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Business-to-business marketing

Networks and alliances are now part of everyday business life, but they often do not work well. The expectations of the partners need to be carefully orchestrated, and their inclination to take control has to be curbed. This can be difficult as more markets become digital and based on extranets. These trends often cause overlaps between consumer and business-to-business markets, and dual marketing is then required. What are the advantages and potential pitfalls of this approach ?

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Marketing issues today are often examined and investigated on a sectoral basis. This article initially focuses on marketing in the business-to-business sector, with an emphasis on networks and digital markets.

However, organisations that survive and flourish often learn from the experiences of those in other sectors. Thus the article also looks at the strategies adopted by businesses that serve both consumer and business markets.

Finally, some of the lessons manufacturers can learn from the service sector are explored.

Business relationships and interaction

The maintenance of relationships, partnerships, networks and alliances is now part of everyday business practice. They are usually established to share

- technologies;
- resources;
- expertise;
- access to markets.

Some of these relationships, particularly in the early stages of development, are simple in structure. Others become such dense and closely connected networks that they start behaving almost like a separate organisation, or, as Hakansson and Ford[1] argued, a quasi-organisation.

All networks offer benefits, opportunities and limitations, but what are the particular advantages and problems of these novel quasi-organisations, and how should managers behave and interact within them ?

Hakansson and Ford focused on three broad issues :

- opportunities and restrictions;
- influencing skills;
- control.

Technically, for example, networks present a variety of options, and they can be very innovative if the various partners bring their special contributions to bear on the relationship.

Less encouragingly, it can be difficult to implement change, as the expectations and joint resources of all the partners need to be managed in concert. Networks can also become stagnant, as existing relationships, investments and established practices can restrict further innovation.

How is momentum maintained, and who or what drives strategy ?

Hakansson and Ford suggested that each of the member organisations has a role to play, with relationship managers at the bridgehead. At the organisational level, influence can be strong, but it is not always positive, as the least committed can have a strong but negative influence. The most committed can, with effort, be key drivers of the network strategy and generate impetus for change.

Effectively managing network relationships also means appreciating the standing of each firm in the marketplace. Each partner has its own interests at heart, and will attempt to use its influence to extract benefit for itself. The key to success seems to be a strategy based on influence, and Hakansson and Ford expressly warned organisations against seeking to control the network.

When they work well, strong networks offer the types of opportunity and variety that the organisations could not provide for their customers when working independently. However, network strategies are often ones of gradual learning and systematising action, and they are consequently rarely radical or dynamic.

Electronic relationships in business-to-business markets

Electronic commerce in consumer markets has received more attention than that in the business-to-business sector, although business applications can enable companies to form electronic relationships relatively easily.

Some of these relationships are simple exchanges comparable with those in conventional markets. However, more complex needs can also be satisfied digitally in networks that enable businesses to connect with intermediaries, resellers, suppliers and customers.

Of particular importance in digital markets are

- auctions;
- aggregators;
- bid systems;
- exchanges.

According to Forrester Research[2], 'by 2004 digital markets will account for 53 per cent of all online business trade'.

These markets offer a wide range of services, including

- logistics services;
- legal services;
- payment risk management;
- conflict resolution services.

When they are operated efficiently, they claim to 'lower purchasing costs, reduce inventory and warehouse cost, enhance the efficiency of logistics and procurement, lower marketing cost, and increase sales in the market'.

Dou and Chou[3] researched the nature and structure of digital markets on the basis of a framework of key business models, including fixed pricing and flexible/dynamic pricing options. They looked at the use of extranets for basic transactions and auctions for more competitive environments.

A marketplace model allows buyers and sellers to exchange goods and services, and it offers the additional benefit of support services. What advice is there for those building digital markets ?

Critical evaluation of the

- market characteristics;
- product to be exchanged;
- needs of the consumer;

help in the determination of the preferred business model.

Commodity products, such as perishable items and basic parts and components, are price sensitive, and most appropriate for auction.

The marketplace model serves customers' more complex needs by, for example, allowing them to select from a range of manufacturer's options. It can also help when buyers need assistance, and it can provide enhanced efficiency and reduced transaction costs.

Dual marketing

While some organisations build relationships and networks in conventional or digital business markets, others operate in dual markets.

The following are examples of dual market products :

- Power tools may be sold for home use or to the professional business market.

- PCs can be channelled to the home or office environments.

- Detergents may be sold to the domestic user or for industrial cleaning applications.

Biemans[4] looked at overlaps that exist for organisations selling the same products in both consumer and business markets.

Selling a range of products to different markets is fairly commonplace, and this is typically dealt with by various divisions within the organisation.

Selling an identical product across two distinct sectors, however, is not quite so straightforward, and greater understanding of buyer behaviour and market structure is required. For example, one sector may need a relational approach and the other may not.

The use of dual marketing has accelerated in recent years because of

- advances in technology;
- the amalgamation of consumer and business markets;
- the preponderance of relationship marketing approaches in businesses.

However, Biemans argued that dual marketing is an area that has been neglected in the literature and in practice, although its use is now fairly widespread in

- catering;
- transportation;
- manufacturing;
- financial services;
- the energy business.

What are the advantages and pitfalls of the dual marketing approach ?

Opportunities for dual marketing are sometimes missed when marketers fail to identify the points of overlap between different markets, or when the marketing function itself is not sufficiently organised to meet these opportunities.

The potential benefits include increased sales as a product is introduced to a new group of customers as part of a market development strategy. Internally, economies of scale are possible, and there is also the opportunity to improve market information and synergies in brand development and equity in the marketplace.

