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# Situational Segmentation of Industrial Markets

by Richard N. Cardozo

Organisational buying situations may be classified on four distinct dimensions. Individual dimensions and combinations of dimensions may be used to group industrial market transactions into separate segments. Segmentation based on buying situations can help marketers design and modify marketing programmes, and can assist marketers in predicting the response of particular segments to specified offerings. For example, Choffray and Lilien [5] have shown that knowledge about the composition of the decision-making unit (DMU) or buying centre in a specified situation helps marketers design or modify communication programmes, and concentrate attention on those market segments to which their competitive advantages are most meaningful.

Formal analysis of differences among organisational buying situations received its greatest impetus from Robinson, Faris and Wind [14] who in 1967 differentiated new tasks from modified rebuys from straight rebuys. Moriarity and Galper [11] and the Scientific American [15] have classified buying situations by product. Hakansson, Johanson and Wootz [8] and Luffman [10] differentiated situations on the basis of perceived risk. Other scholars have refined and expanded these classifications.

Interviews\* with purchasing personnel and other members of DMUs, and with industrial marketing personnel, indicate that practitioners have adapted these classifications to suit their own needs and have in that process enriched the classification system. Specifically, practitioners differentiate buying situations on the bases of importance to the buying organisation, the source or origin of the buying process, and the level of funding approval needed.

Information from scholarly and practitioner sources may be combined to produce a four-dimensional classification system for industrial buying situations. These dimensions include:

<sup>\*</sup>Extensive interviews were conducted over a period of several years with more than 30 organisations in the United States. These organisations varied with respect to products and services produced, geographical location and size.

- (1) buyers' familiarity with the buying task (new or rebuy);
- (2) product type;
- (3) importance of the purchase to the buying organisation; and,
- (4) principal type of uncertainty present in the purchase situation.

#### Familiarity with the Buying Task

One may classify buying tasks into "buyclasses" [14] on the basis of the familiarity of personnel in the buying organisation with the buying task. A "new task" is one with which members of the buying organisation have not dealt before, at least in their present organisation. A "straight rebuy" involves purchases of previously purchased items from suppliers already judged acceptable. "Modified rebuys" represent an intermediate residual category of purchases with which individuals in the buying organisation are familiar, but for which buyers may re-evaluate their buying objectives and will re-evaluate suppliers. In their analysis of organisational buying, Robinson, Faris and Wind [14] described modified rebuys as having some of the characteristics of new tasks and many of the characteristics of straight rebuys. Brand [1] follows this position and limits modified rebuys to changing of suppliers. But in a study of industrial marketing organisations Doyle, Woodside and Michell [6] found that new tasks and modified rebuys were quite similar, and that the two combined differed from straight rebuys. In contrast, professional purchasing personnel group buying tasks into "new" and "rebuy", without distinguishing between modified and straight rebuys.

Because empirical evidence suggests that the purchasing process does differ to some extent between modified and straight rebuys, and because that difference may enable marketers to develop useful strategies to deal with particular buying decisions, the three-category system remains useful. For particular analytical purposes, "modified rebuys" may be combined either with "new tasks" or with "straight rebuys," provided the definitions of each of the three classes is complete and unambiguous, and the basis for the combination reported fully. For purposes of managing either the marketing effort or the purchasing process, the combination may be justified on the basis of practical utility.

Both the individuals involved in the purchasing process and the process itself vary among new tasks, modified rebuys and straight rebuys. The three buyclasses vary with respect to the following stages of the purchase process:

- source of problem recognition
- formation of the DMU
- determination and description of the characteristics of the item(s) to be purchased
- search for and qualification of vendors
- analysis of alternatives
- evaluation of offers and negotiation
- order routines and performance evaluation.

