

The first aspects that we considered when evaluating the direct-buying customers were the heterogeneity characteristics, which involve the amount of years as customer and their annual turnover.

Graph 5-1 Group Years as Customers

As can be seen in Graph 5.1 it is possible to observe the presence of four groups of customers according to the amount of years they have been served by Formica-PSM. The results illustrate that of the 54 companies, a majority belong to group one which includes companies that have been customers



between 0 to 10 years, followed by customers in group two that are between 11-20 years old. The third largest group are customers with a range between 21 to 30 years. Finally, the smallest group of customer includes customers that are more than 30 years old.

According to the data collected, it is possible to mention that although the largest group corresponds to the customers that have worked with the company between 0 and 10 years, it should be taken into consideration that ten years is also a significant amount of time. These customers still have time to continue developing to a much longer relationship. This is a good indicator for the company as these types of relationships are more likely to continue over a longer

period due to the level of experience and trust shared, and the adjustments made; all this, allowing companies to achieve a higher and better degree of fit.

Turnover is an important aspect to look at since it is arguable that a company's turnover can be an indicator of its future growth and purchasing potential. We also think that the profitable lifetime duration of a customer can be related to the income of the firm. From the results obtained, customers were categorised on the basis of annual turnover in 2002. The categorisation is based on the European Commission Recommendation (96/280/EC) of 3 April, 1996, which concerns the definition of small and medium-sized enterprises [Official Journal L 107 of 30.04.1996]. The present EU recommendation establishes that small enterprises should have an annual turnover not exceeding \$62,979,000 SEK, whereas the annual turnover of medium-sized enterprises should not exceed \$359,880,000 SEK.²⁶⁰

However, as a considerably amount of Formica-PSM customers have a relatively low turnover compared to these standards, this definition needed to be adapted to our research situation. This meant that we extended the number of categories to four, in order to obtain a more realistic distribution of customers in each group. The distribution is presented in the Table 5.1.

Table 5-1 Categorisation on Customers' Turnover 2002

Definition of small, medium-sized and large companies				
	Category 1	Category 2	Category 3	Category 4
Turnover 2002 in SEK	0-50 Mn SEK	51-100 Mn SEK	101-200 Mn SEK	201 – Mn SEK
Number of customers	34	13	3	3

It is possible to observe that under this categorisation the majority of Formica-PSM direct-buying customers are small and medium size companies. 64% have a turnover below 50 million SEK and where 24% have a turnover between 51 to 100 million SEK. The remaining 12% is divided between group 3 and 4 with 6%, respectively. It should be mentioned that only one company was not included in the calculation.

²⁶⁰ Europa.eu.int & SEB, Calculation from € to SEK was based on exchange rate 1 € = 8,997 SEK

5.2 Exchange characteristics

The exchange characteristics include the relationship duration, interdependence, switching costs, customer perception of value, loyalty, trust and commitment. Within these sections we have included the exchange characteristics suggested by Reinartz and Kumar (2003).

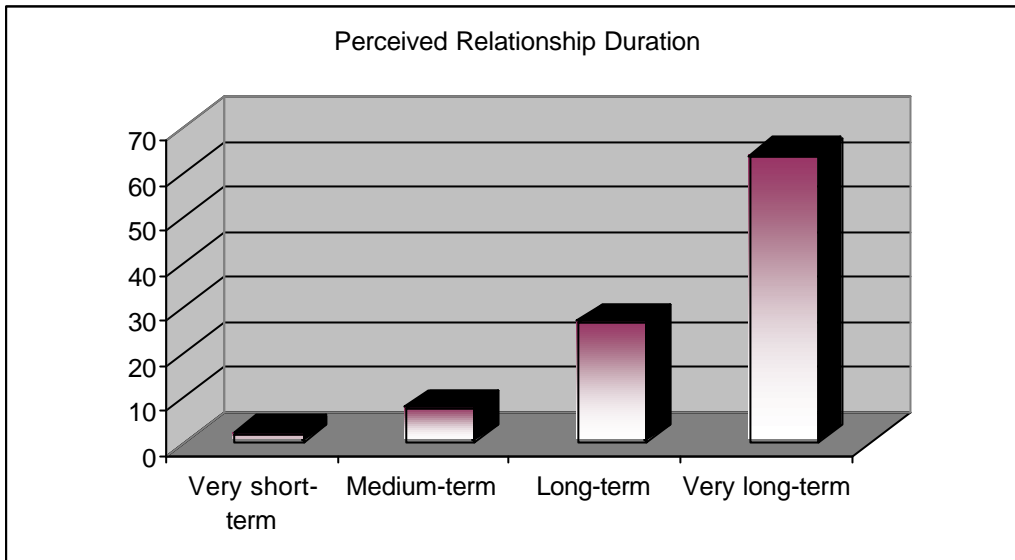
5.2.1 Relationship duration

Customer time orientation

The time orientation of each customer needs to be assessed as long-term oriented customers will value different aspects than the short-term oriented ones, which should be considered in order to apply the appropriate marketing tools. In order to investigate the time orientation of the customers, the questionnaire included questions on what time-orientation the customers prefer in a supplier relationship, the perceived duration of the relationship with Formica-PSM, and whether the duration of the relationship was a reason for remaining a customer.

The results from the study show that a dominant majority of the customers generally prefer a long-term orientation when dealing with their suppliers, while very few customers prefer short-term oriented supplier relationships. Furthermore, as illustrated in Graph 5.2, a majority of 90% of the direct-buying customers perceive this relationship to have a long-term orientation. Out of this 90%, 63% qualified it as very long-term and 27% refer to it as long-term. Additionally, 8% of the customers think that the relationship has medium-term duration and 2% refer to a very short-term perspective.

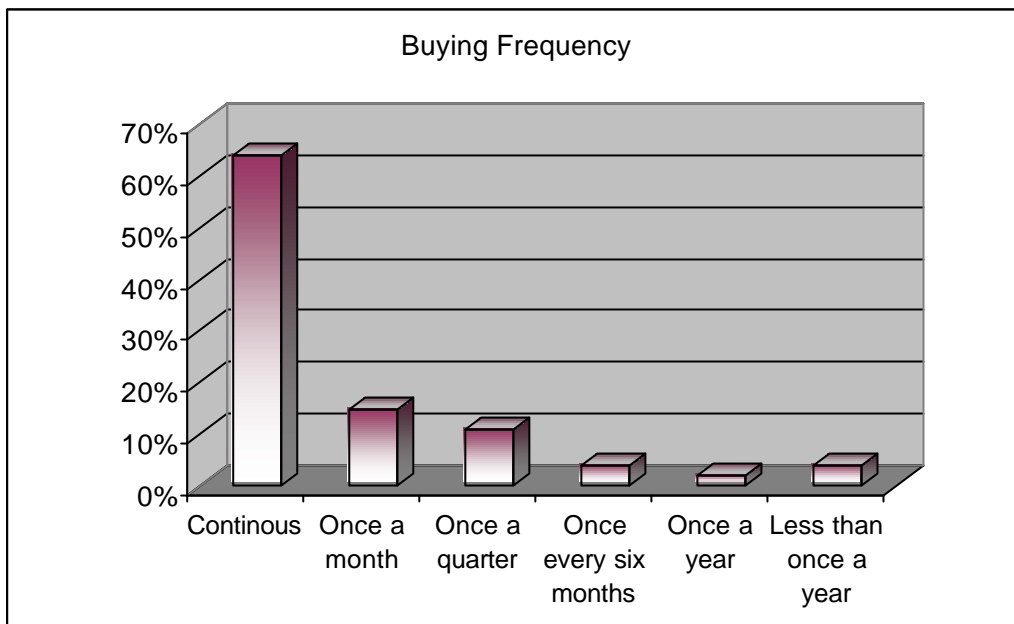
Graph 5-2 Perceived Relationship Duration



Furthermore, the relationship duration is perceived to be a reason for being a Formica-PSM customer. The attitude towards the statement “*The relationship duration is a reason for being a Formica-PSM customer*” was positive among a majority of the customers, where 21% totally agreed and 56% partly agreed with the statement. 17% were unsure about how important the duration of the relationship is for them to be customers of Formica-PSM. The remaining 6% had a negative attitude towards this statement, where 4% partly disagreed and 2% totally disagreed.

As noticed in Graph 5.3 presented below, it is possible to observe that the majority of customers tend to have a continuous buying frequency as many as 64% stated this kind of buying behaviour, whereas 26% tend to buy once a month and once a quarter. As many as 4% buy every six months, 2% once year and the remaining 4% less than once a year. The contact frequency follows a similar pattern, where many as 75% contact the company everyday, once a week or at least once a month. The remaining 25% are divided in 17% contacting the company once a quarter, 2% once every six months and 6% once a year.

Graph 5-3 Buying Frequency



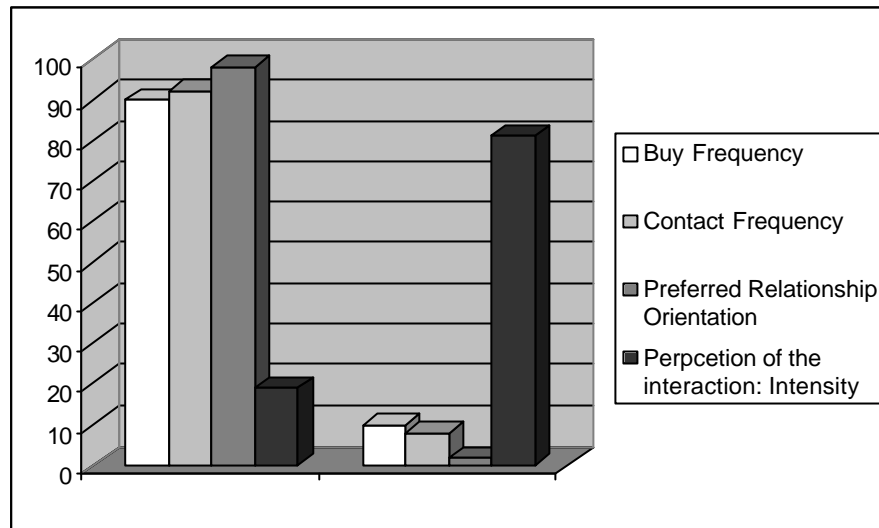
These are interesting results, since after identifying that customers have a rather high frequency of buying and frequency of contact, and a preferred long-term orientation in their relationship with suppliers, we expected this to have some impact in their perceived intensity of interaction. The fact that this is actually not the case may indicate that just because customers have a long-term orientation and regard their frequency of purchase and company contact as high does not necessarily mean that customers will interpret the relation as intense.

When assessing the intensity of the relationship, it was particularly surprising to observe that many as 65% of the customers found it difficult to define whether the intensity of the relationships with Formica-PSM is either superficial or intense. Further, the results show that the remaining 35% have divided opinions from which 12% referred to the interaction as partly intensive and 6% considered it intensive. On the other hand, 13% perceived the relation to be partly superficial, and 4% referred to it as superficial.²⁶¹

Graph 5.4 shows that when customers have a high purchase frequency, high contact frequency and consider their relationship to be long term, they still tend to perceive a rather low intensity. It seems the relative perceived intensity is actually higher when they have low purchase and contact frequency and see their relationship as short term.

²⁶¹ From the 54 interviewed companies, 48 answered this question, leaving a total of 6 missing cases.

Graph 5-4 Summarised Findings from the Section



The results from this section show that the customer base is relatively homogenous in their perception of the duration of the relationship, which is actually a rather common characteristic in a B2B setting. A considerable share of the customer base are long-term oriented in their relationship with Formica-PSM, which means excellent opportunities to develop a loyal customer base that will stay with Formica-PSM for a long time and contribute to securing future revenues. However, it is important to notice that the fact that there are customers that are unsure or just partly agree that the relationship duration is an important reason for being a Formica-PSM customer, indicating that there are other reasons besides duration for them to be customers.

5.2.2 *Switching costs*

- | |
|--|
| <p>Investments</p> <ul style="list-style-type: none"> - Investment actions - Exposure - Knowledge <p>Facility to change a supplier</p> |
|--|

From the social exchange perspective, investments are important determinants for customers' decision to stay or exit a relationship. These investments involve economic and non-economic resources in terms of emotions, time, effort and money as well as shared activities, common personal contacts and property. Over time, these investments become increasingly important as they enable the creation of barriers preventing customers from leaving the relationship. The higher the

level of investments, the greater the value derived from the relationship, resulting in a high degree of switching costs.

Thus, switching costs are of crucial importance to any company as they are a source of market power and economic profits. In the study, these switching costs were examined in terms of the investment actions, exposure and knowledge undertaken both by customers and Formica-PSM. The first type refers to all transaction specific investments that can contribute to the development of the relationship as it indicates a certain willingness to adapt to the specific relationship and includes all kind of investments in people, lasting assets and procedures. Exposure implies the risk that organisations and buyers face when selecting a vendor, and are less tangible kind of costs and can be classified into three categories: financial, performance and personal. Finally, knowledge refers to all the learning costs that are incurred when getting to a particular relationship derived from the interaction between the parties.

The investment actions, exposure and knowledge were studied from the customer’s perspective. This implies that customers were asked to specify the type of investments they have undertaken in the relationship with Formica-PSM. Furthermore, customers were asked to specify what investments they considered Formica-PSM has put into the relationship, in order to evaluate the customer perception of the balance of adaptation and commitment between the parties.

The Investments

To determine the customers’ perception regarding their monetary and non-monetary investments in the relationship with Formica-PSM, seven investment actions were evaluated which are shown in Table 5.2 together with the number of times each aspect was mentioned.

Table 5-2 Customer Investments in the Relationship

	Times mentioned	Percentage
Knowledge	30	59% of the time
Personal contacts	17	33% of the time
Long-term assets	16	31% of the time
Money	14	27% of the time
Time	11	22% of the time
Processes	6	12% of the time
Personnel	6	12% of the time
Other	6	12% of the time
None	8	16% of the time

The results show that customers perceive knowledge, personal contacts, and long-term assets as the most important aspects in which they have invested to develop a relation with Formica-PSM. It is interesting to notice that customers do not evaluate their investment totally on monetary terms. These aspects are considered as customers switching costs and are therefore the aspects that Formica-PSM should be concerned about when developing relationships with its customers and the ones to be stressed to increase the difficulty to replace Formica-PSM as a supplier. However, money and time are also very relevant and should not be disregarded.

Additional to these 7 alternatives, “other” and “none” alternatives were included. The “other” alternative provided the respondents the possibility to add a comment. This alternative was mentioned 12% of the time and among the comments stated were “*quality*”, “*brand recognition*”, “*closeness*” and “*products*”. The second additional alternative referred to “none” so customers had the possibility to express whether they had not invested in the relation, and this alternative was mentioned 16% of the time.²⁶²

The customers were also asked to specify the areas in which they perceived Formica-PSM has invested in the relationship. The results are presented in the Table 5.3.

Table 5-3 Perceived Supplier Investments

	Times mentioned	Percentage
Knowledge	18	43% of the time
Personal contacts	19	45% of the time
Long-term assets	10	24% of the time
Money	10	24% of the time
Time	7	17% of the time
Processes	4	10% of the time
Personnel	3	7% of the time
Other	1	2% of the time
None	12	29% of the time

The results show that Formica-PSM is mainly recognised for its investments in *personal contacts* and *knowledge*. These results are consistent with the frequency of contact presented in the relationship duration section, which was regarded as high

²⁶² From the 54 interviewed companies, 51 answered this question, leaving a total of 3 missing cases.

with a majority of customers satisfied with the present contact frequency and no specific desires to increase it.

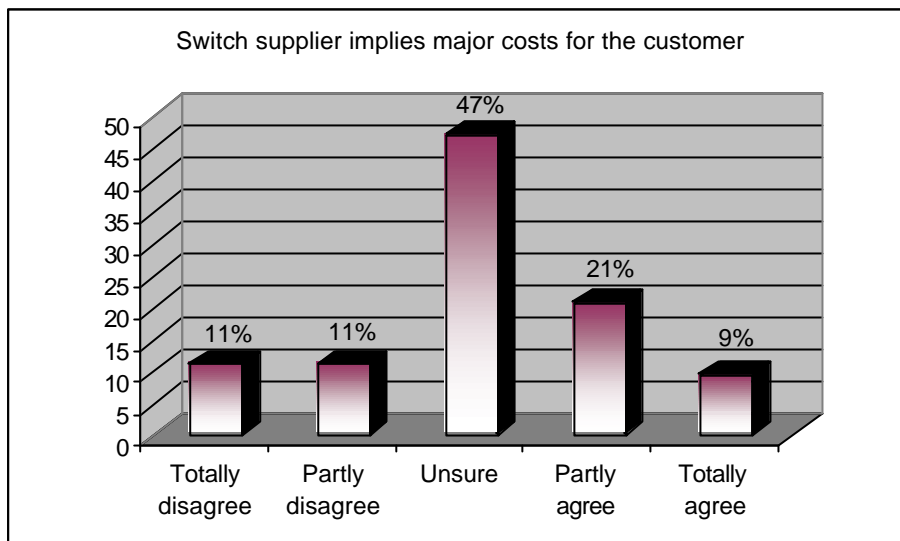
The fact that customers regard personal contacts as high investments could lead to the assumption that there have been established good relations with the personnel serving these accounts. However, only 7% think that Formica-PSM has invested in personnel for the specific relationship. Therefore, it seems that customers perceive a potential area of development for Formica-PSM.

Only one customer used the open question alternative mentioning “*providing machines*” as an investment from Formica-PSM side. Interestingly “none” was the third alternative most mentioned in the survey (29% of the time), whereas 12 companies (22%) did not respond to this question stating that they did not know. It was surprising to notice that both B and TT were among the companies not answering this question, as these companies are receiving special service from Formica-PSM, for instance the availability of having stock in the Formica-PSM warehouse.

Facility to change a supplier

Once the types of investments performed by customers and their perception of Formica-PSM investments in the relation were identified, it was relevant to determine if customers actually think that leaving Formica-PSM as a supplier would imply considerable costs. In this respect, the majority of the respondents turned out to be unsure whether a change of supplier would imply major costs for the customer. The remaining results present polarized stands, where 30% have a positive attitude towards this statement, meaning that changing a supplier would imply costs for the customer, whereas 23% have a negative position. These results go in hand with the findings in the previous section. If the company is not been able to communicate its investment properly, it is difficult for customers to feel they may lose from leaving the relationship with Formica-PSM. Graph 5.5 indicates these distinct view points.

Graph 5-5 Costs of Switching the Supplier



It can thus be concluded that a rather small share of the customers would be reluctant to replace the existing supplier, while a considerably amount of customers can possibly be lost if Formica-PSM does not manage to stress its investments in a more successful way. Further, this implies a risk that potential competitors acquire these customers from Formica-PSM. In order to prevent this scenario, the company needs to establish an awareness of what is gained from the relationship with Formica-PSM among the customers.

Personal contacts and knowledge are relevant characteristics of a long-term oriented relationship as they imply certain commitment as well as incentives to customers to remain in the relationship. These results, together with the fact that the majority of the customers prefer a *long-term orientation* in their relationships, represent a positive result for Formica-PSM. It is possible to conclude that the relational investments by Formica-PSM are not being properly communicated as these are not well-known among customers. While doing this, Formica-PSM should also stress its investments in long-term assets, money, time and processes as these were the least mentioned aspect by customers in the survey.

Overall it can be said that the rate of mention was higher on customer investments than investments by Formica-PSM, but they value more or less the same things.

5.2.3 Interdependence

Equity
Co-operation
Single or multiple suppliers
Costs and rewards

Customers and suppliers are often interrelated and depend on each other to a varied extent. The degree of interdependence is important to consider as it determines in what ways Formica-PSM can develop the existing customer relationships, which in turn can provide the creation of competitive advantage. The level of interdependence is determined by the degree of equity and co-operation in the relationship, the available number of alternative partners and the historical costs and rewards from the relationship.

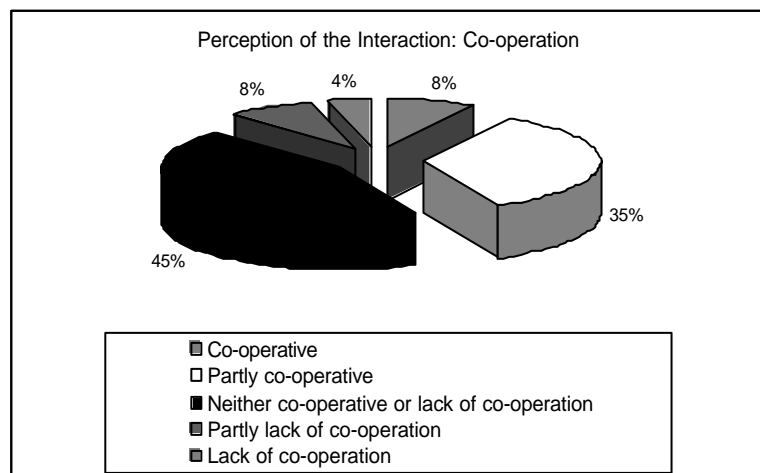
Equity

The degree of equity in the relationships between Formica-PSM and its customers was rather difficult to determine, since 66% of the customers were unsure whether the relationship is characterised by equity or not. 4% of the customers totally agreed with that both parties in the relationship are equal and 18% partly agreed with this view. The relationship is perceived as partly unequal and unequal by 6% respectively.²⁶³

Cooperation

Co-operative relationships can be a source of competitive advantage, as they enable the supplier to gain a deeper understanding of specific customer needs and hence deliver superior value. Consequently, the customers were asked to

Graph 5-6 Co-operation



²⁶³ From the 54 interviewed companies, 51 answered this question, leaving a total of 4 missing cases.

specify the level of co-operation in their relationship with Formica-PSM. As presented in Graph 5.6, there are varying degrees of co-operation in the customer relationships, 8% find the relationship to be co-operative while a rather large share (35%) think that the relationship is partly co-operative. 45% of the customers think that the relationship is neither co-operative nor lacking co-operation. 8% think that there is partly a lack of co-operation while 4% believe that there is a lack of co-operation.²⁶⁴

Single or multiple suppliers

Industrial purchasing and loyalty literature have discussed the impact of having single or multiple suppliers. Therefore, it was relevant to determine what is most preferable by the group of direct-buying customers of Formica-PSM and which pattern they follow. 61% of the customers are currently buying laminate products from multiple suppliers, whereas the remaining 39% are buying exclusively from Formica-PSM.

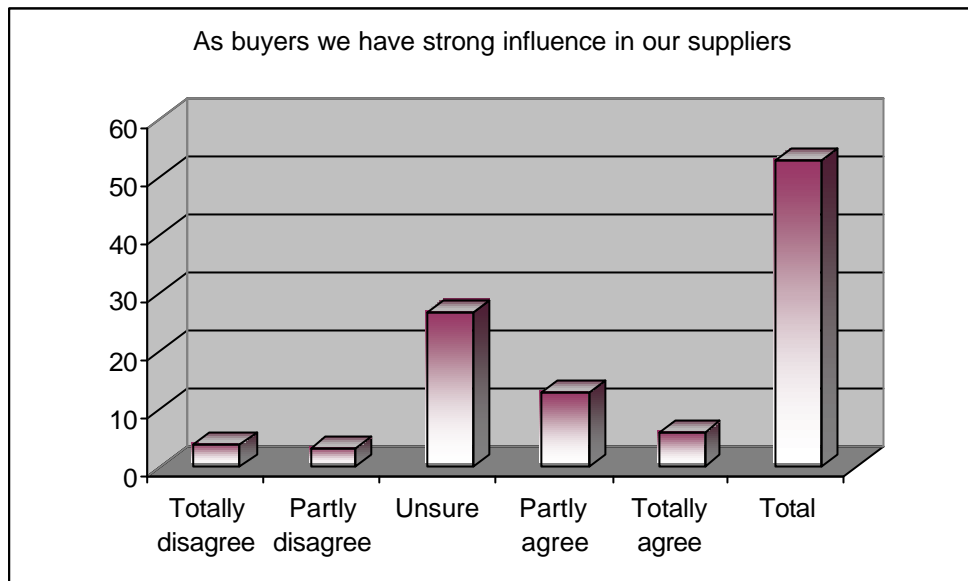
These results allow one to argue that industrial purchasers are still very concerned about supply reliability and dependency avoidance on one single supplier. Therefore, the majority prefer to rely on different suppliers to fulfil their orders so dependency does not arise. Nevertheless, we argue that changes are occurring in purchasing strategies and customers are more willing to enter into dependent relationships. The present results show that 39% of the interviewed customers belong to this group.

To further develop our understanding of how customers perceive their position in supplier relationships, the customers attitudes to the statement “*As a buyer, we have a strong influence on our suppliers*” was measured and the result is shown in Graph 5.7. There is a wide spread of answers, which indicate an insecurity in this matter. The perceived degree of influence on suppliers was rather difficult to assess, as 51% are unsure about their power as a customer. 11% of the customers consider their company to have strong influence on their suppliers, and 25% partly agreed with this statement. 13% were negative to the statement, of which 6% partly disagreed and 7% considered not to have any influence at all.²⁶⁵

²⁶⁴ Out of 54 customers, 3 customers did not reply to this question.

²⁶⁵ From the 54 interviewed companies, 53 answered this question, leaving a total of 1 missing case.

Graph 5-7 Influence on Suppliers

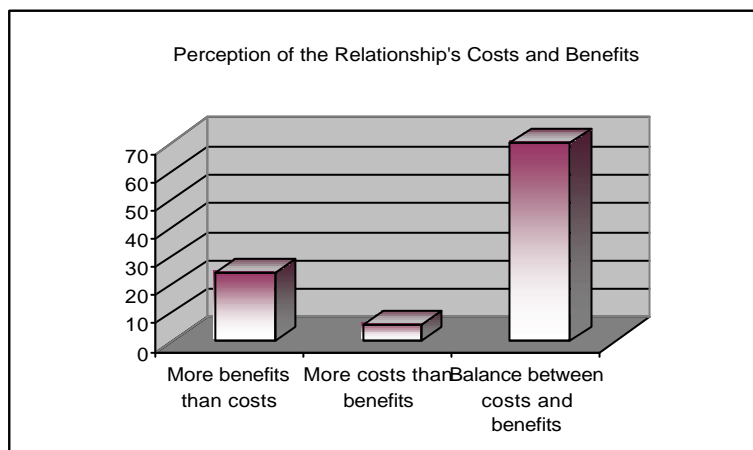


Costs and rewards

As mentioned in the frame of reference, relationships can be considered a result of a social exchange process, which implies the negotiation between rewards and costs between the parties involved. Therefore, the perceived costs and rewards derived from the relationship with Formica-PSM are crucial to study.

Graph 5-8 Costs and Benefits

Graph 5.8 shows that a majority of 70% perceive that there is a balance between costs and rewards received from the relationship. 24% consider the relationship to provide them with more rewards than costs; while 6% perceives the relationship to cost more in comparison to what they actually gain.



