

# The Basics of Business Management – Vol II

Marketing, Logistics, Procurement and Law



---

Elly R. Twineyo Kamugisha

**bookboon**  
The eBook company

ELLY R. TWINEYO KAMUGISHA

---

**THE BASICS  
OF BUSINESS  
MANAGEMENT – VOL II**  
MARKETING, LOGISTICS,  
PROCUREMENT AND LAW

The Basics of Business Management – Vol II: Marketing, Logistics, Procurement and Law

1<sup>st</sup> edition

© 2017 Elly R. Twineyo Kamugisha & [bookboon.com](http://bookboon.com)

ISBN 978-87-403-1607-0

Peer review by Timothy Esemu (PhD)

# CONTENTS

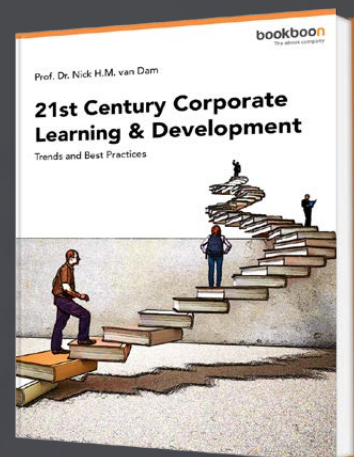
## The Basics of Business Management – Vol I: Leadership, Financial Management and Economics

	<b>Part I: Leaders And Managers</b>	<b>Vol I</b>
<b>1</b>	<b>Introduction to management and leadership</b>	<b>Vol I</b>
	<b>Part II: Financial Management</b>	<b>Vol I</b>
<b>2</b>	<b>Management of Cash</b>	<b>Vol I</b>
<b>3</b>	<b>Credit Management</b>	<b>Vol I</b>
<b>4</b>	<b>Management of Working Capital</b>	<b>Vol I</b>
<b>5</b>	<b>Financial ratios and investment analysis</b>	<b>Vol I</b>

# Free eBook on Learning & Development

By the Chief Learning Officer of McKinsey

[Download Now](#)



	<b>Part III: Microeconomics</b>	<b>Vol I</b>
	<b>Introduction</b>	<b>Vol I</b>
<b>6</b>	<b>Supply and Demand</b>	<b>Vol I</b>
<b>7</b>	<b>Theory of Production</b>	<b>Vol I</b>
<b>8</b>	<b>Market Structures and Competition</b>	<b>Vol I</b>
	<b>Part IV: Macroeconomics</b>	<b>Vol I</b>
	<b>Introduction</b>	<b>Vol I</b>
<b>9</b>	<b>Economic Growth and Economic Development</b>	<b>Vol I</b>
<b>10</b>	<b>Population, Unemployment and the Labour Market</b>	<b>Vol I</b>
<b>11</b>	<b>International Trade</b>	<b>Vol I</b>
<b>12</b>	<b>National and International Competitiveness</b>	<b>Vol I</b>
<b>13</b>	<b>Consumption, Saving and Investment</b>	<b>Vol I</b>
<b>14</b>	<b>Money, Banking and the Financial System</b>	<b>Vol I</b>
<b>15</b>	<b>Public Finance and Fiscal Policy</b>	<b>Vol I</b>
<b>16</b>	<b>Foreign Aid</b>	<b>Vol I</b>
	<b>Endnotes</b>	<b>Vol I</b>
	<b>The Basics of Business Management – Vol II: Marketing, Logistics, Procurement and Law</b>	
	<b>Part I: Marketing and international business</b>	<b>7</b>
<b>1</b>	<b>The Marketing Environment</b>	<b>8</b>
<b>2</b>	<b>The Marketing Mix</b>	<b>26</b>
<b>3</b>	<b>Consumer Behaviour</b>	<b>57</b>
<b>4</b>	<b>Market Segmentation</b>	<b>66</b>
<b>5</b>	<b>Branding</b>	<b>81</b>
<b>6</b>	<b>Services Management</b>	<b>94</b>

<b>7</b>	<b>Relationship Marketing</b>	<b>108</b>
<b>8</b>	<b>Industrial Marketing</b>	<b>118</b>
<b>9</b>	<b>International Marketing</b>	<b>140</b>
	<b>Part II: Logistics management</b>	<b>153</b>
<b>10</b>	<b>Logistics Management</b>	<b>154</b>
<b>11</b>	<b>Reverse Logistics</b>	<b>180</b>
<b>12</b>	<b>International Logistics</b>	<b>183</b>
	<b>Part III: Procurement</b>	<b>192</b>
<b>13</b>	<b>Procurement and Disposal Management</b>	<b>193</b>
<b>14</b>	<b>Outsourcing</b>	<b>230</b>
<b>15</b>	<b>e-Procurement</b>	<b>233</b>
<b>16</b>	<b>Project Procurement</b>	<b>237</b>
	<b>Part IV: Legal issues in business management</b>	<b>247</b>
<b>17</b>	<b>Law of Contract</b>	<b>248</b>
<b>18</b>	<b>Sale of Goods Act and Supply of Goods and Services Act</b>	<b>303</b>
<b>19</b>	<b>Agency and Bailment</b>	<b>315</b>
<b>20</b>	<b>Intellectual Property Rights</b>	<b>322</b>
<b>21</b>	<b>Insurance</b>	<b>326</b>
	<b>Endnotes</b>	<b>329</b>

# **PART I: MARKETING AND INTERNATIONAL BUSINESS**

# 1 THE MARKETING ENVIRONMENT

**Types of marketing environment:** There are two types of the environment that companies interact with: the micro and macro environment.

The *microenvironment* is of immediate concern to the management of businesses. These are factors that are close to a business and have a direct impact on its operations and success. Common microenvironment factors comprise of the employees, suppliers, customers, distribution channels, competitors, shareholders and the media. This microenvironment is unique for each organisation. That is, no organisation has the elements of the microenvironment identical to those of another organisation.

The *macro environment* relates to factors in the environment that affect demand and supply for goods or services of all the organisations within a sector or industry. Broadly, we can look at the external environment under PESTLE – the political, economic, socio-cultural, technological, legal and ecology or nature factors.

## 1) Socio-cultural factors:

*Demographics* (study of population dynamics): Marketers are interested in the issues of population (size, growth, age, distribution, etc.) because people make up markets. The population age mix is very important to marketers. Different age groups have different needs and wants that have to be satisfied. The composition of a country's age distribution determines which products companies can produce for different age segments. A country with a big percentage of older people implies a big market (and demand) for products for that group. For example, for businesses in furniture and bedrooms items, older people are a target market for recliner chairs and flat mattresses.

*Education* levels matter to the marketers. Different levels of literacy and education groups (illiterate, high school level, college and professional groups) have different sets of needs and wants. A segment of people with low levels of education in most cases has less demand for such products as computers, magazines, and management books.

*Lifestyles* of a population also must be carefully analysed by marketers. For example in Western countries (e.g. EU, USA and Australia), there is an increasing number of households made up of single people. Also, most women are no longer 'sit and stay home' moms (or house wives). They go out and work. In these markets there has been an increase in the sales of convenience foods. This is in contrast with the household patterns in developing countries, especially in Africa and some countries in Asia, where there are big families with few women going out to work. Convenience foods would not sale well in these countries.

*Culture:* People's beliefs, values and norms, tastes and preferences are shaped by the society in which they live. We should note that societies are made up of sub-cultures. A sub-culture is a smaller group of people where its members usually share ethnic background, beliefs, values and religion. While a sub-culture group may arise out of a common race or religion, a social activity or hobby may also give rise to such a group. Marketers have to learn the different consumption habits of sub-cultures as they may differ from one sub-culture to another.

- 2) *Ethnic groups and marketing:* Two points can be presented concerning ethnic markets. First, different ethnic groups have their specific needs and wants as well as specific consumer habits. Marketers must, therefore, understand each ethnic group's buying habits and the products they prefer. Secondly, due to emigration, marketers can consider targeting ethnic groups from regions (Asia, Africa, etc.) with products from their countries of ethnic origin. Marketers should be careful to never assume that if a product is popular among Latin Americans in the USA it will be highly demanded in Brazil or Argentina. This is because migration influences product consumption behaviour.

**Migration and Chinese in Canada:** Can the growth and expansion of the economy encourage the rich to migrate?

*Portfolio Magazine* of June 2016 carries an article on the rich young Chinese whose members include the Chinese supercar club who are mainly below the age of 21<sup>1</sup> in mainly Vancouver Canada. Some have diamond wrist watches costing \$ 250,000 and go to school cruising Lamborghinis. Some are driving Lamborghini Huracan – a car that costs nearly \$281,000 <sup>2</sup>. Others are driving Lamborghini Aventador Roadster Galaxy, whose cost price is at \$600,000. The cheapest they drive is around \$115,000 – that is an Audi RS5. Even cops are mesmerized by these young Chinese. "A cop once pulled me over just to look at the car"<sup>3</sup>, one remarked. Watch an online reality show *Ultra Rich Asian Girls of Vancouver* and follow the story of their lives.

These are sons and daughters of the rich Chinese. Many wealthy Chinese are sending their families and their riches in the West. Some are looking for good schools for their children; but others are seeking to escape scrutiny by the Chinese government in China<sup>4</sup>. According to government statistics in British Columbia<sup>5</sup>, with welcoming immigration policies, between 2005 and 2012 at least 37 000 Chinese millionaires became permanent residents of Canada's British Columbia. This was under the then *Immigrant Investor Programme*. In the metropolitan area of Vancouver, with a population of 2.3 million, the number of Chinese has risen from less than 7 percent of the population in 1981 to 18 percent in 2011<sup>6</sup>.

- 3) *Economics*: Marketers are interested in markets whose people have the purchasing power. Purchasing power in an economy depends on current income, savings, prices and availability of credit. The marketers are interested in the country's purchasing power parity as well.
- *Income distribution*: Different economies (developed, developing, less developed) have varying levels of wealth. Not only is national wealth varying but there are also different categories of people classified according to income. In developed countries, income tends to be evenly distributed while in poor countries income tends to be highly unevenly spread<sup>3</sup>. The rich are usually markets for luxury goods and brands (wherever these rich are whether in countries with high levels of poverty). The greater number of people in the poor economies could form markets for inexpensive undifferentiated goods, even unbranded goods.
  - The *saving culture* too should concern marketers. In classical economics, when a person saves, it means he/she has foregone consumption. The more a person saves, the less he/she spends on current consumption<sup>5</sup>. A high propensity to save will result in a lower propensity to consume. Some countries have a higher propensity to save while others have less. For most Indians, savings account for about 20% of personal income while they account for 18% among the Japanese, 6% in the US and less than 5% among the Africans. According to Bloomberg's *Business Week*, China has one of the highest savings rates in the world (38%), followed by India (34.7%)<sup>7</sup>.
- 4) *Legal environment*: Businesses and marketing in particular is influenced by the regulatory environment<sup>6</sup>. The regulatory environment that affects companies includes company laws, employment and labour laws, investment laws as well as the laws of contract, health and safety, data protection, environment and taxation.
- 5) *Political environment*: Political environment is not limited to the regulator environment<sup>7</sup>. It also includes creation of an enabling macroeconomic environment, smooth political change, political stability and national ideology. Most countries in the world (including those in sub-Saharan Africa) have embraced the market economy and favoured privatisation of public enterprises. The political ideology that favours nationalisation of private enterprises discourages investment, research and development and marketing effort. *We will cover the issue of political risk later in this book.*

- 6) *Technology*: Technology is one of those dramatic forces shaping people's lives. In marketing terms, every new technology creates both opportunities and challenges. Technology can lead a firm's products to become obsolete. Companies that do not adapt to new technologies quickly risk closing or running bankrupt. You may need to read about the collapse of Kodak – a company that was associated with the history and invention of still photographs. It failed to innovate and embrace new technological advances. Newcomers took over. The invention of CD and DVD format to record music and video affected the market for VHS or commonly known as video decks and video tapes. On the other hand, ICT has meant that there are many channels of promoting products. It is possible to establish a website, market and sale on the internet; run a virtual shop as has been done by Amazon or eBay. Amazon does not at all operate any big stores or warehouses in its big market of USA and Britain. The falling cost of telecommunications via the cellphone/ mobile technology coupled with their increased user-friendliness has made it possible to work from home and promote products via telephone.
- 7) *Nature (or Ecology)*: The natural environment is a crucial macroeconomic factor. Nature is a source of raw materials, supplies air and water, and there is a concern that activities of some industries pollute the environment. Concerns of climate change are no longer a scientist's rhetoric but there are big signs that the glaciers in Alaska (Canada and USA) are declining. What will happen to the life in these areas? Extinction? Your guess is as good as mine!

### **Firm's Competitor Analysis**

In order for a firm to successfully market itself and its products, it needs to identify and focus on what is special and different about its business. The best approach is to try and express the uniqueness in a single statement. The statement, as Rosser Reeves<sup>8</sup> called it, is the unique selling proposition (UPS) – also called unique selling point – (USP) about the firm's business versus the competitors. This message, once developed, should be used by the firm consistently in its promotion or communications with its varied audiences.

To create a USP<sup>9</sup>, there are several questions that a firm should ask about its business.

- i) What is unique about our business or brand compared to our direct competitors (e.g. Coca Cola vs. Pepsi Cola)?
- ii) Which of these factors are most important to the customers (and prospects) and end users of our brands?
- iii) Which of our products or brands are not easily imitated by competitors?
- iv) Which of these factors can be easily communicated and understood by buyers or end users?

- v) Can the firm construct a memorable message (USP) out of these unique and meaningful qualities about its business or brand? and;
- vi) How will your company communicate this message (USP) to the customers and end users (consumers)?

End users are the consumers but consumers are not always the customers. Customers may purchase goods or services for the end users – the consumers. For example, a mother as the customer buys toys for her baby who is the consumer – the end user.

Product	Brand	USP
Anti-dandruff	Head & Shoulders	"You get rid of dandruff"
Pizza	Domino's Pizza	"You get fresh, hot pizza delivered to your door in 30 minutes or less – or its free"
Courier services	FedEx	"When your package absolutely, positively has to get there overnight"
Chocolate	M&M	"It melts in your mouth, not in your hands"

**Table 1:** Some of the USP that have been successful

www.sylvania.com

**We do not reinvent the wheel we reinvent light.**

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

**OSRAM SYLVANIA**

## Identifying your competitors

A firm has to identify what is unique about its business or brand. Once this has been done, as it does not operate in a vacuum, it needs to critically look at its competition. It makes sense to always begin by identifying your direct competitors (e.g. Coca Cola vs Pepsi Cola)<sup>10</sup>. This is not to say that it is always the direct competitor that affects your market share or total sales. Sometimes bottled water is a bigger competitor to Coca Cola than Pepsi Cola is.

The firm's closest competitors are those firms targeting the same target market (or segment) with similar marketing strategies – product, price, distribution and promotion.

## Who are your competitors?

In order for a firm to compete effectively, it needs to know the following about the competition.

<i>Questions about competition</i>	<i>Answers</i>
Who are your competitors?	Direct competitors: Coca Cola vs. Pepsi Cola; coffee vs. tea; Non-direct competitors: water vs. Coca Cola or Pepsi Cola
What are your competitors' strengths and weaknesses?	Eye-catching colours? Bottle shape? Better marketing team? Better technology? Convenient location? Established distribution channels?
What are your competitors planning to do next?	Introduce better but affordable version? Outspend you on promotions? Undertake a consumer sales promotion around the festive season? Open another distribution outlet?
What are your competitors spending trends?	Are their spending trends consistent or increasing? How about your spending trends?

**Table 2:** Question to understand a company's competitors

## Who are your competitors?

Those who are frequent flyers, mainly in the EU, will make comparisons about KLM, British Airways, Air France and Emirates. It is easy to get an answer that Coca Cola's competitor is Pepsi Cola whenever you ask most people. However, the Coca Cola UK executive once identified tap water as the major competitor! Indeed water – bottled or tap water – has become a serious competitor to both Coca Cola and Pepsi Cola. Consumers (including those with health problems) have abandoned the decaffeinated and low – calorie iterations of both Coca Cola and Pepsi Cola for water, juices and energy drinks. So this tells us that there are different levels of competitors – not simply the direct competitors. Let us now look at competitor levels to be able to say who a firm's competitors are.

**Competitors' levels:** We will look at them as first, second and third level competitors. This is different from the common approach of classifying them as direct versus indirect competitors.

*First level:* These are the specific brands which are direct competitors to a firm's product or service in the same market or geographical locality. These are commonly referred to as direct competitors such as Coca Cola vs. Pepsi Cola; or direct substitutes such as coffee vs. tea.

*Second level:* These are the competitors who offer similar products in a different business category.

*Third level:* These are competitors who compete for the "same occasion" pounds or dollars. Here, for example, we can have direct competitors: Coca cola, Pepsi cola; water, juice, coffee, or tea.

In common practice, most small firms with fewer resources have classified their competitors as direct or indirect: direct competitors being a company that produces another brand of chips, or Coca vs. Pepsi. Indirect competitors are regarded as all those competitors that put on the market products that give similar satisfaction as the company's brand. For example all products of soft drinks and beverages, bottled and tap water are competitors of Coke. Coke also currently produces bottled water brand – *Dasani* – to compete with other bottled water brands and the colas. Pepsi too produces *Aquafina* – as the bottled water brand.

### **Competitors' strength and weaknesses**

Companies should be very aware of their direct competitors and other key non-direct competitors. A company needs to know not only their direct competitors by name but also by the following:

- i) Each competitor's market share;
- ii) How target customers perceive your competitors' product and services;
- iii) Your competitors' financial strength; and
- iv) Each competitor's ability and speed of innovation and ability to bring to the market new products or services.

### Cost of Direct Competition

A firm needs to thoroughly understand the cost of direct competition in order to take deliberate decisions on the marketing mix. It may be “too hot” to compete at certain periods of time. Situations when the cost of direct competition is unwise from the marketing and sales perspective include the following:

- i) When a firm is faced with taking a loss on any marketing programme;
- ii) When a firm’s direct competitors can out-compete it both in money and quality of the offer; and
- iii) When a firm’s competitor has more strategic and tactical advantage (e.g. they have a liked advertising message and well organised channels of distribution).



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.

### Estimating competitors' action

What will your competitors do next?

Undertake and obtain important marketing intelligence about your company's competitors:

- Annual forecast of sales, spending and profits;
- Promotion programmes;
- Introduction and success of new products and services;
- Market, product or service category and trends; and
- Direction of future growth.

### Product Life Cycle (PLC)

The PLC is a very important concept in business and, particularly, in marketing as it provides a theoretical understanding of the product's stage in its life in the market. The concept of PLC was first introduced by an economist, Raymond Vernon (1966)<sup>11</sup>, when analysing the international life cycle of products. He proposed four stages: introduction, growth, maturity and decline. Since then, the PLC has become a common theoretical tool used in marketing.

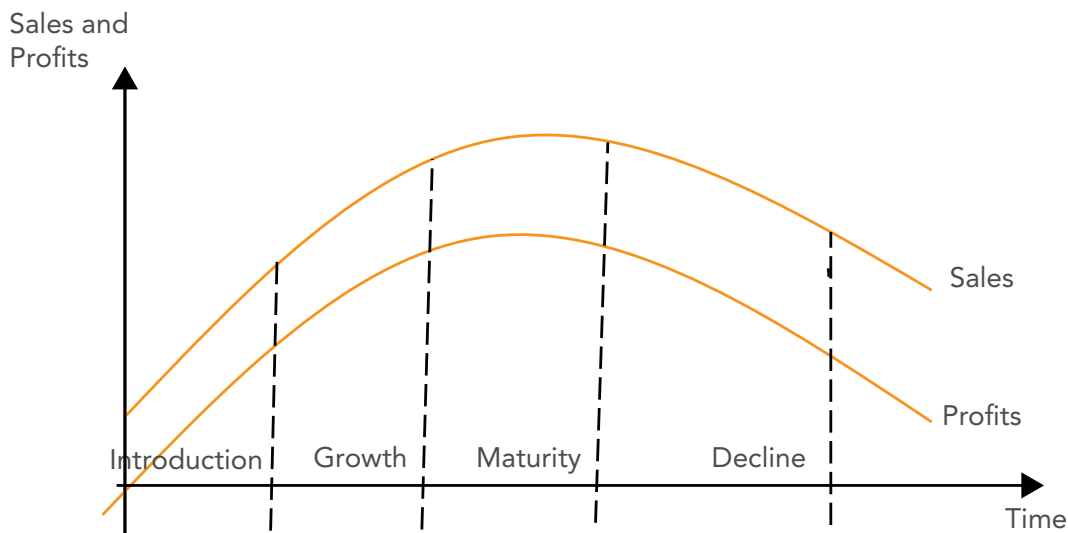
When using the PLC, it is necessary to specify and define the market level being examined. We can look at five meaningful levels of a product or service as we use the PLC: product category, product forms, product lines, products and brands.

<b>Levels of a product or service</b>	
Product category	Broad category of a product such as detergents, cars, newspapers, refrigerators or beers.
Product forms	Different versions that a product can take. For example Refrigerators: solar fridge, electric fridge Stove: Gas stove, electric stove Car: 3-door, 5-door;
Product lines	Clusters of products that a firm produces: Deutsche Telekom or Orange S.A (formerly France Telecom) has got telephony (mobile, landlines) and data services. Unilever has got detergents, cooking oils and fats products;
Products	Individual items within a product line.
Brands	Distinctive features of a product identified through some unique characteristic (symbol, logo, name, etc.)

**Table 3:** Levels of a product or service

The PLC applies in different ways to each of these levels identified above.

- *The Product category* may have a long maturity stage – most product categories stay at this stage of maturity indefinitely.
- *Product forms*, however, seem to go through the standard PLC stages. For example the black and white television seems to have followed all the stages until decline – when the brighter colour television replaced it. Generally, it may currently be very hard to find a black and white television on any market (including in the markets of developing countries where the most poor live). Some young people in affluent societies may not even know that it was ever manufactured at all.
- *Branded products*: Many have erratic life cycles. Some may have a short life cycle while others have a longer one. Some brands, for instance, may die at infancy while others may die of ‘old age’ and others may really never die.



**Figure 1:** Illustrating the stages of the product life cycle

**Introduction:** This stage starts when a new product has been launched. Most new products take time to gain acceptance in the market and there is initially slow growth in sales. The profits are initially negative or low because of fewer sales amidst heavy distribution and promotion costs. At this stage the product is a loss maker for the firm. We should, incidentally, note that some products do gain quick acceptance and make big sales immediately after the launch. This sometimes depends on the company’s image and brand or the previous product that a company successfully promoted and sold in the same market. For example, whenever Apple releases its new version of the iPhone, customers usually line up for it.


*We should note that as the product gains acceptance on the market during this stage, there are several modifications to the product due to customer comments, requests, queries or complaints.*

**Growth:** At this stage there are more buyers and the product has gained acceptance. Sales rise more rapidly and the company begins to make a profit out of the sales of the product. Competitors are attracted to the market by the opportunities for large scale production. Prices are likely to stay stable or even fall slightly depending on the rise or fall in the product's effective demand.


**Maturity:** At this stage, the rate of sales growth slows down and the product reaches a period of maturity, which perhaps is the longest period of any successful product's life cycle. At this stage, the company is enjoying enough total sales and ample profits from the product.

SIMPLY CLEVER

ŠKODA



**We will turn your CV into an opportunity of a lifetime**



The advertisement features a man in a dark suit and tie, leaning over a white desk and looking at a document. On the desk, there is a small white car and a house-like structure made of paper and CVs. The background is a light grey gradient.

Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



**Decline:** In due course, most customers prefer other products or brands and the sales of this product decline. Some products reach a stage of decline very fast but others do so more slowly. Eventually sales will begin to fall. This fall is caused by a number of factors, such as changes in technology, changes in consumer tastes and preferences, availability of substitutes and generally increased competition in the market. The costs of staying in the market become increasingly higher and may lead to the collapse of the business. At this stage, unless the company undertakes better product modification to remain competitive, it must leave the market. In summary, this is the stage at which it is better to allow it to 'die' than to hang on.

**The PLC and strategic planning:** The PLC has relevance for a firm's strategic planning. The future of brands and products is important to a firm. The PLC helps planners to assess the life of the product and answer the following question: *What is the stage that a product has reached in its product life cycle?*

- i) This helps marketers to know the possible remaining life of the product and how much longer the product will significantly contribute to profits;
- ii) To know how urgent and important is the need to innovate and develop new products or improve existing ones; and
- iii) To know the stage of the PLC so as to enable the company's planners to develop appropriate marketing strategies mix (price, product, place and promotion) to suit the PLC stage.

### **Difficulties of working with the PLC**

In theory, the PLC is a good tool to analyse products and brands. In practice, however, this tool may pose some challenges to planners and marketers. We can look at the following:

- i) It is not easy to recognise the stage of a product along the PLC.
- ii) The PLC does not apply to all products or brands. Some products have no maturity. They are launched and then go straight to decline. Some brands never decline, especially when supported by good promotional effort.
- iii) The PLC is changeable. Some firm's strategic decisions can help to extend the product's life cycle (for example via promotions or minor product modifications).
- iv) Competition is not standard in all market segments or industries. There could be intense competition at the introduction and growth than at any other stage. Most products intensely compete at launch and, instead of growing, die immediately. This may give a chance to products that go past growth to enjoy less competition at the Maturity Stage.

## **Acceptance of new products and services**

Once the product has been made and launched on the market, it has to be accepted by consumers – in other words be adopted. The adoption process refers to the stages a customer goes through before deciding to purchase, repurchase or not purchase a product. Most adoption models identify five stages of the process: awareness, interest, evaluation, trial and, finally, adoption. Depending on the product and whether the purchase is high value, there can sometimes be a lag between awareness and adoption.

## **Diffusion**

Diffusion is the process by which an innovation is communicated through certain channels among the members of a social system over time (Rogers, 2003)<sup>12</sup>. It is the rate at which knowledge and use of the product progress throughout the society<sup>13</sup>. It should not be confused with adoption. While the diffusion theory views product integration (or use) in a macro context, adoption theory takes a more individual approach from awareness to adoption or use of an innovation. Diffusion can, therefore, be regarded as the aggregate sum of all adoptions for a particular social system over a period of time. The diffusion process is concerned with how innovations spread – that is, how they are assimilated within a market. It is a process by which the acceptance of an innovation (a new product, new service, new idea, or new practice) is spread by communication to members of a social system, a target market, over a period of time. Communication can be via mass media, sales people, or informal conversations.

## **Innovation**

While there is no one universally accepted definition of product innovation or new product, there are a number of definitions and explanations of what product characteristics constitute a new product or service and how to classify such innovations. Available literature Kindra et al., 1994<sup>14</sup> indicates that the new products or services can be classified under three groups as follows:

- i) Firm oriented: the product is new if it is defined that way by the company developing or marketing it. This definition ignores whether or not the product is actually new to the market place – to the competitors or consumers.
- ii) Market oriented: How much exposure the customer has had to the product and how much market share has been attained.
- iii) Consumer oriented: How consumers perceive the product to be new. This is to say that if consumers perceive the product to be new to them then it is new. Under this definition, newness is based on the consumer's perception of the product itself, rather than on its physical features or market realities. *This approach has been endorsed by some advertising and marketing practitioners but has not yet received ample systematic research attention.*

### Factors that influence the diffusion of an innovation

Currently, there is no precise formula for evaluating a new product's potential acceptance. However some researchers on the topic of diffusion have identified five product characteristics that may influence consumer acceptance of new products. Rogers (1983<sup>15</sup>, 1995<sup>16</sup> and 2003<sup>17</sup>) has identified the factors that influence innovation as i) relative advantage ii) compatibility iii) complexity iv) trialability, and; v) observability.

- 1) **The complexity of the new product:** Complexity is the extent to which a new product is difficult to understand and use. It affects product acceptance. The higher the degree of complexity, the lower the possibility of its acceptance.
- 2) **The relative advantage that the product offers:** Relative advantage refers to the degree to which potential customers perceive a new product as having superior attributes (and, therefore, giving more benefits) than existing substitutes. The more the benefits perceived to be obtained from using the new product, the higher the rate of its acceptance. Some 'smart phones' such as iPhone or Samsung Galaxy give more benefits (internet, email, sms, calling and storage) than other regular cell phones. Internet (websites and email) offer a faster way to reach a company's customers than by ordinary mail or even speed mail (DHL, UPS, FEDEX, etc.).

**e-learning for kids**

- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFKI. An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

- 3) **Compatibility:** This is the degree to which the new product fits into existing patterns, needs, values and practices. If the new product is inconsistent with the consumers' present needs, values and practices, it is either likely to take a longer period of time before it is accepted or it may never be accepted at all. For example some societies like small gadgets – computers, phones, etc while other prefer bigger ones. Japanese, for instance, prefer high quality small sizes (cars, cameras, cellular phones, etc.). While the Americans go for big things, at least judging by the size of their cars and Sport Utility Vehicles (SUVs). In most cultures in Africa, the preference is also for big things because in most parts of the continent 'big' is the symbol for rich or famous persons.
- 4) **Trialability (or divisibility):** Trialability refers to the extent to which a new product is capable of being tried on a limited basis. The ability to try, sample or test drive the new product is vital to the acceptance process. The greater the opportunity to try a new product, the easier it is for consumers to understand it and to finally accept it. The automobile dealers have understood this. They make a customer "get the feel" of the car and test drive it before such a customer can purchase it. Most internet sites which sell content often allow visitors' trial by allowing them as guests to visit their web pages. Promoters of new consumer goods (for example lotions, soap, cooking oil, etc.) often give free samples at their promotions and launches.
- 5) **Observability (communicability):** *Can the innovation be easily communicated?* Observability refers to the ease with which a product's benefits can be described, imagined or observed. It is ultimately the ease with which the new product's benefits can be communicated to the potential customers. The easier it is for the product benefits to be communicated, the higher the degree of acceptance and vice versa. This explains why it is not always easy to promote new service offerings – because it is difficult to communicate their intangible benefits.

**Adoption of an innovation:** Schiffman<sup>18</sup> refers to adoption as a micro process that focuses on the process concerned with the speed of a new product (an innovation) from its source to the consuming public. Stanton<sup>19</sup> defines the adoption process as the set of successive decisions an individual makes before accepting an innovation. Like diffusion, there is no general agreement on how to define adoption. Tauber defines consumer adoption as the acceptance and continued use of a product (and further qualified it that) purchase is not necessarily a sufficient condition for adoption since adoption includes some degree of commitment<sup>20</sup>. A single usage of a product does not necessarily constitute adoption of the product. There must be continued usage of a product in order for it to be referred to as having been adopted. It can be said that first time purchases only possess the product but they become adopters only when continued use and satisfaction result from that purchase.

### Adoption process

Most potential customers do not adopt a new product immediately after they have become aware of its existence. In most literature, they are instead assumed to go through five stages in the adoption process. The proposed five stages are awareness, interest, evaluation, trial and adoption (Rogers 1983<sup>21</sup>, 1995<sup>22</sup> and 2003<sup>23</sup>).

### Adopter categories

As we have already observed under the process of adoption that, in any social system<sup>24</sup>, all members cannot adopt new ideas or new products at the same time. The normal distribution curve has innovators at 2.5%, early adopters at 13.5%, early majority at 34%, late majority at 34%, and laggards at 16%. It should be noted that some members may never get interested in the innovation and, therefore, never accept it.

### Barriers to adoption of innovations

Everyday new products are being introduced to the market but not all are adopted by the consumers. There is often resistance to adoption of certain new products. Ram and Sheth<sup>25</sup> identify two categories of barriers that account for technology resistance: functional and psychological barriers. According to them, functional barriers relate to usage barrier, value barrier and risk barrier while psychological barriers relate to tradition barrier and image barrier<sup>26</sup>. Let us look at them here.

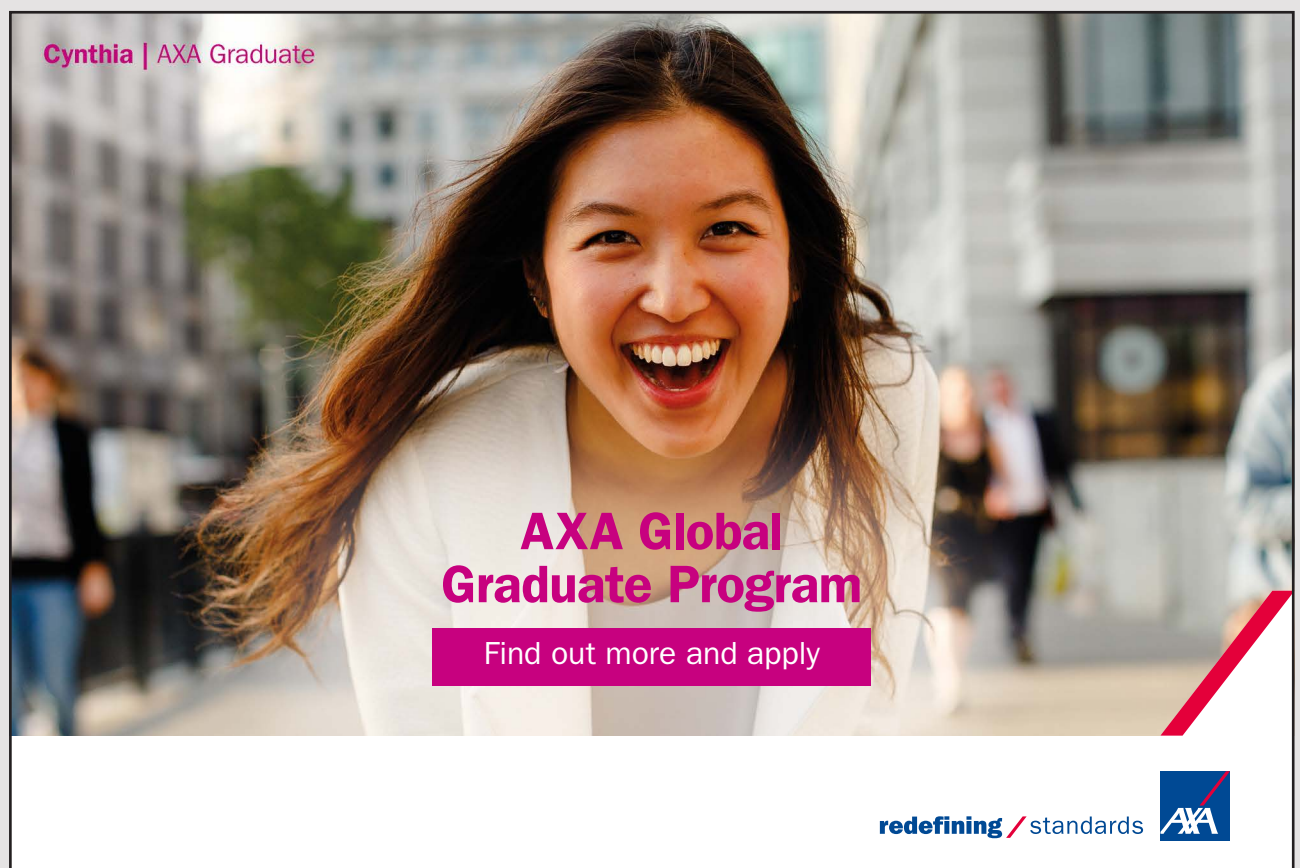
Categories of barriers	Barriers
Functional barriers	Usage: Adoption may not be consistent with current behaviour patterns. Value: That the product does not present value to the customer Risk: Risk of various kinds (physical, psychological, social, economic and time risks) may be associated with adoption.
Psychological barriers	Adoption may not be consistent with tradition or image that the customer prefers.

**Table 4:** Barriers to adoption of innovations

### The experience curves

The experience curve works on the fact that there is usually more learning that results in the quality, clarity and economies of scale. For example, the more the units of a product are made over time, the more likely each unit will be cheaper to produce. There are a number of reasons for this:


- *Economies of scale:* The firm that has a big market buys in bulk (large quantities) of raw materials and processes them in large quantities. This reduces costs associated with bulk purchases and bulk transportation, mass production, unit production cost and marketing efforts.
- *Learning:* Repetition brings skills (although if badly utilised it instead brings monotony). The more a worker does a task, the more they improve and become efficient at doing it. It may take less time to do the task than before.



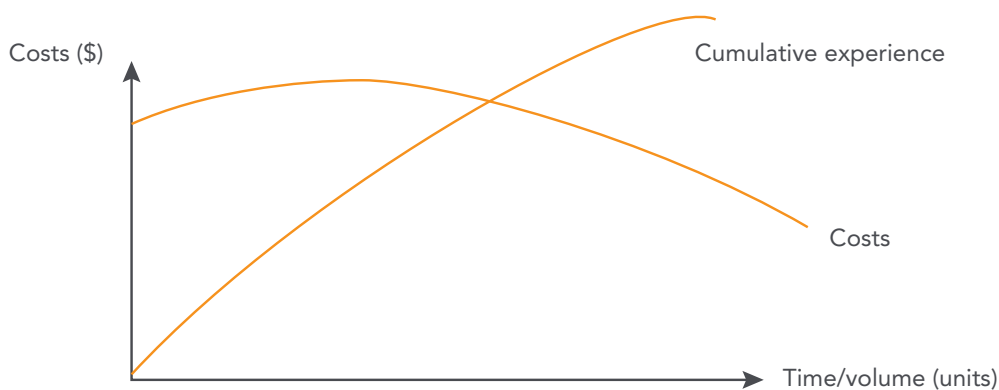
Cynthia | AXA Graduate

**AXA Global  
Graduate Program**

Find out more and apply

redefining / standards 

- *Technological improvements:* When some equipment has just been installed in some factory, however good the operators are, they will still face some challenges associated with its use. Eventually the workers can easily understand and use the equipment to do a lot and do it even faster. They can use it to make improved products because they have learnt the technology. In the manufacture of vehicles, they can use that technology or equipment to produce components that “fit all sizes”. It is said, for instance, that some motor vehicle industry manufacturers are cutting costs by designing components that can be used in different models of the vehicles. This is simplifying products and cutting costs. This makes their cars competitive. Toyota has been known to make a component that can be used by most of its cars in the same range.



**Figure 2:** Learning Curve

### Challenges of working with the experience curve

- i) The assumption that the longer you use the equipment the more experienced you get does not always apply because at times repetition breeds monotony.
- ii) Technological changes do not always mean improvements in quality and hence improvement in sales and profits. Rather, improvement in technology may render the particular process (or current products) obsolete. What happened to the radio cassette when CD/DVD technology was introduced or when the CD/DVD was itself replaced by the memory stick?
- iii) Economies of scale and low costs of production may not translate into low prices because cost is not the only determinant of price. There are other factors such the demand, the current competition, general price (or level of inflation) and other market factors present in each market that equally account for changes in price.
- iv) In modern marketing, the focus is not necessarily on the process but on the customer. Customer-focused, also known as *market-led* organisations put emphasis on the needs of the customer first.

## 2 THE MARKETING MIX

Basically, the marketing mix is composed of 4Ps for a product (product, price, place and promotion) and 7Ps for services (product, price, place, promotion, people and physical evidence)

### Historic Perspective

The concept of marketing mix was introduced by Niel Borden. He is said to have begun using the phrase “Marketing Mix” in his teaching and writing 15 years before he wrote “The Concept of the Marketing Mix” in 1964<sup>27</sup>. In this article, Borden mentioned how the phrase was suggested to him by a paragraph in a research bulletin on “The Management of Marketing Costs” by James Culliton (1948)<sup>28</sup> – especially by Culliton’s description of a marketing executive as a “mixer of ingredients”. Neil Boden (1964) described a marketing executive as “one who is constantly engaged in fashioning creatively a mix of marketing procedures and policies in his efforts to produce a profitable enterprise”<sup>29</sup>. Borden went ahead to provide some “market forces” bearing on the marketing mix such as consumer’s buying behaviour, motivation in purchasing, buying habits, living habits, environment (present and future, as revealed by trends, etc.), the trade’s behaviour – wholesalers and retailers behaviour.

### *Marketing mix concept of four Ps*

McCarthy (1960), in his book, *Basic Marketing: A Marginal Approach*<sup>30</sup> reduced the marketing mix concept to four elements – product, price, place and promotion. We will look at each of these 4 Ps separately.

**Product:** A product is a package of benefits meeting a customer’s particular needs. CIM<sup>31</sup> adds that it is anything that can be offered to a market, for attention, acquisition, use or consumption that might satisfy a want or need.

	<b>Aspect</b>	<b>Sample</b>
1.	Physical Aspect (What a product is)	Hotel Room, conference hall, knife or bank account
2.	Functional Aspect (What the product does)	Hotel Room: sleep and rest Bank Account: keep money
3.	Symbolic Aspect (What the product means to the customer)	If you stay at a 5 Star Hotel, you belong to the ‘who is who’ group. If you bank with Barclays Bank Premier Club you belong to the exclusive club of people

**Table 5:** There are three key aspects of a product

## Levels of a product

The three main levels of the product are itemised here. We should note that Kotler (1997)<sup>32</sup> identifies five levels but in this book we shall focus on three.

Level		Explanation
1.	Core Product	The fundamental service or benefit that the customer is really purchasing. A bank keeps your money. A hotel room offers rest and sleep away from home.
2.	Generic Product	A car includes seats, steering wheel, gear, etc. A hotel room includes a bed, bathroom, towels, dresser and closet.
3.	Augmented product	A television with a remote control gives a customer extra satisfaction. At this level of augmentation and transformations to the product, the marketer should ensure that the product meets the customer's desires beyond their expectations.

**Table 6:** Levels of a product

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**

I was a construction supervisor in the North Sea advising and helping foremen solve problems

Real work  
International opportunities  
Three work placements




**The Product Mix Decision:** A product mix or product assortment refers to a set of all products sold by the organisation. A company's product mix is composed of product line, product width, product depth, product length and consistency.

**Product Line:** This is a group of broadly similar products targeted at a similar group of customers. Three examples will suffice.

- a) Michelin has 3 product lines viz: tyres, maps and restaurant rating services.
- b) Apple Company has communication products and computer products.
- c) Orange has two main product lines – telephony and data/internet.

**Product width:** It refers to the number of *different product lines* the company carries. For example Unilever and Proctor & Gamble have different product lines such as cosmetics, detergents, tooth paste, etc.

**Product Length:** The *number of items* in the product mix.

**Product Depth:** The number or variety of options in each segment or product line. In some countries, Pepsi Cola's Mirinda drink has a depth of five (Mirinda Orange, Mirinda Apple, Mirinda Lemon, Mirinda Fruity and Mirinda Pineapple).

**Product Attributes:** These are the product features referring to styling, packaging, branding, size, quality, colour, shape, etc.

**Product Benefits:** These stem from product performance and image which contribute to the satisfaction that the product delivers to its consumers.

**Marketing Support Services:** These are the services provided in addition to the product itself e.g. presale, delivery, installation, after sales services.

**Packaging Decisions:** This is the element of a product strategy. It includes all activities for designing and producing a container for the product. The package is composed of three levels. Most perfumes have i) primary package (the bottle); ii) secondary package (the outer paper box); and iii) shipping package (metallic or wooden box containing several packages for export).

**Packaging is useful as a marketing tool:**

- i) Self-service;
- ii) Identify – branding;
- iii) Prestige of better package (for consumer affluence);
- iv) Increases on sales; and
- v) Instructions on how to use the product (useful information)

**Pricing:** Price represents the revenue earning part of the marketing mix. Price is the only element in the marketing mix that delivers revenue while other elements create costs. Two basic roles of price are allocation and information. As an allocative instrument, the price of a product determines who can buy the product and how much it can be purchased; or the total demand of the product. A company's pricing policy is a very powerful marketing tool as it directly influences profit.

Price also plays an information role. This role can also relate to the positioning of the product or brand. Price can be an important tool of positioning and communicating the quality of the product. *The company must decide whether to position its product on price-quality relationship.* Some categories of customers regard a higher price as being associated with quality. This may not always be the case in the world where there fake products.

**Place (Distribution)** refers to the availability of the product to the customers. Where can a buyer find the product and pay for it? Place refers to two things:

1. Presence of logistics (for example warehouses, trucks and retail outlets); and
2. Availability of distribution channels (often referred to as the *marketing channels*) such as wholesalers, agents, and retailers that can help a manufacturer to reach final consumers.

*Why do companies use intermediaries? Role of channel players*

The channel players:

- Give useful information about the market conditions and requirements to the manufacturers or producers;
- Give important information to the consumers about the operation or use of products that they are selling;
- Carry out promotional activities such advertising, personal selling and sales promotion for the manufacturers or producers products;
- Order and pay for the products from the manufacturers or producers;

- Can pre-finance manufacturers or producers to produce for them certain products that they may require soon;
- Take on the risk of purchasing from manufacturers or producers and find markets for the products. Until all the items they have bought from manufacturers or producers are all sold, the risk of financial loss is present;
- Take on physical possession of manufacturers or producers products and provide storage for them. Storage is another cost; and
- They, in addition to physical possession, take the title to the goods and later sell them as their own to customers.

### *Strategies for deciding the number of intermediaries*

Companies have to decide on the number of intermediaries to use at each level of the distribution flow:

There are three strategies to decide upon depending on the product:

- 1) Exclusive distribution;
- 2) Selective distribution; or
- 3) Intensive distribution.

**ie** business school

**93%**  
OF MIM STUDENTS ARE  
WORKING IN THEIR SECTOR 3 MONTHS  
FOLLOWING GRADUATION

---

## MASTER IN MANAGEMENT

---

- STUDY IN THE CENTER OF MADRID AND TAKE ADVANTAGE OF THE UNIQUE OPPORTUNITIES THAT THE CAPITAL OF SPAIN OFFERS
- PROPEL YOUR EDUCATION BY EARNING A DOUBLE DEGREE THAT BEST SUITS YOUR PROFESSIONAL GOALS
- STUDY A SEMESTER ABROAD AND BECOME A GLOBAL CITIZEN WITH THE BEYOND BORDERS EXPERIENCE

Length: 10 MONTHS  
Av. Experience: 1 YEAR  
Language: ENGLISH / SPANISH  
Format: FULL-TIME  
Intakes: SEPT / FEB

---

**5 SPECIALIZATIONS**  
PERSONALIZE YOUR PROGRAM

**#10 WORLDWIDE**  
MASTER IN MANAGEMENT  
FINANCIAL TIMES

**55 NATIONALITIES**  
IN CLASS

---

[www.ie.edu/master-management](http://www.ie.edu/master-management) | [mim.admissions@ie.edu](mailto:mim.admissions@ie.edu) | [f](#) [t](#) [i](#) Follow us on IE MIM Experience

**Promotion (Marketing Communications):** Promotion is concerned with how a company presents and sends out messages about itself and its product to the target audiences. It is the element of the marketing mix that helps a company to inform, remind, reassure, persuade and differentiate its offerings to different target audiences, including actual and potential customers. Potential customers must know about a company's product before they can make a decision to buy.

**Marketing communications** can be defined as the process of presenting a set of messages to a target market (audience) through multiple cues and media with the intention of creating a favourable response from the market towards the company's total product offering. It involves a dialogue i.e. providing feedback. Marketing communications – the promotion "P" of marketing mix – has been defined by others as all forms of communications that organisations use to establish meaning and influence buying behaviour among existing and potential customers<sup>33</sup>. Marketing communication may, therefore, be understood to be all forms of communication between an organisation and its customer and potential customers. It involves all the communications by an organisation with its environment and the various stakeholders who might influence it, not just its customers. The company is the sender of messages and receiver of responses from the market. The company communicates with the market through its promotion, product, price and place or point of sale. The major elements for the traditional components of the communications mix (usually referred to as the promotion) are advertising, personal selling, public relations and direct marketing.

### **Marketing communication mix as a management process?**

Marketing communications is a management process through which an organisation enters into a dialogue with its various audiences (CIM)<sup>34</sup>. The objective of this management process is to position (or reposition) the organisation and/or their offerings in the mind of each member of the target audience (buyers, staff, shareholders, the press, etc.) in a consistent and most likeable way. Marketing communications is about the promotion of both the organisation and its products or services.

Traditional promotional tools	New promotional tools
<ul style="list-style-type: none"> <li>• Advertising</li> <li>• Personal selling</li> <li>• Direct marketing</li> <li>• Sales promotion</li> <li>• Public relations (and publicity)</li> </ul>	<ul style="list-style-type: none"> <li>• Word -of – month</li> <li>• Branding</li> <li>• Packaging</li> <li>• Exhibitions</li> <li>• Sponsoring</li> <li>• Corporate identity</li> <li>• Point of sales and merchandising</li> <li>• Websites</li> </ul>

**Table 7:** Promotional tools

**Integrated Marketing Communication (IMC)** means different things to different people but it is likely to occur when an organisation attempts to enter into a coordinated dialogue with its various internal and external audiences. IMC has developed as a result of a number of reasons. There are organisation drivers, market based drivers and communication based drivers. The organisations want to communicate effectively and efficiently to audiences that have now become “communications literate.” It has to be noted that there have been changes in the communications arena. Technological advances have brought Short Message Service (SMS) media, e-marketing and websites.

**Marketing communications and the exchange process:** Is there an economic justification for undertaking marketing communications by organisations?

Marketing communications can be looked at in the context of the exchange process. In business and the modern thinking in economics, all activities undertaken by individuals or organisations can be seen as a series of transactions (or exchanges). An exchange involves two or more parties and each party offers something of value. In marketing sense, when you buy something you will have experienced an exchange. Communication is central to the exchange process, as explained by the **DRIP Model**.

**THE DRIP MODEL:** In the exchange process, the role of marketing communications can be seen in the following:

- i) **Differentiate:** Communication helps organisations to differentiate their offering from that of the competitors. It helps consumers differentiate between competing offerings.
- ii) **Reminds/reassures:** It reminds customers of the benefits they previously enjoyed from past transactions and so encourage them to enter a similar exchange. Sometimes communication is meant to reassure the customers that they made a good choice when they bought from the firm. Communications help to reassure customers of the benefits of the brands they have purchased.
- iii) **Informs:** Communication may be giving information to potential customers about the organisation's offering. Information is vital in the exchange process.
- iv) **Persuades:** It persuades current and potential customers of the desirability of entering into an exchange relationship. At times, amidst the congested market, the organisation has to persuade customers to choose their products instead of those of the competitors. Advertising is a tool of marketing communications which persuades people to buy a product.



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"

Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

**The marketing mix communicates:** All the elements of the marketing mix communicate. In the market place, many retailers and products are similar both in character and quality. Therefore, companies have to distinguish themselves not only through the price but also by customer service. Companies compete through offering a better service than the competition. This brings in the service mix as part of the marketing communications process.

**The product communicates:** Through product cues, the product communicates with the potential and actual customers. The product is a carrier of certain messages, which can be called product messages. The product conveys certain meanings through its colour, shape, size, physical materials, package, labels and brand name. Let us see how the different constituent elements of a product function as communicators.

- 1) *Physical features* of the product communicate: The product's material, design, shape, size, finish, etc. convey some message to the buyer. Some shapes are associated with femininity while others are seen as representing masculinity. The communication can be visual (through sight) tactile (through touching and feeling) and functional. For example, in high priced durable products (e.g. a luxury car), its performance is an important communication cue.
- 2) *The package communicates:* In a self-service environment for example in a supermarket, the package takes up the role of a *silent sales man* on the shelf. The package provides the first appeal to the buyer. The package's design, the colour, the shape and size, label and lettering, the material used and the brand name are vital communication cues. The colours on the package communicate greatly. Colours can, for example, be inviting, friendly, soothing, or dull. There are colours that arouse appetite and others that invite sleep. Some colours are associated prosperity while others are associated with respect or superiority, peace, love and friendship or even romance. Some colours are very attractive and capture the buyer's attention. This era is no longer Henry Ford's era of "People can have Model T in any color as long as it's black."<sup>35</sup>
- 3) *Package design:* The size, shape and design of a package all have a communicative role. The cues of size, shape and design communicate messages such as good quality, high class, high end product or a cheap product.
- 4) *The brand name communicates:* A name is a vital communicator of quality and class among others. Gone are the days of Shakespeare's "what's in a name?"<sup>36</sup>. Customers are no longer looking for just products but certain brands. Car buyers with ample means are looking for brands such *Range Rover, Mercedes Benz, Lexus, BMW, Volvo, Jeep Cherokee, Buick*, etc. not just a four-wheel vehicle or SUV.

**The price communicates:** The price conveys something more than the price itself. Let us look at some things that price communicates in the following:

- a) Customers view price as an index of quality. When several brands of the same product (say a soft drink) are available, customers tend to use price as a cue to quality. Customers tend to associate the highly priced brands with good quality.
- b) In certain cases, price becomes a symbol of status for the buyer. The status conscious buyer uses high price as a status symbol – a sign of prestige. Customers buying a highly priced designer T-shirt do not care that if you removed the label of the designer (*Nike, CAT, D&G, Calvin Klein, Tommy, Christian Dior*, etc.) the same item would cost far less. All they need is to buy labels. If you want to understand the difference between the cost on designer T-shirt and non-labeled T-shirt, read a book, *No Logo* by *Naomi Klein*<sup>37</sup>.
- c) Price can also be seen as an indicator of technological superiority. Some buyers tend to associate price with technological improvements (product innovations). Indeed most new technological products have always initially charged a high price (skimming) during the period of product launch. Ipads, smart phones brands (*iPhone, Samsung*) are priced highly at the launch.

**The place communicates:** It is usual to find people saying that they buy groceries from only 'Z Store'. The reason for this decision is based on different factors ranging from location, convenience, good customer service, quality products, class, etc. The buyers will make such comments as:

“It has good parking”

“They sell quality products”

“They have a big choice”

“It is cheap”

“It has nice staff”

## Resistance to IMC

IMC is being resisted for various reasons, which include organisational and staff reluctance to change, the perceived complexity to plan and coordinate IMC, lack of experience in an integrated communications approach, the need to use a lot of financial resources to achieve it, and the traditional hierarchical structures of most organisations. These factors for resistance can be minimised or overcome. This can be through adopting a customer focus (or market led) approach to marketing, development programmes, appointing change agents and developing an incremental approach through which an organisation requires to move step-by-step when introducing IMC. Kotler (1998)<sup>38</sup> has put forward a simple model of the communications process to provide a framework for understanding how communication works. Kotler's model is an improvement of the communication process model based on Schramm's model (1955)<sup>39</sup>. The flow is that there is a sender (source) of the message via a medium or media to a receiver. The sender can be an individual or company while the receiver can be a customer, other target audiences – potential customers, distributors and the public. In marketing, message can include one or a combination of the promotional mix. The media can be electronic or print media. Electronic media include television and radio, while print media include newspapers, newsletters, and magazines.

Excellent Economics and Business programmes at:



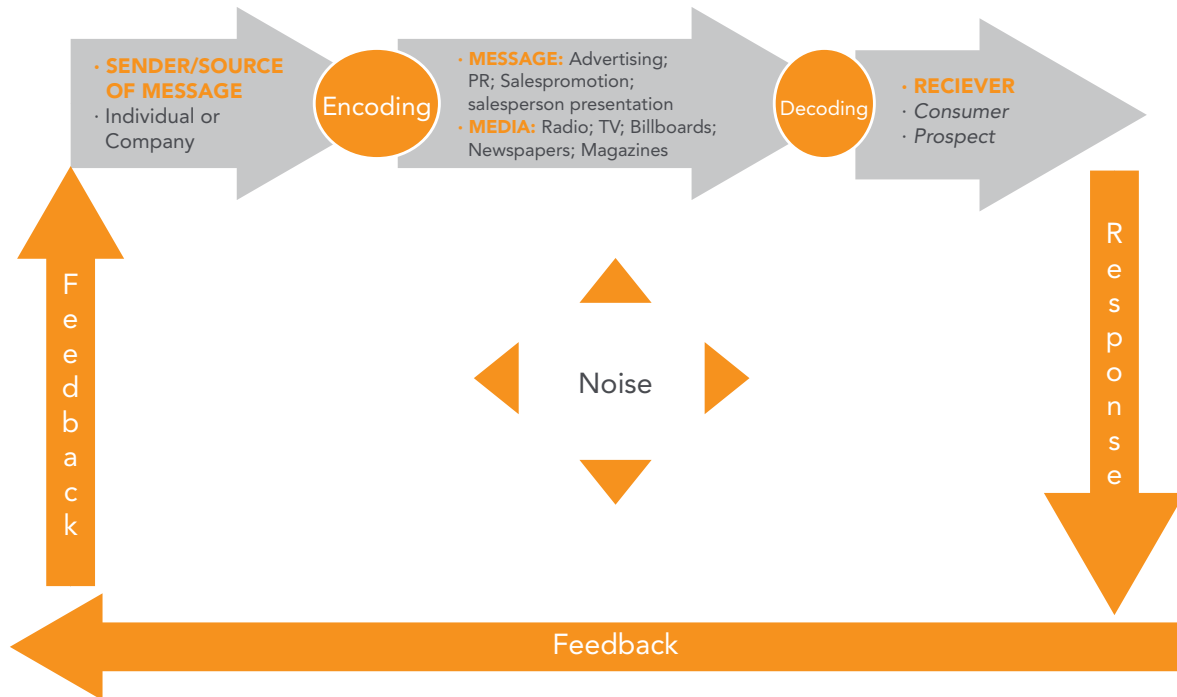
university of  
 groningen




**“The perfect start  
of a successful,  
international career.”**

**CLICK HERE**  
to discover why both socially  
and academically the University  
of Groningen is one of the best  
places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)



**Figure 3:** The Basic Communications Model

The elements of the model, as adapted from both Schramm (1955) and Kotler (1997), can be classified as follows:

- *Encoding:* The process of putting the intended message into a symbolic form (e.g. words, pictures, illustrations, etc.).
- *Decoding:* The process by which the receiver assigns meaning to the message received from the sender. The receiver translates and interprets message.
- *Response:* The reactions of the receiver after being exposed to the message. There are several responses from the receivers of a message (e.g. an advertisement) including buying the product the company is promoting, doing nothing, telling a friend about the advertisement, calling the company to get more information, etc.
- *Feedback:* This is the part of the receiver's response which is communicated back to the sender.
- *Noise:* It is a distortion during the communication process. It can be called a communication disruption or dysfunction. It prevents the receiver from getting all the contents of message that was sent by the sender. Noise is usually a message (say an advertisement) from other competitors.

While the sender's task is to get his or her message through to the receiver, the target audience may not receive the intended message for any of the three reasons<sup>40</sup>:

1. **Selective attention:** Potential buyers are bombarded by several commercial messages each day. It becomes difficult for the receiver to choose which one to focus on. To win his/her attention, the marketer must design the message that attracts attention amidst surrounding distractions.
2. **Selective distortion:** People may twist the message to hear what they want to hear. People (as receivers) have set attitudes which influence what they see or hear. This attitude issue leads receivers to amplify (add things to the message that are not there) the message. Some receivers do not even notice other things that are in the message. To achieve the intended objectives of the message, the communicator has to strive for message simplicity, clarity, interest and repetition to get the main points across the audience. *People always remember the first and last part of the message and, therefore, communicators need to repeat messages.*
3. **Selective recall:** In the long term, people will not retain all parts of the entire message received. They will retain in their memory only a small fraction of the message that reaches them.

### **Selecting the communication channels (Choosing the media)**

The communicator has to select the effective and efficient channel(s) of communication. There are two broad types of communication channels. These are *personal* and *non-personal*. Within each of these broad types are found many sub-channels.

#### **Personal communication channels**

In personal communication channels, two or more people communicate directly with each other. They might communicate face-to-face, over the telephone, person to audience or through the mail, the internet "chat" and 'skype' via voice on the internet. Personal communication channels are effective because they allow for personalised (individualised) presentation and feedback. Some of the communication channels are, for example, where the firm's sales people contact buyers in the target market. Other personal communications about the product may reach buyers through channels not directly controlled by the company. These channels might include independent experts (such as consumer advocates), consumer (buying) guides or consumer product performance evaluation reports making statements to target buyers. There are also the social channels which might include friends, neighbours, family members and associates talking to target buyers. In developed as well developing countries, the influence of the family on the purchase decision is crucial for most purchases. The last channel we can look at is the word-of-mouth influence. The role of opinion leaders in marketing communication is vital and influences purchase behaviour of buyers of, especially, expensive, risky and highly visible products.

### **Non-personal communication channels**

Non-personal communication channels refer to where media carry messages without personal contact or interaction. They include major media, atmospheres and events. Non personal media include print media (newspapers, magazines), electronic media (CDs, videotapes, etc.), broadcast media (radio, TV, SMS) online media (internet websites) and poster media (billboards, sign posts and banners). Most non-personal messages come through paid media. Atmospheres are designed environments that create or reinforce the buyer's leaning towards a product. For example, banks are designed to communicate confidence and other factors that might be valued by their clients. Events are occurrences staged to communicate messages to target audiences (examples of events include public tours, road shows, etc.).

## American online LIGS University

is currently enrolling in the  
Interactive Online **BBA, MBA, MSc,**  
**DBA and PhD** programs:

- ▶ enroll **by September 30th, 2014** and
- ▶ **save up to 16%** on the tuition!
- ▶ pay in 10 installments / 2 years
- ▶ Interactive Online education
- ▶ visit [www.ligsuniversity.com](http://www.ligsuniversity.com) to find out more!

Note: LIGS University is not accredited by any nationally recognized accrediting agency listed by the US Secretary of Education. More info [here](#).



### **The promotional strategies (“the overall communication strategy”)**

After the organisation has established its marketing communication objectives and the product or organisation positioning required, the next step is to determine the overall marketing communication strategy. The communication strategy can be one or a mix of the strategies. These promotion mix strategies are referred to as the **3Ps of the marketing communication strategy**:

- i) Pull communication strategies;
- ii) Push communication strategies; and
- iii) Profile communication strategies

**Push strategy:** A company (a manufacturer) needs to communicate with members of the distribution channels such as dealers and retailers in order to create enough exposure and visibility of its product. A push strategy involves pushing, through communications, the product down through the channel intermediaries and ultimately to the final consumer (end users). The major objective of the company targeting its communication at the channel members is to induce them to carry the product and to promote it to the end users. The company’s communications activities involved are primarily sales force and trade promotion which are directed at the channel players (wholesaler or distributor, retailers or supermarkets). The manufacturer’s representative aggressively encourages the channels’ sales force to sell their brands. The sales force is trained in product knowledge and are given sales commission for selling those products or brands.

**Pull strategy** is used to generate and sustain a dialogue with end user customers. Using the pull strategy, the producer directs its marketing at the final consumer to induce them to buy the product. Under this strategy, consumer demand “pulls” the product through the channels. The pull strategy usually involves primarily advertising and consumer sales promotions as the key marketing activities. Branding is a pull strategy.

**Profile based communication strategies:** Companies need to address how the corporate entity is perceived by its stakeholder audiences (customers, potential customers, staff, shareholders, etc.). Companies can create a good image through the implementation of a profile communication strategy. Corporate identity and corporate image are related facts of the profile development strategy. Nowadays organisations are adopting the corporate branding instead of corporate identity. Corporate branding refers to the practice of promoting the brand name of a corporate entity instead of its specific products or services. Corporate identity is about how an organisation presents itself. Corporate image is what the audience believes an organisation to be as a result of their understanding of the organisation's corporate identity. Corporate identity is about the way the organisation communicates with its audience. There are two main forms of communication: those that are planned (that is, those which are pre-determined by the organisation) and those that are unplanned and unexpected.

**Factors in designing the promotional mix strategies**

Companies must consider many factors in the process of developing their promotional mix. These factors include the type of product/market in which they are competing, buyer-seller readiness stage and product life cycle.

**Type of product market:** The importance of different promotional tools varies between consumer and business (industrial) markets. For example consumer goods usually spend more of their promotional budget on *advertising, sales promotion, personal selling and public relations*. Advertising becomes an important tool of promotion in consumer markets because there are a larger number of buyers, purchases tend to be routine and emotions play a more important role in consumer decision processes. In the industrial goods market, however, companies spend more on *personal selling, sales promotion, advertising and then public relations*. Overall, personal selling (sales presentations) is used more with expensive and risky purchases and in business markets with fewer and larger sellers.

Consumer goods	Industrial goods
Advertising Sales promotion Personal selling Public relations	Personal selling Sales promotion Advertising Public relations

**Table 8:** Relative importance of promotional tools in consumer versus industrial markets

Although advertising is less important than sales calls (personal selling) in business markets, it nevertheless plays a significant role. In business markets, advertising can create awareness (by introducing the company and its products), developing sales leads, reminding and reassuring buyers.

**Communication strategy:** The choice of the push or pull strategy will heavily influence the promotional mix while the push strategy uses primarily sales force and trade promotion, the pull strategy primarily uses advertising and consumer promotion.

**Buyer-readiness stage:** The cost effectiveness of the promotional tools varies at different stages of buyer readiness. Advertising and public relations play the leading role in the awareness creation and knowledge stage. At this stage, their role is much more than the roles created by salespeople with their 'cold calls'. Customer liking, preference and conviction are mostly influenced by personal selling, followed more by advertising and less by sales promotion. Ultimately, closing the sale or ordering is mostly done with sales calls and sales promotion. In summary, advertising and public relations are the most cost effective tools at the early stages of the customer decision making process, while personal selling (given its high costs) and sales promotion should be used at the later stages.

**DON'T EAT  
YELLOW  
SNOW**

**What will  
your advice  
be?**

**Some advice just states the obvious.** But to give the kind of advice that's going to make a real difference to your clients you've got to listen critically, dig beneath the surface, challenge assumptions and be credible and confident enough to make suggestions right from day one. At Grant Thornton you've got to be ready to kick start a career right at the heart of business.

Sound like you? Here's our advice: visit [GrantThornton.ca/careers/students](https://www.grantthornton.ca/careers/students)

Scan here to learn more about a career with Grant Thornton.

 **Grant Thornton**  
An instinct for growth™

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd

**Product life cycle stage:** The cost effectiveness of promotional tools varies at different stages of the product life cycle. In the introduction stage, advertising and public relations are highly cost effective. These two tools are then followed by personal selling and sales promotion. In the growth stage, spending on all the tools can be reduced since the product or brand is *already well known*. Demand is being increased by word-of-mouth. In the maturity stage, sales promotion and advertising are more important than personal selling. Advertising is used to remind and reassure the buyers about the product. In the decline stage, advertising and public relations are reduced and salespeople are available to give the product only very little attention.

#### *Evaluating the results of promotion*

Once the promotional plan has been implemented, the company must measure its impact on the target audience(s). The evaluation is intended to find out whether the target audience has now a positive or negative perception of the company's products. It is also to find out whether the target audience's current attitude is different from the previous one which they had before the promotion.

#### **Tools of the promotional mix**

There are several tools that can be used to communicate with target audiences. The range of promotional tools continues to grow from the traditional view to the modern view. There are a variety of media that can be used for above-the-line campaigns. The list of the media is expanding, both in the printed and advertising field as well as in the broadcast field. There are several thousands of publications targeted at different audiences. In the broadcast field, the number of television stations has steadily increased through satellite, cable and digital television. Even in the less developed countries of Africa, Latin America, and Asia, there are a number of commercial radio stations and this number is still growing. The promotional tools are used to influence a customer or potential customers towards a product and the company offering the product(s). These tools represent the development of deliberate methods calculated to cause a favourable response in the customer's behaviour.

### **Primary (traditional) tools**

Let us start with the primary tools of promotion.

**Advertising:** Advertising is any form of non-personal presentation and promotion of ideas, goods or services by an identified sponsor<sup>41</sup>. CIM (2003) defines advertising as non-personal paid for communications targeted through mass media with the purpose of achieving set objectives<sup>42</sup>. Advertising objectives can be to inform, persuade, or remind/reassure. Advertising is a means through which a company reaches large audiences in a cost effective manner. It is, however, not possible for companies to obtain personalised feedback from an advertising message. While the purpose of advertising is to achieve set objectives, these objectives will vary depending on the following factors:

- a) The nature of the product (or service) to be advertised;
- b) The stage of the product in its life cycle;
- c) The intensity of competition in the market place in which the company operates;
- d) The message that is to be sent out; and
- e) The role that advertising is to play.

In developing an advertising campaign or programme, the marketer must always first identify the target market and buyer motives. Once this has been done, then the marketer can take major decisions in developing an advertising programme. Five major decisions have been identified<sup>43</sup>:

- a) Mission – which should answer “What are the advertising objectives?”
- b) Money – which should address “How much can be spent?”
- c) Message – to answer “What message should be sent?”
- d) Media – to answer the question of “What media should be used?”
- e) Measurement – to answer the question on evaluation “How should the results be evaluated?”

**Personal selling:** This is the most direct and oldest means of promotion. Personal selling has been defined by Baron et al (1991) as the presentation of products and associated persuasive communication to potential clients, which is employed by the supplying organisation<sup>44</sup>. Personal selling is a face-to-face interaction between a salesperson and a prospective customer. The sales force, therefore, plays an important function of providing a direct link to the buyers. It is, therefore, very important that the sales force is a well-trained and competitively spirited team. Training for sales force should include training in sales presentation, negotiation and customer service. Most importantly, they must have product knowledge to be able to explain the features, attributes and benefits of the product that is being promoted. A salesperson undertakes different activities. These include the following:

- 1) *Prospecting:* Generating sales leads and gathering additional prospective customers.
- 2) *Communicating:* Communicating information about the company's products and services to the current and potential customers.
- 3) *Information gathering:* Acting as a useful source of marketing intelligence because of their links with the end customer. In this way, they supply regular reports on the competitive activity within their specific sales area.