In practice, these stages of the purchase process may overlap. Particularly in straight

Stage in Purchase Process	New Task	Modified Rebuy	Straight Rebuy	
Source of problem/ opportunity recognition	<ul> <li>New product development</li> <li>Analysis of operations</li> <li>Expansion of capacity</li> </ul>	<ul> <li>Change in specifications or process for existing product</li> <li>Expansion of operations</li> <li>New offer from non-supplier Dissatisfaction with current supplier(s) (Process resembles that for straight rebuys except for seeking bids from non-suppliers)</li> </ul>	<ul> <li>Inventory control system</li> <li>Production schedule</li> <li>Sales forecast</li> </ul>	
Formation of decision- making unit	New Opera- product tions Expan- change sion	Expan- New New sion product price or offered offered change in specif- ication or process		
— Initiator	Senior Engineer- Senior manage- ing manage- ment, ment, mark- engineer- eting, ing engineer- ing or research	Engineer- Engineer- Purchas- ing ing ing	Purchasing or using department	
- Source of contact with supplier	line managers, technical specialists	Manufac- Engineer- Purchas- ing, ing, ing engineer- purchas- ing and/ ing or pur- chasing	Purchasing	
— Size of DMU — Membership ın DMU	3-6 members Senior Line man- Similar to manage- agers and "new ment, technical product" functional specialists managers, in engin- technical eering, specialists manufac- from mar- turing; keting, purchas- engineer- ing spec- ing manu- ialist facturing; purchas- ing specialist	3-6 members Line managers, technical specialists, purchasing	2-3 members Purchasing, engineering, manufacturing	

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#### Table I. Differences among Buyclasses

Stage in Purchase Process	New Task		Modified Rebuy	Straight Rebuy	
Activity of DMU members     Senior manage- ment involved ment consulted early as if large influencers; expenditures or major resources involved; Technical specialists dominate early stages; purchasing assists in acquir- ing information and participates in qualifying suppliers; technical specialists dominate evaluation tages purchasing assists in acquir- ing information and participates in qualifying suppliers; technical specialists dominate evaluation tages purchasing activity in final		Buyers works with technical personnel to make decision; confirms with line managers.	Purchasing consults with staff specialists in using department		
	supplier choice.				
Determination & description of characteristics and quantity of item(s) to be purchased	Extensive requests and samples from informally and thr request for quotati specifications; fore determine quantity product	for information vendors, ough formal on to determine casts to for new	New specifications from engineering; quantities from sales and production forecasts	Specifications available from prior purchases; quantities, from sales and production forecasts; negligible information sought from suppliers	
Search for and qualification of sources	Intensive working sessions (perhaps including site visit) with suppliers who appear interested and capable; technical specialists interested in reducing number of prospective vendors; buyers, in increas- ing number		Respond to non-supplier initiative; contact current vendors and perhaps other non-suppliers.	Contact current vendors, perhaps others considered capable	
Acquisition & analyses of proposals	Obtain and analyse formal quotations, samples, results of tests; refine specifications.		n some cases, seek new quotations from established suppliers; in others seek new information only from non-supplier involved	For annual/continuing supply agreement, seek quotations from vendors who have qualified; for individual purchases, draw against supply agreement	
Evaluation of offers, suppliers	Evaluation by technical personnel; senior management may add other considerations not directly related to value analysis		Technical evaluation of non- supplier's offering	Evaluate against pre-set criteria price & delivery offered; some organisations maintain multiple sources	
Negotiation	Much negotiation on specifications, performance and guarantee; some on delivery; little on price		Negotiation emphasises price & delivery	Minimum negotiation; emphasis on price, delivery & terms of sale	
Selection of order routine & performance evaluation	Routine for new ta organisation; new t monitored closely a	sk varies by vendors at first	Similar to new task for new vendor; to straight rebuy, for established supplier	Order routine specified in supply agreement; in addition to regular informal contact, evaluation through formal vendor rating system; exception reports from using department.	
Length of process	7-60 months		7-60 months	1 week to 7 months	

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#### Table I. Differences among Buyclasses (cont.)

rebuy situations many stages may be dramatically compressed, and the entire process may be shorter [1].

A summary of differences among these buyclasses along these dimensions, based on previously published research [1, 6, 14, 15, 17] supplemented with data from interviews in a variety of buying organisations in the United States, appears in Table I. Note that the source of problem/opportunity recognition affects the formation of the decision-making unit, but has little impact on subsequent stages of the process.