It can thus be concluded that a majority of the customers seem to consider the interaction with Formica-PSM to be mutually rewarding, with a balance between costs and rewards. This is an important result since relationships are likely to continue as long as mutual value exists and as long as the exchange creates mutual

feelings of reciprocate benefits. Furthermore, close relationships are likely to develop when the customer perceive that benefits, such as cost reduction, or revenues can be obtained.

It is important to notice that even if 70% feel that the relationship means equal costs and rewards, this can be interpreted as though these customers are not receiving any superior benefits from being a Formica-PSM customer. The risk here is that some customers can switch to an alternative supplier if that company manages to communicate the benefits of being a customer more clearly than Formica-PSM does. Further, it is interesting to notice that a there is a group of customers that remain with Formica-PSM despite their perception of more costs than benefits derived from the relationship. This group of customers needs to be identified, since it might include key customers that are of importance to Formica-PSM which may defect.

An equal and co-operative relationship means greater possibilities for openness and communication, which would enable Formica-PSM to sense different attitudes and needs among customers. Furthermore, equity and co-operation is important when developing close relationships, which seems to be preferred by a majority of the customers.

The customer base consists of a wide range of small to large companies, which can be argued to be reflected in the perceived abilities to influence suppliers. As a result, it is interesting to analyse whether the powerful customers are significantly contributing to the profits of Formica-PSM or if their requirements mean more costs than benefits to the supplier. Furthermore, customers that perceive a lack of influence in the relationship can be more dependent on the perceived value and benefits in the relationships to remain with Formica-PSM.

5.2.4 Customer perception of value

Satisfaction Price fairness Quality
--

Customer value can serve as an important source of competitive advantage, as it is an important element in all marketing exchanges. The customer perception of value is created by the supplier's ability to deliver value to its customers, as well as

the degree of superiority compared to competitive alternatives. As stated in the theoretical framework, it is determined by *satisfaction*, *price fairness* and *quality*.

Satisfaction

The level of customer satisfaction indicates to what extent the perceived quality corresponds to pre-purchase expectations. Hence, it is important to determine the expectations customers have to assure they are met on time. Customer satisfaction needs to be studied since a high degree of satisfaction among customers can lead to repeat purchases and favourable word-of-mouth. In turn, low satisfaction rate can lead to the opposite.

In order to determine the customer satisfaction, the customers were asked to evaluate the ability of *Formica-PSM to meet their expectations in terms of* the following eight aspects. These aspects are presented in the Table 5.4 together with the number of times each was mentioned.

Table 5-4 Formica-PSM meet expectations

	Times mentioned	Percentage
Delivery	37	71% of the time
Customer Service	30	58% of the time
Products	29	56% of the time
Sales Personnel	13	25% of the time
Availability of information	12	23% of the time
Price	10	19% of the time
Promises	7	14% of the time
Performance	4	8% of the time
Other	2	4% of the time
None	1	2% of the time

In addition, “*other*” and “*none*” alternatives were included in this question to give the respondents the possibility to express any additional aspect to the available alternatives or for them to express whether any expectations are met at all. *Other* was selected by two companies, one referring to “*quality*” whereas the second customer used it to express its discontent stating that “*the personnel is harsh and unfriendly*”. One customer believed that Formica-PSM did not meet any of their expectations.

These results point out that *delivery, customer service* and *products* are the main aspects in which customers feel their expectations are met. These are very interesting results, as according to company representatives accuracy on the delivery was one of the main aspects creating problems among customers. However, as the results indicate, it seems not to be a problem from the customers' point of view.

Another important highlight of the survey is that Formica-PSM representatives mentioned that the customers required an improved customer service to remain with the company. The results allow us to conclude that the re-structuring of customer service is valued by customers since it was the second aspect most mentioned in the survey. On the other hand, there are still possibilities to develop it even further.

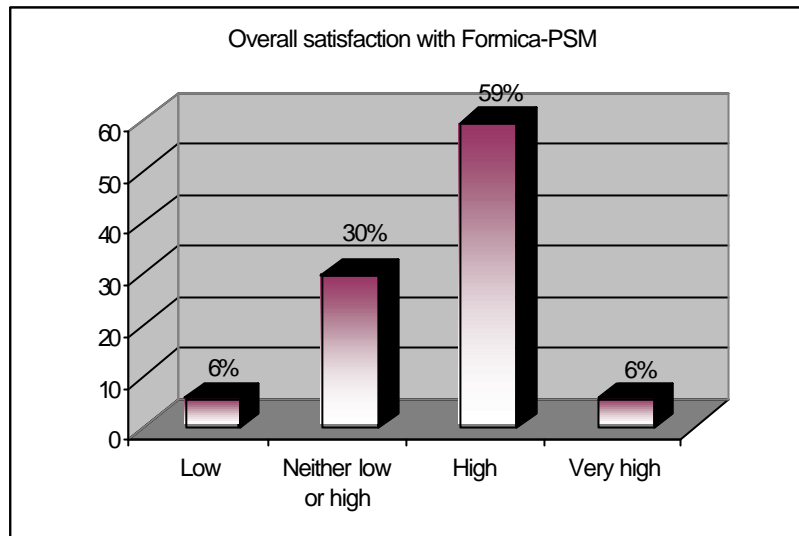
Finally, it is worth mentioning that *price, promises, and performance* had a rather low rate of mention among customers as aspects in which Formica-PSM meet customers' expectations. This can decrease their rate of purchase and create negative word-of-mouth publicity. Thus, these are areas that Formica-PSM needs to stress further for customers to perceive the company's trustworthiness and increase their satisfaction.²⁶⁶

Satisfaction is a very important aspect for the continuance of a relationship as it is a determinant for the customers' perception of value. As long as the current experience with a supplier provides value to customers, they are likely to be satisfied. In order to assess the level of satisfaction, customers make an overall evaluation over time of the current and prior experiences with a supplier, which are further affected by aspects such as quality, price and expectations. The theoretical framework suggests that in studies that aim to link customer satisfaction with economic returns, which is in our interest, the overall satisfaction is important to consider. Hence, the customers were asked to specify their overall satisfaction with Formica-PSM.

²⁶⁶ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases.

Graph 5-9 Overall Satisfaction

Graph 5.9 presents the results of the *overall satisfaction* among customers with respect to Formica-PSM. Of this number, only 6% have a very high level of satisfaction, 59% consider to have a high level of overall satisfaction and 30%



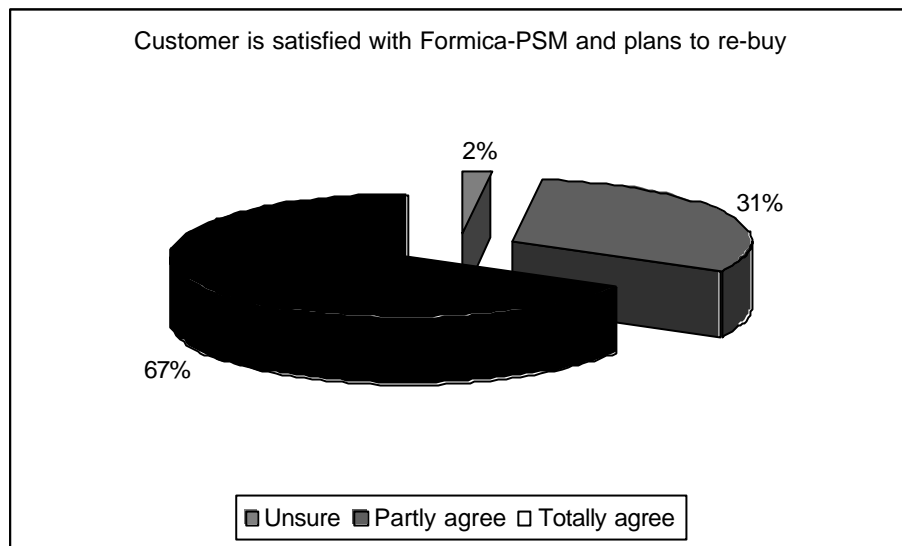
neither low nor high. It is important to mention that there were no companies referring to a very low level of satisfaction. Nevertheless, 6% of the interviewees consider having a low level of overall satisfaction.

Although in general these results are rather positive, the 30% that are found in a medium level of satisfaction can be either an opportunity or a threat. Therefore, the company should determine which aspects need to be developed for customers to increase their satisfaction. For instance, the fact that customers have not mentioned Formica-PSM meeting expectations in terms of performance, promises and price could be indicators to track down to improve overall satisfaction among customers.

Customer satisfaction is closely related to the future repurchase intentions, which was measured in the survey by using the statement “*We are satisfied with Formica-PSM, and plans to re-buy.*” Graph 5.10 illustrates these results where it is possible to see that 98% of the customers have a positive attitude towards this assertion, since as many as 67% totally agreed with this statement and a further 31% partly agreed, leaving only 2% of customers that were unsure about the statement.²⁶⁷

²⁶⁷ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases.

Graph 5-10 Repurchase



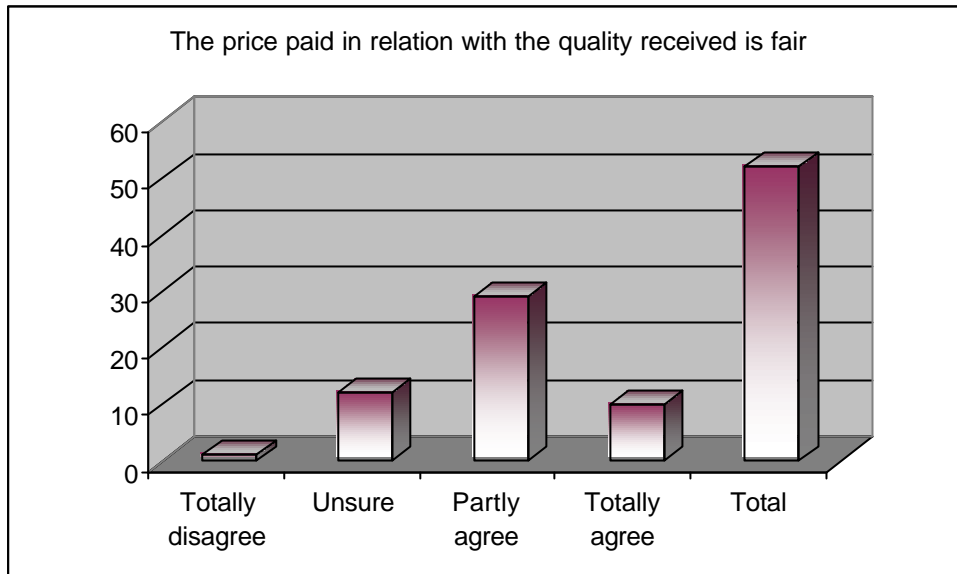
Price fairness

Price plays an important role in the customers' perception of value since it symbolises the amount of money that needs to be sacrificed to obtain a certain product or service. Price fairness is thus central to customers and if the supplier is perceived to charge an unfair price the result can be a negative effect on the value perception and customer profitability. Furthermore, the perception of price fairness has been identified as an important factor for determining the length and depth of the relationship.

Subsequently, the customers' attitude toward the statement "*The price paid in relation to the quality received is fair*" was measured. From the total, 19% totally agreed with this statement and 56% partly agreed. Again, there is a positive attitude towards the statement but it is not completely perceived as a truth. This, in combination with the 23% of unsure customers and the 2% that totally disagreed with this statement, indicates that prices may not be totally perceived as fair. This may further stress the fact that *price* was not among the most mentioned aspects in which Formica-PSM met customers expectations.²⁶⁸ The results are presented in the following graph.

²⁶⁸ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases.

Graph 5-11 Price Fairness



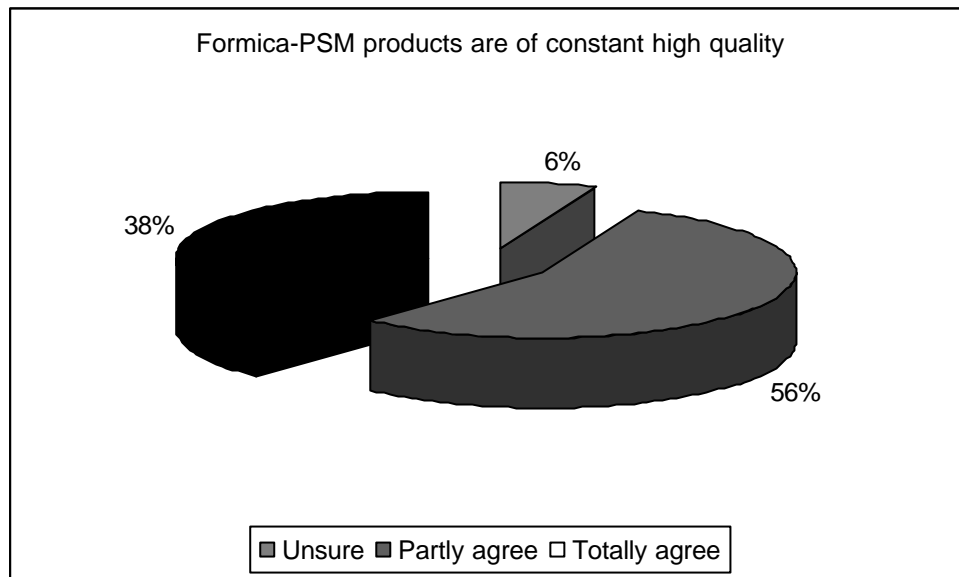
Quality

In this study, we refer to quality as a result of the customer judgments on the overall superiority of Formica-PSM products. Within this definition product characteristics are of central importance. However, quality is more than the actual physical product, which means that intangible factors such as services are also important determinants of the perceived quality, which are influenced by the attention received by customer service personnel, the service provided by the salesmen and the way of solving conflict. Finally, since customers balance the product and service performance in relation with the price, this can thus be interpreted as a signal of product quality.

The results from the study show that quality was the most mentioned factor when the customers were asked to specify what characterises Formica-PSM the most, as 80% of the customers mentioned this alternative. Moreover, customers were asked to evaluate the statement “*Formica-PSM products are of constant high quality*” in order to determine the quality of the product characteristics. The results presented in Graph 5.12 show that customers do have a positive perception of the products’ quality. On the other hand, the results show that this is an area for future improvement and development, since 56% partly agreed and a further 6% were unsure with the statement, which may be an indicator that the quality is perceived as “good” but not “high”.²⁶⁹

²⁶⁹ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases.

Graph 5-12 Constant High Quality

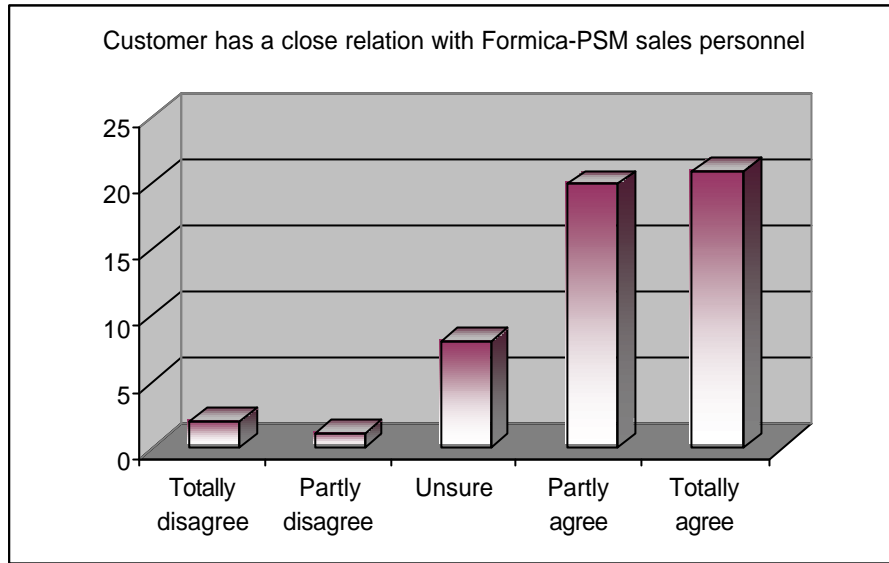


As services have been identified as an important determinant of perceived quality, we also aimed to measure whether customers are satisfied with the customer service they receive. Half of the customers (52%) totally agreed with that they are satisfied with the customer service received, which goes in hand with the fact that customer service was among aspects most mentioned regarding customer expectations met. On the other hand, 33% partly agreed, 11% were unsure and 4% partly disagreed, indicating that there are customers that consider this could be improved even more to provide better service.²⁷⁰

Personal contact is one of the most significant mechanisms to influence a relationship allowing the establishment of trust, loyalty and confidence. As mentioned before, personal contact was one of the aspects in which Formica-PSM is recognised to invest the most to develop the relationship with customers. One of the possible reasons for this may be explained by the interaction between the customer and the sales personnel.

²⁷⁰ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases.

Graph 5-13 Close relation with Sales Personnel



According to Graph 5.13, the majority of the customers (79%) stated they have a positive attitude towards the statement “*Our company has a close relation with Formica-PSM sales personnel*”. From this amount, 40% totally agreed with the statement yet as many as 39% stated they have a close relation to some extent. From the remaining 21%, 15 % were unsure whether the relation with the sales personnel could be referred to as close or not. 2% partly disagreed while 4 % totally disagreed that they have a close relation with the sales personnel.²⁷¹ It is positive that a large share of the customers has a relatively close relationship with the sales personnel, as this can be utilised as a channel for determining the customers’ needs and expectations.

Moreover, conflict resolution plays an important role for the longevity of customer relationships. Therefore, well-established routines to handle conflicts will serve to reduce customer dissatisfaction and defection. Formica-PSM is perceived to solve problems in a rather friendly manner, since almost all customers (96%) were positive towards the statement “*Conflicts are solved in a friendly manner*”. From this amount, 60 % of the customers totally agreed and 36 partly agreed. The remaining 4 % were unsure.²⁷² A conclusion of the presented results is that Formica-PSM is highly recognised for providing overall quality. On the other hand, customers perceive that there are issues about the product and customer service that may be improved. Moreover, the results show that customers are more satisfied with the quality of customer service (52% totally agreed) than with the constant quality of the products (38% totally agreed).

²⁷¹ From the 54 interviewed companies, 52 answered this question, leaving a total of 2 missing cases

²⁷² From the 54 interviewed companies, 50 answered this question, leaving a total of 4 missing cases

Overall perception of value

The customers were asked to specify what outcomes they obtain from the relationship with Formica-PSM, as this indicates the ability of Formica-PSM to deliver customer value. The results are presented in Table 5.5 indicating the times and percentage of mention.

Table 5-5 Outcomes Obtained from the Relationship

	Times mentioned	Percentage
Quality of products	35	66% of the time
Knowledge	23	43% of the time
Market share	18	34% of the time
Processes	12	23% of the time
Revenue	10	19% of the time
Assets	4	8% of the time
None	4	8% of the time
Other	1	2% of the time

As presented in the above table, *product quality* is the most mention outcome derived from the relationship with Formica-PSM, followed by *knowledge*. Customers also consider that the relationship has helped them to improve their *market share* and a further 23% think that the relationship has positively influenced their processes. Although market share is normally argued to influence *revenue*, this was mentioned only 19% of time, whereas *long-term assets* were the least mentioned outcome derived from the relationship.

Only one customer referred to the “*other*” alternative stating that the relationship with Formica-PSM has had a positive influence on their customers, whereas the “*none*” alternative was mentioned 8% of the time reflecting that the co-operation with Formica-PSM has not provided any positive influence on their businesses.

5.2.5 Loyalty

Behavioural

Attitudinal

Loyalty is an interesting aspect to study as it has been argued to be the ultimate objective for any customer-supplier relationship in order to increase the chances for profitable returns. Taking into consideration that this factor is a very debated among theorists, we decided to measure both the behavioural and attitudinal types of loyalty as a way to provide a more holistic perspective. The number of *purchases, the frequency of such purchases, degree of cross-buying and brand switching*, this one in terms of use of single and multiple suppliers, were considered in order to measure the behavioural loyalty. On the other hand, attitudinal loyalty was measured taking into consideration the degree in which customer would recommend the company to others, since this type of loyalty refers to customer preferences and their feelings towards a supplier.

Behavioural

The frequency of the relationship between Formica-PSM and its customers was measured by analysing aspects such as the *buying frequency, contact frequency, the perceived frequency* and whether an *increase of contact frequency* was desired by customers.

The results from the survey show that the majority (90%) of the direct-buying customers have continuous *buying frequency*. From this total, as many as 65% companies said they buy from Formica-PSM on a continuous basis, 15% once a month and 11% buy once a quarter. From the remaining 10%, 4% buy once every six months, 2% once a year and 4% buy less than once a year. As mentioned before, repeat repurchase is one determinant for customer loyalty, and in this respect the results are positive for Formica-PSM.

When analysing the *frequency of contact*, it was possible to observe a large share of customers that have had frequent contact with Formica-PSM, since 76% responded that they had contact with the company at least once a month, where 15% has daily contact and 35% are in contact with Formica-PSM every week. Within the remaining 24% it is possible to observe that the behaviour in terms of frequency of contact differs among customers. 17% of the customers have contact

with Formica-PSM on a quarterly basis, 2% are in contact every sixth month and the last 5% of the customers have contact on a yearly basis.

In order to complement the previous results, we studied which *perception customers have of the relationship frequency*. The results show that most of the customers (48%) perceived their relationship with Formica-PSM as very frequent or frequent, whereas 33% perceived it as medium frequent. The remaining 19% of the customers described their relationship with Formica-PSM as less frequent or infrequent. Therefore, it can be said that the perception among customers agreed with their actual behaviour.

Furthermore, the majority of customers (78%) are currently satisfied with the present frequency of contact. This is important for Formica-PSM to know as it can be very negative to increase the contact with a customer that is not interested in this. However, 9% of them would like to have more frequency of contact with Formica-PSM. On the other hand, 13% of the customers were unsure whether they *would like to have more contact* with the company and this could be interpreted in different ways. The insecurity can indicate that there are customers reluctant to either stay or leave the relationship. It could also be that this issue is not as important as other aspects are, or that the need of contact varies depending on the operation of its own company.

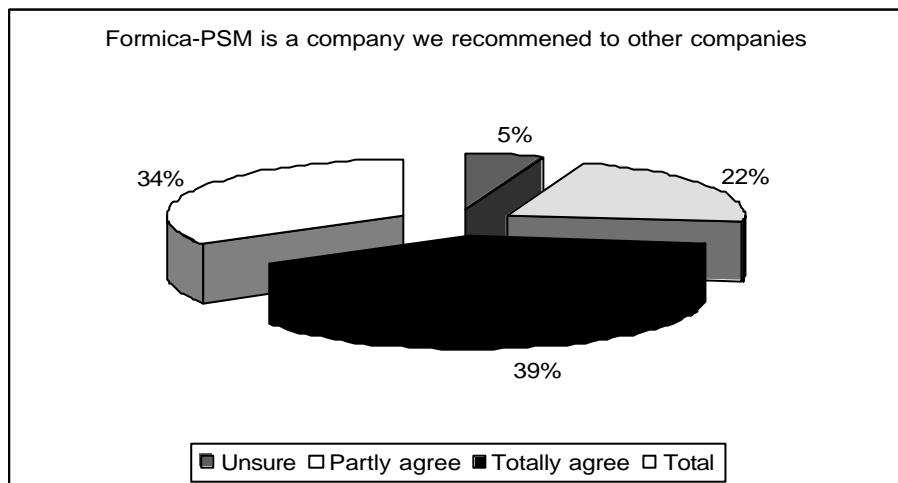
Customers can buy products in a focused manner or across product categories from a given supplier. Although studies on the effect of cross-buying in terms of profitability and buying behaviour are rather scarce, it has been argued that customer retention and therefore profitability can be enhanced more easily when customer are engaged in buying from different categories as their level of dependence is likely to increased as well as their switching costs. The results of the study had a very interesting outcome in this respect as 72% of the customers stated to buy only from one product category, leaving the remaining 28% as *cross-buying* customers.²⁷³ We believe that cross-buying can be seen as an indicator of which customers could be more dependent on the company and easier to retain, although not because they are 100% loyal to the company.

²⁷³ From the 54 interviewed companies, 53 answered this question, leaving a total of 1 missing case.

Attitudinal

We decided to complement “tangible” aspects of loyalty with a question that would measure the “soft” dimension of this factor by asking customers whether “*Formica is a company they recommend to other companies*”. Customers showed a positive attitude towards this statement, where 59% totally agreed and 33% partly agreed. We think this is a favourable result as customers would not recommend the company unless they are satisfied with it, and satisfaction is a prerequisite for loyalty development. However, it was also possible to observe that 8% of the customers were unsure about this statement, implying that there may be an area in which Formica-PSM could improve. Graph 5.14 shows these results:

Graph 5-14 Recommendation



Finally, we decided to measure whether “*Loyal customer should be rewarded*”. The results suggest that customers believe that loyal customers should be rewarded, since 92% have a positive attitude towards this statement, where 58% totally agree and 34% partly agree. Thus, it is possible to conclude that the company should identify the more loyal customers and develop strategies to reward their preference. The remaining 8% were unsure about this statement, which reflects the fact that there are customers that will prefer a more transactional approach with lesser degree of commitment and co-operation.

Overall, in order to develop loyal customers it is important to understand the nature of the interactions the company has with its customers. This implies a clear differentiation between discrete transactions, which have a distinct beginning, short duration and sharp ending by performance, and relational exchanges which reflect an ongoing process. Thus, it is possible to conclude that a high percentage of Formica-PSM direct-buying customers are considered to have a relational

approach in their buying behaviour. On the other hand, there are still some customers characterised by having a more transactional approach when buying from this company.

It is preferable to develop close relationships with those customers that have a high frequency of contact, as these kinds of relationships tend to be more rewarding due to the mutual understanding of each others goals. Moreover, relationship strength can lead to loyalty establishment. Customers with less frequent contact expect a different kind of interaction and therefore need to be approached in a different way. In short-lived or transaction relationships price plays a large role in the exchange. However, it is important to have in mind that a lack of personal contact, limited exchange and adaptation can complicate the creation of trust, co-operation and loyalty.

5.2.6 Trust

Credibility

Benevolence

Trust is important in relational exchanges because relationships that are characterised by trust are normally highly valued by the parties, which increases their willingness to commit to such relations. Moreover, trust is essential to the establishment of successful relationships as it concerns the partners' confidence in the supplier reliability and integrity, and if managed properly, trust can develop into relationship commitment. As stated in the Frame of reference (Chapter 3), trust can be analysed from the dimensions of *credibility* and *benevolence*. Credibility concerns the belief that the supplier has the required expertise to perform the job reliably, and involves aspects such as consistency, competence and reputation.