Companies must beware of confusing consumers by exposing them to mixed messages targeted at different groups. Other potential disadvantages include business customers believing that products that are also available to consumers are less sophisticated.

When considering the dual marketing approach, businesses must decide whether to build on the similarities between the markets or to emphasise the differences.

In the former case, Biemans recommended carefully segmenting and targeting groups, irrespective of whether they are in business or consumer markets.

Integrated communication avoids positioning problems, and a single branding strategy helps to keep the approach simple and build overall brand awareness.

Internally, marketing must be organised to support the strategy and ensure that it is integrated, coordinated, and attentive to changes in the marketplace. However, if the strategy is designed to stress the differences between markets, differing communications and distribution channels and dual brands may be more appropriate.

Biemans suggested that there are seven steps that can help the novice to implement a dual marketing strategy :

- Investigate the logic of dual marketing.
- Determine the scope.
- Tailor the marketing efforts to dual marketing.
- Eliminate organisational barriers.
- Investigate opportunities for synergy.
- Evaluate dual marketing.
- Optimise the marketing organisation.

Numerous markets offer the opportunity for dual marketing and synergies.

Perhaps the largest barrier to effective implementation is organisational design and, in particular, the role and position of marketing. Biemans asked whether marketing organisations really have the capacity to reflect the characteristics and dynamics of the marketplace.

Service excellence

Over the last three decades, academics and practitioners have forcefully emphasised the importance of service delivery across all industries, not just within the pure service firms.

Ford, Heaton and Brown[5] considered what makes successful service firms truly outstanding organisations, and they drew lessons that are relevant to all organisations, particularly those in the business-to-business sector.

They outlined ten basic components of excellent service delivery for manufacturers :

- *Understand what the customer wants and expects* : Managers should examine the business from the customer's standpoint and not from the firm's production, organisational or financial perspective. They should examine the drivers of satisfaction, understand what customers value, and build competencies that enable the organisation to deliver quality service. US entertainment corporation the Walt Disney Company refers to this as guestology, for instance, but it is increasingly known in marketing terms as experiential marketing.

- *Consider the entire customer experience* : Outstanding or benchmark service organisations pay close attention to the customer's environment. This means attending to the customer from the first meeting through all the various contact points in the service experience, and even beyond.

- *Focus on continuous improvement* : Many organisations claim that continuous improvement is the key to service excellence. It is important to focus on everything that affects the customer, and not simply on the product.

- *Reward employees for effective customer relationships* : Many businesses develop rules and regulations and have sterile production processes that isolate employees. Service organisations have long realised that this approach does not empower employees and can lead to a negative effect on service levels.

- *Train employees in the emotional aspects of service delivery* : At the Walt Disney Company, employees are trained to deal with all types of customer, fierce or friendly. In manufacturing and other businesses where the customer is distant, employees may need to cope with mundane, boring or repetitive jobs. Management must attend to the emotional costs of employees working in such environments, and develop techniques to help them do their jobs well.

- *Develop a service culture* : A service culture within a firm can be transferred through training and rewards, or informally recounted through organisational stories, that is, stories about the organisation that employees remember and repeat.

- *Do not fail customers twice* : Reliability is important in every industry. However, service organisations appear to be more conscious of the cost associated with dissatisfaction and the potential negative impact on repeat business.

- *Empower customers* : Customer participation should be valued, as it helps businesses to meet their expectations, build commitment, and tie the customer to the organisation. Manufacturers can manage customers and employees in similar ways to develop their skills, knowledge and competencies as coproducers, whether they are specifying machinery or monitoring orders and stock levels.

- *Ensure that managers lead from the front* : Leaders need to be at the forefront of the business. Employees in the service industries see and learn from their managers, who are dedicated to customer service. However, employees in some manufacturing businesses never see their management, and are thus unable to learn from them.

- *Treat customers like guests* : Employees should treat customers like guests. This shifts the experience from pure selling towards customer satisfaction. (However, note that some observers claim that describing a customer as a passenger, a member, a guest, or even a patient can distract the employee and the organisation from the provision of customer satisfaction.)

While these approaches may seem familiar, the evidence demonstrates that they are not being followed.

The expertise of benchmark organisations may well help to guide others working in quite different environments. Examples and evidence of good practice in service excellence, electronic commerce and relationship marketing can benefit a range of organisations, whether they operate in the consumer, business-to-business or service sectors.

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Selection, rejection and turnover

Organisations are battling to attract the best talent. What are the latest selection techniques, and which traditional approaches have proved themselves over time ? Which work best for the various categories of staff ? How can one take account of gender and equity issues, and deal with rejections so that the organisation's reputation is not damaged ? What are the embedding forces that help in retaining valued employees, and how should these be managed ?

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Recent trends in selection

A successful organisation must be able not only to select the right people for its current and future needs, but also to retain them.

This article considers recent findings on the selection and rejection process. The factors that lead to employee turnover or to an individual remaining with the organisation are considered.

It also examines the impact of various approaches to managing equity, and how this affects the recruitment of women in management.

Robertson and Smith[1] argued that there is increasing confidence in the validity of most personnel selection methods, for example

- cognitive ability tests;
- personality questionnaires;
- interviews;
- assessment centres;
- biodata.

In their comprehensive review of recent research, they found the following :

- Job performance is not just about effective task performance. For example organisational citizenship behaviour is also relevant.
- General cognitive ability is the main predictor of subsequent job performance.
- Emotional intelligence has not yet been found to predict performance for any specific occupational area.
- Assessment of personality increasingly plays a role in selection.
- Assessment centres appear primarily to measure general mental ability, and may not provide a good guide to the further development of candidates. Cheaper alternatives may be more appropriate.
- The use of physiological measures in selection and the benchmarking of assessment systems against those used by leading organisations are likely to become increasingly important trends.