.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if  
you could  
build your  
future and  
create the  
future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

- 4) *Allocating*: Assisting in evaluating customer's profitability and credit worthiness. They also control the allocation of products to customers during periods of product shortages.
- 5) *Servicing*: Providing to customers such services as advising on the right product, obtaining credit, and technical assistance on the operation of a product.
- 6) *Selling*: Approaching the customer, making the presentation, overcoming objections and closing a sale.
- 7) *Shaping*: Helping to build and sustain relationships with major customers.

**Sales promotion:** Sales promotion has been defined by the Institute of Sales Promotion (ISP) of UK as "a range of tactical marketing techniques, designed within a strategic marketing framework in order to achieve a specific sales and marketing objective". Sales promotion consists of a diverse collection of incentive tools, mostly short term, designed to stimulate quicker and/or greater purchase of particular products/services by consumers or the trade where advertising offers a reason to buy, sales promotion offers an incentive to buy<sup>45</sup>. Sales promotion can take three forms – consumer promotion, business (sales force) promotion and trade promotion.

*Consumer promotion tools:* The tools of consumer promotion include samples, coupons, price-off, cash refunds, premiums, free trials and warranties.

*Tools for trade promotion:* Trade promotion tools are those methods used by manufacturers or producers to realise sales promotion objectives. These tools include price offs, free goods and display allowances.

*Business (sales force) promotion tools:* These are the tools used to obtain business leads, reward customers and motivate the sales force. These tools include trade shows and specialty advertising (such as branded pens, key holders, cardholders and wall clocks).

### **Why sales promotion?**

The Institute of Sales Promotion (ISP) of UK views sales promotion as a tactical promotional tool used as a means of achieving short term objectives. In summary, we can look at the following sales promotion objectives:

- i) Helps achieve short term sales volume for a brand.
- ii) Encourages trial by non-users.
- iii) Encourages brand switching by getting users of the competitor brand to use or consume your brand. This easily happens in the consumer goods.

- iv) Increases awareness and interest about a company and its products amongst the target audience.
- v) Helps to smoothen seasonal declines in the demand for a given product or brand.
- vi) Helps a company to generate a customer database which will be obtained from the filled in forms or mailed-in applications. This database will be used in future to expand sales.
- vii) The promotion will help increase shelf (or display) space allocated to a given brand in retail outlets.

**Public Relations:** Public Relations (PR) is defined as the planned and sustained effort to establish and maintain goodwill and mutual understanding between an organisation and its publics<sup>46</sup>. The purpose of a company engaging in public relations is mainly to relate positively with its stakeholders (customers, potential customers, suppliers, dealers, etc.). All organisations require a good image. Large organisations have established departments responsible for public relations. The major tool used in public relations is the press release. Other tools include product publicity, corporate communications, organisation's brochure, corporate and product videos, trade exhibitions, speeches, and publications (e.g. magazine).

**Publicity:** In business, and indeed in marketing, publicity can be defined as the appearance of any newsworthy item in the press about an organisation or its employees. Whereas the other forms of promotion that we have covered are designed and controlled by the organisation, publicity cannot easily be controlled by the organisation. Anyone or media can write about an organisation without having discussed with that organisation. However, an organisation can plan properly and influence publicity. For example a good publicity campaign can often build a public story which describes, for example, innovations in products (or services) of the organisation. The contents of the publicity story have to be newsworthy and of interest to a large section of the public, otherwise that story will never be written about in the press. Since publicity cannot easily be controllable, there can be negative or positive news in the press about an organisation. This calls for good relations with the media. Organisations should always keep 'close' on their media relations. This is necessary because news items appearing in the media have a greater degree of credibility for the public than advertising messages designed, and paid for in media, by the organisation.

**Direct marketing:** Direct marketing is an interactive marketing system that uses one or more advertising media to affect a measurable response and/or transaction at any location<sup>47</sup>. Direct marketing has been described by the Institute of Direct Marketing as 'the planned recording, analysis and tracking of customer behaviour to develop relational marketing strategies'<sup>48</sup>. The definitions of direct marketing point to the fact that direct marketing has the broader role of establishing and building a long term relationship with the customer. This relationship can be termed as *direct relationship marketing*. Direct marketing uses one or more advertising media to obtain a significant response. It helps a company to create a direct relationship with its prospects (potential customers) on an individual basis. It is a form of direct supply and uses a variety of alternative media channels such as direct mail and direct response advertising.

**Tools of Direct Marketing:** Telemarketing (Telesales); Direct mail; Mail order; Door-to-door selling; Door drops; Direct response advertising; Email; Voice mail; Catalogues; Customer care lines (Toll free); Internet and news media; computerized home shopping; SMS media



**Maastricht University**

*Leading  
in Learning!*

**Join the best at  
the Maastricht University  
School of Business and  
Economics!**

**Top master's programmes**

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

**Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)**

**Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014**

[www.mastersopenday.nl](http://www.mastersopenday.nl)

Direct response advertising: newspaper adverts can include coupons to fill out and return, live advert on radio or television can give a phone number to ring and receive discounts there and then. Such direct response adverts include the television live advert (*what you see is what you get; call now*).

## **Messages and Media**

To accomplish the tasks of informing, persuading and reminding/reassuring target audiences in order to differentiate an organisation or its products or services, it is important to deliver messages that enable the audiences to understand and act upon the information received. This requires looking at models or frameworks which show how marketing communications work.

### **Messages**

#### **Source credibility and message attractiveness**

*Source credibility* can be defined as the degree of expertise and trust worthiness customers attribute to the source (or origin) of the message. This means, therefore, that the greater the degree of perceived credibility of the source, the greater the likelihood that the receiver will accept the message. The reverse is also true.

*Source attractiveness*: This is determined by message likeability and the similarity of the person in the advert to the target audience (or costumers). For example, if a housewife sees a woman who she takes to be like any other women (like herself) using foam soap (or detergents), she is more likely to accept and be influenced by the message (by the advert). This advert, in which a common person is using a product, is referred to as the *common man's appeal*.

In trying to come up with the best message content, companies search for a unique selling proposition, theme or idea. Message can appeal to emotions, morality or rationality. Marketers can, therefore, present their message to target audiences by appealing to peoples' emotion, morality or rationality. Rational appeals aim to influence the audience's self-interest. They should show that the product will produce the claimed benefits. Such appeals can be factual. Emotional appeals try to create negative or positive emotions that will influence buyer behaviour. Marketers normally use the positive emotional appeals such as love, pride, humor or joy to motivate consumer purchase. Social marketing and behaviour change campaigns have used negative emotional appeals to discourage bad behaviour. For example, *Mothers Against Drink and Drive* (MADD) can use the emotion of fear and crying to discourage drunken driving. Moral appeals are directed at the target audience's sense of right and wrong. Social campaigners use moral appeals to dissuade society from doing injustice. The campaigners against slave trade used this type of appeal – telling society that all people had rights and that people can never be seen as property. Most non-governmental organisations (NGOs) too use this type of appeal.

## Message Appeal

The message in most advertisements can be presented in two main forms – as a rational or emotional appeal.

<b>Rational message appeals</b>	
Issue	comment
Factual	Benefits presented using factual arguments (e.g. health warning on cigarettes: 'Smoking is harmful to your health')
Demonstration	Shows the target audience how the product works (e.g. vacuum cleaner promotions)
Slice of life	A common person is used to show how for example foam soap cleans her clothes. Unilever has used of a woman washing dirty clothes using foam soap 'Omo' brand in some African countries of Uganda, Kenya, Tanzania, etc.
Comparative advertising	Show the target audience the distinction between two related products (e.g. a credit card and debit card)
<b>Emotional Message appeals</b>	
Issue	Comment
Humour	Show the target audience how this product makes people laugh or smile
Fantasy	Engage and encourages the target audience to find out what is happening in the advert
Music	Used to provide campaign continuity but also differentiation through recognition (automobile manufacturers use this kind of appeal).
Sex	Often times women-models have been used primarily to attract attention and to be salient (a beautiful woman is good to look at!)
Fear	Suggest that there will be physical danger to life or social isolation ('don't drink and drive', life insurance, anti-perspiration sprays (Chios), anti-dandruff shampoos, etc.)


**Table 9:** Presenting message appeals

## Message execution

The impact of a message depends on two things: what is said and how it is said. Depending on the promotional objectives of companies, some adverts can aim for rational positioning while others for emotional positioning.

## Message execution styles

The advertiser can present any message using one or a combination of execution styles listed here:



The image shows a central blue square with the letters 'BI' in white. Radiating from this square are numerous colorful, 3D-style rectangular bars of various colors (red, orange, yellow, green, blue, purple, pink) that fan out in all directions. Each bar has a label for a business program. The labels include: 'Business', 'Strategic Marketing Management', 'International Business', 'Leadership & Organisational Psychology', 'Shipping Management', and 'Financial Economics'. The bars are arranged in a circular pattern around the central 'BI' logo.

## Empowering People. Improving Business.

BI Norwegian Business School is one of Europe's largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD  
**EQUIS**  
ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

Message execution style	Comment
Lifestyle	The message emphasizes how the product fits in with a given lifestyle
Slice of life	The message, especially in an advertisement, can show a person or group of people (e.g. family) using the product in a normal setting (a woman using Unilever's washing powder <i>Omo</i> to clean dirty clothes)
Fantasy	The messages create a fantasy around the product itself or its use. Some companies fantasize the target audience into becoming the movie star or soccer player. The message is that when you use the product you are like the star yourself.
Image	The message evokes some image around the product (for instance beauty, love, fear, toughness, humbleness, etc.). Such adverts make no claims about the product except via a suggestion (e.g. such as a friend telling another that he needs another computer because his old one failed)
Personality symbol	The message has a character that personifies the product either in an animated form or the real person. Common adverts fitting here include 'Mr. Clean'.
Testimonials	Here the advert features a real person who is highly credible, likeable, or expert source endorsing the product. Such a person can be a celebrity, a professional doctor, dentist, or scientist. When the target audience sees a dentist endorsing a tooth paste, they will be motivated to buy. The professionals are usually believable and are referred to as opinion formers.
Musical	This message contains background music or shows one or more persons or cartoon characters singing a song involving the product. Coca Cola used music in the advert at the 2010 Soccer World Cup in South Africa.
Technical expertise	The message shows the company's expertise or experience and even pride in making the product ( <i>Mercedes Benz</i> , <i>Guinness Stout</i> beer and <i>Johnnie Walker</i> whisky have used execution approach)
Scientific evidence	The message presents results of research or documented scientific evidence that the product (mainly brands) is the best on the market. Such adverts are used for medicines and other health products.

**Table 10:** Message execution style

## Media Decisions

### Media Planning

In the current environment, media planning is becoming increasingly complex. There are various factors that have caused this:

- i) The changing media environment aided by new media technology (e.g. sms media, internet, social media).
- ii) Media fragmentation has reduced the number of mass media market channels. Imagine how many FM radio stations you can find in just one city alone. To promote a product requires that you advertise it on many radios. This has cost implications.
- iii) Consumers have become more aware and sophisticated. They can easily avoid, ignore or discount advertising messages. They are, for example, uncomfortable with the messages that tend to exaggerate the offering.
- iv) The governments are becoming more serious in penalizing firms that engage in persuasive messages.

### Media strategy

Companies plan how to achieve the best fit between the media channels and the target audiences at the lowest price. This is part of the overall marketing strategy of any company.

### Media planning

*Criteria for choosing a media channel:*

A company must decide on the following factors before using any media for its targeted audience.

- 1) **Reach or penetration or coverage:** This is a measure of the percentage of particular target audience reached by a medium. It is the number of persons or households exposed to a particular media schedule at least once during a specified time period.
- 2) **Frequency:** Frequency is the number of times the target audience has an opportunity to get exposed to the advertising message. The message could be seen (on television or in print media) or heard (on radio).
- 3) **Impact:** This is the qualitative value of using one medium instead of another. It answers the question of “*How much exposure would a company get by using a medium X instead of Y?*”

- 4) **Product:** The choice of the media depends on the complexity of the product to be advertised. A television would be a good media for exposing how effective a washing powder is. Magazines are good for advertising technical details.
- 5) **Cost:** The Company wishing to put an advert in the press will have to consider the cost of different media. Dailies are cheaper than magazines. Television is more expensive than radio. The cost is the cost-per-thousand exposes rather than the total cost.
- 6) **Target audience:** A company has to consider the media habits of the target audience. It would be a waste of funds to try to reach teenagers through the daily newspapers. Television followed by radio is the most effective media for reaching teenagers.
- 7) **Message:** A message about an emergency should be put on radio and/or television. Likewise a grand-sale starting tomorrow will require radio/or newspaper.

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



## **Media Timing**

A message schedule is the formal listing of which adverts are to appear and in which media. A good media schedule should have both short term and long-term campaign lists.

## **Establishing the total promotion budget**

*How does the company decide on the total promotion budget and its allocation among the promotional mix?*

There is no standard and uniform method of deciding how much to spend on marketing communications. This is in fact one of the most difficult marketing decisions facing companies. There are always the managers in other departments still with their traditional view that marketing communication is merely expenditure. Whereas manufacturers of, say, industrial equipment can spend around 10%, 15% or less than 20%, there are heavy promotions in the consumer goods sector. For example, promotional expenditure ranges from 15–50% of total sales in the women's beauty and care products.

## **How do companies decide their marketing communications budget?**

The following are some of the considerations that can influence the amount of expenditure.

1. The variety of marketing communication tools to be used;
2. The tasks to be undertaken;
3. The competitiveness in the market place for a specific product;
4. The reputation of the organisation seeking to undertake the promotions; and
5. Other factors include any special requirements for planning a certain product.

Costs involved in marketing communications budget include:

1. Production costs;
2. Staff salaries;
3. Overheads and expenses;
4. Airtime and broadcast media; and
5. Space and printed media.

Let us describe the methods that can be used to decide the budget.

- 1) **All you can afford:** The marketing manager can ask the financial controller how much they are willing to allocate on promotion. Once the controller gives what they can spend, the marketing department spends it. This can work well for new companies without a history of spending on promotion. But even established companies have used this method.
- 2) **Historical basis:** Management will decide the budget based on what they allocated the previous year(s). So they will allocate what they allocated based on year-on-year costs analysis that provides the basis for following a trend. Using this method of allocation, there is a danger of not increasing the budget amidst a competitive market place.
- 3) **Matching the competition:** This happens where an organisation is trying to compete for market share from the market leader. The organisation is trying to reach the same customers (or potential customers) through the same channels. So it is necessary to set a budget that matches the competition.
- 4) **Percentage of sales method:** This is a common method used to determine a marketing communications budget. Many companies set their expenditure at an agreed percentage of sales. This method is commonly used because it is easy to evaluate, can be easily monitored and can be varied in progressive steps. It can be increased with the increase in the price of the products being sold.
- 5) **Completely arbitrarily:** This is a situation where a senior manager can influence the company to set a budget that is not linked to expected sales. The person making the decision may be using intuition or basing on factors not known to people in other departments. This can cause worries and fear among other people in other departments. It is not scientific. It can result in revenue loss to the company.
- 6) **Objective and task method:** This is probably one of the logical methods of deciding the budget. It requires the marketer to develop their budget based on the identification and definition of specific communication objectives, determining the tasks required to achieve the objectives and finally estimating the cost of undertaking these tasks.

## 3 CONSUMER BEHAVIOUR

In today's market place, there is a diversity of cultures, consumers, marketers and (advertising) media. Consumer behaviour covers a wide area focusing on understanding how and why customers make purchase decisions. Let us look at it here.

**Consumer Motivation:** What motivates a consumer? Let us begin with understanding motives.

### What are motives?

The concept of consumer motivation is based on the human needs (which are consumer needs). Companies survive or make profits amidst a competitive environment by knowing how to ably identify and satisfy customer needs better than the rivals.



Brain power

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)

**SKF**

**Motivation:** Customers have ‘drives’ that make them buy certain products. These are basic human motives which can be expressed in many different ways. Motivation can be described as the driving force within individuals that impels them take action<sup>49</sup>. The driving force is produced by a state of tension. Tension exists due to unfulfilled needs. Human beings as individuals strive (both consciously and subconsciously) to reduce this tension through behaviour that they anticipate will fulfill their needs and thereby relieve them of the stress that they feel. So the process of reducing tension is by fulfilling individual goals or needs.

**Needs:** Every human being as an individual has needs. Individuals always strive to satisfy their needs and goals. Some of these needs are physiological while others are acquired needs.

- a) **Physiological needs:** Such needs include shelter, clothing, food, water and sex. These are considered primary needs because they are needed to sustain biological life (the biogenic needs).
- b) **Acquired Needs:** These are needs that we acquire or learn in response to our culture or the surrounding environment. Such needs include those needs for self-esteem, prestige, affection, power and learning. These are considered secondary needs. This is because acquired needs are psychological (psychogenic needs). They result from an individual’s subjective psychological state or his/her relationship with others.

**Goals:** The sought after results of motivated behaviour are called goals. We can state that all individual’s behaviour is goal oriented.

- i) **Generic Goals:** These are the general classes or categories of goals that explain how consumers seek to fulfill their needs.
- ii) **Product specific goals:** These refer to the specifically branded products and services that consumers select as their goals.

Generic Goals	Product Specific Goals
To buy a TV; To buy a car; To buy a smart phone;	Sony flat screen 21"; Benz C 220; iPhone 5; Samsung Galaxy Note 3

**Table 11:** Generic vs Product Specific Goals

## Motives

Motives can be classified into two: rational and emotional motives.

**Rational motives:** The term rationality is used in the economic sense. It assumes that consumers behave rationally when they are considering all alternative choices and they choose those goods or services that give them the greatest utility. In a marketing context the term rationality, therefore, implies that a consumer selects goals based on a totally objective criteria such as weight, size or price.

**Emotional motives:** In the marketing context, emotional motives refer to the selection of goals by consumers according to subjective criteria. The consumer basing on subjective (or personal) criteria will select a product or service for pride, respect, affection, fear or status.

### Is motivation a static construct?

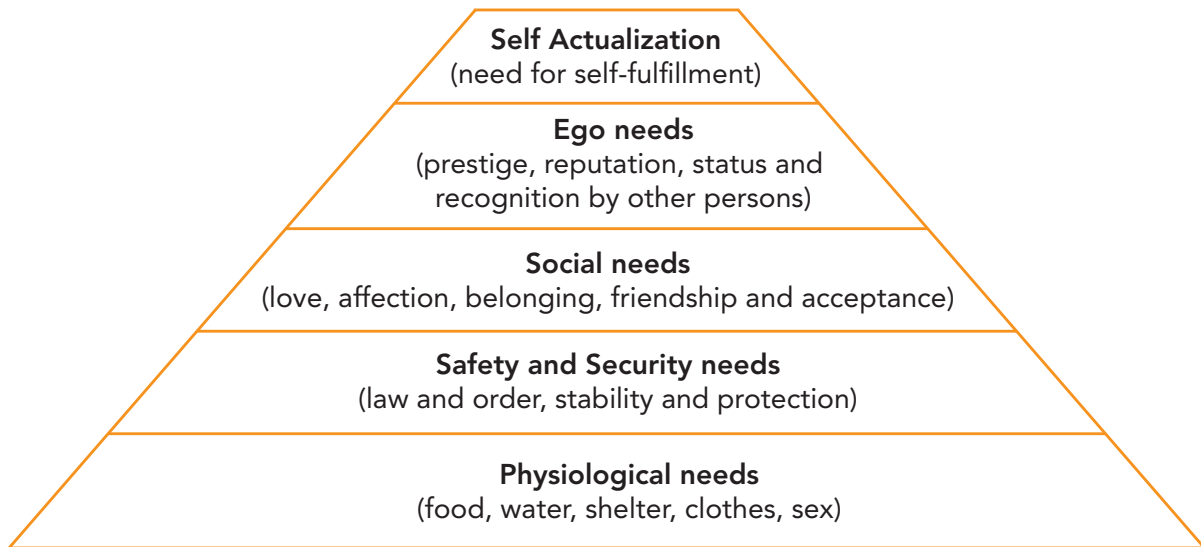
Motivation is a dynamic variable or construct that is constantly changing in response to life experiences. Needs and goals are not static. They are changing in reaction to, among others, the individual's environment, experiences and interactions with others. Instead, individuals are continuously seeking to satisfy their needs, which can be different at different periods of time. New needs emerge as the old ones are satisfied. Some needs are, in fact, never fully satisfied.

## Hierarchy of Needs

### The Theory of Human Motivation

*Is it possible to think of a hierarchy of human needs? Can human needs be ranked in some chronological order?*

Abraham Maslow (a clinical psychologist) formulated a theory of human motivation based on the concept of universal 'hierarchy of human needs'. Maslow's hierarchy of human needs<sup>50</sup> can be presented in a diagrammatic form. Maslow's theory identified five basic levels of human needs which he ranked in order of importance. He ranked the human needs from the lower level (termed as biogenic needs) to higher level (psychogenic needs). The theory basically says that individuals seek to satisfy lower level needs before the higher level ones<sup>51</sup>. As he puts it, "for the man who is extremely and dangerously hungry, no other interest exists but food"<sup>52</sup>.



**Figure 4:** Levels of needs

Source: Adapted from Maslow, A.H., (1943), "A theory of Human Motivation",  
*Psychological Review* 50: 370–96

## TURN TO THE EXPERTS FOR **SUBSCRIPTION** CONSULTANCY

Subscribe is one of the leading companies in Europe when it comes to innovation and business development within subscription businesses.

We innovate new subscription business models or improve existing ones. We do business reviews of existing subscription businesses and we develop acquisition and retention strategies.

Learn more at [linkedin.com/company/subscribe](https://www.linkedin.com/company/subscribe) or contact  
Managing Director Morten Suhr Hansen at [mha@subscribe.dk](mailto:mha@subscribe.dk)

**SUBSCR**✓**BE** - to the future

Maslow's hierarchy of needs has received wide acceptance in various social disciplines because it appears to reflect assumed motivations of many people in society. The five levels of need presented by the hierarchy are generic enough to encompass most lists of people's needs. In marketing, therefore, Maslow's hierarchy of needs is a useful tool for understanding consumer motivations. The hierarchy is also a useful framework for companies and marketers trying to develop appropriate advertising appeals for their products. Companies can develop messages appealing to a social need or self-actualisation. It can be readily adaptable to marketing strategy because consumer goods usually serve to satisfy each of the need levels. A person who buys food or clothing uses them to satisfy physiological needs. People who buy financial services (e.g. insurance) satisfy safety and security needs. People who buy personal care products (e.g. deodorants, lotions, tooth paste) are satisfying social needs. Luxury products are usually bought to fulfill ego needs. Argued along the same lines, we might come to the conclusion that some people attain university degrees as a way of achieving self-fulfillment.

*Some critique of the theory*

- i) The major problem with the theory is that it cannot be tested empirically. It is not possible to measure precisely how satisfied one need must be before a person desires the next higher need.
- ii) The need hierarchy may not apply very well in less developed countries of Africa and Asia where even the basic needs cannot basically be recognised and satisfied.
- iii) Some people, moreover, based on their level of income and environment, desire different products concurrently.
- iv) Finally, this hierarchy appears to be both culture and time bound. That means it may be inapplicable in the future.

**Personality:** Personality can be defined as those inner psychological characteristics that both determine and reflect how a person responds to his or her environment<sup>53</sup>. This definition puts emphasis on the inner characteristics of a person. It is concerned with those specific qualities, attributes, traits, factors and mannerisms that differentiate one person from another. These inner characteristics influence a person's product choices. They influence how an individual consumes particular products or services. The identification of those specific personality characteristics associated with consumer behaviour is useful in the development of companies' segmentation strategies. *In order to fully grasp this, please read about the theories of personality including the Freudian theory, the Neo-Freudian theory and the Trait theory.*

**Brand personality:** The notion of brand personality refers to the situation where consumers attribute various descriptive personalities like traits or characteristics to different brands in a wide variety of product categories. Such personality like images of brands reflects consumers' visions of the main attribute of strong brands. Based on consumers subscribing to brand personality notion, some consumers will be described as “dependable”, “authentic”, “western” or “classic”. In most markets or countries, consumers tend to see Benz as representing class, Volvo for safety and BMW as performance driven. Brand personality can either be functional (provides safety) or symbolise (the winner in all of us).

**Consumer perception:** Perception is defined as the process by which an individual selects, organises and interprets stimuli into a meaningful and coherent picture of the world<sup>54</sup>. It is the way we see the world around us. Two persons exposed to the same stimuli under the same apparent conditions may interpret it differently.

**Perceived Risk:** Consumers are always making decisions regarding what products or services to buy and where to buy them. In trying to decide on which products or services to buy and where to buy them, consumers perceive some level of risk. This risk is referred to as perceived risk. Perceived risk can be defined as the uncertainty that consumers face when they cannot foresee the consequences of their purchase decision. This risk is perceived and whether or not it actually exists is a different issue. A risk that is not perceived (regardless of how real or how dangerous) will not influence a consumer's behaviour.

### Types of Perceived Risk

- 1) Functional Risk: This is a risk that the product will not perform as expected (Will the new torch light well?)
- 2) Physical Risk: This is the risk that the product might harm the consumer or others. (Will it hurt my children?)
- 3) Financial Risk: This is the risk that the product will not be worth its cost (in other words value for money). (Is this smart phone worth its cost of US\$ 2000?).
- 4) Social Risk: The risk that poor quality product choice may hurt your social standing or result in social embarrassment. (Will my friends laugh at my new car?)
- 5) Psychological Risk: The risk that a poor quality product choice will hurt the consumer's ego. (“Will I be embarrassed to give my friends a ride in my tiny new car?”)
- 6) Time Risk: The risk that the time spent during product search may be wasted if the product does not perform as expected. (Will I have to go through the shopping experience all over again?)

### How to reduce perceived risk

Consumers develop their own ways for reducing perceived risk. Such risk reduction strategies enable them to act with increased confidence when taking product decisions.

The common risk reduction strategies are discussed here<sup>55</sup>.

- 1) Consumers seek information: To minimise perceived risk, consumers seek information, mainly through word-of-mouth communications, about the product they intend to buy. They consult friends and family as well as other people whose opinion they value. Those people may range from sales executives to individuals who have used a similar product before to the general media. The people whose opinion they value are, therefore, opinion leaders and opinion formers. Opinion leaders give advice on the product category specific goods.
- 2) Consumers become brand loyal. Consumers avoid risk by buying the brands that they have bought before. They avoid purchasing new brands that they do not have experience with. Ultimately this creates brand loyalty.



What do you want to do?

No matter what you want out of your future career, an employer with a broad range of operations in a load of countries will always be the ticket. Working within the Volvo Group means more than 100,000 friends and colleagues in more than 185 countries all over the world. We offer graduates great career opportunities – check out the Career section at our web site [www.volvogroup.com](http://www.volvogroup.com). We look forward to getting to know you!

**VOLVO**  
AB Volvo (publ)  
[www.volvogroup.com](http://www.volvogroup.com)

VOLVO TRUCKS | RENAULT TRUCKS | MACK TRUCKS | VOLVO BUSES | VOLVO CONSTRUCTION EQUIPMENT | VOLVO PENTA | VOLVO AERO | VOLVO IT  
VOLVO FINANCIAL SERVICES | VOLVO 3P | VOLVO POWERTRAIN | VOLVO PARTS | VOLVO TECHNOLOGY | VOLVO LOGISTICS | BUSINESS AREA ASIA

- 3) Consumers select by brand image: They buy well-known brand names. The implied assumption when buying known brands is that they are quality and can perform. Such brands have marketers whose promotional efforts supplement the perceived quality of their products by projecting them with a favourable brand image.
- 4) Consumers buy the most expensive models: They may feel that the most expensive model of a product is likely to be the best in terms of quality. They associate higher price to quality.
- 5) Consumers seek reassurance: If not certain about the performance of a product choice, a consumer seeks reassurance through private laboratory test results, warranties, and pre-purchase trials. Free trials, limited trial periods, and test driving a new model car are important for reassurance.
- 6) Consumers rely on company (or store) image: If they have no other information about a product they only buy it from a reputable store. This is because stores with reputation allow product testing, return privileges and permit adjustment in case a customer is not satisfied with the product.

**Consumer Attitude:** Attitudes can be defined as learned predispositions<sup>56</sup>. This definition was originally given by a psychologist, Gordon Allport<sup>57</sup> in his writing on prejudice – an issue in psychology. In marketing, attitudes propel a consumer towards a particular type of behaviour. They can also repel a consumer from a particular kind of behaviour in the market place. Again, in marketing, attitudes can be favourable or unfavourable towards a given object (e.g. a brand, an advertisement or retailer). Attitudes relating to the purchase behaviour are formed basing on the type of purchase, direct past experience with the product or the retail store in which it is shopped.

We can say that attitude can be formed due to:

- i) Direct experience with the product;
- ii) Word of mouth communications; and/or
- iii) Exposure to mass media advertising.
- iv) The internet (website, email)
- v) Direct marketing (inserts, pull-outs, retailers' catalogues, sms via cellphone, etc.)

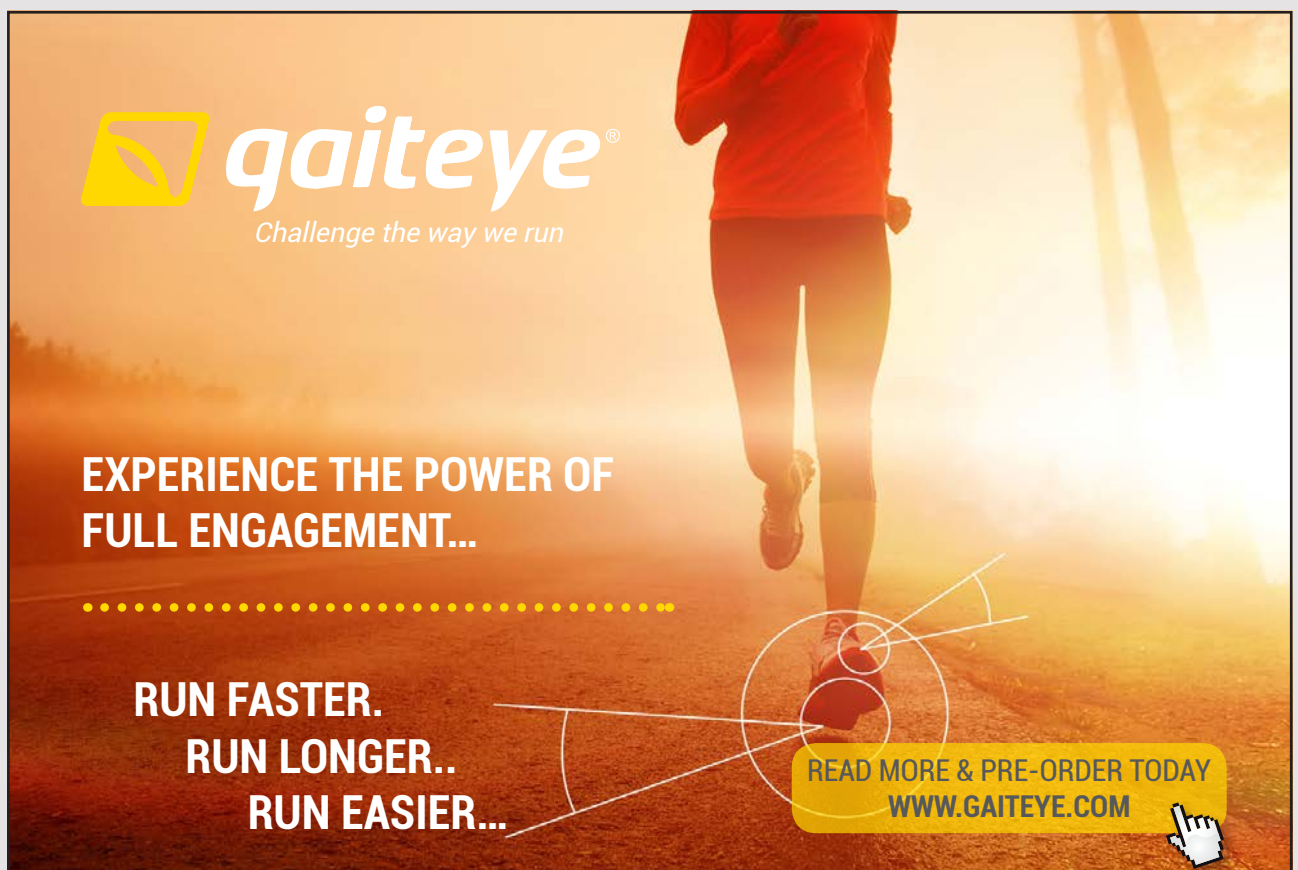
**Attitudes and the word “object”:** In consumer behaviour, the word *object* is broadly defined and it includes specific consumption (or marketing) related concepts such as product, product category, brand, service, possessions, product use, causes or issues, people, advertisement, internet site, price, medium, or retailer<sup>58</sup>. The following are the main characteristics of attitudes:

- i) Attitudes are learned. When a consumer uses the product or brand for the first time, it will influence his/her attitude towards that product or brand. If the experience was a bad one, then the consumer will give it an unfavourable evaluation. The reverse is also true.
- ii) Attitudes are relatively consistent with regard to the behaviour they reflect. Attitudes are however never permanent. Attitudes do change. When we say that attitudes are consistent<sup>59</sup> we mean that if a consumer prefers a British refrigerator over an American one, such a consumer is likely to buy a British refrigerator next time he/she is looking for a new refrigerator.
- iii) Situations, circumstances or conditions can influence attitudes. Attitudes may be influenced by circumstances or conditions prevailing at a particular point in time. Therefore, attitude may change from what it was due to changes in the prevailing circumstances. Joseph may feel it is all right to have lunch at Pizza Hut but does not prefer it for dinner. This does not mean that he cannot pass there one evening and pick dinner en-route to a dance club with friends.

## 4 MARKET SEGMENTATION

### Historical Perspective

The concept of market segmentation has become of paramount importance in marketing theory. *What are its origins?* In his 1956 *Journal of Marketing* article entitled “Product Differentiation and Market Segmentation as alternative to marketing strategies”, Wendel Smith introduced the concept of market segmentation. He introduced the concept as being “based upon development on the demand side of the market and represents a more precise adjustment of product and marketing effort to consumer and user requirements”<sup>60</sup>. Smith’s market segmentation concept was rapidly adopted in theory and practice and was later developed by a number of researchers in 1960s and 1970s<sup>61</sup>. The underlying principle of market segmentation is that markets are not homogeneous and that it makes business sense to differentiate marketing offers for different customer groups who have unique wants and needs that require being satisfied. The days of Henry Ford’s you can get it “in any colour as long as it is black” referring to Ford T Model which came only in one colour – black – are long gone. There are literary no longer mass markets. Instead marketers need to customize their offers to individual customers. There is need for market segmentation.



**gaiteye**<sup>®</sup>  
Challenge the way we run

**EXPERIENCE THE POWER OF  
FULL ENGAGEMENT...**

.....

**RUN FASTER.  
RUN LONGER..  
RUN EASIER...**

**READ MORE & PRE-ORDER TODAY  
WWW.GAITEYE.COM**

The advertisement features a runner in a red top and black leggings running on a path. The background is a warm, golden-orange glow. Technical diagrams, including a circle with intersecting lines and a dotted line, are overlaid on the runner's feet. A yellow button with a hand cursor icon is located in the bottom right corner.

**Market segmentation** can be defined as the sub-dividing of a market into distinct and increasingly homogeneous sub-groups of customers, where any sub-group can conceivably be selected as a target market to be met with a distinct marketing mix<sup>62</sup>. Simply put, market segmentation consists of dividing a market into groups of potential customers (called market segments) with distinct characteristics, behaviour, needs and wants and then using the marketing mix to reach and influence them to buy your products or services. Market segmentation is based on the principle that it is easier to sell to a focused market than a vague and indistinct market. It is difficult and expensive to sell to everyone. With the modern customers, there are rarely mass markets where a company has to target everyone. The marketer needs to focus on a targeted audience (market segment) and launch his/her marketing mix. Different customer segments should be targeted differently; each with a different set of marketing mix as programmes. Customer needs and wants differ and satisfying them usually requires targeted approaches for each market segment.

### **Benefits of segmentation**

- i) The marketer does not have to waste financial and human resources trying to reach everyone in a mass market.
- ii) The marketer can tailor the marketing mix to reach a specific segment and increase sales. Well selected segments make it easier for the sales force to deal with and to increase their sales.
- iii) It helps the marketer to get the unique requirements of customers and focus on marketing what is required in that market.
- iv) The customer influences what is produced and this reduces wasteful and unnecessary inventory of unwanted products.
- v) Messages are tailored to specific customer audiences and this improves the image of the brand.

### **Criteria for effective segmentation**

- 1) Measurable: The size, purchasing power, location and content of a segment can be easily measured.
- 2) Accessible: The segment should be reached and effectively served via organisation's promotion and distribution channels.
- 3) Substantiality (market size): The segment should be sufficiently large and profitable to merit an organisation's investment in it.
- 4) Differentiable: Each market segment should respond differently to the marketing mix. Each segment should be different from the other so that it can be targeted differently.
- 5) Actionable: Effective marketing strategies can be implemented to attract and serve the segment(s).
- 6) Determinate: The buyers' decision factors should be clearly identified.

### How to segment and target markets

- i) Group potential customers into segments in which customers have similar buyer characteristics;
- ii) Group products into product categories;
- iii) Develop a *Market-Product Grid* and estimate the size of the market;
- iv) Select target markets;
- v) Prepare marketing activities to reach target markets; and
- vi) Count the returns out of marketing to a segment efficiently and effectiveness.

### Segmenting consumer markets

A company should try to identify market segments via segmentation and plan and reach each customer segment by applying its promotion and distribution activities in a unique way. An understanding of each group's characteristics such as age, gender, geographical location, income, and buyer behaviour plays an important role in developing a successful, efficient and effective marketing strategy.

Below we discuss the common bases for segmenting consumer markets:

Bases for segmenting consumer markets: geographical segmentation; demographic segmentation; geodemographic segmentation; and behavioural segmentation.

**Geographic segmentation:** Dividing an entire mass market into homogenous groups on the basis of their locations and then geographically customizing the marketing mixes. This is often the starting point in segmentation. Geographical location does not assure that all people in one location will make the same buying behaviour decisions but it does help identify some general patterns. It is possible to know how many people are in any city or region. Population size, however, may not be enough reason for a business to expand into a specific city or region. Businesses must look at other factors such as the economy. While population numbers may indicate the overall size of a market, other geographic indicators such as employment and job growth by region are useful in guiding marketers for a specific product that they intend to sell.

**Demographic segmentation:** This is the most common method of market segmentation. It defines consumer groups according to demographic indicators such as age, generation, gender, social class, race or ethnicity, religion, income, occupation, level of education, household size or family size and family life cycle. In some countries (such as Canada) this segmentation approach is also called *socio-economic segmentation*. Marketers have to review a lot of data regarding the demographic variables. One of the primary sources of this data is the country statistics office.

**Geodemographic Segmentation:** This approach combines geographical and demographic variables. This approach analyses people by where they live and their demographic characteristics. An example of this approach is ACORN – A classification of residential neighbourhoods (also referred to as *neighbourhood marketing*). The marketer can collect data about how and where people live and analyse socio-economic data. In the UK, ACORN and MOSAIC (Experian's people classification system) are the best known geo-demographic systems.

**ACORN** is one of the measurements of consumer lifestyles and it was developed by the British market research group CACI. Under ACORN, using postcodes, population is broken down into five (5) lifestyle categories, 17 groups and 56 types. Marketers use ACORN information to improve on their understanding of different customers and target markets. Using this information, the marketers are able to locate their operations, field sales force and position retail outlets, among others.

This e-book  
is made with  
**SetaPDF**



PDF components for PHP developers

[www.setasign.com](http://www.setasign.com)

**MOSAIC:** MOSAIC is a geo-demographic segmentation system that was developed by Experian. Originally developed using the 1990 UK population and housing census figures, MOSAIC is now based on the 2000 census figures and is upgraded annually. The MOSAIC segmentation systems consist of sixty (60) segments which are presented in twelve (12) separate groups. This system assigns lifestyle groups to differing geographical catchment areas (e.g. area catchment profiles by income and household composition around Central London), segmented by income families, blue collar owners, low-rise council flats, stylish singles, Victorian low status, town houses and flats, country dwellers, etc.

**Psychographic (Lifestyle) segmentation:** Psychographic segmentation is a useful tool for gaining a deeper insight into consumer buyer behaviour. It divides a population into groups that have similar psychographic characteristics, values and lifestyles. The psychographic criteria used for segmenting consumer and service markets includes using attitudes and perceptions (e.g. negative feelings about fatty foods), the lifestyles of customers (e.g. fashion minded, introvert, extrovert, etc.) and the types of benefits sought by customers from products and brands and as well as their consumption choices. Psychographic approaches rely on the analysis of consumers' activities, interests, opinions, values and attitudes in order to understand consumers' individual lifestyles and patterns of behaviour. Therefore, this approach of segmentation includes an understanding of the values that are important to different types of consumers.

**Behavioural segmentation (Benefits sought):** The marketer should segment the potential customers based on the benefits that they derive from consuming certain goods or services. Behavioural segmentation variables include benefits sought, usage rate, brand loyalty, user status, readiness to buy and occasions when they buy. The marketer may ask such questions as:

- What benefits does an economy class passenger enjoy on our flights?
- What benefits does the business class passenger enjoy on our flight?
- What benefits does the first class passenger enjoy on our flight?

For example, different customers in different classes on the plane seek different benefits (and enjoy different services). Passengers in the first class, business class, and economy class seek unique and different benefits from using a certain airline (e.g. KLM, British Airways, Air France, or Emirates). The marketer must identify the key benefits that each passenger of the different class is seeking and provide an appropriate service that gives the benefits being sought.

**VALS™:** Behavioural segmentation focuses on the individual's relationship with the product. This approach of segmentation puts buyers in groups based on their attitudes and use of the product and the benefits they expect to receive. So the tool looks at the consumer product usage, purchase and ownership. It is important to consider the benefits sought (status, recognition, time saving, ease of use, etc.), usage rate (heavy users, 80/20 Principle, medium users, light users) and loyalty to the product or brand. In summary, we can look at markets segmented based upon consumer knowledge, attitude or response to a product (occasion segmentation, benefit segmentation, user status, usage rate, loyalty status, buyer readiness stage and attitude towards the product among others).

### **The market segmentation process**

Entities may use a *management-driven* approach whereby segments are predefined by managers based on their observation of the behavioural and demographic characteristics of the likely users. Entities may alternatively use a *market-driven* approach in which segments are defined by asking potential customers which attributes and benefits are important to them.

When using a *market-driven approach to segmenting a market*, marketers follow the following stages.

- i) **Develop a relevant profile for each segment:** The marketers must first identify the promising segments. After this the marketer must undertake an in-depth analysis of customers in order to accurately match buyer's needs with the organisation's marketing offers. At this stage, the process must identify characteristics that explain both the similarities and differences among segments. The main task at this stage is to develop a profile of the typical customer in each segment. This profile may include information about customer lifestyle patterns, attitudes towards brands or product attributes, product/brand usage habits, geographical location and demographic variables (age, sex, gender, income, occupation, etc.).
- ii) **Anticipate or forecast market potential:** In this stage, the organisation has to combine marketing opportunity analysis and market segmentation to anticipate market potential within each segment. The organisation must be sure of the total market segment in terms of potential total sales and the number of customers. The organisation must also forecast its market share vis-à-vis that of the other competitors. The addition of an organisation's market share and all competitors' market shares gives the size of the total market. *The market size is always one hundred percent. Each organisation competes for a share out of the total market of 100 percent.* At this level, the organisation must decide whether to penetrate the market segment or not.

- iii) **Forecast potential market share:** Once an organisation has estimated the market potential, it must forecast its potential market share. All the competitors' positions in the target market segment must be analysed and a specific marketing strategy must be designed to reach the selected segment. The marketing strategy will determine the resources required and when to enter the target market segment. Obviously, the marketing strategy will contain the marketing mix – price, product, place and promotion for a product (*or add physical evidence, people and processes for marketing services*).
- iv) **Select the specific market segments:** At this stage, the organisation makes the final decision on which segment to enter. All the considerations regarding skilled personnel, actions of competitors, legal issues, political risk and other factors are identified and a decision is taken.

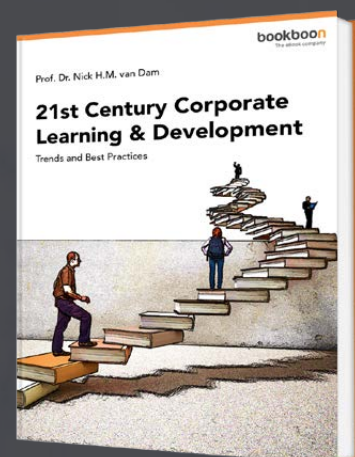
### Segment validity and attractiveness

For any organisation to finally enter a market segment, it must determine its validity and attractiveness.

# Free eBook on Learning & Development

By the Chief Learning Officer of McKinsey

Download Now



**Segment validity:** To be valid, a specific market segment must be worth designing and developing a unique marketing mix for. The segment must give *YES* answers to the following questions for it to be valid:

- i) Can it be measured?
- ii) It is big enough?
- iii) Does it respond differently from other segments?
- iv) Can it be reached profitably?
- v) Is it suitable and stable?

**Segment attractiveness:** Segment attractiveness is different from segment validity. A segment might be valid and potentially profitable but not potentially attractive. For example, a segment which has high entry barriers might cost more to enter but will be less vulnerable to competitors. Segments which are more attractive will be those whose needs can be met by the company while building on its strengths, where forecasts for demand, sales growth and profitability are favourable.

**There are two criteria of evaluating segment attractiveness:** *marketing criteria* and *financial criteria*.

*Marketing criteria:* The marketing evaluation criteria will look at the aspects of market size, market growth rate, entry and exit barriers, price competition, customer loyalty, rate of product copying and imitation or piracy, competitive intensity and availability of substitute products, among others.

*Financial criteria:* The financial criteria to evaluate the attractiveness of the market will mainly look at costs and sales volumes. It will focus on costs regarding entry, promotion and distribution; working capital requirements (stock or inventory, production, etc.), cash flow, pricing strategy chosen and sales volumes needed.

### **Segmenting International Markets**

The bases for segmenting international markets include the following:

- 1) Geography: Location or region.
- 2) Economic factors: Population, income or level of economic development (GNP, purchasing power parity (PPP), per capita income, etc.).
- 3) Political factors: Political ideology, political system, type and stability of government, amount of bureaucracy, etc.
- 4) Legal factors: Business regulatory policies, laws, employment laws, monetary regulation, etc.
- 5) Cultural factors: Language, religion, values, customs, attitude and behaviour.

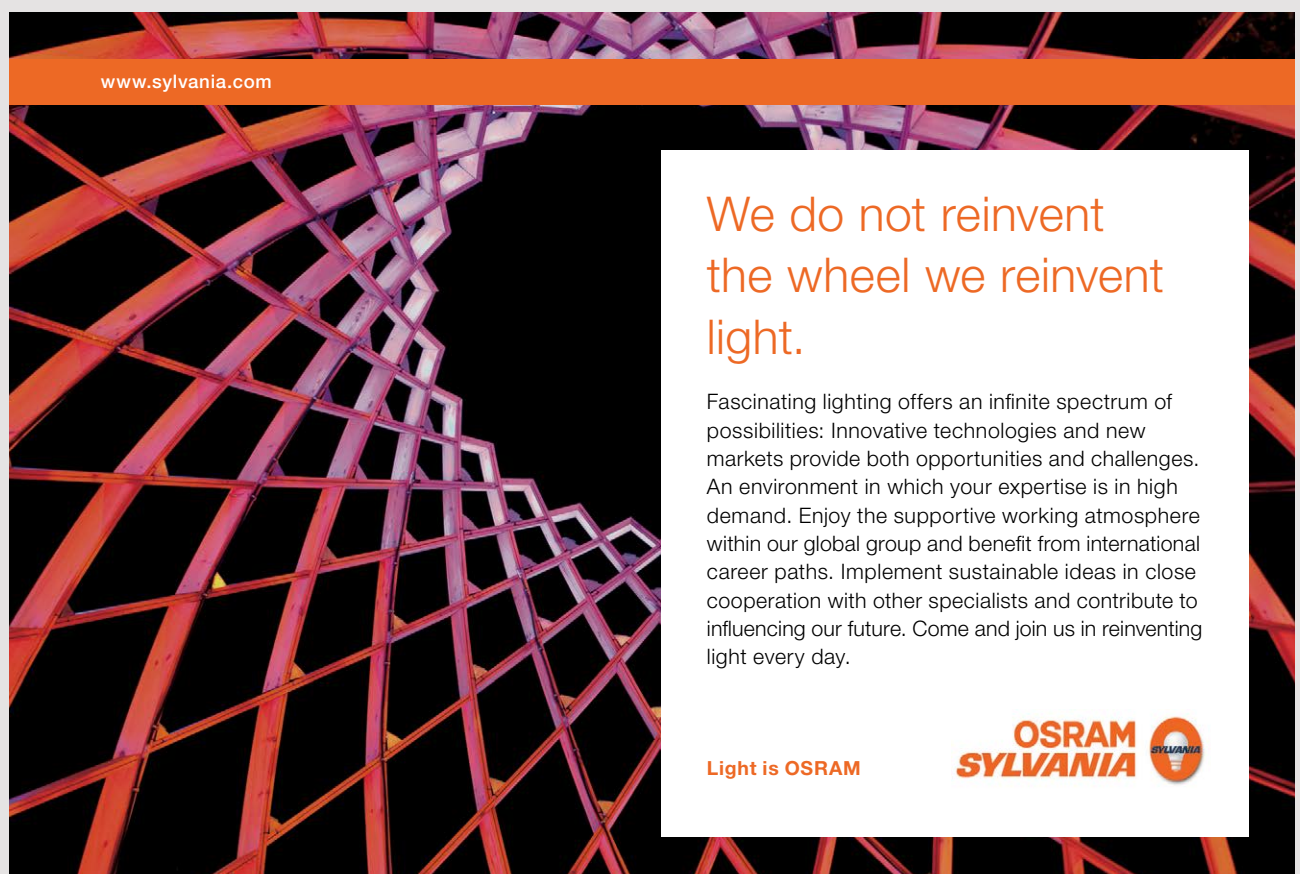
**Target Marketing** (Strategies for reaching target markets)

**Target Market:** After segment validity and attractiveness have been analysed, the target market segment is selected. A target market is a segment selected for special attention by an organisation. The organisation plans a specific marketing strategy for such a market segment. Target marketing refers to the approaches that can be used to reach and serve a selected market segment.

**Four approaches to targeting can be considered:** undifferentiated, differentiated, concentrated and customized or micro-marketing.

1. **Undifferentiated marketing:** This is the strategy that focuses on producing a single product and marketing it to all customers (or market segments). It is also referred to as *mass marketing*. There is no differentiation between market segments. The strategy views the market as one mass market with one marketing strategy for the entire market. This is the strategy that was being used during the period when Henry Ford said that the Ford Model T could be got in any colour as long as it was black. It is expensive to implement this strategy. We note however that it is usually preferred in markets where there is limited segment differentiation. The post office, for example, will use this strategy and target every one for ordinary mail.
2. **Differentiated Marketing:** This is the strategy that focuses on several products (then price, promote and distribute them) with different marketing strategies designed to satisfy the different segments selected. These segments should be smaller than the mass market. This approach recognises that there are various market segments to target, each of which is attractive to the marketing organisation. In order to exploit the market segments, a marketing mix is designed for each attractive segment. For example:
  - A clothing fashion brand can target efficiently as casual wear, traditional wear, etc.
  - A computer manufacturer/brand can target home use, office use, education, government, young, or older.
  - A soft beverage company can produce drinks targeting children, teenagers, the old, etc. It can also target according to health concerns, that is, diet drink, decaffeinated drink, etc.
  - A tour agency may target customers interested in history, excitement, discovery, animal viewing, bird watching and beach fun lovers, etc.

3. **Concentrated marketing (Niche marketing):** Concentrated marketing is the strategy that focuses marketing effort on satisfying a single market segment. It is also called *niche marketing*. This strategy is often adopted by organisations that either are adopting a very exclusive strategy in the market (say they offer highly specialised goods and services to the A+ class of society) or have limited resources by which to support their marketing strategy. This approach is adopted and used a lot by small to medium organisations that lack the financial resources.
4. **Customised targeting strategy:** This strategy focuses specifically on the potential customer at a very basic level such as postal code, specific occupation or lifestyle and, therefore, it is possible to target individuals themselves. Some literature calls it *micro marketing*. The salesperson at your favourite shopping store may contact you when new merchandise arrives. She/he will give you information on the products attributes, potential benefits and delivery schedules. This approach is also used in consumer markets with high value and highly customised products (e.g. purchase of a custom-made car from BMW or Benz).



www.sylvania.com

We do not reinvent  
the wheel we reinvent  
light.

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

OSRAM  
SYLVANIA



## Positioning

This is the third and last stage in the segmentation process. Once the market has been segmented, the size of segments determined, a strategy for reaching the organisation's target market has been chosen, the marketer must decide how best to position their product. Simply put, *positioning is the use of the marketing mix to enable potential customers form a mental image of the organisation's product or brand in their minds relative to other competing products*. Positioning seeks to put a product or brand in a certain position or place in the minds of prospective customers.

## Positioning Strategies

Several marketing scholars and professional marketing associations<sup>63</sup> have discussed the positioning strategies and ways of developing successful positioning strategies. We present the eight positioning strategies here.

- i) *Product features or attributes*: Products have distinctive features or attributes that make them different in a given market. We should note that a brand is usually positioned on the bases of its attributes, features or benefits that it has relative to other competitor brands in the market. For example, different brands communicate different benefits to customers and consumers.

BMW: engine performance and vehicle design; Volvo: safety issues; and Weetabix: contains all the vitamins you need each day; Red Bull provides all the energy; Mall or Tank Station that opens 24 hours.

- ii) *Price-quality*: Prices can be good indicators of quality. A high price can denote high quality. In some markets or countries you find two kinds of the same brand at different prices. In developed countries, the more expensive an item of the same brand is, the higher the quality.
- iii) *Product use or application*: Kellogg's positioned cornflakes as "any time of day food" not just at breakfast.
- iv) *Product user*: Position messages by identifying the target user. Some restaurants are only for lunch, breakfast or dinner; and some hotels emphasize weekend breaks or longer holidays while others are either leisure or conferencing centres.
- v) *Competitor*: A competitor's position in the market may be used as a frame of reference in order to create a distinct positioning statement. For example, Avis Rent A Car says "We Are Number 2 so we try harder"<sup>64</sup>. The Number One car rental which is used as a frame of reference is *Hertz*.

- vi) *Benefit*: Positioning can be established by referring to the benefits that a product's usage confers on those who consumer it.
- vii) *Product class dissociation*: Positioning a brand against a product class or an associated product class claiming that yours is different from the rest (e.g. our foods is fat free, we serve traditional dishes, etc.).

“Our drink is decaffeinated”; “our beer contains no sugar”; the diamond industry claims “a diamond is forever”.

- viii) *Heritage*: Heritage and tradition are sometimes used for positioning brands symbolizing quality, class, experience and knowledge. For example, some brands use the year they were established as a way of showing that they have been here long and so are a successful brand – see ads of Guinness, Johnnie Walker, and Mercedes Benz.

### **Segmenting business markets**

#### **Segmentation, Target marketing, and positioning in Industrial Market**

The concept of market segmentation is a logical out-growth of the marketing concept and economic theory and is at least conceptually as applicable as in industrial marketing as it is for the marketing of consumer goods (Wind and Cardozo, 1974)<sup>65</sup>. However, industrial buying is more complex than consumer buyer behaviour. Industrial customers differ in their needs and wants, resources, buying attitudes and, for many industrial products, there are several people with different responsibilities involved. A business market segment is a group of present or potential customers with some common characteristic which is relevant in explaining (and predicting) their response to a supplier's marketing stimuli (Wind and Cardozo, 1974). Another definition is that segmentation is about identifying and targeting customer groups through their needs and wants, as well as determining which customers and needs to address and with what manner and intensity (Freitag et al, 2001)<sup>66</sup>.

#### **Benefits of industrial market segmentation**

- 1) The seller is able to identify and compare marketing opportunities;
- 2) The seller can develop separate marketing programmes to meet the needs of each segment; and
- 3) The seller can develop marketing programmes and budgets based on clear idea of the particular characteristics of the specific market segments.

## Segmentation variables

Segmentation variables are the requirements for effective market segmentation. Webster<sup>67</sup> describes segmentation variables as customer characteristics that relate to some important difference in the customer's response to marketing effort. To be useful, the variables that are selected for analysis must meet three criteria:

1. **Measurable:** There should be information on the variables of interest. This information may either be from the secondary or primary sources.
2. **Substantial** (or relevant): The variables chosen should be relevant to a substantial group of customers.
3. **Operational relevance:** The variables selected for evaluation among customers' groups should be related to the differences in customer requirements and consumer behaviour. They should show marketing strategies with respect to products, price, promotion or distribution.



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.

### Basis for segmenting industrial markets

Industrial marketing is segmented based on micro segmentation and macro segmentation. Wind and Cardozo<sup>68</sup> propose that industrial markets be segmented in two stages.

- i) The first stage involves formation of micro segments based on the characteristics of the buying organisation and the buying situation.
- ii) They suggest the second stage as dividing those macro segments into micro segments based on the characteristics of the Decision Making Unit (DMU).

**Macro segmentation:** The macro segmentation approaches identifies the market segments based on the differences between organisations and industries using key organisational characteristics such as company size, usage rate, product application, organisational structure, geographical location, SIC (Standard Industry Classification) category, end market served and on whether it is a new or repeat purchase.

Example of macro variables used to segment the industrial market

Variable	Examples
Industry	Manufacturing, construction, and mining
Organisational	Size of customer's business
Location	Distance from the supplier to the customer's premises, urban or rural location, far or near, or export market
Customer's sector	Sector's growth rate, customer's growth stage within the sector
End-user markets	Which industry or sector? Road construction, residential contractors, mining contractors
Product application	Computer, projector, television, ship builder, vehicle assembler
Type of purchase (New or repeat purchase)	Prospect or current customer

Micro segmentation divides the market on the basis of the differences in criteria that are more directly related to the purchasing decision making process and behaviour of those individuals involved in the DMU.

### **Target marketing**

To determine where marketing opportunities exist, the marketer needs to undertake market segmentation and profit analysis. Once this has been done, decisions must be taken on which segments to serve i.e. which segments to target. Target marketing requires evaluating market segments:

- i) Segment size and growth: Segment structure attractiveness (level of competition, substitute, products, power of buyers and powerful suppliers).
- ii) Company objectives and resources: There are three market selection (targeting) strategies available – undifferentiated (mass) marketing, differentiated (segmented) marketing and concentrated (niche) marketing.

To choose a target marketing strategy requires consideration of company resources, the degree of product variability, product's life-cycle stage, market variability and the competitor's marketing strategies.


**Positioning:** This is the place the product occupies in the consumers' minds relative to competing products. It is typically defined by consumers on the basis of important attributes.

## 5 BRANDING


During the early days, branding was used to mark ownership of cattle or other forms of livestock<sup>69</sup> and later on, during medieval times brands served as distinguishing symbols on goods created by craftsmen<sup>70</sup>. There is agreement amongst scholars that a brand is more than a name or slogan. It can be defined as a cluster of both physical and functional attributes and socio-psychological beliefs and values associated with a particular product or service<sup>71</sup>. Keith Warne (cited in CIM Canada Marketing Journal) wrote that branding is not about nice logos. Branding is a process of creating positive perceptions about a company, product or service, in the minds of target market prospects. It is much more than a logo, a tagline or a symbol.”<sup>72</sup>

SIMPLY CLEVER

ŠKODA



**We will turn your CV into an opportunity of a lifetime**



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



**Traditional definition of a brand:** A brand is a name, term, sign, symbol or design, or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors<sup>73</sup>. According to Webster's Dictionary, a brand is defined as "a means of notification" or "an arbitrarily adopted name that is given by the manufacturer or merchant to an article or service to distinguish it as produced or sold by that manufacturer or merchant that may be used and protected as a trademark. de Chernatony and Riley<sup>74</sup> show various components of a brand which include a logo, a shorthand, a company, an identity, an image in a customer's mind, a personality, a legal investment, a relationship, adding value, an identity system, a risk reducer and a value system. But a brand is more than just a trademark for legal protection of the product or service. Marketers must look at brand management beyond a trademark and legal protection. Brand management should aim at building into customers' minds a set of perceptions and attitudes relating to an offering that should lead to positive buying behaviour. This requires marketing managers to have greater knowledge about their customers. This is because the power of a brand is normally measured by its effect on buyers.

Powerful brands have caused their customer base to either defer or refuse to buy if "their brand" is not available. They say I will come tomorrow when you have got brand X. Successful brands have their brand names turned into English language slang or jargons. Imagine such use of brand names to replace the real English words:

- Photocopying as xeroxing a document;
- Posting as FedExing it;
- Razor – I need a Gillette (instead of a razor); and
- Soft drink – I need a Cola (instead of a soda).

### **Benefits of Branding**

A strong brand creates a feeling of security, trust and confidence in the minds of customers. We can look at the hierarchy of brand elements that explain the customer benefits at the national level, functional level and product attributes. Different writers (Kotler<sup>75</sup>, Aaker<sup>76</sup>, Hines, others) have presented the benefits of branding to the company and the customers.

Who benefits?	Which benefits?
Customers	<ul style="list-style-type: none"> <li>• Supporting the feelings of self-mage (prestige)</li> <li>• Belonging or feelings of membership to a certain group of consumers (e.g. Benz is for class)</li> <li>• Feelings of security</li> <li>• Feelings of confidence</li> <li>• Feelings of trust</li> <li>• Enable easier choice and good shopping experience</li> </ul>
Marketers	<ul style="list-style-type: none"> <li>• Enable extra value to be added (brand helps with augmentation) Reduces the price-quality gap (price not viewed as important but the brand)</li> <li>• Branding is a pull strategy (a good brand pulls its own customers)</li> <li>• Product differentiation (e.g. Adidas is not Nike)</li> </ul>
Shareholders	<ul style="list-style-type: none"> <li>• Strong brands bring in more revenue (sales)</li> <li>• Strong brands attracts new investors</li> <li>• A strong brand gives a company's shares higher value on the stock exchange.</li> </ul>

**Table 12:** Benefits of branding to customers and firms

## The importance of Branding

### Internal and external Brand elements:

Branding is composed of two elements – one external and another internal to the customer. These elements are based on the Kapferer's *Brand Identity Prism Model*. Kapferer (1992)<sup>77</sup> identifies six aspects of a brand identity – grouped into two dimensions i) the constructed source versus the constructed receiver; and ii) externalisation versus internalisation.

*Constructed source versus the constructed receiver:* A well-presented brand has to be viewed as a person – and a person has physique and personality (that is, *constructed source*) and also as a stereotypical user (that is, the *constructed receiver*, having reflections and self-image).

*Externalisation versus internalisation:*

*Externalisation:* A brand has got social aspects that define its external expression (physique, reflections and relationship). The external brand elements include the following:

- **Physique:** The physical characteristics of the brand that make customers want to know what it does.
- **Reflections:** Relate to the target user or customer.
- **Relationship:** Which means the customer must have an identifying relationship with the brand itself.

*Internalisation:* A brand has aspects that are incorporated into the brand itself (personality, culture and self-image). The internal elements of a brand include the following:

- Brand Personality: This relates to customers' description of the brand.
- Brand culture: Refers to the social context within which a brand is perceived – example as in the case of Volvo for “safety” or Mercedes for “engineering excellence”.
- Self-image: Encompasses what a customer feels the brand says about him/her e.g. the self-image of driving a *Rolls-Royce* versus a *Toyota Corona*.

### Key concepts related to branding

**Brand attributes:** According to Aaker (1991) there are *six types* of brand attributes: *awareness, image, perceived quality, perceived value, personality* and *organisational association*.



- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFK! An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

**Brand Personality** five distinguishable dimensions of brand personality, which are viewed as traits, associated with the brand – and these are *sincerity, excitement, competence, sophistication and ruggedness* (Aaker 1997). We should say that just like people, brands have a personality. Personality is who you are. Personality combines identity (inside-out) and image (outside-in). Personality is about successful adaptation to the universal conditions of existence and the freedom of self-determination. In Psychology, there are *three aspects defined as a part of personality*:

- *Private personality*: thoughts, feelings, fantasies, ambitions and talents;
- *Public personality*: how you want other to see you; and
- *Attributed personality*: how others see you.

Brand personality should be clearly defined just like you would describe the personality of a real person. Successful brands have done this. Choose verbal concepts to express the brand personality using professional *lingua* or terminology. Use simple words to create a lively picture of a personality that is absolutely clear to anyone. A brand personality stems from a brand's identity and the consumers view of the particular brand. Brand personality is manifested in its visual communication and behaviour which all lead to the *brand effect* (visibility, brand equity, market share and profit).

**Brand associations:** These are also important components of brand equity. Brand associations contain meaning of the brand for consumers. It can be defined as anything linked in the memory of the consumer to a brand such as specific features, a celebrity spokesperson, particular symbol, etc.

**Perceived quality:** Another major dimension of brand equity. Perceived quality is not the actual quality of the product but the consumer's subjective evaluation of the product. It provides value to consumers by providing them with a reason to buy and by differentiating one brand from the competitor brands.

**Brand loyalty:** This is a major component of brand equity. Brand loyalty has been defined as the attachment that a customer has to a brand (Aaker, 1991:39)<sup>78</sup>. It has also been defined as a deeply held commitment to rebuy or repatronise a preferred product or service consistently in the future, despite situational influences and marketing efforts having potential to cause switching behaviour (Oliver, 1999)<sup>79</sup>. Yet another explanation of brand loyalty is from a behaviour dimension. Rossiter and Percy (1987)<sup>80</sup> argue that brand loyalty is often characterised by a favourable attitude towards a brand and repeated purchases of the same brand overtime.

**Brand Trust:** The confidence that one will find what is desired from another rather than what is feared<sup>81</sup>. It represents the confidence that the relational party in an exchange will not exploit another's vulnerability. To trust a brand implicitly means that there is a high probability or expectancy that the brand is having specific qualities that make it constant, competent, honest, responsible, concerned, etc. We should note that brand trust evolves from past experience and prior interaction with the brand.

**Brand Equity:** Attempts to define the relationship between customers and brands produced the term brand equity in marketing theory. The concept of brand equity has been a subject of debate in both marketing and accounting literature with regard to its importance to brand management. Financial Accountants have generally adopted *brand equity* as *brand valuation* (or *brand value*); which is seen as the total value of a brand as a separate asset (when it is sold or included on a balance sheet). First, the concept of measuring the consumers' level of attachment to a brand can be called *brand strength* (a synonym of brand loyalty). The third definition could be called *brand image*. *When marketers use the term brand equity they tend to mean brand description or brand strength*. Both brand description and brand strength are sometimes referred to as consumer brand equity in order to distinguish them from the asset valuation meaning.

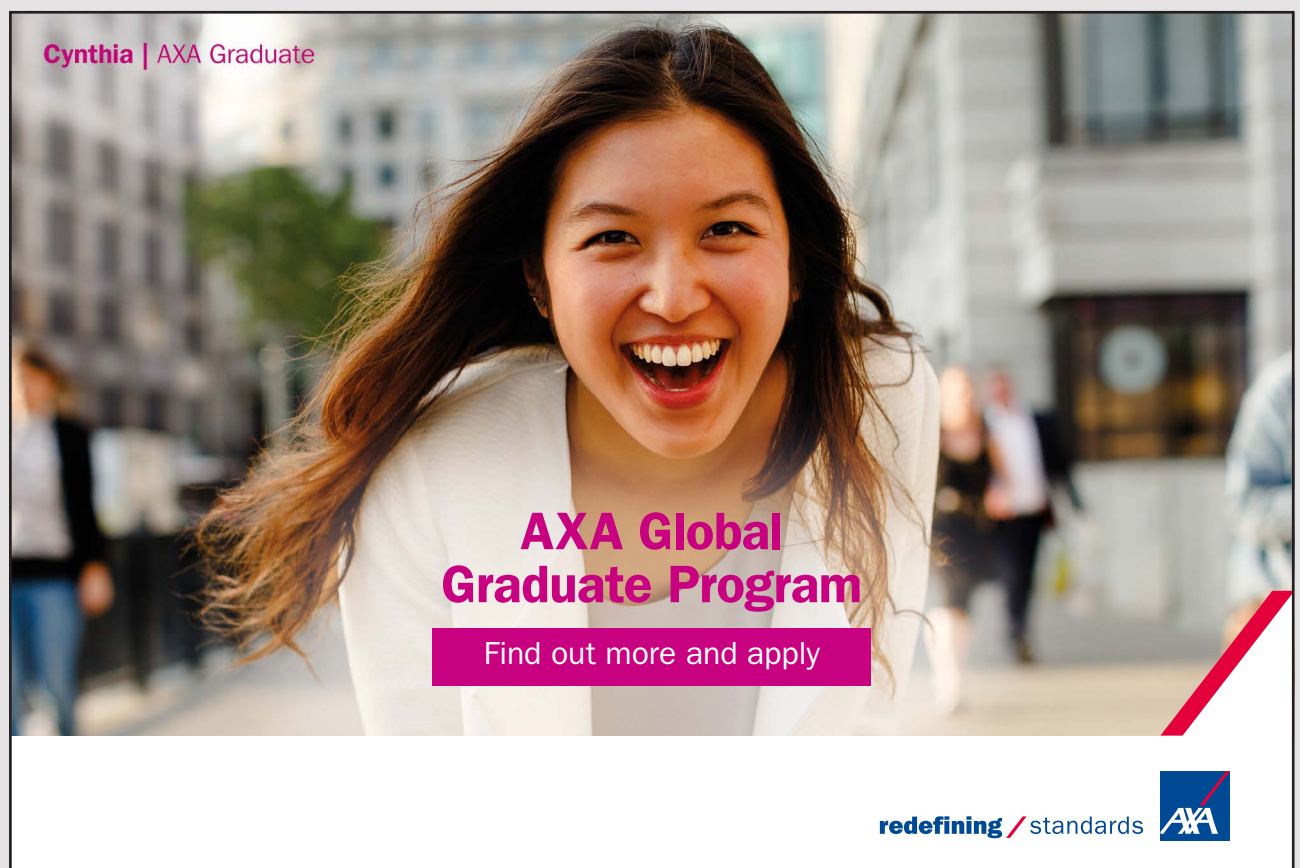
### Methods of Brand valuation

- Valuation based on marketing and on Research and Development (R&D) costs. This method of valuation is based on the aggregate cost of all marketing activities as well as on and R&D expenditures devoted to the brand over a stipulated period. This method ensures that the brand is an asset whose values originate from a firm's investment over time.
- Valuation based on premium pricing. This method of valuation uses the resulting extra revenue due to price differences as a basis for brand valuation. Under this approach, price premium can be simply observed in the market or can alternatively be measured through customer oriented market research.
- Valuation at market value: This method is the logical choice since it uses objective market measures and, thus, permits compensation over time and across companies.
- Valuation based on consumer factors such as esteem, recognition or awareness. Customers' preference and attitude can also be used to evaluate the brand.
- Valuation based on future earnings potential. This is the approach where future earnings are discounted to present day values and may help to overcome the difficulties arising from historical cost approach.
- Replacement costs valuation. This method tries to overcome the difficulties arising from the historical cost approach.

