

**THE VALUE OF THE MIDDLEMAN IN THE SUPPLY  
CHAIN OF SOUTH AFRICAN TYRE PRODUCTION**

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By

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## Executive Summary

Only a few middlemen linking chemical intermediate product supply to world tyre productions have managed to survive new direct business models. In fact, the only region, where the practice of using a middleman in the supply chain of tyre production, for a certain primary manufacturer, is in South Africa. Tyre producers in other world regions, similar in market complexity to South Africa, have experienced the elimination of the middleman. Hence the question of this research, why is the middleman in the supply chain of tyre production in South Africa still a better option than that of direct business models?

To begin with, the thesis stated that the middleman in the supply chain of South African tyre producers delivers better value than that of the direct business model. To prove/disprove this thesis, the principle that value is a trade-off between what you get for what you give was the basis of this research (Zeithaml, 1998). Further, a model was developed, from secondary literature, to conceptualise this *trade-off* to provide evidence to prove/disprove that the middleman provides greater value than value from the direct business model.

From this point, the research approach was to collect data through interviews to find out the most important aspect of value created by the middleman. Data collected were analysed, using the structure of the model as a guide, to find evidence of the *trade-off*. This analysis provided evidence that the *relationship* between the middleman and the tyre producers in South Africa and between the middleman and primary product supplier is the *value* that the direct business model cannot replace.

## **Acknowledgements**

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# Table of Contents

Executive Summary .....	2
Acknowledgements .....	3
Table of Contents .....	4
<b>CHAPTER 1 INTRODUCTION.....</b>	<b>6</b>
1.1 Background to the research problem .....	7
1.2 Perceived value .....	9
1.3 Research questions and purpose .....	11
1.4 Research approach .....	12
1.5 Research Structure .....	12
<b>CHAPTER 2 LITERATURE REVIEW.....</b>	<b>14</b>
2.1 Introduction.....	14
2.2 Perceived Value .....	16
2.3 Perceived benefits .....	21
2.3.1 Product .....	22
2.3.2 Service.....	23
2.3.3 Distribution .....	26
2.4 Exchange sacrifices.....	31
2.4.1 Price .....	31
2.4.2 Process cost.....	32
2.5 Conclusion .....	33
<b>CHAPTER 3 RESEARCH METHODOLOGY .....</b>	<b>35</b>
3.1 Introduction.....	35
3.2 Research objective .....	35
3.3 Research paradigm.....	36
3.4 Qualitative case study methods.....	37
3.5 Data generation .....	40
3.5.1 Sample.....	40
3.5.2 Interviews.....	41
3.6 Data analysis .....	44
3.7 Ethical considerations .....	45
3.8 Conclusion .....	46
<b>CHAPTER 4 RESEARCH FINDINGS .....</b>	<b>47</b>
4.1 Introduction.....	47

4.2	Value perceptions of the principal and South African tyre producers .....	48
4.2.1	Value, the principal and the agent .....	49
4.2.2	Value, the customer and the agent .....	52
4.3	Attributes of value in terms of product, service and distribution .....	55
4.3.1	Value and the product .....	55
4.3.2	Value and service .....	57
4.3.3	Value and distribution .....	60
4.4	Exchange sacrifices .....	67
4.4.1	Price .....	67
4.4.2	Process cost .....	71
4.5	Conclusion .....	71
<b>CHAPTER 5 CONCLUSIONS .....</b>		<b>73</b>
5.1	Introduction .....	73
5.2	Conclusions about the two research questions .....	74
5.3	Implications for theory .....	82
5.4	Limitations and further research .....	83
5.5	Conclusion .....	84
<b>REFERENCES.....</b>		<b>85</b>

## CHAPTER 1 INTRODUCTION

Trade and investment liberalisation, globalisation, technological innovations, computers and telecommunications have combined to create unlimited customer choice, a higher level of competition and an ever-increasing pace of change (Hill, 2005; Prahalad & Ramaswamy, 2004). These changes have forced manufacturers of goods to become more integrated as consolidation results in improved efficiency, better quality and service and cost reductions (Grönroos, 2004; Ravald & Grönroos, 1996; Sheth & Parvatiyar, 1995).

The integration of organisational structures has led to manufacturers selling and distributing their goods directly to the customer. In addition, integration means the removal of transactions from middlemen and organising it internally (Williamson, 1973). The implication of bypassing traditional dealer distribution channels to sell directly to the customer, first coined by Dell Computers as the “direct business model” (Magretta, 1998: 73), is disintermediation or “elimination of the middleman” (Rosenbloom, 2004: 16). According to Ellis (2005), it is a natural progression, when markets mature and information diffuses, that middlemen risk being bypassed by their customers to promote supply chain integration.

However, the direct business model has enjoyed varying degrees of success due to typical large business bureaucracies (Magretta, 1998) and marketplace idiosyncrasies (Williamson, 1981; Ouchi, 1980). For example, European rubber chemical product manufacturers still make use of middlemen in South Africa to mediate product exchanges as opposed to other geographical regions where they have eliminated middlemen in the supply chain of tyre production. In accordance with this phenomenon, the

aim of this research is to understand why middlemen are still mediating exchanges in the supply chain of South African tyre production.

## **1.1 Background to the research problem**

During the politically turbulent 1970's and 1980's many multinational companies withdrew from South Africa in support of international sanctions to force the government of the time to abandon its racist policies. Included amongst these were multinational tyre producers, such as Bridgestone Firestone, Continental and Goodyear who also divested in South Africa in support of international sanctions (Swart, 2004). Because the residual tyre production facilities acquired by local conglomerates remained world class, the return of tyre producers, following a new democracy in South Africa in 1994, was seamless (Swart, 2004).

According to Swart (2004), the reintegration of the South African production facilities with their original brand owners brought a myriad of large corporate company benefits such as economics of scale in procurement processes. In particular Swart (2004) is referring to cost economics realised from the effects of serving regional production requirements from a central location (Hill, 2005).

For example, suppliers negotiate supply agreements with the central purchasing offices of tyre producers. One of the consequences of central negotiations was the change in role of the middleman under study from distributor to commission agent. This change supports the cause and effect relationship of supply chain integration as discussed in the previous section. Further, the main difference between commission agents and distributors is that commission agents do not take ownership of goods for the purpose of reselling (Lamb, Hair, McDaniel, Boschoff and Terblanche,

2000). The American Marketing Association (2005) defines commission agents as:

...agents who generally operate on an extended contractual basis; often sell within an exclusive territory; handle non competing but related lines of goods; possesses limited authority with regard to prices and terms of sale.

The middleman is referred to as the agent. In addition, the agent represents several multinational manufacturers of intermediate or input products used in the production of tyres.

The manufacturer of intermediary rubber chemical products is referred to as the principal. The principal and agent operate under an exclusive agreement that is consistent with the above definition of commission agents.

The principal is a world-leading manufacturer of rubber chemical intermediary products commanding the largest share of the global market for rubber curatives and antioxidant chemicals (Ahston, 2004). These products are manufactured in factories located in the UK and Europe (Ashton, 2004). The reasons for a principal to have a continued relationship with an agent in the supply chain of South African tyre production, when he does not make use of middlemen anywhere else in the world, is the focus of this study.

In turn, the tyre producers in South Africa are continuing to channel product procurement and administration through the agent (Ashton, 2004; Dunwoodie, 2004; Swart, 2004). Furthermore, both tyre producers in South Africa and their respective central purchasing locations are aware that the agent benefits financially from commissions earned by

administering their orders even though supply agreements are exclusively concluded by the principal (Ashton, 2004). To clarify, agents who administer customer orders on behalf of sellers are according to Rosenbloom (2004) limited to facilitating information and promotion flows related to coordinating the physical product flow from manufacturer to customer.

This research contends that the direct business model cannot match the agents' value contribution in this administration process in the supply channel of tyre production in South Africa. Thus, the focus of this study is to determine whether the perception of the value delivered by the agent would be sustainable and thus prevent elimination from the supply channel. The aspect of perceived value is introduced in Section 1.2.

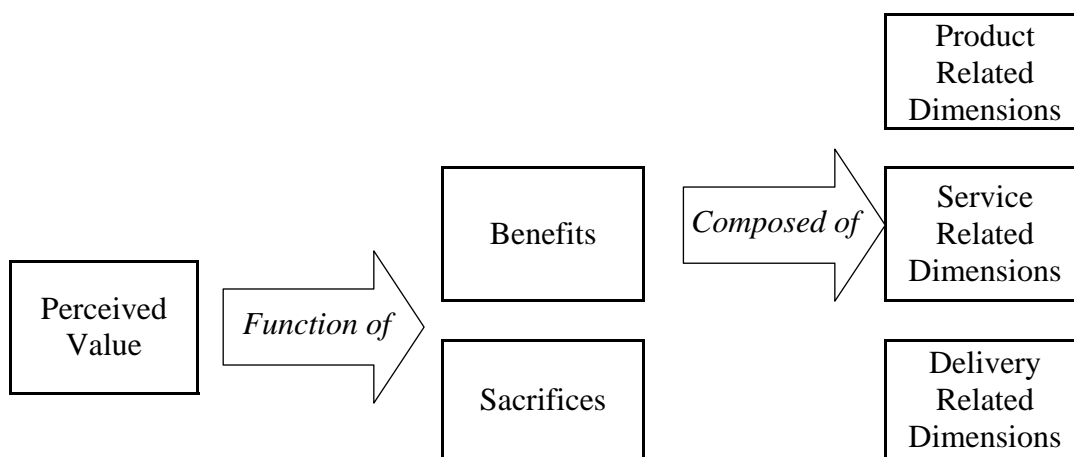
## **1.2 Perceived value**

As C.S. Lewis said, "What you see and hear depends a good deal on where you are standing" (Connolly & Rianoshek, 2002: 40). And understanding where you are standing, in terms of value, reveals the information that underlies the cognitive evaluations of experiences (Rao, 2002; Anderson & Narus, 1998). In this context, evaluating past experiences is simply matching something now with something from the past to form perceptions (Connolly & Rianoshek, 2002; Ulaga & Chacour, 2001). Moreover, perception is a human reaction governed by habit, history, belief and culture (Connolly & Rianoshek, 2002). Therefore in a business setting, the perceptions of value received are forces from subjective past experiences about what has been gained when compared to what has been given away (Forsstrom, 2005; Gronroos, 2004; Eggert & Ulaga, 2002; Ulaga & Chacour, 2001; Lapierre, 2000; Zeithaml, 1998; Lapierre, 1997).

In Zeithaml's (1998: 13) seminal work on consumer perceptions, "value is considered as all relevant *get* components as well as all relevant *give* components". The give components of value are the sacrifice made by the customer, while the get components are the benefits to the customer (Zeithaml, 1998).

Lapierre (1997; 2000) and others (Ulaga & Eggert, 2003; Eggert & Ulaga, 2002; Ulaga & Chacour, 2001; Anderson & Narus, 1998; Bagozzi, 1974) described perceived value in the exchange paradigm as the differences between benefits and sacrifices. Because the exchange paradigm is the transfer of things-of-value in return for payment (Kotler, 2001), perceived value is the function of benefits and sacrifices composed of product, service and delivery related dimensions (Ulaga & Chacour, 2001; Lapierre, 1997). This concept is illustrated in Figure 1 below.

**Figure 1: Components of perceived value**



**Source: Adapted from (Lapierre, 1997; Ulaga & Chacour, 2001).**

The common elements of perceived value identified in the preceding paragraphs are the multiple dimensions of product, service and delivery (Eggert & Ulaga, 2002; Ulaga & Chacour, 2001; Lapierre, 1997). The perception of these common elements is influenced by competing activities of rivals forging the experience that determines perception (Ulaga & Eggert, 2003; Eggert & Ulaga, 2002; Ulaga & Chacour, 2001; Anderson & Narus, 1998). These elements are considered in structuring the research questions discussed in the following section.

### **1.3 Research questions and purpose**

Kim and Mauborgne (1997) investigated high growth businesses and found that they used product, service and delivery as platforms to launch value for their customers. To measure customer's perceptions of value strategies, Lapierre (2000) developed a model to measure value as benefits weighted against sacrifices. The model was based on Zeithaml's (1998) findings that perceived value equals benefits minus sacrifices. Lapierre's (2000) model explains the various concepts of benefits and sacrifices exchanged between businesses and is adapted for this research based on Kim and Mauborgne's (1997) dimensions of product, service and delivery weighted against the sacrifice dimensions of price and process costs (Eggert & Ulaga, 2002; Lapierre, 2000). The model adapted for this research is illustrated in Figure 2 of Chapter 2.

This research will test the above model to determine:

- i. Why the value provided by middlemen in the supply chain of South African tyre production is perceived to be greater than that derived from direct business routes, and

- ii. Identifying the most important aspect which contributes to the value of the agent.

The purpose of this research is to give agents some insight into their value in the supply channel of South African tyre production. By demonstrating that the benefits outweigh the sacrifices, the agent can begin to develop value proposition strategies to continue to earn the support of their customers.

