1. The Relationship Aspect of Marketing

1.1 Introduction – the Power of Relationships

It is a common experience that the relationship between a customer and a supplier can be very strong and sometimes almost impossible for others to challenge.

In this opening chapter, we will introduce the basic framework for the understanding of relationships between buyers and sellers and what might eventually make relationships almost unbreakable. Recognizing the power of relationships as a key aspect of strategic marketing also means that the marketing concept for the future must be renewed and the marketing literature rewritten.

Consider the following situation: Two competing construction companies make a bid for a major, prestigious contract. One of the two companies has maintained a long, close relationship with the customer. The two competing firms' offers are almost identical in price, quality, delivery and service. Who do you think will win the game and get the account? Now, what do you think would happen, if the proposed budget presented by the supplier with the long-standing buyer relationship is 5% higher – with the quality and other terms still being identical? What if the price difference is 9%? Or even 24%?

The outcome depends on many variables. It depends on the cultural context of the relationship, the managerial policies within the buying organisation and a multitude of other factors. Generally, however, the buyer will always be influenced by the previous relationship experiences with the two competing suppliers.

As mentioned, there is conclusive evidence that the supplier-customer relationship is an essential part of what goes on in business life and always has been – be it rational or not. So, the relationship approach to marketing is genuine and important. Relationship capital counts, and marketing in a relationship perspective requires specific attention and explanations not necessarily in accordance with the exchange-centric perception of marketing So, the fact we build on can be narrowed down to this fundamental assumption:

The value of relationships > The value of exchanges

The assumption makes it necessary to adjust the understanding of marketing as a discipline and of marketing management as a company philosophy. Hence, the existence of the intrinsic value of relationships is also a strong stimulus for researchers to establish a new paradigm of marketing strategies.

In relationship marketing management, the focus is on the overall rapport between customer and supplier, not just on the individual episodic exchange between them. Creating, building and preserving relationships becomes the real value driver behind competitive advantage and outstanding performance. In that respect, relationship marketing is the art of initiating and maintaining profitable relationships, turning prospects into customers and customers into friends.

Taking the above example from the construction industry to the next level, it can thus be argued that there is a distinct correlation between the long-term profitability of a company and its customer relationships. Relationships must then be considered an intangible asset – an external, not fully controlled resource base.

As shall be demonstrated later, outstanding customer relationships, longstanding consumer loyalty and competitive advantage in the marketplace are not just results of generally satisfying customers. It takes much more than that. It demands extremely satisfied customers. This highest rung on the customer satisfaction ladder can, however, be difficult and risky to reach.

Systematic analysis of relationships as well as the economics of such relationships can help companies increase their marketing skills and improve their overall market performance. In fact, the customer with the building project might very well end up saving money by choosing the project with the highest proposed budget. Why? It is due to the fact that existing relationships often are combined with more effective regulating mechanisms, e.g. smooth cooperation, trust and partnership and hence they are less costly to administer. Therefore, a buyer must consider the cost of breaking the relationship, before deciding which supplier to use. Consequently, also marketing professionals must take the relationship aspects into consideration in their marketing strategies.

1.2 What Business is Marketing Really in?

It has been suggested that relationship marketing is no more than taking marketing back to its roots. Accordingly, it can be claimed that the relationship approach to marketing represents a kind of "backward" paradigm shift.[1] Throughout the history of modern marketing, the leading marketing management theories have focused almost entirely on fast moving consumer good industries. The main thrust of marketing strategies in the past was based on the belief that the optimal marketing approach was to know how, when and where to position your product to make consumers buy. The dilemma between the exchange-based and the relationship marketing concept can be summarized as shown in fig. 1-1.

These two definitions draw on distinctly different theoretical sources. The classical definition (left) underscores business success through careful planning made and executed by specialists under straight, centralized managerial control. This is the management regime definition.