**Brand Image:** Refers to the strong, favourable and unique brand associations in memory which result in perceived quality, a positive attitude and an overall positive affect.

**Brand awareness** refers to how easy it is for the consumer to remember the brand. Brand awareness refers to the strength of a brand's presence in consumers' minds. It is an important component of brand equity. There are several levels of brand awareness ranging from mere recognition of the brand to dominance (which refers to the condition that the brand involved is the only brand revealed by the consumer).


**Brand recall** is the most common way to measure *brand awareness*. Brand awareness is a necessary condition for the creation of a brand image. When a brand is well established in customer's memory, it is easier to attach associations to the brand and establish them firmly in memory.



Cynthia | AXA Graduate

**AXA Global  
Graduate Program**

Find out more and apply

redefining / standards 

## Brand Strategies

When a company decides to brand, there are two options that it can use i) company brand or ii) product brands. Let us look at the brand strategies:

- i) *Individual name*: Each product has a unique name. The main advantage of individual product branding is that an unsuccessful brand does not seriously affect the company's other products or the firm's reputation.
- ii) *Company brand*: Here the company name is the most prominent feature of the brand (Mercedes-Benz, Fiat, Nokia, Virgin, etc.)
- iii) *Range brand*: Companies group types of products under different brands.
- iv) *Company name combined with individual product names*.

## Specific Strategies for brands (brand strategy decisions)

**Line extensions:** A company introduces additional items in the same product category under the same brand name usually with new features, flavours, forms, colour, more ingredients, package sizes, etc.

**Brand extensions** (Brand names extended to new product categories). The company uses existing brand name in the market to launch a product in a new category. It also involves using the same brand name that is already successfully established in one market or market channel to enter the other. It is often termed *brand stretching* when the existing market and the new market to be entered are very different. We can look at examples of brand extensions

- Yamaha Motors got involved in Audio videos and stereos;
- Swatch becoming involved in motor vehicles;
- Penguin books entering the disks market and is launching its own DVDs;
- Tesco (a retailer) entering into internet services.

**Brand revitalisation:** Increasing sales volume and improving profits of a poorly performing brand through establishing new markets (e.g. overseas markets) or new segments, or increasing usage of the brand. New segments, for example, for a company selling computers could be family, schools and individuals so that it is not only selling to businesses. The company can increase usage of its brand by encouraging customers to buy it for several uses. For example, most cell phones can be used for calling, sending messages "sms", as a calculator, watch, radio, calendar, organiser, etc.

**Brand repositioning:** This is a competitive strategy aimed at changing the current brand's market position to increase market share. A brand can lose its position due to changes in tastes and preference and needs to be presented differently to the customers. The aims of repositioning include changing the consumer's beliefs about the brand and altering their beliefs about the brand and so winning back the customers. This can be done by promotion such advertising and presenting the message about the brand in a different manner. Repositioning has been done by some companies with success. Coca Cola has won back the teen segment for the Coke; Pepsi cola has successfully repositioned its several years old Mountain Dew brand. In most markets, Mountain Dew is bought by that segment of 18–24 years but still has a market among the 30 years and above.

**Brand Survival: These are the factors** that affect current and future purchases of a brand. Companies view building strong brands as one of the most important goals of product and brand management. This is because powerful and successful brands bring in higher revenue streams and profits. All companies want to build brands that last forever (if possible). The experience of recent years since 2000s have shown that brands such as Arthur Andersen (Accountants), Enron (energy), Ratners (Jeweler Chain, US), Allders (department store, chain, UK), MCI (telecommunications), MG Rover (car brands) can collapse. The factors that can account for the demise of these brands may be many and varied. They are related to customers' perceptions, company, financial issues, politics and the environment.

### **Branding and services**

Some services sector practitioners believe that branding should not be as widely used in their sector as it is used in the marketing of tangible products. We must, however, mention that branding is as useful in services marketing as it is in the marketing of tangible products. If we recognise the importance of branding services, then it is not necessary to consider ways to create successful brands in services as the approach is similar to that under tangible products. Doyle has identified *four possible dimensions of strong branding*<sup>82</sup>. While these are not directly focused at any particular sector, they are relevant to services marketing.

- **Prioritise quality:** High quality is a common factor among leading brands in all sectors – consumer, industrial and services marketing. High quality services are, therefore, pertinent to service brands.
- **Offer superior service:** Research has found high rates of brand switching among customers dissatisfied with service levels. Most services companies should focus on offering superior service as a means of differentiating their offering.

- **Get there first:** In branding, it is being the first in the customer's mind which is very important. There are well known brands in service industry such as BBC, CNN, Master Card, American Express (Amex), British Airways, Emirates, etc. that have stuck in the minds of most people globally.
- **Be different:** The importance of "being different" especially in the mature market is vital. Targeting niche markets have become key for successful brands.

### Country Image and Nation Branding

Publicity is important. Unfortunately, like most publicity coming from outside the organisation, publicity about a country is difficult to control by the management of that country. In business, we define publicity as the appearance of any newsworthy item about an organisation or public figure. Not all news about the organisation or country is positive or favourable. News come from different sources – from inside (via press releases, emails, notices, etc.) and outside (from the press writing about the organisation, its products and even its staff). Whether it is an organisation or a country, there is a need to attract a positive image from the public. Some countries have set up a media centre in order to constantly address the media and the public about emerging issues in order to reduce negative publicity.

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



### Month 16

I was a construction supervisor in the North Sea advising and helping foremen solve problems

Real work  
International opportunities  
Three work placements



Given how the image of countries of Africa has been 'soiled' by wars, conflict and mainly foreign bad press, these countries must undertake organised nation branding. *Nation branding refers to a country's effort to establish a symbol, name, or logo that makes it unique*; and the nation brand should be likeable. The term 'Nation Brand' was coined by Anholt<sup>83</sup> in 1990s when he defined it as the sum of people's perceptions of a country across the following six areas of nation competence: exports, governance, tourism, investment and immigration, culture and heritage and people<sup>84</sup>. According to Simon Anholt (cited in Dinnie 2008:22)<sup>85</sup>, the reputations of countries function like the brand images of companies and that they are equally critical to the progress and prosperity of those countries. Various experts have identified common reasons in favour of nation branding. These include:

- Attracting tourists who bring foreign exchange;
- Stimulation of inward FDI;
- To boost exports; and
- To attract talent (countries compete to attract higher education students and skilled workers).

Countries may obtain a wider set of rewards from nation branding, beyond those stated above. In addition to those key goals, nation branding can also increase currency stability, help restore international credibility and investor confidence, reverse international ratings downgrades and increase international political influence. It can as well stimulate stronger international partnerships and enhance nation building by nourishing confidence, pride, harmony, ambition, national resolve<sup>86</sup>. Countries in Africa, like those in Central and Eastern Europe, may undertake nation branding for one more additional objective: to distance themselves from the old image associated with the old economic and political system. Countries in Central and Eastern Europe, on the other hand, want to disassociate themselves from communism which collapsed during the rule of Mikhail Gorbachev of the former Union of Soviet Socialist Republics (USSR).

Nation branding has since early 1990s emerged as an important discipline, especially for developing countries, including those in Africa. Like companies endeavour and spend a lot to promote and protect their brands in the market amidst competition, developing countries urgently need branding. These countries, in addition to the motives of nation branding already stated, also compete for aid (which they need to exit with a carefully crafted aid exit strategy). Besides, they need branding in order to cultivate friendship with the rich and the advanced developing countries (which currently include Brazil, China and India).

*Is it enough to develop the nation branding without good (brand) positioning?*

In marketing literature featuring the discipline of psychology, positioning can be viewed from the psychological point. Positioning is the in mind of the target audience<sup>87</sup>. Who do you want to communicate to and influence? That is your audience. Countries want to communicate to other countries, investors, tourists, lenders and donors. In addition to these, developing countries need to communicate to their Diaspora citizens as well: to either woo them back home or to simply encourage them to send remittances home and invest.

The country may need country brand ambassadors. A key issue when appointing brand ambassadors is to ensure that as far as possible, the individuals selected truly reflect the personality of the country and the positive attributes that the nation wishes to project<sup>88</sup>. More than these ambassadors, a country needs to hire 'image builders'. These include companies whose role it is to design message and strategies and present them to target audiences. These companies should either have a good knowledge of the country and the government or be willing acquire such knowledge at the quickest possible pace.

There is another way to get the message reach the target audiences. That is by quietly covering the costs of your country's experts and people of respect to visit different places and send a positive message. These are not your country's ambassadors. We know our country's ambassadors and we know they have that assignment as ambassadors for their countries. It is their role to promote the country. These individuals are personalities including celebrities from your country who understand the country and its challenges well. These are credible people who may/not have worked in those countries where you are sending them. These could be reputable journalists and media personalities, celebrities, writers who you think feel positively about the regime.

There is another way the country can become visible and attract attention: sports. Most people in the world love one sport or the other. Athletics attracts global attention. Such games as the Soccer World Cup or the Olympics attract people of different age brackets, class and status. They watched live or via television by big audience. Investing in training and participation of sports men and women in international games will help a country to remain visible for some time when they win some of the games. Sports are also important in both domestic and international politics because the youth tend to associate with politicians and leaders who support sports.

*The diaspora is another network for image building:* Regardless of how they went, the Diaspora still has love for their countries. Many countries ignore their Diaspora as vital ambassadors with inward Foreign Direct Investments (FDIs) and individual remittances. These are individuals and families who understand their home country very well. They have over time acquired both tacit and current technology, skills and money to invest in a country where other foreign people and companies may be reluctant to invest. Some research<sup>89</sup> shows that China has benefited hugely from its Diaspora in terms of FDI – the Chinese Diaspora has provided an estimated 70% of recent China’s foreign investment.

Most Diaspora tends to visit their countries around the festive periods of Christmas, Easter or Idd. When they come they are tourists. They leave foreign currency in their countries. This is in addition to remittances. We need to therefore, encourage investment in their home countries. Some of them have hereditary assets such as land. They should be encouraged to utilise it. There is need, however, to put in place systems by government including the central banks on how their remittances and FDI can be promoted and protected.

**ie** business school

**93%**  
OF MIM STUDENTS ARE  
WORKING IN THEIR SECTOR 3 MONTHS  
FOLLOWING GRADUATION

**MASTER IN MANAGEMENT**

- STUDY IN THE CENTER OF MADRID AND TAKE ADVANTAGE OF THE UNIQUE OPPORTUNITIES THAT THE CAPITAL OF SPAIN OFFERS
- PROPEL YOUR EDUCATION BY EARNING A DOUBLE DEGREE THAT BEST SUITS YOUR PROFESSIONAL GOALS
- STUDY A SEMESTER ABROAD AND BECOME A GLOBAL CITIZEN WITH THE BEYOND BORDERS EXPERIENCE

Length: 10 MONTHS  
Av. Experience: 1 YEAR  
Language: ENGLISH / SPANISH  
Format: FULL-TIME  
Intakes: SEPT / FEB

**5 SPECIALIZATIONS**  
PERSONALIZE YOUR PROGRAM

**#10 WORLDWIDE**  
MASTER IN MANAGEMENT  
FINANCIAL TIMES

**55 NATIONALITIES**  
IN CLASS

[www.ie.edu/master-management](http://www.ie.edu/master-management) | [mim.admissions@ie.edu](mailto:mim.admissions@ie.edu) | [f](#) [t](#) [i](#) Follow us on IE MIM Experience

## 6 SERVICES MANAGEMENT

<ul style="list-style-type: none"> <li>• Banks</li> <li>• Hotels</li> <li>• Airlines</li> <li>• Education services</li> </ul>	<ul style="list-style-type: none"> <li>• Health services (hospitals, clinics, etc.)</li> <li>• Legal services</li> <li>• Car repair</li> <li>• TV repair</li> </ul>
---	---

**Table 13:** Examples of services in developing countries

The debate on the differences between services and products has never ended. But basically products can be seen and touched. When a customer is trying to buy services, however, it is difficult to see and touch them. Services are simultaneously being consumed as they are being performed. This chapter will look at the characteristics of services and how to market them. Attempts will also be made to show how buyers of services ‘see’ evidence of a service.

### The concept of services

A service was defined by the American Marketing Association (AMA) in 1960 as “activities, benefits or satisfactions which are offered for sale or are provided in connection with the sale of goods”<sup>90</sup>. Later, Stanton (1981) defined services as ‘those separately identifiable, essentially intangible activities which provide want, satisfaction and are not necessarily tied to the sale of a product or another service’<sup>91</sup>. More recently Kotler<sup>92</sup> states that “A service is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production neither may nor may not tie to a physical product”<sup>93</sup>. Another definition has been offered by Sommers et al (1998) and states that “services are identifiable, intangible activities that are sometimes the main object of a transaction and at other times support the sale of tangible products”<sup>94</sup>. For the purpose of this text, we will focus on services being sold as services (not support services).

### Characteristics of services

There is a high degree of agreement in literature about the characteristics of services. These characteristics make services different from physical products<sup>95</sup>.

- 1) **Intangibility:** Services are intangible. They cannot be touched, seen, tasted, or smelt. This is unlike the products which can be physically touched.
- 2) **Inseparability (of production and consumption):** Generally, services are first sold, then produced and consumed simultaneously. A service is consumed while it is being performed and in most cases the consumer is actively involved in the performance of the service that they are using (e.g. the act of getting a hair cut)

3) **Variability (or Heterogeneity):** It is extremely difficult to perform a homogeneous service to all service clients. Service varies in performance depending on who is providing it, when and where it is provided. Services cannot be standardised as can be done for products. For example a waitress at a restaurant cannot give similar services at 10:00am, 1pm and at 5pm. The service she performs will vary depending mainly on when she gives it and where she gives it as well as on the customer him/herself.

Class	Beverages	Cocktails	Beer	Wine	Spirits	Liqueurs & digestifs
<b>Business</b>	<p><i>Juice</i> – orange, pineapple, apple, mango or tomato;</p> <p><i>Soft drinks</i> - a full range of sodas and mixers, still and sparkling water;</p> <p><i>Mocktail</i> – orange fizz; apple spritzer;</p> <p><i>Hot drinks:</i> tea ( different brands – Ceylon, chamomile; Moroccan mint; Earl grey or green); coffee (different types – freshly brewed; espresso; cappuccino; or decaffeinated)</p>	<p>Bloody Mary; Cosmopolitan; Kir Royale; Manhattan; Rob Roy; Rusty Nail; Classic Martini; Breakfast Martini; Mojito;</p>	<p>A selection including Budweiser; Heineken; Amstel Light</p>	<p>A selection of Champagne; Wine; and Port. A separate Wine list with several brands/ types to choose from.</p>	<p>Chivas Regal 18; Grenfiddich Scotch Whiskey (15 years old); Jameson Irish Whiskey; Jack Daniel's Tennessee Whiskey; Hennessy XO Cognac; Grey Goose Vodka; Bombay Sapphire gin; Bacardi Superior rum</p>	<p>Campari; Cointreau; Drambuie; Baileys; Tia Maria</p>

<b>Economy</b>	<i>Juice</i> – orange, pineapple, apple, mango or tomato;	None	Beers (Limited choices offered)	Red wine (Limited choices offered); White wine (Limited choices offered)	Limited choice offered	None
	<i>Soft drinks</i> - sodas, still and sparkling water;					
	<i>Mocktail</i> – None					
	<i>Hot drinks:</i> tea (one type/brand); coffee (one type/brand)					

**Table 14:** Different services offered on the same flight

- 4) **Perishability:** Another difficulty in marketing services arises due to the fact that services cannot be produced before they are required and then be stored to meet future demand. Services, as performances, cannot be stored. If a service is not used when available then that service capacity has been wasted.

"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"

Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

### The elements of service (or service package)

When buying a product (such as a computer), it is easy to explain what a customer has bought or received. It is however difficult to explain what one has purchased after the service has been performed. In most cases there is nothing tangible to show as what one has bought.

We are going to present a service package as being composed of four elements: tangible elements, intangible elements, core service and peripheral services. We will take it that the service package is composed of tangible and intangible elements.

### The services mix (7Ps)

4Ps	<ul style="list-style-type: none"> <li>• Product</li> <li>• Price</li> <li>• Place</li> <li>• Promotion</li> </ul>
More 3Ps	<ul style="list-style-type: none"> <li>• People</li> <li>• Process</li> <li>• Physical evidence</li> </ul>

**Table 15:** The service mix (7Ps)

The services mix has got 7Ps. This is due to the fact that they are complex to market. We will discuss these Ps.

**Product:** Unlike tangible products, services' marketing is affected by the aspect of intangibility. It is desirable to provide tangible surrogates for the intangible whenever this is possible.

**Price:** The issue of intangibility affects price and the mechanisms of setting prices. A look at the following explanations will suffice.

- i) At times there is no sure way of knowing what the performance (or provision) of a service will involve until it has been completed. It, therefore, becomes difficult for pricing such a service prior to its provision.
- ii) Costing a unit of service (as compared to costing a unit of a product) is somewhat difficult and imprecise task due to the service characteristics of intangibility and variability. Marketers cannot easily use the cost-based pricing methods to assign prices to services as a result of intangibility and flexibility.
- iii) It is also difficult to price a service and put the actual value on such things as skill, expertise and value. When a consumer is charged a higher price, such a consumer will be expecting high quality throughout the performance of the service. But as we have already discussed, there is always variability in the provision of a service.

- iv) Customers are likely to perceive a stronger *price-quality relationship* for services than for products. Yet, we know in marketing that price is not always a good indicator of quality.
- v) Differential pricing: In most cases providers of services offer the same services but to different classes of customers. Take the example of airlines whose service is transport passengers from one airport to another. While the overall service of an airline is to fly them say from London Gatwick to Charles de Gaulle Paris, inside the plane there are three different classes of services – first, business and economy (or tourist) classes. In each section or class inside the same plane customers receive different services. For the three different classes, passengers pay different prices (and receive different services).

**Promotion:** There will always be problems with promoting what cannot be seen, touched or smelt. Marketers have to be very creative to ensure that their message and tools work effectively. Since a service has no physical appearance itself, it has to rely heavily on promotional activity and well-designed promotional materials to provide an image. It is usually appropriate to create an appealing image of the service provider (the company providing the services). This is a better way of promoting services because the service organisation is after all more tangible than the service. Telecoms companies use more their own image to promote their services. In turn, customers of the telecommunications companies associate more with the company than with the services they receive. Orange in France, for example, offers such services as telephony, voice, data and internet. Customers know Orange as a company and can, therefore, relate to this company's services. It is often difficult to relate the service to the service organisation when making promotional programmes (e.g. advertising) but is not completely impossible. It is also not easy to promote a service with intangible benefits. In promoting a tangible product, it is easy to present its features, attributes and benefits. Its features are visible and can be seen by the customer. These features (and the benefits) can easily be communicated in a message. Services, on the other hand, cannot be held in stock and this means that services cannot be performed during slack periods and held over for use during peak seasons. This is only possible for products because they are tangible. In fact during off-season, promotion of services should only aim to increase sales and, therefore, change of price will not be as a result of the quality of service being poor.

**Place (or channels of distribution):** Service operators do not need to have a physical distribution system because services cannot be stored. However, there may be tickets to reserve access to a service and/or to act as proof of purchase to be distributed. This is more of office (administration) procedure and should not be compared to physical distribution (as in the case of a product). In marketing a service, the location of the service organisation's premises at which a service is performed is a very important aspect in the services mix. Customers associate the location and premises with the quality of service they expect to receive. Traditionally most services have been sold directly to customers or business users from the producers.

Excellent Economics and Business programmes at:



university of  
 groningen



“The perfect start  
of a successful,  
international career.”

**CLICK HERE**  
to discover why both socially  
and academically the University  
of Groningen is one of the best  
places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

**People:** People are the most important element of any service provision. We have seen that services are usually produced and consumed at the same time. The people who provide these services have to be skilled and professionals to be able to be part of the process of simultaneously producing and consuming a service. We can refer to the customer as a co-producer and the staff of the service organisation performing the service as a co-consumer. Staff in service organisations have to ensure that they are appealing and, therefore, likeable. People usually buy from the sales persons they like. This, therefore, calls for all staff to have a good attitude, be skilled and present themselves in a professional way. In fact, staff in service organisations who are unprofessional can taint the image of a service provider. Some customers can choose never to use the services of such an organisation – they can switch brands.

Remember any disappointment you had at a restaurant, bar or while on tour?

Skills and professionalism can be improved by training. Training should begin at the induction of staff and become continuous. Continued professional development is necessary because the environment of businesses is continuously changing.

Service: Hotel, restaurant/bar, tour agency, bank	Staff: Waiter/waitress, tour agents, drivers, tour guide, teller, cashier, credit officer,
---	--

**Processes:** This is another element of the extended marketing mix. Processes involve the methods through which the marketer’s task is achieved. So an efficient process may become a marketing advantage in its own right. Organisations with efficient procedures may in the long term save money but also, in the era of computers and the internet, time management is a key ingredient of customer service. The process that the customer participates in at different points in time during the consumption of a service determines the quality of that service. These processes are performed by the staff of the service organisation with the customer.

**Physical Evidence:** Physical evidence as part of the marketing mix refers to the material part of a service. Unlike a product, a service does not have physical attributes and so the consumer relies on material cues. Examples of physical evidence include brochures, uniforms, furnishings, signage (such as those on vehicles and fronts of hotels, etc.), paper work, (invoices, tickets, delivery notes, etc.), business cards and the office itself (magnificence and ambiance). Physical evidence is very vital when marketing services. Some organisations depend heavily upon physical evidence as a way of marketing communications. Most banks, insurance, mail and tourism attraction companies rely on physical evidence for messages and promotions generally.

### **Positioning of service brands:**

In most marketing literature, whenever positioning is mentioned, it is most likely talking about a tangible product. Services have a number of distinctive characteristics which make them different from physical goods and, subsequently, affect their positioning strategies<sup>96</sup>.

### **Service Quality**

The characteristics of services have made it difficult to determine what constitutes service quality. According to Mudie and Cottam (1999), service quality refers to the extent to which a service is what it claims to be and what it claims to do. It must not be confused with grade<sup>97</sup>. Service quality has become an important research topic because of its apparent relationship to costs, profitability, customer satisfaction, customer retention and positive word of mouth (Buttle, 1996)<sup>98</sup>. Quality is defined by the consumer, though the staff of the service provider can advise on the quality of different offerings. For instance, human heads have different shapes and sizes. They should, therefore, not have the same hair style. So, based on experience, a barber can recommend the best hair style for one's shape of the head.

### **Ten Dimensions of service quality**

The *ten dimensions of service quality* were initially suggested by Zeithaml et al., (1985)<sup>99</sup> in a qualitative research.

- 1) Reliability: The ability to consistently perform the service dependably and accurately. It also means that the service organisation has to honour its promises. Reliability involves such things as accuracy in billing, keeping records correctly and providing the service at the designated time.
- 2) Access: Since production and consumption of the service are inseparable, they are undertaken simultaneously, a customer's ease of contact with and timely access of the service supplier is very vital. This means that the service is easily accessible by telephone (lines are not busy) and they do not put you on hold "forever", waiting time to receive service (e.g. at a bank) is not long, there are convenient hours of operation and the suppliers' service facility is conveniently located.
- 3) Responsiveness: Employees' willingness and ability to provide timely and adequate response to inquiries and complaints of customers. It is vital that service suppliers attend promptly to customers' requests, questions, complaints and problems. A timely service involves, for example, mailing a transaction slip immediately, calling the customer back quickly and giving a prompt service (e.g. setting up an appointment for a customer quickly).

- 4) **Competence:** Possession of the required skills and knowledge to perform the service. Competence of the service supplier could be centralised around the organisation as a whole or around the contact personnel. This dimension of service quality involves knowledge and skills of the contact personnel, knowledge and skill of the operational support personnel such as IT, customer care and billing.
- 5) **Courtesy:** Treatment of customers politely, with respect, consideration and friendliness. Customers (including the rude ones) should perceive service staff (including receptionists, telephone operators, security staff, etc.) as polite, respectful and customer friendly. Also, cleanliness and neat appearance of contact personnel is critical to service delivery. Customers typically do not distinguish between the service and the service provider.
- 6) **Communication:** Keeping customers informed in a language they understand. The company should adjust its language for different customers. For example the staff can increase the level of sophistication with a well-educated customer but use plain language with a novice. Effective communication involves explaining the service itself and the benefit it offers, how much time it takes to have the consumer's problem handled. Communicate all the time with the customers. Tell them about the change in the schedules of service. Honestly tell customers when there are delays in services provision. Please communicate with customers.

## American online LIGS University

is currently enrolling in the  
Interactive Online **BBA, MBA, MSc,**  
**DBA and PhD** programs:

- ▶ enroll **by September 30th, 2014** and
- ▶ **save up to 16%** on the tuition!
- ▶ pay in 10 installments / 2 years
- ▶ Interactive **Online education**
- ▶ visit [www.ligsuniversity.com](http://www.ligsuniversity.com) to  
find out more!

**Note:** LIGS University is not accredited by any nationally recognized accrediting agency listed by the US Secretary of Education. More info [here](#).



- 7) Understanding the customer: Making effort to understand the customer's needs. Service staff should not simply try to sell their service but rather show that they want to meet the customer's needs. This involves knowing the customer, his/her specific requirements, providing individualised attention and recognizing the regular customer. In relationship marketing, this means making a customer your friend as the service staff. To look for a long term relationship is very critical especially in services where there is a relative lack of objective measures for evaluating service quality.
- 8) Credibility: Trustworthiness, believability and honesty of the service supplier are crucial determinants of patronage. The company's image, name, reputation and personal characteristics of the contact personnel contribute greatly to the credibility of the service supplier.
- 9) Security: The customer's feeling of freedom from danger, risk or doubt. The following explanation will suffice:
  - a) Physical security (Will I get mugged at the ATM?)
  - b) Financial security (Does the company know where the insurance certificate is?)
  - c) Confidentiality (Are dealings with the company private?)

The customer needs to feel that the conversation with service staff (e.g. in a bank, or at the medical centre) is private and confidential. For security purposes, service providers, especially banks and medical services, should design their service area to reflect privacy and confidentiality.
- 10) Tangibility: The physical evidence of the service, consisting of physical facilities, appearance of personnel, tools or equipment, physical presentation of the service and other customers in the service facility (Zeithaml et al., 1985)<sup>100</sup>.

## Measuring Service Quality

### The development of the SERVQUAL Scale

Service quality has been viewed as a multidimensional construct (or concept). Consumers assess and evaluate a service through a number of factors. These factors are referred to as *dimensions*. Evaluation of service quality involves a comparison of customer's expectations of the service before it occurs with the perceptions of the service after the service encounter. So the **SERVQUAL** Scale is comprised of two sets of matched items measuring expectations and perceptions. While in their original formulation, Zeithaml, et al., (1985)<sup>101</sup> identified ten components of service quality, in their development of SERVQUAL Scale, Parasuraman, et al., (1988)<sup>102</sup> indicated that there were **five key underlying dimensions**: *reliability, assurance, tangibles, empathy and responsiveness*. Reliability, tangibles and responsiveness remained distinct while the remaining seven components were collapsed into two aggregate dimensions of *assurance* and *empathy*.

The mnemonic **RATER** is a helpful aide memoiré where R = *Reliability*, A = *Assurance*, T = *Tangibles*, E = *Empathy*; and R = *Responsiveness*.

The appropriateness of these five dimensions has been tested in a variety of service industries. They appear applicable to most services. However, to apply these components/dimensions to a particular service supplier will require definitions in specific and behavioural terms. It requires the ability to explain, for example, what empathy means in services.

## **Service Quality Problems**

### **The causes of service quality problems**

There are several reasons that have been put forward to explain the causes of poor service quality.

- 1) Inseparability of production and consumption. Unlike goods which are first produced then sold and later consumed, the performance of a service takes place in the presence of the consumer. The human encounter has got its challenges. These challenges include the fact that a service staff can give variable (non-homogeneous) treatment to different customers requiring the same service.
- 2) Viewing customers as just numbers: The tendency to provide a standardised service to all customers looking for a similar service can result in poor quality of service.
- 3) Inadequate services to internal customers: To provide a good service requires that the employees feel as part and parcel of the service organisation. The employees also require proper support from management. The front line staff for example in a hotel require equipment (such as telephone and computers), uniforms, skills training in customer care and regular information on new promotions taking place.
- 4) Lack of coordinated communications: Efficient and effective communication is vital to the smooth running of a service organisation. Communication helps companies to obtain customers and keep them. In an organisation where there are communication gaps between the staff and management or staff and customers, the following are likely to occur.
  - Failure to respond to customer queries on time;
  - Failure to communicate with customers in a way they understand;
  - Failure to keep customers informed; and
  - Failure to listen and express empathy for customers.
- 5) Failure to seek long term benefits from an investment in a service organisation: Some service suppliers tend to think of the short term and transaction approach to marketing instead of seeking to build a long term relationship (*refer relationship marketing*).

**Improving service quality:** To improve service quality, the services organisation needs to improve on the *five key service quality dimensions* as identified by Parasuraman et al (1985<sup>103</sup>, 1988<sup>104</sup> and 1994<sup>105</sup>). These dimensions are *reliability, tangibles, responsiveness, assurance and empathy*. Again, Parasuraman et al (1985<sup>103</sup>, 1988<sup>104</sup>, and 1994<sup>105</sup>) have devised an instrument or model known as SERVQUAL instrument (a questionnaire) to measure service quality based on these five dimensions. This instrument currently has 21 questions to capture the attributes of the five dimensions.

### The Service Encounter

Services firms rely largely on creating positive customer experiences to key keep customers loyal. A key component to achieving this goal is to gain an understanding of the importance of the times when a customer comes into contact with the organisation's service personnel. These contact points are usually called "moments of truth"<sup>106</sup> and serve as episodes upon which customers evaluate the service provider on whether they meet their expectations. These 'moments of truth' are the service encounters. They represent the time when customers and staff of the service organisation interact. The interaction may take various forms. Some service encounters are brief while others are extended encounters.

**DON'T EAT YELLOW SNOW**

What will your advice be?

Some advice just states the obvious. But to give the kind of advice that's going to make a real difference to your clients you've got to listen critically, dig beneath the surface, challenge assumptions and be credible and confident enough to make suggestions right from day one. At Grant Thornton you've got to be ready to kick start a career right at the heart of business.

Sound like you? Here's our advice: visit [GrantThornton.ca/careers/students](https://www.grantthornton.ca/careers/students)

Scan here to learn more about a career with Grant Thornton.

 **Grant Thornton**  
An instinct for growth™

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd

*A service encounter refers to that period of time during which a customer and staff of the service organisation interact.* The service encounter has been viewed as a social interaction involving one human being interacting with another<sup>107</sup>. This interaction can be face to face, over the telephone, videoconferencing, email, etc. Before we look at the types of encounters, let us first identify key players involved in a service encounter<sup>108</sup>. These are listed here.

- The service organisation: which sets policies and guidelines
- The employees: who enact the policies of the service organisation
- The customer: who seeks to satisfy their needs and wants

Several dimensions on which to assess *service encounter* have been proposed by Chandon et al (1997)<sup>109</sup>. These dimensions and their sub-categories differ depending on who is doing the assessment or evaluation i.e., whether it is the organisation itself or the customer. From the customer's viewpoint, the service provider's staff perceived competence (expertise), listening skills and dedication to service delivery are likely to be key in a customer's evaluation of the service required. When is it from the service provider's staff viewpoint, customer courtesy is associated with efficiency in terms of getting the transaction completed and employee satisfaction are likely to be key in staff assessment process.

### **Types of encounters**

There are three common types of service encounter and they are identified here.

**The remote encounter:** This occurs without any direct human contact. The service provider interacts with the customer through mail and via electronic or automated systems such as the Automated Teller Machine (ATM), Ticketron (automated ticketing machine), email and internet (at a website). Customers can now visit a website and interact with the service provider. There are service firms that have no services facilities (such stores, shops) but are just 'virtual shops'. Amazon.com, for example, sells more books in the US and UK but has no premises as stores or shops in these markets. We can say that in the modern world of today, technology (and the internet) has facilitated remote encounters. You can buy from the net (from the seller's website) or purchase air e-tickets. You can also undertake computer troubleshooting by remote encounter.

Evaluation of remote encounter:

- To be user-friendly, machines need to function. The machines should always be tested, modified and made uniform.
- Leaflets and brochures sent by mail should be designed in a reader-friendly manner.

**Indirect personal encounter:** This is where customers interact with the service via a telephone. In most service organisations – such as telecommunications, insurance, banks, retailers – customers interact with services organisation staff through the telephone. Such interactions could be a general enquiry, making order or offering after-sales services. There is a great potential of variability in the indirect encounter. However, this can be avoided by training staff in the services offerings and, in most cases, requiring the employees to work to a script; as is the case in film industry where film stars use a script to ensure they do not deviate from the story.

**Direct personal encounter:** This is where customers interact face to face with the employees of the services organisation. The customer can easily judge service quality by looking at the appearance and approach of the services organisation's employees. The way the employees talk and respond to questions as well as their appearance can be bases upon which the customers assess service quality.

## 7 RELATIONSHIP MARKETING

Let us first define some concepts related to relationship marketing.

**Customer service** is the term that has been understood differently by different companies. Its meaning varies considerably from one company to another. However, *customer care can be understood to include all the marketing logistics required to accept, process, deliver and prepare customer orders through to the caring and friendliness of the staff in the service encounter.* Customer service is crucial during pre-sale, sale and after sales services. It should not be less important after the sale than during the sale. Customers need re-assurance and comfort that their purchase was worth it (in order to avoid post-purchase dissonance). So that in case there are few initial problems associated with the operation or use of the product, a customer still believes that it was a good choice which they made.



.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if  
you could  
build your  
future and  
create the  
future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

**Customer Care:** In modern marketing, customer care has become a key and important element of the competitive edge. It has been referred to as *the non-product benefit to customers – which is greatly valued by customers*. Customers' perception of a service is an important aspect that companies should bear in their customer-focused services to their customers. People remember a good service even after a long period of time. Therefore, a good service will attract customers to repurchase from the same store or supermarket or restaurant. A bad customer experience can lead a customer never go back (unless the company is a monopolist provider) and even convince other customers away from that organisation. Companies and their staff need to consider the following as they service their customers.

- First class services justify the price in the eyes of customers. A good service reduces perceived price feelings;
- Service is only noticed whenever it exceeds customer's expectations (what Kotler called 'customer delight');
- Never think of customers as a number, think of them as individuals;
- Do not tell customers your problems or organisation failures, but solve their problems.
- Staff are also customers. So, treat your internal customers well (Managers cannot force staff to give customer care. Instead, staff have to be motivated to serve. So recruiting the right staff is the beginning of a good customer care programme).

**Loyalty Ladder:** In marketing, customers progress in their relationship from a lower level upwards. The earlier model by Dwyer et al., (1987) had proposed five stages (*awareness, exploration, expansion* and finally partners (*commitment*) and, sometimes, *dissolution*). The well-known *concept of a ladder of loyalty* was vividly adapted in recent literature by Payne et al., (1995)<sup>110</sup> to create a *relationship ladder*. The 'ladder of loyalty' was adapted by Payne et al (1995) to the 'relationship ladder, as presented in Egan, 2008, in *Relationship Marketing*<sup>111</sup>. Payne et al., (1995) present *six steps on a ladder of loyalty* (prospect, customer, client, supporter, advocate and partners). Kotler (1997)<sup>112</sup> suggests eight steps, starting from a suspect as you climb the ladder of loyalty. In marketing, and particularly in selling, we start from a suspect. This is why in the steps of selling we start by looking at potential customers from the level of a suspect. Kotler (1997), therefore, presents the ladder as follows: *suspect, prospect, first time customer, repeat customer, clients, advocates, members and partners*. Christopher et al, (2002)<sup>113</sup> too present six steps of the ladder of customer loyalty – *prospect, purchaser, client, supporter, advocate and partner*. Regardless of which ladder we look at, it is clear that the relationship between an organisation and a customer goes through stages. It starts from a situation where both parties (customer and organisation) have mistrust issues and finally becomes a relationship of trust. Loyal customers become unpaid 'word-of-mouth' spokespersons of the organisation from which they regularly purchase stuff. The organisation, in turn, gives discounts and sells on credit to its loyal customers. You may need to look again at the variables of a relationship.

**Customer Retention:** Researchers have found out that customer retention is important for company success and profitability. Dawkins and Reichheld (1990)<sup>114</sup> have explained the advantages of retaining customers. They have claimed that a 5-percent increase in customer retention rate led to an increase in customers of between 25 percent and 85 percent in a number of industries: credit card, insurance brokerage, motor services and office building management. Existing literature says that companies have considered it an asset in strategic planning. Inevitably, companies will have to recognise the importance of retaining customers – including reduced costs of promotion to existing customers and obtaining free advice on the performance of products.

### **Benefits of retaining customers**

The benefits of retaining customers can be classified as *economic (quantitative)* and *non-economic (qualitative)* benefits.

Customer *life time value* (LTV): In a relationship, a seller seeks to minimise their costs and maximise their revenue. The **Profitability** equation: **Profit = Revenue – Expenses**. Customer retention helps to increase company revenue through (i) increases in sales volume; (ii) premium prices; and (iii) by reducing the expenses (or costs) of generating business (or revenue).

There are **economic benefits**, to the seller, of retaining customers include

- Reduced customers' acquisition on replacement costs (advertising, commissions to agent or introductory fees);
- Current customers give free referrals (i.e. convince other potential customers to buy from a company at no cost); and
- Customers buy whenever they want and do not usually wait for promotions or price reductions before deciding to purchase.

*Read Reichheld (1996)<sup>115</sup> on six economic benefits of retaining customers*

There also **non-economic benefits** to the seller. These are based on the behavioural or psychological aspects of purchases. They include:

- Satisfied customers promote the products of seller via word of mouth and referral by customers to their friends and relatives about your company.
- Existing customers are a source of customer feedback;
- Customers provide advice on product improvement (design, packaging, shape, size, etc.);
- Commitment and trust in a relationship lead to close cooperation; and
- Satisfied customers reduce uncertainty and conflict between the seller and the buyers (customers);

**Customer Retention service programmes:** In a bid to retain customers, various companies (airlines, stores, supermarkets, hotels, etc.) have started retention service programmes. Most of them come with a membership card. Airlines give frequent flyer miles to passengers with membership cards. The purpose of this card is to keep you (retain you) on the company's service or product. Why not if the more you buy the more your chances of a trip to the Bahamas or Monaco!

**Customer satisfaction:** Customer satisfaction has been widely covered in marketing literature. However, most managers have not yet launched a specific customer care initiative to take advantage of what customer satisfaction brings to their companies. Customer satisfaction impacts on the financial success of an organisation. This has been confirmed by more recent research. The research found out that 98% of dissatisfied customers switch to a competitor without complaining and that "totally satisfied" customers are six times more likely to purchase a company's products than merely satisfied customers<sup>116</sup>. It was also found out that a 5% reduction in customer defection can result in profits increases from 30–85%<sup>117</sup>.



Join the best at  
the Maastricht University  
School of Business and  
Economics!

**Top master's programmes**

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)

Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014

[www.mastersopenday.nl](http://www.mastersopenday.nl)

### **Factors that impact on customer satisfaction**

- **Customer satisfaction measurement:** Different organisations have used different methods to measure customer satisfaction levels. The methods used have been either direct (e.g. undertaking customer survey) or indirect (e.g. examining the profile of repurchase customers). Both indirect and direct measures recognise that the concept 'satisfaction' is a relative issue and not an absolute one. It should be said that customers are satisfied when the product or service meets their expectations.
- **Customers experience with the purchasing environment created by the seller of a product or service provider:** A customer does not only purchase a good or service but also should enjoy the experience created by the seller or service organisation. Companies should, therefore, try to understand or create and improve the selling or service experience of the customer. In the case of services, the service experience of the customer will be affected by such factors as customer-employee interactions, physical environment, responsiveness and procedures.
- **Customer care programmes:** Customer care can be delivered by staff who understand what it is. Staff, especially those in direct contact with customers, need training on how to handle customers (including the stubborn customers).
- **Issuing of customer service guidelines:** It is not enough to train staff in promising and communicating customer care, staffs need to be issued guidelines on how to handle customers.
- **Use of customer relationship management software and techniques:** Organisations that use information on customers to be able to serve their customers better consequently gain a competitive advantage. Such organisations will require undertaking customer profiling (customers' residence, age, income, education, employment, etc.), have software for account management, good front office customer records and engage in efforts of customisation of customer marketing.
- **Customer loyalty schemes:** In order to maintain customer loyalty in an increasingly competitive market, especially in retail, several organisations have introduced customer loyalty programmes. In recent times, in the UK, customers registering with loyalty schemes represented over 29 percent of the European total<sup>118</sup>. That number has been increasing. In Canada, customers have such cards for Zellers, Sears, Costco, Home Depot, and The Brick, among others. In the UK, they have cards for Sainsbury, Tesco, among others.

- Customer complaints handling: Organisations with a customer's queries or complaints desk have used them to attract and retain customers. Customers need a person to complaint to. Some complaints are simple and others are too difficult to be handled by a front office desk. So, those that cannot be handled at the front office can be forwarded to management.
- The more the company is willing to listen and attend to customers' complaints, the more the customers perceive it as friendly and customer focused. For example, customers who have had their complaints resolved are more likely to remain loyal to the company and even tell others about their experience.

### **Customer loyalty schemes and brand switching**

Customer retention schemes are important in avoiding customers switching to other brands. Switching is costly to both the customer and the seller. Switching costs are partly influenced by marketing variables of price and advertising and the relationship characteristics between the customer and the seller. If the switching costs are high and the relationship between the customer and the seller is good, the customer will be reluctant to switch. Of course, the costs of switching are not only direct, they are also indirect.

Consider a customer who has been using *Orange* company for cellular phone services for some time and that person switches, he/she will suffer the following costs:

- May lose contact with friends he/she has not informed about his/her switching;
- May lose business when those who knew the *Orange* number cannot reach him;
- The cost of informing his/her contacts is considered; and
- The cost of getting used to the system of the other new company to which the customer has switched (how to contact customer service and how to load pre-paid customers' airtime, among others).

What are the costs to the seller when customers switch?

- The loss of sales from those who have switched;
- The costs of promotions to bring on new customers; and
- The loss of free promotion usually done by loyal customers (via word-of-mouth), among others

We state that customer retention is beneficial to both the customer and the seller. We also note that customer switching is not always beneficial to the customer or the seller. It is, however, the responsibility of the seller to reduce customer switching efforts by customers.

## Relationship marketing theory

### Historical perspective

The term relationship marketing first appeared in marketing literature in 1983 when Leonard Berry presented his paper “Relationship Marketing” at the American Marketing Association’s Services Conference<sup>119</sup>. Berry defined relationship marketing as “attracting, maintaining and, in multi-service organisations, enhancing a customer relationship”. Berry further explained the importance of not only attracting the customers but keeping them. While attracting new customers is vital, more important to the service provider is transforming indifferent customers into loyal ones. He focused on relationships between organisations and customers. We can say that there are several definitions that have been given by marketing scholars<sup>120</sup>. What is key in these definitions is that relationship marketing is about attracting and keeping a relationship between a customer and the business.



The image shows the BI Norwegian Business School logo, which consists of a central blue square with the letters 'BI' in white. Surrounding this central square are numerous colorful, 3D-style rectangular bars of various colors (red, orange, yellow, green, blue, purple) that radiate outwards, creating a starburst effect. Each bar has a label for a different business program, such as 'Business', 'Strategic Marketing Management', 'International Business', 'Leadership & Organisational Psychology', 'Shipping Management', and 'Financial Economics'.

## Empowering People. Improving Business.

BI Norwegian Business School is one of Europe’s largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD  
**EQUIS**  
ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

## Approaches to Relationship Marketing

We can look at three schools of thought with regard to relationship marketing.

1. **The North-American Approach:** Parvatiyar and Sheth (2000)<sup>121</sup> have argued that it is necessary to develop an acceptable definition for an energizing discipline which encompasses all facets of the phenomenon and which also effectively delimits the domain so as to allow focused understanding and growth of knowledge in such a field. They have criticized the definition by Morgan and Hunt (1994)<sup>122</sup> for being too broad and all inclusive. They defined relationship marketing as the ongoing process of engaging in cooperative and collaborative activities and programmes with the immediate and end-user customers to enhance mutual economic value at a reduced cost.
2. **Anglo-Australian Approach:** Christopher et al, (1991<sup>123</sup>, 2002<sup>124</sup>) have emphasized three key issues.
  - Relationship marketing strategies are concerned with a broader scope of external market relationship that include suppliers, business referrals and influence sources;
  - Relationship marketing also focuses on the internal (staff) relationships critical to the success of external marketing plans; and
  - Improving marketing performance ultimately requires a resolution of the competing interests of customers, staff and shareholders by changing the way managers manage the activities of the business.

They analyse the role of customer service, quality and marketing in enhancing relationships with an organisation's customers.
3. **The Nordic School Approach:** Here we examine the contribution of the so-called Nordic School of Services and that of Nordic Authors, mainly represented by Gronroos<sup>125</sup> and Gummesson<sup>126</sup>. This school has helped to extend the notion of relationship marketing from service marketing (and industrial marketing) to general marketing theory – going ahead to define relationship marketing as the new marketing paradigm. Also the Nordic School views relationship marketing more as marketing-oriented management.

## The rise of relationship marketing

There are several factors that contributed to the rise of relationship marketing. The environmental factors that have contributed to its rise include technological change<sup>127</sup>. There is a growing trend for firms in advanced economies to be service oriented, global in nature, niche-oriented information-oriented and adopt information technology. Another factor to consider is the trend towards strategic network competition, as opposed to traditional and hierarchical competition. Network competition implies that a company is no longer competing with just company A, it is competing with company A and its partners. It means that Toyota Company will be competing with say Nissan with Nissan's partners (e.g. suppliers, advertising agencies, dealers, etc.).

### **Motivation for relationship marketing**

A good relationship should be beneficial to both the consumers and the firms. Benefits should motivate the relational exchanges in relationship marketing.

### **Why firms get involved in relational exchanges**

Firms enter into relational exchanges with other firms and consumers. Firms enter this relationship when such relationships enable them to better compete. Customers who have a good relationship with a company continue buying from it.

#### *Why consumers involve in relational exchanges*

- Consumers prefer to buy from the firms that they know and trust. Trust is related to the partner's reliability, integrity and competence.
- Past experience with the firm leads to either repurchase or rejection.
- The partnering firm shares values with consumers.
- Customers perceive that risks associated with the market offering are reduced.
- The customer experiences decreases in search costs.
- The relationship allows the customer to request customised products or services.

It should be noted, however, that there could be costs associated with such relations between firms and customers. The costs may include the monetary and time costs of co-production, the decreased prices that might result from accepting standardised market offerings, the premature exclusion of market offerings from other firms that might be even more superior; and the increased potential vulnerability of the consumer to the partner firm's opportunistic behaviour.

### **Relationship Marketing Based Strategies**

According to Hunt et al (2006)<sup>128</sup>, successful relationship marketing based strategies have been linked to improvements in cooperative advantages in the market place; superior financial performance; increased levels of customer satisfaction; organisational learning; partners' prosperity to stay; acquaintance by partners; and decreased uncertainty. They have put down a minimum of *eight types of factors that influence RM-based strategy success* as relational factors:

- resource factors;
- competence factors;
- internal marketing factors;
- information technology factors;
- market offering factors;
- historical factors; and
- public policy factors.

These authors look at resource factors as complementary and idiosyncratic; competences factors as marketing related capabilities and alliance competences; and marketing offering factors to include quality, customization and brand equity. They present Information Technology (IT) factors to include CRM, data bases and data mining. According to these authors, public policy factors include property rights, contract law and alternative governance mechanism. Historical factors include opportunistic behaviour, termination costs and relationship benefits; and relational factors include trust, commitment and co-operation, keeping promises, shared values and communication.

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



## 8 INDUSTRIAL MARKETING

Industrial marketing consists of all activities involved in the marketing of products and services to organisations (i.e. commercial enterprises, profit and not-for-profit institutions, government agencies and resellers) that use products and services in the production of consumer or industrial goods and services and to facilitate the operation of their enterprises (Reeder et al, 1999)<sup>129</sup>. The concept of industrial marketing is used to describe marketing activities targeted at all individuals and organisations that acquire products and services that are used in the production of other products and services. It is also used to describe marketing activities between organisations and reseller enterprises.

What emerges from the explanation of the concept of industrial marketing?

- 1) Customers are businesses or organisations;
- 2) Products are bought for use in the processing of other goods;
- 3) The goods bought are not consumer goods; and
- 4) The demand for goods is derived demand (their demand is dependent on the demand of the final goods to be produced out of output products or raw materials).

The products sold include capital goods (e.g. machines), output products (raw materials) and operational products (e.g. accessory equipment or supplies).

### **Factors characterising industrial marketing**

Different factors characterising industrial marketing have been given but most agree on the following<sup>130</sup>:

- i) the nature of demand which is derived demand;
- ii) small number of buyers;
- iii) the large order sizes;
- iv) product complexity;
- v) multiple buying influences (the procurement process with multiple buying influences within the DMU);
- vi) the complexity of the procurement process which is a long purchase cycle with complex decision making mechanisms involving several people;
- vii) buyer-seller interdependence; and
- viii) each purchase being unique and tailored to each buyer (customised purchases).

### **Influences on consumer behaviour**

In the consumer markets, the purchase decision is usually an individual consumer's own decision. The influences on this person's decision are personal, psychological, cultural and social factors. An individual's decision to buy can be quick and taken faster than the group (the DMU) decisions which tend to be slow and oftentimes complex. This is mainly because an individual is using his/her personal finances while the DMU is using organisation's finances and the DMU is buying for users while individuals *usually* buy for themselves. The DMU is the buying centre of the organisation and while it is composed of different officeholders, not one individual independently makes a purchase decisions of a new purchase (except for already approved routine purchases on usually not big ticket items, e.g. stationery and cleaning detergents). In a new purchase process, the organisation's decision is influenced by users, management and personal factors (age of individual members of the DMU, qualifications, experience and character). The demand for purchases under the organisation buying is derived demand, that is, a product or service is demanded for what it will help deliver. For example, the demand for cotton thread is derived from what that thread will help to make, that is, cotton material products (e.g. shirts, dresses, suits, etc.). The relationship between an individual buyer and the selling organisation is usually transactional (one-off) while that between a buying organisation and the selling organisation is usually long-term.

### **The buying process**

*The buying organisation:* There are three groups of buyers which can be targeted by the industrial marketers with their products.

- a) **Manufacturers:** These usually buy raw materials, components and finished items. The manufacturers tend to be geographically concentrated (at times in industrial areas/zones). They buy in relatively larger quantities and their purchase decisions are taken by a selected number of people.
- b) **Intermediate customers:** These are channel members or resellers, who buy and sell to make a margin or profit. Some make some changes to the product they sell (such as repackaging them).
- c) **Public institutions:** organisations such as hospitals, prisons, police, fire department and schools are another category of buyers of industrial products.

## Classification of industrial customers and industrial products

To be able to plan the marketing mix, the industrial marketer needs to classify the industrial goods. Classification will help the marketer get a better scope of the target market by knowing who is involved in the purchasing process and what marketing factors influence the buying decision. Reeder et al (1999)<sup>131</sup> has classified industrial goods into three broad classifications:

- i) Materials and parts – goods that enter production directly;
- ii) Capital items – goods that affect the cost structure of the firm; and
- iii) Supplies and services – goods that facilitate the firm's operations.

We can also have the three broad classifications as

- iv) Capital goods (e.g. machines, buildings, land, etc.);
- v) Operational goods (supplies, maintenance services, accessory equipment);
- vi) Output products (e.g. raw materials, components, production services).

**Materials and parts:** These are goods that enter the product directly and consist of raw materials, manufactured materials and component parts.



**Brain power**

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)

**SKF**

**Capital items:** These are the items used in the production process and they wear-out overtime. They are treated as a depreciation expense by the buying organisation. They consist of installations and accessory equipment. Installations are long-term investment items of a firm such as factories and office buildings and fixed equipment such as generators, computers, furnaces, etc. Accessories are light equipment and tools (such as portable power drills, fixers, etc.).

**Supplies and services:** Supplies and services support the operation of the purchasing firm and are usually treated as operating expense items for the periods in which they are consumed. Supplies include such items as soap, washing powder, paper, toilet paper, etc. that are required by any organisation for their day-to-day operations.

**Services** are required by organisations to accomplish their manufacturing and selling objectives. Organisations require a wide range of services categorised as operating, maintenance and repair services.

### **Unique characteristics of organisational buying**

Unlike consumer markets, industrial market buyers are characterised by

- i) multiple influences; and
- ii) technical sophistication.

With the exception of very small organisations, purchase decisions are never a 'one-man' decision. The decision to purchase is usually shared by several people, i.e. the members of the DMU.

**Organisational buying and buyer behaviour:** Industrial buyers have been reputed for making rational purchase decisions and going through a number of clearly defined stages in their decision making process. The stages in the decision making process and the influence of the purchase situations are described in the marketing literature by the model referred to as the *Buygrid Model*.

### **The Buy grid model**

This is a conceptual model which describes the different combinations of buying phases and buying situations. It incorporates three types of buying situations:

- i) New task;
- ii) Straight rebuy; and
- iii) Modified rebuy and the eight phases in the buying decision process.

## Buying situations

- 1) **New task:** It is a buying situation in which the organisation purchases a product or service for the first time. In the new task buying situation, the buyer seeks a variety of information to explore alternative solutions before a purchase decision can be made. The greater the cost (or perceived risk) related to the potential purchase, the higher the need for information and the larger the number of people involved in the DMU.
- 2) **Modified rebuy:** This is a buying situation in which the organisational buyer wants to replace a product or service that the organisation has been using. Decision making may involve plans to modify the product specifications prices, terms or suppliers. This is the case when managers of an organisation feel that significant benefits such as quality improvements or cost reduction can be achieved by making the change. The fact that the organisation has previous experience with the purchase and use of the product means that the decision criteria may be well defined in such situations. Still, there is the perceived risk that the new supplier may perform poorer than the current supplier. The modified rebuy situation is most likely to occur when the organisation is not happy with the performance of the present supply. The decision making unit is usually smaller than in the new task situation.
- 3) **Straight rebuy:** It is the buying situation in which the buyer is making continuing or recurring orders of a product or service without any modification. This is the most common buying situation in industrial purchasing. Organisational buyers usually have well developed criteria that have been used in the previous purchases. Most buyers' criteria consist of prompt delivery, consistent quality, reasonable price and good after sales services. New suppliers can only be considered if these conditions change.

## Phases in purchase decision process

Organisational purchase decisions are expected to go through a set of phases. *The purchases in the new task situations are supposed to go through eight phases*, although the number of phases and their relative importance may decrease in the case of the modified rebuy and straight rebuy purchase situations.

### **Phase 1: Anticipation or recognition of a problem (need)**

The purchase decision is triggered by the buying organisation's recognition of a need, problem or potential opportunity. The trigger may either be internal (e.g. declining efficiency due to outmoded technology) or external (e.g. new information from a potential supplier of a superior quality performance equipment). This is a phase in the purchase decision process where the information a vendor provides is critical since the organisation is in wide search for solutions to the problem identified. The marketers' involvement at this stage offers him/her an advantage over the competing suppliers.

### **Phase 2: Determining the characteristics and quantity of the needed items**

Having acknowledged the problem, the next step is to explore alternative solutions, analyse and evaluate alternative solutions and analyse and evaluate them. It is at this stage that such questions relating to types of goods and services to be brought, application requirements and performance specifications are asked. The department which is the user of the product to be purchased is the most prominent at this stage. The questions and advice of the user department's staff receives due attention.

## **TURN TO THE EXPERTS FOR SUBSCRIPTION CONSULTANCY**

**Subscribe is one of the leading companies in Europe when it comes to innovation and business development within subscription businesses.**

**We innovate new subscription business models or improve existing ones. We do business reviews of existing subscription businesses and we develop acquisition and retention strategies.**

**Learn more at [linkedin.com/company/subscribe](https://www.linkedin.com/company/subscribe) or contact  
Managing Director Morten Suhr Hansen at [mha@subscribe.dk](mailto:mha@subscribe.dk)**

**SUBSCR**✓**BE** - *to the future*

### **Phase 3: Description of the characteristics and quantity of the needed item**

This is usually the most critical phase for the marketer. It is at this stage that those people who prepare or influence the decision on the specifications enter the purchasing process.

### **Phase 4: Search for and qualification of potential sources**

Once the organisation has identified the solution, it begins to search for alternative sources of supply. In purchasing, this stage is about prequalification of suppliers. A list is made from which using different tendering (procurement) methods; the seller will enter the contract to supply the goods. This is the stage where vendors are selected.

### **Phase 5: Acquisition and analysis of proposals**

In this phase, requests for proposals from qualified vendors will be made. In straight rebuy situations, the current vendor will be the only supplier that the buyer will contact. In the case of modified rebuy situations, there will be the need to analyse incoming proposals critically before making a final decision. The analysis of suppliers' proposals is more elaborate in the case of a new task situation.

Phase 4 and 5 may occur simultaneously in a straight rebuy (where buyers may only check a catalogue or contact suppliers to obtain update information about prices and delivery schedules).

### **Phase 6: Evaluation of proposals and selection of suppliers**

At this level, the decision making unit carefully compares the various proposals in terms of the criteria already agreed upon. The buyer selects a few proposals and initiates negotiations with the vendors concerned. Negotiations are usually on supplier terms, prices, deliveries and other aspects of the suppliers' offer.

### **Phase 7: Selection of an order routine**

An order is placed with the selected vendor and the delivery and the payment conditions are specified. The purchase process is completed when the ordered item is delivered and has been accepted for use. At this level, the user department's voice is very important because user staff evaluation determines how successful the purchase has been.

### **Phase 8: Performance feedback and evaluation**

This is the phase in which the performance of the product is matched against the expectations of the user department in order to determine the gap (if any between them). This phase involves the user department's evaluation as to whether the purchased item solved the original problem.

You may look at the procurement process under the chapter on procurement for further details.

**The Buying Centre:** Let us state the obvious: *companies do not buy, people do*. It is, therefore, important for the industrial marketer to identify those people who are involved in the buying decision processes of goods and/or services that organisations are vending. Those individuals involved in the buying decision making process as a group are referred to as the DMU.

### **The roles of buying centre members**

In most of the marketing literature, buying managers are known to assume some roles in the purchase decision making process. Webster and Wind (1972)<sup>132</sup> suggested four major roles (users, influencers, deciders and gatekeepers) and these been expanded to six.

- 1) The initiators: An individual or group of individuals who become aware of an organisation problem and recognise that it can be solved by buying a certain product or service.
- 2) The gate keepers: The organisational members who control the flow of information into the buying centre. They can control printed information, advertisements and which sales persons are allowed to speak to individuals within the buying centre.
- 3) Influencers: These are individuals *inside or outside* the organisation who directly or indirectly influence purchase decision either by providing information on vendor evaluation criteria or establishing product specifications. Such people in a manufacturing concern include technical staff and examples include engineers, quality controllers and IT persons.
- 4) The deciders: These are organisational members who have authority (formal or informal) to make the actual purchase decision. They are decision-makers in an organisation. In routine purchase of sundries or standard items, the buyer is usually the decider but where the purchase is big and complex, group decision may be required. Group decisions help to avoid personal responsibility in case of product performance problems or failure.

- 5) The buyers (procurement personnel): These are organisational members with formal authority in the selection of suppliers and in making arrangements for the delivery of the goods. They are also directly involved in negotiating the conditions of the transactions.
- 6) The users: These are the organisational members who actually make use of the products or services purchased in their normal working processes.

### Factors that influence the buying process of an organisation

The factors that influence the buying process of an organisation can be grouped into three:

- i) the environment;
- ii) the organisation; and
- iii) the DMU.

**Environmental influences:** These are economic, technological, physical, political, legal and cultural forces. Environmental influences are subtle but difficult to identify and to measure. These forces influence the buying process by providing information but also constraints and opportunities. These forces pose challenges for the marketer who must carefully appraise each of them.



What do you want to do?

No matter what you want out of your future career, an employer with a broad range of operations in a load of countries will always be the ticket. Working within the Volvo Group means more than 100,000 friends and colleagues in more than 185 countries all over the world. We offer graduates great career opportunities – check out the Career section at our web site [www.volvogroup.com](http://www.volvogroup.com). We look forward to getting to know you!

**VOLVO**  
AB Volvo (publ)  
[www.volvogroup.com](http://www.volvogroup.com)

VOLVO TRUCKS | RENAULT TRUCKS | MACK TRUCKS | VOLVO BUSES | VOLVO CONSTRUCTION EQUIPMENT | VOLVO PENTA | VOLVO AERO | VOLVO IT  
VOLVO FINANCIAL SERVICES | VOLVO 3P | VOLVO POWERTRAIN | VOLVO PARTS | VOLVO TECHNOLOGY | VOLVO LOGISTICS | BUSINESS AREA ASIA

**Organisational influences:** These factors cause individuals to act differently than they would if they were functioning in a different organisation. Organisational buying behaviour is motivated and directed by the organisation's goals and is constrained by its financial, technological and human resources. We can use Leavitt's classification of variables (tasks, structure, technology and people) for understanding the influence of formal organisation on buying process. According to Leavitt (1964)<sup>133</sup> organisations are multivariate systems composed of four sets of interactive variables – tasks, structures, technology and people.

**Social (Interpersonal) influences:** Members of buying centre are influenced by their interaction with each other and with “outsiders” such as vendors or sales people. This is a dyadic interpersonal relationship between the members themselves and the suppliers' staff – the marketers. Group functioning is influenced by five classes of variables:

- a) The individual members' goals and personal characteristics.
- b) The nature of leadership within the group
- c) The structure of the group
- d) The tasks performed by the group
- e) External influences – organisational and environmental

**The influence of the individual:** In the final analysis, all organisational buying behaviour is individual behaviour. Only the individual as an individual or a member of a group can analyse buying situations, decide and act (Webster et al, 1972)<sup>134</sup>. The individual is at the centre of the buying process. The individual is motivated by a combination of both personal and organisational objectives and influenced by other members of the buying centre – and constrained by organisational policies and information gathered through the formal organisation. It is usually the specific individual who is the target for marketing effort and not the organisation, which is an abstract. The organisational buyer's personality, perceived role set, cognition and learning are the basic psychological processes that affect his/her response to the potential vendors.

### **Objectives in organisational buying**

### **Models of industrial buyer behaviour**

Many models have been developed to explain organisational buyer behaviour. Buyer-behaviour models give a common and useful point for undertaking and influencing buying behaviour in industrial markets. We will look at two models: The **Sheth model** and **Webster and Wind model**.

### Webster and Wind, 1972 Model:

**A General Model for Understanding organisational Buying Behaviour:** The background to this model is that industrial buying takes place in the context of a formal organisation influenced by the budget, cost and profit considerations<sup>135</sup>. The authors present a “general model” and state that it can be applied to all organisational buying. They also caution that it, like any other model, suffers all the weaknesses of general models. It does not describe a specific buying situation in the richness of detail required to make a model operational and it cannot be quantified<sup>136</sup>. However, this general model offers a compensating set of benefits that general models offer. The model gives a comprehensive overview of organisational buying that can enable a person to evaluate the relevance of specific variables and, thereby, permits greater insight into the basic processes of industrial buying behaviour. The model asserts that organisational buying is a decision making process carried out by individuals, in interaction with other people, in the context of a formal organisation. The organisation, in turn, is influenced by several forces in the environment. They have categorised the variables determining organisational buying behaviour into four classes:

- i. individual;
- ii. social;
- iii. organisational; and
- iv. environmental variables.

*These have already been covered above.* Within each of the four classes of variables, there are two broad categories of variables. The first category has those that are directly related to the buying problem called *task variables*. The second category has those that extend beyond the buying problem, which are called *non-task variables*.

Task variables: price; services; quality; assurance of supply; etc.	Non-task variables: status; promotions; salaries increases; increased job security; social interaction; etc.
---	--

**The Sheth Model:** The Sheth model<sup>137</sup> describes the complex relationship involving the large number of variables and competing relationships among them. It is a generic model which tries to describe and explain all types of industrial buying decisions. While the model seems complicated, it is very useful in examining organisational buying behaviour from the following viewpoints:

- The conditions that precipitate joint decision-making;
- The psychological world of the decision-makers; and
- The inevitable conflict among those involved in the decision process and the resolution of this conflict.

**Psychological world of the decision makers:** There are several different aspects of the psychology of the decision makers:

**Expectations of the decision makers about suppliers' brands:** The Sheth model specifies five different processes which create differential expectations among the individuals involved in the purchase process:

- i) the background of individuals;
- ii) information sources;
- iii) active search; iv) perceptual distortion; and
- iv) satisfaction with past purchases.

**gaiTeye**<sup>®</sup>  
*Challenge the way we run*

**EXPERIENCE THE POWER OF  
FULL ENGAGEMENT...**

.....

**RUN FASTER.  
RUN LONGER..  
RUN EASIER...**

**READ MORE & PRE-ORDER TODAY  
[WWW.GAITEYE.COM](http://WWW.GAITEYE.COM)**

*Expectations:* In this model, expectations refer to the perceived potential of alternative suppliers and brands to satisfy a number of explicit and implicit objectives in any particular buying decision. Explicit objectives include product quality, delivery time, quality of supply, after sales service (where appropriate) and price. Implicit objectives include reputation, size, location, reciprocity relationship with the supplier, personality, technical expertise, salesmanship and style of the salesperson. Expectations can be measured by obtaining a profile of each supplier or brand and assess how satisfactory that profile is perceived to be enabling the decision maker to achieve his/her explicit and implicit objectives. Most studies have shown that expectations vary substantially among the members of the DMU (purchasing personal, engineers, product users, etc.).

*Background of individuals:* The background and task orientation of each of the individuals in the buying centre matters in the purchase decisions. The different educational backgrounds (such as engineers, plant managers, economists, accountants, and procurement specialists) usually generate substantially different professional goals and values. The lifestyle of individual decision makers too influences their expectations.

## Marketing Mix Strategies in Industrial Marketing

4 Ps: Product; Price; Promotion; Place (distribution)

**Industrial marketing channels:** Marketing channels (also called trade channels or distribution channels) are those interdependent organisations involved in the process of making a product or services available to end users<sup>138</sup>. Channel members are vital to business success. Management guru Peter Drucker<sup>139</sup> predicted that in the twenty first century business, the biggest change would not be in new methods of production or consumption but in distribution channels (Doyle and Lowe, 1998<sup>140</sup>). Distribution is an essential element in the product offering of the industrial marketer. Distribution has two related but distinct meanings in industrial marketing:

- Distribution includes resellers who buy and sell the product as it moves along the channels of distribution
- Distribution includes physical distribution – the movement and storage of products as they move from the manufacturer to the end user.

The first meaning is usually called the **marketing channel** while the second one is known as **logistics**.

### **Key functions of the marketing channels**

Members of the marketing channel perform the following functions:

- 1) Gathering information about potential and current customers, competitors and other information on the competition.
- 2) Develop and implement promotions (advertisement, personal selling and sales promotion) to increase sales.
- 3) Acquire funds to finance inventories at different levels in the marketing channel.
- 4) Assume business risks associated with carrying out channel work.
- 5) Store the goods from the manufacturer and sometimes transport the physical goods from their storage to end users.
- 6) Give credit terms to the final customer of the manufacturer's goods.
- 7) Advise the manufacturer about the trends in the market of their products.
- 8) Advise customers on the functionality of the goods.

