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# Developing Relations on B2B Markets

*The Case of Rolls-Royce Marine AS Expanding  
Operations on the Russian Maritime Market*

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## **Abstract**

This thesis is presented as a requirement for completion of the Master's program in Marketing and Brand Management at the Norwegian School of Economics. The study features a list of suggestions for Rolls-Royce Marine AS for developing relations and designing its offerings as part of its possible market entry to the Russian maritime market.

The interest in the topic emerged through a close cooperation with the company, where one of the authors was employed as a summer employee and grew to understand the market challenges from the inside. Given the authors' Russian background combined with the attractiveness of the Russian market for RRM, it was decided to work on this topic.

The authors would like to express their appreciation for the people in the company that gave their time for interviewing and therefore permitted the better practical quality of the research.

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# 1. Introduction

The paper is focusing on the case of Rolls-Royce Marine AS (RRM) – a Norway-based company offering ship design services and selling parts – expanding operations on the Russian maritime market. Even though the company has extensive international presence, it has almost no experience or proper knowledge about the Russian market. Such a situation creates a challenge when trying to approach so unfamiliar and unstable market as Russia. Thus the main purpose of the current project is to analyze the company and its possibilities and opportunities on a new market, and to recommend ways for developing relations and offers given the market's particularities.

Rolls-Royce Marine (RRM) is one of the four global market sectors within Rolls-Royce. RRM is involved in encompassing vessel design, integration of complex systems, and supply and support of power and propulsion equipment, being leaders in mission-critical systems for offshore oil & gas, merchant and naval vessels. For the purpose of the project we are focusing on the Offshore Ship Technology division of RRM (ShipTech). The division specializes in offering full engineering and design services within the offshore supply vessels. ShipTech represents the “designer” part of a value creating chain. In further cooperation with shipyards (i.e. using them as subcontractors) that results in a customized offshore supply vessel as an end product. However it does not mean that the option of supplying just the outfitting equipment is left aside, and we paid special attention to such an option in the paper.

It is worth mentioning that Russian maritime market is not new to RRM: the company has already had several single operations and even has offices in some major cities of Russia. However these minor operations do not embrace the whole potential that the market offers to the company. At the same time, very little knowledge and experience with Russia don't allow for exploiting the opportunities, which results in RRM being lost and not being able to decide which way to choose to pursue the objective. Based on the theoretical background, related to the strategies for managing customer relations and operations on B2B markets, a set of recommendations on how to market the services for RRM has been developed.

The final aim of this research is delivering a set of possible recommendations for operating on the Russian market for RRM, while seriously considering the unfamiliar

market particularities and the company's strategy, goal and resources. The information about company's views and approaches to doing business (derived from the interviews with the managers) is entwined with the theoretical background and Russian maritime market assessment to result in the most suitable solution for the company.

Considering the anticipated research outcome and the goal of the project, the **research question** was formulated as follows: "How should the company manage its customer relations and how it should design its offerings given the market characteristics, company's strategy and resources?"

The rest of the paper follows the generally accepted structure. In the second chapter we introduce the company and the market to be analyzed. The company information includes general facts, coupled with RRM's strategic orientations and its usual way of managing operations and relations with customers. When introducing the situation on the Russian market, we start with the general macroeconomical overview of the country, followed by a closer investigation of the maritime market and description of its main players. The third chapter represents the theoretical background used as a foundation for the research. More specifically, we first look at the relationship marketing theory (i.e. we compare discrete and relational exchange types, followed by closer analysis of different types of customers involved in B2B relations, and concluding with the international context of relationship approach), which lies behind RRM's approach to doing business. Second, we turn to the interfirm governance theory with transaction cost analysis as a foundation (i.e. we overview three main types of governance structure on B2B markets along the development of the relationships, and then we analyze the governance mechanisms used to safeguard parties' interests in the relations and to protect from opportunistic behavior from the part of the partner). Finally we conclude the third chapter with the purchasing portfolio strategies, namely the Kraljic (1983) matrix. The fourth chapter represents the methodology used when writing the paper. Namely, we describe the process of collecting primary data from the company as well as analysis of secondary data about the market. The chapter also covers the main limitations of the research together with the security of its credibility. The fifth chapter presents the results of data collection: we overview the main findings about the company, collected from RRM's employees (e.g. company's overall strategic orientation, its approach to managing clients and

operations, its values and corporate culture, contractual security), followed by the assessment of Russian maritime market (i.e. market's potential assessment, estimated risks and challenges, together with the detailed description of customers presented on the market). Finally the sixth chapter presents our main recommendations based on the data collected and on the theoretical background.



## **2. Background**

### **2.1. Rolls-Royce Marine AS**

Rolls-Royce Marine AS (RRM) is one of the four global market sectors within Rolls-Royce. Apart from this subsidiary the head company (Rolls-Royce Group Plc.) also includes such entities as Rolls-Royce Deutschland, Rolls-Royce Marine Power Operations Ltd, Rolls-Royce North America, Rolls-Royce Corporation, Rolls-Royce Turbomeca Ltd. and others, who are engaged in the different areas of presence like aerospace, power generation, defense, etc. (Rolls-Royce 2013). Rolls-Royce Group's operations are widely spread across the globe with business activities present on all the continents through the scope of product delivered to different governments, national companies and transnationals. Rolls-Royce Marine AS was founded in 1998 and its main office is located in Ulsteinvik, Norway. As of 2012 the revenue constituted \$2,209,431,025. RRM employs 2346 people (EBSCO 2012). RRM is involved in encompassing vessel design, integration of complex systems, and supply and support of power and propulsion equipment, being leaders in mission-critical systems for offshore oil & gas, merchant and naval vessels.

The current project is focusing on the Offshore Ship Technology division (ShipTech). This division specializes in offering full engineering and design services within the offshore supply vessels. RRM focuses on supplying its customers with a full-package deal including all stages of product development; there's a strong core philosophy within the company of designing integrated systems rather than just a ship with equipment. This approach helps the client get an end product where the overall design philosophy is ensured as RRM engages in all engineering activities and interfacing of the equipment portfolio. ShipTech represents the "designer" part of a value creating chain. With further cooperation with shipyards (i.e. using them as subcontractors) this results in a customized offshore supply vessel as an end product.

The company doesn't operate its own production sites. That is a part of RRM's strategy – no shipyards in order to avoid favoring any of them, and to artificially create competition between shipyards. However RRM has docks in 35 countries worldwide, which allows for service activities. When it comes to investing in the development of the shipyard of interest, RRM only approves of personnel training and consulting activities, not the equipment upgrade or investing in physical assets.

RRM's main customers are in most cases shipowners (e.g. shipbrokers, charterers, shipping or oil & gas companies). The process of working with a client starts with the value proposal and continues through contract agreement, implementation and follow-up. The ability to provide the whole package of a service along with the product rather than just a simple product is the distinguishing trait of the company and its competitive advantage.