The marketing mix in terms of product, price, place and promotion is what is going to convince the consumer and

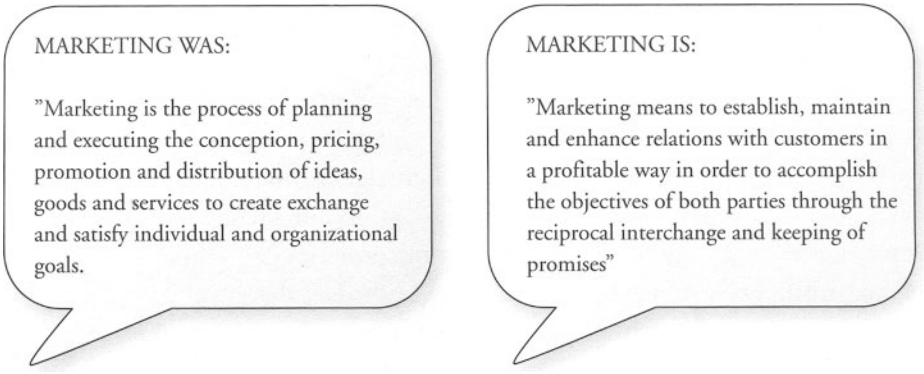

Figure 1-1: What business is marketing really in? Source: American Marketing Association, AMA (1985), Grönroos (1990; 1992)

create market dominance. The consumer's only possible response is.... to buy or not to buy! Any business success formula should be derived from the marketing concept: "Satisfy the needs of the consumers better and/or at a lower cost than your competitors allowing you to make an above average profit. John Egan[2] has expressed this view as follows:

> "Despite the obvious problems, little was changing in marketing education. Marketing theory remained mired in a futile search for laws, regularities and predictability. The marketing mix was (is) still the dominant marketing model, although it was seen as offering a too seductive sense of simplicity.... The toolbox approach of science-oriented marketing was criticised as a neglect of process in favour of structure leading to a consequent lack of study into other key variables....
>
> So it appeared that marketing, the leading department of the first three-quarters of the century, was loosing its primacy.... Marketers were so busy attending to the practise of marketing that they may not have noticed that it was, for all practical purposes, dead. If not dead, it was certainly in crises."[3]

Excellent fast moving consumer goods companies like Procter and Gamble, Coca Cola, Lego or Disney would never have become so successful had their core competence not been within exchange-based 4 P marketing. But is that all?

The relationship-based approach to marketing – the definition (to the right) in figure 1-1 – does not deny the exchange as *the moment of truth*. But it relies on a different assumption. Marketing is about relationships: How they are established, develop, become consolidated and terminate. How they work, how expectations are created and promises kept. According to this approach, there will be many moments of truth. This definition recognises the voice of each individual customer. The marketing process does not stop after the purchase. In other words: "If the purchase is the courtesy, then the relationship is the marriage".[4]

A well-known CEO of a great company more than 70 years ago said it this way: "Your customers are your fortune".[5]

Even in traditional exchange-oriented business-to-consumer industries such as retail, insurance, financial services, IT, automobiles etc., it becomes increasingly clear that the heart of marketing lies in the relationship. Consumers have always been searching for positive relationships with suppliers and emotional associations to brands, because it makes buying easier. Not at any price, but within the range of tolerable cost differences. This, however, is nothing new.

What *is* new to marketing as a discipline is that it must revitalise itself by moving from "left to right" in the previous figure and redefine itself through a more holistic, consistent view of the customer.

1.3 The Classical Buyer-Seller Relationship

When is it reasonable to conclude that a relationship between two parties has evolved? The nice young person giving you a smile from the cash register in the supermarket? The local taxi company that your secretary calls whenever a cab is needed? The employment agency you used only once to hire

A SUPPLIER/CUSTOMER RELATIONSHIP IS:

"A relationship is composed of the sum of exchanges and contacts between supplier and customer over time combined with the regulating mechanisms that support and explain the parties* intensions for the future based on mutual understanding."

Figure 1-2: Definition of a relationship

an IT person with very specific skills? The accounting firm re-elected every year at the general meeting? When does a relationship become meaningful in this context?