### **The nature of industrial marketing channels:**

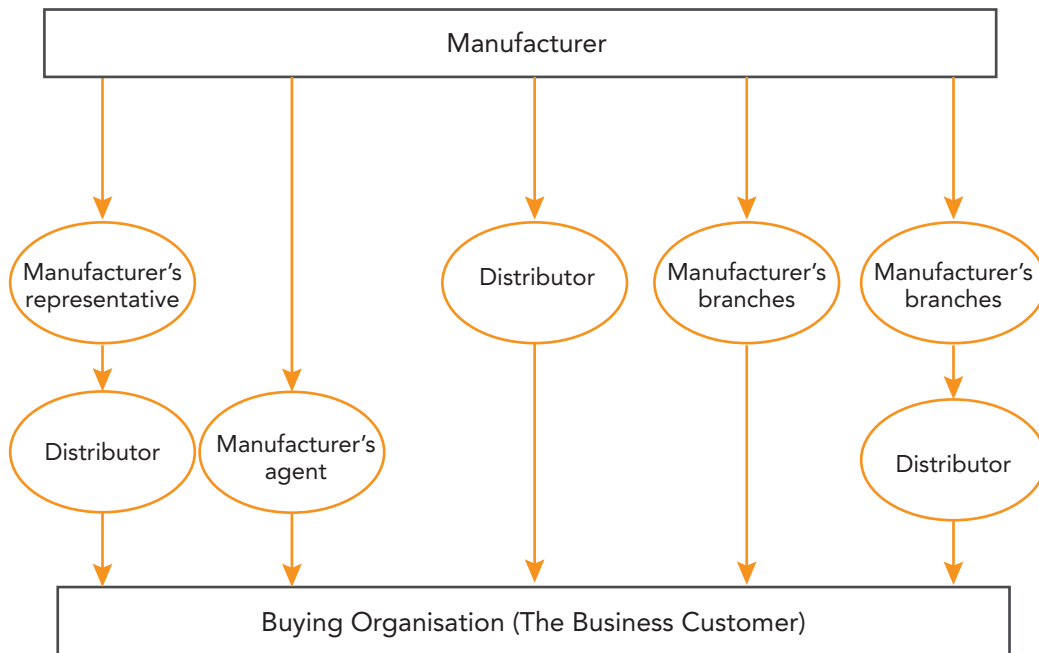
The following characterise industrial marketing channels:

- i) Fewer customer outlets than consumer goods;
- ii) Fewer in number and except for such products as office supplies, there is no need for extensive distribution;
- iii) Most commonly direct-to-user marketing channels; and
- iv) Requires a high level of technical expertise which demands investments in physical facilities and training and can only be made on selective basis.

### **Number of levels in the distribution channel**

The alternatives that are available to the selling organisation are often limited to not more than two to three choices:

- i) Going direct to the end user (two level);
- ii) Using one intermediary (three level); and
- iii) Using two intermediaries (four level).



**Figure 5:** Illustration of the channel choices

This e-book  
is made with  
**SetaPDF**



PDF components for PHP developers

[www.setasign.com](http://www.setasign.com)

## Choosing the right distributor

The decision to appoint an independent distributor requires the manufacturer to consider some key issues with regard to the potential relationship. These issues include:

- i) The marketing functions that the manufacturer will assign to or share with the distributor. Not all the customers will be assigned or served by the distributor. Fewer but large customers will be handled directly by the manufacturer. The remaining customers are assigned to the available distributors.
- ii) Distributor size: The manufacturer has to make a careful decision on the size of the distributor (in terms of money worthiness, number of employees, number of locations, etc.). Depending on the size of the manufacturer, the selection of a big or small distributor will have future repercussions on how the end users perceive good or bad service.
- iii) Product lines coverage: At times it is necessary to let the distributor handle generic product models and leave specialised (or customised) product orders to the staff of the manufacturer. It is also important to always consider how many product lines the distributor is handling. It is vital for a manufacturer to minimise the fragmentation of their product lines. It would be beneficial to find a distributor who can as well stock the complimentary products of a manufacturer. These products are supposed to be jointly demanded.
- iv) Type of distributor: It should be noted that even though all distributors perform the same primary functions (e.g. inventory, selling and providing credit), the choice of the distributor should move beyond those primary roles. The right distributor must satisfy the goals of the manufacturer's marketing objectives and (fit in) the strategic objectives. These objectives include the manufacturer's market coverage, requirements for market development, production concentration and the need to provide good after sales services.
- v) Distribution policies: The manufacturer's distribution policies (whether exclusive or intensive) will influence the decision to choose the distributor.

## Industrial marketing communications

### Tools of industrial marketing communications

- Personal selling
- Advertising
- Sales promotion
- Public relations; and publicity
- Direct marketing
- Internet (via websites)

**Personal selling** is the most dominant tool in industrial marketing communications strategy. However, advertising, sales promotion as well as public relations and publicity are also vital in promoting industrial products.

**Advertising:** Advertising is never employed by itself in industrial marketing. The complexity of industrial products, the buyers' expectations and the uniqueness of information required, usually requires personal contact (the role of personal selling). But there is need to identify the role of advertising in industrial markets. Advertising:

- i) Is an effective means of reaching inaccessible (or even known) buying influences;
- ii) Creates product awareness;
- iii) Enhances the sales call effectiveness (This is especially good in "cold calls");
- iv) Increases the overall efficiency of the selling effort; and
- v) Creates and maintains demand at the distributor level (by supporting channel members).

*Industrial advertising media:* It has always been common for the industrial marketers to use trade publications, business magazines and industry directories. Sometimes, however, depending on their advertising objectives, industrial marketers also use direct marketing (like direct mail, catalogues and telemarketing).

**Sales promotion:** In industrial marketing, there is use of sales promotion as well. Sales promotion is in form of trade shows, exhibitions at a trade fair, premium incentives and specialty advertising. Promotional contests and give-aways are not common in industrial marketing but they are sometimes used to promote products. Specialty advertising refers to a situation where a manufacturer gives for free useful but low cost promotional products such as calendars, pens, cigarette lighter, key holders, caps, ash trays or other gifts given to prospects by sales people. These gifts have a name and address on it and at times have an advertising message that is why it is classified as specialty advertising.

**Publicity:** Publicity is a highly effective tool for promoting an organisation. This has high credibility at a low cost. Favourable and positive publicity promotes an organisation more times than advertising. Advertising is perceived as "selling" oneself. Publicity is seen as credible and, therefore, believable. Audiences have their views on a paid for message. A favourable editorial about a company and/or its products can generate sales leads and bring about better relationship between a company and its customers.

## Pricing policies for industrial goods

Price is the revenue earning element of the marketing mix. Price is important in marketing strategies of the organisation. Once goods have been produced, they have to be sold. A price has to be decided. This price is influenced by three factors – costs, competition and demand.

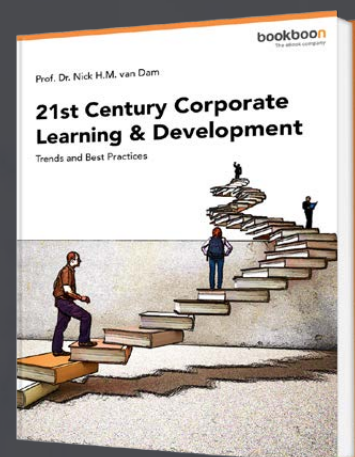
**The effect of the right price:** A company's profitability (and profitability is important for success) in the short and long run mainly depends on the pricing of its products and/or services. The right price can boost profits at times faster than increasing the volume. The wrong price does the opposite. Evidence shows that a 1 (one) percent increase in price with constant volume yields an 11.1 percent increase in operating profit and an increase in volume of 1 percent with constant price gives 3.3 percent better result in the operating profit<sup>141</sup>. Setting prices is, therefore, one important aspect of the company's marketing decision making.

**Price strategy:** These are the main types of influence on price setting in practice. There is no specific approach to deciding the price of industrial products. Such a decision will depend on the considerations of customer demand, the nature of derived demand, cost, profit calculations and competition.

# Free eBook on Learning & Development

By the Chief Learning Officer of McKinsey

Download Now



**Pricing approaches:** We examine four pricing approaches. The approaches are cost-oriented, demand-oriented and competition oriented and market oriented approach<sup>142</sup>.

- i) **Cost oriented pricing:** In practice, cost is the important influence on price. Price can be based on estimating all cost (whether variable or fixed) attributed to a product and then adding a profit margin (a desirable mark-up). Many firms base product prices on this simple cost plus approach. Cost oriented pricing is used by companies because it is easy to justify to the customers. Companies use readily available data from the company's accounts department to determine the price.
- ii) **Demand oriented pricing:** The Company looks beyond the cost of the product and instead bases its price on the intensity of demand. A strong demand may lead to a high price and a weak demand may lead to reducing price. In industrial marketing, the order quantity will determine the price charged per unit. Purchases of more units of a product may attract a lower price than purchases of few units. Price is a result of negotiations.
- iii) **Competition oriented pricing:**  
The company can then set a price that is either lower, higher or the same as that of the competitors.  
This approach is to base price on the competitor's price. To set the price basing on the competitor's price requires a thorough knowledge of competitor's price. The next step is to evaluate the company's own products (their unique features and attributes), the relative weaknesses or strengths of its competitive position and the competitors, the company can then set a price that is either lower, higher or the same as that of the competitors. Therefore, the price set will be influenced by the anticipated reactions of competitors to the pricing decisions. For undifferentiated products, price reductions on such products usually lead all suppliers to reduce their price.
- iv) **Market-oriented pricing:** In modern marketing management, a market orientation to pricing, promotion and distribution is vital. Under this approach, price is determined by considering the strategic and tactical trade-offs in the market-oriented focus on customers. Determination of price is more difficult than under the cost-oriented or competitor-oriented approach because several factors have to be considered before the price is arrived at. These factors include the marketing strategy, price-quality relationship, costs, price effects on distributors, etc.

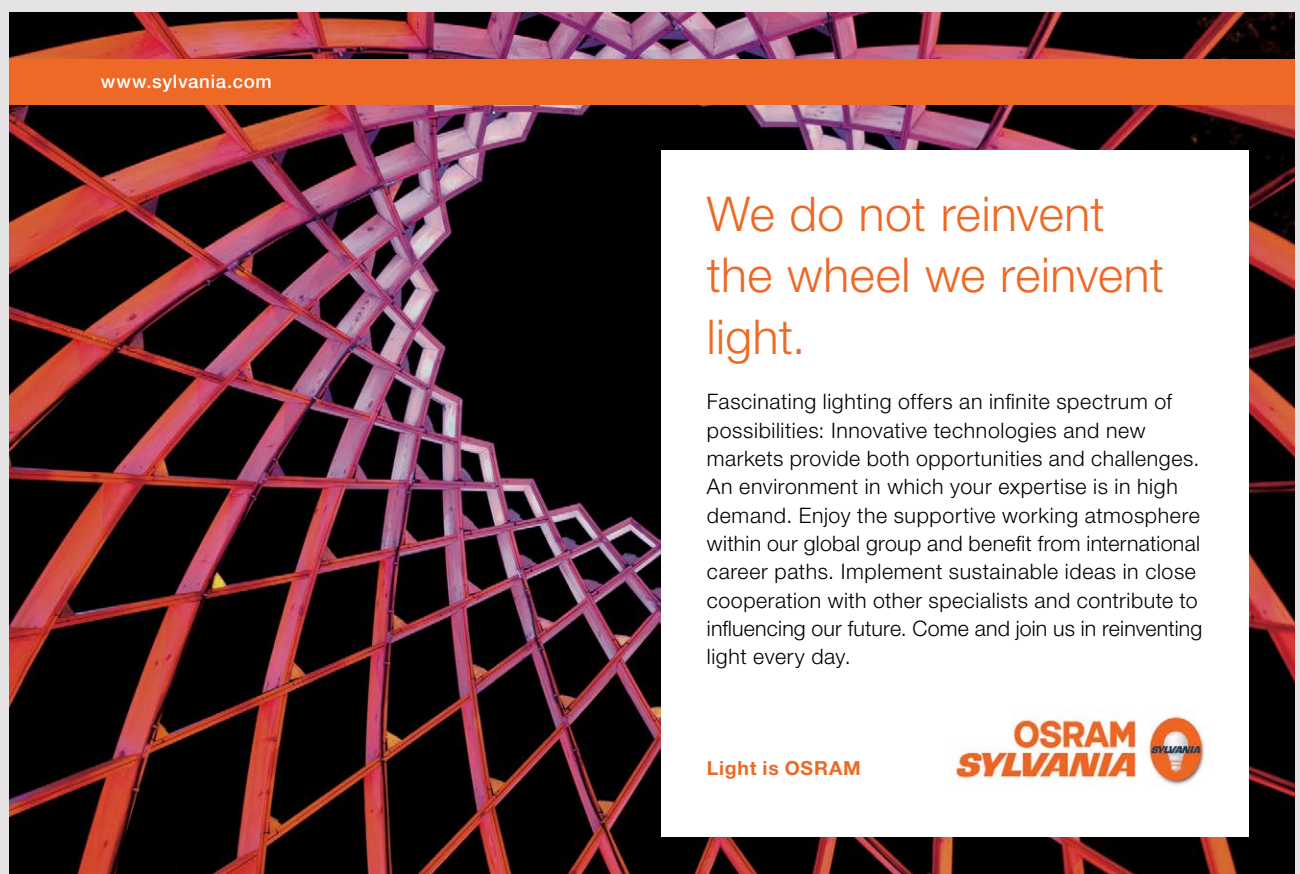
**Pricing objectives:** Pricing objectives are the basis for the formulation of the pricing strategy. In industrial markets, companies commonly use variations of the following five pricing objectives.

1. **Maximising profits:** In economic theory, companies in a competitive environment, seek to maximise profits. Profit maximisation is, therefore, a normal goal for a company.
2. **Maintaining or increasing market share:** Market share is sought as a goal because companies that have a large share of their particular markets are more likely to be profitable than competitors in the same market. In the short run, a company whose objective is market leadership may not earn ample profits – but it will in the long run. It may intensively use a penetration pricing strategy.
3. **Stabilizing prices:** This is a policy which attempts to keep company prices stable in the long run. Minor changes in the price of variable costs (raw materials, power, water, labour, etc.) will not make the company change the price of its products. Such a policy helps a company to build public trust, enjoy goodwill and popularity.
4. **Follow the competitor:** Companies which have no set price policy simply determine prices by either following or beating the competitors' prices. Such companies are usually small and would rather follow a price leader or large company in the case where the product is undifferentiated or fairly standardised.
5. **Long term survival:** This is usually a short time objective where a firm can put in place a price that will just allow it to stay in business and cover essential costs. In the short time, the firm will ignore the goal of profit maximisation for the goal of survival. When the situation that has initiated the use of survival pricing has passed, the prices are retuned to more appropriate levels.
6. **Sales maximisation:** Seeking to maximise the number of items sold. This objective may be chosen where the firm wants to have an underlying goal of taking advantage of economies of scale that the sales of products or services be realised in the production or sales areas.
7. **Sales revenue maximisation:** seeking to maximise revenue from the sale of products without regard to profit. This objective may be important when introducing a new product into the market where the firm is aiming at growing the market share and establishing long term customer base.
8. **Price differentiation:** This is a price mainly used to achieve service quality. It can be used to offer same products or services to different market segments. You have different prices on the same plain for different prices – first class, second class and economy.
9. **Price stability in the market:** It is always not good to engage in price wars. Sometimes firms charge prices to maintain 'peace' in the market.
10. **Price-Quality leadership:** This objective is used to signal product quality to the customer by placing the prices on products that convey their quality. For example, this is where price of quality and ostentation products are usually assigned higher prices than others.

## Pricing strategies

Pricing strategies must always be formulated bearing in mind the overall corporate objectives and the marketing strategy. The overall corporate objectives are normally concerned with the company's long-run growth, profit and survival. Price is important for business profit, growth and survival. The pricing strategy, therefore, is used to accomplish the business objectives. This pricing strategy statement guides all of the company's pricing decisions for a particular product line for a particular period. It is, therefore, true that a company with many product lines can have several pricing strategies but it must, however, be consistent with one another and with the overall marketing strategy. Most researchers and scholars have identified a number of strategies but most have focused on the following:

- i) **Market skimming:** This strategy involves setting a high initial price for a new product (an innovation or a desirable variation) in order to take advantage of those buyers who are willing to pay such a price and then gradually reducing it overtime. A company can initially set a **premium price** and then gradually reduce it to attract more buyers. This strategy can be seen as a good example of price discrimination overtime (*price discrimination is covered under the pricing structure*). This strategy helps a company generate greater profits per unit earlier during product introduction and also helps the company to cover the costs of developing and promoting the new product.




www.sylvania.com

We do not reinvent  
the wheel we reinvent  
light.

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

OSRAM  
SYLVANIA



- ii) **Market penetration:** The firm sets a relatively low price designed to stimulate demand and, thereby, achieve a large market share. This strategy works well if the demand for the product is elastic. When the price elasticity of demand for the product is high enough, the lower price will result in more sales (and a large increase in sales volume) and vice versa.
- iii) **Intermediate price:** Skimming and penetration strategies are only guides and cannot be applied in all situations<sup>143</sup>. An intermediate price can be set between a high or low initial price. This price should consider such factors as cost, appropriate marketing strategies, competition and the market segment to be served.

**Pricing structure:** The pricing structure is concerned with which aspects of each product or service will be priced, how prices will vary for different customers and products or services and the time and conditions of payment. The simplest pricing structure would be where a company charges one uniform price for a product or services with no discounts or price variations. However, such a pricing structure may not help a company operating in a competitive environment (to take advantage of new profit opportunities in the market).

**Price differentials:** There can be price differentiation in the form of quantity discounts, trade discounts, cash discounts, promotional discounts and seasonal discounts.

- i) **Quantity discount:** A reduction in suggested price is based on the number of units bought or the monetary value of the purchase.
- ii) **Trade discount:** Given to distributors to cover the operating costs they incur in providing sales effort and other inventory and marketing activities.
- iii) **Cash discounts:** Given to customers to encourage them to pay quickly for the goods. The purpose of allowing a customer a reduction in the cost price is to encourage quick payment so that a company can maintain a better cash flow.
- iv) **Promotional discounts:** Given to dealers or distributors as a form of efforts undertaken by them in promoting a manufacturer's product.
- v) **Seasonal discounts:** Reductions from the cost price to encourage buyers to make orders early in the season or in the off-season.
- vi) **Geographical pricing:** The price of a product in one location may be different from the price in another location. This is due to the costs of shipping and handling among other factors. The taxes in one location may also be different from those in another location.

## 9 INTERNATIONAL MARKETING

*What is international marketing?*

We can refer to international marketing as the management process responsible for identifying, anticipating and satisfying customer's needs and wants profitably. This is an adaptation of CIM definition of marketing. According to Doole and Lowe (2008)<sup>144</sup>, international marketing involves the firm in making one or more marketing mix decisions across national boundaries. International marketing involves buyers and consumers across borders. It also involves the marketing strategies that companies undertakes to succeed in the international marketing environment. Decisions have to be taken by companies with regard to either standardising or adapting the marketing mix strategies (price, product, place and promotion) for products and add processes, physical evidence and people for services. Some companies choose to run a franchise, others prefer licensing agreements and yet others decide to establish processing facilities in their various countries of operation. It should be noted that how international marketing is defined and interpreted depends on the level of involvement of the company in the international market place. Thus, international marketing could be export marketing, international marketing or global marketing.

Doole and Lowe (2008) distinguish international marketing from global marketing. International marketing involves operating across a number of foreign country markets in which not only do the uncontrollable variables differ significantly between one market and another, but the controllable factors in the form of cost and price structures, opportunities for advertising and distributive infrastructure are also likely to differ significantly<sup>145</sup>. Global marketing management is a larger and complex international operation. Here a company coordinates, integrates and controls a whole series of marketing programmes into a substantial global effort<sup>146</sup>. The primary objective of the company is to achieve a degree of synergy in the overall operation so that by taking advantage of different exchange rates, tax rates, labour rates, skill levels and market opportunities, the organisation as a whole will be greater than the sum of its parts.

### **How companies go international:**

Paliwoda and Thomas<sup>147</sup> present five reasons how companies go international and we briefly explain them here.

- 1) Product maturity: The product life cycle stage at home may be at the mature stage whereas there may be new markets abroad enabling the product to start a new life cycle again.
- 2) Competition: Stiff competition may drive a firm abroad. There may be less intense competition abroad than at home.

- 3) Excess capacity utilization: Where on a given manufactured item which has been on sale in the domestic market for sufficiently long to have recouped its original research and development costs may find new export markets at a price that only includes actual production costs plus overhead. This may, however, attract legal battles since the product may be sold at a price cheaper than in the domestic market. The company may be open to charges of dumping.
- 4) Geographical diversification: Geographical diversification may be preferable to product-line diversification. Finding new or modified products does not expose the company to the attendant risks of expanding the product range simultaneously with foreign market entry.
- 5) Potential of a population's purchasing power: Markets may be local, regional, national, international or even global.

### Understanding international markets

There are various models used in scanning the environment with regard to international marketing. We will look at two environmental analysis models: **SLEPT** and 'C' factors:

- SLEPT: Socio-cultural, legal, economic, political and technological factors.
- C factors: Corporation, Countries, Currency and Competitors.



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.

**Social/cultural factors:** In international marketing, social and cultural factors influence consumer-buyer behaviour. Differences in the market's social conditions, religion and beliefs as well as in material culture influence perceptions and attitude ultimately affect individual's product choice decisions. Social/cultural factors include the family structures, family size, age structure, religion, language, artifacts and aesthetics.

**Family structure:** The role of the family and family groupings varies from society to society. In Africa where they have extended families, the bread winner is likely to buy more quantities of food for the family than where there are nucleus families. We note that family size varies depending on how developed a society is. In the EU and USA, there are small size families. It is most common to find a family of three – mother, father and one child. In Sub-Saharan Africa, you find large families some exceeding ten members! At different stages of *family life cycle (FLC)*, people demand different products. In developed countries, markets have often used the FLC model to target consumers at different stages. The FLC has five stages:

- i) Bachelor or spinster – Single person;
- ii) Newly-weds;
- iii) Full Nest;
- iv) Empty nest – Children have left the home of their parents (usually after reaching age 18 in developed countries); and
- v) Solitary survivor (widow or widower).

**Culture:** Cultural aspects have a big influence on individuals' buyer behaviour. The components of cultures are religion, language, education, values and attitudes, law and politics, social organisation and technology and material culture. Let us take the example of religion. It can affect market entry where there are religious conflict, marketing organisation with regard to days of prayer, goods via type of clothes worn and types of food eaten, promotion (for example which images can be shown) and methods of doing business (e.g. Islamic banking).

<p><i>Religion</i></p> <ul style="list-style-type: none"> <li>- Sacred objects</li> <li>- Beliefs and norms</li> <li>- Prayer</li> <li>- Taboos</li> <li>- Rituals</li> <li>- Holidays</li> </ul>	<p><i>Language</i></p> <ul style="list-style-type: none"> <li>- Spoken language</li> <li>- Written language</li> <li>- Official language</li> <li>- Language hierarchy</li> <li>- Linguistic language</li> <li>- Mass media</li> </ul>	<p><i>Values and attitudes</i></p> <ul style="list-style-type: none"> <li>- Design</li> <li>- Colour</li> <li>- Music</li> <li>- Beauty</li> <li>- Architecture</li> <li>- Good taste</li> </ul>
<p><i>Law and politics</i></p> <ul style="list-style-type: none"> <li>- Domestic country law</li> <li>- Foreign law</li> <li>- International law</li> <li>- Regulations</li> <li>- Political risk</li> <li>- Ideologies</li> </ul>	<p><i>Social organisation</i></p> <ul style="list-style-type: none"> <li>- Kinship</li> <li>- Social institutions</li> <li>- Authority structures</li> <li>- Interest groups</li> <li>- Social mobility</li> <li>- Status systems</li> </ul>	<p><i>Material culture</i></p> <ul style="list-style-type: none"> <li>- Transportation</li> <li>- Tools and objects</li> <li>- Urbanization</li> <li>- Science</li> <li>- Invention</li> </ul>
	<p><i>Education</i></p> <ul style="list-style-type: none"> <li>- Formal education</li> <li>- Informal education</li> <li>- Vocational training</li> <li>- Literacy levels</li> <li>- Human resource planning</li> </ul>	

**Table 17:** A Cultural Framework

Source: Adapted from CIM (2004) Study Text, Analysis and Evaluation.

**Symbols** are important aspects of language and culture. Each symbol may carry a number of different meanings and associations to people of different cultures. In the West, the colour white symbolises purity while in some Eastern cultures it symbolises death.

**Norms** – each culture establishes its own norms, often derived from religious observance. In Muslim cultures (in Iran, Iraq, Saudi Arabia, United Arab Emirates, etc.), alcoholic drinks, pork, and unclad females are taboo. Out of respect to Hindu culture, McDonald’s restaurants in India do not sell hamburgers that contain beef and there is no pork on their menu out of respect for Muslims in this country<sup>148</sup>. Islam too restricts personal adornment and indulgence products.

**Material life** principally refers to technologies that are used to produce, distribute and consume goods and services within a society. For example, Coke uses large tricycles to distribute Coke products along the narrow streets in Indian urban centres.

**Family members**, especially the elders, can influence peoples' choices of what they buy and, sometimes, where they live or work. In Africa and other developing countries where kings are still the cultural leaders of even more than a million persons, a king or cultural leader can influence the buyer behaviour of most of his/her subjects. The caste type of culture in India resembles that of kings, with superiors and inferiors.

**Religion** plays a big part in consumer product choices. Religion affects consumer buying behaviour. Christian dominated countries are good markets for Christmas seasons' cards in December. The same can be said of the end of the month of *Ramadhan* for Moslems. In India, Buddhists worship cows and therefore can not eat beef. In the Islamic countries pork is a taboo. In those countries where Islam is the religion, all meat must be Halal (a Moslem makes a prayer before the animal is slaughtered).

SIMPLY CLEVER

ŠKODA



We will turn your CV into  
an opportunity of a lifetime



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



### **Islamic banking and culture**

Islamic banking is a good example of culture in the economy. The Koran, the holy book of the Muslim, abjures the charging of interest – which is regarded as usury. While interest is banned, profits are allowed. There is however no standard interpretation of the Sharia law regarding this issue. Originally Islamic banks offered current accounts, but depositors have asked for shares in the bank profits. Products commonly promoted by Islamic banks include leasing, trade finance and commodities trading.

### **Culture and international product promotion**

Global promotion, especially global advertising, can be quite expensive. Global advertising refers to the transfer of advertising appeals, messages, art, copy, photographs, stories, and video and film segments from one country to another<sup>149</sup>. Coca Cola and Pepsi Cola have always undertaken Global advertising campaign where they try to standardize their message. We caution that internationalisation of brands is quite complex to achieve. This, therefore, calls for adaption of messages and products for different markets – other than the home market. *You may need to read about the standardisation versus adaption debate for both message and product.* In 1989 Proctor & Gamble spent 3.2 billion Canadian dollars worldwide on advertising (including 100 million Canadian dollars in Canada alone) while Unilever spent 2 billion Canadian dollars on a global advertising (including 38 million Canadian dollars in Canada alone)<sup>150</sup>.

As part of the socio-cultural issues, *language* differences affect the way a product is used in a market. As a means of communication, language is spoken (verbal) and silent language (nonverbal). The most challenging form of communication in international marketing is nonverbal rather than verbal communication. The West tends to be verbal while the East is more non-verbal<sup>151</sup>. For example, gestures are understood differently in different cultures. In the US showing a ring sign with a thumb and pointing finger is a sign of approval but this gesture is regarded as grossly insulting in Greece and Brazil<sup>152</sup>. In Japan, intimate scenes between men and women are considered to be in bad taste. Europeans are in the habit of kissing women's hands. While kissing, however, the nose must never touch the hand; and this rite reserved is solely for married<sup>153</sup>. How do you tell that the lady being kissed on the hand is married? In USA and UK, her wedding ring will be on the left hand. In Spain, Denmark, the Netherlands and Germany, catholic women wear the ring on the right hand<sup>154</sup>. Ford's sales of its Pinto model in Brazil were at the beginning very dismal. The cause of low sales? Pinto stands for small male genitals in Brazilian slang. When Ford changed the name of its model to Corcel, meaning a horse, sales rose.

It also affects the promotion of products in terms of branding and advertising. A name (brand) can be everything in a different language. According to Doole and Lowe (2008)<sup>155</sup> examples of companies facing marketing problems due to language differences include:

- 1) Initially, Coca-Cola had problems in China as Coca-Cola's message almost translated into 'a thirsty mouthful of candle wax'. They later managed to find a new pronunciation which translated as "joyful tastes and happiness".
- 2) General Motor's brand name 'Nova' was unsuccessful in Spain because in Spanish 'nova' means 'no go'.
- 3) Pepsi Cola had to change its campaign 'Come Alive with Pepsi' because in German, it literally translated to mean 'Come Alive Out of the Grave'.
- 4) In 1989, United Colours of Benetton art direction and advertising focused on inter-racial juxtapositions: one advert showed a white hand and a black hand handcuffed together. Another advert showed a black woman breastfeeding a white baby. This was shown in Canada but not in the US where it evoked the history of slavery. The woman-baby advertisement won acclaim in France, the Netherlands, Denmark, Italy and Austria<sup>156</sup>.
- 5) Translating copy or the written text of advertisement is a big challenge. Advertising slogans usually present the most difficult translation problems. Examples: KFC's "finger lickin' good" came out in Chinese as "eat your fingers off" and Pepsi's "Come alive" Asian version was misunderstood to as a call to bring ancestors back from the grave.
- 6) Ikea, the furniture chain store, was forced to order from its suppliers for big beds and sheets after finding out that Americans liked big beds unlike the Swedes. Otherwise initially it had dismal sales of its beds and bed linens. Before this experience in USA, Ikea insisted that its stores carry the basic product line with little room for adaptation to local tastes. It wanted to sell a standardised product line in all its stores and markets instead of adapting its offering to suit the requirements in each market.
- 7) Consumer products are more sensitive to cultural differences. Food is too sensitive. For example Campbell reportedly lost over \$10 million trying to change the *wet soup habits* of the German consumer from *dehydrated soup* to *canned concentrate*<sup>157</sup>.

**Legal factors:** Legislation in the importing country may affect a firm's export business. Each country has got its legal system, structure of the laws affecting corporate business. Laws in the firm's home country may be very different from those of its exporting market. There are laws and regulations on product packaging, advertising, ownership of business, repatriation of export earnings and safety regulations.

**Economic factors:** Economic factors relate to the overall level of economic activity in the importing country, relative levels of inflation in the domestic and overseas market, the exchange rates and the relative prosperity (GDP levels) of individual overseas markets, among others. The international market requires a thorough understanding of the economic environment prevailing overseas. This helps in deciding the marketing mix from each of these markets. For example in less developed countries of Africa, the marketer may consider small packages because of the low levels of income.

**Political factors:** These are factors that may affect the operations of a business in a given country. They are associated with political risks.



- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFKI. An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

**Political risk:** This is the risk that political factors will affect the firm's strategy and damage its performance. Such risks include wars, coups, expropriation or nationalisation, political instability, and the making by politicians of decisions that affect business performance. For example, bad politics can affect businesses operations. Stable political environments are crucial to FDI and doing business in any country. Politics plays a key role in the economic growth of a country. Unstable political regimes expose foreign businesses to a number of risks that they would generally not face in their home market. When dealing with markets in politically unstable countries foreign businesses face political risks (particularly less developed countries pose major political risks).

A political risk checklist has been outlined by writers on international business, Gillespie et al., (2010: 111)<sup>158</sup> looking at the questions Foreign Direct Investments (FDIs) ask.

Bad politics can affect businesses operations:

- i) Appropriation or nationalisation of foreign business (this happened in Uganda during Amin's time (1971–79) when he nationalised and gave away private Asian businesses to locals). Government might want to renegotiate deals to obtain a better bargain.
- ii) Restrictions on profits repatriation, at times for currency reasons
- iii) Arbitrary changes in taxation
- iv) Operational restrictions – which can include exchange controls, employment policies, limiting foreign ownership, etc.
- v) Direct government interventions e.g. confiscation of private property without indemnity; a forced takeover by government.
- vi) Corruption and cronyism which may lead to unfair favours for some companies over others. Such favours may include tax holidays, tax rebates, etc. In 2001, the Nigerian government claimed ownership of Shell's equipment and machinery without any prior warning.
- vii) *Discriminatory restrictions* which tend to be imposed on purely foreign businesses and sometimes on firms from a particular country fall under these restrictions. For example USA has for long imposed bans on imports from Libya and Iran. The US still imposes a ban on Cuban imports.

We should mention that there are many sources of risk data including international management consulting firms, Economic Intelligence Unit, the World Bank, some government sources, embassies and missions and the media.

### **Some measures to reduce political risk**

Political risk may not be eliminated but it could be lessened by foreign firms in politically unstable environments:

- 1) Have joint ventures with local partners with good contacts. The Chinese will advise international investors in China to use a “Chinese hand”.
- 2) Take out insurance since the future cannot clearly be forecasted properly.
- 3) Take the option of leasing rather than outright purchase of facilities in overseas markets.
- 4) Undertake local borrowing (do this only in countries experiencing less inflation).
- 5) Spread activities over a number of countries. In diversification terminology, this is called vertical integration. This is to say that “Don’t put all your eggs in one box (or basket)”.

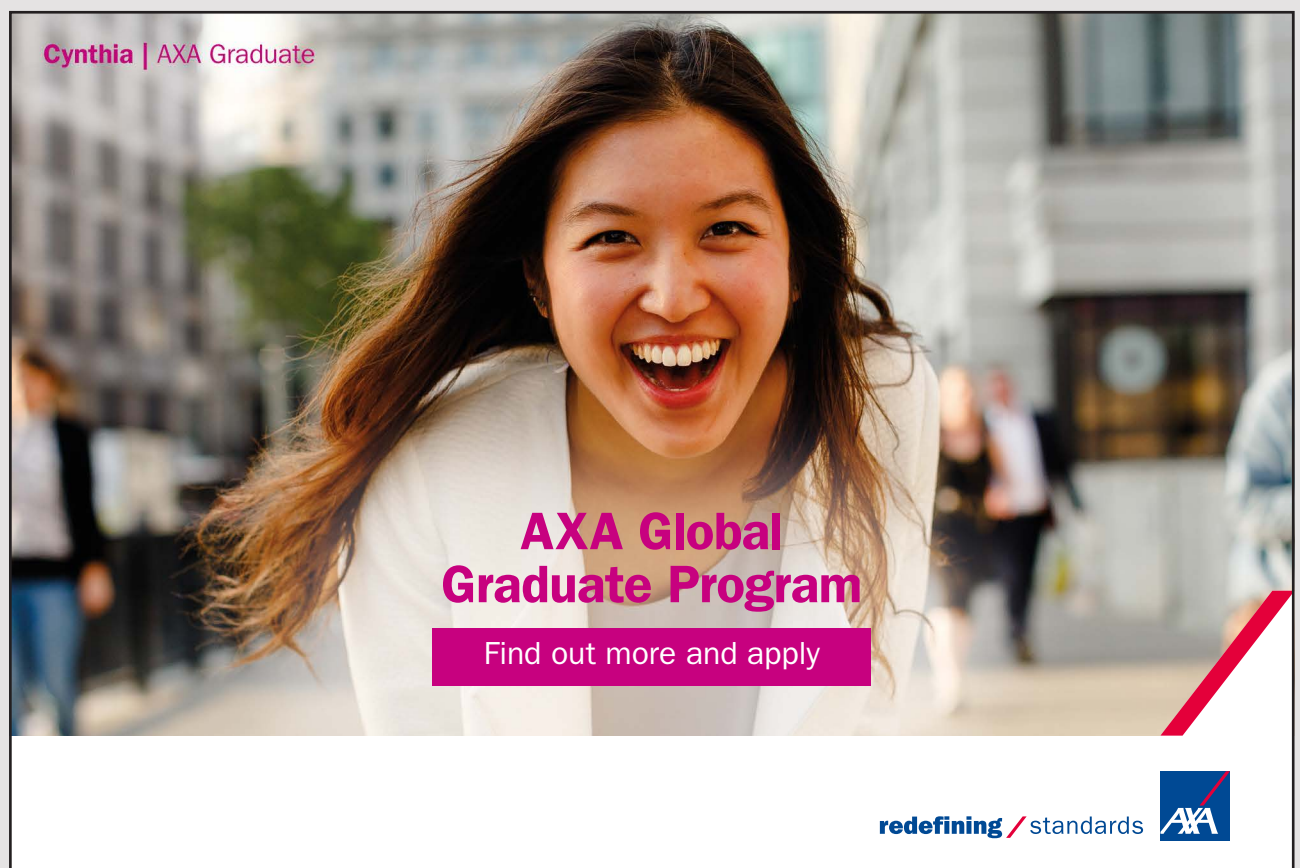
#### *Foreign businesses get this caution*

Foreign investors need to avoid sharing companies with serving regime’s politicians in developing countries. This is because in a volatile political environment, an investor could lose a lot. Regimes in these countries usually change via military means and so do the politicians. Investors should use the politicians to their benefit but avoid jointly investing with them. It is safer for foreign investors to avoid involving in politics of the countries where they have put their money.

**Technological factors:** The English clergyman, Rev. Thomas Malthus (1766–1834) feared that man’s capacity to produce children was higher than his capacity to provide for them. Thanks to technology, society can afford to provide for its people (we know that many people are starving in politically unstable countries but the reasons cannot be covered under here under the field of marketing). Technology has enhanced industrialisation, modernisation and globalisation. Technology has become a major driving force in the field of international marketing. Technology helps in product research, promotion (e.g. advertising), after sales support service (e.g. computer remote trouble shooting), distribution and product development. In terms of sales, there are companies engaged in e-sales. Marketing communications has taken advantage of the computer and internet (email, websites, advertising, etc.) to reach markets and sell to a wider audience of customers. Do you need any product in the world? Don’t even mind who sales it? Visit the internet. Go Google or Excite or Yahoo and then search. Wireless technology has made it possible for businesses to reach their customers. Eventually the cost of owning a phone in developing countries is reducing since they do not need to buy wires and poles to install a line.

Modernization in mobile telephony has spread benefits of telephone communication globally. Even the poor and developing countries of Latin America, Africa, and Asia have accessed cell telephone technology. For example, in Uganda in East Africa, one cellphone company had over ten (10) million mobile phone subscribers in 2012 out of total population of about 32 millions. There are currently seven registered and operational mobile telephony service providers in Uganda.


Virtual shops such as amazon.com or ebay.com are doing business with customers from several countries via the internet. But as in many changes that have happened on the globe, less developed countries are at the tail of the technology revolution. Most households or families do not have a computer and so cannot shop from China, UK or USA in the comfort of their homes – online.



**Cynthia | AXA Graduate**

**AXA Global Graduate Program**

Find out more and apply

redefining / standards 

## **Export Market entry strategies**

The Paliwoda and Thomas suggested the criteria<sup>159</sup> used for selecting a market entry and we explain them here briefly.

1. Speed of market entry desired: If speed is required, the company can use an agent/distributor.
2. Direct and indirect costs: The company has to first consider the costs that will be involved in exporting. These costs may include freight, strikes, or disruptions to output, integrity in the supply of raw materials, lack of continuity with power supply.
3. Flexibility required: Agents can be appointed or distributors given exclusive sales territory rights, usually only where it is deemed unlikely that there will be very much for the expansion by the company directly into that market.
4. Risk factors: The risks include political risk, economic risk and competitive risk. The company wishing to export has to consider such risks and how to minimise them. Some scholars have suggested the need for a joint venture with a local partner.
5. Investment payback period: Shorter-term payback may be realised from licensing and franchising deals, whereas joint ventures or wholly owned subsidiaries will tie up capital for a number of years.
6. Long term profit objectives: The growth envisaged in that market for the years ahead. Here the question of distribution channel policy decisions are important

**Indirect export:** This is where the local seller (producer or trader) uses independent intermediaries to export the company's product(s). The company can use the following channels to export indirectly:

- 1) Domestic purchasing (through a domestic based export merchant). The local export merchant buys the manufacturer/producer's products and then sells them abroad.
- 2) Local (domestic) export agents: These agents (who include trading houses) seek and negotiate foreign purchases and are paid a commission.
- 3) Export management company: A manufacturer/producer can appoint a company which agrees to manage a company's export activities on its behalf at a fee.
- 4) Cooperative organisation: This is an organisation that collects and exports products on behalf of its members. This mode of exporting is commonly used in developing by producers of primary products such coffee, tea, cocoa, fruits and vegetables. Most countries in Sub-Saharan Africa used to have this arrangement for the traditional cash crops e.g., cotton.

**Direct exporting:** Eventually some companies may choose to handle their own exports. The investment costs and risks are higher than indirect exporting but companies may want to have greater control of the exporting process.

Types of direct exporting:

- 1) Foreign manufacturing strategies (without direct investment)
- 2) Manufacturing locally the product which used to be exported to a given country. For example Coca Cola and Pepsi Cola (all from USA) are now produced locally in most Sub-Saharan Africa. The companies import some of the raw materials and make the drink locally. This is not franchising which we look at later.
- 3) Licensing: A foreign company gives a license to local manufacturer to provide the product in its export market. The licensor licenses a foreign company to use a manufacturing process, trademark, patent, trade secret, or other item of value for a fee or royalty.
- 4) Joint ventures and strategies alliances: Another way of getting involved in direct exporting is by foreign investors and local investors creating a joint venture in which they share ownership and control.

### **The internationalisation process**

**The concept of firm internationalisation:** There is no generally accepted definition of the concept of internationalisation. Existing literature refers to the concept as the engagement of firms in international trade. It is used to refer to the export development phenomenon, the progressive engagement of firms in export trade activities<sup>160</sup>. The concept explains the process by which individual firms initiate, develop and sustain their involvement in international trade activities. A model for firm internationalisation is represented by the Uppsala Model, developed by the Swedish researchers<sup>161</sup>. These scholars consider that the internationalisation process is an evolutionary and sequential one, which develops as the firm becomes more and more involved on the international market<sup>162</sup>. According to them, firms enter foreign markets in a gradual way, in accordance to the level of knowledge and the information accumulated about the destination market. The external markets have different degrees of attractiveness, in accordance to the geographical and cultural proximity to the home country<sup>163</sup>. The Uppsala Model considers that the firms starts the approach of exporting with the usage of the traditional export methods to countries closer from the perspective of geographical and cultural proximity, gradually developing complex ways to operate, at firm level, at destination country level and towards geographically and culturally more distant countries. *There can be distinguished four such methods for market penetration: irregular export, export through an agent, subsidiary and production*<sup>164</sup>.

## **PART II: LOGISTICS MANAGEMENT**

# 10 LOGISTICS MANAGEMENT

Logistics refers to the flow of materials and supporting documents (information) from the suppliers into an organisation and finally to customers. Logistics management, therefore, entails looking at all the logistics management activities and then planning, organising, staffing and controlling. Logistics management covers inbound logistic, work in progress and outbound logistics. Materials are processed and the final goods dispatched to customers according to orders; so it is responsible for the movement and storage of materials through the supply chain.

## Aims of logistics in supply chain

Logistics should move materials within the supply chain cost effectively. It should ensure that an organisation's customers are satisfied with its delivery services. Once the customer orders have been delivered at the required time, right place and right product and to the right customer, this will result in customer satisfaction. The part of delivery to customer is the work of logistics management.

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**  
I was a construction supervisor in the North Sea advising and helping foremen solve problems

Real work  
International opportunities  
Three work placements





**Inward transport:** The purchased materials have to flow from suppliers to the organisation. Transport moves materials from suppliers (upstream) to the organisation's receiving area. The organisation has to choose the best mode of transport suitable for the kind of materials being transported. Not only should you choose the mode of transport but you should also choose the best transport operator. The best transport operator will design the right route and schedule the transport, ensure that all safety and legal requirements are met, then get deliveries on time and at a reasonable cost. To save costs – and in procurement – time is of essence – it is always necessary to arrange insurance<sup>166</sup> and associated cover before the transporter begins their journey.

**Receiving, inspection and sorting:** The organisation that purchased and wants to use the materials has to ensure that they check those materials delivered and establish that they correspond with those in the purchase order. They have to unload the materials from the vehicle, inspect them for damage and sort them. Once they have inspected the materials and found no damages, the staff of the organisation will receive the materials.

**Warehousing:** We can say that warehousing refers to those activities involved in moving materials from the delivery trucks into storage and taking care of them until they are needed. Some products need to be sorted again, packaged, labeled and branded while in a warehouse. Warehousing will be covered in detail later in this section.

**Stock control:** This will as well be covered further under warehousing. We can simply say that stock control sets policy for inventory management. It considers the materials to store, investment in the materials, stock levels, order sizes, order timing and customer care levels required, among others.

**Order Picking:** When customers have placed their orders, they need to be fulfilled by the producer or seller. It is the duty of logistics staff to ensure fulfillment of the order. Picking orders involves identifying and removing materials from the store and preparing them for dispatch. Once the materials for a customer order have been located, identified, checked, found to be damage-free, removed from racks and consolidated into a single load, they are wrapped and moved to a departure area for loading onto delivery vehicles. Usually this process has to ensure that all the approvals for order fulfillment have been given. In some cases, where the materials have to be delivered by the seller organisation, the approvals include those of the vehicle to transport the materials to the customer's premises.

**Materials handling:** Materials handling refers to movement of materials through the operations and within the organisation. This is concerned with the movement of materials in short distances generally within a warehouse, or between storage areas and transport (Donald Waters, 2003). This work is usually done by machines and causal employees. It involves moving materials from one operation to the next and moving the materials picked from the stores to the point where they are required – within the organisation.

**Core (Business) Operations:** The core operations refer to the main activity that the organisation is engaged in. It may be production (for example a beer company's main activity is production of the beer) or it may be service delivery, or even consultancy work. It may also be courier services such as are offered by UPS, FedEx, and DHL. Whatever the core activity, it is the role of logistics to move what is produced to the end user.



**ie** business school

93%  
OF MIM STUDENTS ARE  
WORKING IN THEIR SECTOR 3 MONTHS  
FOLLOWING GRADUATION

## MASTER IN MANAGEMENT

- STUDY IN THE CENTER OF MADRID AND TAKE ADVANTAGE OF THE UNIQUE OPPORTUNITIES THAT THE CAPITAL OF SPAIN OFFERS
- PROPEL YOUR EDUCATION BY EARNING A DOUBLE DEGREE THAT BEST SUITS YOUR PROFESSIONAL GOALS
- STUDY A SEMESTER ABROAD AND BECOME A GLOBAL CITIZEN WITH THE BEYOND BORDERS EXPERIENCE

Length: 10 MONTHS  
Av. Experience: 1 YEAR  
Language: ENGLISH / SPANISH  
Format: FULL-TIME  
Intakes: SEPT / FEB

5 SPECIALIZATIONS  
PERSONALIZE YOUR PROGRAM

#10 WORLDWIDE  
MASTER IN MANAGEMENT  
FINANCIAL TIMES

55 NATIONALITIES  
IN CLASS

[www.ie.edu/master-management](http://www.ie.edu/master-management) | [mim.admissions@ie.edu](mailto:mim.admissions@ie.edu) | [f](#) [t](#) [i](#) Follow us on IE MIM Experience

**Outbound logistics:** These are the downstream activities that take place within logistics management. These are the activities involved in moving the goods out of the organisations to the customer. These activities include:

- 1) **Outward transport:** This is the taking of materials (usually finished goods) from the departure areas to the customers. Before the materials are transported to the customers, they have to be checked to ensure that they are made of the right materials, packed in the right orders, comprised of the right amounts and certified to ensure that they are without any damages.
- 2) **Physical distribution:** This refers to the physical delivery of finished goods to the customers. Outward transport is part of it. Physical distribution is concerned with routing, scheduling and receipt of the goods by the customer. Once the goods have been received then the order has been fulfilled.
- 3) **Recycling, returns and disposal:** The topic of reverse logistics is discussed in detail in this book. Please refer to it. We can say here that there might be some problems with the delivered goods. For example, the goods may not be functioning properly, of a wrong type or damaged in transit. This will necessitate taking them back. They have to be returned to the selling organisation.
- 4) **Recycling and waste disposal:** Some materials can be reused or recycled. Others have to be disposed of in a recommended manner.
- 5) **Location:** Location of facilities such stores or depots will depend on the approach taken by the organisation, that is, centralised or decentralised system. In the centralised system, all the logistics activities will be undertaken at the organisation's offices or headquarters. In the decentralised system, some logistics activities can be carried out in different locations. Under this system, stocks of finished goods may be held at the end of the production, moved to nearby warehouses, put into stores closer to the customers or passed on to be managed by other organisations<sup>167</sup>.
- 6) **Communication:** Communication is a very important role of the logistics function, and indeed of the management of any organisation. Alongside the physical flow of the materials, there must be the associated flow of information. This does not only happen from downstream but also from upstream (from suppliers to the organisation). Information has to link all parts of logistics passing on information about products, customers demand, materials to be moved, timing, stock levels, stock availability, problems, costs and service levels, among others. Logistics managers should always see themselves as processing rather than merely moving goods along the supply chain.

## Principles of Logistics Management

The principles of logistics management coincide (and work in tandem) with the principles of business. These principles need to be considered when planning logistics operations that require an extensive infrastructure. Though the importance of several of these principles varies from operation to operation, all the seven principles must, at a minimum, be considered when designing a logistical operation.

- 1) **Responsiveness:** Responsiveness is the right support in the right quantity in the right place at the right time. Among the logistic principles, responsiveness is the keystone; all else becomes irrelevant if the logistics system cannot support the concept of operations. Speed is, thus, key for any business operation. For example, in entities such as Fedex, UPS and DHL competitiveness is based on this principle.
- 2) **Simplicity:** Simplicity reflects the need to reduce complexity and often fosters efficiency in both the planning and execution of contract or delivery to the customer. The establishment of priorities and pre-allocation of supplies and services by the supported unit may simplify logistics support operations. But many entities in the developing countries, unfortunately, instead prefer complexity and in a complex environment, they fail.
- 3) **Flexibility:** Flexibility is the ability to adapt logistics structures and procedures to changing situations, missions and concepts of operations. During the planning process, plans must be flexible in order to ensure the successful delivery of required equipment and supplies to those operational units involved in operational contingencies.
- 4) **Economy:** Economy means using the most efficient and cost-effective resources and delivery methods in conjunction with limiting the amount of risk to the resources so that they can be delivered to the users. Resources are not just limited to the supplies and equipment but also include those delivery systems such as the choice between fast, minimal space on high-cost planes versus slow, massive storage space on relatively low-cost shipping.
- 5) **Attainability:** Attainability is the minimum amount of supplies that the logisticians need to commence operations. The attainability aspect tends to focus much on how resources are put to best possible use. This principle lays down elements to do with questions such as:
  - How many staff are on the job?
  - Are they facilitated; and
  - How many man-hours are needed for the job to be done?

- 6) **Sustainability:** Sustainability is a measure of the ability to maintain logistics support to all users throughout the duration of the operation. For example, if we are shipping beer products for Carlsberg, Heineken, and Guinness over a 3 year contract, do we have the capacity to do it over that period? This is in relation to the available equipment, people, money, time, etc.
- 7) **Survivability:** This principle is just what it sounds like. Survivability is the ability of the logistical system to be able to survive in the face of evolving trends, e.g. supply chain integration, globalisation, others.

### What are the factors encouraging entities to improve the management of logistics and supply chains?

1. Knowledgeable customers, who are demanding higher quality, lower costs, and better service.
2. Existence of stiff competition forces organisations to improve all the aspects of supply chains.
3. Big and powerful buyers such as *McDonalds*, *Wal-Mart*, *Tesco* and *Sainsbury* demanding customised logistics from suppliers, such big retail/chains.
4. Changes in the retail markets aiming at servicing customers better including opening 24-hours, home delivery and telephone and online shopping.



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"

Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

5. Increasing international trade and globalisation.
6. Improved communications between organisations and customers (It is now possible to use a mobile phone to send message, money or call from most locations in the world). There is also the use of electronic data interchange (EDI), electronic funds transfer (EFT), e-commerce, and e-procurement.
7. The introduction of cost effective approaches to operations such as Just in time, Lean operations, mass customisation and virtual operations.
8. Processing organisations co-operation through alliances, flagship companies and partnerships.

### **Five key issues for logistics effectiveness**

- 1) **Movement of product:** This is often the way that logistics is viewed in most companies. Moving products should complement the corporate strategy. Products must also flow, not just move, from, to, between and among vendors, manufacturing sites, warehouses and customers. If it does not flow, then there is no supply pipeline. Instead there are imbalances in inventories with components and finished goods not being where they should be. The movement may be extremely broad in geographical scope. While other departments in the company may focus on selected geographical regions for sourcing, manufacturing or sales, logistics must deal with all of these. Everything must move. The movement plan must be flexible. Forecasting may be the weakest link in all corporate planning and execution. So the movement must be able to adjust and deal with the swings in business activity. This may require a multi-mode, and/or a multi-carrier and/or multi-level service programme to keep the global supply chain moving smoothly.
- 2) **Movement of information:** It is not enough to move products and materials. You must know where they are. You must know what inventories are where and, if critical action is required, you must know what orders are coming in and when they must be delivered. Timely and accurate information is, therefore, important for sound decision-making. The information must flow between the company and its suppliers, carriers, forwarders, warehouses and customers. It must also move internally among purchasing, customer service, logistics, manufacturing, sales, marketing and accounting personnel. And doing this goes beyond email, faxes and phone calls. Investment in information technology is not an alternative anymore rather, it is an absolute requirement for logistics and corporate effectiveness. Systems should exist at the macro or corporate level and view.

- 3) **Time/service:** The ability to respond to the dynamics of the market place (such as changing forecasts, customer requirements, new product introductions, new sourcing and how to manage all these changes) must be done quickly. For instance, raw materials and components must be ordered and arrive completely, accurately and quickly; and orders must be filled completely, accurately and quickly. Service is more than having to expedite a shipment. Time/service is a factor of competition, customer requirements, your company's position in the industry, your corporate culture, how well everyone in the global supply chain works together and how well everyone works together in your company. Logistics is the link among all this. Distance means time. And time delays are not acceptable. Movement of product and movement of information show their impact here.
- 4) **Cost:** Cost is the key measure by which logistics effectiveness is often measured. Logistics costs include freight, warehouse labour, warehouse rent charges and other items on the profit & loss (P&L) or inventory, a balance sheet item. Cost control, containment and management are important for corporate profitability. Minimising the cost of the various logistics elements (such as freight and warehousing), can sub-optimize the effectiveness of the logistics function and of the entire company in satisfying its customers. Cost has a relation to service. As you define your service against your costs or costs against service, the give and take develops into your operating costs and budgets. Ultimately there is need to ensure that the cost can be managed. Otherwise costs can get out of control.
- 5) **Integration** (within your company, between you and your customers and between you and your vendors). Integration means bringing it all together. This requires that since logistics is a process, effectiveness requires that each relevant element of the organisation does its part. This requires reorganisation of the organisation chart and functions. The traditional organisation chart with its boxes and defined responsibilities is a collection of functional silos. It can no longer deliver effectively. Each silo segments and collects different parts of the vendor purchase/manufacturing/sales activity and stores it. There is no process here. There is, instead, a compartmentalisation, a fragmentation of the process. In addition to internal integration, an organisation has to bring together and work with the external players. The organisation's vendors, including the carriers and warehouses, must understand what you are doing and why. These stakeholders have to share the organisation's logistics vision and plan with them. This sharing and understanding will better enable them to cooperate with and assist the organisation. Integration with customers is also important. You and everyone in your company must be working to satisfy your customers. You should review written customer requirements with everyone in the logistics department and with everyone in the company. Meeting with key customers is very good. What does he need? How does he need it? Why does he need it? When does he need it? The more you know about your customer and his needs, the more valued a supplier you are to him. This is a competitive advantage.

## Issues and Challenges for Logistics

Infrastructure developments, particularly road links, all over the world are still a big challenge especially for developing countries. Differences in framework conditions for logistics services (financial, physical and ICT infrastructure, logistics education, etc) and regulatory conditions have not been harmonized between different countries. Evolving logistics best practices have been a challenge to logistics companies because, to compete globally, they need to adopt the new changes.

## Warehousing

A warehouse is any location where stocks of materials are held on their journey through the supply chain (Waters, 2003)<sup>168</sup>. Whether in the old or modern era, all organisations hold stocks and those stocks are held in warehouses. Such stocks may occur at any point in the supply chain where the flow of materials is interrupted. In business, different terms have been used to refer to warehouses. They are commonly referred to as distribution centres, logistics centres or simply as stores.



Excellent Economics and Business programmes at:



university of  
 groningen



“The perfect start  
of a successful,  
international career.”

**CLICK HERE**  
to discover why both socially  
and academically the University  
of Groningen is one of the best  
places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

## Reasons for warehousing

In commerce, warehouses are required for several reasons. We outline them here.

1. Protection of materials (or goods) in the supply chain: Warehouses provide secure storage of materials in the process of acquisition, production and distribution.
2. Ensuring uninterrupted production: Raw materials are brought into the store from suppliers, and kept in the warehouse waiting processing, into final goods.
3. Sorting while in the warehouse: Finished goods are sorted, packaged and branded before being distributed to the customers.
4. Economic Order Quantity (EOQ): Businesses have to ensure that they have ample quantities of suppliers for a given set of buyers. Once the finished goods fall below the minimum, there is a danger of failure to meet market demand for a certain period of time. This can lead customers to switch to other brands. The EOQ can be understood by the 'tap and water tank analogy'. This means that as the water is continuously used, the tank needs to be continuously filled to a level that ensures that at no time will the users run out of water.
5. Anticipating high demand: Some businesses may store goods to meet high anticipated demand. This is the case with such goods which are highly demanded in a particular period or season. For example, a shop selling Christmas cards does not wait for Christmas to stock the cards. Instead, it has to buy and store them in advance.
6. Scarce materials. There are materials that are vital for production of certain goods but which are usually scarce. Such materials need to be purchased and stored. Failure to do this will likely result in shortages of such goods and lead to brand switching.

**Basic Activities within a Warehouse:** The main activity of a warehouse is for storage of goods or materials. Warehouses receive deliveries of supplies (referred to as inbound logistics), check and sort them. They store these materials until they are required. These materials can be required by the production section as inputs or by customers as final goods. Storage is the basic function, but not the only activity, of warehousing. There are several necessary activities of warehousing. Below we list them:

- Receive materials from suppliers;
- Check materials using the order documents for numbers, damages and quality;
- Label materials so that they can be easily identified;
- Sorting goods as required;
- Hold materials or finished goods in stock until when required;
- Picking goods from these stores to give them out as orders;
- Packing and packaging as needed;

- Load delivery vehicles and dispatch orders;
- Ensure effective communications between the warehouse, other systems and customers; and
- Prepare and keep records.

### Types of Warehouses

We can look at the types of warehouses based on the following:

1. **Product based:** Agricultural Warehouses; Industrial Warehouses; Chemical or Oil Warehouses;
2. **Functionality based:** Customs Bonded Warehouse; General Storage Warehouse
3. **Temperature controlled:** Cold storage Warehouse
4. **Mode of transport based:** Roadside Warehouse; Railside Warehouse; Air Cargo Warehouse

### Ownership of Warehouses

- 1) Private warehouses: These are warehouses owned or leased by a private business to support its operations.
- 2) Public warehouses: These are independent businesses and they make money by charging user fees. Organisations wishing to use them will be charged fees for the duration of the storage of their goods. Such warehouses include: bulk storage, cold stores, silos and tankers.
- 3) Government warehouses: These are owned and managed by the (central or local) government. India, for instance, has the Central Warehousing Corporation of India, the State Warehousing Corporation and the Food Corporation of India, all of them providing warehousing services.

**Size of warehouse:** The size of the warehouse is important in logistics management. It will determine the amount stored, sorted and ordered. There are a number of factors that will be critical in deciding the warehouse size. The list includes:

- Nature and size of the materials to be stored;
- Warehouse stock layout;
- Size of the market to be served;
- Effective and efficient customer service levels required;
- Available materials handling systems;
- Required size of office area at the warehouse; and
- Whether the business can take advantage of economies of scale of using a certain size of the warehouse.

## Materials handling and warehouse

There are three (3) levels of technology for handling materials. In most developing countries, this is mainly done by hand, trolleys and baskets (Level 1). Where there is a bit more mechanization you find, folk lifts and cranes (Level 2). But in advanced technologies you get automated warehousing (Level 3).

- 1) **Manual warehousing** is the most common. Manual warehouses will work where the items are small or light enough to be lifted. Items are either stored on shelves or in bins. In supermarkets, people move around and manually pick the items from the shelves and bins or they use trolleys to carry items around the store and to the counter.
- 2) **Mechanised warehousing** is where there is use of machines (instead of muscle power). Here forklift trucks and cranes are used. In some warehouses, conveyor belts are used to move very heavy and large quantities of goods along a fixed path.
- 3) **Automated warehouses:** These warehouses have reduced the cost of operations. They operate at reduced rate compared to manual or mechanised warehouses. They, however, require very high investments in equipment initially. Equipment automatically picks materials and put them into storage areas.

## American online LIGS University

is currently enrolling in the  
Interactive Online **BBA, MBA, MSc,**  
**DBA and PhD** programs:

- ▶ enroll **by September 30th, 2014** and
- ▶ **save up to 16%** on the tuition!
- ▶ pay in 10 installments / 2 years
- ▶ Interactive Online education
- ▶ visit [www.ligsuniversity.com](http://www.ligsuniversity.com) to find out more!

Note: LIGS University is not accredited by any nationally recognized accrediting agency listed by the US Secretary of Education. More info [here](#).



## Features of a warehouse building

The following features are desirable when selecting and designing a warehouse building:

- Adequate ceiling height;
- Durable floor surfaces;
- Adequate space outside the warehouse areas to serve as offices;
- Proximity to users of the warehouse items;
- Access to water points for fire hoses;
- Adequate (and if possible) natural lighting;
- Adequate heating equipment;
- Adequate space for broad gangways;
- No intrusive pillars and floor joints;
- No excessive decorative features;
- Well ventilated atmosphere;
- Accessibility by roads and to railways networks; and
- Adequate space for loading and unloading.

## Inventory Management

Inventory Management is composed of three things:

- 1) **Stocks:** These are supplies of materials and goods that are held by the organisation.
- 2) **Inventory:** A list of materials and goods that are held in stock by an organization. The firm holds the inventory (a physical resource that a firm holds in stock) with the intent of selling it as finished goods or transforming it (materials) into a more valuable state.
- 3) **Inventory System:** A set of policies and controls that monitors levels of inventory and determines what levels should be maintained, when stock should be replenished and how large orders should be.

All organisations have some type of inventory control system. Inventory planning helps determine what goods and/or services need to be produced. Inventory planning helps determine whether the organisation produces the goods or services or whether they are purchased from another organisation. Inventory planning also involves demand forecasting.

### Basic components of inventory planning

There are three basic components of inventory planning:

- 1) Planning what inventory is to be stocked and how it is to be acquired (purchased or manufactured)
- 2) This information is used in *forecasting* demand for the inventory and in *controlling* inventory levels
- 3) Feedback provides a means *to revise* the plan and forecast based on experiences and observations

Inputs	Process Work-in-progress	Outputs
Raw materials Purchased parts for assembly Maintenance and repair materials	Partially completed products Products to assemble These are often factory floor or in the factory's warehouse	Finished goods Scrap and waste These are usually in the dispatch warehouse or are goods in transit They also include reverse logistics

**Table 19:** Types of inventory


### “Push” and “Pull” Inventories

A ***push strategy*** refers to when products are produced or manufactured in anticipation of demand and production is based on long term forecasts. Because of long term forecasts, there is a lot of uncertainty. In the long term, conditions in the market will change. A Push based supply chain is associated with high levels of inventory, high manufacturing and transportation costs.

A ***pull strategy*** refers to when a product (s) is manufactured according to a specific order (not forecast). Under this strategy, demand is known and inventory is very low or non-existent.

**The Bullwhip effect:** This refers to the uncertainty caused by information flowing upstream (to suppliers) and downstream (to customers) in the supply chain. In most cases information on demand forecasts becomes less reliable as it moves up to wholesalers and manufactures to suppliers. Various factors may distort demand conditions. The common drivers that lead to distortion in market demand include:

- Activities of unforecasted sales products;
- Lack of confidence by customers in the ability of suppliers to deliver orders on time (this results in customers not ordering);
- Order cancellations, which may result from previous re-ordering; and
- Incentives associated with freight. Such incentives as transport discounts for volume orders may stimulate customers to accumulate orders and later order in bulk.



**DON'T EAT YELLOW SNOW**

What will your advice be?

Some advice just states the obvious. But to give the kind of advice that's going to make a real difference to your clients you've got to listen critically, dig beneath the surface, challenge assumptions and be credible and confident enough to make suggestions right from day one. At Grant Thornton you've got to be ready to kick start a career right at the heart of business.

Sound like you? Here's our advice: visit [GrantThornton.ca/careers/students](https://www.grantthornton.ca/careers/students)

Scan here to learn more about a career with Grant Thornton.



 **Grant Thornton**  
An instinct for growth™

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd

The bullwhip effect results into

- holding excessive stock and other high costs of materials;
- cash flow problems;
- poor customer service (e.g. late delivery);
- stock-outs (which may result in customers switching brands)
- overtime payments to workers; and
- increased freight costs.

### **Stock control techniques**

**Reasons for keeping stock** (Reasons for inventories)

- 1) Improve customer service
- 2) Economies of purchasing
- 3) Economies of production
- 4) Transportation savings
- 5) Hedge against future
- 6) Unplanned shocks (worker's strikes, natural disasters, changes in demand, etc.)
- 7) To maintain independence of supply chain

### **Reasons against inventory**

- Non-value added costs
- Opportunity cost
- Complacency
- Inventory deteriorates, becomes obsolete, lost, stolen, etc.

**Keeping stock may increase certain costs, e.g.**

- a) carrying costs
- b) cost of customer responsiveness
- c) cost of coordinating production
- d) cost of diluted return on investment
- e) reduced-capacity costs
- f) large-lot quality cost
- g) cost of production problems
- h) *Inventory Costs:*

**Inventory costs may be looked from mainly four categories.**

- Procurement costs – Order processing
- Shipping – Handling
- Carrying costs: Capital (opportunity) costs; Inventory risk costs; Space costs; and Inventory service costs
- Out-of-stock costs: Lost sales cost; Back-order cost

**Classifying Inventory Items**

**ABC Classification**

- **A Items:** very tight control, complete and accurate records, frequent review
- **B Items:** less tightly controlled, good records, regular review
- **C Items:** simplest controls possible, minimal records, large inventories, periodic review and reorder

**Selected Inventory control methods**

**ABC Analysis (Always Better Control):** Classify the items on the basis of importance and the technique of grouping is called as ABC analysis. To provide maximum overall protection against the stock outs for a given investment in safety stock. This analysis is prepared and checked weekly or monthly.

Category	% of items	% of value
A (High Cost)	10	70
B (Medium Cost)	20	20
C (Low Cost)	70	10

**Advantages of Using ABC**

- Preference for keeping inventory can be placed properly after ABC analysis.
- With this analysis, store personnel are better utilised.
- Storage, handling and delivery of materials to the production department improve.

**VED Analysis (Vital, Essential, Desirable):** This classification is applicable only for spare parts. It is based on the price, availability etc. For **V items**, a reasonable large volume of stocks might be necessary, while for **D items**, no stocks are, perhaps, required to be kept. For **V items of A** classification, a close control should be kept on stock levels, but if it is **C items**, then large quantities must be stored.

**FSN Analysis (Fast, Slow moving and Non-moving):** It based on the issues from stores.

**SDE Analysis (Scarce, Difficult, Easy):** Scarce item merely equals to the **A item**. But we can't apply the same procedure for its stocking.

**HML Analysis (High, Medium, Low):** The only difference between this and the SDE is that it is the unit value and not the annual consumption value.

**H** Unit value > 1000

**M** Unit value 100 to 1000

**L** Unit value < 100

### Transport

Transport is responsible for the physical movement of materials between points in the supply chain.



.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if you could build your future and create the future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

### Functions of transportation

- 1) **Product movement:** Raw Material, Semi-Finished items, WIP, Finished goods, packaging material and rejected material are moved as required up or down the supply chain. So, the question here would be: What exactly is moved? How is this done? What Resources are used?
- 2) **Product Storage:** Temporary storage in stationary vehicles or vehicles kept moving on a circuitous route – Product storage is expensive in a transport vehicle. But sometimes this is adopted in order to keep overall costs low, for instance, when unloading and reloading would become more expensive than storage.

### Principles of transportation

- 1) **Economies of scale:** It is common knowledge that per unit cost of transportation comes down as the bulk of the items transported increases. Hence, in order to gain benefits in terms of reduction in transportation costs, logisticians try to consolidate the bulk and then ship the consignment rather than shipping half truck loads or half container loads. This benefit is referred to as the economies of scale.
- 2) **Economies of distance:** The transportation cost per kilometer comes down as the distance moved increases. Hence, transportation to reach the destination is planned in a single long lap rather than a number of short laps. The fixed costs and other costs such as overheads of loading and unloading are spread over the distance through which the load is moved. When alternate transportation strategies are evaluated to meet customer service expectation, economies of scale and economies of distance are fundamental.