Benevolence is associated with the belief that the supplier is interested in the customers' concerns and welfare, aspects such as honesty, fairness and responsibility. In order to assess the attitudes of the most important aspects of credibility and benevolence, the customers were asked to specify in *what ways Formica-PSM is recognised by the customers*. The results are presented in Table 5.6

Table 5-6 Outcomes Obtained from the Relationship

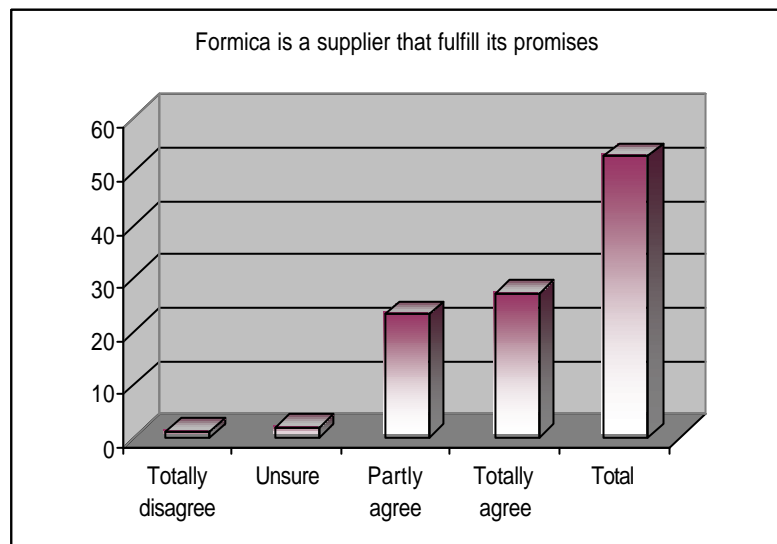
	Times mentioned	Percentage
Quality	41	80% of the time
Trustworthiness	24	47% of the time
Reputation	21	41% of the time
Honesty	12	24% of the time
Integrity	2	4% of the time
Other	6	11% of the time
None	1	2% of the time

Credibility

The results indicate that Formica-PSM is mostly recognised for *quality*, *trustworthiness* and *reputation* which can be interpreted as a symbol for consistency and competence. From the open questions, 6 additional aspects were mentioned in terms of “*new developments*”, “*the number of different colours*”, “*sometimes too long delivery time, which is very negative*”, “*good products*”, “*good prices and secure deliveries*”, “*service*”, which we associate to the perceived credibility among customers.

Graph 5-15 Fulfilment of Promises

Also, the attitudes to the statement “*Formica-PSM is a supplier that fulfils its promises*” were evaluated in order to obtain an indication on how reliable and consistent Formica-PSM is considered to be. In Graph 5.15 it is possible to see that 94% of the customers



are positive to the statement, of which 51% totally agreed, whereas 43% partly agreed. 4% were unsure and 2% totally disagreed. These results in combination with those presented in the section of customer perception of value show a contradiction, since “*promises*” was one of the aspect less mentioned in which Formica-PSM meets the customers’ expectations.

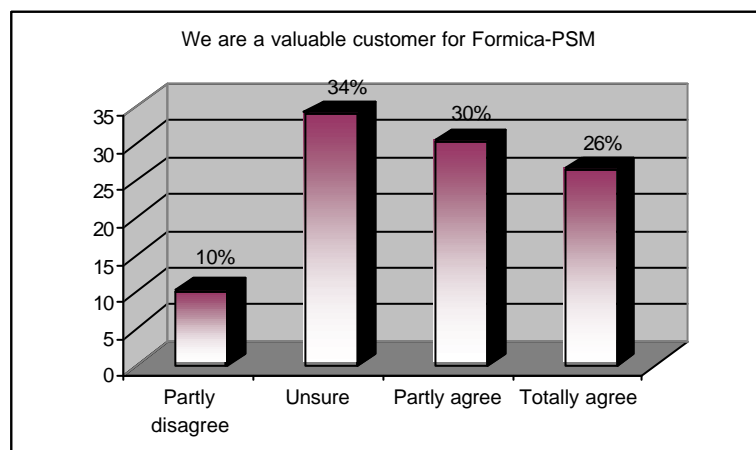
In addition, the customers’ perception of Formica-PSM competence was assessed by the statement “*Formica-PSM has the competence to perform in this industry*”. The vast majority, 94%, are positive to this statement, of which 54% of the customers totally agreed and 40% partly agreed. 6% of the customers are unsure about the competence of Formica-PSM. Although overall customers have a positive attitude about the competence of Formica-PSM, they do not rely on Formica-PSM 100%, as 46% of the customers show some insecurity. According to the results presented on the section of customer perception of value, “*performance*” was the aspect that was mentioned least among customers in terms of customer expectation fulfilment. This could imply that customers consider Formica-PSM to have the competence to perform in the industry but may not be exploiting this potential 100%.

The aspects associated with credibility have proved to be very frequently mentioned by the customers, which constitutes excellent elements for creating trust. Nevertheless, quality and reputation need to be complemented by additional factors important in a dyadic relationship to achieve an overall trustworthiness.

Benevolence

The aspects connected to benevolence, honesty (24%) and integrity (4%), were less frequently mentioned in relation to the credibility aspects. These rather low figures can be weighed against the results from the statement “*We are a valuable customer to Formica-PSM*”, which aimed to identify how concerned Formica-PSM is about the individual customer. Graph 5.16 shows that customers’ perception of being valuable greatly varies.²⁷⁴

Graph 5-16 Value of Customers



It is of concern that a relatively small group of customer totally agreed that they feel valuable as customers, and that a large amount of customers partly agrees or

²⁷⁴ 53 from 54 companies, 53 answered this question, leaving 1 missing case

are unsure about it. Together with the low ratings on honesty and integrity, benevolence hence becomes an interesting area to further analyse.

Besides these results, it is interesting to compare how the attitudes to credibility and benevolence correspond to the overall trustworthiness of Formica-PSM. Trustworthiness was mentioned 47% of the time as an aspect that the company is highly recognised for. To further confirm this result, the customers' perceptions of the overall trustworthiness of the relationship with Formica-PSM were measured by the statement "*The relation with Formica-PSM is trustworthy*". There are a majority of customers (92%) with a positive attitude to this statement, of which 64% totally agreed and 28% partly agreed. 4% of the customers are unsure whether the relationship is trustworthy and 4% totally disagree with this statement.

On the whole, customers have a positive perception of Formica-PSM as a trustworthy party. On the other hand, there is a high percentage of customers (36%) that see this aspect as a potential area for improvement, and the most important parts to focus on can be the ones connected to benevolence.

5.2.7 Commitment

Affective commitment

Calculative commitment

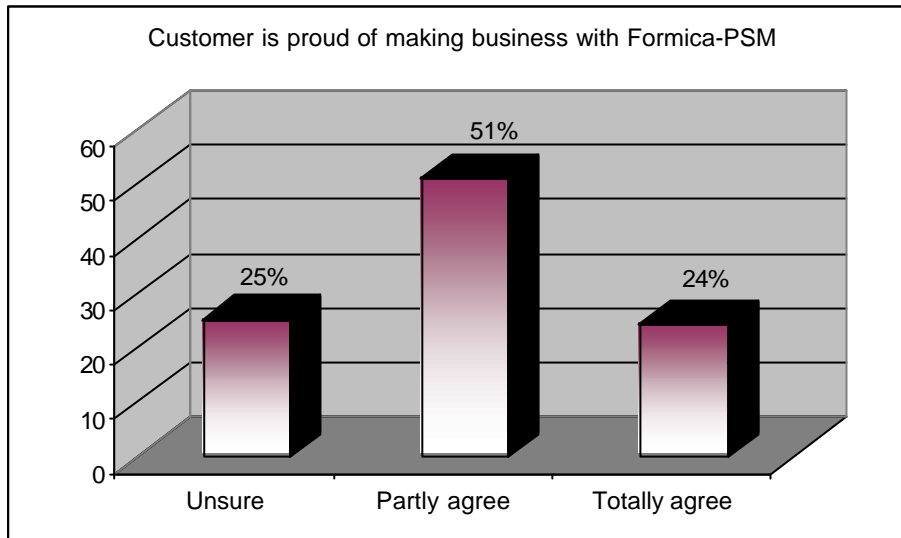
Commitment is central in a relationship, as it means that the relationship is so important that maximum efforts should be invested to maintain it. Commitment can be analysed in terms of *affective commitment* (emotional attachment), which can be defined by shared values, relationship duration and reputation. *Calculative commitment* can be studied as a second dimension of commitment as it concerns the cognitive evaluation of relationship value. Important aspects of cognitive value are perceived supplier investments and relationship termination costs.

Affective commitment

A majority of the customers (77%) are positive to the statement "*We believe that the values of Formica-PSM correspond to the values of our company*". Out of these 77%, 30% totally agreed and 47% partly agreed with the statement. 20% were not sure, and

4% partly disagreed. No customer totally disagreed with this statement. Also, the degree of affective commitment was measured by the statement “*We are proud to do business with Formica-PSM*”. The results are illustrated in Graph 5.17

Graph 5-17 Proud of Doing Business with the Supplier



The graph above shows that more than half of the customers are proud to do business with Formica-PSM. On the other hand, one fourth of the customers are rather unsure about this statement and therefore may not be as committed in the relationship as the others.

It is important to mention that relationship duration and reputation can have considerable impact on the affective commitment; however the results from the surveys within these areas are presented in the Heterogeneity and Relationship duration sections described before.

Calculative commitment

With the purpose of determining the calculative commitment, it was appropriate to evaluate whether customers perceive “*Formica-PSM as a valuable supplier*” and in turn whether *customers feel they are a valuable customer* to the company. If the customer values the supplier at the same time that it feels valued by its supplier, it is likely that the relationship will develop towards a more committed and co-operative end, increasing the amount of mutual benefits.

The results show that the majority of the customers (88%) have a positive attitude towards the statement “*Formica-PSM is a valuable supplier for us*”, from which 41%

totally agreed and 47% partly agreed with this view. From the remaining 12%, only 6% were unsure and 6% partly disagreed that Formica-PSM would be a valuable supplier.²⁷⁵

These findings provide an indication of what the possibilities for building a relationship with the customers look like. Customers that consider Formica-PSM a valuable supplier constitute a favourable group for developing the relationship, while customers that do not value Formica-PSM as much can be more reluctant to commit to a relationship. On the other hand, it is impossible to satisfy all customers, and in this case the percentage is rather small.

It is important to notice that perceived supplier investments and relationship termination costs can be important determinants of calculative commitment. These subjects have though been already analysed in the Investments and Switching Costs sections.

Overall, it can be said that since customers constitute the lifeblood of the business, Formica-PSM needs to emphasise the value of each customer connecting with a better communication of the investments undertaken to develop a certain relationship. A major share of the customers prefers a long-term relationship with their suppliers and if Formica-PSM wants to live up to these expectations, it must make the customers feel valuable.

Finally, in order to establish a relationship characterized by commitment, it is advantageous if the parties have similar values, as this will enable a mutual understanding and co-operation. If the values are too contradicting, there is a high risk for conflicts among the parties to arise. The results indicate that there might be a degree of insecurity of what values Formica-PSM has.

This chapter has indented to present a general overview of the current situation of the direct-buying customers at Formica-PSM. Based on these findings, the following chapter will be concentrated on answering the hypothesis stated in the frame of reference in Chapter 3. This will be done by determining which relationship characteristics are related to each other, to further on be linked to customer's profitability.

²⁷⁵ From the 54 interviewed companies, 53 answered this question, leaving a total of 1 missing case.

6 Analysis of relationship characteristics and customer profitability

This chapter will present the outcomes of our statistical analysis of each of the six areas of relationship characteristics presented in the frame of reference, in order to identify the determinants of each characteristic and answer to the hypotheses stated in Chapter 3. Furthermore, the section provides an analysis of the customer base in terms of profitability. At the end, the relationship characteristics specifically impacting customer's profitability are presented.

6.1 Analysis of relationship duration

In the frame of reference, Ganesan (1994) stated that a benefit of analysing a customer's time orientation is that the insight from the analysis can be used to change the customer's position along the spectrum of long- to short-term orientation. Furthermore, Burgess and Huston (1983) stated that relationships that have lasted a long time would be more likely to continue. In order to test this relation, we analysed the significance between the *years as customer* and the statement "*We are satisfied with Formica-PSM and plan to repurchase*", as the plans for future purchases indicate a continuance of the relationship. The results allow us to conclude that the amount of years as customer is not significantly related to whether the customer is satisfied and intend to repurchase, and hence we cannot agree with this view in the case of Formica-PSM.²⁷⁶ Nevertheless, we see a tendency where the younger the customers the more insecurity regarding whether they are satisfied and plan to re-buy. Customers of 8 years or less tend to be unsure, while companies that have been customers for around 16 years are more positive to this.

Additionally, Anderson and Weitz (1989) have argued that older dyads continue since experience breeds trust. In order to test this statement, we analysed the significance between *years as customer* and the statement "*The relation with Formica-PSM is trustworthy.*" The results indicate that there is no significant relation between the variables.²⁷⁷ Based on this result, we think that the opinion of Anderson and Weitz (1989) has no statistical foundation in the case of Formica-PSM. However, it is possible to see a trend in which younger customers, 7 years or less, are negative to or unsure about this statement, while customers around 16 years are more positive to the trustworthiness in the Formica-PSM relationship.

²⁷⁶ ($|t|=0,639 < 1,684$, $p = 0,526 > 0,05$)

²⁷⁷ ($|t|=1,076 > 1,684$, $p = 0,288 > 0,05$)

In order to analyse whether we could further reject or confirm these obtained results, we studied the relation between *years as customer* and the statement “*Formica-PSM is recognised for trustworthiness.*” The data analysis shows that there is no significant relation between the years as customer and the relation, even if it seems like customers older than 18 years are more positive to this statement than the others.²⁷⁸

Regarding determinants of relationship duration, Ganesan (1994) suggested that long-term orientated customers will be more concerned about *mutual dependence* and *trust* in the relationship, whereas short-term oriented ones would be more concerned about *price*. We analysed whether customers’ actions agreed with these statements by comparing *perceived relationship duration* and the *perceived equity*. In this respect, we did not find any significant relation.²⁷⁹ Further, we crossed the degree of trustworthiness represented by the statement “*Formica-PSM is recognised by its trustworthiness with the perceived relationship duration*” and the results showed no interdependence. However, we can see that customers that have a long-term orientation tend to be very positive to this statement, while the only customer with a short-term orientation totally disagreed with this.

It is important to notice that there is no significant relation between *years as customer* and the statement “*The price paid in relation to the quality received is fair.*”²⁸⁰ However, our analysis indicate that customers younger than 12 years totally disagree that the price paid is fair in relation to the quality received, where as customers for 20 years or more totally agrees with this.




From the discussion presented under relationship duration, we are able to confirm or reject the following hypotheses:

²⁷⁸ ($|t|=0,897 < 1,684$, $p = 0,374 > 0,05$)

²⁷⁹ ($X^2 = 3,058 < 7,78$, $p = 0,704 > 0,05$)

²⁸⁰ ($F = 0,349 < 2,84$, $p = 0,790 > 0,05$)

Table 6-1 Hypotheses on Relationship Duration

Relationship Characteristic	Hypothesis	Accept	Reject
1.Relationship Duration	1.1 Customers in relationships that have lasted a long time are likely to remain in the relation and repurchase		
	1.2 Older dyads are likely to continue as trust is developed		
	1.3 Long-term orientation in a buyer-seller relationship is determined by mutual interdependence and trust, and short-term are affected by price		

As illustrated in Table 6.1, our three hypotheses on relationship duration are rejected with regards to the findings in the analysis. A long relationship does not mean guaranteed continuation or repurchase. Still, there seem to be a trend that younger customers show more insecurity regarding their probability to repurchase. Neither are older dyads related to trust, even if there was a tendency for older customers to have a higher degree of trust in the relationship. We must also reject the ideas of short- and long-term oriented customers being affected by the suggested aspects from the frame of reference.

6.2 Analysis of switching costs

The social exchange theory emphasises the amount of resources invested as one of the major factors for relationships duration or termination, which in turn affects the profitable lifetime duration of the customer.

The *customer investments* were analysed in relation to the relationship duration (years as customer) in order to see whether these factors are related. The analysis shows that there is no significance between the *years as customer* and customer investments in *money, time, personnel* and *personal contacts*.²⁸¹ On the other hand, we found years as customer to be significantly related with customer

Crossed variables	Significant	Not significant
Years as customer*		
Customer investments in:		
Money		X
Knowledge	X	
Personal contacts		X
Processes	X	
Long-term assets	X	
Time		X
Personnel		X

²⁸¹ Years as customer* Money ($|t|=0,332 < 1,684$, $p = 0,526 > 0,05$), Time ($|t|=0,217 < 1,684$, $p = 0,829 > 0,05$), Personnel ($|t|=0,092 < 1,684$, $p = 0,927 > 0,05$), Personal contacts ($|t|=0,476 < 1,684$, $p = 0,636 > 0,05$)

investments in *long-term assets* and *processes* and a weak relation with customer investments in *knowledge*.²⁸²

Similarly, the *supplier investments* were analysed in relation to *relationship duration* (years as customer) to determine eventual significant relations. The results allow us to conclude that there is no significant relation between *years as customer* and *supplier investments* in terms of *money*, *personal contacts*, *processes*, *time* and *personnel*.²⁸³ However, *years as customer* and *supplier investments* in *long-term assets* was proved to be related, and also a weak relation with *supplier investments* in *knowledge*.²⁸⁴

Crossed variables	Significant	Not significant
Years as customer*		
Supplier investments in:		
Money		X
Knowledge	X	
Personal contacts		X
Processes		X
Long-term assets	X	
Time		X
Personnel		X

Further, we analysed the relation between the statement “*Changing supplier means considerable costs to our company*” and *customer investments in the relationship* as we think that these factors can affect the continuance or determination of a relationship.

The results show that there is no significant relation *between costs of changing supplier* and customer investments in *money*, *personal contacts*, *long-term assets*, *time*, *knowledge* and *personnel*.²⁸⁵ On the other hand, there is a relationship with *customer investments in terms of processes*.²⁸⁶ Consequently, customers that make these types of investment can also be more devoted to remain in the relationship. It is interesting to notice that a considerable share of the customers that were unsure about whether switching supplier would imply major costs have not invested in processes.

We also analysed the relation between the statement “*Changing supplier means considerable costs to our company*” and the *supplier investments in the relationship*. The data analysis proved that there is no significant relation between the statement and

²⁸² Years as customer* L-T Assets ($|t|=2,359 > 1,684$, $p = 0,022 < 0,05$), Processes ($|t|=2,042 > 1,684$, $p = 0,047 < 0,05$), Knowledge ($|t|=1,187 > 1,684$, $p = 0,241 > 0,05$),

²⁸³ Years as customer* Money ($|t|=0,273 < 1,684$, $p = 0,786 > 0,05$), Time ($|t|=0,461 < 1,684$, $p = 0,648 > 0,05$), Personal contacts ($|t|=0,012 < 1,684$, $p = 0,991 > 0,05$), Processes ($|t|=0,188 < 1,684$, $p = 0,852 > 0,05$)

²⁸⁴ Years as customer* L-T assets ($|t|=2,458 > 1,684$, $p = 0,018 < 0,05$), Knowledge ($|t|=1,211 > 1,684$, $p = 0,233 > 0,05$)

²⁸⁵ Long-term assets ($X^2 = 2,35 < 9,49$, $p = 0,67 > 0,05$) Time ($X^2 = 2,27 < 9,49$, $p = 0,68 > 0,05$), Personnel ($X^2 = 2,03 < 5,99$, $p = 0,362 > 0,05$) Money ($X^2 = 4,45 < 9,49$, $p = 0,34 > 0,05$) Knowledge ($X^2 = 5,26 < 9,49$, $p = 0,26 > 0,05$) Personal contacts ($X^2 = 4,1 < 9,49$, $p = 0,38 > 0,05$)

²⁸⁶ Processes ($X^2 = 9,65 > 9,49$, $p = 0,04 < 0,05$)

supplier investments in terms of *money, personnel, processes long-term assets, knowledge* and *personal contacts*.²⁸⁷ Nevertheless, there is a significant relation between the statement and supplier investments in *time*.²⁸⁸

From the results in Table 6.2, we see that the majority of customers that are unsure or disagree whether changing Formica-PSM as a supplier implies major costs tend to not perceive Formica-PSM investing in terms of *time*. This indicates that Formica-PSM should stress and communicate these kinds of investments among customers to nurture continuance of the relationship.

Table 6-2 Formica-PSM Investments in the relation: Time vs. Termination Costs

		Switching supplier implies major costs for the customer					Total
Formica-PSM Investments in the relation		Totally disagree	Partly disagree	Unsure	Partly agree	Totally agree	
Time	Not mentioned	4	5	13	9	4	35
	Mentioned		1	6			7
Total		4	6	19	9	4	42

In order to test the influence of *shared values* into *commitment*, we compared the statement “*The supplier’s values agree with customer’s values*” against “*Switching a supplier implies major costs.*” The chi-square test shows that there is strong interdependence between these variables and therefore they affect each other.²⁸⁹ Likewise, we determined that the statement “*The supplier is valuable to the customer*” and “*Switching supplier implies major costs*” are interdependent.²⁹⁰ These results reflect the fact that increased switching costs are not necessarily related to monetary aspects.

From the discussion presented under switching costs, we are able to confirm or reject the following hypotheses:



²⁸⁷ Money ($X^2=5,91 < 9,49$, $p=0,20 > 0,05$) Processes: ($X^2=1,59 < 5,99$, $p=0,451 > 0,05$) Personnel ($X^2=2,42 < 5,99$, $p=0,33 > 0,05$) Long-term assets: ($X^2=3,92 < 9,49$, $p=0,41 > 0,05$), Knowledge ($X^2=7,119 < 9,49$, $p=0,130 > 0,05$) Personal contacts ($X^2=7,518 < 9,49$, $p=0,111 > 0,05$)

²⁸⁸ Time ($X^2=5,96 < 5,99$, $p=0,05=0,05$)

²⁸⁹ ($X^2=7,14 > 5,99$, $p=0,028 > 0,05$)

²⁹⁰ ($X^2=7,53 > 5,99$, $p=0,023 < 0,05$)

Table 6-3 Hypotheses on Switching Costs

Relationship Characteristic	Hypothesis	Accept	Reject
2. Switching costs	3.1 The resources invested in the relationship are determinants for the duration of the relationship as they act as switching costs.		
	3.2 Shared values are related to the perceived costs of changing a supplier.		

As illustrated in Table 6.3, the results allow us to confirm both hypotheses, as we found proof for investments in the relation by customers and suppliers to constitute costs of switching. Specifically, investments in *knowledge, processes, long-term assets* and *time* were important. Also, it is very necessary that the customer and supplier have a shared values if switching costs are to be created.

6.3 Analysis of interdependence

According to Huston and Burgess (1979), partners in relationships characterised by equity would be more likely to be satisfied. Based on the results from the statistical analysis it is not possible to agree that there is a relation between *overall satisfaction* and the *perceived equity*.²⁹¹ On the other hand, we measured the relationship between *overall satisfaction* and the statement “*As a buyer, we have a strong influence on our suppliers*”, as we consider it to indicate the perceived equity in the relationship and the variables showed to be strongly related.²⁹²

In addition to the cross tabulation, we conducted a factor analysis that provided three factors which will be considered throughout the analysis. From the results obtained from the factor

Factor 2: Interdependence	
As buyers customers have a strong influence on our suppliers	.789
We are a valuable customer for Formica-PSM	.747
Formica-PSM is a valuable supplier for us	.718

analysis, we found that factor 2 explains important correlations in terms of interdependence and commitment. The result shows that customers that answer positively to either of these statements are likely to have a positive attitude towards the others, reflecting some sort of balance of the relationship. For instance, buyers that consider they have a strong influence on their suppliers, feel

²⁹¹ ($X^2=4,08 < 5,99$, $p=0,13 > 0,05$)

²⁹² ($X^2=16,41 > 12,6$, $p=0,01 < 0,05$)

valuable as customers but also feel that Formica-PSM is a valuable supplier for them. Therefore, we agree that customer's influence on supplier should not be perceived as something negative.

Jackson (1985) has suggested that the power of each party depends on the number of alternative suppliers and the costs of switching. In our analysis of the relation between *perceived supplier influence* and the customers that have *single or multiple suppliers* no significant relation was determined.²⁹³ This indicates that customers with many suppliers do not necessarily feel that they have more influence in their suppliers compared to customers with a single one. Similarly, there is no relation between *perceived supplier influence* and *costs of switching*²⁹⁴, meaning that customers having strong influence on their suppliers do not need to perceive that the costs of switching are high or low.

Further, the degree of *equity* and *intensity* in the relationship is often referred to when discussing relationship co-operation. Hence, we analysed whether there was a relation between *co-operation* and *equity* in the relationship, and the result proved that there is a significant relation between these two factors.²⁹⁵ This implies that the customers perceiving the relationship to be equal are also the ones that perceived the relationship to be co-operative and vice versa. However, in our case company, the majority tend to say neither co-operative nor superficial, which was combined with neither equal or unequal. Similarly, a significant relation between *co-operation* and *intensity* of the relationship was identified when analysing the relation between these factors.²⁹⁶ In other words, the customers referring to the relationship as co-operative also think that the relationship is characterised by intensity.

Considering relationship costs and rewards, Huston and Burgess (1979) argued that inequity and equity is related to the rewards-costs history of the relationship. In line with this, we identified a strong relation between the *equity* in the relationship and the *relationship costs and rewards*.²⁹⁷ The customers that perceived the relationship to have a balance of equality tend to describe the relationship as a balance between costs and benefits.

²⁹³ ($X^2=5,653 < 9,49$, $p=0,227 > 0,05$)

²⁹⁴ ($X^2=8,353 < 15,5$, $p=0,400 > 0,05$)





²⁹⁵ ($X^2=28,16 > 9,49$, $p=0,00 < 0,05$)

²⁹⁶ ($X^2=21,47 > 9,49$, $p=0,00 < 0,05$)

²⁹⁷ ($X^2=16,665 > 9,49$, $p=0,002 < 0,05$)

From the discussion presented under independence, we are able to confirm or reject the following hypotheses:

Table 6-4 Hypotheses on Interdependence

Relationship Characteristic	Hypothesis	Accept	Reject
3. Interdependence	3.1 Customers in relationships characterised by equity will tend to be more satisfied		
	3.2 Strong influence on suppliers is negative to interdependence		
	3.3 The degree of power of the customer will depend on the number of suppliers they have and the cost of switching		
	3.4 Intensity and equity are related to the rewards and costs derived from the relationship		

As illustrated in Table 6.4, our first three hypotheses on interdependence are rejected, as equal relationships do not necessarily lead to a higher degree of satisfaction. In addition, the fact that customers have strong influence on their suppliers does not necessarily mean that the relationship is unbalanced in terms of equity and co-operation, or not beneficial to the supplier. A strong supplier influence rather seems related to aspects connected to mutual rewarding relationships. Similarly, there is no connection between how many suppliers a customer has and the perceived costs of switching suppliers, meaning that a strong influence from the buyer do not need to be something negative to the relationship. The fourth and last hypothesis was however accepted, as the degree of equity in the relationship is affected by the previous outcomes of the relationship, and a balance of costs and benefits will increase the perception of equity.

6.4 Analysis of perceived customer value

Based on Zeithaml (1988), we determined that the customer’s perception of value depends on their level of comparison with other alternatives in terms of price fairness, quality and their level of satisfaction. In this section we will present the interdependent variables that characterise each of these factors in accordance with the results of the quantitative study conducted and based on statistical tests.