One possible definition is presented in figure 1-2.

The level of understanding between the parties, the type of regulating mechanisms, the motives and the goals for future exchanges differ. In industrial markets, relationships are generally reciprocal or *one-to-one*. In consumer markets, it can to some extent seem artificial to use the term "relationship", as the supplier primarily communicates the 4 P one-way with the end customers – *one-to-many*. But that is also changing rapidly with information technology as enabler.

A company's portfolio of relationships is not only comprised of its customers, but of all its stakeholders such as suppliers, financial institutions, competitors, alliance partners etc. The exchange balance between inducements to and contributions from each stakeholder must still be kept competitive and dynamic in order to maintain the stakeholders' interest in doing business with the company. The relationship factor, however, may play an important role in the stakeholder "balances score"; and the relationship dimension may easily influence the relative balances as a consequence of intangibles such as trust and experience.

1.4 Elements of the Buyer-Seller Relationship

The simplified model in figure 1-3 illustrates the basic aspects of a relationship in a vertical supplier-customer structure. The exchange is the precondition for interaction which again is the precondition for integration.
When a company buys a commodity or a standard raw material with a transparent price structure in a perfect market, the procurement manager will typically act on a pure market basis. He will focus on the exchange. He will ask several suppliers for a bid and compare quality, price, delivery time etc. He will act within the constraints of an exchange-based contract framework. He may purchase through a dealer, broker or trader and has no particular interest in further interaction with the specific supplier. The supplier will ask for a payment guarantee. Pure market contracts are *exchange-centric*. The pure market contract leaves no or minimal room for trust and confidence.

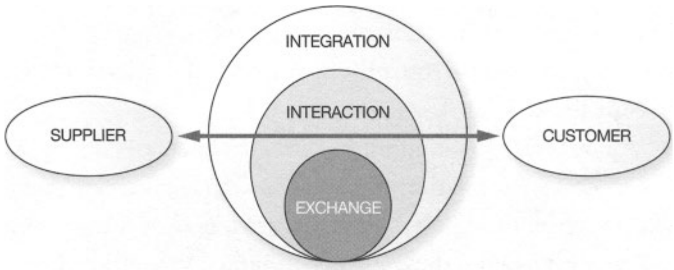

Figure 1-3: Elements of relationships between customer and supplier

At the opposite end of the spectrum, consider a car manufacturer working with a series of strategic subcontractor partners within a closely coordinated supply chain network based on just-in-time and joint R&D. The production plan for the upcoming week must be perfectly coordinated backwards within the supply chain taking into account the subcontractors and their supplies. In this case, the market mechanisms have been removed and do not function at the exchange level just described. The relationship is integrated into a semi-pyramidal, cooperative structure where the actors actively try to eliminate the friction between them. Therefore, network contracts are *integration-centric.*

In between we find thousands of different relationship hybrids. Many types of interactions require direct two-way communication between the supplier and the customer, often in the shape of mutual iterations in operational or strategic problem solving. This enhanced interaction between the parties develops over time and often at different organisational levels, either under managerial control or as bottom-up initiatives.

The *interactive-centric* relationships carry some elements of arms length control like in the pure exchange situations. But they are quite frequently inclined to also adopt integrative qualities.

A marketer must understand the characteristics and qualities of customer relationships before deciding on any strategic or tactical move. The structural attributes of relationships that are influencing the exchange, interaction and/or integration behaviour of the parties are composed of four distinctly different elements as shown in figure 1-4.