The company operates on a global basis, and has recently started considering expanding operations on the Russian maritime market, due to it being a strategically attractive option. Even though RRM has already had several single operations on the market (e.g. several contracts for supplying offshore vessels have been signed), as well as it now has representative offices in some major cities in Russia, it has not yet established close and long-term relations with customers and suppliers that would allow for operations on a more consistent basis. RRM has to come up with a way to manage its offerings depending on the chosen clientele.

The company is focusing on building strong customer relations, and RRM's management believes that by doing so, the company would be able to get a foothold on the Russian market. At the same time, RRM is not looking for establishing a joint venture or alliance neither with the shipowners nor with the shipyards, regarding such and option as a potential danger to lose control (Interview with Rolls-Royce Marine 2013).

Shipowners represent the most common link to the market for RRM. The main challenge for the company is to convince the final owners of the vessels in buying RRM's products and services. Having succeeded in that, it is important to find the right shipyard that would be able to build the vessel and fulfill the order. The biggest difficulty concerns finding the decision makers and get in contact with them.

Apart from offering full ship design services, RRM is selling the outfitting equipment such as power and propulsion systems featuring diesel engines and gas turbines, propellers, thrusters and water jets. Although departments other than ShipTech manage these operations, this is of a particular interest for us as researchers. The reason for that is that such "self-sufficient" products are easier to market and sell due to larger variety of usage situations. For RRM this can be a solid starting point for

both creating positive associations among the Russian customers and looking for potential contacts to establish relations with.

## **2.2. Russian Maritime Market**

### ***2.2.1. Russia's macroeconomical overview***

Russia is one of the world's largest players on the B2B market. It possesses several characteristics that are peculiar to its structure. Having been a large part of the Russian Empire and later USSR, Russia today inherits some of the former country's traits and presently is involved in several industries and areas of production and manufacturing such as (MarketLine 2012):

- Complete range of mining and extractive industries producing coal, oil, gas, chemicals, and metals
- All forms of machine building from rolling mills to high performance aircraft and space vehicles
- Defense industries including radar, missile production, and advanced electronic components, shipbuilding
- Road and rail transportation equipment
- Communications equipment
- Agricultural machinery, tractors, and construction equipment
- Electric power generation and transmitting equipment
- Medical and scientific instruments
- Consumer durables, textiles, foodstuffs, handicrafts

The primary Russian export articles are petroleum and petroleum products, natural gas, metals, wood and wood products, chemicals. A wide variety of civilian and military manufactures are also in demand.

A wide natural resource base including major deposits of oil, natural gas, coal, many strategic minerals, and wood make the Russian economy rather resource-based and resources-dependent (MarketLine 2012).

In general, Russian economy is experiencing a steady growth, although the overall numbers are lower than those before the financial crisis. Moreover, Russia is one of the most attractive emerging markets, which is due to several reasons. First, Russia is

the leading exporter of gas and one of the largest exporters of oil, owning about 50% of world's natural resources (hydrocarbons, minerals/metals, wood). Second, the demand for a wide range of goods (products, technologies, services and experience) is steadily increasing, and the country lacks and is in need of external investments and involvement in different sectors. This opens up an enormous market with rather high potential.

Being a leading oil and natural gas exporter as well as a permanent member of the UN Security Council, Russia finally joined the WTO in December 2011, which ended the anomaly of the country being outside the world trade system. It is expected that the removal of the trade barriers will enhance trading opportunities between Russia and the rest of the world. As a member of the WTO, it is expected that Russia will incorporate certain rules and regulations that will resolve the complaints of foreign investors on issues such as corruption, minority shareholder protection, and the independence of the judiciary. Despite the global slowdown, Russian external trade showed tremendous growth, with the country's current account surplus increasing in 2009. According to data released by the Bank of Russia in 2012, further improvement of \$98.8 billion in the current account surplus was seen in 2011. According to MarketLine's (2012) projections, the unemployment rate is expected to be over 6% for 2012–2016.

Doing large-scale business on Russia is likely to be influenced by several local factors that have to be taken into consideration:

- High level of corruption (Russia ranks 143 out of 183 countries according to the corruption perception index (Transparency International 2012))
- Lack of transparency (deeply rooted especially when it comes to large-scale commercial deals with state-owned entities) (Smith 2010)
- Bureaucracy (massive amounts of paperwork that lacks definitive meaning or purpose; paper pushing consumes time that could reflect negatively on operations)
- Tax regime (a complicated and not always clear system of imposing taxes)
- Contract risk and unpredictability (uncertainty of on-time payment for services and goods/equipment)
- Unpredictable political risk (business interests interfere with political life, existing possibility to “buy” a desired position, politicians often act as

lobbyists. The political power in Russia is also very concentrated and vertically organized with most of serious decision-making happening in the country run by a small group of people)

Also several other features characterize the business society in Russia, such as business prospects often depending not on the characteristics of the product but rather on the ability of finding the right man to partner up with, or the fact that foreign companies and investors will be more likely asked to transfer payments to overseas accounts.

### ***2.2.2. Russian maritime market – general overview of the industry***

The leadership of Russia has identified several priority areas of industrial development and modernization of the country, shipbuilding/maritime industry being among them. The issues of the development of the industry were discussed on the highest level in Russia several times since 2007 and both leaders of the country have recently visited shipyards and offshore installations.

Shipbuilding is and has always been an important industry for the Russian economy. The country possesses 40000 km of coastal line and nearly 100000 km of inner waterways, with a substantial amount of foreign and domestic trade being operated via shipping. It is also estimated that up to 25% of world's hydrocarbons are stored on the Russian shelves, and that also requires serious development of the industry to successfully operate the fields (Industrialist of Russia 2012).

Russia has a long history in shipping and shipbuilding however there has been a dramatic new buildings reduction since 1990, and the industry is suffering from lack of investments and decomposition of heritage Soviet R&D. The shipbuilding industry is plagued with several disadvantages, which can be summarized as follows (GlobalSecurity.org 2011):

- Labor intensity is 3-5 times higher than in other countries
- It takes 2-3 times longer to build a vessel
- The end product therefore is more expensive
- Lack of hardware and qualified manpower
- Legal framework and banking system do not facilitate production

According to Dmitry Mironenko, vice-president of United Shipbuilding Corporation, Russia's largest shipbuilder group (Gerden 2013):

*“Despite the efforts taken by the government for the development of commercial shipbuilding in recent years, the main problem of the industry still remains the technological gap with its Asian, and especially EU rivals, which has grown with the increase of tonnage of ships under construction. The current level of depreciation of fixed assets in the industry is still around 70% with the average age of the industry's production equipment is 20 years. The situation is aggravated by the lack of high-tech shipboard equipment and the technologies for its production. This means that the majority of shipboard equipment for domestic shipyards is currently imported from abroad. Finally, rapid development of the industry is prevented by low productivity of the domestic shipbuilding.”*

Products for navy today dominate the structure of Russian shipbuilding production, while the usage of the production capacity is approximately 50%. In 2012 defense orders accounted for two-thirds of revenue of domestic shipyards, equivalent to 90 billion rubles (\$3 billion), which is three times more than in 2011. At the same time revenue from commercial shipbuilding fell by 16%, compared to 2011 (Interview with Rolls-Royce Marine 2013). Some experts see a rolling back to the USSR production portfolio trend, when the majority of industry in the country was living off the military orders while civilian technology was secondary and therefore was neglected and getting obsolete.