#### **1.4 Research approach**

The research approach is to create an understanding of a phenomenon through the positivist criteria of internal and external validity, reliability and objectivity (Winegardener, 2004; Smith, 1999a; Denzin & Lincoln, 1994) striving for an objective truth of a tangible social reality (Remenyi, 1996). The method used is an explanatory case study where most of the data have been gathered through interviews (Winegardener, 2004; Yin, 2003; Smith, 1999a), which imply that the researcher and those being studied interact with one another (Yin, 2003).

The researcher conducting this study has a prior understanding of the relationship between the agent, principal and tyre production in South Africa. This understanding has been gained through two decades of working experience in the tyre production marketplace. The conceptual understanding of how value is created and perceived is developed through a review of the literature in Chapter 2.

#### **1.5 Research Structure**

This dissertation has five chapters. Chapter 1 introduces the background of fundamental business and environmental changes that have impacted on

both the role and the value of the middlemen in the supply channel of South African tyre production. This is followed by a brief introduction to the concept of perceived value in business before introducing the goals and objectives of this research.

The literature review undertaken in Chapter 2 examines how value is perceived in business markets. Benefits and sacrifices that influence perceptions are assembled into a theoretical framework to manage and interpret data collection for analysis.

The case study methodology used in this research is discussed in Chapter 3. This methodology is used to examine the research problem. Furthermore, this chapter discusses the data generation and protocols characteristic of qualitative research.

Chapter 4 tables and reports the findings of the research according to the methodology in Chapter 3. Chapter 5 provides concluding discussions and recommendations flowing from the research findings in Chapter 4.

## CHAPTER 2 LITERATURE REVIEW

### 2.1 Introduction

The previous chapter introduced the research problem of how value created by agents is perceived by South African tyre manufacturers. The aim of this chapter is to review the concept of perceived value within Lapierre's (2000) theoretical framework. To do this, this chapter will demonstrate that perceived value in business markets is the difference between the benefits which have been received in exchange for the costs incurred.

To measure if having an agent to mediate exchanges between suppliers and manufacturers is better than dealing directly with suppliers, a framework was developed using the benefits of product, service and distribution as value adding benefits in business markets. These three concepts are based on the findings of Kim and Mauborgne (1997), who have demonstrated that businesses pursuing value strategies through product, service and delivery (distribution) show improved profitability. According to Kim and Mauborgne (1997) "the companies we studied that were most successful at repeating value innovation were those that took advantage of all three platforms on which value innovation can take place: product, service and delivery."

Similarly, Ulaga and Chacour (2001) and Lapierre (2001; 1997) demonstrated that value is added in business by focussing on the platforms of product, service and *relationship*.

Ulaga and Chacour (2001), Kim and Mauborgne (1997) and Lapierre (1997) agree on the importance of focussing on the two platforms of product and service and while Kim and Mauborgne (1997) focus on delivery as a third platform, Ulaga and Chacour (2001) and Lapierre (1997) focus on relationship as a third platform. In light of this research both delivery (distribution) and relationship are important aspects of the value of the middleman.

In support, “The precise meaning of the three platforms varies across industries and companies, but in general, the product platform is the physical product; the service platform is support such as maintenance, customer service, warranties and training for distributors and retailers; and the delivery platform includes logistics and the channel used to deliver the product to customers” (Kim and Mauborgne 1997).

Distribution is supported by Baker and Littler (1999) and others (Lamb, Hair, McDaniel, Boschoff & Terblanche, 2000; Dodge 1970) as one of the most important strategies in business-to-business (B2B) markets. Of further interest to this study is the fact that Williamson (1981) and others (Rindfleisch & Heide, 1997; Klein, Frazier & Roth, 1990; John & Weitz, 1988, Anderson & Gatignon, 1986, Anderson 1985; Frazier, 1983) have demonstrated that enhanced efficiency in distribution channels reduces costs, which is a major source of overall value.

Service is part of Ulaga and Chacour (2001) and Lapierre’s (1997) benefit concepts and therefore consistent with Kim and Mauborgne’s (1997) service value platform. Also, service is an expected performance in B2B markets to augment the product at the core of the exchange (Baker & Littler, 1999). According to Grönroos (2004) and Gummesson (1998), service cannot be differentiated to add value when a similar service is also

available elsewhere and when that happens, service becomes standard to a product. However, Grönroos (2004) found that service in the best case scenarios can enhance the value of products and in the worst case scenarios, can destroy a product's value. Thus, service is considered an important concept to this study and considered as integral to the product and distribution process.

To receive benefits certain sacrifices are made. The first and most important sacrifice is the monetary price paid. Second are the process costs which involve all the processes that are required for a timely delivery of a product (Ulaga & Chacour, 2001). Heskett, Jones, Loveman, Sasser and Schlessiner (1994) and Kotler (1972) argued that value to the customer means the results that they receive in terms of monetary price and other costs, such as time, energy and feelings incurred.

This section has introduced product, service and distribution as benefit platforms to deliver value to the customer and the customers' sacrifices of price and process costs. These concepts are considered the most relevant to the study of perceived value in distribution channels.

Next, the chapter introduces the concept of perceived value and the theoretical framework, adapted from Lapierre (2000) to include Kim and Mauborgne's (1997) value platforms.

## **2.2 Perceived Value**

The aim of this section is to introduce the reader to the concept of perceived value, as well as to a theoretical model to test how the value propositions developed from empirical research by, Ulaga and Chacour (2001), Lapierre (2000) and Kim and Mauborgne (1997) are perceived.

As mentioned in Chapter 1, perceptions are formed by comparing something in the present with an experience in the past (Connolly & Rainoshek, 2002). For example, if a benefit is received today at a lower overall cost than in the previous week, the human perception will interpret the change as an improved experience. Further, Connolly and Rainoshek (2002) and Ulaga and Chacour (2001) argued that perception is governed by past experiences.

Lapierre (1997) supports the fact that perceptions originate in the need system of individuals and further argues that needs are only satisfied when expectations are met. Thus perceptions are influenced by subjective past experiences which individuals use to make judgements. Further, since it is people who form perceptions, perceived value is entirely dependent upon the individual experience and therefore a difficult concept to measure (Forsström, 2005; Vargo & Lusch, 2004, Payne & Holt, 2001; Tzokas & Saren, 1997).

Lapierre (1997) demonstrated that value is an individual and situational construct and therefore different levels of people in business will respond differently to received-value. Ulaga and Eggert, 2003 and others (Payne & Holt, 2001; Ulaga & Chacour, 2001) concur that people in business do not have an unequivocal understanding of what value means because neither businesses nor people are homogenous.

Although perceptions are dependent on past experiences, Kim and Mauborgne (2000; 1997) and others (Treacy & Wiersema, 1993; Rackahm & De Vincentis, 1999) have shown that by focussing on improving value by concentrating on product, service and distribution, the perceptions of a business or an individual could be influenced to reach an unequivocal understanding (meaning that they establish a benchmark).

With this knowledge, businesses can start to develop value-creating strategies according to their own strengths and in doing so influence customer expectations. For example Treacy and Wiersema (1993) and Hamel and Prahalad (1990) argued that businesses using value-creating propositions that were based on their own competencies could refine customer expectations. By taking advantage of their strengths they could therefore differentiate themselves from rival competitors. As mentioned, Kim and Mauborgne (1997) found that businesses differentiating on value were high growth companies.

Other writers on value proposition strategies (Prahalad & Ramaswamy, 2004; Rackahm & De Vincentis, 1999; Drucker, 1954) argued that a value proposition strategy that is exclusively based on the competencies of the supplying business would fail if the propositions were not congruent with the need system of the receiving business. However, it is the contention of this study that both views on value creating propositions are credible and interrelated.

As suppliers vie for business, customers over time experience benefits from new value strategies and develop a higher level of understanding of received value; their expectations are raised. Thus value proposition strategies employed alter and improve perceptions. This thinking is both supported and consistent with Eggert and Ulaga (2002) and Anderson and Narus (1990; 1998) who stated that perceived value is an impressionable cognitive variable. For example Grönroos (2004) and Gummesson (1998) pointed out that service has become an expected standard but one that must be consistent. A lapse in the quality of service can destroy any historical value that was created through high levels of service; the customer has a short memory.

A more recent publication by Prahalad & Ramaswamy (2004), argues that value cannot be created without integrating the customer into the process. According to Lapierre (2000) engaging the customer to establish value propositions can only be achieved by distinguishing between concepts such as product, service and distribution. Further these concepts should be developed in line with that which the customer values (Lapierre, 2000; Rackham & De Vincentis, 1999), for example, a customer focusing on the cost elements of value would require a value proposition strategy that is about lessening the costs and effort of the customer to acquire the product (Rackham & De Vincentis, 1999).

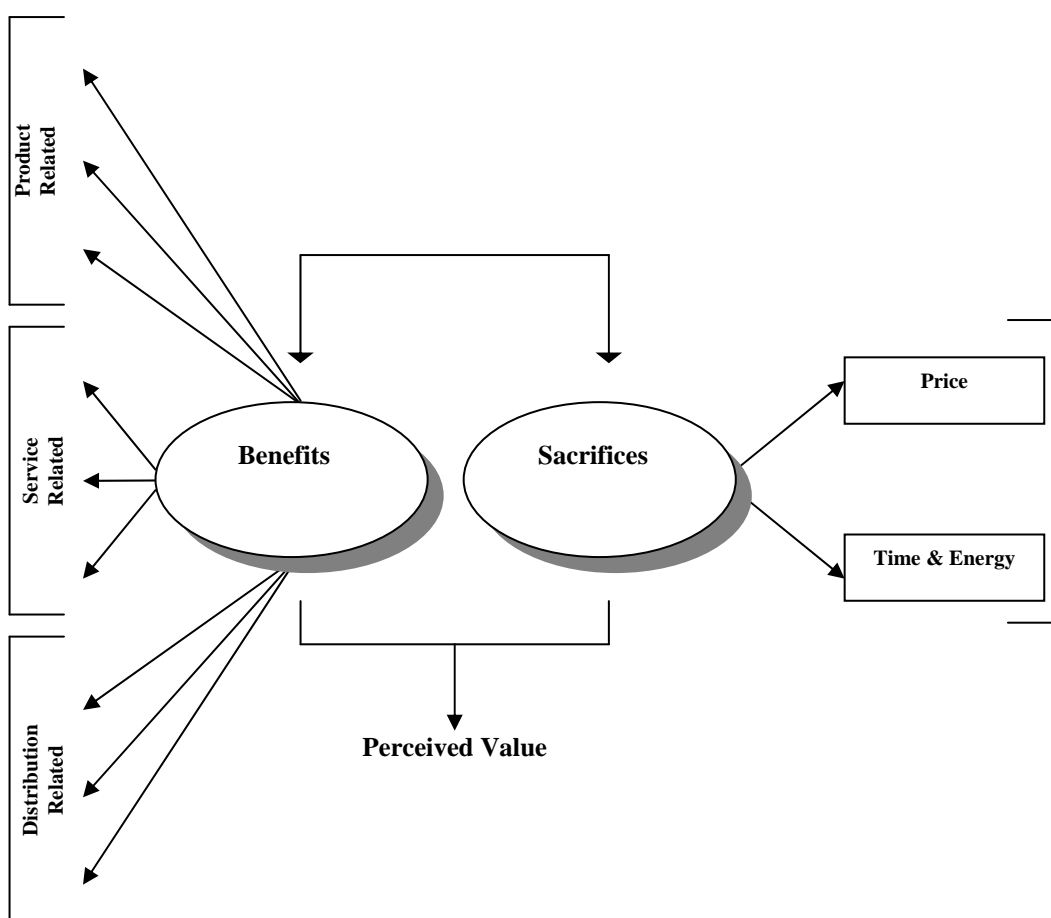
To determine how a strategy that uses value as its main thrust (value proposition strategy) should be shaped, the customer's perceptions of such propositions must be determined. According to Ouchi (1980) and others (Handy, 1998; Winter, 1998; Chandler, 1992; Coase, 1937), profit is the signal that indicates to a business if their performance in the market place was useful. However, waiting for changes in profit to indicate if a value proposition strategy resonates with customers could be fatal. Profits are also affected by other factors such as demand and supply, rival pricing strategies and increased operational costs, to name a few.

In the Kim and Mauborgne (1997) study however, growth in profits applied because the study that they conducted was based on historical performances that were linked to value platforms to draw their conclusions. A much faster feedback on customer value perceptions is needed; it would be useful to be able to measure the *anticipated* value that a supplier would give instead of *reflecting* on profit levels.

To achieve this a model can be used, as illustrated in Figure 2. This model is adapted from Lapierre (2000) and shows Kim and Mauborgne's (1997)

value platforms on the left hand side of the framework which, combined, indicate overall customer benefits. Based on Zeithaml's (1998) equation that  $\text{value} = \text{benefits} - \text{sacrifices}$ , the framework illustrates that the benefits are weighted against the sacrifices of price and process cost as detailed on the right hand side of the framework.