Price Fairness

Since price is present in all buying situations, it has been argued that the customer's perception of price and its perception of price fairness are important determinants of the customer's perception of value and profitability. Contrary to what we could have expected, our results have proven that this is not necessarily true. The findings from the mailing survey indicate that there is no significant relation between *price fairness* in terms of quality received and the statement "*We are a valuable customer to the supplier.*"²⁹⁸ This shows that customers do not feel more or less valuable because of the price they pay in relation to the quality received and similarly, customers do not perceive a *supplier to be valuable* because of the *price fairness* in terms of quality received since the results showed no significance between these variables.²⁹⁹ This is an interesting finding reflecting that value is not dependent on the perception of price fairness. Equally, our results indicate that there is no relation between perception of *price fairness* and the *perceived relationship duration* as the value shows no relation.³⁰⁰

It is important to consider that customers may have psychological reactions affecting their responses towards price changes but this is not dependent on whether they have been customers for a short or long time. Nevertheless, around 71% consider that the price is fair in terms of quality and since the company is thinking to change their price strategy it would be important to keep in mind that there may be some customers that would react to price increases in different ways.

Quality

In the theory it was argued that from a tangible perspective quality will deal with the characteristics of the product itself. We agree with this argument, as we were able to determine that customers that mentioned *quality* as one of the aspects for which the company is recognised tend to agree or totally agree with the statement "*The supplier's products are of constant high quality.*"³⁰¹

It is argued that price can be used as a signal for product quality. Our results agree with this proposition, since when comparing *price fairness* in terms of *quality* and the

²⁹⁸ ($X^2=0,94 < 3,86$, $p=0,331 > 0,05$)

²⁹⁹ ($X^2=0,66 < 3,86$, $p=0,415 > 0,05$)

³⁰⁰ ($X^2=2,75 < 5,99$, $p=0,252 > 0,05$)

³⁰¹ ($X^2=10,80 > 5,99$, $p=0,005 < 0,05$)

statement “*The supplier’s products are of constant high quality*” there was found a strong interdependence.³⁰²

However, it was also suggested in the theoretical framework that service factors are determinants of the quality perceived. When crossing *quality* as one of the aspects characterising the company with *customer’s satisfaction with the customer service received* no significant relation was found. This reflects the fact that customers that agreed to the statement *customers satisfaction with the customer service received* would not necessarily have mentioned that *quality* is a representative aspect of the company.³⁰³ However, this is the only aspect we measured in terms of additional services so further conclusions about the role played by services in terms of quality perception should be made with caution.

In his working paper, Naumann mentions that company’s reputation and image are possible indicators for *quality* and therefore will affect the *customer’s perception of value*. The test indicates that the result is almost significant and therefore it is possible to say that there is a trend indicating a relationship between *reputation* and the *perceived quality of the products*. The majority of the customers that mentioned that Formica-PSM is recognised by its reputation tend to agree that the supplier’s products are of constant high quality.³⁰⁴ Although we were not able to find a statistical relation between the *supplier’s quality* and *supplier is perceived as valuable*, we were able to see that the majority of the customers that answered quality tend to agree that the supplier is valuable.³⁰⁵

Satisfaction

The definitions presented in our frame of reference have stated that satisfaction is a determinant of customer value as it represents a constant evaluation over time of the experience of current and past purchases being affected by price, quality and the fulfilment of customer’s expectations. We were interested to determine whether the relations between satisfaction and these variables actually prevailed in our study. The theory mentions that satisfied customers are likely to be less price sensitive, meaning that highly satisfied customers would be less sensitive to price changes. When comparing *overall satisfaction* with *price fairness* in terms of quality the results of the research showed that although the statistical values are under the

³⁰² ($X^2=10,07>5,99$, $p=0,006<0,05$)

³⁰³ ($X^2=0,001<3,86$, $p=0,981>0,05$)

³⁰⁴ ($X^2=3,46<3,86$, $p=0,063>0,05$)

³⁰⁵ ($X^2=3,64<3,86$, $p=0,724>0,05$)

limit of acceptance there is a strong tendency for a relation between these two variables.³⁰⁶ This implies that the variables are not totally independent from each other, and that the customers which stated to be satisfied would probably respond that the price is fair. This permits to argue that customer's reactions to price changes are going to occur in some relatedness of how satisfy they are.

In the same way, we wanted to verify the relation between satisfaction and the perceived quality. To do that, we combined the variable *overall satisfaction* and “*The supplier's products are of constant high quality.*” The chi-square test indicates that there is not a significant relation between these aspects.³⁰⁷ Moreover, we cross *overall satisfaction* with “*The supplier is recognised for: quality.*” And contrary to the theory, the study showed that there is no relation between these two variables.³⁰⁸ These findings furthermore stress the idea that satisfaction should not be measured primarily on quality (the higher the quality, the higher the customer satisfaction) as it is commonly believed.

The question that assessed customer expectations included eight categories: *performance, customer service, delivery, price, products, availability of information, promises and sales personnel.* The results of the chi-square tests showed different relations between the variables measured. Firstly, the research shows that there is not a significant relation between *overall satisfaction* and *expectations with respect to performance, price, availability of information, promises and sales personnel.*³⁰⁹ However, according to the values obtained from the test, it is possible to say that there is a very strong relation between *overall satisfaction* and *expectations met* with regards to *customer service* and *delivery*, and a rather weak relation with *products.*³¹⁰ From these results it is therefore possible to conclude that only certain types of expectations will have an effect on satisfaction.

Anderson *et al* (1994) stated that as long as the current experience with a supplier provides value to customers, they are likely to be satisfied. We decided to cross these factors in order to test whether this statement would agree with our findings. When crossing “*We are a valuable customer to Formica-PSM*” with *overall satisfaction* we

³⁰⁶ ($X^2=3,52<3,86$, $p=0,060>0,05$)

³⁰⁷ ($X^2=1,67<5,99$, $p=0,433>0,05$)

³⁰⁸ ($X^2=5,32<7,81$, $p=0,150<0,05$)

³⁰⁹ Performance ($X^2=4,58<7,81$, $p=0,205>0,05$), Price ($X^2=1,75<7,81$, $p=0,625>0,05$), Availability of information ($X^2=0,525<7,81$, $p=0,913>0,05$), Promises ($X^2=1,318<7,81$, $p=0,725>0,05$) Sales Personnel ($X^2=0,267<7,81$, $p=0,966>0,05$)

³¹⁰ Customer Service ($X^2=22,434>7,81$, $p=0,000<0,05$), Delivery ($X^2=9,105>7,81$, $p=0,028<0,05$) Products ($X^2=7,906>7,81$, $p=0,966>0,05$)

discovered that these aspects are indeed strongly related.³¹¹ Therefore, it is important that the customer perceives that he is obtaining value derived from the trade-offs of the relationship in order to be satisfied. This goes hand in hand with our findings regarding the *perception of costs and benefits* in the relationship and the *overall satisfaction*, where we found that there is significance in the interrelation of the variables.³¹² Moreover, we were able to determine that the *perception of costs and benefits* and their *perception of co-operation* of the relationship are interrelated.³¹³ Thus, it could be possible to argue that *overall satisfaction* would indirectly be affected by the perceived *co-operation* of the relationship. In this respect, our results showed that although the values are on the limit of rejection it could be said that there is a strong tendency towards interrelation between these two variables.³¹⁴

Bolton (1998) mentions that there is a link between satisfaction and the duration of the relationship where the strength of the link is determined by prior experiences with the organisation. However, authors as Gummesson (2002) have concluded that close relationships do not necessarily result in high levels of satisfaction. We would agree with both, since we determined that *the customer's duration in the relationship* is related to the *level of satisfaction*, where older customers tend to be more satisfied than newer.³¹⁵ However, even though a customer has been in the relation for a long time this does not necessarily mean he will be satisfied. That could be a very risky assumption for the business as many satisfied customers actually switch supplier for various other reasons. In this respect, we found that older customers just answered to be medium to highly satisfied, indicating a potential area for improvement.

Satisfaction is one of many crucial success factors of any business and therefore it should be assessed in the correct way by measuring the aspects that actually will have an impact on it. It has been said that satisfaction presumably leads to repeat purchases and favourable word-of-mouth publicity. The results of our mail survey permit us to support these theoretical propositions. The values of the chi-square demonstrate that there is indeed a rather strong link between *overall satisfaction* and *repurchase*,³¹⁶ reflecting the importance for companies to assess the level of customer satisfaction on a regular basis in an effort to secure future business. It was equally important to determine that customers' *overall satisfaction* is not

³¹¹ ($X^2=6,009>3,86$, $p=0,014<0,05$)

³¹² ($X^2=26,62>12,6$, $p=0,041<0,05$)

³¹³ ($X^2=16,10>15,5$, $p=0,04<0,05$)

³¹⁴ ($X^2=5,62<5,99$, $p=0,06>0,05$)

³¹⁵ ($F=4,06>4,00$, $p=0,04<0,05$)







³¹⁶ ($X^2=16,90>5,99$, $p=0,00<0,05$)

dependent on their degree of *cross-buying*³¹⁷ or whether they buy from *single or multiple suppliers*.³¹⁸

It was interesting to determine that customers that responded to having a *close relationship with the sales personnel* tended to have a medium to high level of *satisfaction*³¹⁹, implying that the salesmen can play an important role in satisfying customers and increasing the repurchase. Regarding *customer service*, the results of the chi-square test are at the limit of acceptance, which may point out that this factor is not totally independent from *customer satisfaction*, but in fact influences it to some extent.³²⁰ Our results revealed that there is a relation between the statement “*We are positive to recommend Formica-PSM to others*” and *overall satisfaction*.³²¹ It seems to be a diagonal trend pointing to the fact that those customers that are said to be highly or very highly satisfied tend to agree or totally agree that they would recommend the company to others. Similarly, customers that would *recommend the firm to others* are *proud to do business with the company*.³²² Accordingly, it is possible to say that satisfaction may be one of the most important aspects for relationship stability and loyalty and that customer satisfaction is a vital prerequisite for a business’ success providing companies with the opportunity to enhance their profitability.

From the discussion presented under customer perception of value, we are able to confirm or reject the following hypotheses:

Table 6-5 Hypotheses on Customer's perception of Value

Relationship Characteristic	Hypothesis	Accept Reject	
			
4. Perceived customer value	4.1 Customer’s perception of value depends on their level of comparison with other alternatives in terms of price fairness, quality and satisfaction.		
	4.2 Satisfaction is related to the duration of the relation but not related to closeness of the relation		
	4.3 Satisfaction is both a driver and outcome of the customer’s perception of value		

³¹⁷ ($X^2=0,09 < 7,81$, $p=0,99 > 0,05$)

³¹⁸ ($X^2=1,44 < 7,81$, $p=0,69 > 0,05$)

³¹⁹ ($X^2=7,79 > 5,99$, $p=0,02 < 0,05$)

³²⁰ ($X^2=3,81 < 3,86$, $p=0,05 > 0,05$)

³²¹ ($X^2=16,34 > 5,99$, $p=0,00 < 0,05$)

³²² ($X^2=22,52 > 9,49$, $p=0,00 < 0,05$)

As illustrated in Table 6.5, the results allow us to confirm all three hypotheses, even if our opinion regarding the first hypothesis is divided. The perceived price is not linked to how the customer perceives value in a relationship, but quality and satisfaction, however, proved to be important. Although it was not statistically proven that quality is related to the customer perception of the supplier's value, we did find a strong trend that customers stating quality tend to answer that the supplier was valuable to them. Moreover, their perception of quality is related to the product characteristics, their perception of price and reputation of the company.

As satisfaction is not directly related to the quality perceived by customers, it is important to take into consideration whether expectations have been met. For the case of Formica-PSM, it was determined that expectations with regards to customer service, delivery and products are strongly related to satisfaction. In this respect, satisfaction will function both as a driver and as an outcome of the customer's perception of value, since as long as the customer is satisfied he will feel more valuable and will tend to recommend the company to others and to be proud. In turn, as long as the interaction with a supplier provides value the customer will tend to be satisfied. Valuable customers regard the relation as satisfactory, co-operative and balanced in terms of costs and rewards. Further, older customers proved to be more satisfied than younger ones, which is in line with the second hypothesis.

6.5 Analysis of loyalty

In our theoretical framework it was discussed that loyalty involves both behavioural and attitudinal aspects. The first one referring to the number of purchases, frequency of buying and contact, whereas the second refers to the customers preferences and feelings with regards to a brand or supplier. Since we believe that loyalty depends on both behavioural and attitudinal aspects that determine the likelihood of a customer to repurchase, we decided to measure whether these aspects are, according to our results, linked to each other. Furthermore, as there is scarce information and limited research conducted about loyalty in industrial markets, we believe these findings will contribute to the existing knowledge.

Firstly, we compared *repurchase* with the *buying frequency* and the results of the chi-square demonstrate that there is a clear relationship between these two aspects.³²³ We agree with these results since it is likely that customers purchasing in a continuous way from a certain supplier are likely to continue to do so. It was found that *buying frequency* and the *contact frequency* are interdependent aspects³²⁴, which suggests that the contact frequency could indirectly affect repurchasing behaviour to a certain extent. However, this proposition was tested, and the result indicates that there is no relation between *contact frequency* and *repurchase*.³²⁵ Although some interdependencies were found in terms of repurchase, we would argue that this alone would not determine whether a customer is loyal, as there may be other reasons for them to repurchase than loyalty. Instead, the results imply that having a relation between these variables there is a potential to develop loyalty among customers.

Further, Reinartz and Kumar (2003) argue that customer retention is enhanced through cross-buying (the degree of purchasing from different product categories) as well as customer switching costs, particularly in contractual settings. Moreover, they suggest that profitable customer lifetime duration is positively related to the degree of cross-buying behaviour that customers exhibit, whereas focused buying negatively affects this duration. Our results do not agree with this as they show that there is not relation between *years as customers* and *cross-buying*,³²⁶ even if there is a tendency that companies that have been customers for about 20 years are the ones that also buy from different product categories.³²⁷

On the other hand, we could say that there is an indication that older customers tend to cross-buy whereas newer customers do not. However, the importance of cross-buying is that according to these authors it will lead to retention. We crossed *repurchase* as a sign of retention and the degree of *cross-buying*³²⁸ and we did not find any relation. However, we did find interdependence between the degree of *cross-buying* and the *buying frequency*,³²⁹ but suggests that those that buy more frequently tend to not to cross-buy.

³²³ ($X^2=13,17 > 9,49$, $p=0,010 < 0,05$)

³²⁴ ($X^2=44,42 > 5,99$, $p=0,00 < 0,05$)

³²⁵ ($X^2=6,76 < 9,49$, $p=0,149 > 0,05$)

³²⁶ ($F=0,57 < 2,45$, $p=0,452 > 0,05$)

³²⁷ ($X^2=0,758 < 1,684$, $p=0,452 > 0,05$)

³²⁸ ($X^2=0,692 < 5,99$, $p=0,708 > 0,05$)

³²⁹ ($X^2=44,47 > 9,49$, $p=0,00 < 0,05$)

This is a very important result for this study, since the majority of the interviewed customers normally buy from one category, which imply no effect in their likelihood to repurchase. There is no significant relation between *years as customers* and the *frequency of buying*³³⁰. Nevertheless, it seems like newer customers buy more seldom than older ones.

Since it could be discussed that loyalty also depends on whether customers buy from *single and multiple suppliers*, we decided to test if there was a relation between this variable and the degree of *cross-buying* among customers. We did not find any relation between these variables, which reflects that the customer's choice to buy from one category or several is not dependent on how many suppliers they have for the same category.³³¹ On the same line, we discovered that their selection to buy from *single or multiple suppliers* is not related to the likelihood to *repurchase*.³³² Thus, it can be concluded that there may be customers in certain industries that cannot afford the risk to use one company to supply their orders, but not because that would mean the customer is not loyal. On the other hand, there may be other customers that can remain with one single supplier and reduce related risks based on relationship commitment and co-operation.

Furthermore, we analysed the relation between whether the customer has *single or multiple suppliers* and if the customer is *proud of doing business with Formica-PSM*, which was proved not to be related³³³. On the other hand, there is a significant relation between *customers with single or multiple suppliers* and whether they *recommend Formica-PSM to others*³³⁴. In this respect, and surprisingly, the customers that buy from multiple suppliers tend to be more positive to recommend Formica-PSM to others than the customers buying exclusively from the company.

Secondly, we were interested to measure whether customers' preferences and attitudes towards the supplier could have an impact on their loyalty. Since *co-operation* could be one factor motivating customers to continue doing business with a given supplier, we tested this variable with *repurchase* and discovered that they are strongly related.³³⁵ In order to strengthen this, the relationship between *repurchase* was compared with the probability among customers to *recommend the company*. Here we found that there is also a strong relation between the variables as

³³⁰ ($F=0,934 < 2,45$, $p=0,467 > 0,05$)

³³¹ ($X^2=1,468 < 3,86$, $p=0,226 > 0,05$)

³³² ($X^2=3,22 < 5,99$, $p=0,199 > 0,05$)

³³³ ($X^2=1,601 < 5,99$, $p=0,449 > 0,05$)

³³⁴ ($X^2=6,165 > 5,99$, $p=0,046 > 0,05$)

³³⁵ ($X^2=12,702 > 9,49$, $p=0,013 < 0,05$)

the chi-square test proved to be significant.³³⁶ Thus, it could be suggested that co-operation affects repurchase and this affects word-of-mouth.

Uncles (1994) stated that satisfaction is an antecedent to loyalty. Therefore, we decided to test this relationship. According to the values of the chi-square, it is possible to say that there is a strong link between *overall satisfaction* and *repurchase*.³³⁷ This outcome again stresses the importance for companies to assess the level of customer satisfaction regularly. The result though does not imply that satisfaction is the only determinant to loyalty, as customer can have many other reasons behind their reasons to repurchase. However, it does reflect that there is the potential to develop loyal customers and increase the amount of business derived from them.

The third factor obtained from the factor analysis is characterised by variables that represent loyalty. The result shows that customers tend to be satisfied and plan to repurchase, and would recommend the company to others, tended to rate the supplier's ability to fulfil promises positively, to have shared values and to have the relationship duration as a reason for them to remain customers.





Factor 3: LOYALTY	
Customer is satisfied with Formica-PSM and plans to re-buy	.761
Formica-PSM is a company we recommend to other companies	.698
Formica-PSM is a supplier that fulfill its promises	.694
Formica-PSM:s values agree with customer's values	.634
Relationship duration is a reason for being a Formica-PSM customer	.523

From the discussion presented under loyalty, we are able to confirm or reject the following hypotheses:

³³⁶ ($\chi^2=29,40 > 9,49$, $p=0,00 < 0,05$)

³³⁷ ($\chi^2=16,902 > 5,99$, $p=0,00 < 0,05$)

Table 6-6 Hypotheses on Loyalty

Relationship Characteristic	Hypothesis	Accept	Reject
5. Loyalty	5.1 Loyalty depends on behavioural and attitudinal aspects		
	5.2 Cross buying is affected by the duration of the relation and customer retention can be achieved through cross-buying		
	5.3 Frequent buyers will tend to remain in the relation for a longer time		
	5.4 Customers working with multiple suppliers are still likely to be loyal		

As illustrated in Table 6.6, the results allow us to confirm that attitudinal and behavioural aspects do affect loyalty in the respect that there is a clear relation between repurchase and buy frequency as well as buying frequency and frequency of contact. For instance, we found that customers that have continuous buying are more open to the idea of repurchase. In addition, customers with several suppliers do not necessarily need to be less loyal, but we also believe this may vary from industry to industry. In the case of Formica-PSM it was actually the case that customers having multiple suppliers are also more open to the idea of repurchase.

The remaining hypotheses are rejected as the years as customer do not affect the extent of cross-buying and retaining customers does not necessarily need to increased by cross-buying. Further, frequent buying does not imply that the relationship will be long-term, even if the data indicates a trend pointing out that newer customers tend to buy more seldom.

6.6 Analysis of trust and commitment

Two dimensions of trust were identified in terms of credibility, which is based on the belief that the supplier has the required expertise to perform the job reliably, and benevolence, which refers to the belief that the supplier is interested in the customer’s welfare. In this respect, we tested the statement “*The supplier is recognised by its trustworthiness*” against “*The company has the competence to perform in this industry*” and as we expected the values indicate a strong relation between these variables.³³⁸

³³⁸ ($X^2=9,55>5,99$, $p=0,08<0,05$)

As it is suggested that the customers' perception of being valued by the supplier can have an impact on trust, we combined "*Formica-PSM is recognised by its trustworthiness*" with the statement "*We are a valuable customer to Formica-PSM.*" In this case, the results did not show any relationship between the variables³³⁹, indicating that their perception of the company's trustworthiness is independent of whether or not they perceived themselves as valuable customers for the supplier.

Likewise, it is argued that relationships characterised by trust are highly valued by customers. Therefore, it was interesting to determine whether there was a relation between the statement "*Formica-PSM is recognised by its trustworthiness*" and the statement "*Formica-PSM is a valuable supplier to the customer.*" The values of the statistical tests indicate that there is no significant relationship between these variables.³⁴⁰ However, we were able to determine that *fulfilment of promises* is strongly related to the *perceived trustworthiness* of the supplier³⁴¹, but whether this has an impact on the customer's perception of the value of the supplier was not possible to determine as there were many missing cases.

Several authors, among them Ganesan (1994) and Morgan and Hunt (1994) have discussed that trust is a critical factor required for the development of long-lasting relationships. In order for us to see if the amount of years as a customer had some effect on trust, we crossed the variable *years as customer* and "*The supplier is recognised by its trustworthiness*",³⁴² as well as *years as customer* and "*The supplier fulfils its promises*" and the results showed no relation.³⁴³ In this respect, it is possible to say that trust is not a determinant of short or long-term customers. However, we would agree that relationships that are characterised by trust are more likely to continue developing than those without it.

Previous studies have identified the importance of goal congruence, reputation and length of the relationship, satisfaction and perception of the supplier's specific investments in people, long-term assets and procedures and communication to affect trust. Regarding this aspect our results did not show any significant relation when comparing "*The company is recognised for its trustworthiness*" and *shared values*.³⁴⁴ The results did not show any statistical relation between the variables "*Formica-*

³³⁹ ($X^2=0,286<7,81$, $p=0,412>0,05$)

³⁴⁰ ($X^2=2,86<5,99$, $p=0,41>0,05$)

³⁴¹ ($X^2=10,54>7,81$, $p=0,01<0,05$)

³⁴² ($F= 0,80$, $p= 0,37>0,05$)

³⁴³ ($F= 0,55$, $p= 0,64>0,05$)

³⁴⁴ ($X^2=2,36<3,86$, $p=0,50>0,05$)

PSM is recognised for its trustworthiness” and “The company is recognised for its reputation.”³⁴⁵ Therefore, it is possible to say that there is no statistical foundation to suggest that the customer’s trust towards a company will be affected by its reputation. Finally, interdependence between the variable “The company is recognised for its trustworthiness” and any of the *supplier’s investments in the relationship*³⁴⁶ was not found.

Interestingly, our findings indicate that there is no interdependence between customers’ perception of the *supplier’s trustworthiness* with *overall satisfaction* as the results did not prove significant.³⁴⁷ On the other hand, we are able to say that the customers’ perception of the *company’s competence to perform in this industry* and *overall satisfaction* are interrelated, as the chi-square test indicates a relation.³⁴⁸ This indicates that those customers that tend to state they totally agreed with the statement on the supplier’s competence to perform in the industry, tend to have a high or a very high degree of satisfaction. Moreover, it was found that there is interdependence between *overall satisfaction* and the statement “The supplier fulfils its promises.”³⁴⁹ Those stating to be very highly and highly satisfied tend to agree and partly agree with the statement.

The first factor obtained from the factor analysis presents interesting findings in terms of trust. The conclusion is that customers are going to perceive the supplier as competent when

Factor 1: Trust and commitment	
Formica-PSM has the competence required to perform in this industry	.815
Conflicts are solved in a friendly manner	.774
Customer is satisfied with the customer service received	.715
Formica-PSM products are of constant high quality	.592

conflicts are solved in friendly ways, which goes hand in hand with having professional and customer oriented customer service and keeping constantly high quality.

In terms of *co-operation* and the statement “The company is recognised by its trustworthiness”, the value of chi-square showed no interrelation between the variables.³⁵⁰ However, since the values are close to the minimal acceptance it could be said that there is a strong tendency for these aspects to be related.

³⁴⁵ ($X^2=0,25<3,86$, $p=0,61>0,05$)

³⁴⁶ Money ($X^2=3,00<3,86$, $p=0,08>0,05$), Long-term assets ($X^2=3,00<3,86$, $p=0,08>0,05$), Time ($X^2=3,00<3,86$, $p=0,083>0,050$), Personnel ($X^2=0,681<3,86$, $p=0,409>0,050$), Knowledge ($X^2=1,45<3,86$, $p=0,228>0,05$), Personal Contacts ($X^2=0,327<3,86$, $p=0,567>0,05$), Processes ($X^2=1,74<3,86$, $p=0,187>0,050$)

³⁴⁷ ($X^2=2,36<3,86$ $p=0,501>0,05$)

³⁴⁸ ($X^2=12,595>5,99$ $p=0,002<0,05$)

³⁴⁹ ($X^2=6,18>3,86$ $p=0,013<0,05$)

³⁵⁰ ($X^2=8,83<9,49$ $p=0,065>0,05$)

Morgan and Hunt (1994) have statistically verified four major antecedents of relationship commitment and trust. Relationship termination costs are concluded to directly influence commitment while shared values directly influence both commitment and trust. From this perspective we thought it would be interesting to verify if these findings would prevail in our research. In this respect, first we compared the statement *switching supplier implies major costs for the customer*, as a signal of termination costs, and commitment understood as *the customers' investments in the relationship*. According to the findings of this study, there is no relation between termination costs and investments in *money, long-assets, time, knowledge, personal contacts* and *personnel*. On the other hand, there is a strong interdependence between termination costs and *investment in processes*.³⁵¹

Thereafter and referring to Sanzo *et al* (2003), it was determined that there are two types of commitment, affective and calculative. Further, emotional aspects of the relationships and the evaluation of the relationship's value are important to the development of mutually beneficial relationships. Moreover, it is suggested that in a highly valued relationships the parties will commit themselves to such relationships. In our study, we detected that perception of the interaction in terms of *co-operation* understood as the affective part of commitment, and the *values shared by the supplier and the customer* are related.³⁵²

In the survey, the majority of the customers perceiving the relationships as *neither co-operative nor lack of co-operation* tended to partly and totally agree to the statement *supplier and customer have common values*. On the other hand, the relation between *co-operation* and the statement “*We are a valuable customer to the supplier*” did not show any relation,³⁵³ neither when comparing *co-operation* with “*The company is a valuable supplier to the customer*.”³⁵⁴

From the discussion presented under trust and commitment, we are able to confirm or reject the following hypotheses:




³⁵¹ Money ($X^2=4,45<9,49$, $p=0,348>0,05$), Long-assets ($X^2=2,35<9,49$, $p=0,671>0,05$), Time ($X^2=2,27<9,49$, $p=0,685>0,05$), Processes ($X^2=9,65>9,49$, $p=0,04<0,05$) Knowledge ($X^2=5,26<9,49$, $p=0,262>0,05$), Personal contacts ($X^2=4,145<9,49$, $p=0,387>0,05$), Personnel ($X^2=2,03<5,99$, $p=0,362>0,05$)

³⁵² ($X^2=15,13>5,99$, $p=0,001<0,05$)

³⁵³ ($X^2=4,37<5,99$, $p=0,112>0,05$)

³⁵⁴ ($X^2=3,98<5,99$, $p=0,137>0,05$)

Table 6-7 Hypotheses on Trust and Commitment

Relationship Characteristic	Hypothesis	Accept	Reject
6. Trust and Commitment	6.1 Customer's perception of the supplier's competence to perform in the industry and the supplier's fulfilment of promises are determinants of trust		
	6.2 Trust is required for the development of long lasting relationships		
	6.3 Termination costs and shared values are likely to affect customer's trust and commitment		

As illustrated in Table 6.7, the results allow us to accept all three hypotheses. This means that customers perceiving the supplier to have the competence to perform in the industry have a higher degree of trust in the relation, and this perception of competence is affected by the degree of overall satisfaction and the degree of co-operation in the relation.