Even though the investment in the industry increased in the recent years, the most slow developing part of the market yet is the production of the commercial vessels 100000 dwt. and higher – the most sought after segment by shipping companies (Industrialist of Russia 2012).

Government initiatives to provide state support for Russian shipping and shipbuilding included cutting production costs at domestic shipyards, reduction of payback period for locally-built ships, amendments to taxation, labor codes, shipping and water transport regulations and other. Most of the amendments were aimed at supporting ship operators, e.g. tax relief on Russian built and registered vessels lasting until 2027. Apparently these measures did not prove to be very efficient and were not able to tilt the balance in the industry towards commercial fleet progress (Gerden 2013).

Nevertheless, the industry is recognized as very important in the strategic perspective and in addition to the strong legislative base, there has recently been created a state program, which can be translated as “Of the development of Shipbuilding” (Ministry of Industry and Trade 2013). This program, due to last until 2030, was developed by the Ministry of Industry and Trade. The total value of the program is 605.3 billion rubles (\$20 billion), of which 337.9 billion will be allocated from the state budget, the rest from the private sector (Gerden 2013). These are ambitious plans of reducing the technological lag of the Russian inner production in comparison with the foreign analogs and increasing the development and production of maritime projects.

The primary aim of the program is to revitalize the commercial shipbuilding industry because the military production is in more or less satisfiable state. At the same time, given the economy and geography characteristics as well as the long payback period on investment in this industry, it is important to support the local commercial shipbuilders as they serve many of the inner market interests and play a crucial role in the development and functioning of the country economy. At present Russian civil shipbuilding accounts for just 0.6% of the world’s production volume and holds the 21<sup>st</sup> place in this regard, whereas Russian military naval production amounts to 12% of the world capacity and comes second only to the US production (Industrialist of Russia 2012). In accordance with this program the biggest effort will go towards increasing the highly technological production for export as well as increasing the input from the industry to the growth of the GDP. The share of Russian companies in the world portfolio of vessel production should reach 5%. (Ministry of Industry and Trade 2013) Since most of Russia’s maritime cluster lies in arctic climate zone, fluvial shipbuilding is limited by relatively short navigation periods. Also, civil shipbuilding is mainly driven by oil and gas sector, especially with the development of offshore hydrocarbon fields. Therefore one of the most prospective areas for achieving the set goals is the development of oil and gas fields in the cold regions of Arctic and the Far East. The focus is put on the vessels for maintenance, development, extraction and transport provision of the Arctic region and offshore fields. It is estimated that by 2030 the needs for extraction and transportation of oil and gas resources on the Russian hydrocarbons offshore fields will reach 110 million tons of oil and up to 160 billion m<sup>3</sup> of gas a year. In order to perform the forecasted levels of

extraction and transportation, 90 arctic vessels, 140 offshore supply vessels and more than 40 icebreakers need to be built (Industrialist of Russia 2012).

However, due to the recent discovery of shale oil and gas in North America and other places as well as the development of economically attractive extraction techniques, some Arctic destinations could be put on hold until the time when investors deem this opportunity attractive. In addition, present and expected hydrocarbons prices affect the decision-making process. Currently, there are several large offshore projects in operation, like Sakhalin-1 and -2, Varandey, Prirazlomnoe and others where large ice-class vessels are used for maintenance and transportation.

Since the shipbuilding sector is regarded in Russia as strategically important (especially when it comes to vessels supplying the offshore oil fields), there is high governmental control present. This leads to a rather monopolized market with high governmental ownership. Apart from that there also exists a possibility for production localization requirement (PLR) for the maritime sector, the way it was organized when the foreign automakers were allowed to establish in Russia. This is a protectionist measure aimed to ensure that foreign companies do not treat the Russian market as a bare means of selling their products in disregard to the social and economic ramifications. In most cases concerning multinational operations, the hulls are built in the Russian shipyards, whereas all the rest is outsourced due to the internal quality regulations and other concerns for the industry (listed before). PLR represents one serious challenge for companies that advertise persistent quality, which is achieved through being present at and controlling all the stages of the project. Naturally, it would be difficult to ensure the integrity of the process on the Russian part.

Realization of the large technological gap between the local production and foreign competitors pushes towards international cooperation with purpose of technology and experience transfer. United Shipbuilding Corporation recently signed agreements for establishing joint ventures with such companies as DSME and STX in Korea, Yantai Raffles of Singapore, DCNS of France, the Finnish Wärtsilä group and Saipem in Italy. These partnerships and ventures are expected to result in the reinforcement of the shipbuilding clusters in Russia during the following years (Gerden 2013).



### ***2.2.3. Russian maritime market main players***

Russia has the potential for being a very attractive market for maritime operations due to the industrial activity, natural resources base and extensive coastal line. Therefore companies that try to establish a foothold on the market have to devote their attention to the existing large players and seek ways to enter transactions.

The major shipowner on the maritime market in Russia is Sovcomflot (SCF), the largest Russian shipping company. The government owns 100% of shares; HQ is located in St. Petersburg. The company offers a full range of crude oil, refined petroleum products and liquefied gas transportation services. Being one of the world's leading tanker owners, SCF is one of the most active participants in key Russian oil and gas development projects including operations in harsh Arctic environment. In addition the company successfully competes in the international maritime shipping markets (Sovcomflot 2013). The company owns 161 vessels with combined deadweight of nearly 12.5 million tons. At the same time they have eight new vessels in production with combined weight of a million dwt. The average age of a vessel is a little short than eight years, which ranks Sovcomflot as the owner one of the most modern tanker fleets in the world. SCF Group has 7 companies, each engaged in a specific sector (e.g. chartering operations, tankers of different types, etc.) (Sovcomflot 2013) The company operates on the following markets:

- Operating crude oil tankers in Suezmax (120-200,000 dwt) and Aframax (80-120,000 dwt) segments
- Product tankers (45-47,000 dwt), chemical carriers (5-20,000 dwt)
- Liquefied natural gas and petroleum gas-carriers
- Ice-class ships
- Logistical support for offshore development (shuttle oil deliveries in ice conditions, Floating Storage and Offloading units (FSO) services)
- Rendering port-related services including management of oil terminals and tugs operations
- Technical management of the company's and third party vessels

SCF could be regarded as one of the most prospective clients in Russia having a massive fleet and being engaged in different spheres of maritime operations.

Speaking of this project's primary interest in the Offshore Supply Vessel technology carried out by RRM, there is an area of interest on the Russian market in the face of ZAO Rosneftflot (also a part of SCF group) since it is the only company that owns the sufficient offshore supply vessels (OSV) fleet, thus is of a direct interest for RRM and for the current project. The company was founded in conjunction between SCF and Rosneft in 1998 and was known as the Far East Marine Company before 2005 when the head office was moved to Moscow from Yuzhno-Sahalinsk, Russian Federation. There are currently 25 different-purpose ships on the Rosneftflot's balance. The company has already had several one-time operations with Norwegian partners, and is currently undertaking two ice-class projects. All of the vessels were built both on the Russian shipyards and overseas (Rosneftflot 2013). RRM is currently trying to establish first contact with the company.