#### Illustrative Marketing Implications

Marketers facing new task situations should attempt to become involved at the very beginning of the buying process with technical personnel or others who will play a key role in determining specifications and qualifying vendors. Marketers interested in obtaining business in new task situations must be prepared to invest the time necessary to co-operate with the customer as he works through all phases of the buying process.

Similar advice is appropriate for marketers facing modified rebuy situations that result from changes in specifications of one of the buying firm's products. Nonsuppliers should take initiative in cases in which buying organisations are dissatisfied with present suppliers, or are expanding output and interested in adding sources of supply; or in which non-suppliers have a measurably superior offering that current suppliers cannot likely match.

In straight rebuy situations, vendors currently supplying the buying organisation may minimise opportunities for non-suppliers by seeing to it that customers do not have cause for dissatisfaction and by adapting to the changing needs of present customers. Non-suppliers should attempt to persuade purchasing and technical personnel that re-evaluating suppliers will be worth the effort to take advantage of new technology, product features or opportunities for better value. In straight rebuy situations, non-supplier initiatives are likely to be more productive when major supply agreements come up for renewal than when the purchaser simply draws against an existing agreement.

#### **Product Type**

Most purchasers and analysts [2, 4, 9, 15, 16] agree that organisational buying activities vary among specific products purchased. This variation shows itself in the number and identity of departments represented in the DMU [12, 15]. Interview data suggest that the greater the number of departments and the higher the organisational levels represented, the longer the decision process and the more careful scrutiny each alternative receives. Principal dimensions of this variation appear to be product use and degree of standardisation.

Product use includes four categories:

- (1) products and services for maintenance, repair and operation (MRO);
- (2) components of the organisation's finished products;
- (3) materials to be used in the production process; and
- (4) equipment.

Applications for equipment include (a) replacement of existing equipment, (b) retrofit of new equipment into existing facilities and (c) placement of equipment in

expanded or new facilities. Although real estate is not explicitly included in this classification scheme, those organisations that regularly expand or re-locate facilities treat those decisions in a manner similar to capital equipment decisions.

Table II shows the extent to which each of four types of individuals (as designated by job titles) is involved in the purchase decision for each of these four categories of product in new task or modified rebuy situations. An "x" indicates significant involvement; a "—" negligible involvement. Job titles not listed may be significant participants in particular decisions, but not across a broad range of purchase decisions. Across all types of decisions, managers and technical specialists are most important in the early stages of the buying process, but they also are involved in evaluation of bids and negotiations. Purchasing personnel become influential principally in the later stages.

Position	MRO	Product use components	Materials	Equipment
Senior management	_		only for new products	x
Operating management	x	x	x	x
Design engineering		x	x	primarily for new materials or new products
Production engineering		primarily for changes in production process	primarily for changes in production process	x
Research	_	only for new products	primarily to set specifications	x
Purchasing	x	x	x	x

Table II. Participation in Purchase Decisions

Note: "new products" means products that the buying organisation intends to manufacture and sell, but has not done so previously.

The length of the purchase process and care exercised by buyers in analysis of alternatives appear to increase from left to right across the categories in Table II. Purchases of MRO items are generally described as far quicker and less complicated than the other three; components, quicker and less painstaking than materials and equipment. Interviewees reported that equipment purchases typically, but by no means always, received longer and more careful analysis than materials purchases.

The degree of standardisation of the product or service being purchased also affects the composition and behaviour of the DMU. Products (services) may be defined as:

- (1) custom, i.e., a unique design for a particular customer;
- (2) modular, i.e., a unique combination of standard available components or materials; or

(3) standard, i.e., a combination of ingredients that has been offered previously.

Custom and modular products may become standard over time as they are sold repeatedly to one customer or to a broader range of customers. A custom product first purchased as a new task could become a straight rebuy.

In the purchase of custom products, engineering personnel are frequently involved to a greater degree and earlier in the buying process than in purchase situations in which buying organisations select among standard alternatives. Frequently this involvement of technical specialists leads to exclusion of all but one or two vendors, whereas several vendors may be considered as sources for standard products.