Further research could improve our understanding of what is actually being measured by methods such as interviews, assessment centres and biodata.

More conceptual and empirical work could clarify measures of

- *performance* : for example supervisory ratings, promotions, organisational citizenship;
- *attachment* : for example turnover, absenteeism, and commitment;
- *well being* : for example job satisfaction.

Finally, research could aid understanding of the relationship between these measures and predictors, and how to use the predictors in combination.

Questions for higher-level recruitment

The two most popular formats for job

interviews use either situational or behaviour description questions :

- *Situational questions* : Applicants are asked to indicate how they would respond to a hypothetical job situation, the idea being that their intentions are then a predictor of future action.
- *Behaviour description questions* : Applicants are asked to relate actual incidents from their past that would be relevant to the new job. Here the premise is that the past is the best predictor of future performance.

Previous research suggested that situational interviews might be better for lower-level jobs, and behaviour description interviews more effective for higher-level positions. Huffcutt *et al.*[2] decided to test whether this was the case, and if so why.

In two studies, they found that behaviour description interview scores were a reasonably strong predictor of performance, while situational interview scores were not. Situational interviews had lower validity than behaviour description interviews for higher-level positions.

Why should there be diminishing effectiveness for situational interviews from lower-level to higher-level positions, when both the situational interview and behaviour description interview questions were written to assess the same characteristics ?

Huffcutt *et al.* suggested that situational interview and behaviour description interview ratings capture different constructs, and that social and verbal presentation skills might have an influence on behaviour description interview ratings. This could account for the association between behaviour description interview ratings and performance in high-level positions.

They also found a correlation between behaviour description interview ratings and extraversion that suggested that warm, energetic and/or talkative candidates receive better behaviour description interview ratings.

Situational interview scoring tends to be based more on what overt action candidates would take, rather than on why or how they arrived at their decision. This approach may be perfectly adequate, or even preferable, for lower-level positions. However, knowing how candidates arrived at a particular action, and why they chose it, can be just as important as the decision itself for higher-level positions. However, interviewers are not allowed to probe responses to situational interview questions.

Interview developers should therefore only use a situational interview format for higher-level positions with extreme caution.

Applicants' reactions to rejection letters

Recruiting the right person for the job is the paramount concern in the selection process. However, the rejection procedure can also have important consequences for both the individual and the organisation.

Gilliland *et al.*[3] examined applicants' reactions to rejection letters from the perspective of fairness theory, which suggests that an individual may automatically generate alternative scenarios, or counterfactual reasoning, in an attempt to understand why a negative event has occurred.

They identified three types of counterfactual :

1. *Would counterfactuals* : Here, the applicant creates a scenario in which, for example, he or she receives a job offer rather than a rejection letter.
2. *Could counterfactuals* : These address whether the negative event was under the decision maker's discretionary control.
3. *Should counterfactuals* : These lead to an evaluation of whether the decision maker acted in accordance with appropriate standards.

These counterfactuals can be combined in an individual's response. In addition to generating a would counterfactual, a person may also evaluate whether sufficient could and should counterfactuals exist to make the negative judgement valid in his or her mind.

For example, a person's reaction to a rejection letter will be most negative if the applicant feels that the organisation could and should have acted differently, and that if it had, it would have employed her or him.

In the research, applicants received rejection letters containing explanations that were categorised into three groups on the basis of their ability to reduce would, could and should counterfactuals :

- *Would-reducing explanations* : These suggested that a more positive outcome for the candidate would be unlikely even in different circumstances. An example was when the job was offered to a more qualified applicant.

- *Should-reducing explanations* : These suggested that the decision-making process was adequate, and that alternative procedures should not have been used.

- *Could-reducing explanations* : These suggested that the rejection decision was beyond the company's or the decision maker's control.

Three studies considered the impact of the various types of explanation on

- the applicants' perceptions of fairness;
- their perceptions of being treated with sincerity and respect;
- their intentions to recommend the jobs to others;
- their intentions to reapply for future jobs.

The key findings were as follows :

- *Would-reducing explanations* : These properly justified the recruitment decision taken, and had a positive impact on the candidate's perception of fairness and on recommendation intentions.

- *Could-reducing explanations* : These suggested that alternative actions were not feasible, and similarly had a positive effect on the applicant's perception of fairness. In one of the three studies, they were also seen as positive for recommendation intentions and reapplication behaviour.

- *Should-reducing explanations* : These justified the appropriateness of the decision-making process, and were more complicated to assess. They appeared to need additional would-reducing or could-reducing explanations to produce positive perceptions of fairness, interpersonal treatment, and recommendation intentions.

Thus two of the three types of explanation led to greater fairness perception and stronger recommendation intention than either no explanation or one explanation, and three explanations did not produce results any different from those for two explanations. Would-reducing explanations seemed to be particularly important in improving fairness reactions, and combined would-reducing and should-reducing explanations seemed to be the most effective.

Managers should note that a well considered explanation in the letter sent to rejected job applicants may not only positively influence reapplication behaviour, but also mean that the candidate will recommend the organisation to others. This may be an important potential benefit in a competitive marketplace.

However, such explanation policies can also be risky, as they may raise a candidate's expectations unrealistically, or, in the worst case scenario, lead to legal action. Truthful and honest feedback in rejection letters is therefore imperative.

Equity and women in management

In recent years, social and legislative pressures have encouraged organisations to adopt policies that promote the equitable allocation of benefits (and burdens) to individuals and groups.