ZAO Rosneftflot, as a part of Sovcomflot, is the partner worth targeting due to the fact that it holds fleet and does operations sufficient enough for long-term cooperation. Even though there are other companies performing large and long-lasting projects, their fleet mostly consists of such vessels as tankers and dry cargo ships. When in temporary need of exploratory and supply vessels, these companies choose to charter from SCF. Thus having a close to monopoly market, it is worth looking for a partnership with the strongest player.

When it comes to the shipyards, the Russian market is no less monopolistic with the biggest player, the United Shipbuilding Corporation (USC), owning nearly 80% of all the shipyards in Russia. USC has four main branches: Western (which is regarded as the biggest shipbuilding cluster in the country with 14 shipyards throughout St. Petersburg and Kaliningrad area), Northern (9 shipyards), Eastern (or dubbed Far-Eastern in Russian with 12 yards in vicinity), and Southern (which is the newest, it was formed in December 2012 and currently aggregates 6 shipyards) (United Shipbuilding Corporation 2013). Apart from the construction and repair sites, there is a branch devoted to design with 16 engineering-design bureaus throughout the country. As mentioned in the above section regarding the Federal program entitled "Of the development of Shipbuilding", there are plans for substantial investment and partnership programs with purpose of further development of these clusters. Namely, the United Shipbuilding Corporation is involved in the development of The New Admiralty shipyard, on Kotlin Island, St Petersburg. This new industrial complex is

planned to produce vessels with up to 200,000 dwt. and utilize modern equipment and technologies (Gerden 2013). Experts also emphasize that one of the reasons for establishment of the USC is the advancement in the field of offshore supply and transportation vessels and platform building with purpose of extraction hydrocarbons in the world oceans (Industrialist of Russia 2012).

In conclusion to this part, it is worth saying that Rolls-Royce Marine AS is a highly technologically advanced company with long track record in building ships designed for various purposes. For the purpose of the current project we are focusing on the department offering design services for Offshore Support and Supply Vessels. RRM possesses sufficient human capital (especially in engineering) and is capable of offering different options for a customer: from a complete ship to just outfitting the hull. Its ultimate aim is to uphold the value creation chain by offering a complete ship package along a larger time frame, and it has to look for a client on the Russian market in order to secure its presence on this market.

Russian market is regarded as attractive for the maritime sector suppliers: its current capacities are severely deteriorated due to the financial neglect, and it offers a large room for opportunities. Maritime sector is largely used for hydrocarbons extraction, and will be needed for the future Arctic offshore sites development. The Russian government realizes this potential and the national importance of the industry. Therefore it induced the strategic industry revitalization plan, which will include considerable new shipbuilding as well as onshore industry cluster creation. The process is already gaining traction with United Shipbuilding Corporation and Sovcomflot established (both 100% state owned) playing major part as a local contractor and user of the future market capabilities.

Since the purpose of this project is to suggest ways for RRM to secure its place on the Russian market, company's strategic forecasts and present setup of the Russian maritime sector (coupled with the relevant theoretical background) represent the foundation, on which our suggestions and recommendations are based.

### **3. Theoretical Background**

Since the research is targeting the B2B relationship world, it is important to lay the foundation for the research in this field. One of the pillars for this research's theoretical background is the concept of relationship marketing coupled with the main postulates from transaction cost analysis (Williamson 1985). Research of this topic touches such concepts as discrete vs. relational exchange (Macneil (1980); Dwyer, Schurr and Oh (1987)), industrial marketing features such as continuity, customized approach and others suggested by Jackson (1985a), governance structures (Williamson (1985), Heide (1994)) and governance mechanisms (Anderson and Jap 2003), and purchasing strategies (Kraljic (1983), Gelderman and Van Weele (2003)) These topics find further application while examining industrial customers through the prism of prolonged relational context (Jackson (1985a); Jackson (1985b)). In line with this paper's applied nature relational marketing is also discussed and explained in the international settings.

Industrial relationship underlies the necessity to take a closer look on how such complex structures should be managed. Heide (1994) provides a fitting overview of different governance structures that are used on industrial markets: market, non-market unilateral (or hierarchies) and non-market bilateral. Given the scope of the case, it is also important to consider the characteristics that international conditions apply to the concept.

#### **3.1. Relationship Marketing**

##### ***3.1.1. Relational and discrete exchange***

In this chapter the two types of exchange between parties on B2B markets – discrete and relational – are presented. These are described in contrast to each other along several dimensions, i.e. factors or characteristics. The discussion is based on the work of Macneil (1980), who was the first to introduce the notions of relational and discrete exchange. Even though the presented theory was later criticized at some points, it represents a rather clear and accurate picture of what constitutes the exchange process between two parties involved in a relation in one or another way.

According to Macneil (1980), any exchange between two parties or more can represent either discrete or relational type. Discrete exchange usually constitutes nothing more than the transfer of ownership to the product or service – there is no connection to any past or possible future relations between the parties involved in the exchange process (Goldberg 1976). When involved in discrete transactions, the parties only pursue their own interests, remaining autonomous. In comparison relational exchange has history of past interactions and social factors as a foundation. Both parties have mutual interests, which act as an enforcement of obligations (Dwyer, Schurr and Oh 1987).

Both types of exchange can be described deeper along several factors, belonging either to situational or process characteristics. We will cover both, starting with situational.

### **Situational characteristics**

This group includes factors that describe the transactional process in the making: timing of exchange, number of parties involved, obligations and expectations of further relations.

- *Timing of exchange* (length of the actual interaction between members involved in the process): distinct beginning, short duration and rapid ending by performance describe discrete transactions, whereas relational exchange is characterized by traces of previous interactions, prolonged continuity and reflections upon the process (Macneil 1980). In case of the latter, exchange is often determined and carried out according to how it was handled previously. Similarly, present relations will affect the future interactions.
- *Number of parties involved* for discrete transactions is usually two – single buyer and seller, as a simple transaction in most cases does not require additional personnel. On the contrary, for relational exchange there are often more than two parties involved due to its complexity and multidimensionality. These could include consultants, outsourced suppliers, sub-divisions, etc.
- *Interaction-based obligations*: in discrete transactions “content comes from offer and simple claims, obligations come from beliefs and customs”, as opposed to relational exchange, where “content and sources of obligations are promises made in the relations plus customs and laws; obligations are

customized, detailed and administered within the relations” (Dwyer, Schurr and Oh 1987, 12).