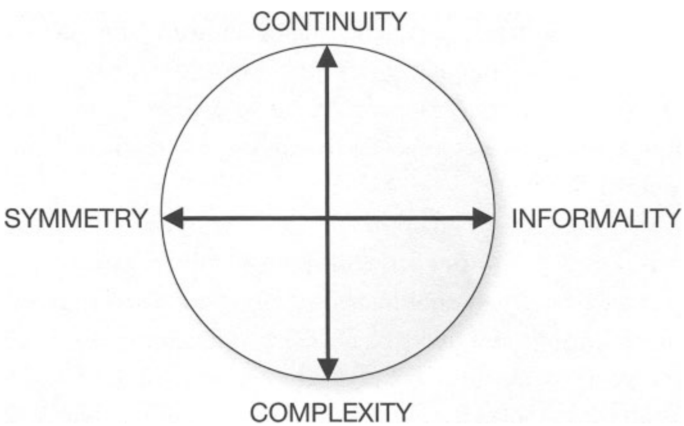

Figure 1-4: Structural attributes of relationships

Continuity means that the buyer and the seller have reached a stage of stability and repetition in their level and pattern of transaction. Rivalry still exists between the two parties and win-lose situations do happen during the ongoing trade between them. But both parties expect a mutual future, for which reason they seek consensus.

Many types of business relationships possess a high degree of embedded continuity. This is the case in most OEM product markets (original equipment manufacturing), where a company designs a component, a module or other features into an end product. In this situation, continuity is a result of product uniqueness and customer requirements. Another example of this is in the field of outsourced accounting or other business services. Accounting firms typically retain their clients for decades. This is due to the fact that all accounting firms have almost identical service packages governed by legislation and professional standards. Here, continuity is in fact rooted in non-uniqueness, which has created a "no-reason-to-change" market. In both cases the arguments behind continuity are relatively straightforward.

As shall be demonstrated later, continuity in customer relationships represents substantial value in terms of retention economics and is one of the key elements in all relationship marketing programmes and investments.

Relationships also differ in their degree of *complexity*. Relationships with high levels of complexity cannot only be difficult to manage, but difficult to break as well. This can lead to a breakdown in communication, redundancy, high control costs and simply mistakes in general. Complexity can be caused by:

- *The exchange*: High involvement durable goods and services such as buying a house or a new car means that very complex relationships between the individual and "the market" evolve. The same will be the case for companies seeking a sole distributor in a new market.

- *The interaction*: Social contact in the context of extensive networks of personal communication between people in organisations makes industrial relationships rather complex and difficult to change.
- *The integration*: Contracts and regulating mechanisms in business-to-business relationships can be complicated, incomplete and inconsistent. Very rarely does a contract cover all possible issues that can come up between two parties. Therefore they must rely on some kind of common problem-solving strategy or understanding. This can, however, also complicate the process.

Whereas continuity in relationships strengthens a business's ability to remain competitive, complexity can become a double-edged sword. Some companies follow a strategy that has a maximum level of complication in order to create an atmosphere of perceived dependence. In insurance and financial services, suppliers consciously try to deliver packages – bundles of products that are tied together in complex "all or nothing" relationship contracts.

A counter-strategy to this would be to reduce the level of complexity through unbundling – i.e. offering transparent, understandable ranges of products, where the customer can choose exactly what he or she wants.

Symmetry is the third structural characteristic of the buyer-seller relationship. Symmetry is a question of relative distribution of influence and information within the relationship. Asymmetry in a relationship can be a powerful motive for individuals as well as companies.

The superior party will tend to capitalise on the cost and effort which his counterpart will have to absorb in order to overcome the gap in knowledge or bargaining power. In some situations however, this approach would not be optimal. When the asymmetry is recognised by both parties, defensive measures such as lower quality, less knowledge sharing, and more control would be adopted be the weaker party.

Several studies[6] have demonstrated that a relationship between companies often continues despite the top management's decision to dissolve it. This is due to the *informality factor*. The real institutionalisation of a business relationship is created between people in organisations and not by command structures. People sometimes view employees in their counterpart organisation as colleagues and management as the enemy.

1.5 Classifying the Pattern of Interaction Between Buyer and Seller

Whereas the basic attributes of the traditional market relationship are external as well as within the company's control and used as part of a *marketing strategy*, it is also interesting to consider how effective a set of marketing actions will be in a dynamic perspective as a function of the customer's *purchasing strategy*. This can be illustrated in the following classification of supplier-customer relationships, see figure 1-5.