### Factors to consider in choosing the mode of transport

- 1) Cost of the type of transport chosen.
- 2) Reliability: unreliability may lead missed delivery, delayed delivery and failed promises.
- 3) Availability: availability and frequency of the mode.
- 4) Speed of individual deliveries: some deliveries are urgent while others are not.
- 5) Type and nature of product to be transported: for example, fruits or flowers cannot be moved from Columbia to USA or from South Africa, Kenya or Uganda to the Netherland by rail or road but by air.
- 6) Flexibility: a lorry can move the goods and even deliver them to your warehouse but planes only land at the airport and ships at ports and harbours.
- 7) Packaging and documentation requirements: shipping items by lorry may require less sophisticated packaging than if they are shipped by rail.

- 8) Customer service requirement: when the customer wants to receive the goods is of essence.
- 9) Legal issues: the laws of some countries prohibit lorries from carrying certain tonnage on their roads and other countries have restrictions on the working hours of drivers, which may affect the delivery schedule.

### **Transport modes**

The mode of transport describes the type of transport used. Types/modes of transport: Road; Rail; Air; Inland water; Maritime/sea; Pipeline; and Intermodal.

**Road transport:** This is the method of moving goods from one location to another by road using a motor vehicle. Goods are transported from one country to another using trucks. The goods can be packed in containers or just placed in the truck.

The advantages of using lorries is that they:

- Are a flexible method of transport;
- Carry bulky non-perishable goods for a long distance;
- Reduce costs of packaging, handling and transshipments;
- Have high accessibility level in land areas;
- Are available in a wider variety of vehicles types/capacities depending on the customer's needs; and
- Have greater efficiency for short and medium distances.

But the disadvantages of using lorries are that they:

- Take much longer to deliver the goods to their destination in less developed countries with poor roads;
- Add to the number of road accidents;
- Create traffic congestion especially when transiting through urban centres; and
- Emit pollution from exhaust emissions that lead to global warming.

**Rail transport:** Rail transport is a method of moving goods from one railway to another using rail wagons. The goods are usually packed in containers. Oil products are simply put in the tanks that form the railway wagons.

The advantages of railway transportation are:

- Large volumes of freight are moved over long distances
- A higher speed of delivery is achieved over those long distances
- There is greater safety of goods in transit (fewer possibilities of the goods being stolen or getting involved in accidents); and
- Cheaper means when compared to air transport.

Railway systems, however, have their disadvantages because they:

- Lack direct connections to most delivery locations;
- Are not able to offer fast delivery services for one-off loads; and
- Require customers to wait until there is enough cargo to fill the wagons.

**Air transport:** This is the method of moving goods from one airport to another using a plane. Goods may be transported in a cargo plane or a passenger plane, as accompanying luggage.



Maastricht University

*Leading  
in Learning!*

Join the best at  
the Maastricht University  
School of Business and  
Economics!

**Top master's programmes**

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)

Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014

[www.mastersopenday.nl](http://www.mastersopenday.nl)

The advantages of air transport are that the planes:

- Allow for speedy delivery to far destinations;
- Lower the risk of damage to the goods;
- Guarantee security of the goods while being transported; and
- Are not susceptible to landforms (e.g. hills, valleys, corners, etc.)

The disadvantages are that the planes are:

- Inflexible;
- Expensive (i.e. high delivery fees); and
- Not suitable for carrying certain products.

**Inland Waters transport:** This is the type of transport where goods are moved by a ship on water from one port to another.

The advantages of water transport are that the ships are:

- Cheaper than other modes of transport;

The disadvantages, however, are that ships:

- Need longer transport periods to arrive at their destination;
- Have schedules that are strongly affected by the weather factors;
- Are inflexible;
- Operate in conditions of perpetual threat from pirates e.g. along the Somali coastlines of East Africa.

**Sea or maritime transport:** This is the movement of goods from one harbour to another through the sea or ocean using the ship. There are three main types of maritime operations:

1. *Liner Shipping:* The business is based on the same ships, routes, price and regular voyages.
2. *Tramp Shipping:* irregular transport price, unsteady transport routes and schedule. It usually delivers particular goods, such as Dry Bulk Cargo and crude oil.
3. *Industry Shipping:* The main purpose of industry shipping is to ensure the supply of raw materials. This sometimes needs specialised containers, such as the high-pressure containers for natural gas.

### Advantages

- Suitable for transporting particular goods, such as crude oil and grains
- It can provide a cheap and high carrying capacity

### Disadvantages

- It needs longer transport time
- Its schedule is strongly affected by the weather factors.
- It is inflexible

**Pipeline transport:** This is the method of moving fluid or gaseous goods (such as petroleum oil and natural gas) from one location to another through a pipe.

The advantages of a pipeline are that it:

- Has high capacity to carry goods;
- Does not easily get affected by weather conditions (Storms do wreck ships and too much surface water can spoil roads);
- Are cheap to operate; and
- Help reduce the problems of traffic jams, pollution and traffic crashes.

But their disadvantages are that they:


- Are expensive to construct;
- Harder supervision;
- Only carry highly specialised goods; and
- Have high costs of regular maintenance.

**Telecommunications and internet:** Except for certain physiographical and oceanic masses that may impair the setting of cables, telecommunication routes are practically unlimited and have very few constraints. The routes provide for instantaneous movement of information (speed of light! Impact of transportation mode on other transport associated costs). High network costs and low distribution costs characterise many telecommunication networks, which are linked to the tertiary sectors. But satellites often use a geostationary orbit which is, however, getting crowded.

**Intermodal transport:** This is a combination of two or more of modes of transport already discussed:

*How has intermodal improved the effectiveness of transport and distribution?*

- 1) Speed: from road, to rail and to sea
- 2) Security: containers can be moved between different modes to deliver a shipment
- 3) Damage: no need for further handling using forklifts, etc.
- 4) Traceability and accountability: using trackers



The logo for BI Norwegian Business School features a central blue square with the letters 'BI' in white. Radiating from this center are numerous colorful, 3D-style rectangular bars in various colors (red, orange, yellow, green, blue, purple, pink) that fan out in all directions. Each bar has a label for a business program: 'Business', 'Strategic Marketing Management', 'International Business', 'Leadership & Organisational Psychology', 'Shipping Management', and 'Financial Economics'.

**Empowering People.  
Improving Business.**

BI Norwegian Business School is one of Europe's largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD  
**EQUIS**  
ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

### **Impact of transportation mode on other transport associated costs**

- 1) **Movement costs:** cost of power to drive the vehicles for transport depends on the mode selected.
- 2) **Inventory costs:** It is quite clear that inventory holding costs are temporal costs and are directly proportional to the transit time. The longer the inventory is in transit, the larger are the costs. Transit capital remains blocked during transit time and unavailable for use. Mode of transport determines the transit time and thereby influences these costs.
- 3) **Obsolescence:** Specially, when the transit time is quite long the inventory can become redundant when it arrives at the point of use. We know that in the changed environment, product life cycles are shrinking and hence this cost becomes highly relevant. Other situations are product deterioration time and expiry date of the product.
- 4) **Packaging:** These costs are mode dependent, as for example, bad road conditions need robust packaging and, smooth transit does not need such packaging. This will also depend on handling system.
- 5) **Insurance:** This cost is obviously proportional to the risk of damage and loss in transit as this is the liability of carrier.
- 6) **Breakage:** This depends on the smoothness of the transit and handling system associated with the mode.
- 7) **Pilferage:** This cost can be eliminated by switching to options such as container transport.
- 8) **Customer Service Costs:** Shortage of products when demanded by the customer leads to customer dissatisfaction – and thereby loss of sale for the company.

# 11 REVERSE LOGISTICS

Reverse logistics is concerned with the flow of materials, or finished goods and their packages and related information from the point of consumption back to the manufacturer or supplier. There are reasons for returns or reverse logistics. Pohlen and Farris (1992) define Reverse Logistics as “...*the movement of goods from a consumer towards a producer in a channel of distribution*”<sup>169</sup>. But it is not only the goods that move backwards. Empty crates of say Coca Cola or Pepsi Cola move backwards. Rejects, damages and even packages are usually part of the returns back to the supplier or manufacturer. So Rogers and Tibben-Lembke (1999)<sup>170</sup> give us an all – encompassing definition. They define reverse logistics as the “*The process of planning, implementing and controlling the efficient, cost effective flow of raw materials, in-process inventory, finished goods and related information from the point of consumption to the point of origin for the purpose of recapturing value or proper disposal.*”

The European Working Group on Reverse Logistics defines reverse logistics as “The process of planning, implementing and controlling backward flows of raw materials, in-process inventory, packaging and finished goods, from a manufacturing, distribution or use point, to a point of recovery or point of proper disposal”<sup>171</sup>. What is coming out of all the definitions is that reverse logistics is about the backward flow of goods or materials (rejects, damaged, ‘empties’, or returns) and associated information to the point of origin. This reverse flow of returns may involve similar activities as the forward flow of materials or goods to the point of use; to the customer.

**Common reasons for returns:** De Brito and Dekker (2003)<sup>172</sup> say products are returned or discarded because they either do not function (anymore) properly or because they or their function are no longer needed. They have identified three categories of reasons for returns: customer returns; distribution returns; and manufacturing returns. The most common type of returns are the customer returns. Customers send back products because they have a warranty or reimbursement guarantees; products requiring service (repairs, spare-parts); end-of-use returns; and to a lesser extent because of end-of-life returns.

**Common Reverse Logistics Activities:** de Brito (2003)<sup>173</sup> has identified the following as the key activities of reverse logistics (she refers to them as the dimension ‘what’): collection, inspection/ testing, selection, sorting and recovery itself. Collection refers to processes of bringing the products from the customer back to point of origin or point of recovery. When goods are returned, their quality is assessed and a decision is made on the type of recovery. Recovery can be refurbishment, removal of only usable parts and dispose or recycle the rest of the parts. A product can be recovered as a whole, by being repaired at a product level (repair)<sup>174</sup>. After the decision on type of recovery has been done, the organisation can sort products and route them to the place where the recovery process is to take place. Rogers and Tibben-Lembke (1999)<sup>175</sup> have identified a number of activities as presented in the table below:

We can, using Rogers and Tibben-Lembke (1999)<sup>176</sup> and Tibben-Lembke (2004)<sup>177</sup> characterisation, have an example of possible reverse logistics activities in a manufacturing company of beverages in a country. Below we give them in the Table 20.

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



<i>Material</i>	<i>Reverse Logistics Activities</i>
Products	Return damaged or rejects to manufacturer Repair Recondition or refurbish
Packaging	Packaging and shipping materials from the end-user or the manufacturer/reseller Reclaim Materials Recycle the plastics Crush the damaged bottles Take them to the dumping group or landfill Reuse reusable bottles

**Table 20:** Common Reverse Logistics Activities

*Driving forces behind reverse logistics*

There are four main categories of driving forces for reverse logistics: economics, legislation (environmental laws), the environmental consciousness of consumers and lately corporate social responsibility or citizenship of companies. Companies undertake reverse logistics activities because they want to make profit from them; the law requires them to do so; the consumers are demanding it; and because companies are beginning to feel socially bound. De Brito and Dekker (2003)<sup>178</sup> in their “framework for Reverse Logistics” have focused on three of the four categories of driving factors: *Corporate citizenship, economics and legislation*

*Benefits of good reverse logistics management*

In the early 1980s and 1990s, organisations viewed returns or reverse logistics as mere costs on their part. They considered costs of transport, storage and disposal. Evidence now shows that a well-managed reverse logistics system created benefits for an organisation; these benefits are related to good image, customer care and profitability.

*Barriers to effective and efficient reverse logistics*

Some companies have found it difficult to successfully implement reverse logistics because of existing internal and external factors such as barriers. In their interviews of 300 respondents, Rogers and Tibben-Lembke (2004)<sup>179</sup> found the factors that hinder organisations reverse logistics mission. These factors include: importance of reverse logistics relative to other issues, company policies, lack of systems, competitive issues, management inattention, financial resources, personnel resources and legal issues.

# 12 INTERNATIONAL LOGISTICS

It occurs when supply chains cross a nation's international borders. It is concerned with flow of materials from one country to another or others. It is about the movement of materials for export or import.

## **Factors encouraging international trade**

There are several factors that encourage international procurement in international trade. They include the following:

- i) The unavailability of certain raw materials locally may lead an organisation to source them abroad.
- ii) There could be quality issues in the local market. The local market may not offer the quality that is required by some countries. Most super markets in countries in Africa that produce fruits and vegetables are stocked with the same products bought from the EU and USA because the local market has failed to provide the quality required by the customers.
- iii) Lead time is an issue. Some organisations may take long to supply the materials required by the procuring organisation. So the organisation may obtain the required materials from abroad faster than from local sources.
- iv) Regional integration efforts may make foreign products from the other members of region cheaper hence forcing local firms to buy from the region instead of locally. For example, there are efforts within the EAC region to remove intra-regional trade taxes. This will make products from the region cheaper.
- v) The technology is an issue. Some companies may require products that the technology available locally does not produce. This will require them to import.
- vi) The manufacturing of certain products e.g. a car require that you procure different materials from various countries and continents. To make a shirt may require buttons, thread, zippers, etc. which may not be obtained from one's local market.

## **Terms of payment in international trade**

Let us mention that terms of payment primarily cover the price of non-payment. Terms of payment, therefore, determine the degree of security for the seller. Commercial or exporting risks can be covered by the following:

- Insuring them via an insurance broker
- Dividing the non-delivery risks between the buyer and seller by specifying the tasks for each.

## Forms of payment in international procurement

There are five main forms of payment in international trade. These are cash-in-advance (advance payments), letter of credit, bills for collection (draft or documentary collection), open account; counter trade or barter.

### *Method of payment and risk bearing*

Depending on the method of payment, the degree of risk can increase for the seller or the buyer. See the method of payment and risk ladder below. The risks are ranked from most secure to less secure for the importer; and the reverse is true for the exporter.

An advertisement for SKF. The background is a blue-tinted image of a woman with long dark hair smiling, with a wind turbine visible behind her. The text is white and blue.

**Brain power**

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

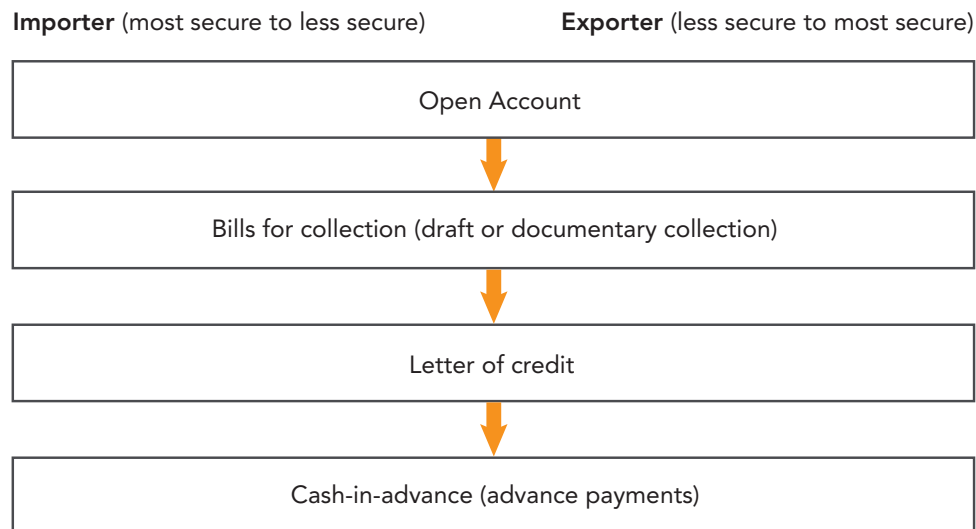
Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)





**Figure 7:** Methods of payment in international trade

We can also look at the time of payment, when the goods are available to the buyer and who bears risk, and when. Table 21 will enable buyers and sellers to make decisions carefully.

<b>Form or method</b>	<b>Time of payment</b>	<b>When Goods are available to the buyer</b>	<b>Risk to the seller</b>	<b>Risk to the seller</b>
Open Account	After the transaction	Before payment	Seller relies on buyer's promise to pay. There can be political and economic risks	None
Bills for collection (draft or documentary collection)	Expected on the maturity date of the draft			Relatively low

**Table 21:** Forms of payment in international trade

*Cash in Advance:* This is the most secure method of payment for the exporter; and the least attractive to the buyers. Payment is expected in full by the exporter before shipment of the goods. This form of payment puts more risk on the buyer. Payment does not necessary lead to shipment of the goods to the buyer. In some cases, the seller first uses the money for some period before shipping the goods.

*Letter of Credit:* This is a bank guarantee for payment under well described conditions of proof of order execution. It is a written understanding given by the buyer's bank (the issuing bank) on behalf of and at the request of its customer (the applicant) routed through the advising bank in the seller's country to the seller as the beneficiary that it (issuing bank) guarantees to pay the seller for the goods within a specified time providing that the conditions are laid in the down in the LC are fully satisfied. This is usually the best and most common form of payment in international trade. A Letter of Credit (also known as a Documentary Credit) is a bank –to – bank commitment of payment in favour of an exporter ( the Beneficiary), guaranteeing that payment will be made against certain documents that, once presented, are found to be in compliance with the terms set by the buyer (the Applicant). *There are four types of the letter of credit: irrevocable; revocable; unconfirmed; and confirmed.*

#### *Uniform Customs and Practice for Documentary Credits (UCP)*

The Letter of Credit is governed by the UCP<sup>180</sup>. The Uniform Customs and Practice for Documentary Credits is an internationally agreed upon set of rules for all parties involved in all types of Letter of Credit transactions. The rules which were adopted by the ICC (International Chamber of Commerce) in Vienna in 1933 have been revised a number of times and used by banks in practically all countries. The UCP for Documentary Credits is a set of rules which are binding on the parties who have adopted them.

#### *General Principles of UCP*

- 1) Letters of credit are separate transactions from the sales or other contracts on which they may be based and banks are in no way involved with or bound by such contracts, even if reference to them is included in the letter of credit.
- 2) In letters of credit transactions, all parties deal with documents and not with the underlying contracts to which the documents may relate. Before payment or acceptance of drafts is effected, banks bear the responsibility for examining the documents to ensure that they appear on their face to be in accordance with the terms and conditions of the letter of credit.
- 3) Banks bear no responsibility for: the form or genuineness of documents; for the goods described in the documents; or the performance of the seller of the goods.

#### **Types of the Letter of Credit**

There are mainly four types of the letter of credit that can be used in trade transactions. These are mainly: Irrevocable Letter of Credit; Revocable Letter of Credit; Unconfirmed Letter of Credit; and Confirmed Letter of Credit.

**Revocable Letter of Credit:** A revocable letter of credit means that the buyer (importer) may instruct their bank to revoke (not honour) it at any time prior to the payment maturing or becoming due. Article 8(a) and (b) of UCP states: *'A revocable Credit may be amended or cancelled by the Issuing Bank at any moment and without prior notice to the Beneficiary.'* Therefore, such a type of letter of credit does not give complete sense of security to the beneficiary. In modern commerce, such letters are rarely being used.

**Irrevocable Letter of Credit:** Once it has been issued, it cannot be withdrawn under any circumstances. It cannot be amended, cancelled or revoked without the consent of the parties to that letter of credit. This gives the beneficiary definite protection. This gives assurance to the seller (exporter) that once they have performed their contractual obligations, they will be paid.

**Confirmed Irrevocable Letter of Credit:** With this letter of credit, a bank in the exporter's country agrees to pay if the importer's bank fails to pay.

#### **Benefits of the Letter of Credit**

The Letter of Credit is beneficial to both the exporter (seller) and the importer (buyer).

## TURN TO THE EXPERTS FOR **SUBSCRIPTION** CONSULTANCY

Subscribe is one of the leading companies in Europe when it comes to innovation and business development within subscription businesses.

We innovate new subscription business models or improve existing ones. We do business reviews of existing subscription businesses and we develop acquisition and retention strategies.

Learn more at [linkedin.com/company/subscribe](https://www.linkedin.com/company/subscribe) or contact  
Managing Director Morten Suhr Hansen at [mha@subscribe.dk](mailto:mha@subscribe.dk)

**SUBSCR**✓**BE** - to the future

<i>Benefits to the seller</i>	<i>Benefits to the buyer</i>
<ul style="list-style-type: none"> <li>• The LC provides a secure mechanism to payment upon fulfillment of contractual obligation by the seller and buyer.</li> <li>• The bank, instead of the buyer, becomes the source of payment for the goods or services sold.</li> <li>• The issuing bank undertakes to pay provided that all the terms and conditions stated in the LC are fulfilled.</li> <li>• The seller enjoys the bank expertise made available to help complete international trade transactions successfully.</li> <li>• The payment for the goods shipped to the buyer can be remitted to you seller's own bank or a bank of your choice.</li> </ul>	<ul style="list-style-type: none"> <li>• Cash is not tied up in purchases or imports</li> <li>• Payment for the purchase will only be made to the seller when the terms and conditions of the LC have been complied with</li> <li>• The buyer can control the shipping schedule or dates for the goods that are being purchased.</li> </ul>

**Table 22:** Benefits of the Letter of Credit

**Documentary Credit:** This is where payment will be made after presentation of a bill exchange against receipt of the relevant shipping document (the most common document are the bill of lading or airway bill).

**Cash against documents** gives the seller (supplier) security that in the event the documents are not accepted by the buyer, the goods remain available to the supplier (seller). The supplier will present the document to his/her bank with instructions to send them to the buyer for collection of payment. It should be noted that bills of exchange can be considered as guaranteed payment if they are countersigned by a bank.

There are disadvantages with this form of payment:

- 1) In case the goods were to be sold to another customer, would they be available at the same price?
- 2) If the goods have to be returned to the seller then there will be double cost of shipping and landing.
- 3) There is also the risk of dead stock and some products could become obsolete due to changes in technology.

**Bill of exchange:** This is a written (and sometimes guaranteed) promise to pay the seller at the date mentioned in the draft. A bill of exchange can be considered as guaranteed payment if they are countersigned by a bank.

**Open Account:** This where payment for the goods is done after delivery of the goods without any security. The seller gives credit to the buyer for a given period of time after the delivery of goods. The period of credit is usually short. The buyer will usually effect the payment through a bank transfer.

Conditions for the Open Account payment:

- i) There is an existing long-term relationship and confidence between the buyer and seller
- ii) The customer is well known in the market and with a good reputation.
- iii) The seller is under pressure to sell his goods
- iv) The buyer is solvent
- v) There is standard merchandise that can be identified along the lines of the delivery circuits.
- vi) There are no political risks or drawbacks envisaged in international trade.

### **International Commercial Terms (InCoTerms)**

The incoterms are a universal trade terminology that were first published in 1936 by the International Chamber of Commerce (ICC) to clarify the obligations of both parties in selling and buying; the buyer and the seller. The Incoterms have been revised six times before 2010 and in this section we use the current Incoterms 2010. The Incoterms 2010 became effective in January 2011.

The Incoterms 2010 cover the following terms

<ul style="list-style-type: none"><li>• Warehousing</li><li>• Packing and loading</li><li>• Inland freight</li><li>• Terminal charges</li><li>• Freight forwarder's fees</li></ul>	<ul style="list-style-type: none"><li>• Ocean/air freight</li><li>• Duty, tax and customs clearance</li><li>• Delivery</li><li>• Security clearance</li></ul>
--	---

The Incoterms 2010 are divided into four groups

Group E: Departure Group F: Main carriage unpaid	Group C: Main carriage paid Group D: Arrival
---	---

In principle the seller must provide the goods according to the terms of the contract. Depending on the terms of the contract, both the seller and buyer have to perform certain tasks in order to finalise the transaction (as below).

<i>Seller</i>	<i>Buyer</i>
Arrange for license Authorisations and form formalities Arrange for shipping Arrange for delivery Bear the risks for his/her activities	Arrange for license Authorisations and form formalities Arrange for shipping Accept delivery Bear risks involved in the contractual terms/activities

Please visit the international Chamber of Commerce (ICC) to keep updated on the changes in the Incoterms. Find ICC at <http://www.iccwbo.org>

**What do you want to do?**

No matter what you want out of your future career, an employer with a broad range of operations in a load of countries will always be the ticket. Working within the Volvo Group means more than 100,000 friends and colleagues in more than 185 countries all over the world. We offer graduates great career opportunities – check out the Career section at our web site [www.volvogroup.com](http://www.volvogroup.com). We look forward to getting to know you!

**VOLVO**  
AB Volvo (publ)  
[www.volvogroup.com](http://www.volvogroup.com)

VOLVO TRUCKS | RENAULT TRUCKS | MACK TRUCKS | VOLVO BUSES | VOLVO CONSTRUCTION EQUIPMENT | VOLVO PENTA | VOLVO AERO | VOLVO IT  
VOLVO FINANCIAL SERVICES | VOLVO 3P | VOLVO POWERTRAIN | VOLVO PARTS | VOLVO TECHNOLOGY | VOLVO LOGISTICS | BUSINESS AREA ASIA

### **Problems with international logistics**

The international market and indeed the global market involve many players as organisations, individuals and governments. There are various problems or challenges that may be encountered by a procurement professional or buying organisation or the exporting organisation. These challenges can be looked at from the aspects of technology, politics, laws, culture, economics and the issues of ecology and the green environment.

- 1) *Socio-cultural factors*: One of the factors that may influence international business transactions is the issue of language. Language includes dialects and accents. Language is important for labeling and transactions. There could be communications problems between the parties. The language used on the packaged products may not be understood by the buyer.
- 2) There is also the issue of *religion*. Different religions come with different beliefs and ways of life. This has both positive and negative implications for international business. For example you will not get market if you do not sell *halal* food (meat) in Arab world. Even in some countries for example Canada, Muslims can only buy from where they sell *halal* food.
- 3) The *level of technology* matters in international business. Some firms from certain countries cannot buy from other countries because their technology is either too old or too new for them. Technology influences the nature and type of products; and media to be used to communicate.
- 4) There are political factors in any country that influence the level of business and international trade. Political stability allows trade and movement of materials.
- 5) Laws of different countries have influence on international transport and movement of materials. For example in some countries there is a limit on goods moved on the roads; on the tare limit.


## **PART III: PROCUREMENT**

# 13 PROCUREMENT AND DISPOSAL MANAGEMENT

Procurement can be defined as the process of acquisition of goods, works and services to satisfy the identified needs of an important function within an entity. Procurement can also be defined as the process through which entities purchase their requirements to fulfill organisational requirements. But the traditional definition of procurement is acquisition by any means of supplies, services or works. This definition was more associated with purchasing than procurement. We can say that procurement, different from purchasing, is a process not an event. It has to be conducted in a systematic manner and involves a number of stakeholders. It requires some skills to manage the purchasing processes efficiently and it has to be conducted in accordance with established procedures.



The advertisement features a background image of a person in a red shirt running on a path. The scene is overlaid with technical diagrams, including a yellow square with a leaf-like shape, a dotted line, and a circular diagram with lines extending from it. The text is white and yellow, set against the orange-tinted background.


 **gaiTEYE**<sup>®</sup>  
*Challenge the way we run*

**EXPERIENCE THE POWER OF  
FULL ENGAGEMENT...**

.....

**RUN FASTER.  
RUN LONGER..  
RUN EASIER...**

**READ MORE & PRE-ORDER TODAY**  
**WWW.GAITEYE.COM**



### **What are the objectives of procurement?**

The key objectives of procurement can be captured in the **traditional five (5Rs) rights of procurement**, as they were originally stated by Bailey and Farmer (1985)<sup>181</sup> namely:

- 1) Acquiring the right product
- 2) From the right supplier
- 3) In the right quality
- 4) At the right time
- 5) At the right price

### **Procurement Planning**

Planning is important for all entities that undertake procurement. It is necessary to prepare a procurement plan for an organisation every year. This plan should always be prepared before the commencement of the year. We can look at procurement planning as the process of determining the procurement needs of an entity, scheduling their acquisition, identifying and confirming their source of funding and ensuring that acquisition is made efficiently and effectively. It entails the selection of a procurement method for various goods, works and services, when to schedule activities and also considers the legal and institutional frameworks in which procurement has to be undertaken. The procurement plan should indicate the products or services or works or capital development that will be purchased, when it will be purchased, how it will be purchased, from where it will be purchased, confirmed source of funds and the person responsible.

### **Contents of a procurement plan**

Procurement planning should be able to answer the following questions:

- Which output/outcome will the procurement contribute to?
- Why does an entity want to procure?
- What does it want to procure?
- When does it want to procure it?
- Where does it want to procure it from?
- How does it want to procure?
- Who in the entity does the procurement?
- When are the funds available and from where?
- How can you be more efficient in the procurement process?

### The contents of the procurement plan

The procurement plan will have the following contents, with items on the table of contents explained.

- Executive summary
- Objectives of the procurement plan
- Output and outcomes that the plan should deliver
- A detailed breakdown of procurements to be undertaken in order of priority
- Type and method of procurement to use
- The quantities of requirements and the unit of measurement
- The procurement value
- Confirmed source of funding for the procurements
- Total time the procurement process will take (lead time)
- Planned date when each procurement will be required by the user
- Latest date when each procurement will be initiated by the user
- Financial year of initiation of the procurement
- Financial year of payment for the procurement
- Levels of authorisation

### Stakeholders in the private procurement process

Like in public sector procurement, the private sector also has various stakeholders in the procurement process. These stakeholders have different levels of power/influence and interest. They also have interest at different levels of the procurement process. See Table 23 below for these stakeholders.

<b>Stakeholders</b>	<b>Stake or interest</b>
User department	They will use the acquisition
Procurement department	Undertakes the acquisition
Accounting officer	Signs the contracts; accounts for the use of funds
Finance department	Responsible for providing the funds
Contracts committee	Awards the contracts; decides that there be a purchase; approves the procurement method(s)
Suppliers	Responsible for providing the procurements
Customers	Purchase what has been made using the procured materials
Government	There for regulation

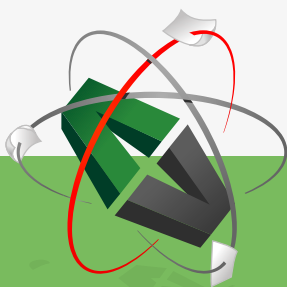
**Table 23:** Stakeholders in the private procurement process

## Benefits of procurement planning

The benefits of procurement planning are that it:

- i) Enhances team work of all the stakeholders.
- ii) Fosters interdepartmental relations and harmony within the organisation.
- iii) Helps an organisation to achieve organisational goals/objectives timely.
- iv) Helps to minimise emergencies.
- v) Makes an organisation efficient and effective because there are cost reductions in planned acquisitions of goods, works or service.
- vi) Helps in cash flow management because the activities follow planned time schedules
- vii) Makes it easier to detect fraud since what is to be achieved, how it is to be achieved and the estimated costs of achieving it have already been set.
- viii) Facilitates efficient and effective inventory management
- ix) Works as a performance management tool since the activities to be undertaken within a given period and at a given cost are already set.
- x) Saves the entity money by obtaining price reductions through quantity discounts.

This e-book  
*is made with*  
**SetaPDF**



PDF components for PHP developers

[www.setasign.com](http://www.setasign.com)

- xi) Enables consolidation of requirements for greater economies.
- xii) Provides for sufficient lead time and resources in the selection of appropriate contract types.
- xiii) Provides sufficient time to go through the procurement process, undertake the required reviews and obtain required approvals before submission of requisitions.

### *Challenges in procurement planning*

Planning involves not only the procurement functions but indeed the entire organisation. It is always a tedious and lengthy process, requiring staff and management time and commitment. There are, therefore, challenges in using a plan. The challenges:

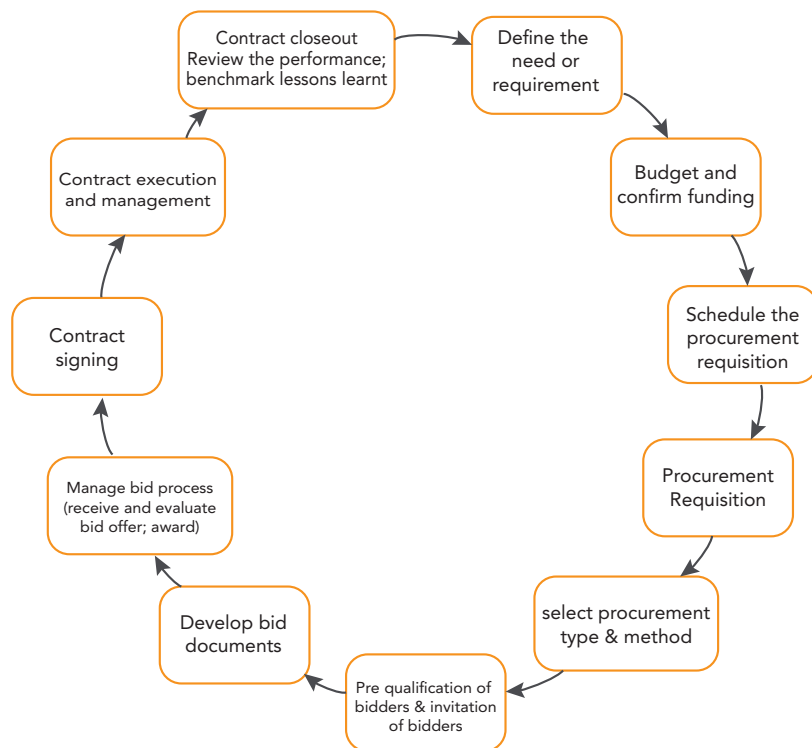
- i) The bureaucratic red tape may discourage the attainment of the organisational objectives via procurement given that it lengthens the process.
- ii) Calls for ample planning skills and competences necessary to prepare user needs but these may not be available in the organisation.
- iii) It requires the support of senior management and where this is not possible the process stalls.
- iv) May deliver products that are more expensive yet they do not necessarily meet the high expectations of the user departments
- v) May enlist undue influence from top managers who tend to influence what is included in the plan as well as what is finally procured.
- vi) Leads to undue centralisation of budgets and decision making.

### *Consequences of lack of procurement planning*

Without procurement planning, an organisation may face negative consequences. Lack of planning may result in:

- Guess work where otherwise market scanning would guide estimations.
- Wastage through obsolete and outdated fashion items being purchased which will not serve the current purpose.
- Inability to aggregate the items into bigger orders that can attract discount purchases.
- Redundancies and time wastage in the procurement unit during the periods when there are no planned items to be acquired.
- Conflicts within the organisation if responsibilities along the procurement chain are not clearly defined.
- Undue influence from top management in procurement decision making.
- Purchase of non-essential items ahead to the core requirements because time schedules for each need have not been agreed on.

**Generic steps in a procurement cycle:** The generic procurement activities in a procurement cycle are outlined in Figure 8. Different organisations may have their activities either compressed or expanded. However, these activities will include those presented in the cycle here.



**Figure 8:** Generic steps in a procurement cycle

Stage	Roles and responsibilities
User department prepares procurement requirements and costs	User depart prepares
Consolidating user departments' procurement plans. Procurement plan agreed by management; and Contracts Committee. Approved procurement plan handed to the public procurement and disposal regulation authority;	Procurement and Disposal Unit (PDU)
User department makes a request to acquire goods or services (User has to first check market prices)	User department
Accounting officer confirms availability of funds (checks the procurement plan to see if this item was in the plan) If funds are available, s/he informs the user and PDU.	Accounting officer (CEO of the state agency)
Preparation and review of bidding documents (Specifications; TORs)	PDU in consultation with user department

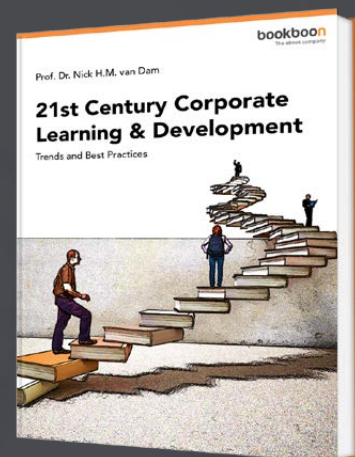
Stage	Roles and responsibilities
Contracts committee approves procurement methods, evaluation methods, bidding documents (Specifications; TORs) and the advertisement (where required)	Contacts committee
Receipt and opening of the bids	PDU
Evaluation of the bids; preparation of evaluation reports (and show the best evaluated bidder) and hand it over to PDU	Evaluation committee (its ad hoc)
Where there is not complaints from the other bidders (referred to 'Administrative Review')	Contacts committee
Signing of the contract between PDU and bidder	Accounting Officer and the bidder's authorised representative
Contract management: Ensure delivery and payment or execution; and Contract monitoring	User department PDU

**Table 24:** A procurement cycle of a government agency from a developing country (Uganda)

# Free eBook on Learning & Development

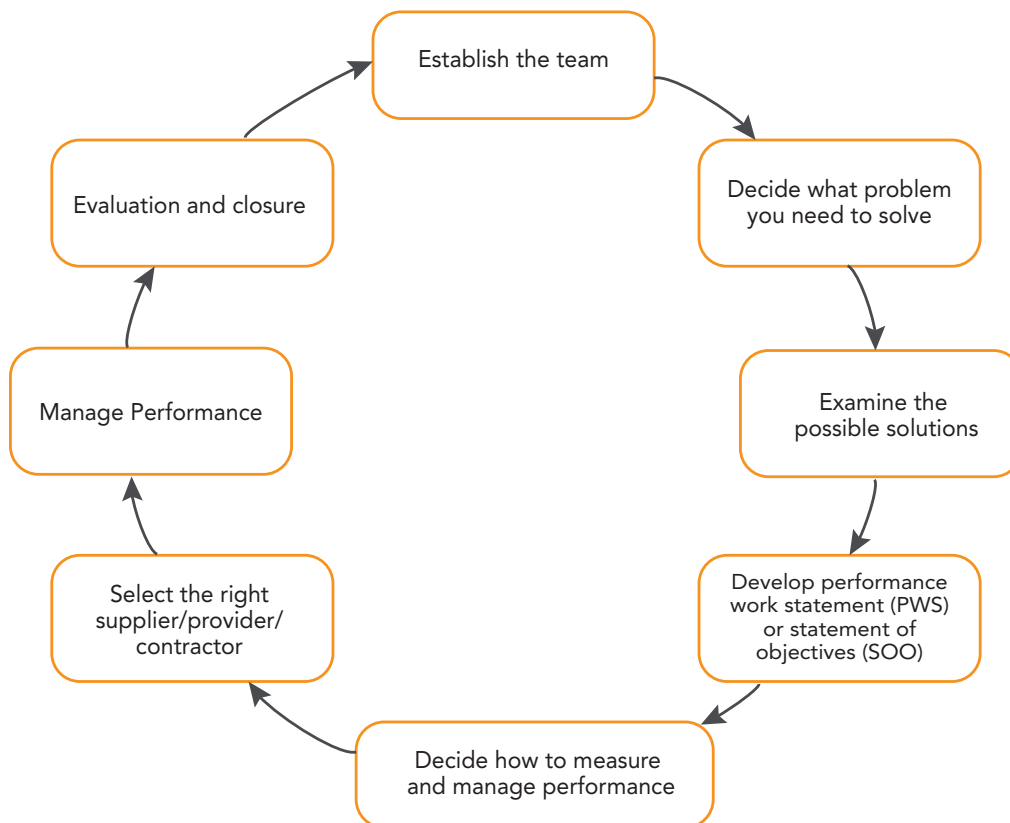
By the Chief Learning Officer of McKinsey

[Download Now](#)



## Performance-Based Services Acquisition

It is necessary to begin acquiring services based on their performance. Performance is important for the success of any activity. Performance-Based Services Acquisition (PBSA)<sup>182</sup> may be referred to as a policy and practice where organisations select procurement and contract administration approaches that best accommodate their requirements. Under PBSA, the contracting organisation (client) sets the standards, the results to be achieved and then gives the supplier or contractor the freedom to achieve it in the best way<sup>183</sup>. It can be used as an approach both for government and private sector.



**Figure 9:** Seven Steps to Performance-Based Services Acquisition Source:

Adapted from [http://acquisition.gov/comp/seven\\_steps/library/SevenSteps\\_execversion.pdf](http://acquisition.gov/comp/seven_steps/library/SevenSteps_execversion.pdf)<sup>184</sup>

## Benefits of Performance-Based Services Acquisition for the client

A well implemented PBSA has various benefits<sup>185</sup> and they may include:

- Increased likelihood of meeting mission needs;
- Focused on intended results not the process;
- Enhanced performance and better value;
- Lessened performance risk;
- No detailed specification or process description needed;

- Supplier or contractor flexibility in proposing solution;
- Contractor buy-in and shared interests;
- Better competition with variety of solutions from which to choose rather than just contractors;
- Shared incentives permitting innovation and cost effectiveness;
- Less likelihood of a successful protest;
- Less frequent and more meaningful surveillance; and
- Documented results for the process.

**Public procurement systems:** Public procurement has received great interest from a number of policy makers, development partners (call them donors) and civil society activists in developing countries. This is because of its advantage of cost saving and ensuring value for money while using public funds. Public procurement used to be perceived as a simple ordering or clerical function of government intended to obtain the right goods, capital assets or services (meeting quality requirements) in the right quantity, for delivery at the right time to the right place, from the right source (a responsive reliable supplier) and at the right price (NIGP, 2002)<sup>186</sup>. The procurement function in government is currently recognised as a key function of public agencies, departments and central government ministries not only in developed countries but also in developing countries<sup>187</sup>.

We can refer to public procurement as purchasing, or hiring, or obtaining goods and services by contractual means by the public sector<sup>188</sup>. Such acquisition has to be effected through government budgets. Funding for public procurement can come from domestic loans or foreign loans guaranteed by the state, foreign aid, or revenue taxes or from an economic activity of the state.

<i>Stakeholders</i>	<i>Interest/stake</i>
User department	It is the consumer or user of the procured items or services
Procurement department	Has the responsibility for undertaking the procurement process. Has a concern for value for money.
Accounting officer	The buck stops with this officer. Has a concern for value for money.
Finance department	Pays for the purchases. Has a concern for value for money.
The procurement regulation authority	To monitor whether procurement procedures have been followed; including value for money.
Ministry of Finance or treasury	Public sector is mostly financed by government through the Ministry of Finance/or treasury. Has a concern for value for money.

<i>Stakeholders</i>	<i>Interest/stake</i>
Donors	Fund development projects. Has a concern for value for money.
The legislature (members of parliament)	Have oversight roles. Have a concern for value for money.
Provider or supplier	Interested in being paid, and good contractual relationship for future supplies.
Inspector General of Government or ombudsman	Have oversight roles. Have a concern for value for money.
The public	Have a concern for value for money.
NGOs	Have a concern for value for money.

**Table 25:** Key stakeholders in public procurement

[www.sylvania.com](http://www.sylvania.com)

**We do not reinvent  
the wheel we reinvent  
light.**

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

**OSRAM  
SYLVANIA**

## Principles of public procurement

Like other disciplines, procurement has principles that guide it. We shall look at those principles under the mnemonic *VETOFACE*.

- *Value for Money*: Value for money can be referred to as the optimum combination of whole lifecycle costs and total quantity appropriate to meet the requirement of any procurement need. Do not waste money. Do not pay more for less. Avoid unnecessary value adding costs. Value for money decisions should be sought while arriving at any procurement decision.
- *Efficiency, effectiveness and economy*: procurement is supposed to provide goods or services that help an entity to deliver its mandate. When making procurements, the purchasing organisation needs to consider value for money. This is why price is usually important in the procurement process.
- *Transparency*: This principle requires that procurement processes be open to the public and decisions taken and reasons for those decisions made accessible to the public at the appropriate time. Procuring entities should ensure that procurement activities are done openly. It should also ensure openness and clarity on the procurement policy governing such bidding processes.
- *Open competition*: The procuring entity and procurement professionals should ensure that there is fair/open competition among all bidders under the same terms and conditions in order to ensure value for money. The competitive procurement methods accepted in public procurement and most donor funded projects are Open Domestic Bidding (ODB), Open International Bidding or International Competitive Bidding (OIB or ICB), Restricted Domestic Bidding (RDB), Restricted International Bidding (RIB) and Request for Quotation or Request for Proposal (RFQ or RFP).
- *Fairness*: To be fair to all, there is need to arrive at procurement decisions without bias whatsoever. In case a conflict of interest occurs, there is need to withdraw from the procurement process by signing up a *Declaration of Interest Form* (DIF) and declaring this to the Contracts Committee.
- *Accountability*: Procurement professionals should always be willing to be held accountable for the outcomes of their decisions. They should justify to stakeholders the reasons for their actions. To ensure accountability, auditing the procurement process is enforced through procurement audit or a complaints mechanism.

- *Confidentiality*: Procurement professionals are required to jealously guard confidential information and only give it out on orders of court. Information, for instance, concerning evaluation of bids is required to be kept confidential until after the procuring entity has already notified the best evaluated bidder of the award. Usually the report of evaluation and information about the best evaluated bidder are displayed on the notice board before notification of the successful bidder and award of the contract. Procurement laws and regulations in different countries require that all the parties engaged in the bidding/procurement process ensure confidentiality and accuracy of information in the procurement process.
- *Equity (non-discrimination)*: Discrimination occurs when one party treats another less favourably than others, either on grounds of race, ethnicity, colour, sexual orientation, religion or beliefs. The procuring entity should ensure that all bidders are treated fairly or equally. Whenever there is need for clarifications to bidders by the procuring entity, the clarification should be given to all the bidders. All bidders should have the same information about the bidding process in which they are participating. This will promote equity and ensure non-discrimination.

#### *Consequences of non-compliance with procurement principles*

It is important that the procuring entity and procurement professionals observe these principles. Failure to ensure adherence to them, may result in negative consequences for the entity and the professionals. These may include:

- Biased decisions;
- Emergency procurement;
- Cost overruns;
- Waste;
- Collusion, fraud, bribery and extortion which are contrary to business ethics;
- Infighting among key players;
- Delays in procurement and delivery of what had to be purchased; and
- Court cases.

### **Methods of Public Procurement**

In this section, we will look at the methods of procurement that a central government ministry, department or agency can use in during procurement.

1. **Open Domestic Bidding**: open to all bidders following a public advertisement of a Bid Notice in at least one widely read national newspaper.
2. **Open International Bidding**: where competition will not be effective without foreign bidders or where foreign bids will increase value for money. Nothing prevents a domestic bidder from participating in open international bidding.

3. **Restricted Domestic Bidding** may be used where:

- a) the supplies, works or services are available only from a limited number of providers; or
- b) there is insufficient time for an open bidding procedure, for example in an emergency situation; or
- c) the estimated value of the procurement or disposal does not exceed the threshold stated in the procurement guidelines issued under this Act.

The invitation to bid shall, in such cases, be addressed to a limited number of potential bidders without advertising the opportunity in a Bid Notice.

4. **Restricted International Bidding** may be used where:

- a) the supplies, works or services are available only from a limited number of providers and;
- b) there is insufficient time for an open bidding procedure, for example in an emergency situation; or
- c) the estimated value of the procurement does not exceed the threshold stated in the public procurement guidelines.



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.

Under this procurement method, the invitation to bid is addressed to a limited number of potential bidders without advertising the opportunity in a Bid Notice;

5. **Request for Quotations (RFQ) or Proposal (RFP)** may be used where:
- a) there is insufficient time for an open or restricted bidding procedure, for example in an emergency situation; or
  - b) where the estimated value of the procurement does not exceed the threshold stated in the public procurement guidelines.

The solicitation document are addressed to a limited number of potential bidders without advertising the opportunity; and a procuring and disposing entity has to obtain at least three bids.

6. **Direct procurement** may be use where:
- i) there is insufficient time for any other procedure for example in an emergency situation; or
  - ii) the works, services or supplies are available from only one provider;
  - iii) an existing contract can be extended for additional works, services or supplies of a similar nature and no advantage could be obtained by further competition (as long as the prices on the extended contract are reasonable);
  - iv) additional works, services or supplies required have to be compatible with existing supplies, works or services and it is advantageous or necessary to purchase the additional works, services or supplies from the original supplier, provided the prices on the additional contract are reasonable; or
  - v) it is essential or preferable to purchase additional works, services or supplies from the original supplier to ensure continuity for downstream work, including continuity in technical approach, use of experience acquired or continued professional liability, if the prices on the additional contract are reasonable;
  - vi) where the value of the new works, services or supplies does not exceed 15% of the value of the original or existing contract and where the original or existing contract has been awarded through a competitive process;

7. **Micro procurement** may be used where the goods or services are below the threshold stated in regulations. Where a procuring and disposing entity engages in micro procurement:
- a) The original invoice or receipt for the supplies procured and the price paid has been obtained and signed by the official procuring the supplies; and
  - b) It shall be responsible for ensuring that value for money is obtained to the extent practical under the procurement procedure.

### **There are other procurement methods usually allowed by governments**

1. **Force Account:** under this method of public procurement, use of the public entity's own personnel and equipment is permitted when it is the only practical method for undertaking some kinds of works. Force account can be justified where:
  - the quantities of work involved cannot be defined in advance;
  - the works are small and for which qualified construction firms are unlikely to bid at reasonable prices; the risks of unavoidable work interruption are better borne by the organisation than by a Contractor; and
  - there are emergencies needing prompt attention.
2. **Community purchase:** At the community level, in local government, members of the community can form a committee for the purposes of purchasing materials or seeds or animals that are usually distributed to the benefiting community members. Such programmes in agriculture, some developing countries, have the community members agreeing and buying some purchases as a community purchase.

### **Evaluation of Bids**

Evaluation of bids is one of the steps in the evaluation process. It is an independent assessment of compliance with the requirements stated in the bid documents. The bids have to comply with the statement of requirements, exhibit of the ability of the bidder to perform the proposed contract, as well as the ability to meet the objectives of the procurement. Evaluation of bids is done by the Evaluation Committee (EC), which is an ad hoc committee. It is assembled as the need arises. Usually the evaluation committee's report recommends the best evaluated bid.

### ***Guiding Principles for Evaluation of Bids***

The following principles guide the evaluation process:

- All bids are assessed against the same criteria;
- The evaluation criteria is made known to all bidders in the bid/solicitation documents;
- The principle of equitable and fair assessment is applied in the evaluation of bids; and
- Evaluation of bids is the responsibility of the Evaluation Committee.


## Steps in evaluation of bids

There are **three key stages** in the evaluation of bids: preliminary bid examination, technical evaluation and financial evaluation. The result of these processes is the evaluation report which is used by the contracts committee to award.


- 1) **Preliminary examination:** This is an important stage in the bidding and contracting process in both private and public sector procurement. After the bidding closing date, day and time, the process of evaluation of bids starts. It starts with the **preliminary examination** of the bids.
- 2) **Technical evaluation of bids:** Under a competitive bid process, the method used for the evaluation of supplies or works (construction of roads, buildings, etc.) is **technical compliance**. This method favours a *lowest cost or price* in terms of the total price of the bid. So the bidder who is technically compliant and has a lowest price will emerge the best evaluated bidder.

SIMPLY CLEVER

ŠKODA



We will turn your CV into an opportunity of a lifetime



Do you like cars? Would you like to be a part of a successful brand? We will appreciate and reward both your enthusiasm and talent. Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



Evaluation of services as consultancy services is discussed here. There are six methods that can be used in the evaluation of consultants: *Quality and Cost Based Selection (QCBS)*, *Quality Based Selection (QBS)*, *Fixed Budget Selection (FBS)*, *Single Source Selection (SSS)*, *Least Cost Selection (LCS)* and *Selection Based on the Consultants Qualifications (CQS)*. These are the same methods used by the World Bank. See the World Bank section for details.

- i) **Financial Evaluation of Bids:** A financial evaluation will be conducted for all those bids that have passed the technical evaluation stage. The process will require that the evaluation committee (EC) examines and compares to determine the best evaluated price<sup>189</sup>. The EC will first correct any arithmetic errors and convert all bids to the single currency that had been stated in the bid documents (it is usually the local currency). It will also apply any margin of preference as had been stated in the bid documents; and make adjustments for non-material omissions and finally determine total evaluated price.
- ii) **Combine Technical and Financial Evaluation:** Once the committee has graded the financial report, it will combine it with the technical report in order to get the best evaluated bid. The combination will be based on a ratio that was stated in the bid documents (for example 70:30; 80:20; 90:10). The firm or bidder with the best marks from the combined documents will become the best evaluated bid. The second best evaluated bidder will be ranked next and the rest will follow that order.
- iii) **Compilation of an Evaluation Report:** At the end of the evaluation process, the evaluation committee will prepare and present an evaluation report to the public procuring entity. This report will indicate all the processes of the evaluation. It will show the number of bid documents that were picked; the number of applications received before the expiry of the bid; the bids that went past the administrative review; and the best evaluated bid. The ranking order will be used to show the best evaluated bid.

The report will also state the procurement method(s) used; the evaluation methods used; the scoring system used; the score sheets of all evaluators; the combined score sheet for each bidder; and the ethical code of conduct signed by each evaluator. The advert (in case of open competitive bid) will be attached as well as a copy of the bid documents. This report will be handed over to the PDU for onward submission to the Contracts Committee via the accounting officer. The Contracts Committee will either accept or reject the evaluation report. Once the report is accepted, the Contracts Committee will offer the award to the best evaluated bidder. Upon acceptance, the best evaluated bidder will sign a contract with the accounting officer and later start the assignment.

*Best evaluated bid*

Under competitive methods, the evaluation report ranks the bids according to the rating or scores. The evaluation committee, using the already set out evaluation method stated in the bidding documents, is supposed to rank them from the best to the worst rated bid. The best evaluated bidder will later be offered an award by the Contracts Committee, when they have approved the evaluation report. The purpose of ranking, among other reasons, is to get a systematic approach for the contracts committee to award fairly. When the best evaluated bidder refuses to accept the offer, then the Contracts Committee will give the same offer to the next best in the ranking order.

**Ethics and Procurement**

Ethics has become a major field of study for managers and academicians. It has been realised that a private sector professional who does not understand the importance of ethics will not deliver results efficiently within a competitive environment. And in the public sector, ethics becomes very important because the resources public officers use are from and for the public. The public pays taxes, engages in business and expects good public service delivery.

Ethics may be generally defined as the principles of conduct governing an individual or group where concern for what is right or wrong, good or bad is paramount. Generally, ethics may be referred to as the well based standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness or specific virtues.

Ethics are determined and shaped by one's values which fall within the socio-cultural spectrum. In the business sector, business ethics refers to the application of ethics to the business relationships with various stakeholders. The business stakeholders include suppliers, distributors, agents, customers and consumers.

Employees as professionals have to be guided by professional ethics. Professional ethics can be described as the guidelines that practitioners have to observe in order to behave and keep their association with their professionalism and performance. A professional has to be ethical in the way they behave and perform their duties. Specifically, the key principles of professional ethics<sup>190</sup> for procurement professionals are:

- To be impartial and act objectively;
- Observe the principle of confidentiality;
- To avoid a conflict of interest in your work;
- To always ensure that you observe the duty of care<sup>191</sup>;

- To ensure openness and full disclosure;
- To ensure optimal use of resources of the organisation; and
- To observe professional responsibilities as prescribed by both the letter of appointment and the professional ethical code of conduct.

### Ethical or legal?

There is a common tendency to think that what is ethical is always legal. Legal means that once one has committed such an act, they face courts of law. Ethical has to do with morals or values. Some acts can be both ethical and legal. For example, in some countries smoking in enclosed public places is banned. In these countries, smoking is not only an ethical issue but also a legal one. Within the EU, for example, 17 countries currently have strong laws on smoking. Spain, Ireland, Malta, Bulgaria, Greece, and Hungary have the strictest laws with total ban on smoking in enclosed public places, public transport (railways, light rail, and buses), and workplaces<sup>192</sup>. Britain, which voted to exit the EU, too has strictest laws on smoking. In some of these countries, enforcement, not the law, has been an issue. In several countries, abortion is both immoral and illegal. The person who commits abortion will face both public humiliation and the courts of law.

**e-learning for kids**

- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFKI. An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

**Values:** What are values?

As aforesaid, ethics are determined and shaped by one's values within a cultural context. For example, what is wrong in one community may not necessarily be treated as bad in another. There are, however, some ethics that are respected globally.

Values can be defined as the underlying beliefs and attitudes that help determine an individual's behaviour. Attitudes are learned and are a predisposition. They are associated with perception which is generally viewed as the way we see 'the world around us'. Values are the broadly held beliefs concerning what is viewed as right and wrong. Values vary from one individual to another. They determine the choices that individuals make in life. People make choices, for example, on the professions to take, where to live, which items to acquire and whom to marry. Personal values may include (but are not limited to) honesty, trustworthiness, humility, compassion, freedom, responsibility, justice and peace.

### **Ethical codes of conduct**

Ethical codes of conduct are essential to the conduct and performance of duties of a professional. They have rules and regulations that have to be observed by professionals subscribing to a certain professional body. There are codes specific to a certain profession<sup>193</sup>. There are also national or even international codes. National codes may be set by the state while international codes could be set by a professional body or inter-governmental organisations. The UN is one such inter-governmental organisation. The Chartered Institute of Purchasing and Supplies (CIPS), the Association of Chartered and Certified Accountants (ACCA) and the Chartered Institute of Marketing (CIM) ethical codes of conduct globally guide all their members.

### **Importance of ethical codes to the staff in the procurement functions**

Observance of the ethical code of conduct by procurement staff dealing with suppliers is necessary for the establishment and keeping of long term relationships. Trust is one of the key variables in a relationship and unethical persons cannot be trusted. They cannot, for example, be trusted to be given goods before they have paid.

As representatives of their organisation, procurement personnel need to be ethical in order to ensure a good image of their employing organisation when dealing with vendors or suppliers. Their job exposes them to temptation with inducement and may force them to act unethically if there were no strict ethical codes.

## Corruption and procurement

Corruption can be defined as ‘abuse of authority or trust for private benefit...a temptation indulged in not only by public officials but also by those in positions of trust or authority in private enterprises or non-profit organisations (IMF, 2000)<sup>194</sup>. It is common to use corruption and fraud interchangeably in literature and common usage. The most prevalent forms of corruption may include bribery, fraud, embezzlement, extortion, nepotism and influence peddling and cronyism. The list also includes the appropriation of public property or assets for private use<sup>195</sup>. Fraud is one of the forms of corruption.

## Procurement and fraud

Fraud has been defined by CIMA<sup>196</sup> as dishonesty obtaining an advantage, avoiding an obligation or causing loss to another party. Fraud is not error. It is an intentional act. It can be referred to as the intentional false representation or concealment of a material fact for the purpose of inducing another person to act upon it for personal benefit.

## Types of fraud

<p>False statements False claims Impersonation Embezzlement Extortion Breach of duty Bribery</p>	<p>Conflict of interest Favouritism Nepotism Forgery Conspiracy Gratuities Kickbacks</p>
--	--

*Fraud detection:* Relatively few frauds and abuse offences are discovered through routine audits. Usually most fraud is uncovered only due to a tip off and, at times, due to complaints from other employees and citizens. At times the offence is discovered after those who had planned the fraud as a team disagree on the sharing of the loot.

## Unethical behaviour in procurement

The unethical behaviour in procurement can occur at any stage in the procurement process. The unethical behaviour includes:

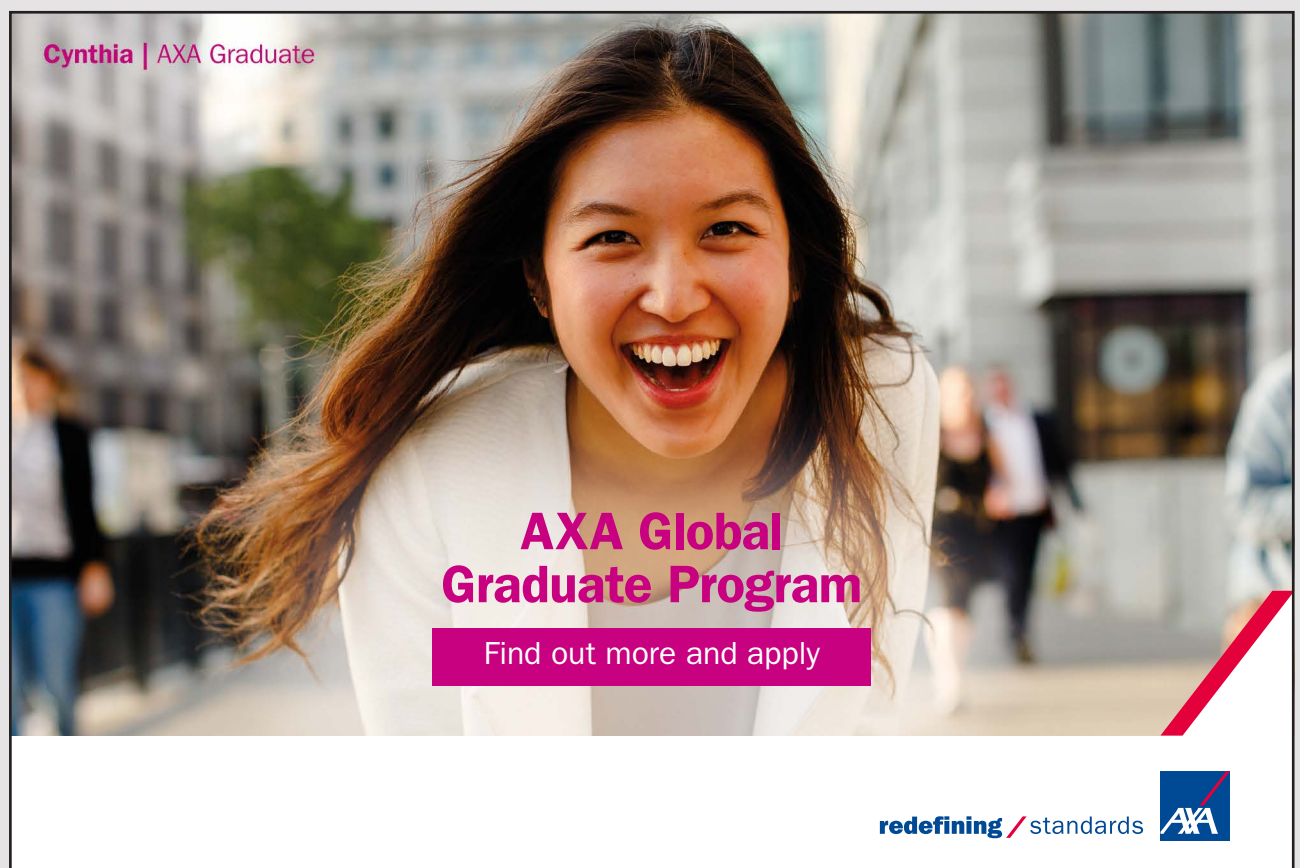
- Collusion between bidders to win contracts in turns;
- Bid trading through which procurement staff open and substitute bids;
- Bribery with gifts and gratuities;
- Employees forming companies and bidding for work (Insider Trading);
- Offers for employment in exchange for tenders and contracts;

- Access to confidential information by those who do not need to know;
- Taking official decisions outside the office;
- Conflict of interest;
- Improper use of the evaluation criteria;
- Using restrictive specifications to make it difficult for more bidders to tender; and
- Issuing unclear instructions to bidders so as to discourage bidders from tendering.

## Supplier evaluation

Main aims of supplier evaluation


- To develop win-win relationships with suppliers;
- To have transparent and clear procedure of supplier measurement;
- To ensure long term relationship with suppliers; and
- To support the procurement function with accurate information.



**Cynthia | AXA Graduate**

**AXA Global Graduate Program**

Find out more and apply

redefining / standards 

Why supplier evaluation?

Potential suppliers	Existing or contracted suppliers
<ul style="list-style-type: none"> <li>To identify capacity of suppliers</li> <li>To identify ability to fulfill contract requirements</li> <li>To identify ability to fulfill specifications</li> </ul>	<ul style="list-style-type: none"> <li>To decrease purchasing costs</li> <li>To increase supplier performance</li> <li>To improve active co-operation</li> </ul>

### Supplier evaluation methods or models

According to the Institute of Supply Management and Weber’s study, there are three fundamental models that can be used to identify and evaluate suppliers. These are categorical models, weighted-point models, and cost-ratio models.

*Categorical model:* This model can be used by small firms and other organisations which are in a process of developing supplier evaluation systems. It is mostly a manual system relying on different personnel to input data.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>Low cost system</li> <li>Good for firms with limited resources</li> <li>Easy to implement</li> <li>Requires minimal data</li> <li>Different personnel can contribute</li> </ul>	<ul style="list-style-type: none"> <li>Usually manual</li> <li>The most subjective model</li> <li>Least reliable</li> <li>Less frequent generation of evaluation</li> </ul>

**Table 26:** Advantages and disadvantages the Categorical model

*Weight-point model:* This model can be used by most firms. It is a flexible system that combines both qualitative and quantitative factors in one single system.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>Flexible system</li> <li>Allows supplier ranking</li> <li>Has moderate implementation costs</li> <li>Compared to the cost-ratio model</li> <li>It combines both qualitative and quantitative factors in a single system</li> </ul>	<ul style="list-style-type: none"> <li>It tends to focus on unit price</li> <li>Requires computer skills by staff</li> </ul>

**Table 27:** Advantages and disadvantages the weight-point model

*Cost-ratio model:* This is the model that can be used by firms with a large supplier base. The model provides a total based approach. It requires high investment costs.

<b>Advantages</b>	<b>Disadvantages</b>
<ul style="list-style-type: none"> <li>• It provides a total cost approach</li> <li>• Allows objective supplier ranking</li> <li>• Identifies specific areas of supplier nonperformance</li> <li>• Gives the greatest potential for long range improvement</li> </ul>	<ul style="list-style-type: none"> <li>• Cost – accounting is required</li> <li>• High costs of establishment and use</li> <li>• Computer resources required (computers, connections, users)</li> <li>• The most complex of the three model</li> </ul>

**Table 28:** Advantages and disadvantages the cost-ratio model

### **Supplier Assessment and Supplier selection**

Supplier assessment is important in the process of selecting potential suppliers or providers. The firm has to select suppliers that are capable of providing the required specifications. Bailey et al (2008)<sup>197</sup>, have proposed five methods that can be used to assess the capability of a supplier. The supplier has to look at *past performance, supplier's reputation, supplier's visit and appraisal, third-party certification, and evaluation of samples.*

### **Supplier development**

Supplier development can be described as an organisation's deliberate effort to improve its supplier's capabilities so that the supplier can be able to meet the buying organisation's supply needs. Supplier development has been defined as *'the process of working with certain suppliers on a one-to-one basis to improve their performance for the benefit of the buying organisation'* (CIPS)<sup>198</sup>. Supplier relationship and development begins by first prequalifying the potential suppliers. The relationship has to be thought of as long term arrangement for working together and continuous communications in order to successfully market existing products and introduce new ones. This relationship has to be based on cooperation (partnership or distribution arrangement) as opposed to competitive and adversarial relationships. The organisation can undertake supplier development in various ways including pre-financing, mentoring and capacity building or training as well as sharing of technical information, supplier technology and equipment.

*History of supplier development:* This concept started with Toyota Motor Corporation in 1930s. In 1939, they enshrined supplier development in their purchasing philosophy and purchasing rules expressly stated it. The rules stated that once a supplier has been nominated, Toyota™ shall make every effort to raise their performance<sup>199</sup>. Generally, the need for thinking critically about and focusing on supplier development in Japan came in the immediate post-war years (1950s). It started with the Aichi Prefecture Government conducting the ‘enterprise group diagnosis’ (or keiretsu shindan) during 1952–53. This government study consultancy chose Toyota keiretsu<sup>200</sup> as a unit to evaluate based on four criteria: existence of a management policy; productivity improvement; quality improvement; and the fulfillment of production plans. This study on Toyota Keiretsu was important in the aspects of supplier development<sup>201</sup>.

*Reasons for supplier development*

According to the CIPS (UK)<sup>202</sup>, there are a number of reasons for supplier development:

- improving supplier performance;
- reducing costs;
- resolving serious quality issues;
- developing new routes to supply;

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**

I was a construction supervisor in the North Sea advising and helping foremen solve problems

Real work  
International opportunities  
Three work placements



- improving business alignment between the supplier and the buying organisation;
- developing a product or service not currently available in the marketplace; and
- generating competition for a high price product or service dominating the marketplace.

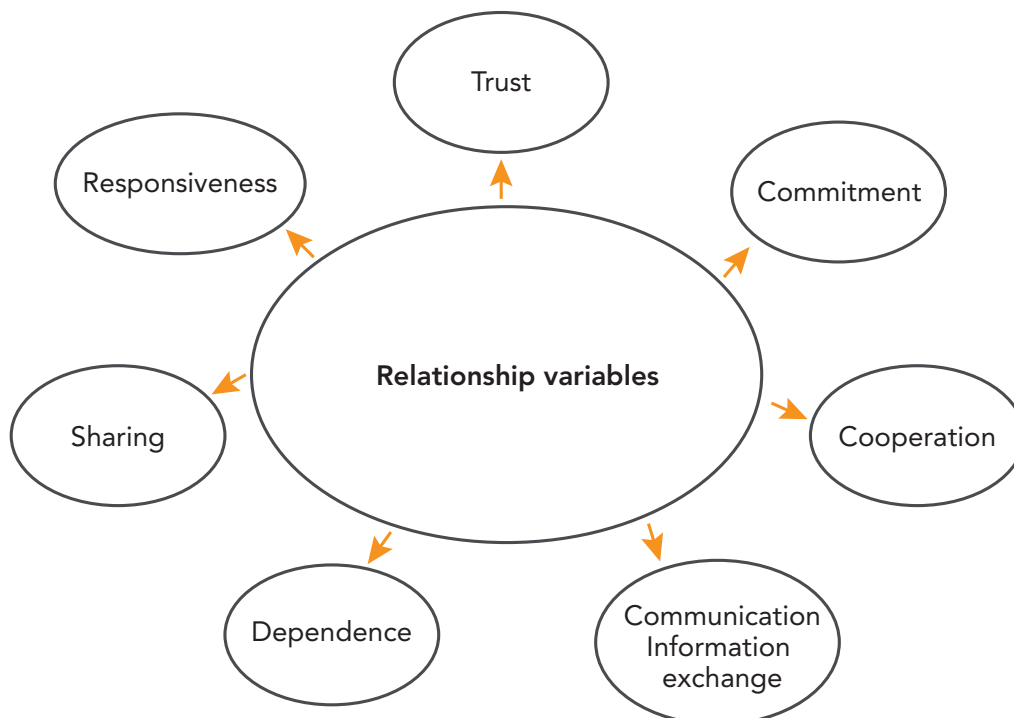
*The importance of supplier development to the supplier organisation*

The supplier will enjoy some benefits which are an incentive for it to expand in order to become competitive:

- produce more units than they would have produced without support;
- access modern technology;
- have its staff capacity built;
- get and use pre-financing with too much conditions usually faced when getting a bank loan; and
- improvement in lead times and delivery.