**Figure 2. A theoretical framework measuring perceived value**



**Source: Adapted from Lapierre (2000: 129)**

The aim of the model in Figure 2 is to measure the worth of an individual supplier so that suppliers can be compared to each other. The difference is obtained by comparative ratings based on what a customer *gives* for what a customer *gets*. For example, a customer would be asked to respond by

rating supplier A against supplier B, weighting each benefit attribute against each of the sacrifice dimensions. For a supplier this information is important because he can then ascertain if the value he delivers is greater or lesser than that of his competitor.

Walter, Mueller and Helfert (2005) recently found and therefore suggested that a realistic view of value creation would include the performance of product and service attributes and the social benefits of relationships. The benefit platforms of product, service and distribution are discussed next.

### **2.3 Perceived benefits**

According to Payne and Holt (2001: 168) perceived benefits represents “a combination of a number of elements which may include physical attributes, service attributes and technical support available in relation to the use of the product”. In line with this, the aim of this section is to review the benefit platforms of product, service and distribution. The setting of this research is in a Business-to-Business (B2B) marketplace where the medium of distribution is middlemen.

By way of introduction, a market is where demand and supply are expressed and a marketplace is where businesses address their own specific demand and supply (Houston & Gassenheimer, 1987; Kotler, 1972). Further, when a market offering is referred to it is inclusive of the three value platforms. According to Vargo and Lusch (2004) and others (Lamb, et al., 2000; Baker & Littler, 1999; Lapierre, 1997; Houston & Gassenheimer, 1987) a market offering exchanged between businesses is typically product and medium of distribution supported by services and relationships.

### **2.3.1 Product**

In B2B markets, products are predominantly used in combination with other products to manufacture finished goods (Lamb, et al., 2000; Baker & Littler, 1999; Dodge, 1970). Demand for a particular finished good by consumers has an indirect impact on B2B products, as it will affect the demand for components making up that product (Baker & Littler 1999; Dodge, 1970). For example, in the production of tyres, an increase in consumer demand will result in an increase in demand for rubber chemical products that in its production depends on petrochemicals, which are derived from crude oil (Business Monitor International, 2005; Ashton, 2005; Dunwoodie, 2005).

According to economists, economic purpose is production and distribution to satisfy existing demand and to satisfy this demand products are transferred from one business to another. Vargo and Lusch (2004) and Houston and Gassenheimer (1987) supported the fact that economic purpose is product exchanged and stated that it is purely the transfer of products between separate businesses in return for payment. Thus, both a consumer and a product are necessary for value to be produced (Tzokas & Saren, 1997).

For a product to be in demand, Houston and Gassenheimer (1987) argue that the product must have a specific property namely its use-value. This contention is further supported by others (Vargo & Lusch, 2004; Tzokas & Saren, 1997; Sheth & Parvatiyar, 1995) who referred to built-in properties of a product as its use value. Further, Ambler (2004) stated that use value is the function that a product serves during the production of other goods. Thus in terms of economic theory, the exchange will take place when a product has both use value and demand (Vargo & Lusch, 2004).

In summary, the product is directly linked to its use value, which in turn establishes demand. A product's use value, in context of B2B markets, is only consumed when it is used in combination with other products or components to produce other goods.

### **2.3.2 Service**

Leading on from the previous section, both service and product have use value and therefore will be consumed. However, the consumption of a service, that accompanies a product exchange, may take place at a different time to that of a product (Gummesson, 1998). Both product and service deliver value but the value is delivered at different times during the process of exchange (Grönroos, 2004; Gummesson, 1998).

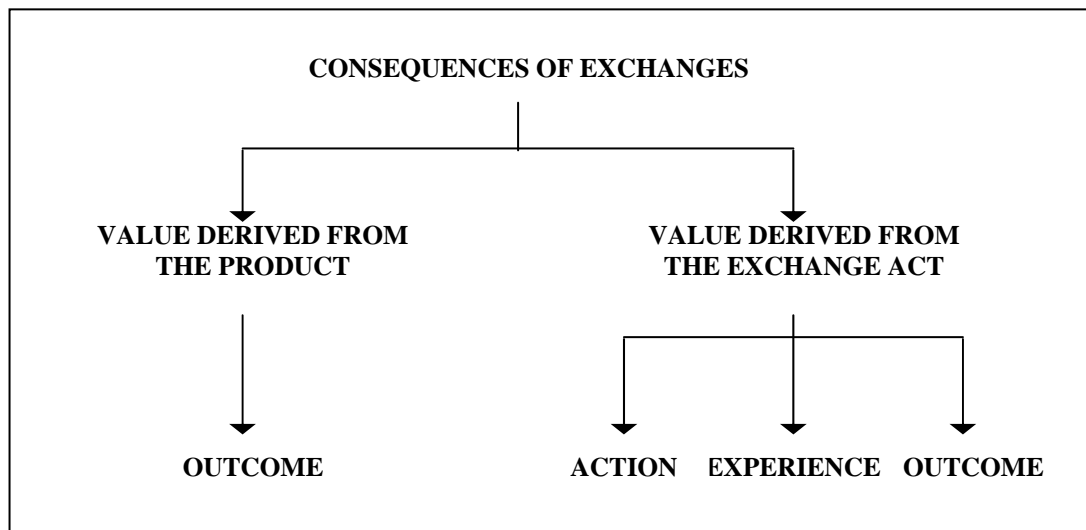
Parasuraman, Zeithaml and Barry (1985) argued that the production and consumption of service are inseparable. For example a customer buys a product for its use value but for the product to be used it has to be delivered to where it will be used and the customer may then use the product at a later date. This shows that the product bought produced a delivery requirement. The customer will have an experience at each of the stages of this process (sale, delivery, use) and at the conclusion of the process will have a collective experience (Kim & Mauborgne, 2000). At each of these points the perception of value can be measured.

As a result, service as a product attribute, is an expected performance and therefore often considered standard to the product (Grönroos, 2004). Houston & Gassenheimer (1987) and Bagozzi (1978) found that the exchange must broadly satisfy the cause and effect that determine the exchange. Accordingly, the product and service combine to complete the exchange (Gummesson, 1998). Therefore, in business markets, value

experienced by the consumer of a single discreet exchange could be over a period of time and deliver different expectations in terms of value (Houston & Gassenheimer, 1987).

Houston and Gassenheimer (1987) showed that the consequences of an exchange illustrate value as derived from the exchange act. Figure 3 presents a graphical illustration of the consequences of exchanges.

**Figure 3. Consequences of exchanges**



**Source: Houston and Gassenheimer (1987:7)**

Figure 3 above further illustrates the use value derived from the product and/or service and is supported by Ambler (2004) who stated that value is derived from the product's function. Vargo and Lusch (2004) and Tzokas and Saren (1997) argue that use value is objectivist value against which humans make judgements of worth based on how well intrinsic properties can meet the needs of the user.

Tzokas and Saren (1997) argue paradoxically that a product can have intrinsic properties that keep it in demand, a certain worth not dependent on what people think of it.

Value derived from the exchange act must be derived at each level of the exchange act, which are the action, the experience and the outcome (Houston & Gassenheimer, 1987). Gummesson (1998) found that the experiences from these behaviours provide incentives to customers for repurchasing loyalty. Consistent with this view are the findings of Treacy and Wiersema (1993) and Rackham and De Vincentis (1999) that value disciplines influence experience of value and therefore impressions of the market offering.

A products' intrinsic properties and the exchange experience, as discussed above, are supported by Smith (1999b) who argued that value has two different meanings; value in use and value in exchange. Furthermore, Payne and Holt (2001) suggested use value (product and service attributes) and exchange value (performances) are linked to a customers' perception of overall value.

Thus, although the use value of the product is the core of the exchange, the role of the service activities on top of the exchange could enhance the customer's overall exchange experience (Grönroos, 2004). Anderson and Narus (1998) and others (Tzokas & Saren, 1997; Houston & Gassenheimer, 1987; Bagozzi, 1978; 1975; 1974) found that the expected outcome of a market offering is a subjective experience. In other words, that judgement of the user is based on past experiences. And this is consistent with Gummesson's (1998) point that a bad service experience can ultimately lead to the destruction of the overall value of a market offering.

On the other hand, good service provides the building blocks for relationships. According to Grönroos (2004) and others (Tzokas & Saren, 2004; Payne & Holt, 2001; Gummesson, 1998; Sheth & Parvatiyar, 1995) customer loyalty is achieved through collaborative efforts to enhance customer experiences of value beyond the mere exchange and this process is the core of relationship marketing. In support, Vargo and Lusch (2004) argued that customers develop relationships with suppliers who provide an entire host of services over an extended period.

Taking care of the customer through service indicates the existence of social interactions between parties beyond the exchange (Grönroos, 2004; Tzokas & Saren, 1997; Grönroos & Ravald, 1996; Bagozzi, 1978). Thus the consequences of service attributes are the non-economic relationship bonds of trust and commitment. Although there is no general consensus, extant literature refers to trust, commitment and satisfaction as characteristics of high value relationships (Van Bruggen, Kacker & Nieuwelaat, 2005; Tzokas & Saren, 2004; Cann, 1998; Morgan & Hunt, 1994).

In summary, service, like product has a use value. Service contributes to the overall experience of the act of the exchange and because this experience is subjective, service could influence buyers' perceptions of a market offering. Further, a focus on service activities is necessary to retain customers and for repeated business. The attributes of service activities are the building blocks of high value relationships.

### **2.3.3 Distribution**

Distribution could be considered as part of a service strategy to create value. However, if product and service amalgamate in creating value,

what value is created through distribution and in particular channel distribution? Thus, the aim of this section is to introduce channel distribution and demonstrate how efficiency in the channel can create value.

According to Ellis (2005), Rosenbloom (2004) and Stern and Reve (1980), the function of middlemen can narrowly be defined as linking buyers and sellers. This link is also referred to as a supplier's integration with a market place. The degree or level at which a supplier chooses to integrate with a market place is dependent on their ability to organise their transactions (Williamson, 1981; Ouchi, 1980). For example a supplier will use a middleman when the middleman can perform transactions more efficiently than they can themselves (Rosenbloom, 2004).

According to Lamb, et al. (2000) and others (Baker & Littler, 1999; Dodge, 1972) the most important strategy for suppliers in B2B markets is how to get the product to the customer. This is mainly due to the fact that B2B markets are often geographically concentrated (Baker & Littler, 1999; Dodge, 1972) and as such each marketplace would require a distribution strategy that works most efficiently with the peculiarities of that marketplace. For example, a marketplace located close to the origin of a seller's product would require a different delivery strategy to the marketplace remote from the product's origin. In support, Baker and Littler (1999) and Dodge (1972) argue that distribution channels as a strategy are common in remote marketplaces.

According to John and Weitz (1988) and others (Williamson, 1981, Stern & Reve, 1980; Bagozzi, 1978) a distribution channel is established when a supplier externalises its activities to rely on middlemen to interface and mediate exchanges with the marketplace. According to Rindfleisch and

Heide (1997) and others (Klein, Frazier & Roth, 1990; Williamson, 1981) a business will externalise its transactions when a market can perform these transactions at a lower or absence of costs than integrated channels.

Distribution efficiency is an important concept to create value (because efficiency lowers cost) for the customer in B2B markets. Efficiency according to Handy (1998: 34) “is the use of price to ensure that the right things are made in the right place at the right cost” and similarly put by Anderson and Gatignon (1986), efficiency is about doing business in a marketplace in the most economical way. For example, Hill (2005), argued that globalisation has increased opportunities for businesses to reduce costs by producing in nations where key inputs are cheap.

Williamson (1981) argued that efficiency could be maximised in a channel of distribution by analysing the cost of transactions. According to Ouchi (1989: 130), “a transaction cost is any activity which is engaged in to satisfy each party to an exchange that the value given and received is in accord with his expectations”.

The transaction cost analysis framework developed by Williamson (1981) has been used to study marketing phenomena such as vertical integration (Rindfleisch & Heide, 1997), foreign market entry (Klein, Frazier and Roth, 1990; Anderson & Gatignon, 1986) and distribution channel management (Frazier, 1983). According to Rindfleisch and Heide (1997), the transaction cost analysis framework views a company as a governance structure that rests on two main human behavioural assumptions, namely bounded rationality and opportunism, and three key dimensions of transactions namely frequency, asset specificity and uncertainty.

Williamson (1981) and Ouchi (1980) refer to distribution via middlemen as market governance structures. A governance structure is the

institutional framework within which to organise transactions (Williamson, 1981; 1979). According to John and Heide (1998), integrated channels are in-house or hierarchical governance structures. Further, John and Heide (1998) and others (Rindfleisch & Heide, 1997, Klein, Frazier & Roth, 1990; Frazier, 1983; Anderson & Gatignon, 1982) agree that the decision between governance structures is based on the cost efficiency to organise transactions.

A governance structure rests on two behavioural assumptions, namely bounded rationality and opportunism (Williamson, 1981). Bounded rationality simply means that limits exist on people's ability to process information without error (Rindfleisch & Heide, 1997; Williamsom, 1973). Rindfleisch and Heide (1997) and Williamson (1981) argued that individuals will choose an action that will lead to the most beneficial outcome within their rational bounds.