Further, supplier fulfilment of promises was proved to be the major sign of trust. Trust does not seem to be a determinant for short and long-term relationships, but, on the other hand, we found a trend that older customers tend to agree more to this statement whereas younger customers are unsure. Therefore, from this trend we would suggest that relationships that are characterised by trust are more likely to continue developing than those without it.

Additionally, customer investments in processes and supplier investments in time are signs of commitment and intimately linked to the degree of switching of a supplier. Also, shared values are related to commitment as it means an opportunity to express goals and work towards similar objectives.

6.7 Customer profitability

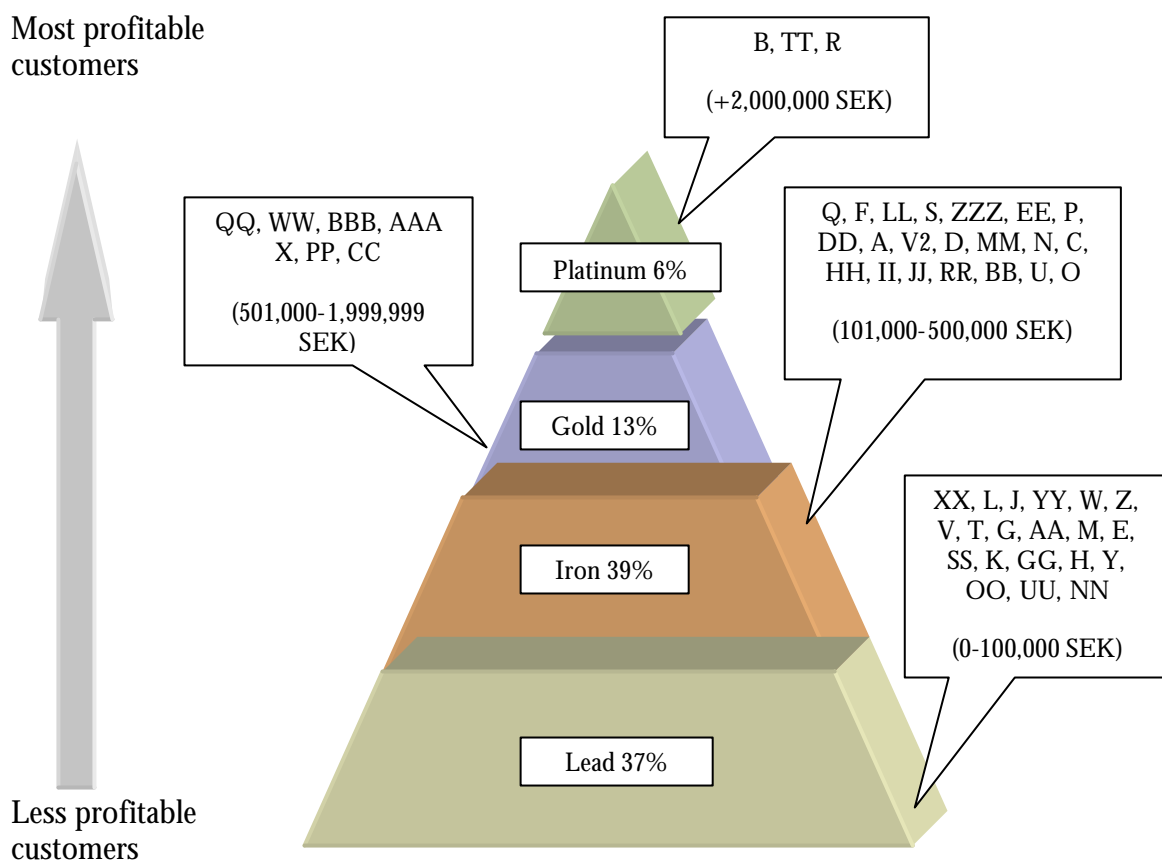
As it has been mentioned in the frame of reference, customers should be considered part of the valuable assets of a company, and as such they need investments. However, customers are not always equally profitable nor will value the services provided by the company in similar ways. By segmenting the customer base, the supplier can identify how much a relationship is worth, which enables an allocation of resources and marketing to its customers accordingly.

Each direct-buying customer has been analysed on the basis of his profitability by using Zeithaml *et al* (2001) pyramid of profitability and their relationship characteristics, which will serve as a basis for conclusions and recommendations to Formica-PSM.

6.7.1 The pyramid of profitability

When analysing Formica-PSM's base of direct-buying customers, it is possible to observe that from the 47 customers that have purchased in the last 1½ year, only ten customers (20%) account for 75% of the profit, which refers to the well known 80-20 rule. Following the pyramid of profitability, Formica-PSM customers can be grouped into 4 different levels, as it is illustrated in Figure 6.1 where each customer has been coded by letters.

Figure 6-1 The pyramid of profitability



Source: Zeithaml *et al* (2001)

The *platinum group* characterises the most profitable customers and together they represent 6% of the total number of customers and 41% of the profit. The next level refers to the *gold customers*, which are profitable but not as high as the platinum group. 13% of the customers belong to this category accounting for 34% of the profit. The *iron customers* are supposed to give the volume needed to operate and to use the capacity of the firm, 39% of the customers are grouped in this category, all together accounting for 22% of the profit. However, their level of expenditure and profitability do not justify special treatment. Finally, 37% of the customers are grouped in the *lead category*, corresponding to only 3% of the profit. Therefore, it can be said that this customers are normally those costing money and resources to the company demanding more than they provide to the firm. The remaining 5% correspond to the customers that have not purchased in the last 1 ½ years.

Platinum customers

The platinum group is composed of three company customers (B, TT, R), which have been customers at Formica-PSM for at least 10 years, as they are categorised into group 1 in years as customer. In terms of turnover, each company has different potentials and hence they have been grouped in different turnover categories (B in group 4, TT group 2 and R in group 3).

The group is characterised as having a rather continuous buying frequency contacting the company either everyday or at least once a week and with no desire to be contacted more frequently. Two companies of the three platinum customers are currently cross-buying, and the other only buys from one category.

The three customers perceive their relationship duration with Formica-PSM as very long-term. This is interesting as these companies are considered rather young customers, which indicates certain determination to continue the relationship into the future. Furthermore, for two of these customers the relationship duration is one of the reasons why they are customers of Formica-PSM.

This long-term perception of the relationship goes hand in hand with the perception of the interaction in terms of intensity. In this respect, B and R consider to have a partly intensive relationship with Formica-PSM, whereas TT regarded it as neither intensive nor superficial.

The platinum group perceives the interaction with Formica-PSM to be rather balanced in terms of equality, and co-operation. However, one of the customers perceives that the relationship implies more costs than benefits (R). Two of the customers purchase laminate products from multiple suppliers, which is particularly important and a potential threat, when considering the fact that these same two customers are unsure whether to change Formica-PSM as a supplier. This implies major costs and only one of them partly agreed with this statement. Hence, it is possible to conclude that in reality and regardless of the perception of the customers the relationship is rather unbalanced where Formica-PSM is more dependent on this category of clients than the contrary. The fact that the customers perceive themselves to have a strong influence on their suppliers does not need to be something negative as it is sometimes believed. In the case of Formica-PSM, it was found that these customers consider themselves to be valuable customers and also value the company as a supplier, which establishes a good basis for the development of more equal and co-operative relationships.

Investments from the customer or the supplier are important since they will determine the ease or difficulty to leave a relationship. It is important to look at both sides of the relation, as this will also indicate how the customer perceives its own investments in the relation and the ones performed by the supplier, which will give a sign of their perception of balance. In this respect, the platinum group stated to have invested in the relationship in terms of long-term assets, personnel and knowledge. Regarding their perception of Formica-PSM investments, only one of the three answered this question, which was quite a surprise. B and TT did not provide any answer to this whereas company R perceived that Formica-PSM investments in this relation have been mainly in terms of knowledge and personal contacts. Whether the reasons for B and TT not answering was due to lack of knowledge or lack of interest is only negative for Formica-PSM, especially since these two customers are among the customers receiving special service from the company, for example the availability of having product stock in Formica-PSM warehouse.

As mentioned, the companies of this group are rather unsure about whether changing the supplier would imply major costs. This stresses the fact that Formica-PSM needs to communicate its investments in the relationship for customers to feel there is strong reasons to stay and major costs if they leave. Moreover, it must also increase the customer investments in processes into the relationship and make them aware so they perceive a more balanced and interdependent relation. Investments not necessarily need to be in economic

terms. As discovered in the previous section, supplier investments in time seemed to be highly related to the statement switching a supplier implies major costs.

In terms of expectations, the platinum customers referred to delivery, price products and customer service, as the main aspects in which Formica-PSM meet their expectations. Delivery and customer service were determined to be strongly interrelated to overall satisfaction, yet only two customers mentioned delivery and only one mentioned customer service, which reflects an important area of service improvement.

Two customers regarded their overall satisfaction as high and totally agreed with the idea to repurchase. The other customer stated a neither low nor high level of overall satisfaction and partly agreed with the idea to repurchase. Thus, it is possible to conclude that overall satisfaction within this group is rather positive although there are other important aspects of expectations that were not mentioned, such as sales personnel, performance, promises and availability of information. In order to prevent a decrease in the level of satisfaction, these aspects need to be assessed on an individual basis to determine whether they can have a negative impact on their level of satisfaction, which could be determined through the sales representative attending each account.

In terms of price, only one platinum customer was unsure whether the price paid in relation with the quality received is fair. The other two companies have a positive attitude towards this statement. In the same way, the three customers consider the products of Formica-PSM to be of constant high quality, are satisfied with the customer service received, consider conflicts to be solved in a friendly manner and have a close relationship with the sales personnel. Moreover, the customers partly and totally agree to recommend Formica-PSM to other companies and believe that loyal customers should be rewarded. These aspects were determined to be highly interrelated to the variable overall satisfaction, which implies certain security for Formica-PSM. These levels of satisfaction need to be kept as it has been proven that they can lead to future purchases and positive word-of-mouth.

We must also consider the customers perception of the outcomes derived from the relationship with Formica-PSM. Here it was determined that customers consider that the co-operation with this company has positively influenced them in terms of knowledge, processes, market share and quality products. These

outcomes represent the benefits that they perceived from the relationship and therefore Formica-PSM needs to emphasise them as well as switching costs.

Honesty, reputation, quality and “other” were among the aspects that platinum customers named characterising Formica-PSM. Trustworthiness and reputation were not mentioned. However, when asking them whether the relationship with Formica-PSM was trustworthy these customers had a positive attitude towards this statement, and partly agreed with the statement Formica-PSM fulfils its promises. As it was expected, these customers regarded Formica-PSM to be competent to perform in this industry and consider themselves proud to be doing business with this supplier.

A positive finding was to know that these customers consider Formica-PSM to be a valuable supplier and, on the other hand, they are considered themselves to be valuable customers to the company. Since they already recognise the company as a valuable supplier, if Formica-PSM engages in communicating the benefits derived from the relationship in a more comprehensive way they most likely will increase the perceived costs of changing supplier in the future. Furthermore, platinum customers seem to have common values with Formica-PSM, which in addition to being a source of switching costs can increase the perceived level of co-operation from medium to high and raise their level of commitment to the relationship.

In the theoretical framework, the platinum customers were described as heavy users, less price sensitive and willing to invest and commit to the supplier. The analysis of this group in the case of Formica-PSM points to similar conclusions. The platinum customers are the ones purchasing the most and on a frequent basis. They perceive to have influence on their suppliers and this is a sign of they will to invest in the development of relationship and commitment. To say that they are less price sensitive could be rather adventurous, since our findings determined that these customers perceive the price to be fair in terms of the quality received, but that it is not enough to determine how the reaction could be in terms of a price change. It could even suggested that as they are currently satisfied with the current price, a future increase could be received negatively and create future conflicts.

Gold customers

The gold category of consists of 7 customers (QQ, WW, BBB, AAA, X, PP, CC). These customers have a rather varied turnover and hence are placed in different

turnover categories. Yet, there are medium to large companies, such as X, that are found in the fourth and highest level of turnover, or CC, WW, and PP that are in the second level.

All customers buy continuously from Formica-PSM, and are in contact with the company normally every day or once a week. As a result, none of them would like the contact to be more frequent. 3 out of 7 customers cross-buy from different product categories while 4 only buy from one product category.

The gold category is dominated by old customers that have purchased from Formica-PSM for 21 years or more. In line with this, the perceived relationship orientation is very-long term and the relationship duration is also a reason for being a Formica-PSM customer.

Regarding the degree of interdependence between Formica-PSM and the gold customers, the relationship is neither equal nor unequal and there is insecurity about whether the customer has supplier influence, which is an aspect that has been proven to have strong influence on satisfaction and for the development of co-operative relations. Corresponding to these results, the relationship is partly co-operative and the relationship is neither intensive nor superficial. Moreover, the majority of these customers are currently working with multiple suppliers. As it was presented before, having multiple suppliers is not a reason to consider a customer disloyal, however if the relation is not managed carefully this can be a potential threat, especially when this is combined with less co-operation and intensity.

The relationship with Formica-PSM is perceived to be balanced in terms of costs and benefits for all gold customers, with an exception from AAA and BBB that see more benefits than costs. Equal costs and benefits allow us to suggest that the relation may not be providing them with any extra value, which is reflected in the customers' perception of switching costs. We see that no gold customers totally agree with the statement that switching suppliers means major costs, where 4 customers partly agree with this (CC, PP, AAA, BBB), 2 are unsure and one partly disagrees (QQ).

The gold customers mainly invest in knowledge, money, long-term assets and personal contacts, while time, personnel and processes are not as important targets of investments. The gold customers are rather equal in their extent of investments and therefore rated high in each aspect. We found that X, QQ, WW,

AAA and BBB are the customers investing the most. One company, CC is only investing in knowledge, which is rather low engagement compared to the other gold customers. In turn, the customers' perception of Formica-PSM investments in the relationship are rather low compared to what the customers perceive to invest themselves. Knowledge, personnel, long-term assets and personal contacts were mentioned most, however still there were only 2 customers recognising each type of investment.

On the other hand, money, time and processes are not perceived as targets for investments by Formica-PSM, CC and AAA are the gold customers that recognise the investments by Formica-PSM the most. One customer (WW) even thinks that Formica-PSM has not made any investments in the relation. In this respect, it could be said that although customers stated to have a balanced relationship, it seems to be more towards their side than the opposite and this required special attention.

Looking at the perceived value in the relationship, Formica-PSM is recognised for meeting the customers' expectations on delivery by all seven customers. Also customer service is living up to most customer expectations. Only CC and WW did not mention this aspect. Furthermore, the customers' expectations on products are met according to half of the group while (CC, QQ, PP, BBB) did not mention this aspect. On the other hand, the customers' expectations are generally not met in terms of performance, price, sales personnel, availability of information and promises, as these aspects had a rather low rate of mention among customers. QQ is the only company that thinks Formica-PSM lives up to their expectations on performance. CC and PP are the only ones mentioning price, and X and BBB are the only ones mentioning sales personnel. In addition, the overall satisfaction with Formica-PSM is generally high or very high, yet two customers out of seven, CC and WW, have neither low nor high satisfaction. All gold customers totally agree to be satisfied and plan to re-buy, yet there seemed to be a lack of expectations' fulfilment in some areas. Conflicts in the relationship are believed to be solved in a somewhat friendly manner, and there is a close relation with the Formica-PSM sales personnel.

The gold customers tend to partly agree that the price they pay in relation to the quality is fair and that Formica-PSM products are of constant high quality. Also, the co-operation with Formica-PSM has a strongly positive influence on the customers' market share and their quality of products. Knowledge, processes and

revenues are also positively affected, while the customers' assets have not been affected at all.

The gold customers mainly recognise Formica-PSM for its reputation and quality but honesty, integrity, and trustworthiness are hardly mentioned in this group. Formica-PSM is considered to have the competence to perform in this industry, however with some doubt from some of the customers such as CC. Moreover, the relation with Formica-PSM is also considered to be trustworthy, despite the low recognition for trustworthiness. Furthermore, the gold customers are positive that Formica-PSM is a supplier that fulfil its promises, but with some hesitation from CC, WW and BBB. Furthermore, these customers tend to be positive that they are valuable customers for Formica-PSM, with half of the customers partly agreeing and the other half totally agreeing with this. Still there is one customer that is unsure about this (WW). This, in combination with the fact that Formica-PSM tends to be a valuable supplier and that customers are perceived to have common values, establishes the basis for developing co-operative relations and pride of doing business together. Nevertheless, there are customers that are unsure regarding this last issue (WW and PP).

Finally, the gold customers are strongly positive to recommend Formica-PSM to other companies, and are also very convinced that loyal customers should be rewarded.

Relating our results to the theory that gold customers are more interested in price discounts and considered as less loyal hence trying to minimise risk by working with several suppliers, we can only partly agree with this statement. The gold customers in our study tend to have many suppliers. However, a customer is not necessarily disloyal for having many suppliers. This is only an area to be aware of in order to increase switching costs and perceived benefits, keep them satisfied and committed so they do not change from the supplier. The group does not seem to be extremely worried about price as it states it has performed other investments in the relation, which indicate some desire to influence the relation.

Nevertheless, there are customers that show insecurity in their opinion towards important aspects and these needs to be assessed in time to avoid them turning into iron or lead customers if not approached in the right way. However, there are different potentials within the group where some might develop into platinum customers.

Iron customers

The iron group is rather large as it consists of 21 customers (Q, F, LL S, ZZZ, EE, P, DD, A, V2, D, MM N, C, HH, II, JJ, RR, BB, U, O). The majority of the customers can be regarded as small-medium size companies as they mainly can be found in the first and second group of turnover. In addition, they are rather new customers compared to the gold category, as 8 have been customers for 0-10 years and an additional 8 have been customers for 11-20 years.

A major share of the iron customers buy continuously and are normally in contact with Formica-PSM once a week or once a month. Most iron customers would not prefer the contact to be more frequent; however 3 customers are not sure about this (A, JJ, N). There is a spread opinion on the perceived relationship frequency, where 7 think it is medium-frequent, 5 think it is frequent and 6 think it is very frequent. A majority of the iron customers only buy from one product category.

The relationship with Formica-PSM is perceived to be long-term oriented by all customers, except U that thinks it is very short-term, which contradicts the opinions of the rest. Further, the relationship duration is perceived to be a reason for being a Formica-PSM customer. These customers consider the interaction to be neither intensive nor superficial, which is something that should be taken in consideration since this is an aspect directly related to profitability.

When analysing the interdependence between the iron customers and Formica-PSM, the majority regarded it as equal nor unequal and only two customers totally agree that the relationship is equal (F and MM). This insecurity about the relationship situation is also mirrored in the perceived degree of co-operation, where most customers think it is neither co-operative nor a lack of co-operation. Yet, it should be mentioned that there is a group that thinks it is co-operative (S and MM), and one customer (ZZZ) that thinks it partly lacks co-operation. This situation is a potential threat to the company as the majority of these customers are working with multiple suppliers. Moreover, there is a major insecurity about whether they have a strong influence on their suppliers, and as mentioned before this is a risk as this is a direct way to involve the customer into the relationship, increasing its commitment. Also, the iron customers tend to think there is a balance between benefits and costs, but it should be mentioned that three iron customers (F, MM and D) think that the relationship with Formica-PSM means more benefits than costs.

Regarding the switching costs in the relationship, there is a high degree of insecurity among the iron customers about whether changing suppliers would mean considerable costs. Further, 4 out of 21 iron customers are negative to that it would mean considerable costs (O, EE, V2, and D) while 6 iron customers are positive to this (F, N, P, C, JJ, II). In contradiction, customers perceive themselves as investing in the relation, which is a source of switching costs. The iron customers are mainly investing in knowledge for the relationship with Formica-PSM. Other important investments are money, long-term assets, time and personal contacts. Very few investments are made in personnel and processes.

However, it is important to notice that there is a rather low rate of mention of customer investments in relation to the amount of customers. We found that the customer investing in the most areas in the relation with Formica-PSM is BB which invests in 5 areas out of 7 possible (money, time, knowledge, personal contact), 9 customers are investing in 3 areas, 5 customers are investing in 2 areas and 2 customers are investing in one area each (II and S). Further, MM and DD have not made any investments. On the other hand, Formica-PSM is mostly recognised for investing in knowledge and personal contacts. Other investments mentioned by the iron customers are money, long-term assets, time, personnel and processes. There seems to be a balance between the areas of customer investments and perceived supplier investments, as 7 customers recognise 3 areas of investments, 3 customers mention 2 areas of investments and 3 customers recognise one area of investments each. Also, F, EE and II think that Formica-PSM has not made investments in the relationship.

When analysing the customer perception of value, we saw that the iron customers are very satisfied with the customer service, deliveries and products and to some extent, the availability of information. Areas where Formica-PSM is not meeting most iron customers' expectations are performance, price, promises and sales personnel. The overall satisfaction with Formica-PSM is generally high and most customers plan to re-buy. Only one iron customer has very high satisfaction (F) and one iron customer has very low satisfaction with Formica-PSM, (U).

Looking at the price fairness, most iron customers partly agree with that the price paid in relation to the quality received is fair, and partly think that the products are of high quality. Most iron customers are positive to the customer service received and believe that eventual conflicts are solved in a friendly manner. The relation

with Formica-PSM sales personnel is perceived to be close by most customers. Only one customer, JJ did not think the relationship is close at all.

The outcomes derived from the co-operation with Formica-PSM have had positive influence on the iron customers in terms of knowledge and quality of products. Furthermore, it has had positive effects on processes, assets and market share to some extent. Few iron customers have seen positive effects on their revenue and two customers do not see any positive influences on their business by co-operating with Formica-PSM (S and D).

Formica-PSM is mainly recognised for its quality, trustworthiness, reputation and honesty, while only one customer recognises the company for integrity. The iron customers have a positive attitude that Formica-PSM has the competence required to perform in its industry, which is a good indicator of trust. However, two customers disagree with the idea that the relationship is trustworthy (BB and U).

There is a very diverse opinion on their value as customers of Formica-PSM, which made it difficult for us to generalise in this matter. 6 customers are unsure about this, while 8 partly think they are valuable and 5 think they are valuable customers. The values of Formica-PSM has partly agrees with most of the values of the iron customers, and a majority is positive to that they are proud of doing business with Formica-PSM.

The iron customers are positive to recommend Formica-PSM to other companies, but not to the extent of the gold customers. Half of the group totally agree that they recommend Formica-PSM while the other half partly agree with this. There is also a positive attitude that loyal customers should be rewarded.

Lead customers

The lead group is formed of 20 companies (XX, L, YY, W, Z, V, T, GG, AA, G, M, E, SS, K, H, Y, J, OO, UU, NN). Customers within this group have been Formica-PSM clients for different years, although the majority (55%) are rather young (0-10years) followed by 30% that have been with Formica-PSM for at least 20 years. In terms of turnover, 11 of these customers can be considered to be rather small companies and therefore catalogued within group 1 (0-50 MSEK), among these are: K, L, T, V, Y, Z, XX, YY, W. On the other hand, within these group there are two of the largest customers of the entire customer base (M and H) with the potential to become profitable customers.

The group has very varied buying frequency, where the majority can be considered to continuously buy, daily, weekly or even monthly (E, L, W, Y, YY, G, T, AA, GG, NN, UU), However, a considerable amount buy once a quarter (M, V, Z, SS, XX, J), and three customers buy every six months and one once a year. Their contact frequency has very similar characteristics to their buying behaviour. However, five companies would like to have more contact (E, M, Z, GG, OO) which is something positive as they seem to have the potential to upgrade their position in the pyramid of profitability. Further, four companies were not sure (L, YY, J). The opinions regarding the relationship frequency are spread but still pointing towards an infrequent type, where 5 customers considered it infrequent among them G, H, and SS, 5 as less frequent such as M, XX, Z and other 5 customers as medium frequent as E, K, L. The remaining five has a more positive opinion (AA, GG, YY). Twelve of the lead customers are only buying from one product category and the others are currently cross-buying,

The majority (75%) of these customers perceive their relationship duration with Formica-PSM as long and very long-term, which is congruent to the fact that these customers have been clients between 0 to 20 years. Therefore, it could be assumed that they may be interested in continuing the relationship into the future. However, still there is 20% perceiving as medium term. Furthermore, fifteen of these customers consider the relationship duration as one of the reasons why they remain customers of Formica-PSM. Among these customers is M which is one of the largest companies in this group.

This long-term perception of the relationship is linked with the perception of the interaction in terms of intensity. The majority of the customers regard it as neither intensive nor superficial. However, there are some that consider it partly or entirely superficial, which given the conditions of this group is not a positive sign. Among these customers we can find, Y, Z, SS, L and T.

65% of the lead customers perceive the interaction with Formica-PSM to be balanced in terms of equity whereas 50% perceives a balance in terms of co-operation. However, there are about several customers that regard the relationship both as unequal and with lack of co-operation, among them are L, T, and others that have a negative attitude towards either one of the aspects. (SS, Z, Y)

From the 20 lead customers eight expressed having strong influence on their suppliers and interestingly here we could find M and H, which are the largest

companies. There are three companies that disagreed with this proposition and one of them was L, which goes in hand with its lack of perception of co-operation and equity.

Regarding their buying behaviour, it was possible to see a clear division where many as 55% buys from multiple suppliers among them M, SS and E, which are among the most profitable customers. The rest of the customers buy laminate products exclusively from Formica-PSM, among them L who perceived a lack of co-operation and inequality from the relationship, and H, one of the largest customers. This represents a threat and an opportunity respectively, since one may decide to take its business to other place, although this also could be something positive for Formica-PSM since the business derived from L has not been profitable. In the case of H, there is the opportunity to increase business and purchase volumes as this company only buys from Formica-PSM.