*Dimensions of a successful relationship*

Supplier-buyer relationship, like any other mutually benefiting relationship, will survive when certain variables are observed. These relationship variables or enablers are presented in Figure 10 below:



**Figure 10:** Key Relationship variables (or enablers)

*Attributes of a good supplier*

It is difficult to find a definition of a good supplier or provider that will be acceptable to all stakeholders. But what is not easy to define can be described. This is what Baily et al. (2008) have done. The following are their description of a good supplier.

<ul style="list-style-type: none"> <li>• Delivers on time</li> <li>• Provides consistent quality</li> <li>• Gives good price</li> <li>• Has stable background</li> <li>• Provides good services back-up</li> </ul>	<ul style="list-style-type: none"> <li>• Is responsive to our needs</li> <li>• Keeps promises</li> <li>• Provides technical support</li> <li>• Keeps the buyer informed on progress</li> </ul>
--	--

**Table 29:** Attributes of a good supplier

Source: Adapted from Baily et al (2008)<sup>203</sup>

**Barriers to supplier development in developing countries**

In developing countries of Africa, supplier development is hindered by various factors. Some of the factors relate to lack of trustworthiness; lack of commitment; and failure of suppliers to be open about their current financial and operations conditions. See the list of the barriers here.

- Lack of or declining trust by one party in another;
- Poor communications with a lack of constant feedback;
- Lack of credibility of customers or buying organisations;
- Lack of clarity and commitment to the relationship;
- The feeling that the customer (who is helping with supplier development) is patronising the supplier;
- Concealment of existing problems for one of the parties;
- There was use of wrong performance metrics when evaluating and measuring the relationship;
- The supplier and buyer have disagreed on the approach and ingredients of supplier development;
- Limited resources to support supplier development by the customer; and
- There could emerge legal and fair competition issues when the customer is a public entity (in public procurement, government laws favour competitive bidding).

## Just-In-Time (JIT)

Just-In-Time is defined as “the production of the minimum number of different units, in the smallest possible quantities, at the latest possible time, thereby eliminating the need for inventory”<sup>204</sup>. The philosophy of JIT is elimination of waste from the acquisition of raw materials up to shipping. JIT is not about producing on time, it is *Just-In-Time*. JIT was developed by Taiichi Ohno the chief production engineer at Toyota™ after the World War II. The Japanese enterprises could not afford the waste in their systems after the devastation caused by the World War II. Ohno was interested in reducing waste, *muda*, and introduced lean production systems. Along the way, JIT became part of reducing waste especially inventory waste and associated costs.

### The possible benefits of a JIT system

- Reduction in inventory costs – there is no idle inventory;
- Reductions in set-up time;
- Producing products that customers want;
- Produce products when the customers want them;
- Reduce the lead time; and
- Produce without waste of resources (labour, materials, or equipment).

**ie** business school

**93%**  
OF MIM STUDENTS ARE  
WORKING IN THEIR SECTOR 3 MONTHS  
FOLLOWING GRADUATION

**MASTER IN MANAGEMENT**

- STUDY IN THE CENTER OF MADRID AND TAKE ADVANTAGE OF THE UNIQUE OPPORTUNITIES THAT THE CAPITAL OF SPAIN OFFERS
- PROPEL YOUR EDUCATION BY EARNING A DOUBLE DEGREE THAT BEST SUITS YOUR PROFESSIONAL GOALS
- STUDY A SEMESTER ABROAD AND BECOME A GLOBAL CITIZEN WITH THE BEYOND BORDERS EXPERIENCE

Length: 10 MONTHS  
Av. Experience: 1 YEAR  
Language: ENGLISH / SPANISH  
Format: FULL-TIME  
Intakes: SEPT / FEB

**5 SPECIALIZATIONS**  
PERSONALIZE YOUR PROGRAM

**#10 WORLDWIDE**  
MASTER IN MANAGEMENT  
FINANCIAL TIMES

**55 NATIONALITIES**  
IN CLASS

[www.ie.edu/master-management](http://www.ie.edu/master-management) | [mim.admissions@ie.edu](mailto:mim.admissions@ie.edu) | [f](#) [t](#) [i](#) Follow us on IE MIM Experience

**Waste in supply chain management:** In the current era, all business entities seek to become competitive in order to realise improved annual turnover and profitability. Efficiency and effective are important to business entities that seek to produce quality products, market and sale them amidst intense competition. Waste, inefficiencies or *muda* in Japanese, is any activity that adds no real value to the product or service being created or delivered<sup>205</sup>. Taiichi Ohno, who was a production engineer and manager of Toyota™, developed the Toyota Production Systems aimed at eliminating *muda*<sup>206</sup> in order to be competitive. These systems were focused on lean production systems. Ohno identified the seven primary sources of waste in production, which he called “The Seven Deadly Wastes”. The story is usually told about one of the techniques that Ohno used whenever he visited a plant. It is said that he would draw a circle (‘Ohno circle’) on the floor and make one member of his staff to stand in the circle – sometimes for the whole day. The purpose was to closely observe the operation (genchi genbutsu) and record areas of opportunity. Genchi genbutsu refers to collecting facts and data at the actual site of the work or problem.

1) Overproduction
2) Delay or waiting
3) Transportation
4) Motion
5) Inventory
6) Over processing
7) Defects/Correction

**Table 30:** The Seven Deadly Wastes

Source: Based on Ohno Taiichi “The Seven Deadly Wastes”

## PROCUREMENT AUDIT

### What are Public Procurement audits?

An audit can be defined as a check or an examination. When such a check or examination is applied to public procurement, then it becomes a public procurement audit. Public procurement audits can be defined as a systematic and comprehensive, independent and periodic examination of public entities’ procurement, objectives, procedures, problems and opportunities thereby facilitating the development of action plans.

The most general definition of an audit is an evaluation of a person, organisation, system, process, project or product. Audits are performed to ascertain the validity and reliability of information and also to provide an assessment of a system's internal control. Auditing is, therefore, a part of some quality control certifications such as ISO 9001. The goal of an audit is to express an opinion on the person/organisation/system etc. under evaluation based on work done on a test basis.

Due to practical constraints, an audit seeks to provide only reasonable assurance that the processes in public procurement are free from material error. Hence, random sampling is often adopted in audits. In the case of financial audits, a set of financial statements are said to be true and fair when they are free of material misstatements – a concept influenced by both quantitative and qualitative factors.

**External Auditors:** These are independent staff assigned by an auditing firm to assess and evaluate financial statements of their clients or to perform other agreed upon evaluations. Most external auditors are called upon from the outside of the company and employed by accounting firms for annual engagements.

### **Objectives of Public Procurement Audits**

With a view of enforcing rules and regulations relating to public procurement, and in order to build credibility in procurement procedures, public procurement authorities conduct procurement audits whose objectives are:

- Verification of procurement and contracting processes followed;
- Verification of technical and physical compliance and price competitiveness of contracts; and
- Review of the contract administration and management.

### **Are procurement audits essential?**

Procurement audits are essential and they service four broad purposes through:

- i) Policing the extent to which procurement policies are adhered to by public agencies and enterprises;
- ii) Helping to ensure the organisation is using procurement techniques, procedures and methods that conform to the best working practice
- iii) Monitoring and measuring the extent to which resources are being effectively used.
- iv) Assisting in the prevention and detection of fraud and of malpractices prevalent in procurement.

### Who should conduct procurement audits?

Procurement audits can be done at different levels and at different times so are the people to conduct them. For example, procurement audits can be carried out by the following: external auditors; internal auditors; a central procurement function; external management consultants; and funding agencies.

The decision about who should conduct public procurement audits and investigations is governed by two major principles.

- i) The auditors should be external to the function or department that is being subjected to the audit.
- ii) The procurement auditors should also have in-depth knowledge of the procurement function. This will enable them to monitor compliance and adherence to procurement policies and procedures. In addition, they will be able to understand procurement problems and can make appropriate recommendations.



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"

Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

### Coverage/Content of procurement audits

The procurement audit covers the following areas:

- i) **Procurement problems and opportunities:** To what extent are the problems, for example, related to management, procurement personnel, colleagues, internal customers, suppliers, or logistics providers? What opportunities are there in the systems to improve procurement operations?
- ii) **Procurement organisation.** How is the procurement function operated in a particular entity? To whom do the procurement personnel report? Is there centralised or decentralised procurement? How does procurement relate with other functions? How do internal customers view the performance of the procurement function?
- iii) **Procurement Personnel.** How many people are performing the procurement function? How qualified are they and what is their level of experience? Do they have appropriate job descriptions? What training and development opportunities do they have? etc.
- iv) **Procurement procedures:** What written or unwritten policies apply to procurement? Is there a procurement manual and, if so, how frequently is it updated? What guidance is offered to the procurement staff in regard to supplier relationships, conflict of interest, buying from abroad, or environmental policies?
- v) **Procurement Reports:** This relates to issues such as what types of reports are prepared by procurement staff? Who prepares the reports? At what interval are the reports prepared?
- vi) **Procurement, suppliers, and prices:** What are the provisions in the procurement budget? Who are the principal suppliers? What attempts have been made to achieve single or partnership sourcing? How are suppliers selected? What is the price compared to the market prices?

Auditors, while preparing reports to senior managers, make a number of findings and recommendations. The reports should contain information that will enable senior managers make appropriate decisions. In particular, procurement audit reports should:

1. Highlight policies, procedures and personnel where efficiency can be improved;
2. Commend good practice and performance where it has been observed;
3. Think beyond full consequences, side effects and reasons likely to occur where these recommendations are made and presented; and
4. Support constructive proposals made by procurement staff that may receive greater attention if made by an outside source.

## **Disposal Management**

Disposal refers to the divestiture of public assets, including intellectual and proprietary rights, goodwill, any other rights of a PDE by any means, including sale, rental, lease, franchise, or auction.

### **What is Disposal process?**

Disposal process refers to the successive stages in the disposal cycle. These stages include

- planning,
- choice of procedure,
- solicitation of offers from bidders,
- evaluation of those offers
- award of contract

### **Reasons for Disposal of assets**

There are a number of reasons why an entity may undertake a disposal of its assets. They include the following:

- i) The asset may no longer be required by the entity due to changes in operational requirements.
- ii) Surplus to needs: the asset maybe in excess of the needs of the entity
- iii) It may be part of asset replacement programme: the asset has reached the point at which it is not keep economical to keep (due to age, usage, mileage, etc.) but is most economical to dispose of it; and thus minimising maintenance costs.
- iv) The asset is unserviceable or beyond reasonable repair
- v) The asset may be technologically obsolete and operationally inefficient, or incompatible with other assets.
- vi) Continued possession or use of such an asset contravenes occupational health and safety standards, or the asset contains hazardous materials.
- vii) It is waste and the costs of capital tied up, storage and handling cannot be justified to keep an asset. The organisation may dispose of such an asset and may instead resort to rentals, or modern supply chain management and rely on just-in-time procurement.

## Methods of Disposal

There are a number of factors that an entity can consider when selecting a disposal method. The entity should consider the following:

- 1) The potential market value of the asset
- 2) The volume of the asset
- 3) The number and location of potential bidders
- 4) The location of the asset for disposal
- 5) National security and public interest issues
- 6) Health and safety issues
- 7) Environmental considerations
- 8) Legal or human rights issues

Excellent Economics and Business programmes at:



university of  
 groningen



**“The perfect start  
of a successful,  
international career.”**

**CLICK HERE**  
to discover why both socially  
and academically the University  
of Groningen is one of the best  
places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

The methods we discuss here can be used by public and private entities for the disposal of their assets.

1. *Public auction:* offers are presented by word of mouth. This is to say that interested buyers simply shout out the amounts of money they are willing to pay for each asset. This method may appropriate where:
  - There are a large number of people who may be interested in buying the assets.
  - There is a large variety of assets in one location to be disposed of.
  - There is no need to control who buys or uses the assets. For example where the government wants to get rid of an old gun, it must ensure that the gun does not fall into the hands of terrorists or robbers. Thus, it cannot use the public auction method to sell the gun.
  - When there is a large number of people interested in buying unusual or high-value assets.
2. *Public bidding:* Under the sealed, public bidding method, the bids are written down and then presented in sealed envelopes. It is appropriate where there is high-value or unusual assets; assets located in remote areas; assets that have a geographically dispersed potential market; assets with end-user or export restrictions attached to their sale; where conditions need to be attached to the sale of the asset; or post-bid negotiations may be required.
3. *Sale to public officers:* this is where an asset is sold to an employee of the entity. Care must be taken not sale the asset below a fair market value. Conditions of this method include:
  - Where there is no likely benefit or financial advantage to the disposing entity, that may require using any other disposal method;
  - Where the assets for disposal are a small number and low value items which are unlikely to attract public interest;
  - Where the personal use of disposal assets would directly benefit the performance of that employee in the execution of their duties within the disposing entity
4. *Direct negotiations:* In some cases, instead of inviting several bidders to present their bids, an entity can dispose-off an asset by negotiating directly with a single buyer. Circumstances under which such a method may be used include where:
  - The market is limited and only a single buyer exists
  - Issues of national security, public interest, legal or human rights issues or environmental considerations are served by selling to a particular company, group or individual
  - An asset is located on a potential buyer's premises on a hire or free use basis and it is reasonable to give that person first option to buy the asset at a market rate.

5. *Trade-in*: An entity may decide to exchange the asset for another asset. For example one can talk to Toyota and hand in the old double cabin pickup in exchange for a new one with modern options. The old pickup will be valued and the owner will pay the balance after offsetting the value of the old one. This is what is referred to as trading-in. This method may be used in order to:
- enable entities to buy new items at lower prices; and
  - enable the entity to upgrade its equipment.

This method should never be used in public agencies to prevent open and fair competition in the disposal process; or reduce value for money in the disposal process.

6. *Transfer to another entity*: an asset may be transferred to another entity. In this case the cost of the asset shall be agreed between the two entities. The transfer may be at no cost, if it is uneconomic to charge for the asset. This is a method that may be appropriate where:
- the receiving entity (the transferee) can make further use of the asset;
  - the benefits to be derived by the transferee exceed the cost of transfer;
  - the transfer provides a cheaper option compared to cost of acquisition of new assets from the open market or the external providers.
7. *Conversion or classification of assets into another form*: This method of disposal can only be used where issues relating to national interest, public interest, legal or human rights and the environment have been considered. Under this method, the Asset is transformed into a form where it is of benefit to the entity that owns it. Conversion or classification of an asset into any other form may be used on grounds of national security or public interest, legal or human rights issues or environment considerations; or where the asset has no residual value in its current form, but where some sale value can be obtained through conversion or classification into any other form.
8. *Donation*: this is the method of disposal where the asset is given out as a donation. The disposing entity becomes a donor to the recipient. According to the government of Uganda, this method is only applicable for obsolete items where no other form of payment can be obtained for the asset.
9. *Destruction of assets*: asset can be disposed by destroying it. It can be burned or crashed. This is the least favoured method. It can be used on grounds of national security or public interest, health and safety, legal or human rights issues or environment considerations. It can also be where the asset has no residual value.

### General principles of disposal of public assets

- Assets for disposal should normally be sold at a fair market value in a manner that maximises revenue and minimises expenses
- Assets with little or no market value may be transferred gratuitously or maybe scrapped in an environmentally acceptable manner
- To the extent feasible, the general public should have the opportunity to purchase the assets being disposed
- Non discrimination
- Promote transparency, accountability and fairness, economy and efficiency in disposal
- Keep confidentiality until a successful bidder is notified of award
- Follow the existing code of ethical conduct in business
- Allow for competition in asset disposal
- Award the highest offering (priced) bidder
- Public accessibility

## American online LIGS University

is currently enrolling in the  
Interactive Online **BBA, MBA, MSc,**  
**DBA and PhD** programs:

- ▶ enroll **by September 30th, 2014** and
- ▶ **save up to 16%** on the tuition!
- ▶ pay in 10 installments / 2 years
- ▶ Interactive **Online** education
- ▶ visit [www.ligsuniversity.com](http://www.ligsuniversity.com) to find out more!

Note: LIGS University is not accredited by any nationally recognized accrediting agency listed by the US Secretary of Education. More info [here](#).



# 14 OUTSOURCING

Outsourcing can be defined as the transfer of an activity or specific process or work stream from one organisation to another one (usually referred to as a third party). We can refer to the third party as a supplier, a contractor or even a subcontractor depending on the level of the relationship between the parties. Organisations should outsource non-core activities.

Outsourcing has increased in recent times and, according to an article in the *Financial Times*, ‘Subcontracting as many non-core activities as possible is a central element of the new economy’<sup>207</sup>. It has been associated closely with determinants of “make-or-buy decision” in organisations. Firms would prefer to “buy” as opposed to “make” as long as the cost of outsourcing is lower than in-house production. There are various reasons for outsourcing non-core activities by organisations in the modern economy.

## The reasons why organisations outsource

- To focus more on core activities utilising core competencies;
- Lack of internal capacity to perform the activity;
- Existence of external suppliers with better capacity to perform those activities that can be outsourced;
- To free up company resources for other core activities;
- To spread the risk of running organisational activities;
- To reduce operating costs such personnel costs (salaries, wages, medical bills, insurance costs, etc.); and
- To economise on production costs<sup>208</sup>.

<ul style="list-style-type: none"> <li>• <i>Building repairs and maintenance</i></li> <li>• <i>Estate management</i></li> <li>• Legal services</li> <li>• Records management</li> <li>• Courier services</li> <li>• Asset repair services (radio, car, watches, etc.)</li> <li>• Clearing and forwarding</li> <li>• Vehicle maintenance</li> </ul>	<ul style="list-style-type: none"> <li>• Car park management</li> <li>• Cleaning</li> <li>• Catering</li> <li>• Security</li> <li>• Waste disposal</li> <li>• Transport management</li> </ul>
--	---

**Table 31:** What services to outsource

### *Effective outsourcing relationship management*

Ensuring a successful relationship with the outsourced organisation requires that it is a high quality supplier, the outsourced activity is clearly defined; with clearly spelt out roles and responsibilities of the parties. Therefore, the contract between the parties has to clearly spell out contractual obligations of all the parties. It will also require maintenance of good relations with the supplier for the entire duration of the contract. Both the parties have to ensure effective contract management or monitoring.

### *Disadvantages of outsourcing*

When the relationship is not well managed, then the outsourcing organisation is likely to suffer disadvantages. The following are the likely disadvantages of outsourcing:

- Over-dependency on suppliers;
- Difficulty of coordinating different suppliers where most non-core activities have been outsourced;
- Quality of service may decline when the supplier experiences management issues;
- Unrealistic expectation of outsourcing providers due to overpromising;
- Communication with suppliers may be hampered by personalities and different levels of technology;
- Lack of supplier flexibility; and
- Extra training costs of those outsourced service providers may be needed to ensure they deliver what you want.

### **Potential risks of outsourcing**

Whilst outsourcing has got benefits for the organisations that undertake it, there are potential risks associated with it. They include the following:

- Poor contract or poor selection of partner;
- Loss of competitive knowledge and skills;
- Power shift to supplier;
- Supplier problems (poor performance or bad relations, opportunistic behaviour, not giving access to best talent or technology);
- Loss of control or core competence in handling the outsourced activities or processes;
- The possibility of creating a competitor in the outsourced provider; and
- The possibility of conflict of interest.

Outsourcing critical components to third party suppliers may open up opportunities for competitors. The outsourcing may mean that companies lose their ability to introduce new designs based on their own agenda rather than the supplier's agenda. Outsourcing the manufacturing of various components to different third party suppliers may, for instance, prevent the development of new insights, innovations and solutions that typically require cross-functional teamwork within the outsourcing organisation.

### Fourth-Party Logistics (4PL)

Fourth-Party Logistics can be thought of as supply chain integrator, a firm that “assembles and manages the resources, capabilities and technology of its own organisation with those of complementary service providers to deliver a comprehensive supply chain solution.” 4PLs manage and direct the activities of multiple 3PLs, serving as an integrator<sup>209</sup>.



**DON'T EAT  
YELLOW  
SNOW**

What will your advice be?

Some advice just states the obvious. But to give the kind of advice that's going to make a real difference to your clients you've got to listen critically, dig beneath the surface, challenge assumptions and be credible and confident enough to make suggestions right from day one. At Grant Thornton you've got to be ready to kick start a career right at the heart of business.

Sound like you? Here's our advice: visit [GrantThornton.ca/careers/students](https://www.grantthornton.ca/careers/students)

Scan here to learn more about a career with Grant Thornton.



 **Grant Thornton**  
An instinct for growth™

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd

# 15 E-PROCUREMENT

In the modern age, where there is need for speed, where time is of essence, with virtual shops and increasing concerns for the green environment, e-procurement is inevitable. It is bound to save organisations time and costs. It will reduce 'the papered office'. The increasing improvement in information technology has enabled organisations to adopt integrated IT systems that aid the use of e-procurement and generally e-commerce platforms. While the paperless office might never be achieved in totality, there is a chance that with IT, at least the size of 'the papered office' will reduce. E-procurement can be defined as the automation of any part of the procurement process with electronic tools. Most organisations are already undertaking a variety of e-procurement activities daily in different ways. Some examples of these e-procurement activities are:

- Booking and purchasing travel online (e-ticket);
- Buying stationery on electronic catalogues or utilising a Vendor Managed Inventory (VMI);
- Online authorisation and electronic submission of purchase orders to suppliers; and
- Paying suppliers by Electronic Funds Transfer (EFT).

E-procurement can be regarded as the use of internet to operate the transactional aspects of requisitioning, authorising ordering, receiving and payment processes for the required services or products. E-procurement can be described as the use of computer and other electronic equipment normally linked by networks to do any or all of the following activities:

- accessing data about products available on the market;
- finding out sources of supplies and appraising them;
- making price comparisons; spot buying from auction sites and market exchanges; and
- receiving invoices and making payment.

Bailey et al (2008) have looked at e-procurement to include a range of technologies that use the computer processing and internet connectivity to accelerate and streamline the following procurement processes:

- Identifying and selecting suppliers of goods and services;
- Placing, receiving and paying for orders;
- Assuring compliance with procurement procedures;
- Consolidating purchases to achieve leverage; and
- Providing visibility of information between collaborative partners.

Planning	Procurement	Payment
<ul style="list-style-type: none"> <li>- Request for Quotations (RFQs)</li> <li>- Request for Purchase (RFPs)</li> <li>- Contract and Supplier relationship Management</li> <li>- Tender Evaluation Tools</li> <li>- Electronic Auctions</li> </ul>	<ul style="list-style-type: none"> <li>- Catalogues</li> <li>- Electronic Purchase Orders (EPOs)</li> <li>- Automatic Approval Workflow</li> <li>- Financial Management</li> <li>- Information (FMIS) systems</li> <li>- Vendor Managed Inventory (VMI) systems</li> </ul>	<ul style="list-style-type: none"> <li>- Credit Cards</li> <li>- Electronic Funds Transfer (EFT)</li> <li>- Electronic Invoicing</li> <li>- Expense Management Systems (EMS)</li> <li>- Evaluated Receipt Settlement (ERS)</li> </ul>

**Table 32:** e-Procurement activities

### Forms of e-procurement adopted by some organisations

The following are the forms commonly used by some organisations in the private sector and government:

- 1) **E-sourcing:** Identifying new suppliers for a specific product and spend category, using internet technology: eRFP/Q (request for proposal/quotation), etc.
- 2) **E-tendering:** Process of sending Requests For Information (RFIs) and Request For Proposals (RFP) and receiving the responses of the suppliers back, using internet technology
- 3) **E-reverse auctions:** This enables the procuring organisation to buy goods and/ or services from a number of known suppliers on web.
- 4) **E-ordering:** Process of making and approving purchasing requisitions, placing purchasing orders and receiving goods and services ordered by using a software system based on internet technology.
- 5) **E-market places:** Places on internet where actual transactions can take place between the buyers and sellers.
- 6) **E-collaboration:** Internet tools used for setting up customised online integration between the buying organisation and one or a few key suppliers or between disparate internal systems.

### *Factors driving the adoption of e-procurement initiatives*

Since the early 2000s, e-procurement initiatives have increased in both the developed and developing countries. Governments in developing countries have started e-government, established national IT authorities, embarked on big IT connections, integrated financial management systems (IFMS) and encouraged the start of e-procurement. The private companies, especially multi-national ones, have introduced e-procurement in their developed countries' operations and are now piloting the technologies in the developing countries such as those in Africa.

### *Risks in e-procurement*

The risks in e-procurement can be grouped into three categories<sup>210</sup>: operations risk; performance risk; accounting risk; and organisation structure risk.

#### *Risks in operations*

- i) Human resources risk: If the personnel do not possess the requisite knowledge, skills or experience to manage the new process.
- ii) Sourcing risk: Because there will be fewer alternative sources, thus increasing the risk of shortages.
- iii) Business interruption risk: Due to the dependence on a smaller number of suppliers who may be exposed to significant risks of their own.

.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if you could build your future and create the future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

*Risks in Financial aspects*

- i) Price risk: If there is not sufficient oversight to the prices contained in the e-catalogs.
- ii) Settlement risk: If there are quality or delivery issues with a reduced number of suppliers; and
- iii) Market risk: If the suppliers are also supplying similar products to the competition.

*Performance measurement risk:* If the systems do not work or cause delays.

- i) Accounting information risk: If the procurement system is not adequately integrated with financial processes and systems; and

*Organisation structure risk:* If the purchasing department is not utilised to provide more value-added services;

**Critical success factors for implementation of e-procurement**

The key factors which could be crucial to the transformation from simple traditional procurement to e-procurement will include the following:

- Strong will and support from the top management;
- Starting by building in-house champions or enthusiasts for the adoption of e-Procurement;
- Development of a dedicated project team to drive the e-procurement;
- Well defined or standardised procurement processes and forms;
- Taking of extreme care to aspects of tender-security, supplier-support such as training and ease of use; and
- Well integrated back end systems, standards, policies and practices to support and strengthen e-procurement processes.

**Critical success factors for e-procurement in government**

- Rendering of support by top political leadership;
- Establishment of High-level Project Implementation Committee;
- Timely policy intervention;
- Significant process re-engineering and standardisation;
- Active involvement of stakeholders;
- Prior capacity building to key stakeholders;
- Public Private Partnership Model; and
- Establishment of an active help-desk.

# 16 PROJECT PROCUREMENT

A project can be defined a set of activities that have a defined start and end point, with a defined goal and known set of resources to be used. It is not an open-ended programme whose activities, resources and end may not be stated.

*Basic Principles to Project Management:* We can look at six basic principles to project management.

<b>Basic Principles to Project Management</b>	
1. <i>Define the job in detail</i>	To achieve better performance results, the project initiators have to clearly state what is to be undertaken. The job has to be described in details.
2. <i>Get the right people involved</i>	The right people (possibly with interest in the job) should be involved during the project document preparation and implementation.
3. Duration of the project has to be estimated and stated. The costs for the whole project will also be estimated – showing the costs to be incurred at every stage of the project.	<i>Estimate the time and costs</i>
4. <i>Establish a change procedure</i>	
5. <i>Agree on acceptance criteria</i>	The parties to project contract the have to agree (usually stated in a contract) the project-end and how it will be handed over to the client. They also agree on what full performance involves. If the project is being undertaken by staff of the organisation not outside contractors, management will agree with the project team how the project will be handed over and accepted.

## *Common elements of all projects*

According the Bailey, et al., (2008)<sup>211</sup>, all projects have the following common elements:

- A clear objective;
- Complex (with various tasks);
- Unique (commonly ‘one-off’);
- uncertain;
- temporary nature (with a defined start and end); and
- life cycle with resources required.

### Factors that can determine a project success

- i) All projects should have defined goals and objectives;
- ii) For projects to succeed, they have to have top management support;
- iii) Sufficient resources to accomplish the projects;
- iv) A competent team to manage the project activities and resources;
- v) Adequate communication between and among key stakeholders, with an operational feedback mechanism; and
- vi) Project control mechanisms (including a contingency plan).

### The World Bank Procurement Guidelines

#### Procurement methods of Goods, Works and Services

The World Bank recommends the same methods as those the African Development Bank. The two banks are related because the World Bank has shares in the African Development Bank.



Join the best at  
the Maastricht University  
School of Business and  
Economics!

#### Top master's programmes

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)

Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014

[www.mastersopenday.nl](http://www.mastersopenday.nl)

The following are the World Bank's procurement methods:

- 1) International competitive Bidding (ICB);
- 2) Limited International Bidding (LIB);
- 3) National Competitive Bidding (NCB);
- 4) Shopping;
- 5) Direct Contracting;
- 6) Force Account;
- 7) Community Participation Procurement; and
- 8) Performance-Based Procurement.

1. **International Competitive Bidding (ICB):** In order to ensure value for money, competitiveness and transparency (among other procurement principles), the Bank recommends ICB as the main method of procurement when procuring goods, services or works using its funding. There are other methods of procurement that can be used where ICB would not be the most economic and efficient method of procurement and where other methods are deemed more appropriate. The Bank emphasises that contracts shall not be divided into smaller units in order to make them less attractive for ICB procedures; and that any proposal to divide a contract into smaller packages shall require the prior approval of the Bank.
2. **Limited International Bidding (LIB):** LIB is basically ICB by direct invitation with open advertisement. This may be an appropriate method of procurement where (a) there are only a limited number of suppliers, or (b) other exceptional reasons may justify departure from full ICB procedures.
3. **National Competitive Bidding (NCB):** NCB is the competitive bidding method which is normally used for public procurement in the country of the Borrower. It may be the most appropriate method of procuring goods or works where the procurement, because of its nature, size or scope, is not likely to attract foreign competition. It may be used in procurements where foreign bidders are not expected to be interested because of the following:
  - a) the contract values are small;
  - b) works are scattered geographically or spread over time;
  - c) works are labour intensive; or
  - d) the goods or works are available locally at prices below the international market.


NCB procedures may also be used where the advantages of ICB are clearly outweighed by the administrative or financial burden involved. In such cases, advertising may be limited to at least a sole electronic portal of free access where the Borrower advertises all government business opportunities or in their absence, in a national newspaper of wide circulation. Bidding documents may be in any of the official languages of the Bank and the currency of the country of the Borrower is generally used for the purposes of such procurement.

4. **Shopping:** Shopping is another procurement method used and is based on comparing price quotations obtained from several suppliers (in the case of goods) or from several contractors (in the case of civil works), with a minimum of three, to assure competitive prices and is an appropriate method for procuring readily available off-the-shelf goods or standard specification commodities of small value, or simple civil works of small value. The requests for quotations shall indicate the description and quantity of the goods or specifications of works, as well as desired delivery (or completion) time and place. Quotations may be submitted by letter, facsimile or by electronic means. The evaluation of quotations shall follow the same principles as of open bidding.
5. **Direct Contracting:** This method is also referred to as *single sourcing*. It is where the contract is awarded directly to a provider, without competition. Such a method may be appropriate under the following circumstances:
  - a) An existing contract for goods or works, awarded in accordance with procedures acceptable to the Bank<sup>212</sup>, may be extended for additional goods or works of a similar nature.
  - b) Standardisation of equipment or spare parts, to be compatible with existing equipment, may justify additional purchases from the original Supplier.
  - c) The required equipment is proprietary and obtainable only from one source.
  - d) The Contractor responsible for a process design requires the purchase of critical items from a particular Supplier as a condition of a performance guarantee.
  - e) In situations when responding to natural disasters or emergencies<sup>213</sup>.
6. **Force Account:** Force account is the construction by use of the Borrower's own personnel and equipment. This method may be allowed when it is the only practical method for undertaking some kinds of works. The Bank allows the use of force account where it can be justified that:
  - the quantities of work involved cannot be defined in advance;
  - the works are small and scattered or in remote locations for which qualified construction firms are unlikely to bid at reasonable prices;
  - the work is required to be carried out without disrupting ongoing operations;
  - the risks of unavoidable work interruption are better borne by the Borrower than by a Contractor; and
  - there are emergencies needing prompt attention.

7. **Community Participation Procurement:** Community Participation Procurement is allowed so that there is project sustainability or specific social objectives.
8. **Performance-Based Procurement:** Performance-Based Procurement is where payments are made for measured outputs.

### **The World Bank and Methods of Procurement for private sector operators**

The Bank advises the private sector borrowers to utilize procurement procedures in accordance with established private sector or commercial practices that are acceptable to it. The Bank will ensure that such procedures result in competitive market prices for the goods and works and that these meet the needs of the project.



The logo for BI Norwegian Business School features a central blue square with the letters 'BI' in white. Radiating from this center are numerous colorful, 3D-style rectangular bars of various colors (red, orange, yellow, green, blue, purple, pink) that fan out in all directions. Each bar has a label for a business program: 'Business', 'Strategic Marketing Management', 'International Business', 'Leadership & Organisational Psychology', 'Shipping Management', and 'Financial Economics'.

## Empowering People. Improving Business.

BI Norwegian Business School is one of Europe's largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD  
**EQUIS**  
ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

### ***The World Bank: The selection of consultants***

The World Bank has set rules and procedures for the selection of consultants<sup>214</sup> to work on the projects it funds. The rules and procedures address the issue of conflict of interest, unfair competitive advantage, eligibility and selection and evaluation methods. There are six methods that can be used in the selection and evaluation of consultants under the World Bank guidelines.

- 1) *Quality and Cost Based Selection (QCBS)*: This method, using a competitive process among shortlisted firms, takes into the quality of the proposal and the cost of the service to be provided in the selection of the successful bidder. The weighting to be assigned to quality and cost will be determined for each case and this will depend on the nature of the assignment. The selection process shall include the following steps<sup>215</sup>:
  - a) preparation of the TOR;
  - b) preparation of cost estimate and the budget;
  - c) advertising;
  - d) preparation of the short list of consultants;
  - e) preparation and issuance of the RFP [which should include: the Letter of Invitation (LOI); Instructions to Consultants (ITC); the TOR and the proposed draft contract];
  - f) receipt of proposals;
  - g) evaluation of technical proposals: consideration of quality;
  - h) public opening of financial proposals;
  - i) evaluation of financial proposal;
  - j) final evaluation of quality and cost; and
  - k) negotiations and award of the contract to the selected firm.

### *Evaluation of Quality*

The bank guidelines require that the Borrower shall evaluate each technical proposal (using an evaluation committee of three or more specialists in the sector), taking into account several criteria:

- a) the consultant's relevant experience for the assignment;
- b) the quality of the methodology proposed;
- c) the qualifications of the key staff proposed;
- d) transfer of knowledge, if required in the TOR; and
- e) the extent of participation by nationals among key staff in the performance of the assignment.

<b>Consultant's specific experience</b>	<b>0–10 points</b>
Methodology	20–50 points
Key personnel	30–60 points
Transfer of knowledge	0–10 points
Participation by nationals	0–10 points
<b>Total</b>	<b>100 points</b>

Source: World Bank (2006); Guidelines: Selection and Employment of Consultants by World Bank Borrowers; May 2004; Revised October 1, 2006

*Evaluation of Cost:* In reviewing the financial proposals, the bank requires that the Borrower checks for any arithmetical errors and they shall be corrected. The guideline require that for the purposes of comparing proposals, the costs shall be converted to a single currency selected by the Borrower (local currency or fully convertible foreign currency) as stated in the RFP. The Borrower shall make this conversion by using the selling (exchange) rates for those currencies quoted by an official source (such as the Central Bank) or by a commercial bank or by an internationally circulated newspaper for similar transactions<sup>216</sup>. *Public entities are advised to use rates quoted by the Central Bank; that is, those for the day and date when the bids were submitted.*

II) *Quality Based Selection (QBS):* Under this method, the RFP may request submission of a technical proposal only (without the financial proposal), or request submission of both technical and financial proposals at the same time, but in separate envelopes (two-envelope system). The RFP shall provide either the estimated budget or the estimated number of key staff time, specifying that this information is given as an indication only and that consultants shall be free to propose their own estimates. If technical proposals alone were invited, after evaluating the technical proposals using the same methodology as in QCBS, the Borrower shall ask the consultant with the highest ranked technical proposal to submit a detailed financial proposal. The Borrower and the consultant shall then negotiate the financial proposal and the contract. This method is appropriate for the following types of procurement or assignments

- a) complex or highly specialised assignments for which it is difficult to define precise
- b) TOR and the required input from the consultants and for which the client expects the consultants to demonstrate innovation in their proposals;
- c) assignments that have a high downstream impact and in which the objective is to have the best experts; and
- d) assignments that can be carried out in substantially different ways, such that proposals will not be comparable.

- III) *Fixed Budget Selection (FBS)*: This method is recommended only when the assignment is simple and can be precisely defined and when the budget is fixed. The applicants that submit the RFP shall be informed of the available budget and requested to provide their best technical and financial proposals in separate envelopes, within the budget. Evaluation of all technical proposals shall be carried out first as in the QCBS method. Proposals that exceed the indicated budget shall be rejected. *The Consultant who has submitted the highest ranked technical proposal among the rest shall be selected and invited to negotiate a contract.*
- IV) *Least Cost Selection (LCS)*: The method is only appropriate when selecting consultants for assignment of a standard or routine nature (such as audits, engineering design of noncomplex works and so forth) where well-established practices and standards exist. Proposals, to be submitted in two envelopes, are invited from a short list. The firm with the lowest price shall then be selected.

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



- V) *Selection Based on the Consultants Qualifications (CQS)*: The Bank's guidelines require that this method be used for small<sup>217</sup> assignments for which the need for preparing and evaluating competitive proposals is not justified. The guidelines require that in such cases, the Borrower shall prepare the TOR, request expressions of interest and information on the consultants' experience and competence relevant to the assignment, establish a short list and select the firm with the most appropriate qualifications and references. *The selected firm shall be asked to submit a combined technical-financial proposal and then be invited to negotiate the contract.*
- VI) *Single Source Selection (SSS)*: The Bank recommends competitive procurement and evaluation methods; first and foremost. Single source selection of consultants does offer the benefits of competition<sup>218</sup>. It may be appropriate only if it presents a clear advantage over competition, for example: (a) for tasks that represent a natural continuation of previous work carried out by the firm; (b) in emergency cases, such as in response to disasters and for consulting services required during the period of time immediately following the emergency; (c) for very small<sup>219</sup> assignments, or (d) when only one firm is qualified or has experience of exceptional worth for the assignment.

**Misprocurement:** According to its rules and procedures for procurement, the Bank finances only those expenditures for goods and works which have been procured in accordance with the agreed provisions in the Financing Agreement and as further elaborated upon in the *Procurement Plan* of the recipient (borrower) of the Bank's support. Therefore, the Bank does not finance expenditures for goods and works which have not been procured in accordance with the agreed provisions in the Financing Agreement and as further elaborated upon in the *Procurement Plan* of the borrower.

*What the does Bank do if it finds out the latter happened?*

If the Bank finds out that its funds were used to finance expenditures for goods and works which have not been procured in accordance with the agreed provisions in the Financing Agreement and as further elaborated upon in the *Procurement Plan* of the borrower, the Bank will declare that a misprocurement. This means that it will cancel that portion of the financing allocated to the goods and works that have been misprocured. Usually the Financing Agreement provides remedies to address misprocurement and the Bank may exercise those remedies provided. The Bank may also declare misprocurement once the contract is awarded after obtaining a "no objection" from the Bank, where it has not issued the "no objection" on the basis of incomplete, inaccurate, or misleading information furnished by the Borrower or the terms and conditions of the contract had been modified without the Bank's "no objection".

**Fraud and Corruption:** *The bank has zero tolerance to corruption.* The Bank's policy requires that borrowers, bidders, suppliers and contractors and their subcontractors under Bank-financed contracts observe the highest standard of ethics during the procurement and execution of such contracts. The bank requires the borrowers to reject a proposal for award if it determines that the bidder recommended for award has, directly or through an agent, engaged in corrupt, fraudulent, collusive, or coercive practices in competing for the contract in question. It will cancel the portion of the Financing allocated to a contract if it determines at any time that representatives of the Borrower or of a beneficiary of such Financing engaged in corrupt, fraudulent, collusive, or coercive practices during the procurement or the execution of that contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to address such practices when they occur. The bank will, for a period of time, remove any unethical bidder from the list of the Bank's funded projects. The Bank looks at the following as unethical behaviour and practices:

- i) "Corrupt Practice" is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party;
- ii) "Fraudulent Practice" is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation;
- iii) "Collusive Practice" is an arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the actions of another party;
- iv) "Coercive Practice" is impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party;

# PART IV: LEGAL ISSUES IN BUSINESS MANAGEMENT

Law is an important subject when one is studying business or management disciplines. There are laws relating to agreements and contracts, procurement and international trade. This section covers the legal aspects in business administration and management. The language is simple and allows students of business and management to understand the concepts and the laws. This section is not intended for use by advocates of the courts (or officers of court). It is intended for those interested in understanding the basics of business and law.

<b>Criminal Law</b>	<b>Civil Law</b>
Plaintiff is the State (State v. Sam)	Plaintiff is a private party ( Sam v. John)
Guilty or Not Guilty	Liable or Not Liable
Guilty verdict results in prison sentence	Liability results in paying damages (i.e. money)
Prosecution must prove guilt beyond a reasonable doubt	Plaintiff only needs a preponderance of evidence (i.e. 50% or more)

**Table 33:** Basic Overview: Criminal Law v Civil Law

# 17 LAW OF CONTRACT

## Formation of Contract

A *contract* is an agreement between two parties that creates an obligation to perform (or not perform) a particular duty.

### *Essential elements of a valid contract*

A legally enforceable contract requires:

- Agreement (*consensus-ad-idem*) – offer and acceptance
- Consideration
- Intention to create a legal relationship
- Capacity to contract (parties competent to contract)
- Free and Genuine Consent
- Legal Formalities



Brain power

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)

**SKF**

## **Agreement as basis for the formation of a contract**

**Consent:** For a contract to come into existence there must be mutual consent between the parties to the contract. In other words there must be *ad idem* – the meeting of minds of the contracting parties. Consent should be outwardly manifested or shown – that is, it should be express.

**Offer and acceptance:** The first key elements in the formation of a contract are: offer and acceptance.

**Offer:** We can define an offer as an expression of willingness by one party (the offeror) to contract made with the intention that it shall become binding on the two parties as soon as it is accepted by the offeree. All agreements, therefore, must contain an offer by one party that has been accepted by another party. The offer may be in writing, by conduct or words. An offer need not be to only companies. An offer can be made to an individual person, company, organisation or even to the world at large. When it is made to an individual, it is referred to as a unilateral offer. The validity of a unilateral offer was established in **Carlill v Carbolic Smoke Ball Company** [1893]. The defendants (Carbolic Smoke Ball Co.) were manufacturers of a medicine/ health product named “the carbolic smoke ball.” The defendants advertised an offer in the newspaper of £100 to any user of the carbolic smoke ball who would catch influenza after using it correctly. To show their sincerity, they also stated in the advertisement that they had already deposited the sum of £100 with the bank. Relying on the advertisement, the plaintiff (Mrs Carlill) bought the smoke ball and used it according to the instructions but caught flu. She claimed £100 from the defendants who refused to honour the claim. They argued that the advertisement was merely an advertising puff. She sued the defendants for £100.

The argument of the defendants:

- 1) There was no offer but a mere statement of intention (a mere advertising puff);
- 2) Even if there was an offer at all, it could not be binding upon them because it was not made to a particular person; and
- 3) There was no communication of acceptance by the plaintiff.

The court of appeal held that the plaintiff was entitled to the sum of £100. The reasons for the ruling:

- 1) The defendant had made an offer to the world at large (i.e. anyone who performed the conditions in the advertisement) which the defendant had accepted by her conduct;
- 2) The conduct by Mrs Carlill of buying and using the product as the advertisement instructed was her acceptance by conduct; and
- 3) As for the existence of an offer, court held that the language of the advertisement made a definite offer.

Therefore, this same principle would apply to those traders/ retailers who put out advertisement for free offers. For example, if Retailer X places an advertisement promising that anyone who buys one pair of shoes will be given another pair, this will become an offer. In other words, anyone who buys a pair of shoes as per advertisement must be given another pair free of charge.

### **An offer or invitation to treat?**

A qualified offer is different from a mere invitation to treat. We can refer to an invitation to treat as where one party is simply inviting offers that can either be accepted or rejected. The following examples will suffice.

- 1) Display of goods with a price ticket. In the case of **Fischer v Ball** [1960], the courts decided that the display of goods with a price ticket in a shop window or supermarket shelf is not an offer to sell but a mere invitation to treat. Therefore, the customer has to enter the shop and make an offer to buy.
- 2) Issue of a catalogue. In the case of **Grainger v Gough** [1896], it was decided that the issue of a catalogue with descriptions of goods for sale at specified prices is not in itself an offer. It is just an invitation to treat. Like what we have stated above (in **Fischer v Ball**), customers can make orders at an agreed price and then the invitation to treat will lead to an offer.

**Termination of offers:** In the current legal environment (English and Commonwealth law), an offer can terminate (end) in one of the following seven ways: acceptance; rejection; counter-offer; revocation; failure of a precondition; lapse of time; and death of one of the parties.

- i) *Acceptance:* When the offer is accepted unconditionally by the offeree and the parties enter into a contract, then we can say that the offer has terminated. For a contract to come into effect there has to be unqualified acceptance of the offer by the offeree. When there is the offer and unconditional acceptance of the offer, then it means that an agreement exists. *Acceptance of the offer can be in writing, oral (word of mouth) or defined from conduct.* Silence is not acceptance. See the case of **Felthouse v Bindley** [1862]
- ii) *Revocation:* As a general rule, the offer can be revoked (i.e. withdrawn by the offeror) at any time before it is accepted. It does not matter how much period the offeror had given to the offeree to accept the offer. Once the offeror decides to withdraw the offer, it can be terminated.
- iii) *Rejection:* The offeree can reject the offer and this terminates the offer. Rejection can take two forms: express rejection or counter-offer.

## TURN TO THE EXPERTS FOR **SUBSCRIPTION** CONSULTANCY

Subscribe is one of the leading companies in Europe when it comes to innovation and business development within subscription businesses.

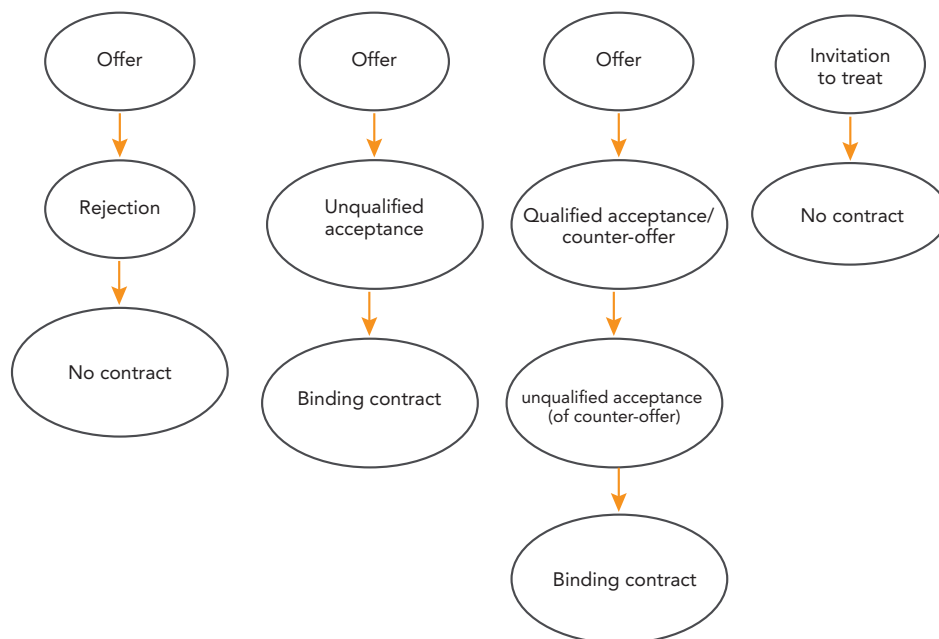
We innovate new subscription business models or improve existing ones. We do business reviews of existing subscription businesses and we develop acquisition and retention strategies.

Learn more at [linkedin.com/company/subscribe](https://www.linkedin.com/company/subscribe) or contact  
Managing Director Morten Suhr Hansen at [mha@subscribe.dk](mailto:mha@subscribe.dk)

**SUBSCR**✓**BE** - to the future

- iv) *Counter-offer*: The offeree may seek to change the terms and conditions without rejecting express all the contents of the offer. When the offeree does not wholly reject the offer but seeks to change the terms and conditions, the offer becomes an unqualified offer and what he proposes is referred to as counter-offer.
- v) *Lapse of time*: Where an offer has been made for a specified period, it will terminate automatically when that period expires. Where there is no specified time, it will terminate after a reasonable time. Reasonable time depends on the circumstances of each case considering the nature of goods and the context in which the offer was made, among others.
- vi) *Failure of a precondition*: For example, an offer will terminate in the case where there was a precondition (precedent condition) in the offer that the goods at the time of offer would be in the same condition at the time of acceptance. Take the example of buying a car from a car selling company. At the time of offer, it had no damage. By the time you come to accept the offer you find it has been damaged! You cannot accept it. This will terminate the offer.
- vii) *Death of one of the parties*: The death of the offeror will automatically terminate the offer as long as the offeree is aware of it. Likewise, the death of the offeree terminates the offer.

*Acceptance of the offer and the contract*: Acceptance of the offer can be in writing, oral (word of mouth) or defined from conduct of the parties. Silence is not acceptance; see the case of **Felthouse v Bindley** [1862]



**Figure 11:** Overview of the processes in contract formation

**Source:** Adapted from CIPS (2006). The Official CIPS Course Book. Lincolnshire: CIPS

**Intention to create legal relations:** This is another major element of a valid contract where the parties must have a legal intention. In contract formation, there is no “I did not know” argument. Whatever you say has legal clothing. If there is no intention for the parties to create legal relations, then the contract will be void.

**Consideration:** This is the second vital element of a valid contract. It is something of value in the eyes of the law. The concept of consideration is based around the concept of a ‘benefit’ to the person making the promise (the promisor), or a ‘detriment’ to the person to whom the promise is made (the promisee). Either is sufficient to make the promise enforceable, though in many cases both will be present. Griffiths and Griffiths (2002)<sup>220</sup> give two forms of consideration as either executed or executory. Executed consideration occurs where the promise is made in return for doing an act. An example here may involve a promise to pay some percentage on a lost and found item. In executory considerations on the other hand, it is a promise in exchange for a promise, any action being in the future. If there is no consideration then there is no contract. Consideration can be termed as the price of the contractual promise. Such a price may consist of payment in monetary form, in kind, the doing of some action, or even the forbearance from enforcing some rights. Consideration is one of the elements of a valid contract. It is something of value in the eyes of the law. The traditional definition of consideration was set out in **Currie v Misa** [1875]:

*...a valuable consideration, in the sense of the law, may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss of responsibility given, suffered or undertaken by the other.*

### **The Principles of Consideration: Sufficiency or adequacy**

Consideration must be of sufficient (that is of some value) but need not be adequate. *Consideration must be sufficient but adequate; and courts of law consistently refuse to rule on its adequacy.* The law is concerned with the existence of a bargain. It is not interested in the value of that bargain. The courts will not rule in favour of plaintiff who made a bad bargain. So the buyers beware (‘caveat emptor?’). Let the rules be known by parties as regards the value of the deal. The most common type of consideration is in monetary terms. The law is not interested in the adequacy of the consideration. It is how sufficient the consideration is legally capable of constituting a consideration that the courts will look at.

**Adequacy is the value of the consideration.** As long as parties to the contract agree on the consideration, then the issue of value is not the concern of the courts. If you made a bad deal you already made it! But was there consideration of any amount? The performance of existing duty as a matter of public duty due to the existence of a running contractual duty cannot constitute valuable consideration. However in a situation where you request for additional service as in the case of **Glasbrook Brothers Ltd v Glamorgan County Council** [1925], then you should pay an additional change i.e. consideration.

It is only the person who has provided consideration in a contract that can enforce a promise under the same contract. He/she is the only person that has a 'locus standi' to enforce it. This takes us to the privity of contract and the third parties. Even when the contract was made for the benefit of another party or person, that beneficiary cannot sue to enforce it. He/ she did not provide any consideration for the promise. This has been amended to change this situation. There is now the Contracts (Rights of Third Parties) Act 1999. In this Act, there are situations where third parties can benefit from a contract despite the lack of consideration. There are other situations where third parties can enjoy rights in a contract between two other parties. We will look at the privity of contract and the rights of third parties later.

What do you want to do?

No matter what you want out of your future career, an employer with a broad range of operations in a load of countries will always be the ticket. Working within the Volvo Group means more than 100,000 friends and colleagues in more than 185 countries all over the world. We offer graduates great career opportunities – check out the Career section at our web site [www.volvogroup.com](http://www.volvogroup.com). We look forward to getting to know you!

**VOLVO**  
AB Volvo (publ)  
[www.volvogroup.com](http://www.volvogroup.com)

VOLVO TRUCKS | RENAULT TRUCKS | MACK TRUCKS | VOLVO BUSES | VOLVO CONSTRUCTION EQUIPMENT | VOLVO PENTA | VOLVO AERO | VOLVO IT  
VOLVO FINANCIAL SERVICES | VOLVO 3P | VOLVO POWERTRAIN | VOLVO PARTS | VOLVO TECHNOLOGY | VOLVO LOGISTICS | BUSINESS AREA ASIA

*Past consideration is not regarded as consideration.* The law enforces consideration that is clearly associated with the promise at hand. For instance, where a promise is made after work has been done, the court cannot enforce it. Consideration will have been made in the past and did not support the promise. See the case of **McArdle** [1951]:

The complainant (plaintiff) had carried out work of refurbishing a house in which his brothers and sister had a beneficial interest. He then asked them to contribute towards the costs, which they agreed to do. It was held that this agreement was unenforceable, because the promise to pay was unsupported by consideration. The only consideration that the plaintiff could point to was his work on the house, but this had been completed before any promise of payment was made. He had asked his siblings to contribute after had done the work. They accepted but did not pay consideration. Court held that it was 'past consideration' and so not consideration at all.

### **The rule of Pinnel's case [1602] and the part payment of a debt**

The rule of Pinnel's case, part payment of a debt is not accepted as sufficient consideration for a promise. The court rejected part payment as full settlement of a debt. It was not sufficient consideration. There are, however, situations in which acceptance of a lesser payment will suffice as consideration. For instance, if the payment of a lesser amount was in a different form at the payee's request, this would be binding. It would be regarded as sufficient consideration.

### *Contractual intention between the parties (intention to create legal relations)*

For an agreement to be legally enforceable, it must be entered into with the intention of creating a legal relationship. Let us look at domestic and commercial agreements to understand contractual intention and legal relations.

*Social or domestic arrangements:* There are several social arrangements that do not constitute a contract because they are done without an intention to create legal relations. Some examples include:

- 1) Providing residential accommodation to a relative or close friend without a contract;
- 2) Giving a lift in your car to a neighbour every morning to town;
- 3) Hosting a party for friends at home; and
- 4) Buying a drink to a person sitting next to you in bar.

Domestic arrangements are generally presumed at law as not legally binding (unless the agreement demonstrates that there was an intention to be bound). Therefore, a domestic agreement between a husband and wife living in one household is presumed at law not to be legally binding. See the case of **Balfour v Balfour** [1919].

**Commercial agreements:** In commercial agreements, there is a strong presumption that the parties intended to create legal relations and be contractually bound. If the parties do not want to create a binding legal relation, they can include a clause in the agreement saying so. We can refer to such a clause as an *honour clause*.

**Contractual capacity:** Under the English law and the common law, a person who has reached the age of majority (full legal age – 18 years) has the legal capacity to enter any contract. *Capacity to contract:* This is the capacity to enter a contract, either by natural persons or artificial persons. For example, under natural persons, infants or minors, mentally incompetent persons or drunkards have no legal capacity to contract. Under corporate capacity, there has to be an authorised signatory. The person signing on behalf of the corporation has to have the powers of attorney. That contract will be legally binding on the parties, as long as they intended to create a binding legal relationship. Capacity to contract by a person of full age, 18 is well established by the Family Law Reform Act 1962 under English law. The other commonwealth countries have adopted it. There are some countries whose age of maturity (age of consent) is 16 years. The following may not have capacity to enforce a contract:

- 1) Minors-less than age of maturity;
- 2) Drunkards;
- 3) Mad persons; and
- 4) Corporate capacity: Traditionally the legal capacity of a company is governed by the doctrine of *ultra vires*. The doctrine of *ultra vires* stipulates that any actions by a company that fall outside its “objects clause” (i.e. the objects in its memorandum of association) is invalid.

### **Factors that vitiate a contract**

To vitiate means to render defective. There are various factors that may render a contract defective: *duress, undue influence, mistakes, misrepresentation and repudiation*.

**Duress:** This is a common law concept that was originally restricted to actual violence or threat of violence made to the contracting party or those close to them, where they had to be frightened of loss of life or bodily harm. It now also covers economic duress. This occurs where one party is forced to enter into a contract as a result of violence or threatened harm to themselves or their immediate family. One party can ask court to set aside the contract on grounds of duress. According to Lord Scarman, in determining whether there was duress or coercion of the will (and, therefore, no consent); it is a matter for the court to establish the following:

- i) Whether the person who alleges to have been coerced did or did not protest;
- ii) At the time did or did not have an alternative course open to him such an adequate legal remedy;
- iii) Was independently advised;
- iv) After entering the contract took steps to avoid it; and
- v) All these matters have to be considered to determine whether the plaintiff acted voluntarily or not.

**gaiteye**<sup>®</sup>  
*Challenge the way we run*

**EXPERIENCE THE POWER OF  
FULL ENGAGEMENT...**

.....

**RUN FASTER.  
RUN LONGER..  
RUN EASIER...**

**READ MORE & PRE-ORDER TODAY  
WWW.GAITEYE.COM**

**Undue influence:** This occurs where one of the contracting parties influences the mind of the other party. It usually happens where there is a close relationship between the parties. It may also happen where there is no relationship but this has to be proved by the person seeking to avoid the contract on the grounds of undue influence.

**Misrepresentation:** This is not part of the contract. It is an untrue statement of fact that induces one of the parties to enter into a contract. *So what is a representation?*

A representation is a pre-contractual statement of fact made during the negotiations stage. This representation may induce one party to enter into the agreement. The statement of fact may relate to either some past fact or a present fact. A representation is a statement of fact not a statement of opinion (which will not amount to a misrepresentation if proved it was wrong). *Misrepresentations can result in civil and criminal consequences.*

*Utmost good faith and misrepresentation:* In the spirit of utmost good faith ('uberrimae fidei'), the parties to the contract must disclose all material facts. Contracts such as those for financial services e.g. insurance or company sales of shares on a stock market require *uberrimae fidei*.

Types of misrepresentation:

- 1) *Fraudulent misrepresentation:* This type of misrepresentation occurs when one of the parties makes a false statement which they themselves don't honestly believe to be true. In such a case, the innocent party may affirm the contract and claim damages for consequential loss and sue for deceit under the *tort of deceit*. Secondly the innocent party may repudiate the contract and claim damages and/or rescission.
- 2) *Negligent misrepresentation:* This type occurs when a false statement is made by a person having a duty of care. In the negotiations process and in the contract, a person having the duty of care is one of the parties to the contract. It happens where proximity exists – that is, present between the parties to the contract.
- 3) *Innocent misrepresentation:* This occurs where the misrepresentation was made without any fault.

### *Remedies for misrepresentation*

In general, the effect of actionable misrepresentation is to render the contract voidable so that the innocent party gets the right to rescind the contract and/or claim damages. Specifically each type of misrepresentation should attract remedies particular to that misrepresentation. A fraudulent misrepresentation gives rise to a remedy of rescission and damages in the tort of deceit. For negligent misrepresentation, there are two ways of claiming damages:

- i) Under the common law the remedies are rescission and damages in the tort of negligence.
- ii) Under the misrepresentation Act (1976), the remedy is the same as in fraudulent misrepresentation.

Rescission: setting aside the contract, this is always a possible remedy in all case of misrepresentation.

***Mistake:*** Mistake is another factor that can vitiate a contract. Under mistake we can see a *common mistake; mutual mistake; unilateral mistake; mistaken identity; and the wrong document.*

### **Doctrine of Privity of Contract**

The principle of privity states that it is only the parties involved in a contract that can sue or can be sued. This however has certain exceptions e.g. If A and B enter into a contract, C cannot enforce it in the event of either contracting parties going into breach because he or she was not party to the contract. The principle of privity states that it is only the parties involved in a contract that can sue or can be sued. This, however, has certain exceptions, e.g. If A and B enter into a contract, C cannot enforce it in the event of either contracting parties going into breach because he or she was not party to the contract. This privity of contract rule was strictly the creation of the common law of England. The general rule under the doctrine of privity of contract is that only the parties to a contract can acquire rights under it and sue upon it. Third parties, therefore, cannot acquire any rights and enforce a contract between two other parties. Also these two parties cannot impose any obligations on a third party who is not a party to the contract. The strict application of the doctrine of privity of contract means that a third party for whom the contract was made for his/her benefit cannot enforce it. A third party cannot sue to enforce the contract, even if the contract was intentionally made for their benefit. The aspect of the rule of privity, namely the idea that a third party cannot have any burdens from the contract enforced on them, is generally accepted as good law. It would be very unfair and contrary to the idea of freedom of contract, if two parties could impose contractual obligations on a third party without the latter's consent. However, the situation where a contract is made for the *benefit* of a third party but has right to sue – even sue for breach of contract can be viewed as unfair. See case of **Tweddle v Atkinson** [1861].

We can give examples we see every day in our society.

*Example 1:* Frank promises his father, Fred, that in return for him taking over the family tea estate, he will pay a sum of US\$ 1,000,000 to his younger brother Arthur. Fred transfers the family tea estate to Frank but Frank refuses to pay Arthur. Arthur is unable to bring an action against Frank for the money, as he is not a party to the contract between Fred and Frank.

*Example 2:* Robert contracts with a contractor to build a house of his mother's country home. This contract is plainly intended to benefit Robert's mother. However, if the contractor provides a defective service or refuses to complete the house, Robert's mother is not entitled to sue the contractor for breach of contract.

This e-book  
is made with  
**SetaPDF**



PDF components for PHP developers

[www.setasign.com](http://www.setasign.com)

### **Case of Tweddle and Right of 3<sup>rd</sup> parties**

Case of **Tweddle v Atkinson** [1861], the bridegroom could not succeed in his action against his father-in-law's estate as he was not party to the contract between his father and father-in-law. However, it was clear that the contract was for the bridegroom benefit and the contract expressly conferred a right of action on the bride groom. Court ruled: "*No stranger to the consideration can take advantage of a contract, although made for his benefit.*"

- i) In consideration of an intended marriage between the plaintiff and the daughter of William Guy, a contract was made between Guy and the plaintiff's father whereby each promised to pay some of money;
- ii) Guy, the father-in-law, failed to pay;
- iii) The plaintiff sued his father-in-law; and
- iv) Court held that he was not party to the contract and couldn't enforce it. It ruled that "*no stranger to the consideration can take advantage of a contract, although made for his benefit.*"

See also *Dunlop case* [1915] **Dunlop Pneumatic Tyre Co. Ltd v Selfridge D Co Ltd** [1915]

- i) Parties to a contract can sue on it;
- ii) Third party can sue only when they have given consideration; and
- iii) Principal who gave consideration to an agent can sue.

### **Measures to mitigate the doctrine of privity**

#### **Common law expectations to the privity rule**

There are a number of exceptions to and means of circumventing, the privity rule

- 1) *Joint parties*: Where a husband and wife for example enter a restaurant and order a meal, any of the two persons is a joint party. Any of the joint parties can sue to enforce a contract that was made with one of the members of the joint parties. See the case of **Lockett v Charles** [1938]. A husband and wife had a meal in a restaurant. The husband paid for meal. The wife suffered food poisoning but when she sued the restaurant, the restaurant argued that she was a third party. Court, however, held that she was a joint party with rights to sue.

- 2) *Contracting on behalf of a group*: In a situation where one member of a family books a holiday on behalf of them all (as was the case in **Jackson v Horison Holidays Ltd** [1975] where in Jackson's case when the holiday proved unsatisfactory), the plaintiff is entitled to claim compensation for all of them. Therefore, Mr. Jackson claimed damages for his wife and children who were considered to be third parties. The application of this exception to the rule is restricted to situations where there is a clear presumption that the plaintiff was acting on behalf of the group as a whole.
- 3) *Assignment*: The transfer of contractual benefits is called assignment. A contracting party assigns his rights and liabilities to a third party who then enforces them on his behalf. Example: Joe and Erica enter into a contract whereby Joe agrees to confer a benefit on Erica. Erica may be able to transfer (assign) the benefit of the contract to a third party (Tracy). Tracy is then entitled to sue Joe on the contract and Erica loses the right to enforce or vary the contract. Erica is called the assignor; Tracy is called the assignee; and Joe is called the debtor. Joe's consent is not necessary for the assignment of contractual benefits from Joe to Tracy.
- 4) *Agency*: In an agency agreement such as real estate or insurance, an agent contracts on behalf of his principal. The agent negotiates, say the price of a house, with the seller on behalf of the buyer. As we see under Agency law, an agency is the relationship that exists when one person (the agent) is appointed by another person (the principal) to act as their representative. For example, a grocery store or shop attendant who is an employee may be an agent of their employer (the shop owner) for the purpose of selling goods and thus any contract of sale concluded between the shop attendant (the employee) and a customer will be binding on the employer. The agent (employee) will, however, not be liable on the contract of sale.
- 5) *Trusts*: A third party can enforce a contract if a wholly constituted trust was created in their favour by the contract. Courts are reluctant to find that there is a trust unless it is clear that this was the intention of the parties. The parties cannot rescind or vary the agreement without the consent of the third party beneficiary and a trustee may owe various special duties to the third party beneficiary.

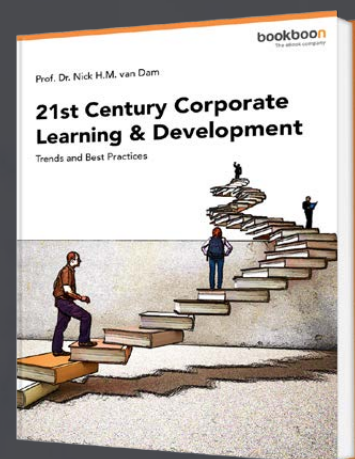
- 6) *Collateral contracts*: A collateral contract (or a collateral warranty) is a “contractual promise from one party to a third party which relates in some way to the terms of the original contract”. Collateral contracts occur where there exists a separate contract related to the main contract between a third party and one of the main contracting parties. The legal consideration for a collateral contract is often the making of the principal contract, or a promise to nominate a party as a sub-contractor or supplier. For example, it is common for clients to request for a subcontractor in construction of long roads or big buildings. It is common for many companies and individuals to be involved in large construction and civil engineering works. These include the employer (client or developer), contractors, sub-contractors, consultants, funders and the tenants who later occupy what has been constructed. See case: **Shanklin Pier Ltd v Detel products Ltd** [1951].

Shanklin hires painters to paint his pier. Detel convinces Shanklin (and Shanklin agrees) and tells painters to buy paint from Detel. Three months later the paint is peeling off; it cannot work well. Shanklin sues Detel and wins the case. Shanklin was a third party. Yes. But also he had a collateral contract with Detel.

# Free eBook on Learning & Development

By the Chief Learning Officer of McKinsey

Download Now



### Statutory expectations to the privity rule

- 1) Tort of Negligence: If a person suffers a loss as a result of another person's negligence, that person may be able to sue in the tort of negligence. To succeed in a negligence action you do not need to show the existence of a contract, but you must show the following:
  - i) A duty of care, that is, the existence of a legally recognised obligation requiring the defendant to conform to a certain standard of behaviour for the protection of others against unreasonable risks.
  - ii) A failure to conform to the required standard.
  - iii) Actual loss or damage to the recognised interests of the plaintiff.
  - iv) A sufficiently causal connection between the conduct and resulting injury to the plaintiff.
- 2) Insurance: Insurance arrangements are often made by the insurer and insured for the benefit of a third party (e.g. life insurance for partner/children). However, at common law that third party beneficiary is not entitled to claim under the insurance contract. This could cause serious injustice and so legislation has been enacted to allow the third party beneficiaries of certain insurance contracts to claim under the insurance policy.
- 3) Road Traffic Act: Under the *Road Traffic Act*, *Third party insurance* provides for the injured person (third party) to claim against an insured vehicle.
- 4) *Carriage of Goods by Sea*: In international trade, when goods are carried by sea, the shipper (the person who wishes to send the goods) enters into a contract with a carrier and a transport document called a *bill of lading* is issued as evidence of this contract. The shipper then sends the bill of lading to the consignee (the person who is to collect the goods). *The consignee must present the bill of lading to the carrier to have the goods released to them.* The contract of carriage (as evidenced in the bill of lading) is entered into by the shipper and the carrier of the goods and the consignee is not a party to this contract. *The consignee is a third party to the contract between the shipper and the carrier of the goods.* Strict application of the rule or doctrine of privity would prevent the consignee from suing the carrier of the goods in contract in the event that goods are lost or damaged. However, the consignee of the goods obtains rights and liabilities under the contract of carriage entered into between the shipper and the carrier of the goods, as evidenced in the bill of lading. In summary, the Bill of lading serves three main functions:
  - 1) As a document of title;
  - 2) As evidence of a contract of carriage; and
  - 3) As a receipt.