- *Expectations of further relations*: for discrete transactions future relations or conflicts of interests are not likely as the transaction is essentially completed after the cash payment is exchanged to the immediately acquired product/service. For relational exchange future relations are most likely; for example, rarely do companies pay for services with cash, and bank transfers and credit operations typically require time and involvement. Also, there bound to be opportunities for future conflicts of interests in the relation, but these are likely to be countered by the mutual trust and co-operative work, and also the benefits that all the parties are deriving from the prolonged relation (Macneil 1980).

### **Process characteristics**

This group of factors belongs to the process of transaction itself: personal relations, contractual solidarity, transferability, cooperation, planning, measurement and specificity, power and, finally, division of benefits and burdens. These characteristics describe the role of the involved parties during the exchange.

- *Personal relations* in discrete transactions are reduced to ritual-like communications, where people play very simple and short-lived roles. As it states in its name, relational exchange is characterized by deep personal involvement, where both formal and informal means of communication are used and the outcome satisfies the parties not only from the economical point of view, but also in a noneconomic, personal sense (Dwyer, Schurr and Oh 1987).
- *Contractual solidarity* (or the way parties act during the process of exchange): normally, the circumstances dictate the code of conduct. In case with discrete relations, it is mainly governed by basic social norms, rules and the prospect of self-gain (Macneil 1980). With relational exchange people are guided by increased legal obligations in addition. This is due to the prolonged continuity and complexity of the transaction, which requires legal guidance and protection from any unexpected events or partner misbehavior. Also, when the exchange is characterized by productive and pleasant cooperation, self-regulation is engaged. That triggers the adjustments to the way parties are

interacting in the way to maximize the positive outcome of the cooperation and also add to the desired continuation of the work.

- *Transferability* (ability to transfer rights, obligations and satisfactions to other parties): discrete transactions possess complete transferability. Obligations can be moved along the supplier side of the interaction from one counter-agent to another and it doesn't matter who fulfills the obligation. Opposite to this, relational exchange is described by limited transferability: it matters who exactly provides the service or delivers the product (Macneil 1980). This feature is also related to the contractual solidarity, which emphasizes the rigidity of obligations sealed by law or a contract.
- *Cooperation*: discrete transaction has no relation to it, since no mutual efforts are needed in the performance of simple and brief roles of the parties. However, during a relational exchange parties combine their efforts over planning and later at the performance stage. It is important to mention that this process is not static – parties adjust their cooperation over time as the relationship progresses and transforms (Dwyer, Schurr and Oh 1987).
- *Planning*: none is necessary for discrete transactions – it focuses solely on the final goal of interaction, which is the substance of exchange; there is no future of the relationship so there is no need for planning involved by definition. When looking at relational exchanges, dedication to the planning aimed at future transactions is of high importance (Macneil 1980). Since relational exchange is a timely procedure, planning plays an important role for future exchanges when the circumstances change and goals shift.
- *Measurement and specificity*: it again is unimportant for discrete transactions; their performance is obvious and simple for all the parties and therefore requires no measurement or specifications (Dwyer, Schurr and Oh 1987). Customers can easily evaluate how the transaction was handled and measure their satisfaction level. For parties involved in relational exchange measurement is important. Normally partners would engage in specifying their needs thoroughly and evaluating performance across different dimensions after the exchange. The reason behind that is obvious: every ongoing transaction paves the way for beginning of the next; therefore it is crucial to adjust future interactions with accordance to the past experience.

- *Power* (one’s ability to impose will on others): this can be put to use after promises are made, and its application seizes precisely when the promises are delivered in case of transactional exchange. This means that once the substance of exchange has traded hands there is no application to power due to the closure of relationship. On the other hand, for relational exchanges the ability to impose power becomes increasingly important as the relationship continues and parties become dependent on each other’s actions (Coughlan, et al. 2005).
- *Division of burdens and benefits* (extent of sharing benefits and burdens): for simple discrete transactions burdens and benefits are clearly divided and belong to either party, but do not cross the threshold between them. Allocation is final and finite: when parties part ways each hold to his result of the transaction. For more complex and prolonged relationships like relational exchanges the division of benefits and burdens is not so distinct. Counter-agents are likely to share portions of both gains and obligations, while ratio of these outcomes is bound to be fluctuating over time and relationship lifespan (Macneil 1980).

Table 1 presents the summarized overview of the two types of exchange.

**Table 1. Comparison of discrete transactions and relational exchange\***

<b>Dimensions for comparison</b>	<b>Discrete exchange</b>	<b>Relational exchange</b>
<b>Situational characteristics:</b>		
<i>Timing of exchange</i>	Distinct beginning, short length, rapid ending	Previous interactions accounted, prolonged continuity, reflections upon the process
<i>Number of parties involved</i>	Normally two: single buyer and seller	Two or more
<i>Interaction-based obligations</i>	Based on beliefs and customs	Based on promises made, in addition to customs and laws
<i>Expectations of further relations</i>	Future relations are not likely	Future relations are most likely
<b>Process characteristics:</b>		
<i>Personal relations</i>	Simple, ritual-like communications	Deep personal involvement (both formal and informal)
<i>Contractual solidarity</i>	Basic social norms, rules and	Increased legal obligations



	the prospect of self-gain dictate the code of conduct	are added to basic social norms and rules
<i>Transferability</i>	Complete transferability	Limited transferability
<i>Cooperation</i>	No mutual cooperation	Maximum combination of efforts by the parties involved
<i>Planning</i>	No planning is necessary	Planning plays an important role in relations
<i>Measurement and specificity</i>	Not important	Of high importance: clear needs specification, performance evaluation
<i>Power</i>	Execution after making promises until those promises are fulfilled	Increase of power with increase of parties' dependence from one another
<i>Division of burdens and benefits</i>	Clearly divided and belong to either party with no crossing the threshold	Division is not clear and distinct

\*Adapted from Dwyer, Schurr and Oh, 1987

It is clearly visible that there exist distinct differences between a one-time transactional operation between two parties and a prolonged collaboration on a more or less continuous project between two or more companies. Given the characteristics it is obvious that the latter approach to exchanges is more common on B2B markets.

### ***3.1.2. Relationship marketing characteristics***

Involvement in industrial or B2B marketing depends on the specificity of the exchange – short-term- (i.e. discrete) or long-term-oriented (i.e. relational). In case of simple discrete transactions, as shown in the previous section, building, managing and upholding the relations between parties is of a lesser interest, since such transactions are usually aiming at gains in a smaller time horizon. And that is compared to relational exchange, when business cannot be limited only to sales, but is expected to provide a greater customer satisfaction, which in turn depends on “how well the relationships are managed by the seller” (Levitt 1983).

“Relationship marketing” as an expression first appeared in the academic literature in 1980s within the contexts of services and industrial marketing (books of Berry (1983) and Jackson (1985) respectively). It seems rather obvious how relationship management fits into the services context: services themselves have relational nature,

and customers usually participate not only in consumption, but also in production of a service (Eiglier and Langeard 1987). In case of industrial marketing, a parallel with relationships marketing is not clearly obvious at first glance. Jackson (1985) in her book addresses that issue, stating that both services marketing and industrial marketing share certain characteristics, such as complexity, personalized interaction, customization and continuity (Crosby 1988). Such similarities explain the reason industrial and services marketing laid the foundation to the relationship marketing theory (Brito 2011).