Within any use category, custom products or services are likely to receive more careful analysis over a longer time period than are modular products or services. Standard products and services are likely to be purchased in less time and with less deliberation.

#### Illustrative Implications for Marketing

Knowledge of the different departments involved in a purchase decision suggests whom the marketer must contact throughout the marketing-purchase decision process for particular types of products. Information about the length of the purchase decision and depth of analysis performed in the buying organisation may help the marketer to estimate his marketing costs, and to determine whether the pursuit of a particular account or group of accounts appears worthwhile. Marketers should recognise that sale of custom or modular products, which may appear to offer a marketer a competitive advantage over standard products in some instances, typically requires longer and more intensive marketing effort than standard products. Finally, because many purchasing departments organise their buying activities into the four use categories, knowledge of the use or application of a particular product may help a marketer to identify quickly the appropriate contact within the purchasing department.

#### Importance of Purchase to Buying Organisation

Importance refers to the degree of risk believed present in the purchase situation. Type of risk forms a separate category. Although both degree and type of risk have been discussed in organisational buying literature [12, 16], attempts to measure them reliably have met with limited success. Perception of risk varies among situations and individuals because of differences in perceptions of the exposure to loss, the uncertainty surrounding decisions and the individual's own risk tolerance and preference. Although individual differences lie beyond the scope of this paper, the two situational components of risk — exposure & uncertainty — can be differentiated here.

The exposure to loss in a particular purchase decision forms one useful dimension for defining the risk present in that situation. Exposure includes both the cost of the purchased products themselves and the total cost to the buying organisation if the purchased product should fail. The cost of purchased products themselves may be expressed in money volume involved and/or as a percentage of annual volume of purchases represented in a particular decision. For example, negotiation of an annual supply agreement for office supplies involves far more money than does the purchase of several reams of paper or of filing cabinets within that agreement. Although both decisions would be classified as straight rebuys of MRO items, the former is clearly more important than the latter. The total cost of purchasing a product which fails to perform as specified or is delivered late, may include costs of down time, product rejection and even recall. Such total costs can far exceed the costs of the purchased product itself. Most professional purchasers consider total cost rather than just the cost of the purchased units themselves in calculating exposure to loss [3, 7].

Some purchase situations may involve limited monetary exposure for the organisation, but substantial non-monetary exposure for the individuals involved in a particular decision. For example, a buyer and maintenance supervisor in a manufacturing complex considered the award of a cleaning contract for the executive and general office a highly important purchase even though the contract represented an insignificant sum and was classified as a routine maintenance purchase. The situation was important to the DMU members because substandard performance — dirty offices — would be highly visible, and would evoke executive criticism of both buyer and maintenance supervisor.

The other dimension useful for defining degree of risk in a purchase situation is the degree of uncertainty with respect to the outcome. That uncertainty may be defined as the difference between what would, in retrospect, have been the best buying decision and the decision actually made. That difference may be expressed in terms of percentage savings, or percentage improvement in performance or specifications for a set purchase price. In the office supplies example cited above, the differences in cost or performance of the items are likely to be small, and the degree of uncertainty therefore modest. In contrast, advance purchases of materials whose prices fluctuate widely, and for which no orderly hedging market exists, involve a great deal of uncertainty. Buying decisions that involve changes, such as adoption of an innovation or modification of a critical process in the organisation, ordinarily carry greater uncertainty than do decisions that do not require major changes. New tasks bear more uncertainty than do rebuys.

The two dimensions of exposure to loss and degree of uncertainty may be combined to form a simple graph of importance, as shown in Figure 1. If the two dimensions were equally powerful determinants of importance, the importance curve would be a straight line running from the upper left to the lower right position of the figure. But because interview data suggest that exposure is more influential (quite probably because it is easier to quantify) than uncertainty, the importance curve is convex to the origin.