- 5) *Contracts (Rights of Third Parties) Act 1999*: The purpose of this Act is to give a third party a right to enforce a contractual term in a contract that is designed for their benefit. Third parties now have a right to bring direct action without having to rely on the promise to sue on the third parties behalf. The Act gives a right of action to a third party without the need for consideration to have been made.
- 6) *Consumer Protection*: Based on the Consumer Protection Act 1987 of England, most commonwealth countries have established Consumer Protection Acts imposing strict liability on actual manufacturers. Consumer Protection Act 1987 introduced what is known as *strict liability on producers of defective products for any infringement that such products can cause*.
- Strict liability*: This means liability is placed on the actual manufacturer:
- i) Anyone importing products into the EU from a country outside the EU
  - ii) Anyone who holds themselves out as being the producer of the product as the own-brand products – retail stores with their own brands – like Sainsbury, ASDA, Albert Hein (The Netherlands) and many other high street stores and supermarkets in UK.

Where a product is proven defective, any of the above may then be liable for any death, personal injury or property damaged – subject to a minimum clause.

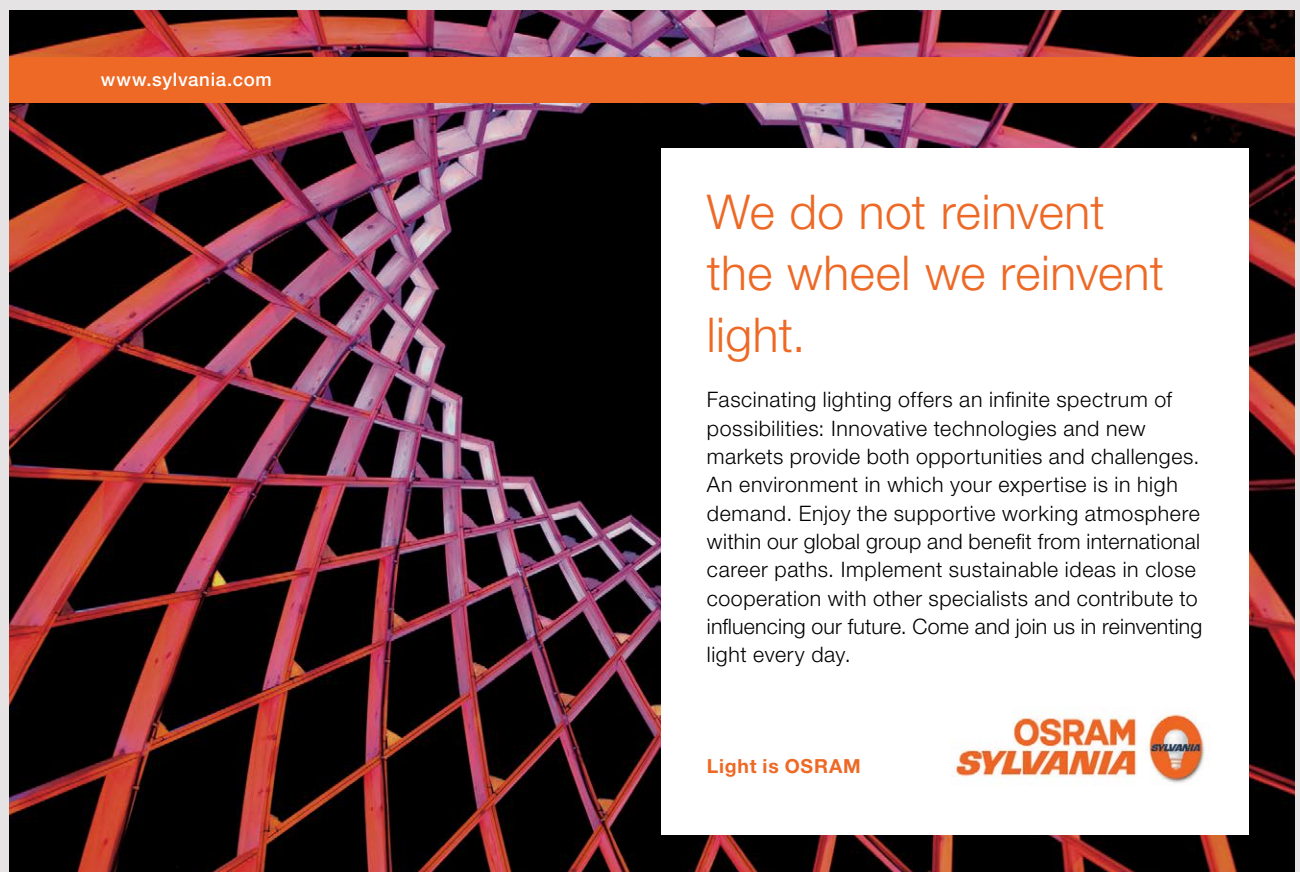
*Subcontractor liability*: The 1999 Act has also addressed the rights and liabilities of subcontracts. In attempting to deal with the privity rule of contract in relation to subcontractors, the Act provides a mechanism whereby third party rights may be created in the principal contract. Read the Contracts (Right of Third Parties) Act 1999 under statutory subcontractor liability. The liability for subcontractors will have to be framed as a collateral contract (*under the principles of Shanklin Pier v Detel case*).

### **Discharge or termination of a contract**

There are four ways in which a contract can be discharged:

- i) Performance (full performance, specific performance, substantial, part and divisible contracts);
- ii) Agreement by the parties;
- iii) Frustration; and
- iv) Breach.

***By Performance:*** Most contracts will be terminated by performance where both parties have successfully undertaken their contractual obligations as stated in the terms of the contract. For example, when a builder constructs the house that he was contracted to build, he is paid fully and the owner accepts it as per the contract. This is called full performance – where the contracting parties complete their contractual obligations. That is, what they undertook to do under the contract. The performance was complete and unconditional. This contract will terminate. No court cases will be involved. There are, however, situations where we find that a contract has terminated by performance to some level and not full performance. Let us look at these situations.




www.sylvania.com

We do not reinvent  
the wheel we reinvent  
light.

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

OSRAM  
SYLVANIA



- i) *Substantial performance*: The doctrine of substantial performance states that where a substantial part of the contract has been performed; the contractual price must be paid less an appropriate amount for the obligations to be fulfilled. The court requires that the provider be paid for the work already done. The remaining work can then be contracted to another provider. See the case of **Hoenig v Isaacs [1951]**. This is a case between an interior design decorator and designer (as the claimant) versus the owner of the apartment (the defendant). The contract was for painting the defendant apartment. There was substantial performance. Only minor (or trifling) work was remaining. Even the independent referee's opinion was that work was generally properly done; except for the wardrobe door which need replacing. Court ruled that the claimant was entitled to sums less a sum to rectify the defects.
- ii) *Partial performance*: In the situation where there has been substantial performance, the remaining part of the contract is remedial or minor the law does not get concerned with this. In a situation where one of the parties fails to fulfill all the obligations in the contract, the innocent party has two options.
- To reject the work performed; or
  - Accept the partial performance and pay for it on 'quantum meruit<sup>221</sup>' basis.
- iii) *Part performance in installment contracts (also known as "Divisible contracts")*. In a divisible contract, the contractor is paid for what has actually been performed or delivered. Where the contract is for the delivery of goods in installments, for example, the supplier would be entitled to payments for installments delivered even if the full contract was not performed.
- iv) *Non-completion of contractual obligations due to a fault of the defendant*  
Once the contract has been agreed, the promisee has to allow the other party to perform fully their obligations. Where the party promisor has been prevented from fully performing their contractual obligations, they can treat the contract as discharged and sue for the amount of the work already performed on a *quantum meruit* basis.

**By Agreement:** A contract can terminate by agreement in three ways:

1. By an express contractual term in the contract (*they may agree that a contract comes to an end after a fixed period*).
2. One of the parties has decided to terminate the contract before all the parties have fully performed the contractual obligations.
3. Substituting the original contract with a new one. This is where parties to the contract decide to waive the rights or obligations under the original contract with a new one with either more or less rights and obligations.

**By Frustration:** Parties usually enter a contract with the intention of full performance. They enter into a contractual relationship with commitment to perform. In some cases, a contract which was feasible to perform later becomes impossible to perform as a result of a change in circumstances beyond the control of the parties to the contract. This situation where there may be a valid contract but it becomes impossible for the parties to execute their duties and responsibilities under the contract due to supervening conditions outside the control of the parties is referred to as *frustration of the contract*.

*What can make a contract become frustrated?*

Subsequent changes in the law or political circumstances like the outbreak of a war which makes performance illegal. Natural disasters such as Tsunami in Asia or hurricanes like Hurricane Katrina in the US.

**By Breach:** A contract may terminate due to a breach. This may occur where either contracting party fails to fulfill their obligations in whole or in part under a contract. The aggrieved party to the contract will then claim damages and in certain situations the contract will be brought to an end.

*See a detailed discussion of the doctrine of frustration later*

### **Designing Contracts and Contract Types**

*How to Prepare a Contract:* There is no standard way of writing a contract. It partly depends on the nature of the contract and the organisation itself whether in the private or public sector. In the public sector, there are standard formats of a contract. Most commonly used contracts are developed from earlier contracts that have been successfully used before. They are subsequently modified to suit the prevailing circumstances. Using an existing (at times modified) contract reduces the amount of administrative effort and time, but there is an equal danger of assuming that all past contracts will be appropriate which is not always true. Care, therefore, must be made when preparing a contract. Organisations seeking to prepare contracts must get advice from the legal experts or legal departments when preparing a particular contract.

### **Checklist for preparation of a good contract (mainly for goods and works)**

We can look at the checklist provided by Monczka et al (1998)<sup>222</sup>:

- Be sure that the contract identifies clearly what you are buying and the cost;
- Be sure that the contract specifies how the item you are buying is going to be transported and delivered to you;
- In case of machinery, make sure that the contract covers the question of how the items are to be installed, if installation is to be part of the contract;

- In most cases, it will be necessary for you to have an acceptance provision detailing exactly how and where you will accept the products;
- Be sure that you address the appropriate warranties;
- Be sure that the contract itself spells out your remedies; and
- Be sure that the contract does a good job on the “boilerplate”.

### **Checklist for preparing of a good contract (Consultancy Services)**

Let us look specifically at consultancy contracts. Let us look at contracts for capacity building. The client must carefully consider the following questions before entering an agreement:

- What needs to be accomplished?
- What kinds of skills are required?
- Which members of management need to be involved?
- What are the policy and legal guidelines applying to that contract?
- What can we learn from the past contracts? Were there problems arising out of poor contracts formation?
- How were the problems (if any) solved in the past?
- How should the disputes be solved should they arise in the contract?
- How long can the consultations be made?
- What is the entity willing to spend?



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.

## Classification of contracts

*There are numerous ways in which contracts can be classified:*

1. By Duration and Coverage
2. Contracts by compensation

### Long-term contracts

- Annual or multi-year;
  - Because of the economies of scale, large quantity buyers generally purchase their high value materials under long-term contracts; and
  - These types of contracts eliminate the yearly supplier evaluations and purchasing administrative efforts.
1. *Definite Quantity Contracts:* These provide for the purchase of definite quantities of materials or services whose time of use is uncertain. The contract, therefore, specifies that instructions regarding delivery schedules will be provided later. Because the quantities are known, however, favourable prices are possible for this type of agreement.
  2. *Requirements Contracts:* These contracts provide for the purchase from one supplier of all of buyers requirements, for a stipulated period of time, for specified materials or services for a designated operation or activity. These types of contracts are typically used in applications such as the support of a firm's automotive repair shop, with parts being purchased from a specific parts dealer during the life of the agreement.
  3. *Indefinite Quantity Contracts:* During an agreed period of time, these contracts provide for the delivery of specific category of materials or services. Quantities and deliberate dates are indefinite, but the buyer is committed to purchase between designated high and low quantity limits.

### Contracts by Compensation

1. *Fixed Price (lump sum) Contracts:* This type of contract is best used when the specific service or product to be delivered can be freely defined and specified before the start of the work. The contractor is required to successfully perform the specified work and deliver agreed upon products or services. The specifications are described in detail, ensuring complete understanding of the requirements by both parties. This type of contract has of recent been favored and this is mainly because of the growing development difficulties with the supplying contractor. Some specific types of fixed contracts are:
  - a) Firm fixed price;
  - b) Fixed price with economic price adjustment; and
  - c) Fixed price determination.

2. **Incentive Contracts:** These are employed to motivate the supplier to improve cost and other requirements like schedule performance. Under this form of a contract, the buyer and the supplier share the cost responsibility. **Fixed price incentive:** Here the ceiling price is agreed to during negotiations.
3. **Cost plus incentive fee:** Here the supplier is reimbursed for all allowable costs incurred up to any agreed ceiling. These are types of contracts where the buyer's obligation is to reimburse the supplier for all allowable, reasonable and allocated costs incurred and to pay a fixed fee. Under this type of contract, the supplier is required to provide his best effort. Usually, cost type contracts are used when:
  - a) Procurement of R&D involve high technical risk;
  - b) Some doubts exist that the project can be successfully completed;
  - c) Product specifications are incomplete; and
  - d) Under this classification five sub-types can be identified.
4. **Cost reimbursement:** A cost reimbursement contract allows for payment to the contractor of all costs incurred, within a predetermined ceiling and allowable cost standards, after the work of the contract is performed. These contracts are used for emergency works where there is insufficient time to fully calculate the costs involved or for high risk works, where it is more economical for the procuring and disposing entity to bear the risk of price variations than to pay the provider to accept the risk or where providers will not accept risk.
5. **Cost sharing:** Under this type of contract, the agency and the contractor agree to split the costs of performance in a predetermined manner. **No fee is given.** This type can sometimes create additional liability issues of which the project manager should be aware.
6. **Time and materials:** These contracts pay at a fixed rate for services rendered and for materials at cost plus a handling fee. This is usually employed if the scope of the work to be completed is not well defined and does not permit a fixed level of effort. This contract is usually assigned a maximum amount payable.
7. **Cost plus fixed fee:** This provides for an adjustment of the fee (upward or down) using a predetermined formula based on the total allowable cost in relation to total target costs. Where the project goals can be specified with a reasonable certainty, it may be possible to introduce an incentive based on the achievement parameters e.g. time-cost-performance.

## **Breach of Contract**

A contract may terminate due to a breach. This may occur where either contracting party fails to fulfill their obligations in whole or in part under a contract. The aggrieved party to the contract will then claim damages and, in certain situations, the contract will be brought to an end.

***Is breach of contract a claim for breach of conditions of a substantial or minor matter?  
See the discussion of breach of a contract below.***

### **Frustration (or Impossibility)**

As already mentioned frustration is where there may be a valid contract but the work becomes impossible to perform due to subsequent or supervening events outside the control of both parties. Frustration occurs where it is possible to perform the contract at the time the contract is made but it subsequently becomes impossible to perform the contract in whole or in part. The contract is deemed frustrated. The legal effect of frustration on a contract is that when it becomes impossible to perform the contract in whole or in part, the contract comes to an end. The doctrine of frustration was developed by the judges in the case of *Davis Contractors Ltd V Fareham UDC [1956]*. In this case, a builder agreed to construct 78 houses within 8 months for a fixed sum. Due to the shortages of labour and material, bad weather and inflation the builder found himself substantially out of pocket. The contract took 22 months to complete. The contractor as the plaintiff claimed that the original contract had been frustrated and sought a *quantum meruit* payment over and above the contract price. House of Lords held that there had been no frustration as the contract had not become impossible to perform and the rise in costs was a risk that the plaintiff must have accepted when making the contract (when he signed the contract).

SIMPLY CLEVER

ŠKODA



**We will turn your CV into  
an opportunity of a lifetime**



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



***What are the situations that result in frustration of a contract?***

**Illegality:** An illegality will have the effect of bringing a contract to an end. If a valid contract is formed but subsequently changes in the public policy, law or political circumstances (e.g. outbreak of war) make performance illegal, then the contract is at an end. A contract between two parties in two different countries will come to an end if there is a ban on trade between these countries by either country's government. See cases explaining frustration: *Case: James D. Fraser & Co Ltd V Denny Mott & Dickson [1944]*. This case involved a contract for the supply of pine timber. The contract was terminated due to frustration. Stocks were still available but supply had become illegal due to wartime restrictions. Court held that the contract was at an end.

**Force majeure clause:** The parties can insert this clause in the contract to provide for the consequences of frustration. This clause covers such situations as natural calamities (tsunami, hurricane e.g. Katrina).

**Common law approaches to the doctrine of frustration are:**

- 1) **The destruction of the specific object:** This is explained by two cases: *Case of Taylor v Caldwell [1863]* where the subject matter of the contract was destroyed. In this case, a contract had been concluded between the parties for the plaintiff to hire a hall for a series of concerts. After the agreement was concluded but before the concerts started, the hall was destroyed by fire. Courts held that the contract was frustrated and that all future obligations were discharged and no money paid could be recovered.

*This does seem unfair and the question of recovery of money paid and compensation for benefits will be covered later.*

**Fibrosa Spolka Akcyjna V Fairbairn [1943]**

In this case an English company agreed to sell machinery to a Polish company. It was agreed that a deposit of one third of the purchase price would be paid at the time of the agreement. Before any machinery was delivered, however, war broke out and the contract was frustrated. The House of Lords held that the Polish company, Fibrosa, was entitled to recover the deposit paid on the ground of a total failure of consideration. Money had been paid to secure performance and there had been no performance.

## II) Law reform (Frustrated Contracts) Act 1943

This law introduced further flexibility. In the case of *Davis Contractors Ltd v Fareham* [1956] the contract became radically different from what was intended by the parties. Courts held that although the contract would come to an end, with all future obligations ceasing, there may be some redistribution between the parties to take account of money, property or services which have been transferred before the frustration event.

i) **The non-occurrence of an event:** This scenario is well explained by the two cases regarding *coronation* below.

I. ***Krell v Henry* [1903]**. In this case, the defendant hired a room for the coronation day. He made it clear that the purpose of hiring the room was to watch the coronation – that is, view the coronation procession. The king fell ill and there was no coronation. So the defendant refused to pay for the room. The room owner sued the defendant. Court of appeal held that no payment of hiring fees be paid.

*Why did the court rule this way?* This is because the sole foundation of letting the room was to view coronation procession and this did not take place. Therefore, the contract had been frustrated.

II. ***Herne Bay Steamship v Hutton* [1903]**. In this case the contract was for the hire of a boat to tour the royal fleet to watch the king's review. The review was cancelled but the fleet remained. The court held that the contract was not frustrated when the review was cancelled. *Why?* The fleet remained and it was still possible for the tour to go ahead. The review was, therefore, not the sole foundation of the contract.

ii) *Interference from the government:* Interference from government can also cause a contract to be frustrated. ***James D. Fraiser & Co. Ltd v Denny Mott and Dickson* [1944]**. Where the contract concerned trade in pine timber which was made illegal in 1939 and consequently the whole contract was held to be frustrated. This is referred to as supervening illegality. It was a government policy to stop timber trade. Parties could not change public policy.

iii) *Unexpected delays*: Long delays of executing the contract can render a contract frustrated. **Jackson v Union Marine Insurance [1873]**. In this case a ship was chartered to proceed from Liverpool to Newport to pick up a cargo of iron for San Francisco. On its way to Newport the ship grounded on a sandbank. It took several months to refloat her and carry out major repairs. The charterers repudiated the contract. Court held that while the express words of the exception might cover the interruption, the length of delay was beyond what the parties had contemplated and frustrated the contract. Although it would still have been possible for the original ship to proceed, the outcome would have been very different due to the long delay.

#### Limitations of the doctrine of frustration

i) *A mere increase in expenses or loss of profit does not amount to frustration*: See the case of 300 tons of Sudanese groundnuts destined for Hamburg. In this case the plaintiff agreed to supply the defendant 300 tons of Sudanese groundnuts to be shipped to Hamburg. A few weeks later Suez Canal is closed due to Israel invasion of Egypt. The plaintiff claims that this frustrated the contract. House of Lords held that the contract was not frustrated. There was still another route via Cape of Good Hope (although it was long and expensive).



- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFK! An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

- ii) *Self-induced frustration*: According to the law, a party may not self-induce frustration. See the case of **Maritime National Fish v Ocean Trawlers** [1935]. In this case the plaintiffs chartered a trawler from the defendants to use for offshore fishing, knowing that they would need to obtain a license for this use. They applied for five licenses but were granted three. The plaintiffs claimed that the contract had been frustrated. Court held that it was not frustrated, arguing instead that the frustration was self-induced. *Why? How?* Lack of a license for the chartered boat was a matter of the plaintiffs own choice and a party cannot rely on frustration that is wholly or partly self-induced. Another case to explain self-induced frustration is that of **The super servant two** [1990]. In this case, the ship owners operated two large badges built to carry heavy structures. They contracted to transport an oil rig. Before the contract could be performed one of the badges was lost. Court held that the plaintiff was entitled to sue for the damages for the expense of alternative means of transport following the loss of the badge before the voyage. Court of Appeal held that as the defendants chose to perform the other contract, the contract with the plaintiff was deemed to be self-induced frustration.
- iii) *Foreseeability of the frustrating event*: If a party could have foreseen the extraneous event at the time the contract was made, that party could not rely on the doctrine of frustration. **See the case of Walton Harvey Ltd v Walker & Homfrays Ltd** [1931]. In this case, the defendant, knowing that there was some likelihood that its hotel would be compulsorily acquired and demolished the authorities, permitted the plaintiff to erect an advertising boarding on its roof. Part way through the 7-year contract, the building was acquired for demolition and the sign removed. The plaintiff sued for damages. The owner of the building as the defendant argued that the compulsory acquisition had frustrated the contract and they were, therefore, excused from further liability. It was held that the contract had not been frustrated. The owner of the building knew that in future the building would be acquired and demolished. The defendant had been aware of the risk but had entered into the contract despite it. There was no provision of exclusion clause made in the contract to deal with the event of compulsory acquisition.

## Effects of frustration

**The Law Reform (Frustrated Contracts) Act 1943:** The common law doctrine of frustration was inflexible where monies had been paid or benefits received before the frustrating event. The Law Reform Act was passed to provide for a just apportionment of losses where a contract is discharged by frustration. This law reform has important clauses:

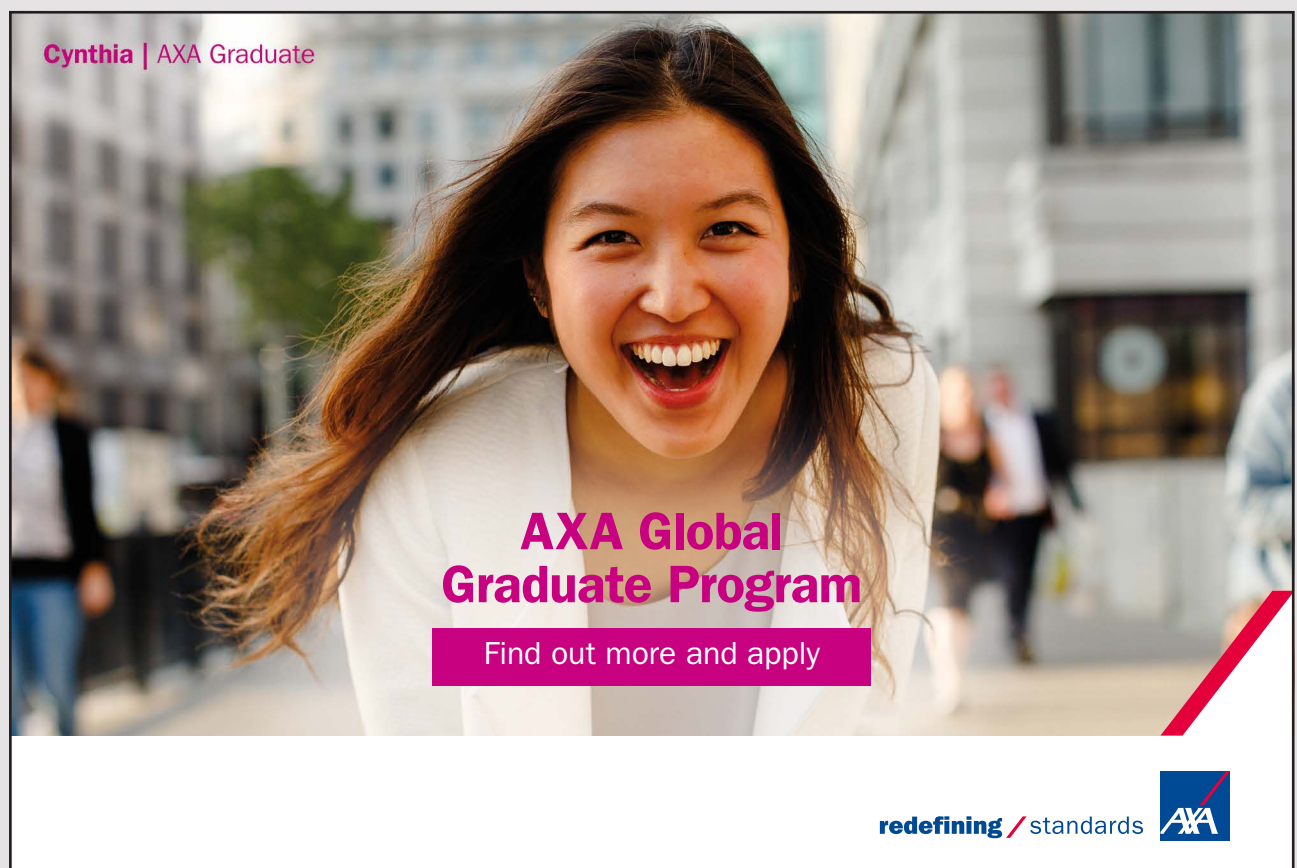
- I. *Monies paid:* S1 (2) provides three rules for recovery of monies paid.
  - i) Money paid before the frustrating event is recoverable;
  - ii) Money payable before the frustrating event is not recovered where there is a total failure of consideration; and
  - iii) If the party to whom sums are paid or payable incurred expenses before the frustration, the court may award such expenses up to the limit of money paid or payable before the frustrating events.
  
- II. *Benefits received:* S1 (3) provides for the situation where valuable benefit has been received. If one party has obtained valuable benefit because of anything done by the other party in performance of the contract, the court may order them to pay a sum in respect of that benefit. The court will have regard to all the circumstances each case.
  
- III. *Scope of the 1943 Act;* S2 (3) allows for contracting out.
  - S2 (4) provides that the Act does not apply where the wholly performed contracted obligations can be separated from those affected by the frustrating event.
  - S2 (5) provides that the Act does not apply to contracts containing a provision to cover frustration.

***Initial Impossibility:*** *Frustration must not be confused with initial impossibility. See the case Couturier V Hastie [1856] where both parties made the same error relating to a fundamental fact and the contract was held to be void. Also S6 of the Sale of Goods Act (SGA 1979) provides that where there is a contract for the sale of specific goods and the goods, without the knowledge of the seller, have perished at the time the contract is made, the contract is void.*

**Breach of contract:** This is a situation where either party fails to fulfill their contractual obligations in whole or in part. The remedy for the innocent or aggrieved party is then to claim damages. In other cases, court may order specific performance.

### We can look at the following equitable remedies


1. *Injunctions*: These are granted to prevent a breach that is anticipated or to prevent a person acting on breach. *Interlocutory injunctions*: Granted during a legal proceeding to ensure the maintenance of status quo pending a full hearing of a court case. Full injunctions: Granted at the end of the court case and lasting as long as decided by the courts.
2. *Mareva injunctions*: These prevent the disposal of assets or removal of the assets out of the jurisdiction of the court pending a full hearing of the case. This type of injunction can freeze assets in a bank account in the United Kingdom.
3. *Specific performance*: This is another type of equitable remedy and is an order available to courts where a contract has not been properly formed or there is a defect such that one party has clearly benefited to the detriment of the other. The court will order specific performance where:
  - i) Damages are an inadequate remedy
  - ii) The party seeking this remedy must not have brought the problem on themselves.
  - iii) Supervision of the order must be possible.



Cynthia | AXA Graduate

**AXA Global  
Graduate Program**

Find out more and apply

redefining / standards 

### **Remedy for Breach of Contract.**

- There are two remedies for breach of contract: Liquidated damages (penalty clause); and
- Unliquidated: where court awards damages

*The normal remedy for breach is damages.* When a party wins a case for breach of contract, they are entitled to damages and costs. If there is no loss sustained as a result of the breach of contract, the courts will award nominal damages in order to acknowledge that the breach took place. The function of awarding contractual damages is to compensate the victim or aggrieved party for their loss.

### **Types of recoverable loss**

1. Damages can include compensation for financial loss, personal injury and damages to property; and
2. Also damages/compensation for mental distress, disappointment and vexation.

**See case of Jarvis V Swans Tours** [1973]. In this case there was a disastrous failure by a tour company to match the expectations arising from its brochure. Swans promised the claimant a “house party” holiday in Switzerland. It also made other promises including a welcome party, afternoon tea and cake, Swiss dinner by candlelight, fondue party as well as a yodeler evening and farewell party. Swans also claimed that the hotel owner spoke English. The hotel owner did not speak English. Jarvis had no one to speak to despite there being 13 persons in the first week of the holiday. The other promises did not come up to the expectations. Court held that the claimant was entitled to damages – the damages awarded being for disappointment, inconvenience and loss of enjoyment. Such damages are only awarded in contracts for provision of pleasure e.g. holidays.

- *Actual loss v speculative loss:* Speculative loss is not recoverable. Only foreseeable loss is recovered not speculative loss.
- *Remoteness of damage:* Damages will be too remote unless they arise naturally in the course of things, or if they do not arise naturally they are such that a reasonable man ought to have contemplated them as likely to result from a breach.

- *Mitigation of loss:* There is a duty on the injured party to minimise their loss. In assessing damages the court will take into account the steps taken by the injured or aggrieved party. The injured party has a duty to take all reasonable steps to reduce their loss. See the case of **Brace v Calder** [1895]. Defendants – a partnership consisting of four members. They agreed to employ the claimant as a manager of a branch of their business for two years. Five months later the partnership was dissolved because of the retirement of two members. The business was transferred to the remaining two. They offered to employ the claimant on the same terms as before but he refused. He raised an action for breach of contract. He sought to recover the salary he would have been paid had he stayed for the whole two years. The dissolution of the partnership constituted a wrongful dismissal. Court held that:
  - i) He was only entitled to normal damages; and
  - ii) It was unreasonable to reject the offer for continued unemployment.

### **Resolution of Commercial Disputes**

1. *Litigation:* This is where the aggrieved party takes the matter to court. The parties require lawyers and the costs are high. The court processes take long to be resolved. At the end of the court proceedings, court decides e.g. award damages or imposes an injunction. We note that as method of dispute resolution, litigation does not leave parties as friends.

#### **Pros**

- It is tried and tested with a vast body of case law;
- It imposes a firm decision that the parties are obliged to respect; and
- It is institutionalised – you can go to court. No need to ask permission.

#### **Cons**

- Lengthy and expensive;
- Litigation requires a lot of management overhead;
- Often drives parties apart (creating enmity);
- Parties have no control over the court processes; and
- Not suited to disputes involving technical issues.

**There are however alternative dispute resolution mechanisms.**

2. **Alternative Dispute Resolution (ADR):** Alternative Dispute Resolution (ADR) can be termed as any process involving the use of a third party who is neutral to intervene as an alternative to litigation. Usually a neutral third party participates to help the parties to the conflict resolve their controversy. ADR is necessary because going to court – litigation – is usually expensive and slow at reaching a verdict. It is also adversarial: It may leave the parties in the conflict as enemies. We can look at the following ADR methods:

1. Conciliation;
2. Mediation;
3. Arbitration;
4. Negotiation; and
5. Adjudication

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**  
I was a construction supervisor in the North Sea advising and helping foremen solve problems

Real work  
International opportunities  
Three work placements



3. **Negotiation:** This is the most common form of alternative dispute resolution. It is a process by which the parties voluntarily seek a mutually acceptable agreement to resolve their common dispute. In terms of the process, it allows the parties (or disputants) to themselves control the process and the resolution. Negotiation is voluntary. Parties choose to negotiate. Once an agreement has been reached, then there is an enforceable contract. There is no third party to facilitate the processes of negotiation. Negotiation can be informal and unstructured.
  
4. **Mediation:** Mediation is a voluntary and informal process, in which the parties in a dispute select a neutral third party to assist them reach a mutually acceptable settlement. This neutral third party is referred as the mediator. Unlike a judge or an arbitrator, the mediator has no power to impose any decision on the parties. The mediator simply encourages the parties to discuss their differences and to arrive at their own agreed solution. What the mediator does is to assist the parties in shaping the solutions to meet their interests. Judges usually encourage the parties to try mediation before going to courts where litigation is the resort. The mediator can employ a variety of skills and techniques to help the parties reach a settlement. The mediator will assist parties to:
  - communicate effectively;
  - develop a cooperative problem solving attitude;
  - identify each party's interests;
  - transmit messages between parties; and
  - explore possible options for agreement.

The mediator will also explain the consequences of not reaching an agreement. The mediator may also help the disputants prove their strengths and weaknesses of their legal positions. Mediation is confidential. While lawyers may be present, there are usually no witnesses. Information shared during mediation may not be used as evidence in courts. At times parties enter formal confidentiality agreement before the start of mediation. When parties meet the mediator separately they also get a chance to share some of their sensitive information. The process of mediation usually starts with an initial meeting of the mediator with the parties. In this meeting, parties put forward their positions. The next step the mediator meets each party separately. The second meeting of all the parties is held where the mediator helps the parties to negotiate (and get a solution) face to face. In case the parties reach an agreement, the decision may be enforceable as a contract.

**Mediation is advantageous because the process:**

- It is quicker and cheaper;
  - It is less adversarial;
  - It is confidential and within control of the parties;
  - It is “without prejudice”;
  - It is flexible enough to go back to court in case one or both parties are dissatisfied because no secrets were given here.
5. **Conciliation:** Like mediation, the parties to a dispute use a neutral third party called a *conciliator* who meets each party separately to hear grievances. Unlike the mediator, the conciliator takes a more proactive role. In conciliation, the parties usually do face each other and negotiate before the conciliator. The conciliators give their own opinion about the dispute from time to time. The conciliator usually has the power to call witness and seek evidence. The conciliator does not make an award.
6. **Arbitration:** Arbitration is a legal technique for the resolution of disputes outside the courts, wherein the parties to a dispute refer it to one or more persons such as (the “arbitrators”, “arbiters” or “arbitral tribunal”), by whose decision (the “award”) they agree to be bound. Arbitration is today most commonly used for the resolution of commercial disputes, particularly in the context of international commercial transactions and sometimes used to enforce credit obligations. The process has provision for the dispute to be heard by either by a lone arbitrator or panel of arbitrators. Besides, the matter can be resolved outside courts. It uses a mini- trial format (both parties submit documentation).

**Arbitration:**

- Is confidential;
- Is unlikely to have its decisions overturned by Court unless the arbitrators are found to have acted in bad faith or were negligent;
- Uses arbitrators who are usually experts in the dispute area;
- Has the option of using more than one person make a decision;
- Is often faster than litigation in court;
- Arbitration can be cheaper;
- Arbitral proceedings and an arbitral award are generally private; and
- In most legal systems, there are limited avenues for appeal of an arbitral award, which can mean swifter enforcement and less scope for a party to delay matters.

**But arbitration also:**

- Though faster than litigation, is a lengthy process and can be expensive;
- Limits grounds for appeal yet the arbitrators are not bound to give reasons for a decision;
- Only usually takes place at the end of the contract and this leaves the claimant party without restitution for some time;
- Adds to the layers of legal costs when the parties need to pay for the arbitrators;
- Turns lengthy when there are multiple arbitrators on the panel, juggling their schedules for hearing dates and, in long cases, can lead to delays;
- In some legal systems, arbitral awards have fewer enforcement remedies than judgments;
- Arbitrators are generally unable to order interlocutory measures against a party, making it easier for a party to take steps to avoid enforcement of an award, such as the relocation of assets offshore;
- Rule of applicable law is not binding and arbitrators not subject to overturn an appeal may be more likely to rule according to their personal ideals; and
- Large corporations may exert inappropriate influence in consumer disputes, pressuring mediators to decide in their favour or lose future business.

**ie** business school

**93%**  
OF MIM STUDENTS ARE  
WORKING IN THEIR SECTOR 3 MONTHS  
FOLLOWING GRADUATION

---

**MASTER IN MANAGEMENT**

---

- STUDY IN THE CENTER OF MADRID AND TAKE ADVANTAGE OF THE UNIQUE OPPORTUNITIES THAT THE CAPITAL OF SPAIN OFFERS
- PROPEL YOUR EDUCATION BY EARNING A DOUBLE DEGREE THAT BEST SUITS YOUR PROFESSIONAL GOALS
- STUDY A SEMESTER ABROAD AND BECOME A GLOBAL CITIZEN WITH THE BEYOND BORDERS EXPERIENCE

Length: 10 MONTHS  
Av. Experience: 1 YEAR  
Language: ENGLISH / SPANISH  
Format: FULL-TIME  
Intakes: SEPT / FEB

---

**5 SPECIALIZATIONS**  
PERSONALIZE YOUR PROGRAM

**#10 WORLDWIDE**  
MASTER IN MANAGEMENT  
FINANCIAL TIMES

**55 NATIONALITIES**  
IN CLASS

[www.ie.edu/master-management](http://www.ie.edu/master-management) | [mim.admissions@ie.edu](mailto:mim.admissions@ie.edu) | [f](#) [t](#) [i](#) Follow us on IE MIM Experience

7. **Adjudication:** A single adjudicator reviews written evidence and arguments set forth by the opposing parties without the need for a hearing. Parties agree the powers of an adjudicator e.g. the ability to make an award on costs for pushing or defending the dispute. Adjudicators will be experts in a particular sector. It is commonly used in construction sector.

**Pros**

- Confidential and not a matter for public record
- Usually undertaken while the contract is still alive – allowing for resolution and payment at the time
- Quicker to resolve e.g. construction contracts include mandatory adjudication with a 42 day resolution period.
- Cheaper than arbitration and litigation as it may not require the use of lawyers.

**Cons**

- Adjudication is enforceable at the time but only final and binding if agreed in advance of the dispute.
- It produces no case law
- It is prone to ambush – one party can spend months preparing their claim and due to short time scales the defendant may struggle to respond in time.
- An adjudicator can only preside over the matter before him. There is no opportunity to counter-claim on a different issue.

	<b>High</b>	<b>Low</b>
<i>Time/resources</i>	Negotiations Mediation	Arbitration Litigation
	<i>Party Control</i>	

**Figure 12:** Dispute Resolution Continuum

**Common Law and Statutory Contractual Terms**

- i) Express terms;
- ii) Implied terms;
- iii) Common law and statutory exclusion clauses;
- iv) Penalties v liquidated damages; and
- v) Retention of title clause.

*Terms of the contract:* Terms of a contract determine the extent of the rights and duties of each party and the remedies available if terms are broken.

*Representation:* A statement that induces the contract but does not form part of it. It is important to note the following about representation:

1. Timing of the statement;
2. Importance of the statement;
3. Special knowledge and skill of person making the statement; and
4. Collateral contracts (Shanklin Pier Ltd v Detel products Ltd).

**Express terms:** Terms have a bearing on the remedy for breach of contract, whether termination or damages. Not all the terms of a contract are of equal importance. The law classifies them into *conditions*, *warranties* and *innominate* terms.

- *Conditions:* It is an important term in the contract. The breach of a condition will entitle the injured party to discharge themselves from the contract and sue for damages.
- *Warranties:* This is a contractual term of lesser importance. To claim for breach, the injured party has the right to claim for damages but not discharge themselves from the contract. Whether a term is a condition or warranty depends on the intention of the parties.
- *Innominate term ("intermediate term"):* Only when the true nature of the breach is considered, do the courts classify the term as "innominate".

**Implied Terms:** Terms may be implied into a contract by court, by statute, or by custom. It is implied by law (court). It must be so obvious it goes without saying. It can also be implied by statute – that is by Sales Goods Act (SGA 1979) or Sale of Supply and Goods Act (SOGAS 1982). Many implied terms are incorporated into contracts by statute. The implied terms cover title, description, fit for purpose and satisfactory quality and sale by sample.

*Implied by custom:* Where a contract is silent, terms are implied by looking at local custom or trade usage. A custom will not be implied if it is contrary to the express terms in the contract.

Exclusion clauses include Ramalpa clause (retention of title); Force Majeure; and Indemnity

**Force Majeure** clause is a flexible way of dealing with problems raised by unforeseen events. Advantages of force majeure clause:

- Parties can provide for suspension of a contract rather than termination; and
- The clause can provide for allocation of expenses or losses rather than relying on the law reform (frustrated contracts) Acts 1943.

### Penalties v Unliquidated damages

**Penalty clauses** (“*liquidated damages*”): Parties can agree at the outset of the contract how much will be paid as damages in the event of a breach taking place. This is particularly common in contracts involving building or construction work; for example to cover loss incurred through delays in completion. This form of damages is called liquidated damages. Such a provision in a contract is often called a penalty clause. However, the actual effect of the clause is intended to be compensatory not penalty. Should it be discovered that a clause is intended to punish rather than compensate, then it is invalid and unenforceable. In such a case, the court will have to assess damages using certain criteria.

**Damages:** It should be noted that damages are never to be considered as a penalty or civil punishment. Damages are to compensate the innocent party for loss and to place them in the position they would have been in had the contract been fully performed; in so far as money alone is capable of doing so. The innocent party is expected to take reasonable steps to minimise their loss. See the case the **Brace v Calder** [1895]. This is the case where the manager versus a partnership where the manager refused another contract. The court ruled that the manager should have received normal damages (not special damages).



“I studied English for 16 years but...  
...I finally learned to speak it in just six lessons”  
Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

*Quantum*: This is the question of how damages are calculated on the principle that only loss that is a direct and foreseeable result of the breach of contract can be claimed. Such damages are known as *general or ordinary*.

*Special damages*: These arise where there are special or knock-on circumstances that lead to an unusual or special loss. The party in breach is not liable for special damages unless they know of the special circumstances at the time the contract was found. The *basic principle* is often referred to as the rule in **Hadley v Baxendale** [1854]. This is the case involving transporting crankshaft and the claim for special damages (that is, profits that would have been earned if the transporter delivered in two days). For *Special damages*, the party in breach is not liable for special damages unless they know of the special circumstances at the time the contract was formed. In this case Hardley's flourmill was unable to operate because the cast iron crankshaft from the steam engine had fractured. The broken crankshaft had to be sent from the mill some distance to a Greenwich foundry to be used as a pattern for a replacement. The courier, Baxendale was engaged to transport the broken crankshaft to the foundry. Baxendale was told that the crankshaft was for a mill but he was not told that the mill was at a standstill because the crankshaft was broken. Most mills did keep a spare. Baxendale undertook to deliver the new crankshaft within two days. Baxendale was negligent and delayed in delivering the new crankshaft. Baxendale was in breach of contract because he failed to deliver in two days. However court held that Hardley was not entitled to *special damages* for the loss of profits when the mill was at the standstill as the special circumstances had not been explained to Baxendale when the contract was formed. Therefore, the special loss of profit was beyond what the courier Baxendale could have been expected to foresee. There is another case, **Victoria Laundry (Windsor) Ltd v Newman Industries** [1949]. In this case Newman agreed to supply a boiler to Victoria Laundry. Victoria required it to expand their business and to allow them to take up a large government contract. The boiler was delivered late and because of this *Victoria Laundry (Windsor)* lost the government contract. Court held that Newman was only liable for ordinary or original damages for the foreseeable loss of business and not for any special damages in respect of the lost contract.

**Balfour Beatty Construction (Scotland) Ltd V Scottish Power Plc** [1994]. Balfour was constructing a concrete aqueduct to carry the Union Canal over a bypass. This required continuous pour of concrete. Work on the first stage was almost complete when the electricity supply failed. As a result, the first stage had to be entirely demolished. Balfour claimed special damages of over a quarter million pounds against Scottish. Balfour lost the case. The House of Lords held that it would have required a high degree of technical knowledge of the construction industry on the part of Scottish for them to have foreseen the result of an interruption of the electricity supply.

*Liquidated damages:* These represent a genuine attempt by the contracting parties to estimate their likely loss in the event of a contractual breach. This clause is always referred to as the penalty clause (but it is not intended to punish)

*Penalty or liquidated damages:* **See the case: Dunlop Pneumatic Tyre Co. v New Garage and Motor Co** [1915]. The appellant, manufacturers of motor tyres, supplied goods to the respondents under a contract which provided that the respondents would not sell tyres at less than the appellant's list price. It was further provided that if the respondents did sell a tyre in breach of this agreement then they would pay the appellants £5. The court held that this sum would be regarded as liquidated damages and not as a penalty. The principles set out in this case can be summarised as follows:

- i) The use of the words penalty or liquidated damages is not conclusive in itself;
- ii) A penalty punishes whereas liquidated damages is a genuine pre-estimate of loss;
- iii) If a sum is clearly a penalty it will be deemed *unforceable*;
- iv) Whether a sum is a penalty or liquidated damages is a question judged at the time of the formation of the contract not at the time of the alleged breach; and
- v) If the same single lump sum is payable on the occurrence of several different situations, it will be presumed to be a *penalty*.

*Advantages of buyer and seller inserting liquidated damages clause*

- i) *Buyer:* The advantage of a buyer inserting liquidated damages clause in the contract is that they do not need to sue for their loss. They simply deduct the liquidated damages from the contract price before payment and leave the seller to argue about the deduction later.
- ii) *Seller:* The advantage to the seller is that it forms the top limit of their potential liability. Both parties know where they stand. First priority is given to the seller in case of a buyer company going into liquidation.
- iii) *Unliquidated damages* (awarded by court or arbitrary by an arbiter): This can be awarded by court or decided arbitrarily by an arbiter. This is where there is no agreed figure for the damages. In this situation, the plaintiff will sue for unliquidated damages. This is the sum that the court (or in case of arbitration, the arbiter) considers appropriate to compensate the injured party for the loss suffered as a result of the breach.

*Retention of title (or Romalpa clause):* A 'retention of title' clause can be inserted into the contract. Where there is no such a clause the matter is governed by the passing of title and risk in S16–S20 SGA 1979. The retention of title clause became known as Romalpa because of the case of Aluminium Ltd [1976].

Case of Aluminium Ltd [1976]. Seller retained ownership of any unmixed foil in the possession of the buyer until the seller had been paid all the sums due to them.

*State of goods and retention of title clause:* This can be explained by the case of **Clough mill Ltd v Martin** [1984]. The courts held that a 'retention of title' clause can be enforced when the goods in the buyer's possession have not been altered – i.e. in their original form. Say if timber is used to make a chair, the retention clause does not apply to the chair.

Advantages of the retention clause to the seller

It protects the seller from loss. The buyer must first pay before they can get property in the goods. The retention clause also gives the seller preferential treatment over the other creditors in the event of the buyer's liquidation (*as happened in Romalpa case*).

### Tendering-Bidding Process

In addition to the tendering process, we also look at the following:

- i) Collateral legal obligations that arise from a tendering process;
- ii) Collateral legal obligations that arise before the tender is awarded; and
- iii) Collateral legal obligations arise after the tender is awarded.

Excellent Economics and Business programmes at:

 **university of groningen**



“The perfect start of a successful, international career.”

**CLICK HERE**  
to discover why both socially and academically the University of Groningen is one of the best places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

*The Tendering Process:* Using the tendering process helps to avoid the battle of the forms. The offer (outstanding offer) is made on the buyer's terms supplied with the invitation to tender. Tenders are used to establish two types of contracts: offer and acceptance (which successfully creates a binding contract) and standing offers.

*Offer and Acceptance* (Invitation to tender): This is an invitation to tender for the supply of a quantity of specific goods or services in accordance with the terms and conditions of the tender documents and attached schedule. An acceptance will result in a binding contract. The contract will be concluded as soon as the offer is unconditionally accepted.

*Standing Offers:* Tender invites a quotation for the supply of certain goods from a prospective supplier from time to time. The supplier in this case creates a *standing offer* and each *call-off order* creates a separate contract between the parties on the terms set out in the tender's documents. The standing order can be revoked at any time but all orders placed before it is revoked must be honoured.

*Tendering procedure:* While the tendering process has been discussed in detail under Procurement, the process can be summarised here as:

- Establish a list of people/organisations to be invited to bid;
- Check if contract is covered by procurement directives;
- Prepare the tender documents;
- Decide on type of tender-open procedure; restricted procedure; and negotiated procedure;
- Review the submitted tenders;
- Letter of intent/or letter of comfort may be issued to the chosen supplier;
- Award tender; and
- Formal agreement drawn up between the parties.

*So why and how do you issue an invitation to tender?*

Preparation of the tender documents usually consists of:

- The specification – precise description of work required;
- The contract terms;
- The instructions to tenders; and
- Where to deliver the bid, deadlines, etc.

*Tenderer's bid:* Where all bidders are happy with the terms and conditions of the tender documentation, then the contract will be awarded to the lowest bidder. For construction works, using technical compliance favours the least cost approach through which the lowest bidder gets the deal.

*Letters of intent:* The purchaser (after tenders have been submitted by prospective suppliers and evaluated) may choose to issue a letter of intent to the chosen supplier indicating their intention to enter into a contract with them. Also, the prospective supplier may issue letters of intent to prospective sub-contractors in the event that they are successful. There is no intention to bind contractually at this stage although work can commence on the issue of a letter of intent.

*Letter of comfort:* These are legally enforceable and whether they are or not will depend on the facts of each individual case. When issuing a letter of comfort, it is essential to make your intentions clear and that you want it to be legally binding.

**Collateral Obligations:** These are obligations that are distinct from but run alongside the main contract; that is, they are collateral. Collateral obligations include:

1. Awarding to the lowest bidder (unless specified otherwise);
2. Not withdrawing any bid within the specified time (e.g. 90 days to ensure that they have reviewed all the bids);
3. Considering all tenders that comply with requirements;
4. Treating all tender bids equally; and
5. Conducting the tender process in good faith.

### **Signing of a formal agreement**

This is the last part of the tendering process; after the award and regulations to finalise the contract terms and conditions have been done. The formal agreement sets out and records the terms of the contract between the parties. In the tendering process the *main contract* comes into existence when the successful bidder is notified that their bid has been successful. So it does not really matter whether a formal agreement is subsequently agreed. Let us remember that the offer has to be accepted for before a contract between the parties can be signed.

*Pre tender obligations:* In most governmental and the World Bank adverts for competitive bids, the following pre-tender obligations by the procuring organisation are clearly stated:

- 1) To award to the lowest bidder;
- 2) The tender price to remain open within the specified time;
- 3) To consider all tenders that comply with requirements;
- 4) To treat all tenders bids equally; and
- 5) To conduct the tender process in good faith.

*Post-tender obligations:* Once the contract is awarded in the tendering process, negotiations can and usually do continue to thrash out details of the terms and conditions until there is agreement between the parties.

### **Battle of the forms**

**How to avoid the battle of the forms:** *Can we avoid the battle of the forms?*

Yes. By tendering process, an organisation avoids the battle of the forms. This is because the tendering process (bidding process) shows all the documents and processes that will be followed to award, execute and close-out the contract.



**American online**  
**LIGS University**  
is currently enrolling in the  
**Interactive Online BBA, MBA, MSc,**  
**DBA and PhD programs:**

- ▶ enroll **by September 30th, 2014** and
- ▶ **save up to 16%** on the tuition!
- ▶ pay in 10 installments / 2 years
- ▶ Interactive Online education
- ▶ visit [www.ligsuniversity.com](http://www.ligsuniversity.com) to find out more!

**Note: LIGS University is not accredited by any nationally recognized accrediting agency listed by the US Secretary of Education. More info [here](#).**

## Contract Management

We can look at contract management as a process that enables both parties to a contract to meet their contractual obligations in order to achieve the objectives required from the contract. Contract management is one of the *post-contract award* processes that, if not handled well, can greatly impact negatively on both the providers (contractors) and the buying organisation (client). The contract management process ensures that supplier's performance meets contractual requirements and the buyer performs according to the terms of the contract. On larger projects with multiple components (products and services), project administration is concerned with managing the interfaces among the various providers.

### *When does contract management start?*

The old view is that it starts at the signing of the contract and is embodied in post-award orientation. The modern view is that effective contract administration starts earlier, with contract management planning. It begins during the acquisition planning phase. This 'new' view recognises the performance-based elements of the contract. Therefore, the Contract Management Plan should be in place before or shortly after the time of contract award.

### *Aims of contract management*

The central aim of contract management is to obtain the goods or services as agreed in the contract and achieve value for money. The buying organisation's supervisor or project manager is supposed to ensure that the buyer performs according to terms of the contract. He/she has to build a good working relationship between the customer and provider. Contract management consists of a range of activities that are carried out together to keep the arrangement between customer and provider running smoothly. These activities can be broadly grouped into three areas.

*Delivery management:* These are the activities undertaken to ensure that the service, goods or works are being delivered as agreed, to the required level of performance, specification and quality among others.

*Relationship management* keeps the relationship between the two parties open and constructive; aiming to resolve or ease tensions and identify problems early.

*Contract administration* handles the formal governance of the contract and changes to the contract documentation.

All the three areas must be managed successfully for contract implementation to be a success.

### *Contract administration activities*

The principal objective of contract administration for both the buyer and the seller is to ensure fulfillment of contractual obligations by all parties to the contract. Contract administration involves the following:

1. Authorising the contractor's work at the appropriate time.
2. Preparing report and to monitoring contractor cost, schedule and technical performance.
3. Controlling quality by inspecting and verifying the adequacy of the contractor's product.
4. Change control – ensure that changes to the contract are properly approved and relevant stakeholders are informed.
5. Risk monitoring and control to ensure that risks are identified and mitigated.
6. Monitoring payments to the provider and ensuring that payment terms in the contract are followed and to ensure that payment is linked to progress.
7. Reviewing documents to establish whether the provider is performing according to the contract and taking corrective action where necessary.
8. Carrying out provider performance evaluation to confirm competence or lack of it in performing similar work on the project or other projects.

### **Key Contract Management Phases**

- 1) Contract development;
- 2) Contract implementation/Relationships Management;
- 3) Contract Monitoring and Review;
- 4) Contract Exit Management; and
- 5) Managing the Transition Period.

### **Post-award Phase – Contract Administration**

#### *Contract administration inputs*

1. Contract;
2. Contract management plan – the plan covers the contract administration activities throughout the life of the contract;
3. Performance reports;
4. Approved change requests; and
5. Work performance information – extent to which quality is being met, what costs have been committed.

*Contract administration tools and techniques*

1. Contract change control system – defines the process by which a contract can be changed, tracking system, dispute resolution system;
2. Performance reviews by buyer;
3. Inspections and audits;
4. Performance reporting;
5. Payment systems;
6. Claims administration;
7. Records management systems; and
8. IT.

*Contract administration outputs*

1. Contract documentation;
2. Requested changes;
3. Recommended corrective action; and
4. Supplier performance evaluation documentation.



**DON'T EAT  
YELLOW  
SNOW**

What will your advice be?

Some advice just states the obvious. But to give the kind of advice that's going to make a real difference to your clients you've got to listen critically, dig beneath the surface, challenge assumptions and be credible and confident enough to make suggestions right from day one. At Grant Thornton you've got to be ready to kick start a career right at the heart of business.

Sound like you? Here's our advice: visit [GrantThornton.ca/careers/students](https://www.grantthornton.ca/careers/students)

Scan here to learn more about a career with Grant Thornton.



 **Grant Thornton**  
An instinct for growth™

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd

### Contract Administration Records

Record keeping is very important in contract management. Copies of all the records from the bidding process, to the contract signing, and to all activities of contract administration should be kept by the contracts manager. These records will help in cases of disputes or litigation. Hence proper record keeping of the contract files and all documents is very critical during contract implementation, closure and post closure.

The following are some of the documents that are kept by contract management.

<ul style="list-style-type: none"> <li>• Memos/letters/reports;</li> <li>• Copies of all contracts;</li> <li>• Notice of award letters;</li> <li>• Copy of the procurement/purchase orders;</li> <li>• Request for insurance and bonds;</li> </ul>	<ul style="list-style-type: none"> <li>• Field reports, if any;</li> <li>• Minutes of Meetings;</li> <li>• Copies of bonds and insurance certificates;</li> <li>• Change orders and the respective correspondence;</li> <li>• Notice of breach; and</li> <li>• Notice of completion.</li> </ul>
--	---

### Benefits of effective contract administration and management

- Value for money – following efficient and effective delivery materials or services. Achieving the expected value for money (cost control). Buying as a whole becomes less costly and more valuable and a much greater percentage of negotiated savings are captured by the business.
- Improved quality of service and customer focus.
- Ensuring that the purchase is delivered and on time.
- Reduced crisis management. Avoiding disputes which usually are experienced during procurement.
- Clarification of the roles and responsibilities of the various stake holders (contract manager, contractors, end-users and where appropriate other independent service providers).
- Early identification and resolution of poor contractor performance and other problems or disputes.
- Common problems in contract administration.
- Limited time for contract administration: Contracting officials often allocate more time on the previous procurement processes rather than the administration of the contract. This often leads to problems in contractor performance; cost overruns; and delays in receiving goods and services.
- Unclear roles and responsibilities.
- The roles and responsibilities of various individuals must be clearly stated.

- Lack of a well-defined relationship between the contracting organisation (buyer) and the contractor (supplier).
- Poor monitoring: The representative of the buyer doesn't follow up all the stages of delivery and require timely report. Sometimes poor monitoring happens because the supplier has compromised the monitoring staff of the buyer.
- Absence of proper contract management plan to show deadlines and milestones.

### **Challenges faced when managing contracts risks**

- Unethical practices (bribery, fraud, etc.);
- Inadequate clause;
- Failure to interpret laws;
- Force majeure;
- Poor monitoring and review;
- Clash of cultures; and
- Complacency leading to deterioration of quality of delivery.

### **The contract management plan**

A contract management plan is important for effective and efficient contract management. This document should be able to define and explain the following:

- What reports are required?
- What content to include in each report?
- The format of presentation of the report
- Who is responsible for producing the report?
- How often are the reports expected?
- To whom should the reports be distributed?
- What key risks and management strategies should be highlighted?
- How will you ensure that measuring and controlling performance focus on Time, Cost and Quality?

## Post-award Phase – Contract Closeout

### *Buyer's and seller's steps*

*This stage of contract closeout involves both product verification and administrative closeout.*

**Contract Completion:** Before handover of the completed work as agreed in the contract, it is necessary that project or procurement staff with necessary technical support first verify the following:

- All products/services have been provided;
- Documentation in the contract file shows receipt and formal acceptance of all contract terms;
- There are no claims or investigations pending;
- Any property provided by the project is returned and discrepancies resolved;
- All actions regarding contract amendments have been attended to;
- All sub-contracting issues have been attended to;
- Warranty matters are resolved and defect period elapsed;
- Any necessary audit has been satisfactorily finalised; and
- The final invoice has been submitted and paid.



.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if  
you could  
build your  
future and  
create the  
future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

After all the above has been verified, the certificate of completion and handover can now take place. The contract has been terminated by the close-out agreed between all the parties – the buyer, the seller and any contractors.

### ***Contract Termination***

- Reasons for termination must be clear to all parties;
- Warning letters for poor performance must be catered for;
- And finally a contract termination letter must be issued whether performance is satisfactory or not; and
- Documentation of lessons learnt and sharing experiences with the supplier need to be considered (contract exit meeting must be considered).

### **The Law of Tort**

A tort is a civil wrong or injury. A remedy, usually in the form of damages, may be obtained for a civil wrong or injury. There are other types of civil wrongs – such as breach of contract and breach of trust. We, therefore, need to distinguish torts from other wrongs: Liability in tort arises from the breach of a duty primarily fixed by law – this is a duty towards people generally and redress for breach of tort is an action for unliquidated damages.

### **Tort of Negligence**

Negligent torts, as their name suggests, are torts that are caused by the negligence of the person who commits the tort (tortfeasor). If a person suffers a loss as a result of another person's negligence, that person may be able to sue in the *tort of negligence*. The modern law of negligence is based on the decision in the classic case of **Donoghue v Stevenson [1932]**. This case decided three things (now known as the **three main elements of tort of negligence**) need to be proved to establish a claim of negligence:

- 1) That a duty of care exists between the parties;
- 2) That the duty has been breached; and
- 3) That loss or damage has resulted from that breach.

Examples of cases that might be brought in negligence

- 1) A patient who sues a doctor when medical treatment goes bad;
- 2) People injured in the car and sue the driver; and
- 3) A company which loses money because an accountant failed to advise them properly.

**Duty of care:** The approach to establish the duty of care was laid out by Lord Atkin in the case of **Donoghue v Stevenson [1932]**.

Neighbours are persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.

*Standard of care – ‘an ordinary reasonable man’:* Do not do what a reasonable man would not have done. The standard of care to be expected of an adult will never be below that expected of an ordinary reasonable man.

*Professional standard:* The standard of care to be expected of an adult will never be below that expected of an ordinary reasonable man. However, a person who professes some expertise (a doctor, an engineer, a lawyer, an accountant, a procurement specialist, etc.) in the matter before court will be judged in accordance with the standard to be expected from a person with that level of expertise.

**Negligence protects against three types of harm:** Personal injury; damage to property; and economic loss. We shall also discuss nervous shock.



Maastricht University

Leading  
in Learning!

Join the best at  
the Maastricht University  
School of Business and  
Economics!

**Top master's programmes**

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)

Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014

[www.mastersopenday.nl](http://www.mastersopenday.nl)

*Economic loss:* The courts have limited the opportunity to recover for economic loss i.e. a claimant cannot recover from monetary loss such as profit. The law allows recovery of financial loss from physical injury or property damage and rarely permits pure economic loss that is not connected to other damage.

See **Spartan Steel v Martin** [1972]. In this case, the defendants had negligently cut a power cable to the plaintiffs' factory, causing a power cut which lasted 14 hours. Without power to heat the factory's furnace, the metal in the furnace solidified and the factory had to temporarily shut down. The plaintiffs claimed damages under three categories:

- Damage to the metal which was in the furnace at the time the power was cut off (physical damage to property);
- Loss of profit that would have been made on the sale of that metal (economic loss caused by damage to property); and
- Loss of profit on the metal that would have been processed during the time the factory was closed due to the power cut (pure economic loss).

The Court of Appeal, by majority, ruled that the first two claims were recoverable but not the third. The defendants have to pay for any loss that directly arose from the damage they caused the factory and the damage itself, but did not have to pay for the lost profit.

*Nervous shock ('psychiatric injury')*: This occurs where a person witnessing an accident suffers from some degree of shock. Witnessing the accident may make a person perhaps upset, frightened, or grief-stricken. The shock may cause a pregnant woman a miscarriage.

*Why is it that psychiatric injury, like physical injury, does not give rise to a claim in tort of negligence?*

To be awarded a claim for nervous shock, the claimant must prove that they have suffered from a genuine injury or illness. In some cases, this injury will actually be a physical one brought about by a mental shock. However, court can accept a claim in situations of what Lord Bridge in **McLoughlin v O'Brian** [1983] described as 'positive psychiatric illness'. Examples of 'positive psychiatric illness', and medical evidence has to be provided to prove this, include clinical depression, personality changes and post-traumatic stress disorders, an illness in which a shocking event causes symptoms including sleeping, tension, horrifying flashbacks and severe depression. Given this above, the right term would be psychiatric injury instead of nervous shock. In summary, a definition of nervous shock was given by Lord Denning in the case of **Hinz v Berry** [1970], he stated that in English law '*no damages are awarded for grief or sorrow caused by a person's death*'.

**Incoterms and contract of carriage:** Read about contracts in international procurement logistics.

# 18 SALE OF GOODS ACT AND SUPPLY OF GOODS AND SERVICES ACT

## Sale of Goods Act 1979

### Implied conditions in the sale of goods:

**A contract of sale:** Section 2 (1) defines a contract of sale.

A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price.

According to section 61, a contract of sale “includes an agreement to sell as well as a sale”.

**Goods** are defined in section 61:

Goods includes all personal chattels other than things in action and money and in Scotland all corporeal...[and]...emblements, industrial growing crops and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

It is clear from the definition of a contract of sale, that the Sale of Goods Act (SGA) relates to contracts of sale for goods only and, therefore, it doesn't cover such things as gifts, free offer used to promote a product, hire purchase agreements, exchange of goods for work done or for rent, lodging or board and exchange of vouchers and token (which are regarded as barter).

The elements of a contract under SGA are the same as we saw under the *Law of Contract*.

**The right to sell:** Section 12(1)

In a contract of sale, other than one to which subsection (3) below applies, there is an implied condition on the part of the seller that in the case of a sale he has a right to sell the goods and in the case of an agreement to sell he will have such a right at the time when the property is to pass.

Section 12(3):

In a contract of sale, other than one to which subsection (3) below applies, there is also an implied warranty that –

- a) the goods are free and will remain free until the time when the property is to pass, from any charge or encumbrance not disclosed or known to the buyer before the contract is made, and
- b) the buyer will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.

A breach of this warranty may occur if, for example, the seller did not tell the buyer that he had used goods as security for a loan he received from a third party<sup>223</sup>.

**Sale by description:** Section 13 defines sale by description.

- 1) Where there is a contract for the sale of goods by description, there is an implied condition that the goods will fit the description.
- 2) If the sale is by sample as well as by description it is not sufficient that the bulk of the goods correspond with the sample if the goods do not also correspond with the description.
- 3) A sale of goods is not prevented from being a sale by description by reason only that, being exposed for sale or hire, they are selected by the buyer.

**Satisfactory quality:** section 14 defines satisfactory quality:

- 1) Except as provided by this section and section below and subject to any other enactment, there is no implied condition or warranty about the quality or fitness for any particular purpose of goods supplied under a contract of sale.
- 2) Where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of merchantable quality, except that there is no such condition –
  - a) as regards defects specifically drawn to the buyer's attention before the contract is made; or
  - b) if the buyer examines the goods before the contract is made, as regards defects which that examination ought to reveal.
- 3) Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known –
  - a) to the seller; or
  - b) where the purchase price or part of it is payable by installments and the goods were previously sold by a credit broker to the seller,

**Fitness for purpose:** section 14 (3) provides:

Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known –

- a) to the seller; or
- b) where the purchase price or part of it is payable by installments and the goods were previously sold by a credit broker to the seller, to that credit broker.

**Sale by sample:** section 15 provides:

- 1) A contract of sale is a contract for sale by sample where there is an express or implied term to that effect in the contract.
- 2) In the case of a contract for sale by sample there is an implied condition-
  - a) that the bulk will correspond with the sample in quality;
  - b) that the buyer will have a reasonable opportunity of comparing the bulk with the sample; and
  - c) that the goods will be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

Section 14 (6) also helps to explain ‘unmerchantable’:

Goods of any kind are of merchantable quality within the meaning of subsection (2) above if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect having regard to any description applied to them, the price (if relevant) and all the other relevant circumstances.

### **Examination and acceptance**

**Acceptance:** Section 35 and 34 explain the term acceptance. Section 35 (1) provides:

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or (*except where section 34 above otherwise provides*) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, or when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them.

Section 34: The buyer has a right to examine the goods:

- 1) Where goods are delivered to the buyer and he has not previously examined them, he is not deemed to have accepted them until he has had a reasonable opportunity examining them for the purpose of ascertaining whether they are in conformity with the contract.
- 2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound on request to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

**Acceptance of goods:** Acceptance is covered under section 35 of SGA.

Under s35, the buyer is deemed to have accepted the goods:

- when buyer intimates to the seller that they have accepted the goods; or
- when the goods have been delivered to the buyer and they act in such a manner which is inconsistent with the seller's ownership of the goods; or
- when after the lapse of a reasonable time the buyer retains the goods without intimating to the seller that they have rejected them.

The buyer cannot make a claim under the SGA:

- if they had examined the goods before purchasing and the defect was obvious (*like in cases where you buy a 'demo' product e.g. stove or fridge with scratches*)
- the defect was pointed out to them; or
- seller told the buyer that the goods did not meet the description on the packaging; or
- they were told that the goods were not 'fit for purpose' for which they were buying them.

### **Transfer of Ownership, Risk and Title under the SGA 1979**

#### **Passage of title**

Title or property in the goods or legal ownership does not necessarily mean that the purchaser has *actual* possession of the goods – or has even paid for the goods. In some situations, the buyer may have possession and has paid for the goods but does not have property or ownership of the goods. *We see, later, the example of hire purchase that fits here.* It is important to know when property passes so that we know who is currently bearing the risk and is liable or bearing the loss in the event that something goes wrong such as when the goods are destroyed or damaged.