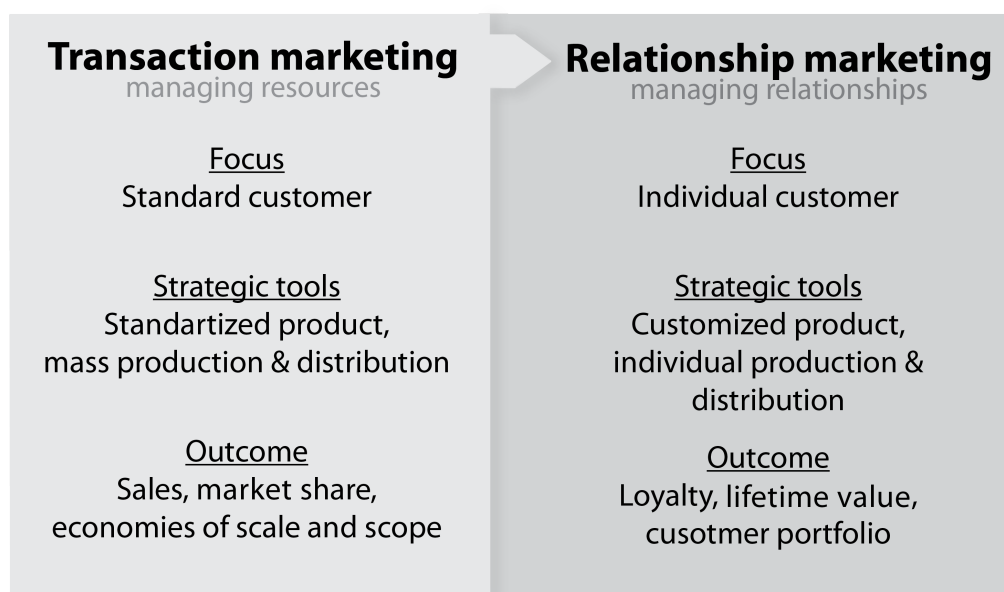
Several authors pointed out that the relationships tend to develop in cases when a customer comes to a more frequent contact with the vendor (Doney and Cannon (1997), Barnes (1997), Bove and Johnson (2000)) over an extended time period (Berry (1995), Bennett (1996)). It is also worth mentioning that the customer is supposed to perceive such relationship with the vendor as important (Ward, Frew and Caldow (1997)). In that case personalized approach and customization (of either product/service or approach to the customer) are crucial in reassuring continuity of relationships. We assume that continuity here implies not the historical record of the relations between parties, but the expectations of future interactions and exchange, just as Heide and John (1990) specified it in their research on buyer-supplier relations. Personalized interaction can result in a better awareness about customer needs and preferences, as well as creation of a unique experience for the customer, so that he would feel special and willing to come back.

With the course of time the definitions of ‘relationship marketing’ were changing from describing the relations with customers to encompassing the whole networks (Berry and Parasuraman (1991), Sheth (1994), Grönroos (1996), Grummesson (2002)). Brito (2011) quotes the definition of Morgan and Hunt (1994), claiming it to be “one of the most daring” and useful when comparing transactional and relationship marketing:

*“Relationship marketing refers to all marketing activities directed towards establishing, developing, and maintaining successful relational exchanges”*  
(Morgan and Hunt 1994).

The definition does differentiate relationship marketing from transactional. For example in terms of the process of value creation, the latter has value delivery to the

customer as a goal, whereas the former implies that the customer is participating in the process of value creation. With transactional approach the customer will most certainly assess the results obtained, while in the relational perspective it is not only the result that plays a role for the customer, but also the process and experience he gets. However Brito (2011) states that these two approaches are not to be considered as mutually exclusive, but should be regarded as a continuum, i.e. a company might stick to a more transaction-based or a more relationship-based approach. The author provides an explanatory model of the transaction versus relationship marketing orientation (Figure 1).



**Figure 1. Transaction versus relationship orientation (based on Brito (2011))**

The right choice of this or that approach is essential and depends on several factors, such as, for example, customer's purchase criteria. The cost of making a mistake can be extremely high. Indeed, Jackson (1985a), for example, in her book mentions:

*“Relationship marketing can be extremely successful, where it is appropriate, but it can also be costly and ineffective if it is not. Conversely, transaction marketing can be profitable and successful, where it is appropriate, but a serious mistake where it is not”* (Jackson 1985a).

For a company sticking to the relationship marketing approach, Brito (2011) (basing his conclusions on the works of Peppers, Rogers and Dorf (1999) and Winer (2001)), suggests three key elements as a foundation: identifying and understanding the

customers, selecting them, and adapting the offering to each of them. Although it might seem that these three elements can be applied not only to relationship marketing situation, it is the realization of them that adds color:

(1) *Identification and understanding of customers*

It is important when intending relational approach to correctly identify customers, followed by a deep understanding and knowledge of their needs. That applies both to present and potential customers. Rust and Kannan (2003) suggest databases are an important tool for developing one-to-one interactions with clients.

(2) *Selecting customers*

One of the central ideas behind relationship marketing, according to Brito (2011), is:

*“It is preferable to do little but good business with few customers than a lot of bad business with many customers”* (Brito 2011).

That is the reason customers should be thoroughly selected prior to exchange. There might be customers that represent low or no interest for the company because they either look for low value products, or do not respect paying agreement, or complain too much.

Storbacka (2000) suggests customers should be chosen along two dimensions: lifetime value of every customer (i.e. the expectations of customer's profit to be generated throughout the relationship) and strategic value (i.e. know-how, prestige, access to markets, etc.; that is intangible benefits that can be valued in a strategic perspective).

(3) *Adapting offering*

Having selected the customers, the company is expected to adapt offers to each and every one of them, realizing the customization and personal interaction characteristics of relational exchange. It is important to mention though, that the product/service level only should not limit that customization itself. In context of relationship marketing, all associated services (e.g. financing, after-sales service, etc.) together with communication strategies and distribution should be tailored to one specific customer. This will ensure that unique positive experience that can become the reason for the client to continue and foster the relations with this particular company.

The application of relationship marketing can result in great benefits for the company, if appropriately and properly used. Compared to simple transaction-based approach, aiming at increasing the value of a single transaction, relationship-based approach has increase of lifetime value of a customer as its primary goal. Thus the motivation behind relationship marketing should not be obtaining a certain market share, but obtaining a share of customers.

### ***3.1.3. Types of customers on B2B market***

The choice of this or that approach in marketing on B2B markets is highly dependent on the type of customers the company is working with and their needs and commitments. When trying to make such an important strategic decision on whether to stick to relationship or transaction marketing, analyzing and understanding customer's purchase criteria can come in handy (Jackson 1985a). For example, there might be a situation when a company is investing considerable amount of resources into creating exceptional customer service through personal interaction, customer support, co-creation, etc., but the customer still prefers doing business with the lower-price-offering competitor. The company will end up losing sales and profit, all simply because it has not carefully studied customer's purchase criteria, which is price in this case.