		Marketing Strategies		
		Competitive	Co-operative	Command
Purchasing Strategies	Competitive	1 Independent	2 Mismatch	3 Independent
	Co-operative	4 Mismatch	5 Interdependent	6 Dependent
	Command	7 Independent	8 Dependent	9 Mismatch

Figure 1-5: Generic classification of supplier-customer relationships. Source: Based on Sørensen (1997)

The relationship behaviour of a supplier in terms of exchange, interaction and integration can be based on any of the three marketing management philosophies:

- *Competitive:* A give and take, zero-sum attitude. What the customer gains, we loose. The regulating mechanism will be based on arm's length and extensive control.

- *Co-operative*: Here, the assumption is that the customer will enter into a win-win relationship and will work to the benefit of both parties. In this case, frictions are minimised and interdependence between the parties will be the end result.
- *Command* relationship behaviour relies on opportunism and is based on pure dominance logic. The philosophy is that a supplier can earn above normal profits by making the customer dependent on the offering. The core of the relationship, i.e. the product, is supposed to have unique qualities that influence the customer to enter into a command relationship in order to attain the product. The end result is the dominant supplier and the dependent customer.

The generic purchasing strategies can be classified in the same categories explaining the logic behind the behaviour of the buyer as being either competitive, cooperative or command-oriented.

Independent relationships are characterised by intense rivalry between supplier and customer. The relationship may have a high degree of continuity and complexity. Independence does not necessarily mean that there is a constant threat of the relationship breaking down. But none of the parties are interested in testing the benefits of a closer cooperative structure. Independence means that both parties consciously evaluate alternatives and deliberately keep switching costs down.

A mismatch scenario occurs when a co-operative-oriented supplier or purchaser is confronted with a counterpart who has a competitive strategic approach. A co-operative style seeks joint optimisation through the utilisation of the different capabilities in organisations. Mismatch occurs because the competitive reaction is not commensurate with advantage of the invitation to co-operate. When suspicion is present regarding motives, control, lack of commitment, focus on formal contractual arrangements etc. and even the potential for a win-lose situation is what meets a peacemaker, then the chances of reaching a positive result are minimal.

As shall be demonstrated later, *interdependence* assumes mutual trust and the inclination to optimise the relationship. This requires a co-operative marketing philosophy as well as a co-operative purchasing attitude. Both parties give up some of their autonomy, impose switching costs on themselves and assume the risk of trusting the other party. But even a mutually co-operative relationship needs regulating mechanisms in terms of control and outside pressure from competing relationships.

- In reality, only a few relationships are truly "generic" in the sense that a marketing strategy is solely based on e.g. a command relationship. Typically, it is a combination of different types of relationships and strategies. Furthermore, relationships are dynamic; they change over time and adapt to the actions of both parties and the mutual experiences.

In recent years, most companies have made radical changes in the structure and perception of their relationships to become an integral part of the implementation of new business models. There is a rapidly growing interest in relationship management as a key success factor, and huge IT investments have been made in order to organise, integrate and interpret relationship data. Value chains have become atomised and company roles become more focused on core competencies. At the same time, inter-company value chains have had to develop and become more integrated, which enables each company to remain competitive. In this combined focus-integration perspective, the relationship as such has become an even more important factor and hence also relationship strategies.

1.6 Defining Relationship Marketing

Kotler et al. have attempted to modify the traditional 4 P framework of marketing in a relationship-oriented direction. Kotler agrees to the notion that the marketing mix represents the *seller's view of marketing*. Hence, he and others suggest that marketers should view the 4 Ps from a *customer-oriented perspective* as demonstrated by the 4 Cs in figure 1-6.