Section 17 of Sale of Goods Act (SGA) 1979: Property passes when intended to pass

- 1) Where there is a contract for the sale of specific or property ascertained goods, the property in them is transferred to and the title passes when the buyer at such time as the parties to the contract intend it to be transferred.
- 2) For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties, and the circumstances of the case.

Section 17 (1 and 2) makes clear that the passage of property is a matter between the contracting parties (in exactly the same manner as most other terms of the contract). Therefore, agreements about when the title passes must be made at the time when the contract is made – not after the conclusion of the contract. It was held in the case of **Dennant v Skinner & Collom** [1948] that it was too late for either party to insert a clause in the contract about the passage of title after the conclusion of the contract.

Section 18 of Sale of Goods Act (SGA) 1979: Ascertaining goods

Sale of specific goods in a deliverable state:

Rule 1: Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment or the time of delivery, or both, is postponed.

Sale of specific goods not in a deliverable state:

Rule 2: Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until the thing is done and the buyer has notice that it has been done.

Rule 1 means that there must be an unconditional contract, that is, with no conditions still to be fulfilled by the buyer before the title or property or ownership will pass. Rule 2 means that notice must be given to the buyer that the goods have been put in a deliverable by the seller before title passes.

On your own read section 17 Rules 3, 4, 5 of SGA.

**Retention of title:** It is usually in the seller's best interests to retain title to the goods until some condition, mostly when payment by the buyer, is satisfied. Since 1976, in the recognition by the Court of Appeal of retention of title clauses in case of **Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd** [1976] these clauses have become commonplace in commercial contract to protect the seller against the liquidation of the buyer and give the seller preferential treatment over other creditors.

Retention of title (*or Romalpa clause*): A '*retention of title*' clause can be inserted into the contract. Where there is no such a clause the matter is governed by the passing of title and risk in S16–S20 SGA 1979. The retention of title clause became known as Romalpa because of the case of **Aluminium Ltd** [1976].

State of goods and retention of title clause: This can be explained by case of **Clough Mill Ltd v Martin** [1984] and that of **Aluminium Ltd** [1976]. The seller retained ownership of any unmixed foil in the possession of the buyer until the seller had been paid all the sums due to them. The courts held that a 'retention of title' clause can be enforced when the goods in the buyer's possession have not been altered – i.e. in their original form. Say if timber is used to make a chair, the retention clause does not apply to the chair.

#### *Advantages of the retention clause to the seller*

It protects the seller from loss. The buyer must first pay before they can get property in the goods. The retention clause also gives the seller preferential treatment over the other creditors in the event of the buyer's liquidation (*as happened in Romalpa case*).

#### **Passage of risk**

Under section 20 (1) of SGA, there is the presumption that the risk in the goods will pass with the property (*risk prima facie passes with property*), but this presumption can be rebutted by an agreement between the contracting parties, or their conduct.

Section 20(1): Unless otherwise agreed, the goods remain at the seller's risk until the property in them is transferred to the buyer, *but when the property in them is transferred to the buyer the goods are at the buyer's risk whether delivery has been made or not.*

This basic rule, as in section 20 (1) that risk passes with the passage of property is mitigated by section 20(2) and 20(3)

Section 20(2): Where delivery has been delayed through the fault of either buyer or seller the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

Section 20 (3) stipulates that the normal duties and liabilities of a contractual bailee or custodian will apply to both the buyer and the seller. Section 20(3):

Nothing in this section affects the duties or liabilities of either seller or buyer as a bailee or custodian of the goods of the other party.

### Passing of title by a non-owner: exceptions to the rules

The Sale of Goods Act 1979 (as amended by *Sale and Supply of Goods Act 1994*) now provides consumers that were not open to them under common law or case law of contract. The Act is intended to show clearly the rights and obligations of both parties – sellers and buyers – and to avoid the need for formal legal action such as going to court. However, situations may arise where the seller has no right to sell – and sells. It is important for the law to show who is protected – is it the innocent buyer who has bought in good faith, or the true owner who has been deprived of his goods? The basic rule to be found in s21 of SGA (the Latin maxim ‘*nemo dat quod non habet*’) is that ‘a seller cannot pass better title than he has’, or ‘a person cannot pass to another property they do not own’. No one can give better title than they have. Section 21(1):

Subject to this Act, where goods are sold by a person who is not their owner and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller’s authority to sell.

The law has developed **some exceptions** to this basic rule (*nemo dat quod non habet*) with five of them being in the SGA 1979 Act.

1. *Estoppel*: Estoppel is defined in English law as a principal of justice and equity. It is wrong when you have already made (by your word or conduct) someone believe in a particular state of affairs then you go back on your word or conduct when it would be unjust or inequitable for them to do so. Estoppel will be effective, so that an innocent party will obtain title, if the following criteria is satisfied:
  - the owner by conduct or words made representations that the seller has authority to sell;
  - the representation was made intentionally or negligently; and
  - the innocent buyer acted on the representation in good faith.
2. *Sale by seller in possession* (section 24): This is where the buyer allows the seller of the goods to retain them after sale. This might happen, for example, where the goods are too big, or those goods in which the seller still has to make some repairs or alterations. Section 24 allows the seller to appear to still be the owner of the goods and he can sell them to innocent second buyer. Section 24 reads:

Where a person having sold goods continues or is in possession of the goods, or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of the previous sale, has the same effect as if the person making the delivery or transfer were expressly authorised by the owner of the goods.

Provided that the provisions of section 24 SGA are satisfied, the second buyer will obtain a good title – *and the first buyer can sue the seller for conversion*. However, there must have been delivery or transfer of the goods to the second buyer.

3. *Sale by buyer in possession*: There are situations where the buyer may acquire possession of the goods before property (title or ownership). In the commercial context, the buyer can acquire the goods with the aim of resale where there is a possibility that the resale happen before property passes.

Section 25(1) reads:

Where a person, having bought or agreed to buy goods obtains, with the consent of the seller, possession of the goods or the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title, under any sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of any lien or other right of the original seller in respect of the goods, has the same effect as if the person making the delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner.

4. *Market overt*: Originally under SGA Section 22(1):

Where goods are sold in market overt, according to the usage of the market, the buyer acquires a good title, provided he buys them in good faith and without notice of any defect or want of title on the part of the seller.

This was abolished by Sale and Supply of Goods Act 1994.

5. *Sale by a mercantile agent*: A mercantile agent is an independent agent acting in the course of business who buys and sells goods or raises money on the security of goods on behalf of one or more principals. Section 2 of the Factors Act 1889 provides special protection to bon fide buyers who acquire goods from mercantile agents provided certain criteria is satisfied:

Section 2 reads:

- 1) Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same ; provided that the person taking under the disposition acts in good faith and has not at the time of the disposition noticed that the person making the disposition has no authority to make the same.
  - 2) Where a mercantile agent has, with the consent of the owner, been in possession of goods or, of the documents of title to goods, any sale, pledge, or other disposition, which would have been valid if the consent had continued, shall be valid notwithstanding the determination of the consent: provided that the person taking under the disposition has not at the time thereof noticed that the consent has been determined.
  - 3) Where a mercantile agent has obtained possession of any documents of title to goods by reason of his being or having been with the consent of the owner, in possession of the goods represented thereby, or of any other documents of title to the goods, his possession of the first-mentioned documents shall, for the purposes of this Act, be deemed to be with the consent of the owner.
6. *Sale by a bailee:* The buyer obtains good title where an agent sells without actual authority of the principal<sup>224</sup> but with ostensible<sup>225</sup> or usual authority.
7. *Hire purchase Act 1964:* Under this Act, the hirer in a hire-purchase agreement does not have ownership of the goods, and has no right to dispose of them, until the expiry of the agreement. In other words, during the lifetime of the agreement, where the buyer (hirer) is paying the instalments, the goods remain the property of the seller. In the event the hirer fails to pay all the amount under the contract, the seller has the option of selling to another buyer (and if agreed pay the first buyer what he had already paid on the purchase).
8. *Sale under court order:* The SGA, s21(2)(b), does not affect the validity of any contract of sale under any special common law or statutory power of sale or under a court order:
- *Innkeepers:* Under the Innkeepers Act 1878, an Innkeeper has *lien* over the property of the guests to secure payments due to the hotel account. The Innkeeper has a right to sell the goods deposited with them in lien of payment and once sold, the buyer obtains a good title.

- *Bailiffs*: These are persons or organisations legally empowered, by statute, to sell goods taken by them from individuals or enterprises where a person has not paid their debt (e.g. rent, tax arrears, etc.) under the court order; and the buyer obtains a good title.
  - *Pawnbroker*: These are persons or organisations that have the rights to sell goods which have been pledged to them if the loan is not repaid; and the buyer obtains a good title.
9. *Sale under a voidable title*: This can be mostly applicable where the buyer has misrepresented his identity to the original seller. A void title is one that has no legal effect. A voidable title is one that is valid until it is voided. Section 23:
- When the seller of goods has a voidable title to them, but his title has not been voided at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title.

In general, the effect of actionable misrepresentation is to render the contract voidable so that the innocent party gets the right to rescind the contract and/or claim damages. See the case *Lewis v Averay* [1971] where Lewis sold his car to someone, a fraudster, who claimed that he was Richard Greene – an actor and star of television. The fraudster, when paying by cheque, for proof of identity, showed Lewis what appeared to be a pass from Pinewood Studios. The fraudster then sold the car to Avery before Lewis. Court held that the contract was not void for mistake but voidable for fraudulent misrepresentation. Court ruled that the fraudster's identity was not important to the seller at the time the contract was made. Since the fraudster sold the car to Avery before Lewis voided the contract, court held that Avery obtained good title to the car.

## **The Supply of Goods and Services Act 1982**

### **Implied conditions:**

#### **Contract for the transfer of goods:** section 1:

- 1) In this Act a "contract for the transfer of goods" means a contract under which one person transfers or agrees to transfer to another the property in goods, other than an excepted Contract.
- 2) For the purposes of this section an excepted contract means any of the following:
  - a) A contract of sale of goods;
  - b) A hire-purchase agreement;
  - c) A contract under which the property in goods is (or is to be) transferred in exchange for trading stamps on their redemption;

- d) A transfer or agreement to transfer which is made by deed and for which there is no consideration other than the presumed consideration imported by the deed;
  - e) A contract intended to operate by way of mortgage, pledge, charge or other security.
- 3) For the purposes of this Act a contract is a contract for the transfer of goods whether or not services are also provided or to be provided under the contract and (subject to subsection (2) above) whatever is the nature of the consideration for the transfer or agreement to transfer.

Section 2 (1):

- 1) In a contract for the transfer of goods, other than one to which subsection (3) below applies, there is an implied condition on the part of the transferor that in the case of a transfer of the property in the goods he has a right to transfer the property and in the case of an agreement to transfer the property in the goods he will have such a right at the time when the property is to be transferred.
- 2) In a contract for the transfer of goods, other than one to which subsection (3) below applies, there is also an implied warranty that –
  - a) the goods are free and will remain free until the time when the property is to be transferred, from any charge or encumbrance not disclosed or known to the transferee before the contract is made and
  - b) the transferee will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.
- 3) This subsection applies to a contract for the transfer of goods in the case of which there appears from the contract or is to be inferred from its circumstances an intention that the transferor should transfer only such title as he or a third person may have.
- 4) In a contract to which subsection (3) above applies there is an implied warranty that all charges or encumbrances known to the transferor and not known to the transferee have been disclosed to the transferee before the contract is made.
- 5) In a contract to which subsection (3) above applies there is also an implied warranty that none of the following will disturb the transferee's quiet possession of the goods, namely –
  - a) the transferor;
  - b) anyone claiming through or under the transferor or that third person otherwise than under a charge or encumbrance disclosed or known to the transferee before the contract is made.
  - c) in a case where the parties to the contract intend that the transferor should transfer only such title as a third person may have, that person;

**Goods:** Under the Supply of Goods and Services Act 1982:

“goods” include all personal chattels (including emblements, industrial growing crops and things attached to or forming part of the land which are agreed to be severed before the transfer or bailment concerned or under the contract concerned), other than things in action and money;

**Transfer is by description.** Section 3 reads:

- 1) This section applies where, under a contract for the transfer of goods, the transferor transfers or agrees to transfer the property in the goods by description.
- 2) In such a case there is an implied condition that the goods will correspond with the description.
- 3) If the transferor transfers or agrees to transfer the property in the goods by sample as well as by description it is not sufficient that the bulk of the goods correspond with the sample if the goods do not also correspond with the description.

### **Implied terms in services**

Care and skill: section 13 reads:

In a contract for the supply of a service where the supplier is acting in the course of a business, there is an implied term that the supplier will carry out the service with reasonable care and skill.

Time for performance: section 14 reads:

- 1) Where, under a contract for the supply of a service by a supplier acting in the course of a business, the time for the service to be carried out is not fixed by the contract, left to be fixed in a manner agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the supplier will carry out the service within a reasonable time.
- 2) What is a reasonable time is a question of fact.

Consideration: section 15 reads:

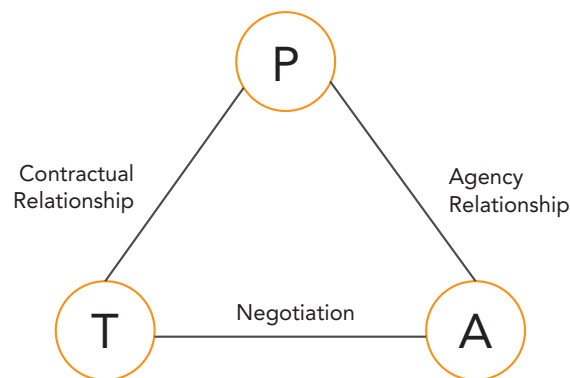
- 1) Where, under a contract for the supply of a service, the consideration for the service is not determined by the contract, left to be determined in a manner agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the party contracting with the supplier will pay a reasonable charge.
- 2) What is a reasonable charge is a question of fact.

# 19 AGENCY AND BAILMENT

## Agency

### *Examples of agency relationship*

1. Insurance agents;
2. Estate agents;
3. Employment procurement e.g. modeling agencies, showbiz agents;
4. Agents for actors, models, athletes; and
5. In publishing, an agent acts for an author to sell their book.



P – Principal  
A – Agent  
T – Third party

**Figure 13:** Agent-Principal relationship

**An agent:** An agent is a person (company or individual) who has the power to make a binding contract between two others who are known as the principal and third party without incurring any personal liability. The agent will be instructed by the principal to enter into negotiations with a third party for the purpose of creating a contractual relationship between the principal and third party. We should note that in certain circumstances the agent may become personally liable. The agent negotiates with the third party (on behalf of the principal). The end result is a contractual relationship between the principal and the third party.

**Agency:** Under the law of agency, an agency describes a relationship where a person called an agent has power to make a binding contract between two others, known as the principal and the third party. A relationship existing between two parties called the Principal (P) and the Agent (A) which is for creating a contractual relationship between the P and third party (T).

## How an agency is created?

There are *five ways* an agency relationship is created. We look at them below:

1. **By express agreement:** Where an agency is created either by written contract or orally.
2. **By implication:** This is where the agency agreement is implied from the conduct of the parties. This is the most common. Under this form an agency is created from the conduct of the parties e.g. where the principal instructs an estate agent to sell his property for the purposes of concluding a successful contract between the seller (the principal) and the third party (the buyer). By implication the agent is expected to act on behalf of the principal in their usual capacity as estate agents. No written contract is required. In practice, however, the principal may be required to sign an agreement confirming their instructions.

*See the case: Spiro v Linten [1973] where:*

- i) The defendant instructed his wife to arrange for the sale of their house even although she did not have authority to enter into a binding contract.
  - ii) The estate agents acted on her instructions and sold the house to the plaintiffs.
  - iii) The defendant knew about the sale and allowed the plaintiffs to make arrangements for alterations to the house.
  - iv) The defendant then refused to complete the contract for sale, relying on the fact that his wife had no authority to enter into a binding contract.
  - v) Court held that the defendant was bound by the contract as he had affirmed the contract by his conduct – i.e. by allowing the plaintiffs to arrange the alterations.
3. **Estoppel:** Estoppel is defined in English law as a principle of justice and equity. It is wrong when you have already made (by your word or conduct) someone believe in a particular state of affairs then you go back on your word or conduct when it would be unjust or inequitable for them to do so. Demonstrated by case of Spiro V Linten [1973] already discussed above.
  4. **Ratification** (where the principal ratifies at a later date): This happens when an agent acts beyond their authority or with no authority but the principal then adopts or ratifies the contract – which contract resulted from the agents actions. Once adopted or ratified the agent gets *retrospective* actual authority and is deemed to have been acting within his authority from the outset. The principal is then bound by the contract from the outset (*ab initio*).

5. **By necessity:** It must be impossible for the agent to obtain instructions from the principal and the agent acted in good faith. Agency of necessity arises when three criteria are fulfilled:
- i) Where an emergency requires the agent to act;
  - ii) It was impossible to obtain instructions from the principal; and
  - iii) The agent acted in good faith and in the interest of all parties.

See the case: **Great Northern Railway v Swaffield** [1874] where a railway company had taken a horse to its destination but there was no one to receive it.

- i) So the railway company placed it with a stable keeper;
- ii) The railway company paid the charges;
- iii) Court held that although the company had no express or implied authority to incur such charges, *it had acted in an emergency as an agent of necessity*; and
- iv) It was, therefore, entitled to claim an indemnity from the owner of the horse.

### **Duties, authority and rights of an agent**

*Agent's duties to the principal:* The principal function of an agent is to bring about a valid legally binding contract between his principal and a third party. The agent acts as a negotiator. The agency relationship is a fiduciary one, that is, the agent is in the position of trust and confidence. The agent acts on authority from the principal. Therefore, the agent must be loyal to the principal. An agent must keep account of money owed and not allow conflict of interest to arise. They must not make any secret profit and must not take bribes.

### ***Types of Authority***

The authority of an agent dictates the level of power to act on behalf of the principal.

**Actual Authority:** This is where the principal's words or conduct reasonably cause the agent to believe that they have been authorised to act. Actual authority can be: *express authority* or *implied actual authority*.

- 1) **Express Authority:** The authority is by a written agency contract (authority determined by the terms of contract). The authority can be created orally (It all depends on what parties agreed the agency would be authorised to do).
- 2) **Implied actual authority:** This must be determined by the surrounding circumstances.

**Usual Authority:** An agent has this authority as a result of his profession or trade e.g. a company secretary. Usual authority can be considered under implied actual authority as it is the authority that an agent has as a result of his profession or trade. For example, a company secretary has got implied actual authority to enter contracts that deal with the administrative affairs of the company. The company secretary would be in position to hire cars, buy office equipment, artifacts for directors, etc.

- 1) *Apparent (or ostensible) authority:* This type of authority arises if the principal's words or conduct would lead a reasonable person in the third party's position to believe that the agent was authorised to act. Remember estoppel. Read the case of *Spiro v Linten* [1973] again.
- 2) *Authority by virtue of position held:* Occurs in partner relationships where partners have apparent (or ostensible) authority to bind the other partners in the firm. The liability of partners is joint and several. In a company, all executives and senior employees who have decision making authority by virtue of their position have apparent authority to bind the corporation. The partner with the powers of attorney has power to commit the corporation by entering into contracts with other parties. He signs the agreement between his/her organization and another.
- 3) *Authority by ratification:* When an agent acts without authority the principal may ratify or adopt the transaction and accept liability on the transactions as negotiated. The ratification or adoption may be express or implied from the principal's conduct.

**Rights of an agent:** Legally, agents have rights when they execute work on behalf of the principal. These rights include:

- 1) Indemnification for expenses incurred for work done;
- 2) Remuneration according to the express terms of the agreement or implied from the nature of the agent's services;
- 3) Retention of the goods as security for payment of a debt (*lien* over the goods); and
- 4) Entitlement to receive such an amount as is customarily paid to a commercial agent dealing in the type of goods to which the agreement relates (in the absence of express agreement on the amount of remuneration to be paid to an agent).

*An Agent's common law duties*

- 1) Look after the interests of the principal and act in good faith;
- 2) Make proper efforts to negotiate and conclude transactions that the principal instructs him to carry out;
- 3) Communicate to the principal all necessary and available information; and
- 4) Comply with all reasonable instructions given by the principal.

### *Breach of agent's duties and remedies available to the principal*

Where an agent breaches any of the above duties the remedies available to the principal include:

- 1) Suing the agent for damages in the event of breach of contract;
- 2) Suing for the tort of conversion if the agent refuses to return the principal's property;
- 3) Suing the agent to recover a bribe, secret profit or any other money received by the agent on behalf of the principal;
- 4) Suing for an account if the agent fails to keep proper accounts of transactions;
- 5) Dismissing the agent without proper compensation.

### **Relationship between principal, agent and third party**

#### *Relationships in an agency*

There are three relationships involving an agent:

- Agents and principals;
- Agents and the third parties with whom they deal on behalf of the principal; and
- Principals and third parties with whom the agent's deals on behalf of the principal.

**To understand the three-sided relationship in agency arrangement, we look at the following:**

- 1) *Liability of agent to principal:* If the agent has acted without authority, but has apparent (or ostensible) authority then the principal is bound by the contract. The agent is, however, liable to indemnify the principal for any resulting loss or damage.
- 2) *Liability of the principal to agent:* If an agent acts within actual authority, the principal must indemnify the agent for payments made during the course of the relationship. This is whether the expenses were expressly authorised or were necessary in promoting the principal business.
- 3) *Liability of third party to principal:* Where an agency relationship exists, the third party is liable to the principal on the terms of the agreement made with the agent unless the principal was undisclosed. But where the agent has acted within his actual authority or where the principal has ratified the agent's actions, the third party will be bound in a normal contractual relationship with the ability to sue and be sued on the contract.

- 4) *Liability of an agent to third party:* There should be no liability of an agent to the third party. However, there are some situations where personal liability on the agent will arise. For example:
- In the case of undisclosed principal or where the principal does not exist, the agent is personally liable; and
  - Whether the agent, unknown to the third party, acts beyond his authority.

**Termination of agency:** An agency relationship can be terminated in one of the following ways:

- 1) By agreement;
- 2) By the principal revoking the agent's authority;
- 3) By the agent renouncing his authority;
- 4) By completing of the duties and obligations of the agreement;
- 5) By lapse of time where the agency has been created for a specified period of time;
- 6) By the death of either the principal or the agent;
- 7) Where the principal becomes bankrupt;
- 8) Where the agent becomes bankrupt to such an extent that it prevents them from carrying out their duties;
- 9) By frustration; and
- 10) By insanity or alcoholism of the principal or the agent (Alcoholics, like insane persons, are not fit to enter legally binding contracts and, once made, the contract can be voidable by the person who was drunk).

## **Bailment**

Bailment is the act of placing property in the custody and control of another, usually by agreement in which the holder ('bailee') is responsible for their safekeeping and return of property.

### *Responsibilities arising from Bailment*

Contracts of bailment cover a wide range of transactions. Bailment occurs when the goods are delivered to a person (the bailee) on condition that they will ultimately return to the bailor. Examples include taking your car to the garage for repairs or parking it in the car park. Another example is taking a jacket to the laundry for dry cleaning or handing it in at the cloakroom.

*For procurement professionals bailment can arise:* when goods are loaned. Goods such as special patterns or tools or designs can be loaned for a period. If so, they will require to be returned. There are also cases of goods that are delivered and are rejected. Those too require to be returned. Until these are picked by the supplier, the purchaser organisation is a bailee.

Hotels and innkeepers: A common innkeeper is a bailee of the guests' property which is brought on to the premises (Hotel Proprietors Act 1956). What are the defenses to the bailee in hotel situation of loss: to show that the loss is due to the guest's negligence or due to acts of God and nature or due to enemies of the crown/state. The bailee in the hotel situation has *lien* over the property of the guests (bailor) to secure payment of the hotel account. The bailee has a right to sell the goods deposited with them in lien of payment (Innkeepers Act 1878).

There is also *involuntary bailment* which occurs where goods are placed with a person without the bailee's consent. The bailee will not be liable for negligence but must not willfully damage or sell the goods. They also have no obligation to return the goods.

## 20 INTELLECTUAL PROPERTY RIGHTS

Intellectual property is a very wide and covers literary and artistic works, films, designs and marks, inventions and computer programmes that are used by business entities for their goods and services. Intellectual property helps companies become competitive. It gives commercial entities monopoly rights over their patents or trademarks.

**Patents:** Patents are statutory property rights that give the owner of the patent the exclusive rights to use certain inventions. Patents are concerned with the functional and the technical aspects of products and processes. Inventions can be products, components, or processes. Before an entity or individual considers applying for a patent, their invention must fulfill specific conditions:

1. The invention must be novel;
2. It must be able to be applied to industry (It can be made or used in any industry);
3. It must be capable of an inventive step (something not obvious to a skilled person in that area of technology, or non-obvious); and
4. It must not fall within an excluded category (In treating humans and animals, surgery, therapy or diagnoses are deemed not capable of industrial application).

Who can be granted the patent rights?

According to the law, patents can be granted to the following:

1. The inventor – the one who actually devised the invention;
2. The inventor's successors in ownership; and
3. The employer of an employee who invents something while in the course of employment.

**Trademarks:** A trademark is a badge of origin which is used so that customers can recognise the product of a particular company. It creates a distinction between products of one company from others. It can take several forms, including logos, pictures, a combination of logos and pictures, specific colours, sounds (such the lion roar of MGM), slogans (such as 'always Coca Cola'), or smells and tastes that are sufficiently distinctive.

*Registering a trademark:*

To be registered, a trademark must fulfill three criteria:

1. It must be distinctive for the goods or services being applied for;
2. It must not be deceptive or contrary to law or morality; and
3. It must not be similar or identical to any previous trademark for the same or similar goods or services.

**Tort of Passing Off**

The tort of passing off offers two protections:

- 1) It protects a trader against unfair competition from rivals; and
- 2) It protects customers who would otherwise be confused about the origin of the goods and services they are being offered.

The tort of passing-off was summarised in the 'Jif Lemon' case – **Reckitt & Colman Products v Borden Inc** [1990] – by Lord Oliver:

...the law of passing off could be summarised in one short general proposition: no man might pass off his goods as those of another.

The **Jif Lemon** Case and other later cases including **Consorzio de Prosciutto Di Parma v Marks and Spencer plc** [1991] give elements for a successful passing off action:

1. The plaintiff must demonstrate goodwill;
2. There must be misrepresentation by the defendant as to the goods or services offered; and
3. There must be actual or likely damage (or consequential damage)

Damage can occur through various ways, including loss of sales caused as the customers may confuse one company's products with an inferior product.

## **Trade secrets and Breach of confidence**

*Trade secrets* – method of manufacture, design, product ingredients, marketing strategies, name list of customers, etc., – are not strongly protected by intellectual property law yet they are of great commercial value to an entity and its competitors. Companies should ensure that their trade secrets are guarded well and ensure they are not breached by current employees, former employees, suppliers and contractors and other companies. Companies should take steps to ensure that those persons with whom the company shares its secrets do not compromise their secrecy. Companies have a legitimate interest in ensuring that their secrets are protected – remain company secrets – and are not either deliberately or advertently disclosed by their current or former employees by inserting an express clause in the in the employment contract. This express clause is referred to as *a restraint of trade clause*. Regardless of any contractual term protecting a company's trade secrets, there exists a common law duty of confidentiality – which means that the breach will give rise to an action for breach of confidence, where an injunction could be pursued to prevent further disclosure.

### **Elements required for a successful breach of confidence**

There are basically three elements to prove breach of confidence and these were established by Megarry J in **Coco v AN Clark (Engineers) Ltd** [1969]

- i) The information must have the 'necessary quality of confidence about it';
- ii) The information was given in confidence to the defendant; and
- iii) There has been unauthorised use or disclosure of that information to which is to the detriment of the party communicating it.

### *Confidential vs public information*

Confidential information must not be public knowledge or public property. Information in the public domain cannot be considered confidential information.

### *Factors considered relevant when distinguishing confidential and non-confidential information*

See the case of **Faccenda Chicken v Fowler** [1986] in which the following elements are considered relevant:

- The nature of employment – did the defendant regularly have access to confidential information and, therefore, should have been aware of its confidential nature?
- The nature of information – was information sufficiently confidential to justify being treated as a trade secret?
- Was the confidential nature of this information sufficiently brought to the attention of the employee?

There are other elements that can make an obligation of confidence to arise:

- Was there an express contractual clause in the employment contract as to the confidentiality?
- Professional relationship where professional advisers (e.g. tax advisors, lawyers, etc.) owe an obligation of confidence to their clients.
- Does it qualify as a breach under the statute such as Official Secrets Act 1989 and the Copyright Design Patent Act 1988?

The final element for any successful action for breach of confidence is that there must be actual or threatened use of the confidential information.

## 21 INSURANCE

Insurance arrangements are often made by the insurer and insured for the benefit of a third party. From the insured's perspective, insurance has a lot to offer. It protects the insured from full liability for his actions by allowing him to have a contract with an insurance company for them to shoulder the risk on his behalf. Viewed from the cost and expenditure point of view, insurance provides the insured business entity with a means to avoid the financial implications of civil liability at minimal cost or inconvenience to himself<sup>226</sup>. The insured usually treats the insurance premium as another cost of production – and can cost can be recouped through a marginal increase in the price of the product.

### Types of insurance

There are two types of insurance risks that entities or individuals can insure against: indemnity insurance and contingency insurance.

- i) *Indemnity insurance* provides full financial cover if a particular situation occurs. For example, comprehensive accident insurance or fire insurance is an indemnity insurance which will pay for the full cost of damage (accident or fire) if the asset was fully insured.
- ii) *Contingency insurance* arises when the insurer promises to pay agreed sum upon the occurrence of the contingent event (most common form is life insurance).

There is also first party insurance and third party insurance:

- *First party insurance* protects the insured from the damage that he will suffer if the event occurs. For example, in the case of fire insurance, the insured person protects his own property against the risk of fire in order to receive indemnity against his own loss.
- On the other hand, *third party insurance* provides compensation to third parties affected by the insured's actions. This is the reason people buy third party insurance under the Road Traffic Act – it provides for the injured person (third party) to claim against an insured vehicle.

**Insurable interest:** In order for the insured person to effect a valid insurance, he must have an *insurable interest* in the subject matter of the policy. The landmark decision of **Lucena v Craufurd** [1806] gave the definition of *insurable interest* as being '*a right in the property, or a right derivable out of some contract about property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party*'. The lack of insurable interest in the contract will render the contract void (under the Gaming Act 1845 and subsequent laws and statutes under common law). The most clear insurable interest is the ownership of the goods or property insured. We have to emphasize that the insurable interest must exist at the time of the loss and, therefore, an expired interest or one that has not yet matured are insufficient.

**The contract:** A contract of insurance is basically subjected to the same rules as any other contract. It should satisfy the elements of a valid contract (offer, acceptance, consideration, etc.) already discussed under the Law of Contract. An insurance contract is a contract *uberrimae fidei* (in good faith), therefore, the parties to the contract are under obligation to inform each other of all the matters relevant to the contract. It is important that the person seeking to get insured provides all the relevant information to enable the insurer decide whether or not to accept the insurance proposal and provide the insurance cover required.

### **Terms of the contract**

There are three categories of the terms of an insurance contract – warranties, conditions and terms descriptive of the risk being insured against.

- i) *Warranties* are the most important terms in an insurance contracts (unlike in other contracts) and their breach gives the insurer the option of rescinding the contract.
- ii) *Conditions* are lesser terms in an insurance contract, the breach of which gives rise to an action for damages or the right to avoid liability for one particular claim.
- iii) *Terms descriptive of the risk:* These are terms which add to the understanding of the risk insured but they do not give rise to any remedy if breached.

**Role of agents:** Under law of agency, the agent acts on behalf of the principal (who is his employer) to ensure that the principal and third party enter into a contractual relationship. In insurance business (and indeed in other financial services business), companies use agencies to obtain business. It is important that the insured knows clearly the relationship between himself, the insurer and the agent.

**Subrogation:** In some situations, the insurer has rights to recover money from the insured in case he has been overcompensated and to enforce the rights of the insured against any third party responsible for the loss. The insured, assuming that he had been fully covered, has a right to receive full indemnity for his losses – but does not have a right to be overcompensated. In the situation of overcompensation, the insurer has a right to recover money from the insured that is over and above full indemnity. The insured can, after paying full indemnity to the insurer for his losses, sue anyone whose negligence caused the loss that the insurer recovers the amount that he paid to the insured as full indemnity.

# ENDNOTES

1. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
2. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
3. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
4. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
5. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
6. Levin, D., and Fremson, R., (2016), Young Rich and Chinese, Portfolio – The business of life & living, Emirates, Issue 126, June 2016, exclusive to Emirates First Class and Business Class.
7. [http://www.businessweek.com/magazine/content/10\\_25/b4183010451928.htm](http://www.businessweek.com/magazine/content/10_25/b4183010451928.htm) (accessed on 10/09/2010).
8. Rosser Reeves, who developed the term, *unique selling proposition*, was a television advertising pioneer of the Ted Bates & Company, an Advertising Agency in New York, USA. In 1950s, Reeves became a prominent advertising expert, with his USP and in 1961 wrote his first book, *Reality of Advertising*. In this book, he laid out his selling technique – *Unique Selling Proposition (USP)*.
9. Reeves, in his book, *Reality Advertising (1961)*, defines a USP as having three parts: 1) Each ad must make a proposition (e.g. When you buy this product you get the following benefits); 2) The proposition must be unique – something that the firm's competitors do not/cannot/or will not offer; and 3) The proposition must sell – it must be something that prospects really want; which pulls them over to your product.
10. This is one of those early classics created by Reeves that promoted M&M chocolates. It was a very memorable message.
11. Raymond Vernon (1966), "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, pp. 190–207.
12. Cited by Everett M. Rogers, Arvind Singhal and Margaret M. Quinlan (2009), "Diffusion of Innovations", A chapter in Don Stacks and Michael Salwen (Eds): *An integrated approach to communication theory and research*. New York: Routledge.
13. Schiffman, L.G., and Kanuk, L.L., (2000). *Consumer Behaviour*. 7/E. Wiscconsin: Prentice Hall.
14. Kindra, G.S., Larache, M., and Muller, T.E., (1994). *Consumer Behaviour: The Canadian Perspective*. 2/E. Toronto, ON: Nelson; Schiffman, L.G., and Kanuk, L.L., (2000). *Consumer Behaviour*. 7/E. Wiscconsin: Prentice Hall; and Rogers, E., (2003). *Diffusion of Innovation*. 5/E. New York: The Free Press.
15. Rogers, E., (1983). *Diffusion of Innovation*. 3/E. New York: The Free Press.
16. Rogers, E., (1999). *Diffusion of Innovation*. 4/E. New York: The Free Press.
17. Rogers, E., (2003). *Diffusion of Innovation*. 5/E. New York: The Free Press.

18. Schiffman, L.G., and Kanuk, L.L., (2003). *Consumer Behaviour*. 8/E. New Jersey: Prentice Hall.
19. Stanton, P., (1981). *Fundamentals of Marketing*. NY: McGraw-Hill.
20. Tauber, E.M., (1973), "Reduce New product failures: Measure needs as well as purchase interests", *Journal of Marketing* 37, 61–70 .
21. Rogers, E., (1983). *Diffusion of Innovation*. 3/E. New York: The Free Press.
22. Rogers, E., (1999). *Diffusion of Innovation*. 4/E. New York: The Free Press.
23. Rogers, E., (2003). *Diffusion of Innovation*. 5/E. New York: The Free Press.
24. A social system is a physical, social or cultural environment to which people belong and within which they function (Schiffman and Kanuk, 2000).
25. Ram, S., and Sheth, J.N., (1989), "Consumer Resistance to Innovations: The Marketing Problem and its Solutions", *Journal of Consumer Marketing*, 6(2), 5–14.
26. Ram, S., and Sheth, J.N., (1989), "Consumer Resistance to Innovations: The Marketing Problem and its Solutions", *Journal of Consumer Marketing*, 6(2), 5–14.
27. Borden's looked at the elements of the marketing mix of manufacturers and they were more than the current 4Ps and 7Ps of the marketing mix. They include product planning, pricing, branding, channels of distribution, personal selling, advertising, promotions, packaging, display, serving and physical handling.
28. Culliton, J.W., (1948), *The Management of Marketing Costs*, Harvard University, Boston, MA.
29. Boden, N., (1964), "The Concept of the Marketing Mix", *Science in Marketing*, George Schwartz (Ed.), New York: John Wiley, 1964. (Available at <http://faculty.mu.edu.sa/public/uploads/1361463588.8451marketing%20mix5.pdf> (accessed on 11/24/2014).
30. McCarthy, E.J., 1960. *Basic Marketing: A Marginal Approach*. Richard. D. Irwin; Nasher: Illinois.
31. CIM – The Chartered Institute of Marketing, UK (<http://www.cim.co.uk/>).
32. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 9/E. New Jersey: Prentice Hall.
33. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2nd Edition. Simon & Schuster.
34. The Chartered Institute of Marketing (CIM), UK.
35. Industrialist Henry Ford (1863–1947), founder of Ford Motors in USA, had Model T in one colour – black. When customers complained that it was in only black, he responded that "People can have Model T in any color so long as it's black".
36. In *The Merchant of Venice*, Shakespeare emphasizes the importance of love regardless of the racial community and the names of people, by saying that 'what's in a name'.
37. Klein, N., (1999). *No Logo*. Knopf Canada and Picador .
38. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.
39. Schramm, W., (1955). 'How Communication Works', in W. Schramm (Ed.), *The Process and effects of mass communication*. Urbana: University of Illinois Press.
40. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.
41. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.

- Institute of Sales Promotion (ISP) of UK.
42. CIM (2003), *Integrated Marketing Communications*, BP.
43. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.  
Institute of Sales Promotion (ISP) of UK.
44. Baron, S., Davies, B., and Swindley, D., (1991). *Macmillan Dictionary of Retailing*. London: Macmillan Press.
45. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.
46. Institute of Sales Promotion (ISP) of UK.
47. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.  
Institute of Sales Promotion (ISP) of UK.
48. Institute of Direct Marketing, UK.
49. Schiffman, L.G., and Kanuk, L.L., (2003). *Consumer Behaviour*. 8/E. New Jersey: Prentice Hall.
50. Abraham H. Maslow (1943), "A theory of Human Motivation", *Psychological Review* 50: 370–96; and, Abraham H. Maslow (1954). *Motivation and personality*. New York: Harper & Row.
51. Maslow, A.H., (1943), "A theory of Human Motivation", *Psychological Review* 50: 370–96; and, Maslow, A.H., (1954). *Motivation and personality*. New York: Harper & Row.
52. Maslow, A.H., (1943), "A theory of Human Motivation", *Psychological Review* 50: 370–96; and, Maslow, A.H., (1954). *Motivation and personality*. New York: Harper & Row.
53. Schiffman, L.G., and Kanuk, L.L., (2003). *Consumer Behaviour*. 8/E. New Jersey: Prentice Hall.
54. Schiffman, L.G., and Kanuk, L.L., (2003). *Consumer Behaviour*. 8/E. New Jersey: Prentice Hall.
55. Some of the key articles on handling perceived risk include Dowling, G.R., and Staelin, R., (1994), "A Model of perceived risk and intended risk handling activity", *Journal of Consumer Research* 21(June 1994): 119–34.
56. Aiken, L.R., (1996). *Rating Scales and Checklists for Evaluating Behaviour, Personality and Attitudes*. New York: John Wiley & Sons Inc.; and Schiffman, O’Cass, A., and Paladino, A., (2013). *Consumer Behaviour*. 6/E. Pearson Education, Australia.
57. Allport, G., (1954). *The Nature of Prejudice*. Reading, MA: Addison-Wesley; (and later by) Lefton, L.A., (1997). *Psychology*. 6/E. Allyn & Bacon.
58. Schiffman, L.G., and Kanuk, L.L., (2003). *Consumer Behaviour*. 8/E. New Jersey: Prentice Hall.
59. It should be pointed out that a consumer’s attitude and choice can be influenced by cost and affordability and marketer’s promotional activities.
60. Smith, W., (1956) ' "Product Differentiation and Market Segmentation as alternative to Marketing Strategies", *Journal of Marketing*, 21; 1–8.
61. These researchers include Yankelovich, D., (1964), "New Criteria for Market Segmentation", *Harvard Business Review*, Vol. 42, pp. 83–90; and Myers, J.H., and Tauber, E., (1977), "Market Structure Analysis", *American Association of Marketing*, Chicago, pp. 68–90.

- Wilkie, W.J., and Cohen, J.B., (1977), "An Overview of Market Segmentation: Behavioural Concepts and Research Approaches, Marketing Science Institute, Report number 77-105, Cambridge, Massachusetts.
62. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 9/E. New Jersey: Prentice Hall.
63. They include CIM (UK) and Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 9/E. New Jersey: Prentice Hall.
64. In the 1960s Avis realised that Hertz was spending 5 times than Avis on advertising. They wanted an ad that would make them sale more. Indeed, "We are no. 2" made them realise an increase from 10% to 35% annually. (see <http://www.createmarketing.co.uk/pdf/avis-case-study.pdf> (accessed on 11/12/2014)).
65. Wind, Y., and Cardozo, R.N., (1974), *Industrial Marketing Segmentation*, *Industrial Marketing Management*, 3, p. 155.
66. Freytag, P.V., in Clarke, A.H., (2001), "Business-to-Business Market Segmentation", *Industrial Marketing Management*, Vol. 30, p. 473–86.
67. Webster, F.E., (1992), "The Changing Role of Marketing in a Corporation", *Journal of Marketing*, Vol. 56, Oct, p. 1–17; and Webster, F.E., (2003), "Marketing Management in Changing Times", *Marketing Management*, Vol. 11, No. 1, p. 18–23.
68. Wind, Y., and Cardozo, R.N., (1974), *Industrial Marketing Segmentation*, *Industrial Marketing Management*, 3, p. 155.
69. David Aaker has developed the 'Aaker's Brand Equity Model' and dimensions of brand personality. In 1991, Aaker published a key book on branding, *Managing Brand*, looking *brand loyalty, brand awareness and brand associations (including perceived quality)*.
70. de Chernatony, L., and McDonald, M., (1992). *Creating Powerful Brands*. Oxford: Butterworth Heinemann.
71. de Chernatony, L., and Dall'Olmo Riley, F. (1998), "Defining a 'brand': beyond the literature with experts' interpretations", *Journal of Marketing Management*, Vol. 14, pp. 417–43; Simoes, C., and Dibb, S., (2001), "Rethinking the Brand Concept: New Brand Orientation", *Corporate Communications, An International journal*, Vol. 5 no. 4, 217–254; and De Chernatony, L., (2006). *From Brand Vision to Brand Evaluation: The Strategic Process of Growing and Strengthening Brands*. 2/E. Elsevier.
72. Warne, K., (2002), "Branding for Business", *CIM – The marketing challenge*, *Journal of the Canadian Institute of Marketing*, Spring 2002, Vol. 5, Issue 2).
73. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 9/E. New Jersey: Prentice Hall.
74. de Chernatony, L., and Dall'Olmo Riley, F. (1998), "Defining a 'brand': beyond the literature with experts' interpretations", *Journal of Marketing Management*, Vol. 14, pp. 417–43; Simoes, C., and Dibb, S., (2001), "Rethinking the Brand Concept: New Brand Orientation", *Corporate Communications, An International journal*, Vol. 5 no. 4, 217–254; and De Chernatony, L., (2006). *From Brand Vision to Brand Evaluation: The Strategic Process of Growing and Strengthening Brands*. 2/E. Elsevier.

75. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation and Control*. 9/E. New Jersey: Prentice Hall.
76. David Aaker has written extensively on branding; and has developed the Aaker's Brand Equity Model and dimensions of brand personality. In 1991, Aaker published a key book on branding, *Managing Brand*, looking *brand loyalty, brand awareness and brand associations (including perceived quality)*.
77. Kapferer, J.N., (1992). *Strategic Brand Management: New Approaches to creating and evaluating Brand Equity*. London: Kogan Page. See also Kapferer, J.N., (2004). *The New Strategic Brand Management*. 3/E. London: Kogan Page.
78. Aaker, D.A., (1991). *Managing Brand Equity: Capitalizing on the value of a Brand Name*. Free Press. New York.
79. Oliver, R.L., (1999), "Whence Consumer Loyalty", *Journal of Marketing*, Vol. 63, 33–44.
80. Rossiter J.R and Percy, L., (1987), *Advertising and Promotion Management*. McGraw-Hill, Singapore.
81. Deutsch, M., (1973). *The Resolutions of Conflict: Construction and Destructive Processes*, New Haven CN: Yale University Press.
82. Doyle, P., 1998. *Marketing Management and Strategy*. Prentice Hall Europe.
83. Anholt, S., (2010): "Editorial", *Place Branding and Public Diplomacy*, Vol. 6, 1, 1–10; Anholt, S., (2004), *Branding Places and nations*. In Clifton, R, Simmons, J and Ahmad, S., (eds.), *Brands and Branding*, Princeton; NJ: Bloomberg Press, London, 213–226.; <http://www.iei.liu.se/fek/722g93/underlag-att-lasa-infor-forelasningen-platsmarknadsforing/1.327517/Anholtplacebranding.pdf> (accessed on 1/7/2014).
84. See Anholt, S., (2002), "Forword" *Journal of Brand Management*, 9(4/5), 229–239; Anholt, S., (2004), *Branding Places and nations*. In Clifton, R, Simmons, J and Ahmad, S, (eds.), *Brands and Branding*, Princeton. NJ: Bloomberg Press, London, 213–226.
85. Source: Dinnie, K., 2008. *Nation Branding: Concepts, Issues, Practice*; 1/E, Elsevier Ltd.
86. This wider set of potential rewards to be gained through nation branding has been proposed by Temporal in Anholt and Dinnie, 2008:17).
87. As Al Ries and Jack Trout (1972), *Positioning: The Battle for Your Mind*: "Positioning is not what you do to a product. Positioning is what you do to the mind of the prospect. That is, you position the product in the mind of the prospect." Kotler and Keller refer to positioning as the 'image to occupy a distinctive place in the mind of the target market'.
88. Dinnie, K., (2008). *Nation Branding: Concepts, Issues, Practice*; 1/E, Elsevier Ltd.
89. Devane, R. (2006), "*The dynamics of diaspora networks: Lessons of experience*", in *Diaspora Networks and the International Migration of Skills: How Countries Can Draw on Their Talent Abroad* (Y. Kuznetsov, ed.), WBI Development Studies, pp. 59–67.
90. American Marketing Association (1960). *Marketing Definitions: A Glossary of Marketing Terms*, Committee on Definitions of American Marketing Association. Chicago: American Marketing Association, (AMA 1960:21).
91. Stanton, P., (1981) – 1981:44. *Fundamentals of Marketing*. NY: McGraw-Hill.
92. Kotler, P., (1998) – 1998:477. *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall.

93. Kotler, P., (1998). *Marketing Management: Analysis, Planning, Implementation and Control*. 10/E. New Jersey: Prentice Hall .
94. Sommers, M.S., Barnes, J.G., and Stanton, W.J., (1998). *Fundamentals of Marketing*. 8/ Canadian Ed. Toronto: McGraw-Hill.
95. Zeithaml, V.A., Parasuraman, A., and Berry, L.L., (1985), "Problems and Strategies in Services Marketing", *Journal of Marketing*. Vol. 49: 33–49.
96. Blankson, C., and Kalafatis, S.P., (1999), "Issues and Challenges in the positioning of service brands: A review", *Journal of Product and Brand Management*, Vol. 8, No. 2. pp. 106–18.
97. Mudie, P., and Cottam, A., (1999), *The Management of Marketing Services*. Butterworth-Heinemann.
98. Buttle, F., (1996). "Relationship Marketing". In Buttle, F., (Ed). *Relationship Marketing: Theory and Practice*. London: Paul Chapman Publishing Ltd.
99. Zeithaml, V.A., Parasuraman, A., and Berry, L.L., (1985), "Problems and Strategies in Services Marketing", *Journal of Marketing*. Vol. 49: 33–49.
100. Zeithaml, V.A., Parasuraman, A., and Berry, L.L., (1985), "Problems and Strategies in Services Marketing", *Journal of Marketing*. Vol. 49: 33–49.
101. Zeithaml, V.A., Parasuraman, A., and Berry, L.L., (1985), "Problems and Strategies in Services Marketing", *Journal of Marketing*. Vol. 49: 33–49.
102. Parasuraman, A., Zeithaml, V.A., and Berry, L.L., (1988), "SERVQUAL: A Multi-item Scale for Measuring Consumer Perceptions of Service Quality", *Journal of Retailing*. 64 (Spring), 12–40.
103. Parasuraman, A., Zeithaml, V.A., and Berry, L.L., (1985), "A Conceptual Model of Service Quality and Implications for Future research", *Journal of Marketing*, Vol. 49, Fall, pp. 41–50; .
104. Parasuraman, A., Zeithaml, V.A., and Berry, L.L., (1988), "SERVQUAL: A Multi-item Scale for Measuring Consumer Perspectives, *Journal of Retailing*, Spring, pp. 12-40; .
105. Parasuraman, A., Zeithaml, V.A., and Berry, L.L., (1994), "Reassessment of Expectations as a Comparison standard on Measuring Service Quality: Implications for Further Research" *Journal of Marketing*, Vol. 58, No. 1, pp. 111–24.
106. Gronroos, C., (1985), "Internal Marketing – Theory and Practice", in Bloch T.M., et al (eds) *Services Marketing in a Changing Environment*. Chicago: American Marketing Association, pp. 41–47.
107. Czepiel, J., Solomon, M., and Surprenant, C., (1985). *The Service Encounter*, Lexington, MA: Lexington Books.
108. The key players involved in a service encounter are described by Shostack. Shostack, L., (1985), "Planning the Service Encounter", in Czepiel, J., Solomon, M., and Surprenant, C., (Eds), *The Service Encounter*, Lexington, MA: Lexington Books.
109. Chandon, J., Leo, P., and Philippe, J., (1997), "Service Encounter Dimensions: A Dyadic Perspective", *International Journal of Service Industry Management*, 8, 65–86.
110. Payne, A., Christopher, M., and Peck, H., (1995). *Relationship Marketing for competitiveness advantage: Winning and keeping customers*. Oxford: Butterworth.
111. Egan, J., (2008). *Relationship Marketing: Exploring Relational Strategies in Marketing*. Pearson Education Limited.
112. Kotler, P., (1997). *Marketing Management: Analysis, Planning, Implementation, and Control*. 9/E. New Jersey: Prentice Hall.

113. Christopher, M., Payne, A., Ballantyne, D., (2002). *Relationship Marketing: Creating Stakeholder Value*. London: Butterworth-Heinemann;
114. Dawkins, P. and Reichheld, F. (1990), "Consumer as a Competitive Weapon," *Directors and Boards*, 14 (Summer), pp 42–47.
115. Reichheld, F., (1996). *The Loyalty Effect: The Hidden Force behind Growth, Profits and Lasting Value*. Boston: Bain & Company, Inc.
116. Galbreath, J., and Rogers, T., (1999), "Customer Relationship Leadership: A leadership and Motivation Model for the Twenty-First Century Business", *The TQM Magazine* 11(3), pp. 161–171.
117. Galbreath, J., and Rogers, T., (1999), "Customer Relationship Leadership: A leadership and Motivation Model for the Twenty-First Century Business", *The TQM Magazine* 11(3), pp. 161–171.
118. "IL Costo della fedetta (European investment in customer loyalty), *Largo Consumo*, Vol. 52 No. 6, P. 89, 1999.
119. Berry, L.L., (1983), "Relationship Marketing", in *Emerging Perspectives on Services Marketing*, Berry L.L., Shostack, G.L., and Upah, G.D., (Eds): Chicago: AMA, 25–28.
120. Berry, L.L., (1983), "Relationship Marketing", in *Emerging Perspectives on Services Marketing*, Berry L.L., Shostack, G.L., and Upah, G.D., (eds): Chicago: AMA, 25–28; Hunt, S.D., (2006), "The explanatory foundations of Relationship Marketing Theory", *Journal of Business & Industrial Marketing*, 21/2 (2006), 72–87; Hunt, S.D., (2006), "The explanatory foundations of Relationship Marketing Theory", *Journal of Business & Industrial Marketing*, 21/2 (2006), 72–87; Berry, L.L., and Parasuraman, A., (1991). *Marketing Services: Competing through Quality*. New York: Free Press; Gummesson, E., (1994), "Relationship Marketing: From 4Ps to 30Rs", Stockholm University; Gronroos, C., (1996), "The Relationship Marketing Logic", *Asia-Australia Marketing Journal* 4, 7–18; Sheth, J.N., and Parvatiyar, A., (1994), (Eds): "Relationship Marketing: Theory, Methods and Application", *Research Conference Proceedings*, Centre for Relationship Marketing, Emory University, Atlanta, GA; Parvatiyar, A., and Sheth, J.N., (2000), "Evolving Relationship Marketing into a Discipline", Emory University, Atlanta, GA.
121. Parvatiyar, A., and Sheth, J.N., (2000), "Evolving Relationship Marketing into a Discipline", Emory University, Atlanta, GA.
122. Morgan, R.M., and Hunt, S.D, (1994) "The Commitment – trust theory of relationship marketing", *Journal of Marketing*, Vol. 58 (April).
123. Christopher, M., Payne, A., Ballantyne, D., (1991). *Relationship Marketing*. London: Butterworth-Heinemann.
124. Christopher, M., Payne, A., Ballantyne, D., (2002). *Relationship Marketing: Creating Stakeholder Value*. London: Butterworth-Heinemann.
125. Gronroos, C., (1990), "Marketing Redefined", *Management Decision*, Vol. 28, No. 8. pp. 5; Gummesson, E., (1994), "Relationship Marketing: From 4Ps to 30Rs", Stockholm University, Stockholm.
126. Gummesson, E., (1994), "Making Marketing Relationship Operational", *International Journal of Service Industry Management*, Vol. 5, No. 5, pp. 5–6.
127. Mulki, J., and Stock, J., (2003), "Evolution of Relationship Marketing", 11<sup>th</sup> Conference on Historical Analysis in Marketing (CHARM): *The Romance of Marketing History*.

128. Hunt, S., Arnett, D., and Madhavaram, S., (2006), "The Explanatory Foundations of Relationship Marketing Theory", *Journal of Business and Industrial Marketing*, Vol. 21, N° 2, pp. 72–87.
129. Reeder, R.R., Brierty, E.G., and Reader, B.H., (1999). *Industrial Marketing*. Englewood Cliffs: Prentice-Hall.
130. Webster and Wind (1972), "A General Model for Understanding Organisational Buying Behaviour", *Journal of Marketing*, Vol. 36 (April), p. 12–19; Wilson, D., (1999). *Organisational Marketing*. London: International Thompson; and Webster, F.E., (1991). *Industrial Marketing*. John Wiley & Sons Inc.
131. Reeder, R.R., Brierty, E.G., and Reader, B.H., (1999). *Industrial Marketing*. Englewood Cliffs: Prentice-Hall.
132. Webster and Wind (1972), "A General Model for Understanding Organisational Buying Behaviour", *Journal of Marketing*, Vol. 36 (April), p. 12–19.
133. Leavitt, H.J. (1964). *Applied Organisation Change in Industry: Structural, Technical and Human Approaches*. In W.W. Cooper, H.J. Leavitt & M.W.I. Shelly (Eds.), *New Perspectives in Organisation Research* (pp. 55–71). New York: John Wiley.
134. Webster and Wind (1972), "A General Model for Understanding Organisational Buying Behaviour", *Journal of Marketing*, Vol. 36 (April), p. 12–19;.
135. Webster and Wind (1972), "A General Model for Understanding Organisational Buying Behaviour", *Journal of Marketing*, Vol. 36 (April), p. 12–19;.
136. Webster and Wind (1972), "A General Model for Understanding Organisational Buying Behaviour", *Journal of Marketing*, Vol. 36 (April), p. 12–19;.
137. Sheth, J.N. (1973), "A model of industrial buyer behaviour," *Journal of marketing*, Vol. 37 (October), pp. 50–56.
138. Doyle, P., 1998. *Marketing Management and Strategy*. Prentice Hall Europe.
139. Peter Drucker (1955). *The Practice of Management*. London: Heinemann.
140. Doyle, P., 1998. *Marketing Management and Strategy*. Prentice Hall Europe.
141. Marn, M.V., and Rosiello, LR., (1992). *Managing Price Gaining Profit*. *Harvard Business Review*, September/October.
142. The first there are covered well by Haas (Haas, R.W., (1995). *Business Marketing: A Managerial Approach*. 6/E. South-Western College Publishers) and the last by Jobber (Jobber, D., (1998). *Principles and Practice of Marketing*. McGraw-Hill).
143. Reeder, R.R., Brierty, E.G., and Reader, B.H., (1999). *Industrial Marketing*. Englewood Cliffs: Prentice-Hall.
144. Doole, I., and Lowe, R., (2008). *International Marketing Strategy: Analysis, Development and Implementation*. 5/E. Cengage.
145. Doole, I., and Lowe, R., (2008). *International Marketing Strategy: Analysis, Development and Implementation*. 5/E. Cengage.
146. Doole, I., and Lowe, R., (2008). *International Marketing Strategy: Analysis, Development and Implementation*. 5/E. Cengage.
147. Paliwoda, S., and Thomas, M., (1998). *International Marketing*. 3/E. Oxford: Butterworth-Heinemann.
148. Kotabe, M., and Helsen, C., (1998). *Global Marketing Management*. John Wiley & Sons.

149. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
150. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
151. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
152. Kotabe, M., and Helsen, C., (1998). *Global Marketing Management*. John Wiley & Sons.
153. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
154. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
155. Doole, I., and Lowe, R., (2008). *International Marketing Strategy: Analysis, Development and Implementation*. 5/E. Cengage.
156. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
157. W.J., Keegan and F.H.R. Seringhaus (1999). *Global Marketing*. 2<sup>nd</sup> Edition. Simon & Schuster.
158. Gillespie, K., Jeannet, J-P, and Hubert David Hennessey (2010): *Global Marketing*. Cengage Learning Inc.
159. See Selecting a market entry mode (Paliwoda, S., and Thomas, M.J, (1998). *International Marketing*. 3/E. Oxford: Butterworth-Heinemann.
160. Leonidou, L.C., and Katsikeas, C.S., (1996), "The export development process: An integrative review of empirical models, *Journal of International Business Studies*, 27(3): 517–51.
161. Dima, S.C., (2010:64-3), "From International Trade to Firm Internationalisation", *European Journal of Interdisciplinary Studies*, Vol. 2, Issue 2).
162. Blomstermo, A., and Sharma, D.D., (2003). *Learning in the Internationalisation Process of Firms*. Edward Elgar Publishing Inc.
163. Dima, S.C., (2010:64-3), "From International Trade to Firm Internationalisation", *European Journal of Interdisciplinary Studies*, Vol. 2, Issue 2).
164. Dima, S.C., (2010:64-3), "From International Trade to Firm Internationalisation", *European Journal of Interdisciplinary Studies*, Vol. 2, Issue 2).
165. Waters, D., (2003). *An Introduction to Supply Chain Management*, 1/E. New York: Palgrave Macmillan.
166. As we will learn under international procurement and international trade, different International Commercial Terms (Incoterms) assign ownership, title and risk differently. Please study Incoterms carefully to see when title and risk transfers. For example under CIF (Cost, Insurance and Freight), risk and ownership transfers when the buyer (or importer) has received the goods at an agreed location in a given country.
167. These other organisations may be the distributors, agents, or wholesalers for the organisation's goods.
168. Waters, D., (2003). *An Introduction to Supply Chain Management*, 1/E. New York: Palgrave Macmillan.
169. Pohlen, T.L., and Farris, T., (1992), "Reverse Logistics in Plastics Recycling", *International Journal of Physical Distribution and Logistics Management*, 22(7): 35–47.
170. Rogers, D.S., and Tibben-Lembke, R.S., (1999), "Going Backwards: Reverse Logistics Trends and Practices, Reverse Logistics Executive Council. Pittsburgh, PA.
171. de Brito. M.P., and Dekker, R., (2003), "A Framework for Reverse Logistics", Version April 2003.
172. de Brito, M.P., and Dekker, R., (2003), "A Framework for Reverse Logistics", Version April 2003.
173. de Brito, M.P., and Dekker, R., (2003), "A Framework for Reverse Logistics", Version April 2003.
174. de Brito, M.P., and Dekker, R., (2003), "A Framework for Reverse Logistics", Version April 2003.

175. Rogers, D.S., and Tibben-Lembke, R.S., (1999), "Going Backwards: Reverse Logistics Trends and Practices, Reverse Logistics Executive Council. Pittsburgh, PA.
176. Rogers, D.S., and Tibben-Lembke, R.S., (1999), "Going Backwards: Reverse Logistics Trends and Practices, Reverse Logistics Executive Council. Pittsburgh, PA.
177. Tibben-Lembke, R., (2004), "Strategic Use of the Secondary Market for Retail Consumer Goods", *California Management Review*, 46 (2), 90104.
178. Marisa P. de Brito and Rommert Dekker (2003). "A Framework for Reverse Logistics" Version April 2003.
179. Tibben-Lembke, R., (2004), "Strategic Use of the Secondary Market for Retail Consumer Goods", *California Management Review*, 46 (2), 90104.
180. Uniform Customs and Practice for Documentary Credits (UCP) and its general principles Source: Scotia Bank (1999), International Trade Finance Services, *Documentary Letters of Credit: A Practical Guide*.
181. Bailey, P., and Farmer, D., (1985). *Purchasing Principles and Management*. 5/E. London: Pitman.
182. USA government describes Performance-Based Services Acquisition as the policy of the Federal Government that requires (1) agencies use performance-based contracting methods to the maximum extent practicable when acquiring services and (2) agencies carefully select acquisition and contract administration strategies, methods and techniques that best accommodate the requirements. See Seven Steps to Performance-Based Services Acquisition at [http://acquisition.gov/comp/seven\\_steps/library/SevenSteps\\_execversion.pdf](http://acquisition.gov/comp/seven_steps/library/SevenSteps_execversion.pdf) (accessed on 23/10/2012).
183. "...rather than micromanaging the details of how contractors operate, the government must set the standards, set the results and give the contractor the freedom to achieve it in the best way" – Presidential Candidate George W. Bush on June 9, 2000.
184. Accessed on 10 July 2012.
185. Seven Steps to Performance-Based Services Acquisition at [http://acquisition.gov/comp/seven\\_steps/library/SevenSteps\\_execversion.pdf](http://acquisition.gov/comp/seven_steps/library/SevenSteps_execversion.pdf) (accessed on 23/10/2012).
186. National Institute of Governmental purchasing (NIGP), 2002.
187. In East Africa, Uganda, Kenya, Tanzania and Rwanda for instance all have a specialized Public Procurement and Disposal Authority (PPDA) as well as specialized Procurement and Disposal Units (PDUs) in each Procurement and Disposal Entity (PDE). A PDE is a government entity that can procure and enter into a contractual relationship with suppliers.
188. Odhiambo and Kamau (2003), define public procurement broadly as purchasing, hiring or obtaining by any contractual means of goods, construction works and services by the public sector (Odhiambo, W., and Kamau, P., (2003), "Public Procurement: Lessons from Kenya, Tanzania and Uganda", OECD Development Centre, Working Paper No. 208, Paris).
189. The best evaluated price does not always have to be the lowest. The bid documents will have explained this.
190. Principles of professional ethics have been adapted from Lysons, K., & Farrington, B., (2006). *Purchasing and Supply Chain Management*. 7/E. FT Prentice Hall, England.
191. Duty of care is discussed in the section of business and law.
192. See [http://ec.europa.eu/health/tobacco/smoke-free\\_environments/index\\_en.htm](http://ec.europa.eu/health/tobacco/smoke-free_environments/index_en.htm) (accessed on August 31, 2016).

193. Professions include law, medicine, accounting, architecture, engineering and procurement.
194. IMF (International Monetary Fund), 2000. Improving Governance and Fighting Corruption in the Baltic and CIS Countries. (<http://www.imf.org/external/pubs/ft/issues/issues21/index.htm> (accessed on 5 June 2011)).
195. IMF (International Monetary Fund), 2000. Improving Governance and Fighting Corruption in the Baltic and CIS Countries. (<http://www.imf.org/external/pubs/ft/issues/issues21/index.htm> (accessed on 5 June 2011)).
196. CIMA. Fraud risk management: a guide to good practice.
197. Bailey, P., Farmer, D., Crocker, D., Jessop, D., and Jones, D., (2008:150). Procurement Principles and Management. 10/E. London: FT Prentice Hall.
198. The Chartered Institute of Marketing (CIM), UK.
199. "Once nominated as Toyota suppliers, they should be treated as part of Toyota (as branch plants); Toyota shall carry out business with these suppliers without switching to others and shall make every effort to raise the performance of these suppliers" (TMC 1988 p. 76; Kyohokai 1994, p. 18). Source: Quoted by Mari Sako (2003), Supplier Development at Honda, Nissan and Toyota: Comparative Case Studies of Organisational Capability Enhancement, Said Business School, University of Oxford, November 2003.
200. The study covered Toyota and its 21 key suppliers.
201. The consulting exercise resulted in a heightened expectation that Toyota provide assistance to improve suppliers' company-wide managerial capabilities (Sako, 2003).
202. CIPS, Supplier Development, CIPS Knowledge Works, Knowledge Summary; at [www.cips.org](http://www.cips.org) (accessed on July 10, 2011).
203. Bailey, P., Farmer, D., Crocker, D., Jessop, D., and Jones, D., (2008:150). Procurement Principles and Management. 10/E. London: FT Prentice Hall.
204. AIDT – Just-In-Time Manufacturing – September 11, 2006.
205. Ron Pereire (2009). The Seven Wastes, *iSixSigma Magazine*, September/October 2009 Issue, Volume 5, Number 5.
206. *Muda* refers to anything that is wasteful and does not add value.
207. Financial Times, 31 July 2001, p. 10.
208. Abraham, Katharine G., and Susan K. Taylor (1996) "Firms' Use of Outside Contractors: Theory and Evidence" *Journal of Labour Economics*, Vol. 14, pp. 394–424.
209. This is according to Lysons, K & Brain Farrington (2006). *Purchasing and Supply Chain Management*. 7/E. London: FT Prentice Hall. *In this section we discuss them basing on African environment.*
210. Most experts on this subject have variously presented them in different wordings.
211. Bailey, P., Farmer, D., Crocker, D., Jessop, D., and Jones, D., (2008:150). Procurement Principles and Management. 10/E. London: FT Prentice Hall.
212. The Bank shall be satisfied in such cases that no advantage could be obtained by further competition and that the prices on the extended contract are reasonable.

213. Procurement of goods and works, under disaster and emergency assistance, shall incorporate greater flexibility. ICB requirements shall be relaxed in favour of NCB, LIB or Shopping as appropriate, with an abbreviated bidding period. Direct Contracting to contractors and suppliers, under existing loans or grants, shall be allowed for new contracts, with unit rates negotiated around those in effect for the existing contracts and adjustments, as required, for inflation and physical factors.
214. World Bank; Guidelines: Selection and Employment of Consultants by World Bank Borrowers; May 2004; Revised October 1, 2006.
215. World Bank (2006); Guidelines: Selection and Employment of Consultants by World Bank Borrowers; May 2004; Revised October 1, 2006.
216. The Bank guides that the RFP shall specify the source of the exchange rate to be used and the date of that exchange rate, provided that the date shall not be earlier than four weeks prior to the deadline for submission of proposals, nor later than the original date of expiration of the period of validity of the proposal.
217. The Bank rules state that the dollar thresholds defining “small” shall be determined depending on each case by taking into account the nature and complexity of the assignment, but shall not exceed US\$200,000.
218. According to the World Bank (2008), Single-Source Selection of consultants does not provide the benefits of competition in regard to quality and cost, lacks transparency in selection and could encourage unacceptable practices. Therefore, single-source selection shall be used only in exceptional cases.
219. According the World Bank (2008), the dollar thresholds defining “very small” shall be determined in each case, taking into account the nature and complexity of the assignment, but shall not exceed US\$100,000.
220. Griffiths, M., and Griffiths, I., (2003). Law for Purchasing and Supply. 3/E. FT Prentice Hall.
221. Quantum Meruit (“what one has earned”; “what the job is worth”; or “the amount he deserves”): Essentially, quantum meruit is an action for payment of the reasonable value of services performed. It is used in various circumstances where the court awards a money payment that is not determined, subject to what is said below, by reference to a contract. (see <https://www.allens.com.au/pubs/pdf/const/pap23jun06.pdf> (accessed on 2/12/2015)).
222. Monczka, R.M., Petersen, K.J., Handsfield, R.B., and Ragatz, R.G., (1998), “Success Factors in Strategic Supplier Alliance: The Buyer Perspective”, Decision Sciences, 29(3), 553–577.
223. Griffiths, M., and Griffiths, I., (2003:99). Law for Purchasing and Supply. 3/E. FT Prentice Hall.
224. For example a company secretary has got actual authority to enter contracts that deal with the administrative affairs of the company such as hire cars or buy office equipment.
225. Ostensible arises if the principal’s words or conduct would lead a reasonable person in the third party’s position to believe that the agent was authorised to act.
226. Griffiths, M., and Griffiths, I., (2003). Law for Purchasing and Supply. 3/E. FT Prentice Hall.