When analysing lead customers' perception of the relationship's costs and benefits we again found L as the only customer who has more costs than benefits derived from the relation. In contrast, twelve customers, some of them buying from multiple suppliers and others only from Formica-PSM, were found to have a balance between benefits and costs, some of them were (H, E, SS, GG, G,W) which are among the most potential customers to be moved to higher levels of the pyramid.

Moreover, seven company customers consider to be receiving more benefits than costs, among them M, T and Y and Z. To find T within this group was a surprise, as this customer catalogued the relationship as unequal and with lack of co-operation, not completely satisfied, dissatisfied with customer service, unsure about the closeness of sales personnel, does not consider itself as a valuable customer, and is unsure about trustworthiness of Formica-PSM. Therefore it could be argued that this customer misunderstood the question and expressed it in terms of more benefits and costs to the supplier. The same situation was found for customers Y and Z as it seems to be lack of fulfilment of expectations, insecurity about the competence of Formica-PSM to perform in the industry, insecurity about their value as customers and about them being proud of doing business with this supplier.

Whether customers buy from one or multiple suppliers is relevant, especially when this is linked to the perception of costs derived from changing a supplier. In this respect, it was possible to determine that almost half of the customers are rather

unsure towards this statement (among them H). This is an interesting finding since the majority of lead customers stated they have a rather balanced relationship in terms of co-operation and equality, but not all customers perceived major costs if changing the supplier. Among them we found E and interestingly L, which only buys from this supplier, thus it is possible to conclude that this customer remains in the relation because of the difficulties to change regardless of its discontent.

The reality is that the relationship between this group and Formica-PSM is unbalanced, but not towards the customer but rather the supplier, since it is investing in this group without receiving something in return. This is clearly observed when assessing the perceived customer investments in the relationship. Among the aspects that were most mentioned were knowledge, personal contacts, money, long-term assets, personnel and processes and time, however, all of them with rather low rate of mention (between 2-3 customers) with the exception of knowledge that was mentioned by 11 customers. Further, four customers stated to have performed no investments. Therefore, the fact is that the majority of these customers are not giving much to the relationship.

Moreover, when analysing their perception of Formica-PSM investment in the relation, they also tend to have a low rate of mention. There were just some customers (2 to 4) who mentioned money, long-term assets, time, processes and personnel, and seven mentioned knowledge and personal contacts. In addition, six customers mentioned no investments. Therefore, if Formica-PSM has invested in these customers, which it has by at least targeting with marketing, sending sales representatives, serving their orders and so on, it is only a small share of these customers who are perceiving it. This also goes hand in hand with the customers' lack of perception of related costs for leaving the supplier. Nevertheless, there are some customers that value the relationship and that have the potential to become profitable. The company should evaluate whether these potential customers have a real opportunity to increase their level of purchases.

Regarding the expectations that are met, the aspects that received major attention from the lead customers referred to delivery, customer service and products. Since delivery and customer service were proven to have a strong relation with overall satisfaction it is relevant to determine which customers are not naming these aspects. In terms of delivery, there are J, NN, H, V, Y, GG and L, and in term of customer service there are H, K, T, W, GG, Z, OO and SS. As noticed, products were also a quite mentioned aspect, yet those that did not refer to it were L, GG, YY, Y, AA, OO, NN and G. Thus, there are potential clients that might not have

their expectations fulfilled which could be a reason undermining their profitability. This is further stressed by the low mentioned that was noticed in the rest of the aspects.

Thirteen of the lead customers regarded their overall satisfaction as very high and high (65%), but still there is a 30% that consider to have a neither low or high overall satisfaction among them H. Only one customer regarded it as low (L). Highly satisfied customer included potential profitable clients such as M, SS, GG. Further, nineteen customers agreed and partly agreed with the idea to repurchase, where only one was unsure (J).

Thus, it is possible to conclude that overall satisfaction within this group is medium to positive although there are other important aspects of expectations that were not mentioned, such as performance, availability of information, promises and sales personnel. In order to prevent a decrease in the level of satisfaction these aspects need to be assessed on an individual basis to determine whether they can have a negative impact on their level of satisfaction, which could be determined through the sales representative attending each account.

In terms of price, the perceptions are rather spread among these customers. 65% of them have a positive attitude towards the price fairness in terms of the quality received, 30% of the customers are unsure about the statement such as H whereas only one (L) totally disagreed. Some how contradicting is the fact that when assessing whether Formica-PSM products are of constant high quality, L did not stated to be against, which allows to suggest that its discontent could be based on late deliveries and lack of fulfilment of promises. On the other hand, this customer did recognise that Formica-PSM meet its expectations in terms of customer service, availability of information and sales personnel. 95% of the customers have a positive attitude towards the constant quality of the products, where only W was unsure. Referring to customer service, 75% have a positive attitude towards the service received and conflicts are perceived to be solved in a friendly manner. Still, there is a varied opinion regarding the close relation with Formica-PSM sales personnel, where 30% is more reluctant or even negative to this statement.

Moreover, fifteen customers partly and totally agree to recommend Formica-PSM leaving four companies unsure or negative towards this statement (J, NN, W, L). It was discussed that overall satisfaction is intimately related to repurchase and recommendation. Although this group has some customers which are medium

satisfied, it could be better to not to invest resources in trying to increase their level of satisfaction, as they are less profitable and do not perceive the investments of the company in the relationship. This should be done once the customers to be promoted in the pyramid are selected.

We must also consider the customers' perception of the outcomes derived from the relationship with Formica-PSM. In this respect 74% of the customers mentioned have had a positive influence in the quality of their products as an outcome of the relationship with Formica.-PSM, even L mentioned it. Yet, all other aspects have a rather low level of mention, only 2 to 6 customers mentioned revenue, market share, knowledge and processes. Some customers that recognised the company in these aspects were E, V, Y, Z, AA, K. These outcomes represent the benefits that they perceived from the relationship and that should be emphasised only to those potential customer to be upgraded so they perceive more switching costs.

Quality, reputation and trustworthiness, were among the aspects that lead customers referred as aspects that characterised Formica-PSM. Accordingly, 14 of the customer had a positive attitude towards the statement *the relation with Formica is trustworthy* and 19 agreed with the statement *Formica fulfils its promises*. Honesty was only mentioned by three customers and integrity by one customer. Moreover, many as 90% of the lead customers considered Formica-PSM to be competent to perform in this industry and only Z and J were unsure about this.

An interesting finding was that not all customers perceived themselves as valuable customers to Formica-PSM, and that only 9 companies do. The rest were unsure or partly disagreed with this idea, among them we found L, T, Z, Y, SS, XX, K, H, G. This may be a reason diminishing their level of purchase. It could be possible that if they felt more valuable and recognised by the company they would do more business. Certainly, this should be related to the real potential of the account and previous behaviour. Regarding the value of Formica-PSM, only 2 companies do not perceive it as a valuable supplier (L,K), which is positive considering the rather high number of customers not feeling perceived as valuable customers. Still, the negative side of having discontent customers is that they are unlikely to feel as proud about doing business with the company, and 45% of the lead customers feel in this way.

Twelve of the lead customers believe to have common values with Formica-PSM and consider themselves proud to be doing business with this supplier, which is

important for them to be aware of as this is a source of switching costs that can increase the perceived level of co-operation and the level of commitment.

The theory suggested that lead customers were the ones costing the company money and resources, demanding more than what they provide to the firm, and normally considered to be “problem customers” as they complain to others. In this respect, we could agree with these ideas as these customers are the least profitable that have remained in the relation mainly because of “emotional” reasons, such as duration, but still demand from the company. It was detected that there are certain customers putting very high demands on the supplier in terms of expectations, service, competence, trust, and they could be considered as “problem customers” as they have the potential to create bad publicity for the firm. On the other hand, not because these customers are not profitable now their complaints are not worth considering. It may be the case that they were profitable once and that because of bad experiences with the supplier decreasing their perception of mutual value and co-operation and hence their decrease their level of satisfaction affecting their possibilities to repurchase. Therefore, it is relevant to determine what their previous level of business was before, what could have been the reasons behind the lack of purchase, if this could have been affected by Formica-PSM’s lack of service, and to detect their future potential in order to move them up the pyramid.

The Non-Buying Group

In addition to the customers included in the pyramid of profitability, there are three direct-buying customers that have not purchased from Formica-PSM in the last 1½ years. Nevertheless, we consider it was also interesting to analyse the results obtained from this group and try to determine possible causes for them to leave the relationship, and if it is advisable to reacquire these accounts and the possibilities to do so. However, it is important to mention that such a decision should be also based on the previous purchasing behaviour of each account in terms of profitability and value.

The group is formed by 3 companies (I, FF, KK). According to the results, it seems that these companies used to be rather young customers, as they were categorised into group 1 (0-10 years) In terms of turnover, these customers can be considered to be rather small companies and therefore catalogued within group 1

(0-50 MSEK). However, KK did not provide any information about its turnover and therefore was not placed in any group.

Although these customers have not purchased in the last 1 ½ years, they still answered to the questions assessing buying and contact frequency. I and FF stated to have less continuous buying frequency referred as one a year and less than once a year respectively, which kinds of agrees with their actual buying behaviour. I and FF indicated having a contact frequency at least once a year. In addition, FF stated to be unsure whether it would like to increase its contact frequency, becoming one potential customer to reacquire.

These customers are currently buying from other suppliers, which may be one of the reasons behind their lack of purchases in the last 1½ years. All of them do not buy from different categories.

The customers perceive the relationship duration as long and very long-term, but with a medium frequency or even infrequent relation, where I and KK feel in this way but have no desire to increase their contact. Moreover, all the non-buying customers prefer a long-term relationship orientation.

We found that the relationship duration is not necessarily a reason for them to be customers of Formica-PSM, which goes hand in hand with their actual behaviour. However, FF was unsure about this statement.

In terms of intensity, one company did not answer and the other two (FF, KK) feel it as rather superficial, which follows the perception of relationship frequency already explained. These group of customers consider that the relationship not entirely equal or co-operative, where FF regarded it as unequal as well as partly uncooperative. KK also believes the relation is partly uncooperative. Insecurities in terms of the equity and co-operation in the relationship in combination with the majority of the customers purchasing from multiple suppliers represents an unfavourable situation for Formica-PSM, besides making it more difficult to persuade them to return.

Customers have varied opinions regarding their influence on their suppliers. There are two customers that believe not to have strong influence at all, among them FF, and only one consider itself as a powerful customer (KK). The analysis of the customers' perception about whether a change of supplier implies major costs is therefore crucial. In this respect, it was possible to observe that the companies are

unsure or disagree with this statement, which in any case is something unfavourable for Formica-PSM and strengthens the possibility that this group of customers had changed to another supplier.

When analysing their perception of the relationship's costs and benefits we found that there is only customer (FF) who perceives more costs than benefits derived from the relation, being a potential reason for its lack of purchase. The rest of the customers consider there is a balance between costs and benefits which could justify a re-approach.

To determine how the relationship is perceived, it is important to assess the aspects in which the customer considers to have invested in the relationship and also their perception of the supplier investments. Regarding customer's investments, 2 customers mentioned money and one mentioned knowledge, whereas one stated not to have invested in the relation (FF). Similarly, when asking for the perceived investments of Formica-PSM, two customers mentioned money, one personal contacts and processes, whereas long-terms assets, time and personnel were not mentioned. Furthermore, FF stated Formica-PSM has not invested anything in the relationship. Thus, it is possible to conclude that if Formica-PSM is willing to recover this group of non-buying customers and keep them in the relationship it is vital to stress its investments in the relationship, but it must also encourage them to invest on it so the overall perception of switching costs increase and reduce their chances to leave again.

We observed that half of these customers mentioned products sales personnel and availability of information among the expectations met by Formica-PSM, signalling areas of probable discontent such as delivery, customer service, price, promises and performance. As expected, the level of satisfaction of this group is medium-low. It is important to mention that these customers have a rather positive attitude towards price fairness in terms of quality received as well as in the ability of the firm to provide constant high quality, which implies that their dissatisfaction can be regarded to other issues.

As mentioned, we noticed that areas in which the customers showed insecurity were regarding the delivery, customer service and fulfilment of promises. These are very important findings, as overall satisfaction was determined to be strongly related to other aspects such as repurchase, the perceived costs and benefits derived from the relation, word-of-mouth, perception of co-operation, and so on. That allows us to suggest that these customers are not being satisfied due to lack

of expectations fulfilled and lack of co-operation which will reduce the likelihood for repurchase, recommendation to others and related proud of making business with the supplier. This is even confirmed when observing that all these customers are unsure whether doing business with Formica-PSM makes them proud and whether they would recommend the supplier to others. Regarding their position towards repurchase, one customer had a positive attitude (KK) and one was unsure (FF).

When assessing the benefits derived from the co-operation with Formica-PSM, only one customer stated knowledge, one stated quality of products and FF stated having obtained no benefit whatsoever. These answers agree with the insecurity of customers to state whether the relation is equal and co-operative. Moreover, in combination with the lack of recognition, it is possible to speculate whether the low benefits derived from the relationship can be a possible reason for not buying from Formica-PSM in the last 1½ years.

Regarding the aspects that customers associate with Formica-PSM, quality and trustworthiness were mentioned, but only by one customer each. On the other hand, FF stated that Formica-PSM was not recognised for any of the aspects. Still FF and KK believe that Formica-PSM has the competence to perform in this industry, and the other customer did not answer this question.

Surprisingly it was noticed that two customers were unsure or negative of their value as customers to Formica-PSM, only KK agreed with this statement. Overall satisfaction is strongly related with how valuable a customer feels. This implies that if customers feel valuable and perceived benefits from the relationship they will likely feel satisfied and glad to do business, co-operate and repurchase. This perception also needs to be linked to the customers' perception of the value of the supplier to them. It was noticed that the same two customers that were feeling unsure or negative of being valuable customers, also had a negative perception of the value of the supplier. Yet, KK consider Formica-PSM to be a valuable supplier. Two customers do believe the relationship with Formica-PSM to be trustworthy, trust being an important factor connected to co-operation.

As it was mentioned, shared values were intimately related to the statement *switching costs implies major costs increasing mutual commitment*, which furthermore is also related to overall satisfaction, the degree of co-operation and ultimately to repurchase. Based on this, it was not a surprise to find spread opinions regarding

this issue, where one customer is unsure, other has a negative attitude, and the last one agrees to this statement.

6.7.2 Costs and value

The pyramid of profitability refers exclusively to the monetary outcome of each group of customers in terms of the difference between sales and standards costs. However, we believe that in order to determine customer's profitability it is necessary to consider other indirect costs that have not been included in this categorisation and that are relevant as they are undertaken to serve customers. Among them we refer to the related costs of 5 business areas including sales, customer service, warehouse, logistics and marketing that can be assigned to each customer.

The total costs of each department were weighted on each customer with respect to the degree of utilisation of each department and only applied to the customers that have purchased in the last 16 months, since the remaining customers have not been active and hence not caused any costs. This means a total number of 48 buying customers.

The division of costs presented is rather general, and it would have been preferable to further weigh the costs within each department in relation to how much of the resources are directed to the customers. However this was very difficult to determine as no such information was available. Yet, following Yorke and Droussiotis (1994) suggestion it is possible to allocate these kinds of costs by spreading them equally over all customers.³⁵⁵

Once this costs have been assigned it could be said that Formica-PSM is only receiving revenue from 16 direct-buying customers, which can indicate that the company is investing far too much in customers that are not providing significant revenue. This stresses the fact that customers should be treated differently and that investments need to be performed according to the situation of each customer. Hence, it is preferable to have a division of costs on a more comprehensive and individual basis in order to determine the real profit of each account to be marketed accordingly. One method to obtain such information would be tracking the share of the sales force time that is spent with the customers, and to dedicate a corresponding share of costs to the customers.

³⁵⁵ Yorke & Droussiotis (1994)

The previous analysis may lead the decision of keeping and dropping certain customers. However, these decisions should be based not only in monetary terms and current profitability, but also on the future potential and the non-monetary value of the account. On the other hand, it could also be a temptation to “punish” customers that are least profitable, which is not a productive way to respond. Therefore, after analysing the situation of each group in the pyramid of profitability we have realised that although some customers are not as profitable as it would be desirable, they may have the potential to be upgraded and therefore considered as valuable accounts.

6.8 Analysis sum up

Through the discussion in this section it is possible to conclude that satisfaction has been proved to play a very important role for the future development of loyalty, trust and commitment in the relations between a supplier and its customers. This is based on the fact that satisfaction was found to have several important interdependencies with key aspects of such factors for instance with repurchase (loyalty), the perceived competence of the supplier to perform in the industry (trust) and the supplier’ capacity to fulfil promises (trust), as well as an indirect effect on co-operation (trust and commitment). All these aspects together indicate that by assessing overall satisfaction companies will have a signal of the future potential to enhance loyalty and commitment, as frequent buyers are more likely to repurchase and to have positive word-of-mouth. Moreover, it was determined that shared values, co-operation and some of the supplier investment in the relation affects the customer’s perception of value as well as their perception of related costs of switching supplier.

The analysis allow us to conclude what aspects of each relationship characteristics are important in a supplier-customer relationship in order to further identify which of these are related to profitability. We have statistically tested the significant relation between the factors identified in this section and profitability, which are presented in Table 6.8. The “thumbs up” indicate which of these aspects are directly related to profitability and will be subject for further discussion. In the following chapter we will draw conclusions on the relationship characteristics that proved to be related to profitability. The conclusions on these factors will be presented in our theoretical model together with a discussion on their relation to profitability.

Table 6-8 Relationship Characteristics vs. Profitability

Relationship characteristics	Significant to profitability	Relationship characteristics	Significant to profitability	Relationship characteristics	Significant to profitability
Years as customer		Customer investments in knowledge		Customer is satisfied with the customer service	
Overall satisfaction		Supplier investments in time		Customer proud to do business with the supplier	
Perceived equity		Supplier investments in long-term assets		Expectations with regards to products	
Perceived supplier influence		Supplier investments in knowledge		Buy frequency	👍
Co-operation	👍	Supplier's products are of constant high quality		Contact frequency	👍
Intensity	👍	Price fairness		Cross-buying	
Single or multiple suppliers		Quality		Supplier is recognised by its trustworthiness	
Formica-PSM is a supplier that we recommend to others		Expectations with regards to customer service		Supplier has the competence to perform in the industry	
Perception of costs and benefits in the relationship		Expectations with regards to delivery		Supplier fulfils its promises	
Change of supplier means considerable costs		We are a valuable customer to the supplier	👍	Supplier is valuable to customer	
Customer investments in long-term assets	👍	Perception of costs and benefits in the relationship		Shared values	
Customer investments in processes		Repurchase			
Customer investments in personnel		Close relationship with sales personnel			

👍 = direct relation to profitability

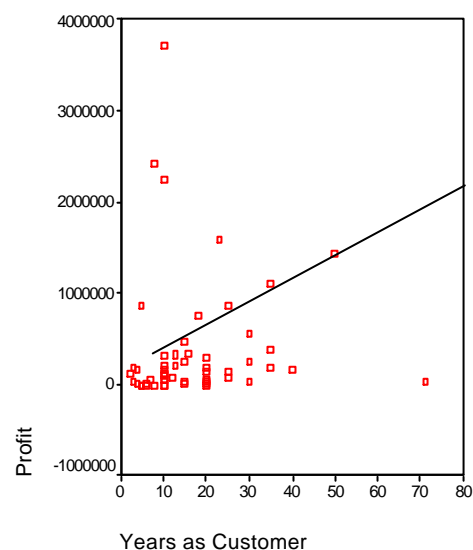
7 Which relationship characteristics impact customer profitability?

In the previous section we presented the significantly related factors for each relationship characteristic and profitability, taking into consideration the theoretical hypotheses presented in Chapter 3. The next step will be to further discuss the factors significantly related to customer profitability, which is the aim of this section. These factors also constitute the basis for our theoretical model, which will be presented in the end of the section. The variables presented in Table 6.8 were tested in order to determine which relationship characteristics have a direct impact on customer profitability.

As stated in our main problem, “Which relationship characteristics impact customer profitability and in what ways can a supplier develop and manage successful B2B relationships in terms of customer profitability?”, the objective of this thesis is to determine what relationship characteristics impact customer profitability in a B2B setting which will constitute the basis for creating customer strategies.

Several authors (Gummesson, 1999, Reicheld, 1996, Dawes and Sawales 1999) have argued that retention is vital for a company to enhance its profitability and that the longevity of relationships can be a source of profit potential. Furthermore, it has been stated that long-term customers are more profitable than short-term customers. However, Reinartz and Kumar (2003) determined that long-life customers are not necessarily the most profitable ones. Our findings go hand in hand with the later authors. By running a linear correlation between the variable **years as customers** and **profitability** we were able to determine that according to our collected data there is not a significant relation. This implies that new and old customers can have either high or low levels of profitability as it is illustrated in Figure 7.1.

Figure 7-1 Years vs. Profitability



On the other hand, if retention is understood as the ability to keep customers constantly purchasing, then we would agree with this view. In this sense we found

that **buy frequency** is closely related to the profitability exhibited by customers.³⁵⁶ This indicates that customers that are buying on a continuous basis account for a larger proportion of the profit than the ones buying less frequently. As it was proven that buying frequency is significantly related to the contact frequency of customers, we expected this to have an effect on customers' profitability. Accordingly, we tested the variables and discovered that indeed there is a strong interdependence between **contact frequency** and profitability.³⁵⁷ Therefore, customers that are in contact with the company everyday or every week belong to the group with the largest profitability.

The **customer perception of being a valuable customer to the supplier** proved to have a significant relation to profitability.³⁵⁸ Further, we see a tendency that the more valuable the customer feels the more profitable it is. This is related to our findings on the **intensity of the relationship**, which also proved to be significantly related to profitability.³⁵⁹ Customers that perceive the relationship to be superficial have an average profitability of \$59,500 SEK, while this number is \$640,300 SEK for customers perceiving the relationship as intense. However, we found the customers partly perceiving the relationship to be intense to have an average profitability of \$1,300,000 SEK. This finding is important to notice as it indicates that the most profitable customers might feel that the relationship could be more intense, and also more co-operative.

Co-operation is one variable significantly related to perceived intensity, which can be explained by the fact that a co-operative relationship also requires a certain degree of closeness and interaction between the parties. Nevertheless, all customers with high profitability might not be interested in having a relationship of this kind.

The **degree of co-operation** in the relationship is very close to a significant relation; hence, we think it is important to mention this variable as well.³⁶⁰ There is a strong tendency for customers with high profitability to define the relationship as co-operative. The explanation behind this could refer to the fact that more frequent buyers tend to contact the company much more often, which permits to learn about each other developing common goals.

³⁵⁶ (F=7,73>4,08, p=0,008<0,05)

³⁵⁷ (F=10,18>4,08, p=0,002<0,05)

³⁵⁸ (F=5,616>4,08, p=0,022<0,05)

³⁵⁹ (F=6,303>4,08, p=0,004<0,05)

³⁶⁰ (F=3,984<4,08, p=0,052>0,05)

Finally, **customer investments in long-term assets** are proved to be significantly related to profitability.³⁶¹ This is understandable as this type of investment is expensive and will be only committed to relations that are perceived trustable and long-lasting.

The six factors discussed above were proved to have a **direct** impact on profitability. Considering that there is a strong relation between the direct characteristics affecting profitability with other variables presented in the previous chapter, it is understood that there are **indirect** relationship characteristics of extreme importance as they are determining customer profitability and hence these should also be discussed.

It is our belief that profitability is indirectly affected by other relational factors where **overall satisfaction** plays a crucial role in the development of profitable relationships. It was proved that satisfied customers are interested in a mutual benefit and therefore are more likely to develop co-operative relationships. The fact that customers have a strong influence on their suppliers does not necessarily mean that the relationship is unbalanced in terms of equity and co-operation, and unbeneficial to the supplier. It was found that buyers having influence on their supplier tend to value the relation and themselves as customers. Having a link between equity and strong influence from the buyer may imply having positive influence on suppliers which may increase customers satisfaction and will to cooperate, which in the end will directly affect profitability as it was also determined that overall satisfaction is related to repurchase.

We determined that satisfaction is actually related to the duration of the relation, meaning that older customers tend to be more satisfied. However, in the case of Formica-PSM the information pointed to the fact that customers tend to be neither greatly nor minimally satisfied which indicate a potential area of improvement and a current disadvantage, as we have stated how important satisfaction is connected to repurchase and therefore vital for the success of the relation. This proves that just because customers have been in the relation for a long time does not necessarily mean that they will be satisfied.

As **repurchase** is intimately related to buying frequency, it is probable that this kind of customers will provide greater profit. We found that customers that have continuous buying and contact behaviour are more open to the idea of

³⁶¹ ($|t|=3,014 > 1,684$, $p = 0,004 > 0,025$)

repurchase. This does not imply that for that reason they are loyal customers, yet it establishes a good basis for loyalty development. A very common perception is to think that customers with multiple suppliers are likely to be less loyal. We believe this is very much dependent on each industry.