French[4] explored various approaches to managing gender equity in almost 2 000 Australian organisations, and studied the relationship between these approaches and their consequences for women in employment.

She identified four approaches to equity management based on two dimensions :

- The first dimension considered the distribution of benefits and burdens. Organisations seeking to give equal access to both sexes (the equality approach) were distinguished from those using the equity approach, which posits that fairness in the workplace requires different treatment of the sexes.

- The second dimension distinguished between those organisations that adopt institutional (that is, systematic or formalised) practices for the implementation of equity management, and those that do not.

The four ideal–typical approaches are as follows :

1. *Classical disparity approach* : This is based on the assumptions that choices made by women, rather than gender discrimination, have led to workplace inequality, and that intervention by the organisation may not help the individual. This is an equity and non-institutional approach.

2. *Anti-discrimination approach* : This ensures compliance with legislation to eliminate direct and indirect expressions of unfair discrimination. It results in the equal treatment of individuals through institutional procedures.

3. *Affirmative action approach* : This adopts special measures to assist members of disadvantaged groups. It therefore follows an equity and institutional approach.

4. *Gender diversity approach* : This seeks to integrate diverse individuals within the organisation. It provides an equal, or identity-neutral, treatment through a non-institutional approach.

French also identified a number of key human resources management factors in the research. These included

- consultation with unions and employees;
- information sharing;
- training;
- reward systems;
- equal employment opportunity structures.

She found a consistent pattern linking these key factors with the four ideal types of equity management approach.

She then considered the link between the four approaches and the following outcomes for the employment status of women :

- percentage of women employed;
- number of women in management;
- number of women in various levels of management.

There did not seem to be a connection between the approach that was adopted and the percentage of women employed in an organisation.

French did, however, find significant links between the approaches and other outcomes.

The following are examples :

- Organisations using a gender diversity approach had a significantly lower percentage of women managers than those adopting an affirmative action approach.

- Organisations using a classical diversity approach had significantly fewer numbers of women in tier 1 management (including the positions of CEO, president, executive director and general manager) than those using the affirmative action approach.

- Organisations using a gender diversity approach had significantly fewer women in tier 2 management (including the positions of divisional managers and state managers) than organisations using the affirmative action approach.

- Organisations using a classical diversity approach had significantly fewer women managers in tier 3 (managers responsible for a functional division) than organisations using the affirmative action approach.

This research suggests that neither the classical disparity nor the gender diversity approach to equity management leads to a significant increase in the status of women's' employment.

French argued that this is perhaps because the broad application of diversity strategies results in limited practical outcomes, or that the diversity approach perhaps simply takes a long time to produce results. By contrast, the use of an anti-discrimination approach does seem to predict a significant increase in women being employed at the senior management level.

Unsurprisingly, an affirmative action strategy consistently predicted a significant increase of women in senior management and higher numbers of women managers throughout the organisation and the three higher-level management tiers.

French's research also provided a framework for conceptualising values and approaches in equity management, and for considering action strategies to achieve equitable treatment for personnel.

Although it did not consider the impact of equity management on performance, the research does enhance our understanding of some consequences of the differing approaches used.

How dissatisfaction leads employee turnover

Recent research into job turnover has centred on understanding the dissatisfaction–quit sequence.

Hom and Kinicki[5] examined how job dissatisfaction can progress into turnover by identifying some of the intermediate linkages in the sequence.

They considered the influence of the following factors on turnover :

- job avoidance;
- inter-role conflict;
- the employment market.

Job avoidance has an indirect impact upon the dissatisfaction–quit sequence. It represents an early phase of organisational withdrawal. Excessive absences or lateness are signs of impending resignation, and organisations should try and address the underlying employee dissatisfaction rather than simply taking disciplinary measures.

Inter-role conflict may intervene indirectly in the dissatisfaction–quit sequence. It is not only the classic work–family tensions that initiate the separation process; single or childless employees can just as easily suffer inter-role conflicts. Organisations should therefore make non-traditional work schedules or arrangements such as flexitime available to all valued employees.

Finally, the prevailing unemployment rate has an impact on turnover. The state of the job market has a direct effect on turnover (independently of job satisfaction). Increasing unemployment weakens the intervening links in the job search sequence, and even employees who wish to leave may not look elsewhere if the job market is shrinking.

Job embeddedness and voluntary turnover

Job turnover is often predicted on the basis of the attitudes of the jobholder, in terms of, for instance,

- job satisfaction;
- organisational commitment;
- job involvement.

These attitudinal measures are significant, but they still do not completely reveal why people leave an organisation.

In an attempt to gain a clearer picture, Mitchell *et al.*[6] developed the concept of job embeddedness, and asked what the embedding forces were that keep a person (even one with a negative attitude) in his or her job.

They stated that job embeddedness has three dimensions, each of which has an organisational and wider community aspect :

- *Links* : These are the formal or informal connections between a person and institutions and/or other people. The more links there are between the person and the web that surrounds him or her, the closer is the tie to the job or organisation.

- *Fit* : The greater the fit is between a person's values, career goals and plans for the future and the corporate culture and demands of the job, the greater will be the likelihood that an employee will feel professionally and personally tied to the organisation.

- *Sacrifice* : This is the perceived cost of material or psychological benefits that will be forfeited by leaving a job, or the ease with which the links to the job can be broken. The more an employee must give up on leaving, the more difficult it is for him or her to leave an organisation.

In a study of two organisations in the USA, the researchers' findings were as follows :

- The greater the degree of job embeddedness is, the less likely it is that the employee will leave the organisation voluntarily.