Williamson (1981:554) defines the second behavioural assumption, namely opportunism "as the individual's propensity for self interest seeking with guile and an effort to realize individual gains through lack of candor or honesty in transactions". According to Klein, Frazier and Roth (1990), the most common opportunistic behaviour is the conscious disclosure of asymmetrical information. Ellis (2005) found that middlemen might withhold certain information as a strategy to leverage business opportunities with either supplier or customer.

Williamson (1981) describes the three dimensions of transactions, namely frequency, asset specificity and uncertainty as key attributes that attenuate the mentioned behavioural assumptions. These dimensions characterise transactions and could independently and collectively affect customer expectations in one way or another (Williamson, 1981).

According to Anderson and Gatignon (1986), transaction frequency (repeated transactions) builds long-term customer relationships. Relationships in turn enhance the progression of integration between parties in a distribution channel (Rindfleisch & Heide, 1997).

Klein, Frazier and Roth (1990) found that uncertainty is caused by the unpredictability of a company's internal and external environment. For example, the motivation for this study is born from the fact that middlemen are aware of the external environment changes, namely the direct business model, that could lead to elimination. Ellis (2005) argued that as markets mature and information diffuses, middlemen risk being bypassed by their customers. Thus uncertainty has a direct impact on the behavioural assumption of opportunism. The higher the uncertainty, the more prone the middleman will be to seeking self interest with guile (Williamson, 1981).

Asset specificity refers to the investments that are necessary to realise transactions (Williamson, 1981). For example, paying commissions to agents is the reward a supplier gives in return for certain activities performed by agents to realise transactions. Another example could be when a supplier is required to provide product on a consignment basis. In this example the advantage to the customer is a reduction in process costs but in turn requires investment into additional inventory from the supplier to realise future transactions.

In summary, distribution channels are established when the market governance structure can perform transactions more economically and efficiently than fully integrated channels or hierarchical governance structures. Value is created through Williamson's (1981) transaction cost analysis framework for distribution channels. The value of the product

and service is therefore enhanced through economising on the cost of the transaction following the exchange.

## **2.4 Exchange sacrifices**

The total cost to exchange the product, the unit to transact, is the total price buyer's incur when making a purchase; "e.g. purchase price, acquisition costs, installation, order handling, repairs and maintenance and risk of failure or poor performance" (Payne & Holt, 2001: 168).

Price is the most important give component to get value from product, service and distribution. The other cost incurred by the buying business is the process costs that are inherent to the primary purpose of the business, for example the costs to store input product for consumption at a later date (Eggert & Ulaga, 2002; Gummesson, 1998).

Price and process cost are considered give components to determine perceived value and are discussed next.

### **2.4.1 Price**

According to Monroe (1991) customers value a reduction in cost more than responding to an increase in benefits. Baker and Littler (1999) and Ravald and Grönroos (1996) also found that customers view price decreases as heralding (customers welcome news of price reductions). It can thus be concluded that when a price is reduced and benefits remain the same, the customers' perceptions of the supplier will increase. On the other hand, an increase in benefits may not always increase perceptions of value to the extent to justify an increase in price.

However, no business can survive by reducing prices, even if it seems easier to instigate lowering prices to create an impression to increase value perceptions (Ravald & Grönroos, 1996).

According to Baker and Littler (1999), price in B2B markets are determined by supply and demand. This implies that benefits remain unchanged but price can move up or down depending on supply and demand. It also confirms that if a product has intrinsic value and therefore demand, price will fluctuate according to available product.

Dodge (1972) found that the initial purchase price is only one component of the cost and found there to be other factors, such as ease of use, speed and production rates, reliability and performance that affect price. Eggert and Ulaga (2002) referred to these costs as process cost.

#### **2.4.2 Process cost**

Another term used for process cost is role price factors (Baker & Littler, 1999). Baker and Littler (1999) add to the list of process cost in B2B markets criteria such as technical support, speed of response, replacement guarantees as well as continuity of supply. Or as Smith (1999b:133) has put it, “the real price of everything, what everything really costs to the man who wants to acquire it is the toil and trouble of acquiring it”.

According to Gummesson (1998), a market offering in a single exchange may be consumed at different times. For example, a product imported for use in production with other products is stored until it can be used and this cost of storing the product until it is used is inherent to the customer’s process cost (Eggert & Ulaga, 2002). However, the customer would have already consumed the service provided in getting the product delivered and

therefore could already at this time express levels of satisfaction that evaluates the service that was provided.

Unlike monetary price where customers want to see reductions in prices, process cost is clearly an acceptable incurred cost, which is incurred as a consequence of the exchange. Any action taken to minimise added transaction cost would enhance perceived value. For example, the elimination of any activity in the supply channel that takes cost out without any added risk provides an increase in value (a supplier investing in consignments stock).

## **2.5 Conclusion**

This chapter demonstrated that the attributes of Kim and Mauborgne's (1997) value platforms of product, service and distribution augers well with Zeithaml's (1998) equation of benefits minus sacrifices equals value.

A product's intrinsic or objectivist value determines demand and moreover price. And because it is argued that demand already exists, based on the products use value, the product will have a price. Thus, the main input dynamic to price (before any differentiating value is even considered) is demand against supply.

The service value platform revealed attributes that have both use value when a service is produced and consumed but also exchange value, based on the overall experience of the exchange. Service use value was identified as produced alongside product exchanges and its exchange value identified as the chief ingredient to influence impressions. The consequence of affecting the cognitive images held of an exchange experience is the building of long-term relationships and thus the establishment of social bonds (trust, commitment and satisfaction) between

businesses. Service therefore does not demand a direct price but has a differentiating influence on process cost and the overall exchange experience.

Distribution as a value platform identified the roles of middlemen in relation to various levels of integration. The literature found that the varying level of integration of channels is purely an economical decision based on the cost to transact. Therefore the agent in the supply chain is established purely based on the fact that there are certain activities, which the agent can perform cheaper than the principal. For example, it could be process cost, where the agent can provide certain services to reduce customers' cost incurred as a consequence of the exchange.

The theoretical framework, confirmed through the literature review, offers a number of opportunities for business today to find a competence to change the terms of competition (Treacy & Wiersema, 1993). This overview of perceived value and the value platforms that can create differentiating impressions, already confirms that deliberate changes or perceived negative actions during the exchange could have long-term consequences.

## **CHAPTER 3 RESEARCH METHODOLOGY**

### **3.1 Introduction**

The purpose of this chapter is to identify the research objectives and then to justify the use of a qualitative case study to pursue these objectives.

The important criteria of validity and reliability in positivist case studies are reviewed before the data generation process is presented and discussed. This flows into the procedures and protocols adhered to for data analysis, including the important ethical considerations relevant to this research. This is followed by the chapter's conclusion.

### **3.2 Research objective**

Yin (2003) and Van der Mescht (2002) stated that the researcher's questions at the beginning of the research concern the nature of a reality that is to be investigated. Further, Yin (2003) argued that the research questions are probably the most important step undertaken in a study as it clearly indicates what the investigator wants to know.

The questions in Chapter 1 of this research are focused on why the agent is still considered a valuable link in the supply chain of tyre production. This reality of the agent providing value is the ontological position of this research. Investigating an existing reality assumes an ontological position that supports an objective of external truths "upon which inquiry can converge" (Denzin & Lincoln, 1994: 109), inasmuch as the target is both to determine and explain truths, "ultimately enabling the prediction and control of the phenomena" (Denzin & Lincoln, 1994: 113).

To answer the research questions, existing theory on value and how value is perceived is reviewed. According to Gummesson (2005: 322) “case study research provides the researcher with an input of real world data from which concepts can be formed and propositions and theory can be tried”. The paradigms in which the propositions and theories from Chapter 1 and 2 can be verified are discussed next.

### **3.3 Research paradigm**

The data collected for analysis and theory testing assumes an objectivist epistemology where the investigator is independent and not capable of influencing the object under study. However, according to Van Der Mescht (2002), the interaction in qualitative case studies between humans in the data generation process lends itself to subjective engagement and subjectivity places “strong demands on the empathy and competency of the interviewer” (Van der Mescht, 2002: 47). Thus the positivist claim for an objectivist epistemology remains problematic, especially in a qualitative research environment.

Just as qualitative research can be conducted in the competing paradigms of positivism, post positivism, critical theory and constructivism (Yin, 2003; Denzin & Lincoln, 1994), the positivist paradigm, used to conduct this study, can be descriptive, exploratory or explanatory (Yin, 2003). The explanatory positivist paradigm is consistent with the desired outcome of this research, especially since the desired outcome of this research is expected to indicate how the findings may apply to other situations.

The aim of a positivist enquiry is the prediction and control of phenomena and this may cast the inquirer in the role of expert, giving the researcher perhaps unmerited privileges (Denzin & Lincoln, 1994). This concern,

together with scepticism over objectivist epistemology in qualitative case studies, requires the research instrument, in this instance the interviewer, to impose strategies to prevent any threats to the validity of the findings. Further, the researcher's insight gained through working in the industry under study could be observed as part of the process where intuition is applied to the interpretation of the data collected. Therefore the positivist criteria, to reach objective truth, of validity, reliability and objectivity are fundamental to uphold the inquiry (Denzin & Lincoln, 1994).

Next, empirical research entails observing and collecting evidence related to a study and drawing conclusions from it to add to the body of knowledge about a subject (Remenyi, 1996). The qualitative case study method, defined as an empirical inquiry (Yin, 2003), will determine the route to evidence collection and analysis (Remenyi, 1996). The qualitative case study method is discussed next.

### **3.4 Qualitative case study methods**

According to Babbie and Mouton (2003) the qualitative researcher is the main instrument of a study conducted in the natural setting of the human behaviour under study. This is supported by the fact that this research required the researcher to get close to the phenomenon under study. Further, Rao (2002) stated that qualitative data could only be obtained by getting psychologically close to the phenomenon under study.

Gummesson (2005) found that the general strategy in qualitative research on marketing is verbal data from personal interviews and surveys. The data generated for this research are from personal interviews and according to Denzin and Lincoln (1994) interviews allow for flexibility to obtain in-

depth information with a small number of respondents. This is consistent with the sample represented in this study.

Next, the researcher is particularly interested in understanding why the value provided by the agent is perceived greater compared to direct business routes. Yin (2003) explains that case study research is appropriate for *why* and *how* research questions, because they deal with issues over time rather than just incidents. In support, Winegardner (2004) contends that whatever the epistemology of the researcher, answering the research questions of *why* and *how* does not require any control over the events. Thus, the question of why the value provided by middlemen is greater than that provided by direct business routes both addresses and validates the case study method as a research strategy.

Furthermore, the case under study is intrinsically bounded by the phenomena, because there is a limit to the number of people who could be interviewed (Winegardner, 2004). Accordingly, Merriam (1998), cited in Winegardner (2004), argues that this applied to the single most defining characteristic of a case.

The case study method is a single case where most of the data is generated through personal interviews and supported by observations and artefacts. According to Yin (2003), a single case study design is appropriate when it represents a unique case in testing a formulated theory. The theoretical framework laid out in Chapter 2 specifies the dimensions that will be investigated and compared against empirical findings. The framework also guides the researcher in where to look for evidence in the primary data.

The positivist paradigm uses validity and reliability criteria that are similar to quantitative research (Winegardner, 2004). The strategies for using and

dealing with the case study validity tests, as espoused by Yin (2003), with emphasis on the particular case under study, are discussed below.

*Construct validity*, is primarily concerned with the multiplicity of data sources of evidence and, secondly, with the establishment of triangulation. Firstly, multiple sources of evidence provide multiple measures of the same phenomenon. Secondly, developing converging lines of inquiry of the same multiple data sources is known as triangulation - a process using multiple sources of perceptions to clarify meaning and verifying the repeatability of an observation (Babbie & Mouton, 2003).

*Internal validity*, also referred to as credibility (Trochim, 2002), is concerned with whether the results of the research are believable in the eyes of the participants (Babbie & Mouton, 2003). The participants are the only ones who can judge the legitimacy of the results. To achieve data credibility, the transcripts of the interviews were made available to the participants.

*External validity* refers to how transferable the findings can be when applied to other contexts (Babbie & Mouton, 2003). Purposive sampling and thick descriptions are strategies used for transferability. Trochim (2002) argues that transferability is a more suitable description of external validity in qualitative studies; transferability because the new researcher who wishes to transfer the results to a different context becomes responsible for the judgement of the transferability.

*Reliability* is based on the assumption of replicability and repeatability (Trochim, 2002). According to Yin (2003: 37) “the objective is to be sure that if a later investigator followed the same procedures as described by an earlier investigator and conducted the same case study all over again, the later investigator should arrive at the same findings and conclusions.

Further, Yin (2003) argued that reliability should be considered an important issue already at the data collection stage, with the goal of minimising errors and biases in the research. The tactics Yin (2003) proposes to ensure reliability is the use of case protocol.

Case protocol “is intended to guide the investigator in carrying out the data collection” (Yin, 2003: 67). The protocol is in essence the procedures the researcher adheres to prior to data collection. For example, the use of an interview guide, containing questions to be discussed with research participants.