Many organisations group the items they purchase into "A", "B" and "C" categories on the basis of importance to the organisation and, therefore, attention needed when purchasing. "A" items are ordinarily limited in number, involve high exposure and considerable uncertainty, and account for a high percentage of an organisation's purchase volume. "C" items typically include hundreds or thousands of items low in uncertainty and generally (but not always) low in annual purchase volume. Together, "C" items typically account for a small percentage of an



Figure 1. Importance of Purchase Decisions to Buying Organisation

organisation's purchase volume. "B" items form an intermediate class.

Importance directly influences the size and composition of the DMU, as well as its behaviour. In most instances in large organisations, the greater the importance, the larger the DMU, the higher the organisational levels involved and the more painstaking the buying process. Decisions involving large amounts of the organisation's resources ordinarily must pass through more organisational levels of funding approval than decisions involving limited exposure to loss. At each level, decisions considered uncertain will receive more careful analysis, including the search for information to reduce or at least to manage the uncertainty, than will decisions regarded as relatively sure. Important decisions in which extensive consultation or analysis appear unproductive or dysfunctional may be made by a very small DMU comprised of the top management of an organisation.

Although importance appears to affect the composition and behaviour of the DMU in a manner similar to product type, the two dimensions are conceptually distinct. Importance may vary within product type, and each of several types of products might be represented at any specified importance level.

#### Illustrative Marketing Implications

Because of the multiple organisational levels involved and the intensity of analysis on the part of the buying organisation, high-importance purchase situations ordinarily require longer and more extensive marketing efforts than do lowimportance situations. When a large purchase is involved but uncertainty is low, marketers may simply have to ensure that they work with their principal contacts in the buying organisation to carry their proposal through the multiple levels of approval needed. Little more than routine selling activity may be needed at each level.

In high-uncertainty situations, marketers will probably have to spend considerable time at every level to provide assurance that their offering will indeed turn out to be the best decision. In such a situation explicit warranties may form an essential part of the offering.

#### Principal Type of Uncertainty in the Buying Situation

Studies by Lehmann and O'Shaughnessy [9], Hakansson, Johanson and Wootz [8] and Parket and Rabinowitz [13] enable us to identify five principal types of uncertainty in purchase situations. These five include:

- (1) need uncertainty,
- (2) technical uncertainty,
- (3) market uncertainty,
- (4) acceptance uncertainty, and
- (5) transaction uncertainty.

Need uncertainty [8] means that the buying organisation lacks a clear and unambiguous definition of the specifications for a product (and attendant services, if any) to be purchased. This type of uncertainty is most likely to appear in the early stages of the purchase process in new task situations and is unlikely to occur in straight rebuys. The buying behaviour reported by Hakansson, Johanson and Wootz [8] in the face of this type of uncertainty closely parallels that described by Robinson, Faris and Wind [14] and Brand [1] for new task situations in general. Hakansson, Johanson and Wootz add that purchasers prefer to deal with known vendors, or at least those who are "culturally close," to manage need uncertainty. This type of uncertainty could occur in any product category and at any importance level.

Technical uncertainty implies that the product may not perform properly in the buying organisation's environment. The cause of such failure, should it occur, might be failure of the product itself to meet specifications ("a performance problem" in Lehmann and O'Shaughnessy's [9] terms); or the lack of proper integration into the operating systems of the buying organisation (Lehmann and O'Shaughnessy's "procedural problem" [9]). Uncertainty with respect to the product itself is most likely to occur in new task situations, and more likely to occur in situations in which custom products are used than when standard products are purchased. Uncertainty related to integration of the product into the organisation could occur either in a new task, or in a modified rebuy situation in which the ability of a new vendor to provide post-purchase service support was untested. Technical uncertainty may occur in any type of product, but appears more likely to occur in the purchase of custom items than standard ones.

Market uncertainty [8] refers to the heterogeneity among offerings [13] and the rate of change in vendor's products and attendant services. Market uncertainty could occur in new tasks or rebuys of any type of product. Buying organisations facing market uncertainty in particular product classes typically maintain contacts with a large number of vendors and attach a high importance to purchases in that product classes. Parket and Rabinowitz [13] found that buyers who perceived product classes as "generic" (i.e., homogeneous) purchased a higher percentage of their requirements from distributors than did those who perceived the product classes as "non-generic" (i.e., heterogeneous).