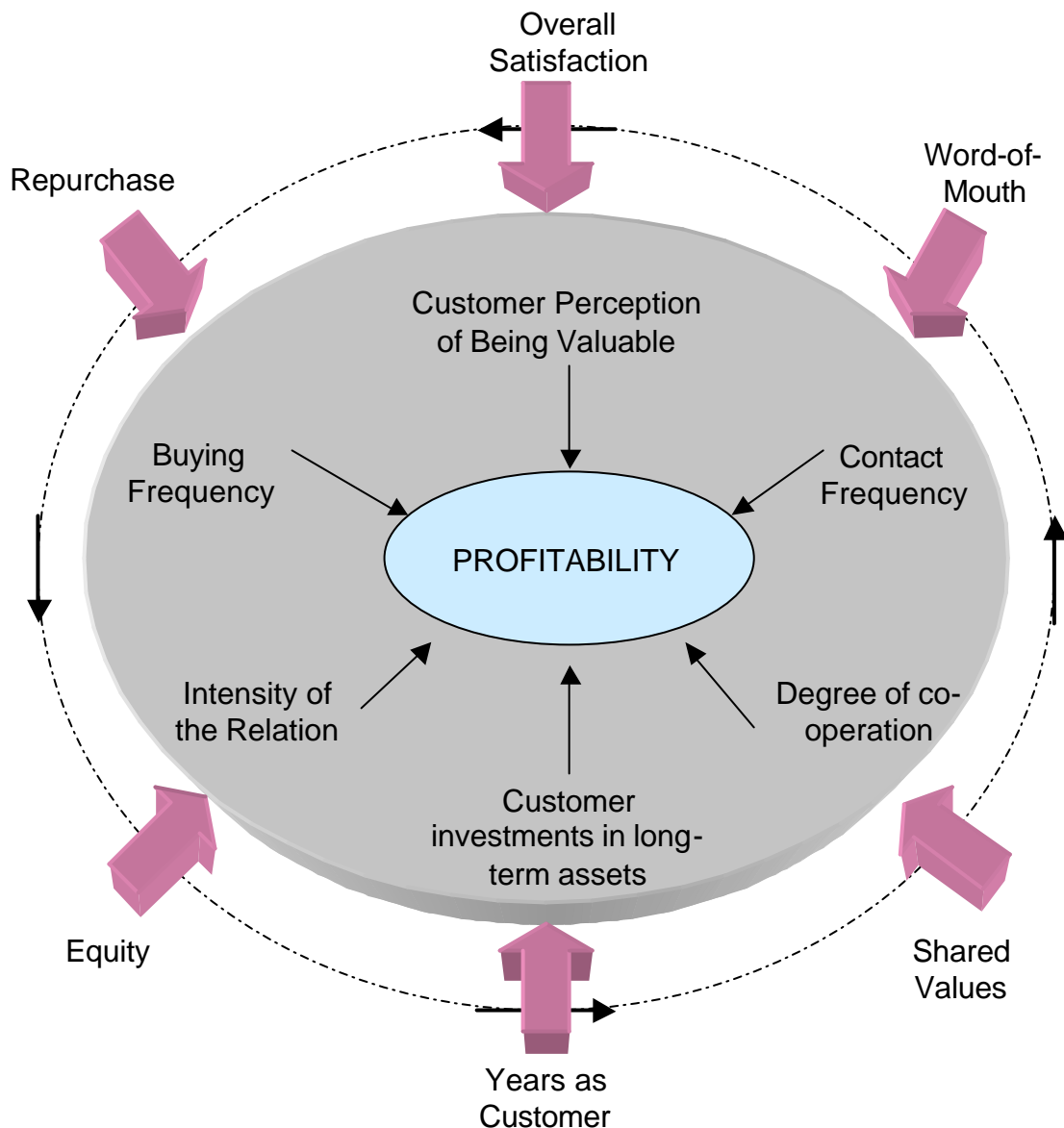
In the case of Formica-PSM it was actually the case that customers having multiple suppliers are also more open to the idea of repurchase, which is a good indication of a good performance as they can more easily replace the supplier. Regarding attitudinal aspects, we found that co-operation and overall satisfaction will be determinants for repurchase leading also to recommendation to other firms. Satisfied co-operative and frequent buyers are more likely to give positive **word-of-mouth** creating favourable attitudes towards the company and attracting new customers, which ultimately will facilitate the acquisition strategy of the firm.

For a relation to be co-operative, we also proved that the perceived **equity** and **shared values** are important determinants. Even if these factors are not directly affecting profitability, they should definitely be taken into consideration as indirect determinants. We are not surprised to find that co-operative relations will tend to have values in common, since through continuous interaction customers and suppliers will have the opportunity to express their goals and work towards similar objectives, and the more co-operative a relationship is the more committed it will become. It was found that customers that consider the supplier competent to perform in the industry will tend to have a higher degree of trust in the relation. This perception of competence is also affected by the degree of overall satisfaction and the degree of co-operation. However, it is clear that fulfilment of promises is the major sign of trust. We would suggest that relationships that are characterised by trust are more likely to continue developing than those without

As mentioned, customer investments in processes and supplier investments in time are signs of commitment to the relationship and intimately linked to the degree of switching a supplier. We argue that investment will increase the commitment in the relation. Furthermore, customer investments in **long-term assets** have proved to be significantly related with the **years as customer**, which consequently can be considered as an important prerequisite for these kinds of investments. A natural explanation is that such investments are not made during the early years of the relationship but in more mature ones when the customer is convinced that they will remain with the supplier and feel that they can make such a committed adaptation to the relationship.

Figure 7.1 presents the relationship characteristics that affect customer's profitability. As illustrated, the relationship characteristics **directly** related to profitability are found in the inner circle. These are determined by the **indirect** factors represented outside the circle. It is important to mention that the indirect factors are not exclusively related to one direct relationship characteristic, rather they affect all. This is illustrated by the outer circle, which represents a movement of the factors. Furthermore, we believe the outer circle to connect all indirect factors with each other.

Figure 7-2 Relationship Characteristics Directly and Indirectly Related to Profitability



Source: Authors own construction (2003)

In conclusion, the obtained results are believed to contribute to the current theoretical field of customer relationship, as our model include and interrelate

aspects that have been studied as a topic in previous research. It is, of course, important to be aware of the limitations to generalise our results, as they are dependent on certain circumstances that are evident in our study. This means that the conditions we have found are more likely to prevail within mature industries, as this is the case of Formica-PSM. However, we still argue that the insights provided in this thesis can also benefit companies in other types of industries that want to become more customer relationship-oriented.

8 *An innovative approach to obtain profitable customer relationships*

This section will provide conclusions and recommendations based on the present situation of Formica-PSM and its customer base. The recommendations will be presented for each customer category based on the findings presented in our theoretical model presented in the previous chapter, with specific focus on the direct and indirect relationship characteristics related to profitability. In addition to this information, we recommend Formica-PSM to conduct an analysis of the purchasing behaviour of each customer previous to the period that we have studied to determine their potential based on the past and current situation.

8.1 *Formica-PSM general situation*

The current competitive conditions experienced in the HPL industry characterised by maturity and overcapacity, where large and strong players are active, which implies there is a need for innovative ways to enhance profitability. As a rather small number of customers account for a major share of sales and profitability, we believe that by developing relationships with its customers Formica-PSM can simplify its way towards attaining profitability as well as establishing a competitive advantage that will differentiate the company from its competitors. However, recognising the need for relationship development is not enough. It is crucial that this is combined with an in-depth understanding of each customer's contribution to the profit of the business. In this respect, Formica-PSM has two systems to generate customer information (marketing and the invoice related data), but they work independently making the decision-making process and strategic planning more complicated. Furthermore, it was also perceived that until now the determination of customer's profitability does not consider costs analysis and assignation to individual customers, which provides an incomplete picture of each customer's contribution to profit.

Our study has shown that Formica-PSM has few investments directed towards the development of relationships with its customers, and the existing ones are not being communicated efficiently so that customers can recognised them as such. For example, the facility to make use of the warehouse and special packaging provided to certain customers free of charge are aspects that the company needs to clearly express in order for customers to be aware of the benefits derived from co-operating with Formica-PSM. Moreover, special conditions of payment that

give preferential treatment to certain customers should also be remarked in order to increase their perceived value of the supplier. Nevertheless, this also has to be done in a careful manner depending on the extent of communication among customers.

In the same way, it was mentioned that according to the level of service that the company wants to provide to its clients it is not possible to reduce the costs related to stock and transport, even though providing these special services may reduce the efficiencies within it. Whether this strategy is good or not, we argue that these costs of serving customers should be communicated more clearly to them. On the other hand, we believe that the level of service provided to customers should be assessed individually depending on the profit of the customer.

Since customers are the lifeblood of the business, it is important to make them feel valuable. Still the present situation is that many of the customers do not feel valuable as a customer to Formica-PSM. This perception needs to be modified by emphasising the value of each customer connecting with a better communication of the investments undertaken to develop a certain relationship.

Further, marketing activities have not been customised to the characteristics of each customer, and this may be diminishing the profit derived from each type of customer. The study showed that although customers belong to the same segment, they have their own particularities and therefore they should be marketed accordingly. It was determined that there are customers acting in a more relational manner, as they are frequent buyers, have continuous contact, value the company and want to have a positive influence on it through co-operation. This implies an opportunity to develop RM strategies. On the other hand, there are customers that have a more transactional approach to the interaction with Formica-PSM and if the company wants to keep or increase the level of profitability of these customers it should not strive for developing relationships with them. It is preferable to develop close relationships with customers having a high frequency of contact, as these kinds of relationships tend to be more rewarding due to the mutual understanding of each others goals. Moreover, relationship strength can lead to loyalty establishment. Customers with less frequent contact expect a different kind of interaction and therefore need to be approached in a different way, which implies a focus on the transactions rather than the relationship in itself.

Regarding the sales organisation, we determined that customers appreciate the improvements made in the area of customer service and the efforts done to reduce the level of claims and wrong orders. On the other hand, we notice that customer service is a subunit of sales providing internal support to the sales organisation, but only providing the basic service to customers. We perceive this as a risk as this can reduce the level of service provided to the customer itself if there is too much focus on the sales personnel.

In addition, the sales organisation has defined strategies only for the current ten top customers. In this respect, it should not be disregarded that customers with lesser contribution to profitability may be in that position because of dissatisfaction and lack of service. We believe the whole customer base should have defined strategies although not all customers should be targeted in the same way. A first step could be to identify the customers to be promoted to higher levels of the pyramid of profitability and the most potential non-buying customers to be re-acquired in order to develop specific strategies for these groups.

We consider that a well-established price strategy is fundamental to the success of a company. In this respect, it is very positive to see that Formica-PSM has decided to implement a formal strategy according to the characteristics of its customers. On the other hand, this strategy needs to take into consideration other aspects such as how good a customer is in terms of accomplishing its line of credit, additional services provided and costs of serving the customer. The ability of a supplier to charge a certain price is determined by their price sensitiveness. Therefore, it is important to connect this information with the actual perception customers have in terms of price fairness. Today, Formica-PSM customers have a positive attitude towards price fairness, although not fully. Therefore, if the company implements a new price strategy it must expect reactions from its customers that may have implications in their overall satisfaction and profitability.

Formica-PSM mentioned that delayed deliveries were among the aspects creating more problems among customers. Interestingly, it was discovered that customers perceive deliveries as one of the aspects in which Formica-PSM meet their expectations the most. However, there are other areas that could be improved for the better image of Formica-PSM, for instance overall performance. The customers believe Formica-PSM has the competence to perform in the HPL industry, yet, it also seems that Formica-PSM may not be fully exploiting this potential as they do not meet customer expectations in this respect. Finally, Formica-PSM is recognised by having products of constant high quality.

Nevertheless, we noticed when talking to customers that the brand is hardly recognised and this may have negative implications for the company's reputation of quality.

Overall, we believe that this study provides Formica-PSM with a basis for the future development of relationships with customers. Four groups of profitable customers and their characteristics were detected, which combined with the findings on the factors impacting customers profitability will allow the company to develop strategies corresponding to each group. In the following section, we will highlight the relevant areas to consider for each group.

8.2 The direct-buying customers

8.2.1 Platinum customers

The platinum customers are, as mentioned previously, the three key customers for Formica-PSM in terms of profitability. This puts the company in a weaker position since if one of the customers would choose to terminate the relationship the supplier would experience a considerable drawback. Hence, it is crucial to identify the key aspects to focus on to manage the relationships with these customers and to keep them with the company contributing to the profits.

Direct relationship characteristics

All platinum customers are positive that they are *valuable customers* to Formica-PSM, which can be related to their awareness of being major customers. An important highlight is that one customer considers that the relationship implies more costs than benefits, which can be a serious threat for terminating the relation. Also, it should be mentioned that this customer currently has two claims which can negatively affect the perceived benefits of the relation. Hence, it is of striking importance to maintain and even increase the customer's perception of being valuable. Consequently we recommend Formica-PSM to:

- ***Nurture the customer's perception of being valuable by communicating the benefits derived from the relationship to the customers, especially in terms of knowledge, market share and quality of their products***

The platinum customers have a high *frequency of buying and contact* and do not see any need to increase the *frequency of contact*. As these aspects are directly related to profitability Formica-PSM should:

- ***Maintain the present level of contact and if possible increase the buying frequency***

The relationship is perceived to be partly *co-operative*, with the exception from one customer that feels it is neither co-operative nor lack of co-operation. This is rather interesting as these customers are heavy buyers with frequent purchases, which we think would indicate close and co-operative relationships. As the degree of co-operation is directly related to profitability, and increases the possibilities for a mutually rewarding relationship, we recommend that Formica-PSM actively work with the platinum customers in this matter:

- ***Focus on creating co-operative customer relationships***

Further, the platinum customers perceive themselves as investing in the development of the relationship, particularly in *long-term assets*, which is positively related to profitability. On the other hand, only one platinum customer perceives Formica-PSM as investing in the relationship. This is negative as the two customers not perceiving any supplier investments receive special treatment, for example warehousing free of charge. We believe that if these customers were more aware of the investments made by Formica-PSM they might also perceive the relationship to be more rewarding. Therefore, our recommendation is to:

- ***Clearly communicate the benefits derived from the relationship and the special agreements that the platinum customers receive***

The relationship is mainly perceived to be partly intense, but one customer thinks it is neither intensive nor superficial. These results indicate a need for enhanced relationship intensity in order to create a closer relationship, which we think is preferable with such major customers. However, it is important that Formica-PSM carefully evaluates whether these customers perceive this as negative or if they do not want the relationship to be more intense:

- ***Increase the relationship intensity if it is preferred by the customers***

Indirect relationship characteristics

Platinum customers mainly have a high level of *overall satisfaction* with Formica-PSM. However, one customer is more insecure in this matter. Not all platinum customers perceive their expectations to be met in terms of customer service and products. As satisfaction is an important indirect determinant of profitability, we recommend that Formica-PSM further investigate the individual expectations of these three customers as they are of high importance to the company. By performing a thorough assessment of the expectations of this group, the company can assure they are met to guarantee that the current levels of satisfaction are kept or even increased.

- ***Increase the level of service provided to the platinum customers and determine their expectations on products and try to meet the needs for improvement***

Further, the relationship with Formica-PSM is considered to be rather *equal*. Due to the high dependency on these customers, we regard Formica-PSM to be the more dependent party in the relation. In order to balance this relation, it is important that Formica-PSM emphasises mutual co-operation and influence to the customers as this can positively affect their perception of Formica-PSM as a valuable supplier. Consequently, Formica-PSM is recommended to:

- ***Emphasise mutual co-operation and positive influence on customers***

The platinum customers tend to be positive to *repurchase*, however one customer is insecure about this. The intention to repurchase is crucial to the relationship continuance, which in turn can lead to enhanced profitable lifetime duration. Therefore, the customer that does not fully agree with this needs to be targeted in order to understand the motives behind the insecurity. Consequently Formica-PSM should:

- ***Identify the reasons for hesitation to repurchase***

Finally, platinum customers are positive to recommend Formica-PSM to other companies, which is positive as favourable *word-of-mouth* will indirectly affect profitability by facilitating the acquisition of new customers. Therefore:

- **Try to access the customer's network in order to gain new customers**

These customers also have similar *values* to the ones of Formica-PSM, which constitutes an excellent basis for creating co-operative, mutually rewarding relationships that can enhance profitability. Also, they belong to the category with the least *years as customers*, 0-10 years, which means that there are promising opportunities to create a good basis for long-term profitability if these customers are managed in the way suggested in our recommendations.

Problems to target
R thinks the relationship implies more cost than benefits
TT thinks there is neither co-operation nor lack of co-operation
TT is insecure about the relationship's intensity
R is insecure about its overall satisfaction
R is somewhat insecure about whether it will repurchase
R has two present claims
TT has three present claims

8.2.2 Gold customers

The gold customers are the second most profitable category and there are prospects within the group that can be identified in order to be promoted as platinum customers. Also, if not managed properly, these customers can become less profitable iron or lead customers.

Direct relationship characteristics

All gold customers except for one are positive that they are *valuable customers* to Formica-PSM, which indicates a good basis for relationship development. However, it is important to determine the reasons why the single customer does not feel valuable as this can have a negative effect on the supplier-customer relationship, which represents a risk for dissolving the relationship. Therefore,

Formica-PSM should try to change the customer's perception or take the risk of losing the customer. An important aspect to this decision is that this customer is the sixth most profitable customer of all direct-buying customers. Our recommendation is consequently:

- ***Trace the reasons for the gold customer not feeling valuable and change this perception since this can lead to mutual benefits***

Also, there is a perceived balance between costs and benefits, two customers even see more benefits than costs from being a Formica-PSM customer, which means that these customers are promising prospects to develop a closer mutual relationship with.

The gold customers have a continuous *buying and contact frequency* and are satisfied with the present level of contact received from Formica-PSM. This is consequently an area that should be maintained, however, no additional actions are needed.

The gold customers perceive the relationship to be partly *co-operative*, which indicates an important area to focus on as the degree of co-operation is directly linked to profitability. What actions Formica-PSM chose in this matter can determine whether some of the customers will become platinum customers, or even decrease in profitability. Therefore, we recommend Formica-PSM to:

- ***Increase the degree of co-operation with the most promising customers***

Further, the gold customers invest in *long-term assets*. In relation to other categories, this group is characterised by a high degree of investments in the relation, which indicates a positive commitment to the relationship, but there is a rather low recognition of Formica-PSM investments in the relationship. In order to retain the customers in the relationship, we think it is important that Formica-PSM communicate commitment to the relationships, to make the customers feel that there are more equal adaptations by each party. This does not have to imply investments in money. Therefore, we recommend to:

- ***Focus more on investments in relationships with gold customers***

The relationship with Formica-PSM is neither *intense* nor superficial, and as in the case of platinum customers we recommend Formica-PSM to determine whether this is perceived as positive or negative by the gold customers, as it would be important to develop more intense relationships with the customers who prefer this. Our recommendation is consequently to:

- ***Increase the relationship intensity if it is preferred by the customers***

Indirect relationship characteristics

The degree of *overall satisfaction* is high or very high for a majority of the customers, and it is important to keep the gold customers satisfied and committed as the majority has several suppliers. Furthermore, all gold customers feel that their expectations are met with regards to delivery and a major share is satisfied with the customer service. Few customers feel that their expectations on price and sales personnel are met, which implies that these are areas to focus on. Consequently, our recommendation is to:

- ***Target the customers expectations on price and sales personnel***

The degree of *equity* in the relation is neither high nor low, which we interpret as insecurity on the power of each party. For the customers interested in developing into platinum customers we recommend Formica-PSM to:

- ***Develop a more mutual and if possible equal relationship with customers***

All gold customers plan to *repurchase*, which is very positive to the relationship continuation. This is consequently an area that should be maintained, however no additional actions are needed.

Finally, gold customers are positive to recommend Formica-PSM to other companies, which is promising as favourable *word-of-mouth* is directly related to profitability. Also, the gold customers tend to think that the *values* of Formica-PSM correspond to their own values, which constitutes a good basis for developing profitable relationships. The gold customers are mainly companies that have been buying from Formica-PSM for 21 years or more, which we think can

indicate a willingness to remain with Formica-PSM if the customers are treated in the right way.

Promising prospects	Problems to target
Customer AAA and BBB see more benefits than costs from being a Formica-PSM customer.	WW is unsure about whether it is a valuable customer
X, QQ, WW, AAA and BBB are investing the most in the relation.	QQ has two claims
QQ is satisfied with performance	AAA has bad payments
CC and AAA recognise Formica-PSM investments the most	CC makes low investments in the relation
CC and PP are satisfied with price	WW see no Formica-PSM investments in the relation
BBB satisfied with sales personnel	Customer service does not live up to expectations of CC and WW
	Products do not live up to expectations of CC, QQ, PP, BBB
	CC and WW have neither low or high satisfaction
	U has a low rate of satisfaction
	WW and PP are unsure about shared values
	WW and PP are unsure about shared values

8.2.3 Iron customers

The iron customers are the third most profitable category, and there are prospects within the group that can be identified in order to develop into gold or platinum customers. There is a high degree of insecurity among the customers in several of the areas presented, which indicates both a potential and a threat. If they are managed properly, a potential can be seen in that customers can be convinced to have a more positive view of the relationship. On the other hand, the high degree of insecurity also means that the customers do not perceive major obstacles for leaving the relationship. These recommendations should be applied to those customers that have the potential to be promoted to higher levels.

Direct relationship characteristics

The iron customers are insecure about whether they are *valuable customers* to Formica-PSM, and perceive the relationship to be a balance between benefits and costs. This means that Formica-PSM should put more emphasis on what the customers are gaining from this relationship and be more sensitive to the customer's expectations on the relationship. It is therefore recommended to:

- ***Nurture a customer perception of being valuable***

A majority of the customers have a continuous *frequency of buying and contact*. Most customers do not want an increased frequency of contact; however, there are a few customers that are unsure about this matter. As an increased frequency of contact can be a way to increase buying frequency and hence repurchase:

- ***Increase the frequency of contact if this is preferred by the potential customers and assess whether customers prefer a transactional or relational approach***

Further, the iron customers are insecure about the *degree of co-operation* and the *intensity of interaction*. The customers believe the relationship to be co-operative constitutes a potential target for a further development of relationships. In order to develop profitable relationships it is important for the relationship to be co-operative and intense, which means that Formica-PSM should:

- ***Focus on the customers with a perception of co-operation***
- ***Target the customers with an intensive or partly intensive relation***
- ***Increase the degree of intensity and co-operation with the most promising customers that are insecure at present***

Rather few customers invest in *long-term assets*, which should be emphasised more in order to create profitable relationships. Preferable this would be with the customers that see high costs of switching while less focus should be on the customers not seeing major obstacles to stop buying from Formica-PSM:

- ***Emphasise customer investments in long-term assets among the potential customers facing barriers to switching supplier and that are interested in having a relational approach***

Indirect relationship characteristics

The *overall satisfaction* among the iron customers is generally very high, which should be utilised as an opportunity to build sustainable relationships. This is mirrored in the fact that most customers plan to *repurchase*, which is very positive for the longevity of the relationship. On the contrary, the degree of positive *word-of-mouth* is not as high among the iron customers as in the previously presented groups.

The *values* of Formica-PSM are partly perceived to agree with the values of the iron customers. Also, there is insecurity about the degree of *equity* in the relationship, where a small group of customers perceive the relationship to be equal. Formica-PSM should therefore:

- ***Communicate the values more clearly to the most promising customers***
- ***Assess the potential customers’ perception of equality and if needed improve it***

Since the iron customers are rather young, they can be difficult to convince due to the short history of the relationship. On the other hand, they prefer a long-term orientation in supplier relationships and if Formica-PSM can manage to do it there are good chances to establish long-lasting relationships.

Promising prospects	Problems to target
Customer A and BB see more benefits than costs from being Formica-PSM customers.	F, O, P, DD, ZZZ are insecure about their value as customers
S and MM think the relation is co-operative	C makes low investments in the relation.
S, MM, N, BB have an intense/partly intense relation	RR has bad payments
N, F, P, JJ have high costs of switching	MM has not made any investments
F and MM perceive the relationship to be equal and co-operative, more benefits than cost, and high satisfaction.	
A, N, JJ are prospects for an increased frequency of contact	

8.2.4 Lead customers

Since the lead customers are the group with least profitability, it is important to assess which of the customers Formica-PSM should focus on and which not. The question is whether it is profitable for Formica-PSM to develop relationships with this group and continue serving them. We recommend though investing only in those that are potentially profitable. It is important to know the previous situation, as it is possible that the current low profitability can be temporary or long-term. Also, it is important to know if the decrease in profit is the result of a bad experience with the company that has motivated them to buy less.

Direct relationship characteristics

Almost half of the lead customers have a very low esteem of their *value as customers*, and this is affecting their satisfaction and their profitability. In this respect it is important to promote them as valuable customers, even more when they have been purchasers for such a long time. In addition, most of these customers consider the relationship to bring equal costs and benefits, with the exception from one customer who sees more costs than benefits. Consequently, our recommendations are:

- ***Nurture a customer perception of being valuable to the most promising customers and communicate the benefits of making business with Formica-PSM***

The *buying* and *contact frequency* varies considerably among the customers, but what is positive is that a number of customers actually would like to have an increased frequency of contact. The recommendation is therefore:

- ***Promote an increased frequency of contact, especially to the five customers demanding it and increase the volume of each purchase***

There is a varying *degree of co-operation* among the lead customers and Formica-PSM, ranging from a perceived balance to a lack of co-operation. Promotion of co-operation is very important to avoid losing potentially profitable customers as it enables tracking of expectations and opinions as well as a communication of shared values which may increase perception of value. Thus, we recommend Formica-PSM to:

- **Identify the reasons for lack of co-operation and enhance it with the most promising customers and promote a close relation between the sales personnel and customers**

Most lead customers do not invest in the relationship with Formica-PSM to a larger extent, which can be explained by their varied frequency of buying and contact. Also, the low perception of being valuable can be one explanation. There are a small number of customers investing, where some of them invest in *long-term assets*. In order to improve the relation, Formica-PSM can:

- **Encourage customer investments, if possible in long-term assets, and make the most promising customers feel more valuable by own commitment to investments, and show the will to invest if relation develops**
- **Otherwise treat them as transactional customers and do not invest in the relation until proven will to relational approach**

There are some lead customers that perceive the relationship to be superficial. As *intensity* is a driver of profitability, it is important to evaluate whether these customers are interesting prospects and if so:

- **Promote intense relations with the customers more likely to increase their purchasing habits and interested in a relational approach. Also emphasise benefits received above costs.**
- **Provide only limited service to the transactional ones**

Indirect relationship characteristics

The *overall satisfaction* among the customers varies, where most customers have a high satisfaction or refer to it as neither low nor high. When targeting the customers to develop the degree of profitability, we recommend to:

- **Increase the level of satisfaction among potential customers as this is a basis for enhancing customer profitability and favourable word-of-mouth**

Looking at *word-of-mouth*, most customers are very positive about recommending Formica-PSM to others, which we interpret as a sign of satisfaction. The positive attitude towards the company also indicates opportunities to build profitable relationships with some of the customers. We believe that the actions recommended in this section can increase the rate of positive word-of-mouth even more, as this is an outcome of actions rather than something Formica-PSM can target directly.

The perception of *equity* varies among the customers, but none of them feel that the relationship is equal. Even if the relationship can not always be equal due to the customer size, it is still important to make the customers feel that there is a sense of equity in the relationship, for example by being sensitive to the customers' expectations and promote co-operation as equity is an indirect determinant of profitability. Therefore, we suggest Formica-PSM to:

- ***Track customers' expectations to make them feel valuable***
- ***Promote co-operation and mutual gain***

Almost all customers are positive to *repurchase*, which indicates a potential to develop the most promising lead customers into a higher category of profitability. Formica-PSM should consequently:

- ***Prioritise targeting the most promising customers that are positive to repurchasing***

Almost half of the customers believe that their *values* agree with the values of Formica-PSM, and we believe that this is an important factor when establishing profitable relationships. For the most promising customers, we therefore recommend to:

- ***Target the customers that have similar values to Formica-PSM***

The lead customers have a spread of *years as customers*, where one group is rather young and the other main group has been customers for at least 20 years. This represents the potential to convince customers to continue developing their relationships and based on their experience with the company encourage them to increase their purchases.

Promising prospects	Problems to target
M and V perceive they are valuable customers	L perceives more costs than benefits
V think the relation is co-operative/ H, M and AA think it is partly co-operative	T and L think there is a lack of co-operation
V, M and GG are investing in long-term assets	T and L think the relationship is superficial
E, G, H, V, AA, SS, XX, YY plan to repurchase	T, L and Z think the relationship is not equal
E, G, M, V, Y, AA, SS, XX, YY, GG have high satisfaction	L have low satisfaction
E, H, V, XX and YY have similar values to Formica-PSM	H, V, GG, J did not mention delivery as expectations met
E, M, Z and GG want to increase frequency of contact	GG, AA, OO, NN did not mention products as expectations met
Establish contact with OO as it has a very positive attitude towards the company and it seems to be a good possibility to start doing business again.	H, GG, SS, OO did not mention customer service as expectations met
OO wants an increased contact frequency and J is unsure	
NN and UU plan to repurchase	
NN is highly satisfied	

8.2.5 Non-buying customers

For this group of customers, a thorough analysis of the previous purchasing behaviour is needed to determine possible reasons why they stopped buying. Some of these customers might have a cyclical buying behaviour and require a more transactional approach. These should only be contacted sporadically to guarantee a sufficient sales volume to be regarded as profitable for the firm. If there are customers that previously were heavy buyers, it might be possible to win them back again if the reasons for dissolving the relationship can be overcome.