### **3.5 Data generation**

According to Winegardner (2004), a single case study will often contain voluminous data from a multiplicity of sources. For this study, personal interviews, field observations and documents constituted the sources of data. Documents can include customer reports, agendas or any documents that have relevance to the investigation.

In this section the process followed for data generation and analysis is discussed. This is followed by the ethical considerations and limitations of the data.

#### **3.5.1 Sample**

The sample selected was based on the knowledge the researcher has of the population through work experience. Babbie and Mouton (2003) refer to this type of sampling as purposive or judgemental; that is, based on the researcher’s judgement and the purpose of the study.

A total of six interviews were conducted. The respondents were representative of the population, inasmuch as the number (six) closely approximates the aggregated characteristics of the population (Babbie & Mouton, 2003). Furthermore, this substantiates what Winegardner (2004) implied when stating that case studies are bounded by the phenomena. For example, there are four tyre producers in South Africa and three of the producers participated in data generation. In addition, two representatives of the principal and one representative of the agent were interviewed, bringing the total number of interviewees to six.

All the interviewees held senior positions, with considerable and lengthy experience in the field under study. Their backgrounds and experience are detailed in Table 1. Further, the interviewees were known to the researcher, which could explain why requests to proof read transcripts for data verification were declined, although transcripts were copied to all respondents via electronic mail. It is therefore concluded that the respondents had sufficient time to object or request changes to the transcribed data.

### **3.5.2 Interviews**

An interview is one of Yin's (2003) traditional sources of evidence in case research. The case data was primarily collected through personal face-to-face semi-structured interviews. The primary goal of the interviews was to elicit the views and experiences of the respondents about their perceptions of the value of the agent as a member of the channel under study.

According to Winegardner (2004), an important element in the positivist design is the articulation of the research questions. Perry (1998) proposes that the first question should capture the perceptions of the respondents,

and not of the researcher. Further probing questions usually always starts with “How?” (Perry, 1998: 792) to eliminate *yes* or *no* responses; and moreover because the more the questions seek to explain how and why something occurs, the more relevant a case study will be (Winegardner, 2004). Winegardner (2004) also encourages the researcher in the positivist paradigm to ask the same questions from three or more sources to get convergence on issues, towards robust fact. Further, a diverse array of evidence on the facts leads to reliance of evidence (Yin, 2003), because it provides triangulation data about the real world (Babbie & Mouton, 2003).

**Table 1: Interviewees’ background**

<b>Interviewee</b>	<b>Length of service in the tyre &amp; rubber industry (years)</b>	<b>Position in the organisation</b>	<b>Primary specialities</b>
A	5	General Manager	Management and cost accounting
B	22	Director	Polymer Chemistry and general management
C	30	Director	Polymer Chemistry and general management
D	8	Director	Global strategic management, production and marketing liaisons
E	18	General Manager	Production, engineering, sales and marketing
F	20	Owner / Director	Chemistry, production and marketing

**Source: developed for this research, sometimes disguised for confidentiality**

The data collection for this thesis broadly followed the question design proposed by Perry (1998), Winegardner (2004) and Yin (2003) above. The interviews remained, however, semi-structured, to allow the interviewee to raise relative issues about real world data without continuous and interrupting probing. Probes were addressed only when the interviewer wanted to redirect the responses to the phenomena. The questions were mostly designed in such a way that all the dimensions of the theoretical framework were covered. Note that not all the questions were asked during each interview; at times more appropriate questions not on the schedule were purposely asked to satisfy or confirm findings from prior interviews for triangulation purposes.

Because the positivist paradigm is seeking for an objective truth, the questions were in line with the theoretical framework established in Chapter 2. The purpose of this design is to facilitate data analysis, as will be discussed later in this chapter. Further, to ensure reliability, as discussed earlier this protocol provides repeatable procedures, which is desirable in a single case study (Yin, 2003).

All the interviews were conducted on the respective business premises of the interviewees. This required special care in planning, i.e. making appointments and warning respondents of the need for punctuality and the time required, especially since five out of the six sites visited required air-travel. The interviews were incorporated into the normal travel itinerary of the researcher. Moreover, the respondents were all well known to the researcher, which made both setting up and conducting of the interviews easy.

The interviews took place in Brussels, Belgium in Europe and in Port Elizabeth, Durban and Johannesburg in South Africa. The interviews were

conducted between July and November 2005 and lasted between 40 to 60 minutes each. Each interview was transcribed within two weeks thereof. This action provided opportunities to review transcribed data prior to subsequent interviews.

The analysis of the transcribed data is discussed next.

### **3.6 Data analysis**

The main objective of a case study research in the positivist paradigm is to test theory (Yin, 2003; Denzin & Lincoln, 1994). The requirement of this paradigm is sufficient prior theory.

The interviews lasted between 40 to 60 minutes each. This is consistent with Yin's (2003) statement that case studies tend to produce large amounts of data that are not readily amenable to mechanical manipulation, analysis and reduction. Further, in Winegardner's (2004: 13) words, single cases will contain "voluminous data from a multiplicity of sources".

Yin (2003) suggests that the positivist researcher should have a general analytical strategy to guide the decision regarding what will be analysed and for what reason. Explanation-building, as an analytical technique is well suited to narrate initial theoretical statements (Yin, 2003). For example, the theoretical framework developed in Chapter 2 aided this researcher to explain and orientate the data according to previous theory. This procedure is supported by Yin (2003: 122) who stated that "the gradual building of an explanation is similar to the process of refining a set of ideas...". Similarly, Perry (1998) emphasised the importance of previous theory raised in the literature review to aid the analysis of data.

Explanation is a “story which defines the relevant things or events and characterises the causal relationship among them” (Unknown A: 56). Accordingly, the theoretical framework guided this researcher to where to look for relevant data and as per Yin’s (2003) recommendation, used sufficient citations to support explanations of the findings.

### **3.7 Ethical considerations**

Remenyi (1998) proposes three major aspects of how, in an ethical sense, research in the business and management environment should be conducted. These aspects are; evidence collection; processing evidence; and the use of the findings.

Because the primary source of evidence for this thesis is collected through personal interviews, the respondents should be provided with assurances regarding the final use of the evidence (Remenyi, 1998). All the respondents were made aware (recorded and transcribed for ethical considerations) that the final purpose of the evidence was the submission of a thesis in the fulfilment of the requirements for a degree of Masters in Business Administration.

The second aspect of concern is the ethical issue related to the processing of evidence (Remenyi, 1998). In qualitative research, the researcher is more subjective and sub-conscious bias on the part of the researcher may be a problem (Remenyi, 1998). Triangulation may help (Remenyi, 1998) and is applied to the evidence, as discussed earlier in this chapter.

It is important that the findings are not presented in such a way as to support any bias on the part of the researcher (Remenyi, 1998). The positivist epistemology of pursuing an objective truth about the phenomena coordinates the findings to a theoretical framework distilled

from empirical research. This will allow the reader to compensate for any subtle bias on the part of the researcher for themselves (Remenyi, 1998).

### **3.8 Conclusion**

Explanation-building requires the researcher to constantly refer to the original purpose of the study (Yin, 2003). This supports the importance of structuring the research questions to keep the study focused on the topic of interest.

The positivist paradigm in qualitative research generates multiple sets of data (through interviews) and relies on prior theory and topic focus to discard evidence that has no relevance (Van der Mescht, 2002).

To maintain objectivity, boundary controls established in the case protocol prevent this researcher from subjectivity and biases.

# CHAPTER 4 RESEARCH FINDINGS

## Research Findings

### 4.1 Introduction

In this chapter the findings pertaining to the perceived value of the agent, in respect of the principal and tyre producers, are reported. This is followed by the findings from the perspective of the theoretical framework, as illustrated in Chapter 2, Figure 2.

In Section 4.2, following the introduction, the value perceptions of the principal and South African tyre producers about the agent are reported. As was already mentioned in Chapter 1, the principal manufactures intermediary rubber chemical products used in the production of tyres. In addition, the principal makes use of the agent to integrate with the customers, the tyre producers, in South Africa. The agents' views are therefore also used from time to time to support the reported findings pertaining to perceptions of value.

In Section 4.3, following the reported perceptions of the principal and tyre producers, the findings on value pertaining to the theoretical framework are presented. More specifically, value in respect of the value delivery platforms of product, service and distribution are reported. This is followed by the findings on price and process costs in Section 4.4.

The concluded findings are supported by indented paragraphs in italic font, which are quotes from the respondents.

## 4.2 Value perceptions of the principal and South African tyre producers

Before reporting the findings on the perception of the agents' value in the supply chain of South African tyre production, the world's demand for and production of tyres is tabled in Table 2 below to put the evidence reported in Sections 4.2.1 and 4.2.2 in perspective. In addition, it is a logical conclusion to expect that China, because of its size and significant growth opportunities, would be the focus of suppliers such as the principal.

One respondent stated that:

*Over capacity of tyres are reducing from approximately 70 million tyres at the moment (2005) to more or less 50 million tyres by 2015. I can show you the balance sheet for tyre production for now (2005) and in the future, 7 to 10 years into the future (Tyre Producer B).*

**Table 2 World Tyre Balance Sheet**

<i>Units in millions</i>	<b>DEMAND</b>			<b>PRODUCTION</b>		
	2005	2015	DIFF.	2005	2015	DIFF
<b>EUROPE</b>	356	447	+91	352	423	+71
<b>AMERICA</b>	403	531	+128	361	428	+67
<b>ASIA</b>	274	396	+122	361	586	+184
<b>AFRICA</b>	28	34	+6	16	26	+10
<b>OF WHICH RSA</b>	10	12	+2	12	19	+19
<b>TOTAL</b>	<b>1060</b>	<b>1408</b>	<b>+348</b>	<b>1130</b>	<b>1463</b>	<b>+333</b>

**Source: Tyre Producer B**

The table above shows demand for and production of tyres in the year 2005 as well as the expected demand for and production of tyres by the year 2015 for all the major regions in the world. In addition, the figures for South African tyre production are detailed in Table 2. Of particular interest to this research is the fact that South Africa only contributes to approximately one percent of the world's demand for and production of tyres. The point of this is that the South African tyre producers are always going to be more dependent on a variety of resources to maintain their position as a producer in a world where best practice, price and volumes will retain the focus of business strategy. For example, it is only logical for a manufacturer to concentrate resources and strategies on world regions where return is acquired at the least amount of risk in the shortest cycle of time.

#### **4.2.1 Value, the principal and the agent**

In this section the findings reported provide a brief historical background to the agent in the supply chain of tyre production in South Africa. This is followed by findings about the value of the agent alongside the direct business route. The purpose of reporting on the background and value of the agent is to provide necessary perspective to the findings relating to the value platforms and customer sacrifices.

As part of a global strategy the principal clearly wants to maintain its market share in all world regions. However, due to cost pressures, as a result of increased competitor activities following the global rationalisation of the tyre industry in the nineties, when plants were closed down to reduce the oversupply of tyres in the market, the principal had to scale down its own organisational structure to defend and maintain its market

share. One of the steps in reorganising was to replace regional sales offices with middlemen.

*From an overall global perspective, we have a desire to maintain or achieve certain market share targets (Principal B).*

*In certain countries, certain geographies, where we can make the change from the agent to direct business, and not take undue risk to get rid of cost, we will eliminate the intermediary. However, in South Africa there are a number of different components, which come together and bring value to the supply chain. Firstly, the local representation (agent) replaced a local office we had down there (South Africa) until 1995. Under these circumstances, the agent is not seen entirely as a freelance intermediary or in the same way as in another country. Secondly is the situation with the power that local purchasers still have down there (South Africa), for example the influence they have over their central purchasing headquarters. We need to continue with local representation in South Africa, but not at the cost of a regional or local office because of the overheads associated with it (Principal A).*

In support, another respondent commented that:

*Our customer base is rationalising and one way to reduce our cost is to rationalise our own organisation. As you rationalise your own sales organisation, there is more importance placed with an intermediary to continue to service those parts of the market, which you want to continue to service because of decent profitability, but where you may not have the appropriate resources to do so yourself (Principal B).*

Furthermore, the principal identified cost reduction, the agents' product range and the customer relationships as the main areas where the agent contributes significant value. In terms of cost reduction one respondent stated that:

*The cost of an agent, compared to a regional office, is variable. The cost difference is, if you do not send volume down there (South Africa), you do not pay (Principal A).*

In terms of the agents' product range a respondent commented as follows:

*Under the present circumstances, the agent handles a range of products (over and above our rubber chemicals range) into the tyre industry, which is something we cannot achieve in breadth. From that point of view the agent provides a service which both the principal and customers are prepared to say, yes, that adds value (Principal B).*

And finally, in terms of the agents' customer relationships, a respondent stated:

*As you are well aware, the relationship between the agent and the customers in the local market (South Africa) is critical because the local customer can also have some influence on central purchasing (customer headquarters in Europe) in the way that they allocate volumes between suppliers (Principal B).*

It is clear from the evidence that the principal/agent structure was established as part of a global strategy to maintain market share by cost reductions. Notwithstanding this fact, the next section explores the evidence to establish, from a customer perspective, whether or not the agent provides greater value compared to the direct business route. In

addition, the evidence will indicate whether or not the principal/agent structure is a strategy that resonates with the tyre producers.