As it was mentioned in the previous section, Jackson (1985b) was one of the first authors to study the relational nature of doing business in industrial markets. For the purpose of current research we will use her work as a basis for understanding customer behavior, as she provides a clear and well-grounded systematization of different types of customers, determining the marketing approach when managing relations with them. Of course some of her points can be argued, but the general idea can serve as a solid foundation for future discussion (Crosby 1988).

#### **Customer commitments**

Jackson (1985b) notes that in the relationship building and upholding process it is usually the vendor who is most active, and customer's interests are fundamental. For example, consider a vendor looking forward to investing resources in establishing and fostering close relationship with its potential customer. It is obvious that it will only make sense when the customer looks forward to long-term commitments they make to

the vendor (in other words, when the switching costs for the customer are regarded as rather high (Heide and John 1990)). In case of low switching costs it might be more reasonable for the vendor to stick to transaction marketing due to the fact that customers do not tend to make long-lasting commitments.

When speaking of customer's commitments, Jackson (1985a) arrays them depending on the time horizon associated with them (from long term to short term): a customer may be primarily interested in (a) technology, (b) vendor, (c) person or (d) product. Of course, combination of these is also a possibility (Jackson 1985a).

(a) *Commitment to technology*

Such a customer has an option of choosing among several vendors that can offer products/services with that particular technology. The customer in this case is locked into the technology, while being completely flexible when it comes to selecting a vendor. Technological commitment is possible when slow technological change takes place or when customers own competitive advantage is dependent on this particular technology (Crosby 1988). Jackson (1985a) states that in case of technological commitment it is important that the vendor succeeds in convincing customers that he is committed to technology, reinforcing it by the competitiveness of the product offered.

Technological unpredictability on the market will add up to the lowered loyalty to one vendor from the part of customers. We will regard technological unpredictability as inability to accurately forecast the technological requirements on the market (Walker and Weber 1984). Heide and John (1990) have concluded in their research the negative effect of technological unpredictability on the continuity of relationship between buyer and seller. Tight interfirm linkages are not beneficial in terms of adaptability to changes in technological aspect, and customers prefer loose relations combined with lower continuity (Balakrishnan and Wernerfelt 1986).

(b) *Commitment to a vendor*

Customers may prefer focusing on a single vendor instead of committing to a specific technology in case of rapid changes. Jackson (1985a) stresses that a vendor's marketing goal is to offer high intervendedor costs, coupled with low intravendedor costs. One of the possible ways to increase intervendedor switching costs is by cultivating mutual learning and extensive knowledge sharing

(Lewis and Yidirim 2005). As for intravendor switching costs, offering customers a choice of new products (in order to be able to meet their changing needs) can reduce these.

When committed to a vendor, a customer usually gets interested not only in the product/service offered, but the company itself, e.g. marketing strategy (whether it is relevant and congruent with customer's own needs and values), as well as financial information, history, long-term capabilities (Crosby 1988).

(c) *Commitment to a person*

Commitment to a person implies that a customer is focusing on a specific representative of the vendor's company (e.g. a sales manager). Jackson (1985a) argues that in such case a customer is looking forward to friendship rather than obtaining extra benefits, which results in such commitment appearing when dealing with not important commodity-type products. In this case a vendor organization should emphasize its ability to provide assistance and personal help to the customer. At the same time, even with such a customer it is important to remember that a sales person as the only company's strength will yield short-term results; for a longer-term effect sales forces should be regarded merely as a "tool", backed up by stronger arguments (e.g. technology, process or product) (Haas, Snehota and Corsaro 2012).

(d) *Commitment to a product/service*

For a customer for whom a specific product is of primary interest, it is vitally important to have access to "modularized usage systems with interchangeable parts" (Jackson 1985a). Such high level of modularity implies greater choice and thus lower switching costs, resulting in a greater number of vendors able to satisfy customer's needs. In such case Jackson (1985a) suggests offering a superior set of features as a way to immediately attract a customer. Marketing communications for such a type of customers should thus stress the features of a specific product (Crosby 1988).

Based on customer's incline towards this or that commitment, Jackson (1985a) distinguishes two main types of customers: always-a-share and lost-for-good. An overview and comparison of these two types are presented in Table 2.

When operating on B2B market there is also a possibility to meet intermediate types of customers. To say more, the categorization suggested by Jackson (1985a), is

somewhat idealistic, and in a more real-life situation a customer would share characteristics of both AAS and LFG types. The approximation to one or another type will depend on the type of product, and on usual actions undertaken by both vendor and a customer (Crosby 1988). In addition a customer can be involved in several business sectors, which could require different approaches to managing relations.

**Table 2. Always-a-share vs. lost-for-good customers\***

<b>Always-a-share (AAS)</b>	<b>Lost-for-good (LFG)</b>
– Buyers share their patronage among a number of vendors (at a time or over several purchases)	– A customer commits to a single vendor
– Easy to switch from one vendor to another	– More reluctant to swap sellers
– More short-term oriented, commitments are not regarded as permanent	– Expectations of prolonged continuity of relations, permanent commitments
– Risk level is not considerably high	– High level of risk-exposure (e.g. financial, performance, personal) (Crosby 1988)
– Low intervendedor switching costs	– High intervendedor switching costs
– Usually applicable to commodity-type products	– Characterized by rather complex, technologically intensive products
– Focus on seller’s immediate capabilities and inducements	– A customer is likely to assess vendor’s future capabilities to satisfy its needs

\*Based on Jackson (1985a) and Jackson (1985b)

The choice between relationship and transaction marketing seems to be rather obvious, if a customer is mostly LFG or mostly AAS. However in case of intermediate types a seller is facing a choice, resulting in concentration on one or another approach. Of course, there is an opportunity to apply both approaches in order to cover a greater number of customers, but there is also a significant challenge in such a strategy due to great differences between them.

### **Strategies for managing AAS and LFG customers**

Under the LFG model a vendor should focus on cultivating highly loyal, long-term oriented customers, and marketing resources should be invested to increase the retention probability of them. AAS customers expect to constantly be offered strong, short-term benefits and inducements: they are more attracted to a beneficial immediate combination of price, product, support, etc. Of course can result in reduced



attractiveness of them to sellers (Jackson 1985b). When it comes to LFG customers' motivations, these can result in rather costly decisions, since such customers require both short-term and long-term benefits to be pleased. In such case it is important to convince LFG customers in the necessity to sacrifice just-in-time advantages in order to get a bigger piece of a pie in the future (Crosby 1988).

### **Costs of switching for a customer on B2B market**

It is possible to “lure” a customer from one end of the continuum to another, i.e. to modify his behavior, and according to Jackson (1985a), the main factor determining the customer position are the switching costs. It is important when speaking about switching costs to distinguish between intervendedor (i.e. involving a vendor change) and intravendedor (i.e. change in, for example, product or technology within one vendor), since a customer is facing costs when making changes anyway, regardless of changing vendor or not. It is thus rather obvious that it is in vendor's interest to make intravendedor switching costs considerably lower than intervendedor ones.