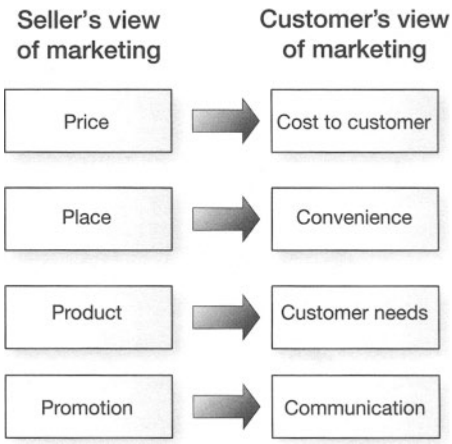

Figure 1-6: From 4 Ps to 4 Cs. Source: Kotler *et al.* (1999)

Every student is familiar with the 4 Ps. The 4 Cs, on the other hand, are new. The 4 Cs are an expression of what the 4 Ps mean to the customer. The P for price is a C for cost in the customer's mind.

This contribution is valuable for some marketers, but it does not represent a paradigm shift or a new relationship-based marketing definition. It is an attempt to update the marketing mix, but it stills sticks to the toolbox view of marketing as positioning. Although there are many aspects of marketing management, the relationship approach appears to have a substantial impact on long-term business success. We will define relationship marketing as in figure 1-7.

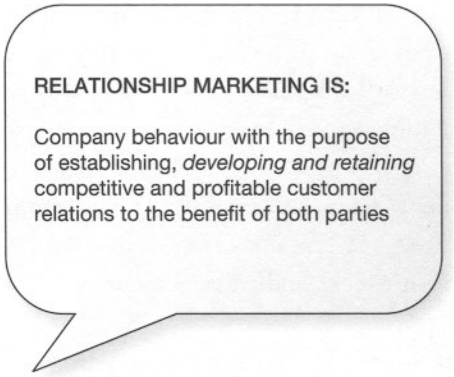

Figure 1-7: From a seller to a customer perspective[7]

We do not consider marketing to be a strictly parametric, programme-oriented discipline, but *a pattern of total organisational behaviour.* Additionally, we consider interdependence, mutual co-operation and commitment between supplier and customer to be absolutely crucial aspects of relationship marketing.

This definition has no ethical basis. Neither does it reflect "good will" per se. The basic notion "for the benefit of both parties" introduces the idea of optimising relationships because it is the most profitable long-term strategy. No more – No less. The bottom line is still the bottom line. The relationship as a whole is considered to be the key to competitive advantage.

Relationship marketing principles do not exist in opposition to traditional segmentation/positioning marketing approach with regard to techniques and marketing mix decisions. Likewise, it would be a mistake to look at the relationship dimension as one tactical approach among others. Relationship marketing is a fundamental managerial approach to business. The basic belief is that reduction of frictions in networks of trade is a prime source of profitability.

The definition above also indicates that not all relationships are profitable. Relationships that are profitable on a lifetime basis may be loss-making in some stages during the lifetime. The recognition of potential loss-making relationships suggests that marketing management must pay attention to three different objectives in terms of:

- The management of the initiation of customer relationships.
- The maintenance and enhancement of existing relationships.
- The handling of relationship termination.

Marketing management introduces two new aspects to the marketing process: *Customer deselection* and *management of different stages of the relationship*. Both elements play key roles in profitability.

1.7 Different Theoretical Directions in Relationship Marketing

Relationship marketing is a relatively new discipline still in search of common ground and well-accepted frameworks. Various sciences have contributed to the systematisation of marketing into a viable research and teaching discipline: Economics, psychology, sociology, political science, mathematics and many more. Relationship marketing as a discipline draws upon these sources as well.

Today, there is no commonly accepted theoretical foundation and no commonly accepted paradigm of relationship marketing. Different research approaches come into play here[8]. Their origins, the complexity of problems studied and their research methodologies differ widely. Some of the main approaches to relationship marketing are shown below.

The four main schools in relationship marketing do not represent an evolutionary process. They have developed independently of each other.