- Job embeddedness is a better predictor of voluntary turnover than job satisfaction and organisational commitment.

- Job embeddedness predicts voluntary turnover better than the existence of perceived alternatives and searching for other jobs.

- Job embeddedness is a better predictor of voluntary turnover than the perceived desirability or ease of changing jobs.

Job embeddedness is a new concept that requires further development, but it does extend current understanding of why people leave or stay with an organisation.

The research demonstrated that organisations should take account of employees' lives both on and off the job. Money and job satisfaction are not the only levers for retention policy; many non-financial and non-attitudinal factors embed people in networks and keep them in their jobs.

Thus organisations can reduce turnover by creating links between people and the organisation and the community, as well as by promoting employee satisfaction and commitment effectively.

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Options on strategic positioning

The use of real options in strategy is becoming more common, and this may not be as complicated as it seems. You do not need to be a genius at statistics, and it can be a useful way of incorporating more flexibility into strategic planning. This is proving to be increasingly advantageous as some old strategy tenets, such as being first into a market or a quick second, are now being challenged.

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We have previously discussed real options theory and its application to strategy evaluation[1,2]. This approach is a way of valuing assets and activities that takes flexibility and uncertainty into account.

For example, a company might use real options to invest in the rights to develop an oil field if and when the price of oil makes extraction viable, and/or the expertise to extract the oil economically is developed. This flexibility would allow the oil company to minimise its investment costs if, for example, it subsequently decided not to pursue its exploitation strategy in the region.

Real options are becoming increasingly popular. US chip manufacturer Intel, for instance, recently used them when acquiring a manufacturing facility, to allow it to expand production quickly in the event of an upturn in the economy[3].

Of course the expected benefits of maintaining excess production capacity can be lower than the opportunity costs of tying up capital. However, in this case, the application of real options demonstrated that being able to add capacity rapidly in an upturn would generate significant positive value.

The use of options theory as an analytical tool involves quantitative techniques such as

- the Black–Scoles model, which helped to launch the traded options movement back in the 1970s;
- binomial option pricing models;
- Monte Carlo simulations;
- risk-adjusted decision trees.

However, these techniques are outside the scope of this article.

A recent survey by Triantis and Borison[3] showed that many companies are not advanced in such techniques. However, several have adopted real options as a general perspective on business.

Thus firms looking at supply contracts along the value chain, joint ventures or alliances, and other relationships view these strategies as bundles of options. They focus on securing options that are worth more to them than the cost to the party with whom they are contracting or, conversely, on granting options to the other party if the value of such options exceeds the expected cost to them. Viewing agreements in such a manner is likely to enhance the win–win outcome.

The formal application of real options theory and the quantitative techniques associated with it is also more prevalent in certain industries. Firms that take large-scale capital investment decisions, such as those in the extractive industries and electricity and power generation, have often integrated real options within their capital investment procedures. 'Projects that involve high volatility, large irreversible investments and significant flexibility are good candidates for real options theory' (reference 3, p 20).

In firms that are used to applying quantitative analysis, such as discounted cash flow or net present value calculations, individuals are also much more likely to consider using real options theory.

Adopting real options for strategy evaluation has organisational implications. One of these is follow-up. The use of real options implies that an initial strategic investment is made in the acquisition of an option on future development. Ongoing reviews are therefore paramount. Successful firms produce a road map that must then be revisited periodically to ensure that the appropriate decisions are being taken.

Triantis and Borison also recommended an incremental approach to introducing real options :

- pilot projects;
- buy-in from senior management;
- specialist training;
- codification of the decision-making process;
- institutionalisation of real options into firm-wide decision-making processes.

Some observers have suggested that this approach has been discredited by the bursting of the dot.com bubble. However, Triantis and Borison claimed that real options theory was not directly responsible for the excessive valuations of Internet companies in the late 1990s.

They argued that real options have a bright future, as companies using this approach are better able to make the correct investment decisions in volatile markets.

First mover disadvantages and real options

The criticism that real options encourage unsustainable business models was further countered by the application by Cottrell and Sick[4] of the real options approach to the important and controversial topic of first mover advantages.

The first mover concept, which originated in the work of Alfred D Chandler and others, assumes that the innovator in any market (specifically the player that moves most aggressively to capitalise on a market opening) will be the ultimate market leader. These first movers build unassailable market positions based on image, reputation and intellectual property rights, and are able to establish a loyal customer base. Their production costs decline along the experience curve more rapidly than those of late entrants.

However, the work of Steven Schnaars[5], amongst others, has suggested that many of these first mover advantages have been exaggerated or are unsustainable. Indeed, according to a recent study, only 10% of Internet-based companies have been able to achieve a sustainable market advantage by moving quickly. Why is this ?

Many companies are able to imitate early movers after learning from their experiences, and customer loyalty can prove ephemeral.

Some also argue that even intellectual property rights are vulnerable. Indeed, a study cited by Cottrell and Sick argued that patents are one of the weakest methods of protecting returns on innovation, perhaps because companies must often go to court to uphold them. Other researchers point to the many examples of first mover advantages being overturned by aggressive or clever imitators, for instance

- VHS and Betamax;
- Microsoft Excel and Lotus 1-2-3;
- Honda and the British motorcycle industry;
- Bloomberg and Reuters.

Cottrell and Sick therefore concluded that first mover advantages may have been exaggerated. Many companies should wait and see how the market develops and determine which technological solutions are accepted.

The authors also recommended taking account of

- the current expected value of the investment;
- the current cost;
- the volatility of the business opportunity;
- the expected time over which the option is to be exercised.