Direct relationship characteristics

The non-buying customers are uncertain about whether they are *valuable customers* to Formica-PSM. As this is one of the direct aspects affecting profitability of customers it is suggested to:

- ***Track customer expectations and address those for the most promising customers***
- ***Communicate the potential benefits derived from the relationship specially in terms of market share, knowledge, quality, and other reasons why it is beneficial for them to return***

- **Communicate co-operation and equity**

The relationship is considered as *infrequent, superficial* and medium *co-operative* which can be explained by the long periods of not buying, however there is one customer expressing that he would like to increase the contact frequency expressing willingness to continue the relationship. As these are aspects directly affecting relationship profitability, it is suggested to:

- **Emphasise an increased degree of contact and co-operation to potential customers**

Very few customers have invested in the relation, and no customers have made any investments in *long-term assets* which correspond to the low involvement in the relationship with Formica-PSM.

- **Do not invest initially but show the will to do so as the relationship develops through time**

Indirect relationship characteristics

There is a medium or low degree of *overall satisfaction* among the customers, which is probably a reason for not buying. However, one customer is highly satisfied and in this case, we recommend Formica-PSM to track this customer. In the other cases, one needs to evaluate additional aspects to decide whether to increase the degree of satisfaction, as it is a determinant for co-operation and repurchase which affect profitability.

- **Meet expectations on delivery and customer service, and increase satisfaction of the most promising customers**

There is insecurity among the customers regarding whether they would recommend Formica-PSM to others, which can be traced to the level of satisfaction. Consequently, if satisfaction is improved this can also lead to positive *word-of-mouth*.

There is insecurity among the customers about whether they have similar *values* to Formica-PSM. For the customers considered as potential prospects, Formica-PSM needs to:

- **Communicate its values more clearly to see if these customers feel they have similar goals increasing the possibilities for future co-operation and the level of commitment**

The customers are unsure about the *equity* between them and Formica-PSM, and to establish a relationship with potential customers the company must emphasise mutuality in the relationship. This implies that the perception of some customers can be moved towards increased equality, which would also nurture the feeling of being a valuable customer and contribute to commitment to the relationship. This can be done by:

- **Show openness to the customers opinions and a willingness to commit to the relationship**

There is no complete security regarding their will to repurchase from Formica-PSM, which indicates that these customers may not be willing to continue the relationship. Consequently:

- **Track the company that is willing to repurchase and the one unsure to this**

Since these group of customers are rather unsure to be proud of making business and to recommend to others,

- **Keep in mind that they may have had bad experiences in the past and it could require some time to re-acquire them as they also buy from other suppliers**

Also, the non-buying group has rather few *years as customers*, which can make it difficult to re-approach them. Nevertheless, if this is done the relationship can last for a long time as they have a long-term orientation.

Promising prospects	Problems to target
FF is unsure about increased contact frequency	FF perceives more costs than benefits and unequal relation
KK perceives to have strong influence as supplier	FF has not invested in the relationship
KK is open to repurchase and FF is unsure	I and KK do not desire to increase contact
	KK perceives the relation as partly unco-operative

9 Suggestions for further research

This study constitutes a first attempt at creating a theoretical model determining relevant relationship characteristics impacting customer's profitability for suppliers to develop and manage their customer base under this approach. Therefore, the study provides a number of opportunities for future research which will be presented in the following section.

9.1 Relevant areas

9.1.1 Relationship perspective

The present study was limited to the analysis of dyadic relationships between a supplier and its industrial customers. We consider that it could be interesting to extend the relationship perspective undertaken in this thesis by adding a more holistic view of the relations in a B2B context. Hence, it would be relevant to determine what and how relationships across customers and the direct and indirect network effects can impact customer's profitability.

9.1.2 Quantitative and Qualitative view

In order to achieve the purpose of this thesis, the research followed a quantitative design. We suggest that by conducting a larger survey with a greater sample could be indicated significant relations between the variables selected in the study.

Since it was stated in this work that there are unprofitable customers that still can be valuable for their future potential, we consider that it would be interesting to complement our results by integrating a qualitative perspective. This could provide a more comprehensive understanding of the reasons behind customer's profitability variations through time and performing actions on time.

9.1.3 International approach

The current research was only focused to examine the Swedish market. We consider this a basis for the development of customer relationships based on profitability in other countries. The company has plans to continue growing internationally, representing a particular interesting area for future studies and an opportunity to test our model in an international perspective. Furthermore, it

could be possible to determine whether national differences could affect the relationship characteristics affecting customer's profitability

9.1.4 Complement the concept of profitability

Because of time constraints, our study considered customer profitability in terms of direct purchases and standard cost. Since we argue that customers are not equally profitable, we consider it important to add a cost analysis including all direct and indirect costs of servicing customers to the determination of each customer's contribution to profit.

9.1.5 Customer segments

As mentioned, the findings of this research refer only to the direct-buying customer segment. It is suggested to explore the application of our model to the other two customer segments of the company.

9.1.6 Other companies and industries

Finally, as our results could be regarded as very industry specific, we consider it important to conduct similar studies for other companies and industries. However, it would be particularly interesting to do so through benchmarking.

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11 Appendix

APPENDIX 1: The questionnaire



Företagsnamn..... Etableringsår.....
Typ av verksamhet..... Omsättning 2002.....
Antal år som kund hos Formica-PSM?.....

DEL 1

I följande sektion kommer ett antal frågor rörande relationen mellan leverantör och kund att presenteras. Var vänlig välj det alternativ som bäst stämmer överens med din åsikt genom kryssmarkeringar.

1. Hur ofta köper ni av Formica-PSM?

- Löpande inköp
- En gång per månad
- En gång per kvartal
- En gång per halvår
- En gång per år
- Mindre än en gång per år

2. Hur ofta har ni kontakt (e-mail, telefonsamtal, etc.) med Formica-PSM?

- Varje dag
- En gång per vecka
- En gång per månad
- En gång per kvartal
- En gång per halvår
- En gång per år
- Mindre än en gång per år

3. Är det önskvärt att kontakten med Formica-PSM kunde vara mer frekvent?

- Ja
- Nej
- Vet ej

4. Hur skulle du beskriva er relation med Formica-PSM? Markera med ett kryss.

Kortsiktig / _____ / _____ / _____ / _____ / _____ / Längsiktig

Mindre Frekvent / _____ / _____ / _____ / _____ / _____ / Frekvent

5. Köper ni enbart laminatprodukter av Formica-PSM eller från flertalet leverantörer?

- Enbart Formica-PSM
- Flera olika leverantörer

6. Köper ni produkter från flera av Formica-PSM:s produktkategorier?

- Ja
- Nej

7. Vad tycker du är mest önskvärt i en relation med en leverantör?

- Ett långsiktig perspektiv
- Ett kortsiktig perspektiv

Kryssmarkera de 3 alternativ som bäst överensstämmer med följande fem påståenden:

8. Vi har investerat i relationen med Formica-PSM med avseende på:

- Pengar
- Långsiktiga tillgångar
- Tid
- Personal
- Kunskap
- Personliga kontakter
- Processer
- Övrigt: _____
- Ingen av ovanstående

9. Formica-PSM har investerat i relationen med vårt företag med avseende på:

- Pengar
- Långsiktiga tillgångar
- Tid
- Personal
- Kunskap
- Personliga kontakter
- Processer
- Övrigt: _____
- Ingen av ovanstående

10. Formica-PSM utmärker sig genom:

- Ärlighet
- Integritet
- Anseende
- Trovärdighet
- Kvalitet
- Övrigt: _____
- Inget av ovanstående

11. Vårt samarbete med Formica-PSM har haft positiv inverkan på vårt företags:

- Kunskaper
- Processer
- Tillgångar
- Vinst
- Marknadsandelar
- Kvalitet på våra produkter
- Övrigt: _____
- Inget av ovanstående

12. Formica PSM möter våra förväntningar med avseende på:

- Prestation
- Kundservice
- Leveranser
- Pris
- Produkter
- Tillgänglighet av information
- Löften
- Försäljningspersonal
- Övrigt: _____
- Inget av ovanstående

13. Vår relation med Formica-PSM innebär:

- Mer fördelar än kostnader
- Mer kostnader än fördelar
- En balans mellan fördelar och kostnader

14. Kryssa för det alternativ som stämmer bäst in på er interaktion med Formica-PSM bland följande tre påståenden:

Jämlik	1	2	3	4	5	Ojämlik
Intensiv	1	2	3	4	5	Ytlig
Samverkan	1	2	3	4	5	Brist på samverkan

15. Hur skulle du värdera den övergripande tillfredsställelsen med Formica-PSM?

- Mycket låg Låg Varken låg eller hög Hög Mycket hög
-

Frågeformuläret övergår nu till en andra del där du kommer att få utvärdera ett antal påståenden

DEL 2

I följande sektion kommer ett antal påståenden rörande relationen mellan leverantör och kund att presenteras. Var vänlig välj det alternativ som bäst stämmer överens med din åsikt. Alternativen är graderade från 1 till 5, där:

1 = Tar helt avstånd, 2 = Tar delvis avstånd, 3 = Tveksam, 4 = Instämmer delvis, 5 = Instämmer helt

	Tar helt avstånd	Tar delvis avstånd	Tveksam	Instämmer delvis	Instämmer helt
16. Vår relation med Formica-PSM är tillförlitlig	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Vi är stolta över att göra affärer med Formica-PSM	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. Vi upplever oss som en värdefull kund för Formica-PSM	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19. Vi anser att Formica-PSM:s värderingar överensstämmer med vårt företags värderingar	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. Som köpare upplever vi oss ha starkt inflytande över våra leverantörer	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. Att byta leverantör innebär avsevärda kostnader för vårt företag	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. Relationens varaktighet är en orsak till att vi är kunder hos Formica-PSM	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
23. Lojala kunder bör belönas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24. Formica-PSM är en värdefull leverantör för oss	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25. Formica-PSM är en leverantör som uppfyller sina löften	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Formuläret fortsätter på nästa sida

	Tar helt avstånd	Tar delvis avstånd	Tveksam	Instämmer delvis	Instämmer helt
26. Vi är tillfredsställda med Formica-PSM som leverantör och planerar att köpa av dem igen	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
27. Vårt företag har en nära relation med säljpersonal på Formica-PSM	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28. Formica-PSM:s produkter är av konstant hög kvalitet	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
29. Det pris vi betalar i förhållande till den kvalitet vi erhåller är rimligt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30. Vi är nöjda med den kundservice Formica-PSM erbjuder	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
31. Formica-PSM har den kompetens som krävs för att uppfylla kraven på en leverantör inom denna industri	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
32. Våra eventuella konflikter med Formica-PSM löses på ett vänligt sätt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
33. Formica-PSM är ett företag vi rekommenderar till andra företag	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Tack för Er medverkan!

APPENDIX 2: Factor Analysis

Descriptive Statistics

	Mean	Std. Deviation	Analysis N
The relation with Formica-PSM is trustworthy	4,63	,703	48
Customer is proud of making business with Formica-PSM	4,08	,679	48
We are a valuable customer for Formica-PSM	3,81	,915	48
Formica-PSM:s values agree with customer's values	4,04	,771	48
As buyers customer have strong influence on our suppliers	3,31	,949	48
Switch supplier implies major costs for the customer	3,08	1,069	48
Relationship duration is a reason for being a Formica-PSM customer	4,02	,699	48
Loyal customers should be rewarded	4,58	,613	48
Formica-PSM is a valuable supplier to us	4,31	,748	48
Formica-PSM is a supplier that fulfill its promises	4,44	,769	48
Customer is satisfied with Formica-PSM and plans to re-buy	4,69	,468	48
Customer has a close relation with Formica-PSM sales personnel	4,21	,898	48
Formica-PSM products are of constant high quality	4,31	,589	48
The price paid in relation with quality received is fair	3,90	,778	48
Customer is satisfied with the customer service received	4,40	,765	48
Formica-PSM has the competence required to perform in this industry	4,52	,618	48
Conflicts are solved in a friendly manner	4,56	,580	48
Formica-PSM is a company we recommend to other companies	4,54	,617	48

Correlation Matrix^a

a. Determinant = 3,114E-05

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		,701
Bartlett's Test of Sphericity	Approx. Chi-Square	416,809
	df	153
	Sig.	,000

Component Matrix

	Component				
	1	2	3	4	5
Formica-PSM is a company we recommend to	,852				

other companies					
Formica-PSM has the competence required to perform in this industry	,748				
Formica-PSM is a valuable supplier to us	,738				
Conflicts are solved in a friendly manner	,733				
Formica-PSM:s values agree with customer's values	,723				
The price paid in relation with quality received is fair	,688				
Customer is satisfied with the customer service received	,612				
Customer is proud of making business with Formica-PSM	,610				
Customer is satisfied with Formica-PSM and plans to re-buy	,606				
As buyers customer have strong influence on our suppliers	,595				
Relationship duration is a reason for being a Formica-PSM customer	,592				
Formica-PSM is a supplier that fulfill its promises	,576	-,466			
The relation with Formica-PSM is trustworthy	,478				
Formica-PSM products are of constant high quality					
Switch supplier implies major costs for the customer		,580			
We are a valuable customer for Formica-PSM	,489	,558			
Customer has a close relation with Formica-PSM sales personnel			,692		
Loyal customers should be rewarded		,486			,626

Extraction Method: Principal Component Analysis.
a 5 components extracted.

Communalities

	Extraction
The relation with Formica-PSM is trustworthy	,419
Customer is proud of making business with Formica-PSM	,567
We are a valuable customer for Formica-PSM	,663
Formica-PSM:s values agree with customer's values	,733
As buyers customer have strong influence on our suppliers	,728
Switch supplier implies major costs for the customer	,408
Relationship duration is a reason for being a Formica-PSM customer	,609
Loyal customers should be rewarded	,889
Formica-PSM is a valuable supplier to us	,739
Formica-PSM is a supplier that fulfill its promises	,758
Customer is satisfied with Formica-PSM and plans to re-buy	,713
Customer has a close relation with Formica-PSM sales personnel	,883
Formica-PSM products are of constant high quality	,408
The price paid in relation with quality received is fair	,508

Customer is satisfied with the customer service received	,723
Formica-PSM has the competence required to perform in this industry	,790
Conflicts are solved in a friendly manner	,728
Formica-PSM is a company we recommend to other companies	,852

Extraction Method: Principal Component Analysis.

Total Variance Explained

Component	Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	6,312	35,068	35,068	3,353	18,627	18,627
2	2,162	12,014	47,082	3,052	16,958	35,586
3	1,407	7,816	54,898	2,897	16,095	51,681
4	1,200	6,665	61,563	1,440	8,001	59,682
5	1,037	5,763	67,326	1,376	7,644	67,326

Extraction Method: Principal Component Analysis.

Rotated Component Matrix

	Component				
	1	2	3	4	5
Formica-PSM has the competence required to perform in this industry	,815				
Conflicts are solved in a friendly manner	,774				
Customer is satisfied with the customer service received	,715				
Formica-PSM products are of constant high quality	,592				
The relation with Formica-PSM is trustworthy					
Switch supplier implies major costs for the customer					
As buyers customer have strong influence on our suppliers		,789			
We are a valuable customer for Formica-PSM		,747			
Formica-PSM is a valuable supplier to us		,718			
The price paid in relation with quality received is fair					
Customer is proud of making business with Formica-PSM					
Customer is satisfied with Formica-PSM and plans to re-buy			,761		
Formica-PSM is a company we recommend to other companies	,483		,698		
Formica-PSM is a supplier that fulfill its promises	,463		,694		
Formica-PSM:s values agree with customer's		,565	,634		

values					
Relationship duration is a reason for being a Formica-PSM customer		,467	,523		
Customer has a close relation with Formica-PSM sales personnel				,925	
Loyal customers should be rewarded					,894

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

a Rotation converged in 10 iterations.

APPENDIX 3: Calculations of standard costs of each department

The total costs of each department were obtained from the budgeted costs of 2003. The alternative would have been to use the actual costs of 2002, but as the budgeted amount was applied as it highlighted separate units of costs, while the actual costs of 2002 were of more general character.

The total costs of each department were weighted on each category with respect to the degree of utilisation of each department. The weighted percentage was obtained from Jörgen Bergengrip, marketing manager at Formica-PSM. The costs were only applied to the customers that have purchased the last 16 months, since the remaining customers have not been active and hence not caused any costs. This means a total number of 48 buying customers.

Sales

The total cost of sales is estimated to 7 500 000 SEK in 2003. 50% of this cost should be allocated to the direct-buying customers, which means a total cost of 3 750 000 SEK or 78 125 SEK per customer.

Customer service

The total cost of customer service is estimated to 1 400 000 SEK in 2003. 50% of this cost should be allocated to the direct-buying customers, which means a total cost of 700 000 SEK or 29 166 SEK per customer.

Warehouse

The total cost of warehousing is estimated to 11 400 000 SEK in 2003. 50% of this cost should be allocated to the direct-buying customers, which means a total cost of 5 700 000 SEK or 118 750 SEK per customer.

Logistics

The total cost is estimated to 1 400 000 SEK in 2003. 50% of this cost should be allocated to the direct-buying customers, which means a total cost of 700 000 SEK or 29 166 SEK per customer.

Marketing

The total fixed cost is estimated to 9 000 000 SEK in 2003. However, as a result of reallocation of costs we were recommended by the Financial Manager of Formica-PSM to use the budgeted cost of 2004, which is 1 600 000 SEK as this would give a more fair result. In addition to this cost, the 2003 budgeted cost of 1 300 000 SEK

for marketing material, e.g. samples should be considered. In total, this means a total cost of 2 900 000 SEK. However, it is important to notice that the estimated costs for marketing material varies considerably from year to year, of which the 2003 costs are very low. Normally the costs are around 2 000 000 to 2 500 000. Furthermore, when calculating the estimated costs per customer, 25% of this cost should be allocated to the direct-buying customers, which means a total cost of 151 042 SEK per customer.

These divisions of costs are rather general, and it would have been preferable to further weight the costs within each department in relation to how much of the resources are directed to the customers. However this was very difficult to determine as this information is not available. One method to obtain such information would be e.g. tracking the share of the salesforce's time that is spent with the customers, and to dedicate a corresponding share of costs to the customers. This has been done by Yourke and Droussiotis (1994) for example. Still they concluded in their study that it is very difficult to find a basis for allocating costs like non-salesforce salaries to individual customers. Consequently, they allocated this kind of costs by spreading them equally over all the customers.³⁶²

³⁶² Yourke & Droussiotis (1994)

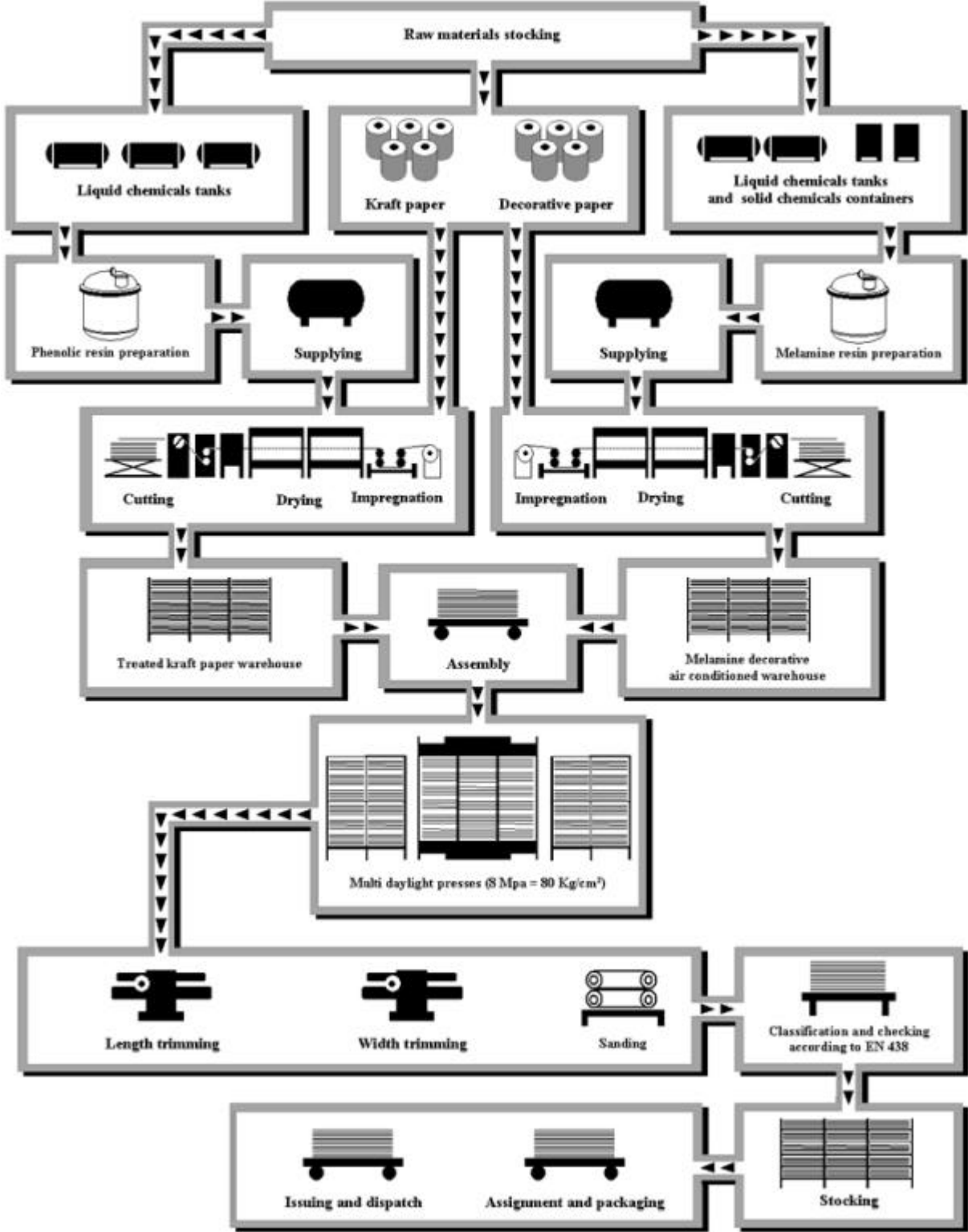
APPENDIX 4: Switching Costs

Switching Cost	Description
Investments in people	Hire personnel, training, learning the product, etc. Investments in people thus create switching costs. The cash outlays for hiring and training are obvious. Other disruptions can be at least as important. The problems of replacing existing personnel with new people can create reluctance to change. The need to wait for the learning that occurs only over time also creates reluctance.
Investments in lasting assets	Such as plant and equipment or other facilities create switching costs. Organisations display strong preferences against abandoning past investments in lasting assets, and therefore those investments contribute to a reluctance to change. Manager frequently find it difficult to accept the idea of a sunk cost: the idea that one should make the best decision now for the future, assuming that what is done is done and not feeling wedded to past mistakes.
Investments in procedures	Investments in a customer organisation's basic business procedures – the ways it performs day-to-day business functions- are especially likely to create switching costs. Procedures are difficult to change and customers are understandably reluctant to change them unnecessarily. If some of a customer's procedures are geared to work with a specific vendor and its products and services and if a change of vendors would require substantial modifications of those procedures, the customer will often be reluctant to change. The more pervasive the procedure –the more employees it involves and the more widely it reaches in the customer organisation- the higher the switching costs created by the investment in procedures. Investments in other procedures – payroll, inventory management, ordering systems or administrating employee benefits, can also create substantial switching costs. In fact it appears that even though formal capital budgeting and related procurement procedures may not explicitly consider investment actions in procedures, such investment can be even more important in erecting barrier to change.
Financial exposure	From the customer perspective, it involves the dollar amounts spent on a product category. It also involves the relative differences in outlays the customer would have made with alternative choices. Thus, feelings of financial exposure can involve awareness of possibly acceptable alternatives with substantially different prices in the market. The vendor also spends money in its relationships with individual accounts. It also faces financial exposure. In some cases, vendors face the risk that they will not collect their receivables an obvious form of financial risk. More frequently, a vendor faces the risk that its relationship with a specific customer will not be profitable –that is, that the revenues it receives from serving a customer will not cover the total costs of serving the customer, among them the costs of the products, the selling effort, service, and any unpriced support. The common lack of knowledge about profitability increases the financial risk that a vendor continues to do business with an

	account that overall reduces rather than increases the vendor's profits.
Performance exposure	For the buyer, is the risk that the vendor's products will not perform as they should or as the buyer expected. It also involves the risk that the vendor's organisations will not perform as expected –late deliveries, lack of knowledge of vendor's representatives, unsatisfactory service. Performance exposure is a mix of immediate and longer-term issues. In the short-run it refers to concerns about product capabilities in actual use, malfunctions, availability and quality of service, and so on. Buyers worry that a product will not work as intended. For the longer-term, additional concerns become important. Especially for products that are important to the execution of the buyer's business strategy, performance exposure involves concerns that because of a poor choice, the purchasing firm will not operate as well as it could had it chosen better. For product categories that entail substantial switching costs, buyer face the risk of painful future investments actions if their vendors do not remain adequately up-to-date technically. Fears that the product will not perform as intended affect the vendor as well as the customer. Poor performance can hurt a vendor's reputation and prospects for future business. Poor performance can also lead to financial problems for the vendor if its must apply resources such as sales, service, and engineering attention, to try to fix the situation. The vendor's performance can be especially troublesome because individuals in the buyer's organisation frequently have key impacts on whether the product works as intended.
Personal risks	Purchases that involve exposure for the customer organisation also create personal exposure for the manager or managers responsible for the procurement. Such managers often believe that they will be blamed if purchase decisions lead to problems. In some cases, they also believe that will receive credit for successful choices, Often, however, managers worry that they will be penalised for poor decisions and bad news more than they will be rewarded for good decisions and favourable news. The result can be conservatism and inertia caused by feelings of personal exposure. The degree of personal exposure can affect the timing of a decision and the choice of a vendor. The desire to make an impact may speed up the decision, and manager concerned with not causing problems may slow down the decision. Less secure and less senior manager will have difficulties in selecting non-traditional vendors, and the desire to appear knowledgeable may broaden the set of vendors on a particular procurement. Purchases and relationships with customers also create personal exposure for individuals within the seller's organisations. Salespeople frequently expect serious harm to their careers if valued customers for whom they are responsible stop buying or significantly reduce their orders. The also feel that the face an asymmetric reward structure.

Source: Jackson (1985)

APPENDIX 5: Production process (HPL)



Source: <http://www.arpaindustriale.com/eng/enter.html>