	POSITIONING STRATEGY APPROACH	TRANSACTION COST APPROACH	POLITICAL ECONOMY APPROACH	NETWORK INTERACTION APPROACH
CONTRIBUTORS	Borden, Kotler	Williamson	Arndt, Skytte	Hedaa, Grønroos, Gummesson
FOCUS	THE MARKETER	BUYING AND SELLING PARTIES	SYSTEMS OF EXCHANGES	COMPLEX SOCIAL PROCESSES
RELATIONSHIP VIEW	A TACTICAL TOOL TO BUILD CUSTOMER LOYALTY	A BALANCE OF ECONOMIC RISK/ RETURN CALCULATIONS	A MIX OF DYADIC FORCES	MUTUALLY INTER-DEPENDENT CLUSTERS
MARKETING SCOPE	SEGMENTATION/ POSITIONING	CONTRACTUAL DOMINANCE	SINGLE PARTNER PERSPECTIVE	TOTAL VALUE CHAIN
INTENT	NORMATIVE: PLANNING AND PLAN	NORMATIVE: ACTIVITY STRUCTURING	DESCRIPTIVE: ANALYTICAL FRAMEWORK	DESCRIPTIVE: SYSTEM BEHAVIOUR

Figure 1-8: Overview of main relationship marketing approaches

The *positioning strategy approach,* which in fact covers a rather heterogeneous body of literature, does not consider relationships to be the most important marketing dimension. Through the marketing mix (the 4 Ps), the intention of marketing is to position the offering of the company or the business unit vis-à-vis target groups identified and prioritised through careful market segmentation and competitor analyses. The relationship dimension is an "extra", a tactical, add-on resource allocation tool among many others that a marketer can use.

The transaction cost approach is a theoretical field that can be used within a relationship-marketing framework, but it was not developed as such. The thrust of this so-called institutional economics school is basically that the transactional system, i.e. the relationship, has a huge impact as a driver of costs and benefits. Markets, buying and selling strategies and the contractual terms under which supply and demand meet cannot be explained without understanding all potential obstacles, all the pros and cons and all the in-between arrangements between two parties. That is, the complex and challenging trade-offs between arm's length and deep partnership. Institutional thinking assumes a kind of Darwinist world order in which own-interests orientation is the key to understanding market behaviour. One of the main discussions under the institutional economic paradigm is activity structuring, i.e. the optimal composition of internal activities ("make") versus externalisation of activities ("buy"), and which marketing management challenges are arising from different activity structures.

The *political economy paradigm* discusses the comprehension and articulation of organisational behaviour and hence relationship marketing in more depth than institutional economics. This approach offers a holistic framework for analysing how and why exchanges take place, how two or more customer-supplier parties interact and relate. It outlines different profiles or archetypes of strategic behaviour, which can be used to create and execute single partner strategies; the ultimate relationship marketing solution.

A famous and genuine attempt to create a new relationship-oriented marketing paradigm is the IMP[9] group. Their starting-point was an amazing curiosity with regard to relationships and markets. For reasons of simplicity, all the descriptive, social-oriented approaches to relationship marketing are labelled the *network interaction approach.* This was not done with the intention of giving the marketer or the market analyst any specific methodologies or techniques to create substantial competitive advantages. But the network approach has indeed made a substantial contribution to the study of vertical supply chains. It has been able to explain how clusters of companies act and where obstacles and limitations may arise and why. It does not pretend to judge what is good or less good marketing, but it has inspired us to create more application-oriented models in particular on business-to-business markets.

In the following chapters, all four approaches to strategic relationship marketing will be drawn upon, not just the one of them. It is necessary to present all of them as they all work together to make a comprehensive set of relationship marketing rules and principles and therefore none of them should be excluded. Having said so, the main layers under the theories and models in relationship marketing, which we will introduce and discuss throughout the book, are *the economic and dyadic perspectives.* A dyad is a relationship between two parties and the relationship-oriented behaviour of the parties seeking balanced solutions in an environmental context. We believe that the economic forces and rationales behind human behaviour in business can best be understood if relationships are in focus and if one recognizes the idea of optimisation.