Estimates of reduced follower costs should be added into the cost side to determine the correct hurdle price for development. The application of the real options approach will in many cases indicate that companies are better off adopting a second mover stance.

Getting it right the second time

Is imitating successful innovation, which some of the above arguments assume, easy ? This is probably not the case. As Gabriel Szulanski and Sidney Winter pointed out, many businesses often fail to reproduce best practice within their own organisation[6].

Szulanski and Winter's thesis was that most people in business overestimate their ability to replicate the (successful) processes in other companies. They believe that this reflects a behavioural tendency in human beings to be overoptimistic about outcomes and their own knowledge and skills.

They also believed that the majority of organisations are insufficiently disciplined. Most attempts at best practice replication go wrong because managers place too much trust in the ability of process experts to understand and articulate how processes work. Documentation may also be fragmented or contradictory, or simply fail to reflect the underlying social reality of a process.

Many managers believe that in replicating best practice they can significantly improve on the original. This is not the case. According to Szulanski and Winter, the correct solution is to identify a working template of the process, such as a model plant or service centre, where the manager can witness the actual process and then go back and interrogate the main participants.

> [This is] *the only thing that will provide a coherent, comprehensive illustration of the knowledge you are trying to leverage* … [when] *you look directly at that activity, don't assume that you'll fully understand what makes it work any better than the experts. Adjust for your own over-confidence* … [above all] *you should copy the template as closely as you can*. (Reference 6, p 65.)

The authors' justification for copying as closely as possible resides in knowledge management theory. In other words, by making even a minor change in the process, it is possible to provoke disproportionate changes to outcomes.

However, they acknowledged one flaw in their logic which they were unable to resolve fully themselves : the need to adapt processes to different circumstances.

This is a classic problem that faces many multinational companies, particularly those based on franchising, such as fast food chain McDonald's and Starbucks coffee shops. How much of the recipe should be kept the same and how much should be changed ?

Szulanski and Winter explained that some companies, such as McDonald's, have made disastrous first attempts to adapt to certain foreign markets. On the other hand, they did not mention that McDonald's was subsequently forced to make changes in countries such as Russia and India because maintaining the existing approach would have been culturally unacceptable or economically impractical.

Starbucks too has had to change its strategy, and even a company from a inherently more adaptable culture, Sweden's IKEA, was forced to adapt to differences in the US market.

The question of when to adapt and when to remain the same puzzles analysts and also business people. 'We don't know the answers to these questions; probably Schultz [the founder of Starbucks] doesn't either' (reference 6, p 66).

How important is speed ?

If being first into a market is of dubious long-term competitive benefit, surely the ability to respond speedily to change, particularly in volatile markets, confers more durable advantages ?

Stephen Drew[7] has argued that this may not be the case, drawing an analogy between business and the animal world. Extremely fast creatures, such as cheetahs and falcons, now exist only in limited numbers, whereas there are more than 250 000 distinct species of the humbler and slower beetle.

Numerous companies have demonstrated impressive, but ultimately unsustainable, feats of rapid change. For example, the staid but profitable GEC company transformed itself into the fast-moving but finally flawed Marconi.

Drew stated that managers do not need to adjust strategy frequently to match fast-moving, volatile conditions. This is to confuse strategy with tactics.

He also did not believe that we can afford to dispense with the traditional tools of strategic analysis as pioneered by Porter and others.

> *Ignoring proven approaches is a dereliction of duty and not a badge of courage in the new economy, and above all does not accelerate effective decision making. A series of opportunistic tactics does not equate to a strategy*. (Reference 7, p 40.)

Drew argued for combining the insights of Porter and the resources-based school with the business model approach underpinning much of the e-business literature. For him, a business that is able to sustain fast movement in the market is one that is capable not just of growing rapidly, but also of sustaining superior profits through positioning or unique capabilities.

> *The sustainability of speed is a business advantage and will depend on the source and nature of the capabilities underpinning any accelerated performance. Any attempt to build speed on standard computer software or generic business processes is likely to be thwarted, as these can easily be purchased or imitated. Where speed is built on proprietary assets, organizational learning, or the complex interaction of unique skills and custom processes, then it is much more likely that sustainable advantage can be achieved … at the end of the day, it is essential that customers value speed … speed for speed's sake is not a sensible strategic objective.*
> (Reference 7, p 48.)

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Mergers and acquisitions

There was a fall in the number of mergers and acquisitions in 2001 in comparison with 2000. This was not just due to the events of 11 September. Have companies finally realised that they add little extra shareholder value ? Probably not. However, boards are learning that some types of merger and acquisition are likely to be more successful than others. Recent research reveals no magic formula, but some interesting patterns of experience are emerging.

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2001 was a lean year for merger and acquisition transactions. For example, the third quarter global mergers and acquisitions activity of $434.5 billion was little more than half of the $798.9 billion registered in the same period in 2000.

These dismal figures confirmed that global mergers and acquisitions volume, which hit record highs in the three years from 1998 to 2000, had dropped back to 1997 levels.

This was in spite of a flurry of hostile bids that had raised hopes that deal volume might be about to recover. Comcast's hostile bid for AT&T's broadband business and EchoStar Communications Corporation's offer for General Motors' Hughes Electronics satellite TV subsidiary were both announced during the quarter, and the figures also included Hewlett–Packard Company's bid for rival computer maker Compaq Computer Corporation.

The depressing global picture also applied to Europe, where the value of announced mergers and acquisitions dropped by 49% year-on-year to $98.2 billion.

Italy was the main source of deals, and these included Italenergia's bid for Montedison and Edison, and Pirelli's acquisition of a controlling interest in Olivetti.