Acceptance uncertainty implies a reluctance to purchase a product because personnel in the buying organisation cannot agree on whether the purchase is appropriate, even though the need may be clearly defined. Acceptance uncertainty may arise from a resistance to change within the buying organisation, or from competition for funds within the buying organisation. (Lehmannn and O'Shaughnessy [9] call the latter a "political problem".) Acceptance uncertainty typically arises in important new task situations. It is likely to appear more frequently in decisions to purchase capital equipment than to purchase other categories of products.

Transaction uncertainty [18] refers to uncertainty associated with delivery dates or terms of sale. Transaction uncertainty is likely to occur in dealing with a vendor unfamiliar to the buying organisation, and will therefore appear in many modified rebuy and new task situations. Transaction uncertainty may also arise in straight rebuys. Transaction uncertainty may occur in the purchase of any type of product at any level of importance.

#### Illustrative Marketing Implications

Marketers facing situations of high need uncertainty should stress their abilities as suppliers to help the customer define the need and solve the underlying problem (or capitalise on the underlying opportunity).

Technical uncertainty with respect to the product itself may be reduced through providing samples, test results, and reports from other users of the product. Technical uncertainty related to integration of the product into the buying organisation's operations may be reduced through firm and detailed offers of post-purchase installation and training services, and offers to modify delivery schedules and even product characteristics if necessary. Testimony from previous customers of a vendor new to a particular buying organisation would also serve to reduce technical uncertainty.

In situations buyers consider high in market uncertainty competition among vendors may focus on product characteristics and perhaps related services. Marketers should invest appropriately in product development and stress technical characteristics of the product. Marketers may be able to turn buyers' perceptions of market uncertainty to their own advantage by attempting to increase the amount of market uncertainty perceived in straight rebuy situations, in order to convert the situation to a modified rebuy [8]. This approach involves persuading buyers that all offerings are not the same (generic), and appears more likely to be profitable for manufacturers than for distributors.

Acceptance uncertainty based on resistance to change may require marketers to follow procedures similar to those for situations high in technical uncertainty. Acceptance uncertainty arising from competition for resources within the organisation may be addressed through multi-level selling emphasising return-on-investment concepts. No matter how well executed this approach may be, marketers should recognise that intra-organisation considerations unrelated to the benefits of a proposed purchase may prevent successful consummation of a sale.

Vendors new to a particular buying organisation may reduce transaction uncertainty through providing detailed post-purchase service agreements and testimony from previously satisfied customers. Suppliers with an established relationship with a buying organisation can minimise transaction uncertainty by reliably meeting delivery dates and terms of sale.

#### Conclusion

The four dimensions — familiarity, product type, importance and type of uncertainty — may be used separately or in combination to classify organisational buying situations. These classes of situations constitute market segments. Individual marketers may choose to vary their marketing programmes among situational segments, or may elect to concentrate their efforts on a particular segment [18].

The particular combination of situational dimensions which are used to form segments depends upon the marketing objective. The dimensions of familiarity and product type are most useful to identify DMU membership for purposes of determining what media to use for sales-support advertising. Tables I (familiarity) and II (product type) together provide more detail on DMU membership than does either one by itself. Knowledge type of uncertainty may be the single most useful dimension to decide what attributes to emphasise in communications about a particular product. The dimensions of importance and familiarity can usefully be applied within any product type to estimate marketing costs. These vary with the number of departments and levels in the buying organisation involved in the buying task, and with the intensity of analysis at each level.

Characteristics of buying situations, particularly when specified on multiple dimensions, appear to constitute a useful basis for segmenting industrial markets. Interview data suggest that the use of situational segmentation, when combined with segmentation based on such characteristics of buying organisations as size, industry classification, and the like, may significantly increase the ability of marketers to refine marketing programmes and select the most promising segments on which to focus their marketing activities.

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