#### **4.2.2 Value, the customer and the agent**

The customer/middleman relationship was the main theme that emerged from the data. In this section the findings regarding the value of the relationship between the tyre producers and the agent is reported.

The tyre producer/agent relationship developed over several decades. The length of time of this relationship supports the fact that there exists a preference to have the agent in the supply chain of tyre production in South Africa. Furthermore, it shows that there is a level of dependency between the tyre producer and the agent.

The relationship between the tyre producer and agent started during the apartheid years of South Africa. The sanctions that followed the then Government's apartheid policies presented opportunities for entrepreneurs to establish representation agreements with absent primary product suppliers, who in support of sanctions, withdrew from dealing directly with the tyre industry in South Africa. Consequently, the agent, trading in a wide range of products (representing a large number of principal suppliers) for use in the production of tyres created the need of both parties (tyre producer and agent) for a relationship. As a result, symbiotic relationships formed between the agent and tyre producers, which survived over two decades of sanctions.

One of the respondents stated that:

*I remember the Swedes saying (in support of sanctions) they would not supply product to South Africa. And I think it was on the same*

*day they announced that, about four middlemen phoned and said we can get it (the product) through another route. If there was a problem in obtaining raw materials (input product), we (agent) were seen as an ally to help them (customers) do that (Agent).*

Another respondent supported the symbiotic relationships by reporting that:

*In the apartheid era, which I call the sanctions era, we only had our personal relationships with local suppliers (agent) to rely on. There was nobody else one could rely on. These relationships were forced by the nature of the environment in which we had to survive and continue to do business (Tyre Producer B).*

Since a new democracy in South Africa in 1994 there has been a continued and unprecedented loyalty as a result of the symbiotic relationship established during the years of sanctions in South Africa. The tyre producers know whom they can trust and are therefore sceptical about establishing new direct relationships, especially with new suppliers and those suppliers that are based abroad. As one respondent stated:

*I am talking about the value of the long- term relationship. The more cycles you go through, of ups and down, trust in a relationship develops – relationships are built in good times and hard times. Long-term relationships add personal value – buying from an unknown guy just because his price is slightly lower is not a relationship. I would rather pay more because I remember the personal relationship, in good and bad times, is reliable (Tyre Producer B).*

*For a tyre producer to interface, on a personal basis, with a supplier sitting eleven thousand kilometres away is impossible. The relationship will suffer and consequently the business (Tyre Producer B).*

However, there is a general acceptance that the relationship, due to business changes, like the direct business model, will not be sustainable in the longer term. As one respondent stated:

*I cannot make a general statement but some middlemen, as I have said before, are not there (in the supply chain) anymore. If we can handle our requirements ourselves, simply moving paper around, where the middleman does not add value, I have taken them (middleman) out of my supply chain. We are definitely going directly where the agents have not and cannot add value (Tyre Producer A).*

Another respondent commented on the sustainability of the future of the agent as follows:

*For how long the agent will remain viable is the question. The more business (methods, like internet e-commerce) changes the less viable a factor the agents' relationship will become in the supply chain. The value that the agent can give in the supply chain, in relation to the cost that he (agent) brings to the supply chain; that is going to be the question (Tyre Producer B).*

From the evidence presented above, it is clear that the tyre producers value the relationship they have with the agent. However, there is a clear acknowledgment that if business models change, and it is therefore perceived that the agent does not deliver value, the agent will be

eliminated from the supply chain. For example, Goodyear's turnaround strategy to lower cost reads: "If an activity adds value, we will feed it. If it doesn't, we will seek to eliminate it" (Keegan, 2004:26). Thus the need to understand and measure where the agent is adding value to the supply chain is of growing importance.

In the following sections, themes that are considered as the most important in terms of value exchanged in respect of the value platforms are reported.

### **4.3 Attributes of value in terms of product, service and distribution**

This section reports evidence from the perspective of the theoretical framework, discussed in Chapter 2. In line with benefits to the customer, themes pertaining to the attributes of the three value platforms of product, service and distribution are reported.

#### **4.3.1 Value and the product**

The product attributes that will determine its value, when weighed against price and process cost, are quality and alternative availability of equivalent products. These attributes are additional to the fact that the product has a specific function and therefore demand for the product exists in the tyre industry for the production of tyres.

Products used in tyre production range from natural and synthetic rubber to fillers and chemical pigments. These products combine according to their unique function to produce rubber compound in a continuous mastication process, which is extruded into sheets for shaping, with other components, such as steel cord and reinforcing fabric, into a tyre for final production.

The use value of a product or component in the production process is only consumed when it is used in combination with other materials. As a result, it is expected that the product will perform the function it is acquired for in the production of tyres. According to the principal, a minimum quality is therefore expected, and if this is met, certain quality requirements become standard to a product.

*There is a minimum quality threshold that you are expected to reach and once you have met that threshold it ceases to become a point of discussion, unless of course it is compromised during a supply contract. It is the standard that they (tyre producers) have become accustomed to and this meets their particular quality needs (Principal A).*

Furthermore, a respondent stated:

*Because of the nature of the products we produce (tyres), product quality is highly important and that also means that there are not as many suppliers as one would like (Tyre Producer, C).*

Leading on from the last respondents' statement, it is clear that the quality requirements placed on products and materials discourages new suppliers to the tyre industry. In addition, the ongoing rationalisation of the tyre industry, as mentioned in Section 4.2.1, places limits on the number of suppliers to the tyre industry. The respondent further stated that:

*The fewer suppliers of consumable products (used in tyre production) there are these days, the less negotiable they (suppliers) are when it comes to price (Tyre Producer C).*

Thus, high product quality requirements, combined with the ongoing rationalisation of the tyre industry, have placed a limit on the number of

alternative suppliers for products and material in all categories (such as rubber chemicals, synthetic polymers and synthetic fibres). High quality requirements combined with the decreasing number of suppliers to supply products that meet the minimum quality requirements are product attributes that will influence how the value of the product is perceived, compared to price and process cost.

#### **4.3.2 Value and service**

Tyre production in South Africa is concentrated in Port Elizabeth because they, tyre producers, wanted to be close to the main consumers of tyres, namely the automotive manufacturers. The economic benefit of being close to their customers is however compromised by being geographically remote from primary input product and material manufacturers. Therefore, a supplier's reliability and knowledge, of how to supply a product, concomitant with conditions of purchase, such as delivery and storage, are service attributes that affect how service value is perceived. As a respondent stated:

*A product benefit is not just the core (use value) product that you buy. Product benefits entail – do you get the product delivered on time and is the quality consistent (Tyre Producer B).*

In support of the service requirements, some respondents articulated the following facts related to the geographical compromise in their supply chain.

*Long distance from primary manufacturers (product for use in tyre production)*

*Limited availability and frequency of shipping lines (primarily from Europe and USA)*

*High minimum order quantities and availability!*

*High cost associated with unused inventory (Tyre Producer B & Tyre Producer C).*

Another respondent commented that:

*If you take South Africa, it is a long way from everywhere, lead times are long and as a norm, there are not multiples of any specific products readily available somewhere else, if we have messed up on inventory (Tyre Producer A).*

Consequently, reliability in terms of physical delivery of product against expected delivery requirements contain additional costs to the process and therefore improves impressions of value received. Furthermore, knowledge of how to overcome and solve any reliability issues that may occur minimises unnecessary cost.

*By knowledge I mean of how things move in the supply channel, so that they (agent) can help logistically with inward flow of product, in other words they can act on your behalf and so help to contain costs (Tyre Producer C).*

In support, another respondent commented about the knowledge role of the agent in the supply chain as follows:

*It gives the buyer more time to spend on other more value-adding things, because he knows that somebody else (meaning the agent) is really doing his job on his behalf (Tyre Producer A).*

A respondent from the principal reported the importance in respect of the agents' knowledge in terms of the commercial aspects of the product. The knowledge to convey information about what customers want, especially, helps to support the principals' global service delivery objectives.

*The other aspect is well known logistics in customer support, if you will, in terms of making sure that what we commit to the customer actually happens (Principal B).*

Consistent with the above view is the emphasis on the importance of delivering to promised service levels:

*I do not know the guy sitting in Belgium but I can talk to Mr, Cornelius and say I have a problem, please sort it out and you know it will be done (Tyre Producer B).*

The service attributes of reliability and knowledge were also identified as the building blocks of the relationship between the tyre producer and agent as reported in Section 4.2.2. Moreover, there is acceptance that this relationship has value and therefore a benefit that tyre producers are willing to pay a premium for. As one respondent commented:

*I do not think you can discount the importance of the relationship. If you have good partners, one would be inclined to say; I remember the people that have been with me through the tough times and I am prepared to pay him more than I would be prepared to pay the unknown supplier, who can now sell you the product in the direct route at much reduced prices (Tyre Producer B).*

And another respondent stated that:

*A company needs good partners. We have identified those companies and I am prepared to pay for the service they provide because our relationship is long-term focused, a win-win relationship that is based on collaborations and reliable service (Tyre Producer A).*

The evidence shows that service in terms of reliable product delivery, in context of the geographical problems associated with the supply chain is essential. As a result, the South African tyre producers have identified business partners with supply chain knowledge and capabilities. Moreover, they have chosen to continue to support the relationships with the partners they have chosen to establish. And, although some middlemen have been eliminated and replaced by direct business routes there is still a general apprehension, by the tyre producers, about replacing the agent and consequently ending the relationship, which they clearly value.

### **4.3.3 Value and distribution**

The findings in this section are reported according to characteristics of Williamson's (1981) transaction cost analysis framework, namely repeated exchanges, uncertainty and asset specificity. These characteristics are interrelated and combine to evaluate the efficiency of the supply chain, as an efficient supply chain translates to value for the customer which, in this instance, is the South African tyre producer. Each characteristic will be discussed in turn.

#### **4.3.3.1 Repeated exchanges**

As reported in the previous section, the relationship between the agent and South African tyre producers developed around the need for products used

to produce tyres. To facilitate this need, the agent was established in the supply chain to administer sales to the regional tyre producers on behalf of the principal. Because the rubber chemicals are used in large volumes, the agent administers regular transactions and therefore a high repetition of transactions. These repeated exchanges produce a high service frequency that provides the foundation for relationships to develop; between the principal and the agent, and between the agent and South African tyre producers. Furthermore, repeated exchanges and, as a consequence, the frequency of interactions, develops the social bonds of relationships, namely trust and commitment. In support, the principal stated that:

*Our open relationship with the agent is valued. We value collaboration that builds trust, and is open and honest. From a suppliers perspective it is key that the agent understands exactly what you want them to do and what you don't want them to do (Principal B).*

In turn, the relationship between the agent and the principal is recognised by the regional tyre producers. In support, one respondent stated the following:

*Now there are agents who have traditional, very strong old relationships with primary suppliers. These strong relationships exist to the level that the principal is interested in keeping the business going with a specific customer (Tyre Producer C).*

And, the experience gained of the principal's objectives, as a result of repeated transactions is of a great benefit to the tyre producers. As the same respondent commented further:

*There is an expectation from us that the agent will resolve the issue with the principal because, at the end of the day, that's what the agent gets paid to do (Tyre Producer C).*

The agent is clearly the link between the principal and the South African tyre producer by virtue of the relationships between the agent and principal and the agent and tyre producer. The agent delivers the service produced through repeated transactions between tyre producers' (central head office in Europe) and principal and therefore the relationship exists between the regional tyre producer and the agent. As Tyre Producer B put it:

*It is impossible for a tyre producer to interface on a personal basis with manufacturers sitting eleven thousand kilometres away. If I have a problem or something I want to discuss I want a look in the eye and direct communication (Tyre Producer B).*

Although the principal confirmed that there are definite advantages of the agents' relationships with the tyre producers, as reported in Section 4.2.1, the principal confirms that there is no value in having a direct relationship with tyre producers in South Africa because purchasing decisions are now made centrally. The principal stated:

*But I think the trend is away from local decision-making. Now that we do everything centrally you do not need to build a relationship with the local purchasing people (tyre producers in South Africa) because they're not really involved in the decision of who is going to supply (Principal A).*

On the other hand, the principals' objectives are achieved through the agents' relationship with the regional tyre producer. This arrangement, between the principal and the agent, is similar in scope to an employer

employee contract where the employee is remunerated according to required skills. As one respondent stated:

*If you go back to the fundamentals, our agent is an extension of our selling arm if you will. From a supplier perspective, it is in your own interest to make sure that the selling arm knows exactly what you want them to do. They represent us in the marketplace and progress, against certain targets and responsibilities will be monitored in the same way as a sales manager or sales director as the case may be (Principal B).*

The agent's view was similar.

*The export manager (of the principal) can without employing people, lever (use the knowledge and skills) four or five people to sell his products in a given territory (Agent).*

Therefore, the main benefit of repeated exchanges is the two independent relationships that exist between the principal and agent on the one hand and the agent and the regional tyre producers on the other hand. Paradoxically, there is clearly a level of dependence of all the parties on the independent relationships to achieve the independent objectives of each party. However, the relationships, as a consequence of the repeated exchanges, ensure that the independent objectives of each party are met and these objectives combine to achieve the overall objective of every exchange that is repeated.