Even before the terrorist attack on the World Trade Center in the USA on 11 September, the markets had not been very receptive to new mergers and acquisitions deals.

According to Dealogic data, the total volume of mergers and acquisitions in the UK and Ireland fell by almost 57% in the period from December 2000 to November 2001 in comparison with the previous 12 months[1]. The total value of the deals for the period also dropped sharply, from $672.6 billion to $289 billion.

2001 may well be remembered by many as the year of the difficult deal. An uncertain economic outlook, falling and volatile stock markets, zealous regulators, and negative investors conspired to make the year one of the toughest for mergers and acquisitions in recent memory.

Almost every large announced transaction ran into problems that threatened its chances of completion. For instance, shareholders in Prudential, the UK insurance group, fatally undermined its merger with its US counterpart American General by pushing Prudential's shares down so sharply that the AIG insurance group was able to step in with a counterbid. Even bigger difficulties faced those attempting to merge the Hewlett–Packard and Compaq groups.

PricewaterhouseCoopers, the financial services firm, also stated that European and US mergers and acquisitions are taking longer than ever to complete.

In Europe, the average time required to complete a deal increased by about 36 days to more than four months between 1996 and 2000. In the USA, it increased by 20 days to more than five months. The increasing size and complexity of deals may be to blame.

Competition (or antitrust) concerns in particular led to a number of blocked deals in 2001. Most notably, the European

Commission vetoed GE's acquisition of Honeywell even after US antitrust regulators had approved the transaction.

Other deals never even got off the drawing board. The planned combination of telecoms equipment groups Alcatel and Lucent Technologies foundered amid deteriorating revenues and wildly fluctuating share prices. Dynegy's proposed rescue of troubled US energy trading group Enron fell apart after the latter company had its credit ratings downgraded[2].

However, some observers see beyond the immediate gloom, arguing that the UK economy seems likely to bounce back in 2002, although a return to 1999 levels of mergers and acquisitions and initial public offering activity seems unlikely.

Criteria for successful acquisitions

The downturn in the US economy and events post 11 September have had a very real impact on deal activity everywhere. Now a company must more than ever do everything within its means to ensure that deal completion is as smooth as possible.

A 2001 report by financial services firm KPMG therefore makes timely reading[3]. It sought to identify how companies approach mergers and acquisitions deals, and then attempted to correlate the transaction with the creation of shareholder value.

For example, main board directors who had been closely involved in their company's deal were asked about the process adopted and their view of the success of the transaction. Then, for each deal, a relative measure of change in the equity price was noted pre-transaction and then a year later. This was compared with the overall trend in the relevant industry segment to arrive at an assessment of whether or not shareholder value had been created.

KPMG found that 30% of the companies surveyed created value as a result of the transaction. This was a significant improvement on its previous survey, in which only 17% of deals were found to have had a similar impact[4]. 24% of companies in Europe and 35% of companies in the USA created shareholder value from mergers and acquisitions transactions. The percentage of deals that destroyed value fell, from 53% to 31%.

However, no significant correlation was found between experience and success. In other words, those companies that were involved in a high number of transactions did not necessarily have a better track record in the creation of shareholder value.

These findings are consistent with the research of Haleblian and Finkelstein[5], who found both positive and negative effects of the acquisition experience.

For example, in the majority of cases when a firm's current acquisition was dissimilar to its prior acquisitions, acquisitions experience had a negative influence on acquisitions performance (for slightly and moderately experienced acquirers). When experience across all acquirers was examined, the graph of the results was U-shaped. The best performers appeared to be either those without experience, which therefore did not make an inappropriate generalisation error, or those which had a significant amount of experience, and so discriminated appropriately. In a minority of cases, or when a firm's current acquisition was similar to its prior acquisitions, acquisitions experience had a positive influence on acquisitions performance.

These results suggest that those firms that make multiple acquisitions within the same industry benefit by generalising past acquisition knowledge. Hence, even though it is possible to apply past experience inappropriately, poor outcomes may be avoided if firms apply experience to similar acquisitions.

The perception gap

The results of the KPMG study did not always correspond with the respondents' more subjective assessment : 75%, for example, believed that their deal had been successful in achieving its objective[3]. Why was there a discrepancy ?

Although each recognised the importance of shareholder value, some survey respondents had other, more immediate goals in mind when embarking on a transaction : 29% of respondents referred to increasing market share as their main motivation, and 28% to expanding into new geographic markets. Only 23% cited the maximisation of shareholder value.

Furthermore, when measuring the success of a transaction, only 25% of respondents evaluated its effect on shareholder value, and most also failed to measure implementation against their original objectives.

The drivers of success

In its previous survey, KPMG identified six factors that were critical in creating shareholder value[4] :

1. synergy evaluation;
2. integration project planning;
3. due diligence;
4. selection of the management team;
5. resolution of cultural issues;
6. communications.

For the 2001 survey, KPMG looked more closely at how these factors are addressed through the conduct of transactions, and what therefore constitutes best practice.

Respondents were found to agree strongly that transactions are more successful in creating shareholder value where the following apply :

- There is a robust and well managed process.
- Priorities are allocated to the activities to be carried out.
- Clear decisions are taken about how and by whom the activities should be handled.