#### **4.3.3.2 Uncertainty**

Uncertainty in the supply chain of South African tyre production has recently been the result of product availability issues due largely to

restrictions placed on rubber chemical products, produced from oil refining, following the oil availability crisis in 2003 and 2004. As a result, the product availability issues pervaded the data and were also the main theme with regards to the uncertainty characteristic.

Tyre producers reported uncertainty to be a manageable risk in the supply chain because of the long established relationships the agent enjoys with both the principal and regional tyre producers. In support, one respondent commented that risk is minimised by the reliability and knowledge competencies of the agent.

*What price value do you add to risk, if any? Trust is at a level, which you believe that the principal being represented by the agent meets what you require in logistics as well as everything else, you almost start passing over the risk. Risk is diminished by the knowledge and experience of how that agent works in his relationship with the principal (Tyre Producer C).*

Clearly the product supply restrictions increased the dependence of the tyre producers on the relationship between the principal and agent. In this case it was to secure supply of rubber chemicals. Regional tyre producers therefore recognise the value of this relationship (agent and principal), especially since supply was not interrupted. Similarly, the benefit of this relationship (and levels of dependence) will diminish in value for the tyre producer when the supply restrictions on rubber chemicals are lifted.

*The overall situation we are faced with at the moment is supply and demand. The relationships that exist in South Africa have been beneficial in terms of maybe getting the companies a greater part of the pie that was available. And whilst this logic applies to South Africa I do not believe it applied to any of the European countries.*

*The South African model is not truly representative of what happens around the world (Principal B).*

#### **4.3.3.3 Asset specificity**

While the supply of rubber chemicals to the tyre producers in South Africa may not have been interrupted to the tyre producers in South Africa the supply restrictions did bring opportunities for change in the principals' levels of investment. For example, the principal removed consignment stock held with the South African tyre producers. As a result, consignment stock was the main theme, in terms of asset specificity, that emerged from the data. The principal stated that:

*When the market goes short (supply restrictions), it changes the leverage that we have and that is why there was this ability to cancel consignment stocks and shorten the terms of payment (days credit) (Principal A).*

In support Shaw (2005) reported in the European Rubber Journal that in the prevailing short market for products, to the tyre and rubber industry, the choice to customers is simply to pay the price or go short of material.

The removal of consignment stock clearly reduced the principals' level of investment, or cost to transact with tyre producers, in South Africa. However, this action translated into uncertainty for both the tyre producers and agent in South Africa. Firstly, the risk of running out of product to produced tyres increased. Consequently investments were made to control the risk and thus, the cash flow cycle of the tyre producers increased; they now have to bear the costs associated with storage and logistics of unused products. Secondly, consignment provided the agent with a consistent monthly income from commissions. Now, commissions will be earned

against shipments which will never be as regular nor as consistent as commissions earned from a steady monthly usage. Thus, although the principal realised the opportunity to take control of his levels of investment, the decision impacted negatively on the level of risk for the customer and for the agent.

This left commission payments on volume sales to the agent as the only investment from the principal to do business. As already mentioned, commission payment is a variable cost that the principal incurs, when selling product into South Africa. The payment is to reward the agent for administering sales on behalf of the principal and tyre producers. The principal explained as follows:

*The cost is variable, because the cost you pay is dependent on the volume supplied in South Africa. Paying an agent is no different than having an employee down there (South Africa), and all the overhead expenses associated with it. The difference is, if you don't send the volume you do not pay (Principal A).*

Clearly, the agent is dependent on commissions earned against sales and if product volumes are not shipped, uncertainty is created due to negative profits. The agent's profit is thus totally dependent on sales volumes, to the South African tyre producers, generated by the principal. Hence, a direct correlation is established between the level of investment by the principal, in the form of sales commissions, and the agents' levels of uncertainty.

The tyre producers find that the agent receiving commission payments is an acceptable reward in return for the service the agent provides on behalf of the principal.

*I think it is an acceptable arrangement. The agent is there to deliver a service and he is there because he has a good relationship with the customers, because people trust him! It is less expensive for the primary manufacturer to appoint an agent than to open, or have an office as a office would cost a certain amount of money (Tyre Producer B).*

The evidence showed a strong interrelationship between the three transaction cost characteristics, namely repeated exchanges, uncertainty and asset specificity. Firstly, repeated exchanges contribute to building long-term business relationships. These relationships in turn increase in value as uncertainty increases and uncertainty as a characteristic is dependent on levels of investments or asset specificity. Clearly, value is provided to the tyre producers when these characteristics are in harmony with each other. However, the value perception of the supply chain appears only to be appreciable when the balance of this equilibrium is disrupted. For example, the tyre producers' dependence on the agent increased when product availability became an issue.

#### **4.4 Exchange sacrifices**

The findings in terms of the exchange sacrifices of price and process cost are reported in this section.

##### **4.4.1 Price**

Prices for the worldwide supply of rubber chemicals are centrally negotiated between the tyre majors and principal. This central purchasing strategy, to negotiate on combined regional tyre producers' volumes through a central office, is to benefit from the economies of scale. As a

result, a supplier's performance in real terms has become price. Likewise, the central purchasing strategy is, by design, a deliberate tactic to have everything negotiated on price.

*It is a requirement of every supplier to come up to a level of best performance, but at the lowest price. Our only point of reference then really becomes price. Everybody needs to come up to a level of best performer, but at the lowest price. More and more central decisions are unchallenged by the regions (Principal A).*

Tyre producers in South Africa still believe, however, that they can challenge central-purchasing decisions. One respondent stated as follows:

*It does not take the responsibility of best practice away from the local purchasing offices. We do not blindly accept and follow centralised purchasing policies (Tyre Producer B).*

As already mentioned, the central purchasing strategy is to exploit the benefit of volume against price. In this situation the tyre producers continued to receive benefits, such as consigned product and extended credit terms, but at much lower prices. The burden on supplier's costs, as a result of more for less, caused the demise of some major suppliers to the industry.

*With all due respect, at that stage we did not care about suppliers, as we wanted to survive ourselves. For example, Natural Rubber growers, a few years ago, replaced natural rubber trees and started planting palm trees for palm oil because they made more money out of that. Central purchasing may have pushed it too far (Tyre Producer A).*

Further, the principal stated that prices in the industry are strategic and not cost driven and stated the following:

*But supply and demand as well as competitive pressures drives the price, and there is no substantive differentiation in pricing as a result of changes in cost (Principal B).*

And, as Principal A put it:

*Everything is driven by strategy, about where you want your presence in the market, what share and at what price to have the share. It could be for example that in South Africa it means I am going for thirty percent market share, regardless of the cost to serve because that is my strategy lead (Principal A).*

It is because of this knowledge that tyre producers are pressing to have more transparent cost and prices of products used in tyre production. Tyre producers would like to have selling prices linked to the oil refined commodities used in the production of intermediary chemicals to provide this transparency. As one respondent stated:

*The price, obviously to all of us will always be an issue. But I am the first one to say, define a price formula that says, for example, take three parts of oil, divide it by benzene to a final selling price. Set something that is transparent that we cannot argue against because the numbers are set and agreed (Tyre Producer A).*

On the other hand, the dynamics in making a decision to purchase a product is not always consciously weighed up against the benefits that could be gained from the exchange. For example, the producer may have to buy a product from an alternative approved source, because internal quality instructions may require re-approval if a product has not been used

in a factory in a stipulated time frame. This concurs with the number of alternative sources of supply as mentioned in Section 4.3.1. This price may be higher than the lowest approved source just to ensure that the number of alternatives is maintained. Approved alternatives are important in pricing dynamics and are therefore important criteria in maintaining the upkeep of available suppliers.

Data from the interviews with the regional tyre producers indicated that the benefits in exchange for the price payable are appreciably more in South Africa. Most interviewees indicated that the product exchanges were fundamentally relational in nature and viewed transactions in terms of their history and associations.

In summary, price has become the only performance measure of central purchasing of tyre producers. However in remote regions, like South Africa, services produced to get product to its destination are still considered as a benefit. Furthermore, there is a general concern that the approach to price, especially during the peak of the industry's reorganisation, has contributed to the current market pricing which is short term as a result of supply restrictions. For example, the principal openly described their pricing structure as strategic rather than cost driven. In turn, the response from tyre producers is to have formula driven prices due to the fact that prices are supply and demand plus competitor driven. Of further interest are the strategic buying decisions, influenced by the regions in respect of best practice, with the aim of maintaining a certain number of alternative suppliers on their list of approved suppliers.

#### **4.4.2 Process cost**

Leading on from Section 4.4.2, the cost identified to maintain best practice could mean paying a higher price to maintain a certain number of suppliers approved as alternative sources. Next, the time and cost to evaluate new products to expand the list of suppliers is an unavoidable cost.

The most pressing process cost is the operational cost as a result of the supply chain. The long shipping time to get product requires warehousing product for a month or longer before it is used. A tyre producing location in France for example has a lead-time of three days from the principal for the same commodity.

Another point of interest to report regarding process cost is the principal's intelligence about the cost to serve different regions. It implies that should the principal focus on only supplying lower "cost to serve" regions, they force their competitors to spend more at the same price to other more expensive regions like South Africa.

#### **4.5 Conclusion**

The primary data provided an in-depth overview in terms of the strategies of the tyre producers and their major suppliers.

In June and August 2004 when the data were collected, the market for rubber chemicals was in a short supply position. Consequently, the supply versus demand and pricing issues pervaded the data collected from tyre production. Principal A captured the situation as follows:

*These are huge super tankers of organisations. They've taken so much cost out themselves; they don't have the infrastructure to deal*

*with short term pricing...I don't think they can cope with pricing changes that fast (Principal A).*

Nevertheless, the evidence provided insight into how the three main parties in the supply chain of tyre production act interdependently to achieve their independent objectives. Moreover, the evidence has shown that perceived value is a variable dependent on the balance of the relationships between the attributes of the value platforms.

In this chapter, valuable evidence about the perception of the agent in the supply chain was presented. As a respondent commented:

*I think perceptions are what drive peoples decisions. We know this from books on psychology. The perception that your (agent) customers have about you (agent) is important. So, the measurement of the perceptions of your (agent) value in the supply chain could be a valuable exercise. But more important is to see how perceptions change (over time) rather than a single snap shot (Tyre Producer B).*

Furthermore, attributes validating product, service and distribution as value delivering platforms were reported and will be discussed further in Chapter 5.

## **CHAPTER 5 CONCLUSIONS**

### **5.1 Introduction**

At the beginning of this research process the researcher was curious to understand why the agent in the supply chain of tyre production in South Africa had not been eliminated as was the case in other world regions following the rationalisation of the global tyre industry and concomitant chemical product supply industries. In addition, a number of authors have found that manufacturers of goods have become more integrated in order to lower costs and improve efficiencies in the supply chain (Grönroos, 2004; Ravald & Grönroos, 1996; Sheth & Parvatiyar, 1995). Therefore, it was suggested in Chapter 1 that the agents' value contribution in the supply chain may be sustainable and therefore prevent disintermediation.

Furthermore, the researcher wanted to know why the value contributed by the agent is perceived as better than fully integrated supply chains. The literature reviewed on value innovation and delivery, in particular that of authors Eggert and Ulaga (2002), Lapierre (2000), Zeithaml (1998) and Kim and Mauborgne (1997), revealed that customers receive value from product, service and distribution and its respective and related attributes. By combining these value concepts as overall benefits to the customer, a theoretical model, to measure customer's perception of value received, was developed for this research to clarify what value is contributed by the agent, as well as how it is contributed by the agent.

However, as predicted by Forsström (2005) and others (Vargo & Lusch, 2004; Tzokas & Saren, 1997) measuring the perception of value is difficult because it is entirely dependent on human experiences, which differ from

person to person. This research concurs with these authors, that value is a difficult concept to measure. Moreover, as the literature and the evidence in the previous chapter suggests, value is a trade-off between benefits and sacrifices and will therefore be different for each specific context and situation.

In this chapter, the value of the agent in the context of the supply chain of tyre production in South Africa is discussed to address the research questions posed in Chapter 1.

## **5.2 Conclusions about the two research questions**

The aim of the research was to test a theoretical model to determine:

- i. Why the value provided by middlemen in the supply chain of South African tyre production is perceived to be greater than that derived from direct business routes, and
- ii. Identifying the most important aspect which contributes to the value of the agent.

In this section the conclusions about the research questions, as posed in Chapter 1, are discussed. Discussions about the conclusions drawn from the primary data are supported by secondary data as reviewed in Chapter 2. Conclusion 1 shows that *relationship* between the agent and the tyre producers is perceived to be the value of the agent in the supply chain. Conclusions 2, 3 and 4 are about the three value dimensions (platforms) of the theoretical framework and address the second research question.