The survey indicated that certain key practices are likely to have a significant bearing on the outcome of a transaction :

- *Early action* : Process management and other key activities are tackled at an early stage in the transaction.
- *Main board leadership* : A main board member is responsible for mergers and acquisitions policy and activity, resulting in leadership and buy-in to the achievement of transaction goals.
- *Pre-bid value assessment* : The target company and the deal are rigorously assessed. The drivers of value and the price range that will enable the purchaser to create value are understood.
- *Preparation of a formal transaction process plan* : A formal transaction process plan setting out clear roles and responsibilities is prepared before the detailed investigation into the target is carried out. This is formally reviewed and approved, and any variations to the original assumptions that arise during the process are addressed.
- *Appointment of a process manager who is involved throughout* : A dedicated process manager with appropriate skills is appointed and involved from an early stage.
- *Empowerment of a process manager with a wide ranging role* : A process manager has responsibility for key activities, including risk and issue management, deal assessment, negotiations and implementation.
- *Independent assessment of post deal implementation* : External advisers are used to provide independent evaluation of the implementation process and measurement post completion.

The combination of these practices is most likely to lead to a successful transaction. The more of them that are adopted, the more likely it is that the deal will increase shareholder value.

The study found that successful companies undertake nearly all the practices earlier than those that fail to create value.

There were significant differences in the adoption of key practices by respondents in Europe and the USA. For example, in European companies, a main board director is more likely to be responsible for the transaction, and a formal plan is more likely to be in place at the earliest stages. In US companies, process managers are more heavily involved than those in Europe, and more emphasis is placed on pre-bid value assessment and issue management.

What kind of deal is likely to succeed ?

Research by the management consultancy McKinsey & Company has confirmed that half or more of the big corporate mergers, acquisitions and alliances fail to create significant shareholder value. The average corporate-control transaction merely puts the market capitalisation of the company at risk and delivers little or no value in return.

Thus companies should only pursue what McKinsey terms above-average deals. What determines an above-average deal ? McKinsey consultants Bieshaar, Knight and van Wassenaer took the question to the stock market, in a study that examined the stock price movements of companies involved in corporate deals a few days before and after the announcement of a transaction[6].

Using multivariate linear regression, they tried to explain the movements in terms of several deal variables, such as deal size, industry, and deal type. They found that there are significant differences in the market's reaction to the various structural forms that a deal may take :

- acquisition;
- merger;
- sale;
- joint venture or alliance.

Mergers and asset sales, for example, were found to define the baseline : the market shows neither a particularly positive nor a particularly negative reaction to them.

Acquisitions, by contrast, were seen to boost the announcement impact of a deal on the acquirer's stock by 2.7% of market capitalisation. This is noteworthy, since acquirers usually pay a hefty acquisition premium, and some past studies have shown the opposite to be the case. Perhaps the most likely explanation is that it is always clear which company controls the post merger integration process in an acquisition. Synergy is more likely when competing management teams are not fighting turf wars, as is the case in some mergers.

The announcement of joint ventures and alliances, however, lags behind the average by 3.1% of market capitalisation. Perhaps the investment community views these deals as incomplete asset combinations that create few immediate synergies and can limit a company's strategic options as well as sapping the attention of managers. Of course there are always exceptions to the rule, but the study illustrated quite clearly that partial deals are more likely than others to diminish a company's value[7].

Contrary to expectations, the study found that neither the size of the deals nor the frequency with which companies pursue them have a positive effect on a company's market capitalisation at the time of an announcement.

The researchers had expected that a big deal, with the potential for greater synergies, would create more value than a small one. They had also thought that those companies doing deals frequently would create more value with each transaction, since these experienced companies would each time be more skilled at completing and then managing the post merger integration process.

In fact, and in accordance with the results discussed above, they do not seem to enjoy any special advantage over their competitors. Why is this ? Perhaps investors recognise that these companies are better at doing deals, and thus expect them to do an above-average number, with above-average execution, in the future. If this is the case, these superior deal-making skills are then embedded in the pre-announcement stock price, and do not show up in the market's reaction to the deal announcement.

The study also identified two features outside the immediate control of managers that seem to be capable of affecting a deal's positive outcome (in keeping with convention, the study defined success narrowly, by the stock market's immediate reaction) :

- The sample of 231 transactions came from three industry sectors : global telecommunications, global petroleum, and European banking. A deal in the telecoms or banking sector was correlated with a 2.3% or 2.0% increase, respectively, in the deal's average impact on the company's stock price. By contrast, competing in the petroleum industry destroyed 4.3% of shareholder value relative to the average. The study concluded that the explanation is that there are potential synergies and transfer skills to be gained through transactions in the growing banking and telecoms industries. However, petroleum is a relatively stagnant and consolidated industry.

- Underperforming companies (with returns below the average of a local stock market index during the five year period under study) appeared to create 1.2% more value per deal than did those companies outperforming the norm. Is this a strange paradox ? This is probably not the case, as some outperformers may already have future 'good deals' built into their share price, and so the market gives them less credit for good news[8]. Alternatively, investors perhaps expect underperformers to use their deals to gain access to the important skills and knowledge they currently lack, whereas outperformers merely gain tangible assets. Finally, hubris may also be a factor : managers of outperforming companies may be less concerned with market reaction when they can rest on the laurels of a strong share price.

There seems to be no magic formula that guarantees success in corporate-control transactions.

As many companies have learned, investors and securities markets can be fickle, and even the most carefully crafted deals can meet with market scepticism when they are announced.

However, the research suggested that companies can greatly improve their chances through the following measures :

- They should pursue transactions aimed at expanding the company's current lines of business, and avoid taking the company into entirely new activities.
- All else being equal, it is better for them to acquire than to merge, and better for them to merge than to ally.
- If they are competing in a growing or fragmented industry, they can expect better deal opportunities than they would get in a more mature or consolidated industry.
- If they are an underperformer and they announce a well conceived deal, they can look forward to a larger boost to their share price than a top performer would enjoy.

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