**Conclusion 1: The agent's *relationship* with both the principal (the supplier) and the South African tyre producers contributes greater value in the supply chain than that which could be derived from a direct business model.** The first conclusion refers to the first research question and relates to the relationship between the principal and the agent, and between the agent and the South African tyre producers. The *literature* suggested that relationships are formed from frequent interactions, over an extended period of time, between businesses (Gronroos, 2004; Tzokas & Saren, 1997; Gronroos & Ravald, 1996; Bagozzi, 1978). These interactions take place beyond mere transactional exchanges and hence contribute to the development of the social relationship constructs of trust and commitment (Van Bruggen, Kacker & Nieuwelaat, 2005; Tzokas & Saren, 2004; Cann, 1998; Morgan & Hunt, 1994). Further, as the relationships develop, various business objectives become connected to those of other organisations, creating interdependency of activities (Rao, 2002; Dwyer, Schurr & Oh, 1987). In addition, relationship development is not necessarily an orderly process and does not depend on a set of conditions but rather depends on the opportunities and/or circumstances at a given point in time (Rao, 2002).

Williamson's (1981) transaction cost characteristics of exchange *frequency*, *levels of investment* and *uncertainty* support the fact that relationship development depends on opportunities and/or circumstances. This is because the service that is necessary in product exchanges, such as delivery, contributes to the relationship development. The *frequency* of exchanges and thus frequent service requirements provide opportunities for regular interactions between parties. In addition, Williamson (1981) argued that *investment* is required by the parties to the exchange to facilitate the exchange. For example, a supplier's investment in holding consigned stock on customer's premises. The final characteristic of

*uncertainty* refers to the unpredictability of a company's internal and external environment that will influence decisions on how and/or with whom to transact (Williamson, 1981).

The *findings* support the literature reviewed. In addition to the product exchange, the related service, for example the delivery of that product, provided the agent with the opportunity to develop relationships with the customer and the supplier through frequent interactions. The relationship built on commitment and trust – some relationships have survived the challenges of sanctions and the apartheid era and more recently the global rationalisation of the tyre industry.

However, as the business environment changed over time so did the levels of dependence within these relationships. The *findings* suggest that the customers' dependence on the agent, at the time of collecting the data for this research, was high. The intermediary product needed in the production of tyres was in short supply, in part due to the ongoing rationalisation but exacerbated by the oil supply position. It was reported that the agent was successful in securing intermediary product for allocation to tyre production in South Africa and that this was attributable to the agents' long-standing relationship with the principal. Thus supporting Rao's (2002) point that relationship development depends on opportunities and/or circumstances provided from changes in the business environment.

Further, the increased dependence on the agent to leverage its resources to secure product on behalf of the customer suggests that there is a direct correlation between the transaction cost characteristic of uncertainty and the level of dependence between parties. Likewise, the findings suggested that the dependence of the customer on the resources of the agent during

times of over-supply of product is less. For example, before rationalisation and the oil crisis affected the products supply position, the relationships were more structural, meaning that a level of investment to promote exchanges was a minimum requirement. This investment was in the form of consigned stock and long terms of credit extended by the principal, implying a high cost to transact with tyre production in South Africa. When the principal reduced their transaction cost by removing terms of credit and consigned product, uncertainty increased and with that the increased levels of dependence on the agents' resources.

In addition, the effect of uncertainty means that the customer becomes indisposed to the supplier and or/link of the supplier. For example, the findings suggested that price and service became secondary in negotiations about securing product supply. Therefore, and as the findings suggests, the perceived value of the agent was higher due to the prevailing circumstances surrounding the product supply position and consequent high levels of transaction uncertainty. Further, the tyre producer's perspective of moderated uncertainty, as a consequence of the relationships of the parties in the supply chain, is preferred compared to a direct business route where the customer would not have been able to negotiate uncertainty. And this is because there is no evidence of a direct relationship between the principal and the South African tyre producers. Thus the *relationship value* of the agent delays the imminence of the direct business route.

**Conclusion 2: Quality and number of alternative suppliers are attributes of the *product* dimension which influence the perceived value of agents by tyre producers.** The second conclusion relates to the perceived value of the product. The *literature* referred to the function a product performs as its use value or its built-in properties (Ambler, 2004;

Vargo & Lusch, 2004; Tzokas & Saren, 1997; Sheth & Parvatiyar, 1995; Houston & Gassenheimer, 1987). Furthermore, these built-in properties are intrinsic to the product and this is what keeps the product in demand and if there is a demand, then the use-value is not dependent on people's impressions (Tzokas & Saren, 1997). Therefore, a need for a products' use value is the reason for an exchange to happen, thus making the product the core of the exchange (Gronroos, 2004).

The *findings* conclude that the product, namely rubber chemicals, is used in combination with other raw materials and products to produce finished goods, namely automobile tyres. Further, the product has unique built-in properties that function when used in combination with other products and as a result is demanded for its use-value. However, the fact that the product is used in combination with other products means that the minimum quality requirements are high. Firstly to ensure that the functional characteristics of the product *in-use* performs to requirements when combined with other materials to produce tyres and secondly to have security about the performance of the tyre in the consumer market, an area where performance and safety are not negotiable.

Next, the *findings* suggest that, as a consequence of the demand for high *quality*, the numbers of *alternative* rubber chemical suppliers are limited. However, it was acknowledged that the rationalisation of the global tyre industry in fact contributed to the elimination of some of the product manufacturers. These two factors, quality and rationalisation, have thus combined to contribute to the current situation in which there is a limited number of rubber chemical product manufacturers.

**Conclusion 3: Reliability and supply chain knowledge are attributes of the *service* dimension that influence perceived value of agents by tyre producers.** The third conclusion relates to the perceived value of service. The *literature* suggests that service, like products, has a use value (Ambler, 2004; Gummesson, 1998). This is confirmed by Kim and Mauborgne's (2000) findings that value could be measured during each stage (sale, delivery and use) of the exchange. However, whereas the products' use value is the reason for the exchange to happen, it also produces a service need for consumption (Gronroos, 2004; Gummesson, 1998; Houston & Gassenheimer, 1987; Parasuraman, Zeithaml & Barry, 1985). For example, when a product is bought for use in production the customer needs communication about the time and mode of delivery. It is during this need for and consumption of service where suppliers and customers interact frequently to collaborate on the details of the exact service requirement. These interactions provide opportunities for suppliers to show customers their commitment and build trust, which when repeated over time evolve into relationships between buyers and sellers.

According to the *findings*, the physical delivery of the product combined with the knowledge of the delivery process is perceived as the most important attributes of service. Knowledge of the delivery process is important because of the geographical distance between the South African tyre producer and primary rubber chemical product manufacturer in Europe. In addition, rubber chemical products require special packaging and stowing on ships to ensure the products' quality does not deteriorate over the three to four week shipping time. Another factor noted is knowledge of alternative solutions that could solve problems as a result of delayed deliveries. For example, knowledge of who else in the region has available product to exchange in a stock-out situation.

In addition to the service attributes of reliability in physical delivery knowledge is the agents' knowledge of the tyre producers' needs. This requires frequent interaction in order to exceed the tyre producers' service expectation. Furthermore, as mentioned in Conclusion 1, this commitment builds trust which develops the relationship between the agent and the tyre producers.

**Conclusion 4: Distribution efficiency is dependent on the transaction cost characteristics of uncertainty, frequency of exchanges and levels of investment.** The *literature* suggests that a supplier's distribution strategy is influenced by a customer's delivery expectations following the sale of a product (Gronroos, 2004; Gummesson, 1998; Houston & Gassenheimer, 1987; Parasuraman, Zeithaml & Barry, 1985). Likewise, the supplier wants a distribution strategy that is capable of delivering to customers' expectations. The combination of the promise to satisfy the customers' delivery expectations and meeting those expectations, in the most economical and efficient way, will influence how a company organises product delivery for transactions (Rindfleisch & Heide, 1997; Frazier, Klein & Roth, 1990; Williamson, 1981). To *organise transactions* refers to the institutional framework or governance structure that a company employs to integrate/interact with a particular marketplace (Williamson, 1981). In turn, the efficiencies and economics of a governance structure are dependent on the frequency of transactions, uncertainty and the required levels of investment. These three mentioned characteristics of distribution efficiency combine to shape a supplier's distribution strategy.

The *findings* support the *literature*. To begin with, the reason why the agent is in the supply chain is because the agent is part of the principal's distribution strategy and system. When the costs of doing business with

the South African tyre producers became too high the suppliers changed their distribution system from direct distribution from using a regional office to using a middleman to interact with the market. This is a classical example of a business economising on transaction costs by reducing levels of investments in regional offices but at the same time maintaining the frequency of exchanges to contain degrees of uncertainty. Because product deliveries are not disrupted, the customer knows that he will receive his products and the agent knows that he will be earning commission on these exchanges. As a result, the principal is able to contain the levels of uncertainty surrounding the exchange.

In addition, the *findings* suggest interdependence between the three transaction cost characteristics as espoused by Williamson (1981). For example, when the industry went into short supply of product, the degree of uncertainty for both customer and agent increased when the principal cancelled his consigned rubber chemical product stock with the tyre producers in South Africa. For the principal this decision greatly reduced costs (levels of investment) in non-turning stock. (Non-turning stock is unused product kept in reserve until the customer is ready to use it. This stock will be transacted and/or paid for when it is used. In the meantime, the principal loses the opportunity of selling this stock to an immediate customer). Further, by getting rid of non-turning stock (consignment stock) the principals cost to transact is reduced because the period/time between delivery and payment is shortened. In turn, the tyre producer's uncertainty increased and to contain their uncertainty they had to hold buffer rubber chemical product stock which increased their cost to transact.

In addition, as the level of supplier investment declined the required level of investment from the customer in order to transact, increased. In both instances the actions were to exercise control over the degree of

uncertainty in supply. For example, by removing the consigned product stock the supplier had more control over available product stock for distribution. In turn, by holding buffer stocks of product, the customer has bought security for planned production and thus ensures continuity of production.

### **5.3 Implications for theory**

This research has provided empirical evidence that it is possible, in Business to Business markets, to develop inter-company relationships in the presence of repeated exchanges. In addition, it has shown that developed and/or established inter-company relationships could contribute to a company's resilience and survival in a dynamic world of change as described in Chapter 1 of this research.

For example, the agent under study clearly focuses on his non-economic social relationship with both the principal (supplier) and South African tyre producer (customer) to survive changes faced namely trade and investment liberalisation, globalisation, technological innovations, computers and telecommunications liberalisation. Although the customer remains sceptical about the long-term future of the agent in his supply chain, for economic reasons, the customer remains committed to the relationship and demonstrates this by continuing to pursue business with the supplier via the agent. In turn, the supplier realises a cost benefit in channelling sales via the agent because he can lever the agents' social relationship to achieve his independent objectives.

The relationship between the agent and the supplier and the relationship between the agent and customer is a non-economic social relationship but the relationship between the supplier and customer is an economic

structural relationship. For example, when the rubber chemical product was in over-supply, before the industry rationalised, the principal invested in consignment stock to secure transactions. When the rubber chemical product went into short supply, the tyre producer in turn had to increase his investment into buffer-stock to secure exchanges. Therefore this relationship is investment dependent and thus structural.

In summation, throughout the dynamics of the changes, over time, both the supplier and customer were able to rely on the agent's non-economic relationships to ensure that the economic relationship objectives of all parties to the exchange were met. Therefore, the inter-company relationships of the agent have proved that by keeping the transaction characteristics of uncertainty, frequency and asset specificity in equilibrium, the level of integration of the supplier within a specific marketplace could be maintained. Or, as Williamson (1981:552) succinctly put it:

With a well-working interface, as with a well-working machine, these transfers occur smoothly. In mechanical systems we look for frictions: do gears mesh, are the parts lubricated, is there needless slippage or other loss of energy? The economic counterpart of friction is transaction cost: do the parties to the exchange operate harmoniously, or are there frequent misunderstandings and conflicts that lead to delays, breakdowns and other malfunctions?

#### **5.4 Limitations and further research**

The theoretical framework proved to be an effective map to guide the researcher in reviewing relevant literature and also in labelling and categorising primary data. Although this map provided a meaningful route

to the concluding discussions of this research, it did not measure the perceptions of value as it was expected to do at the beginning of this research.

Further, the agents' relationship with both tyre producers and the principal was perceived as the main source of value to all parties to the exchange. However, the aspect of relationship marketing was only reviewed, in Chapter 2, as an outcome of excellent service and effective distribution and not in sufficient detail to interpret and analyse the data from a relationship point of view. In fact, *Relationships* are proposed by Ulaga and Chacour (2001) and Lapierre (2001; 1997) as an independent value platform. This research however applied *Distribution* as a value platform based on the findings of Kim and Mauborgne (1997). There is no doubt, however, from the evidence collected, that the value of the relationship would have been at least one of the conclusions.

## **5.5 Conclusion**

In this chapter discussion and comparison of the literature to the findings of the two research questions was presented in four conclusions. The first three conclusions were about further development of value platforms to measure what the customers in context of this research perceive as value. The fourth conclusion offered the relationship between the agent and customer and between the agent and supplier as the perceived value.

In summary, this research confirmed the value of relationships in Business to Business markets. However, although the relationship is clearly of value the integration strategy of suppliers, shaped by the external environment will determine the future of the agent in the supply chain in the context of any region and industry.

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