According to Jackson (1985b), a customer can face several kinds of switching costs when facing a change. We will cover the ones that we believe are important for the current project.

- (a) *Investment costs*: investment of time, money, or resources that a customer makes to adapt to new products, systems, or services (Jackson 1985b). Obviously, the greater they are, the more reluctant is a customer to change commitments and face switching costs, since that will result in the need of abandonment of previous investments.
- (b) *Risk of exposure*: a customer might experience a fear of potentially making a bad choice. Such a fear of disruption or unsatisfactory performance can make a customer reluctant to face change (Jackson 1985b). That feeling can get even stronger in case the product that a customer buys is important to his own operations, or if the seller is not so well-known and well-established, or if a product is complex.

There are different points of view on the Jackson's (1985a) suggested model – both positive and negative, such as for example, the author doesn't differentiate strategies for attracting and strategies for keeping customers (Crosby 1988). However we

believe the spectrum is rather clear and helps coming up with a way to manage customers. There are two main reasons for our position:

- (1) Customers' analysis with respect to the suggested spectrum can facilitate the process of realizing and understanding their interests and concerns (e.g. factors that determine customer's purchase decision and criteria);
- (2) The suggested spectrum can help sellers create and adjust possible marketing strategies: it is obvious that strategies and actions that prove to be efficient for AAS customers may not necessarily be as good for LFG ones.

It is worth mentioning that vendor is partly influencing and determining customer's position along the spectrum, thus it is important for the former to understand and analyze the latter in order to get the best out of the relationship.

#### ***3.1.4. International business relationships***

An extensive amount of research has been conducted on relational side of B2B exchange, however most of them investigate the phenomenon only within the domestic market and domestic operations. The international context and companies involved in operations overseas are practically left out. Obviously, empirical studies could provide invaluable information about how the approach and specific characteristics would change when a company decides to open its horizons geographically. Research on international environment has been done though. Burkert, Ivens and Shan (2012), basing on previous literature, concludes that in an international context: (1) frequency and intensity of contact between buyers and suppliers are lower; (2) social distance between parties involved in a relationship is greater; (3) companies are less willing to adapt and invest in the relationship; (4) the duration of buyer-seller relationships on average is lower.

Other factors influence the process of building and maintaining relationships in an international context, one of which is cultural differences. Cultural distance can become a cornerstone of relationships, playing a crucial role and adding to uncertainty level in international marketing. Obviously, this requires a great deal of attention and sensitivity from the part of the seller (Solberg 2008).

Another complicative factor is that when operating in international environment, the process does not only include product-service exchange, but also exchange of

information, coupled with technical, financial and social exchange. Such points as language differences, verbal/non-verbal or formal/informal communication may complicate the process of sharing information, for example (Burkert, Ivens and Shan 2012).

Finally, international operations of course involve technological and geographical distances, which may hardly influence the relationship development due to complexity forced by differences in, for example, standards. This may result in lower flexibility when communicating with an overseas partner (Homburg, et al. 2002).

### **3.2. Interorganizational Governance on B2B Markets**

In this part of the theoretical background for the project we will overview the main types of exchange schemes on B2B market. When doing business that involves cooperation with an international partner, the decisions are usually more complex, and the environment is more uncertain. As a result, building and maintaining close and long-term relationships is becoming more and more challenging (Homburg, et al. 2002). Creating an appropriate governance structure in such circumstances can be even of greater importance (Burkert, Ivens and Shan 2012).

There is a great amount of previous research done on governance mechanisms within business relations, analyzing the characteristics of different structures and factors influencing the choice of one (Bello and Gilliland (1997); Ferguson, Paulin and Bergeron (2005); Gassenheimer, Calantone and Scully (1995); Lusch and Brown (1996)). However when it comes to analyzing governance mechanisms in the context of international buyer-seller relationships, the research is rather sparse. An important work in that sense is an empirical study carried out by Burkert, Ivens and Shan (2012) – the authors apply and test the results of most previous reserches related to governance mechanisms in business relations within the international environment. The work is of great interest for the current project due to its to-date information and relevant field of analysis, backed by solid foundation. With respect to the purpose of the current project, we will overview the theory of governance structures and mechanisms under the prism of international business relations. However before looking closely into the main governance structures, we deem it important to turn to

the the transaction cost analysis, suggested by Oliver Williamson (1975), as an important theoretical insight into the way the relations between parties are organized.

### ***3.2.1. Transaction Cost Analysis***

According to Williamson (1985, 2), transaction cost analysis represents “<...> an examination of the comparative costs of planning, adapting, and monitoring task completion under alternative governance structures.” The main idea behind the approach is the major concern for the choice of a specific governance structure is the minimization of costs, connected with the transaction, implying the right choice resulting in the efficiency of exchange. Williamson (1975) argues that due to such specific dimensions as *transaction-specific investments* (i.e. physical or human assets that are tailored to the specific relationship and have no value outside it) and *external* (i.e. unpredictability and uncertainty of the environment in which the relationship takes place, leading to the need for adaptation of the contract at the later stages) and *internal* (i.e. performance ambiguity) *uncertainty*, transaction costs increase. Such a costs increase is due to the measures to be taken (i.e. safeguarding, adaptation and evaluation processes) in order to avoid and cope with the following challenges, associated with the abovementioned dimensions:

- a. Transaction-specific investments arise the safeguarding problem, which requires special mechanisms to be designed to minimize the risk of opportunistic exploitation from the receiver of the investments (Williamson 1985). The idea of opportunism plays an essential role in the works of Williamson, who defines it as “self-interest seeking with guile” (Williamson 1975). The author claims that in the situation of imperfect information, all the transactions are to be affected by the problem of opportunism, meaning that whenever the possibility exists, parties will prefer their own interests rather than those of the other party of the relations. Thus Williamson (1975) regards opportunism (potential or actual) and the need for safeguarding from it as the major source for the increase in transaction costs. However at the same time, the author states that it is the threat of opportunistic behavior that pushes the actors to invest in safeguarding from it and is hence significant, and not the fact that people are selfish most of the time (Hodgson 2004). In any case, the

bottom line is that specific investments as they are, might have a positive outcome for investor in terms of the future possibility to extract value from the relationships. However the unapplicability of such investments outside the relations create the dependency problem, leading the investor to be locked-in with the partner, who in most cases will act opportunistically.

- b. External uncertainty implies uncontrollable possibilities that may arise in the decision environment in which the relationship takes place. It is obvious that in case when these uncertainties become too numerous and unpredictable, it is almost impossible to specify them all in the contract beforehand. The situation lead to the need for adjustments and adaptation further in the relationships development (Rubin 1978). Hence special actions and mechanisms should be taken in order to permit the possible future need for adjustments.
- c. Finally, internal uncertainty results in the problem of proper evaluation of performance, meaning the need for assessing the level of contractual compliance within the relationships (Heide 1994)

The situation leads to the general market mechanisms being unable to cope with the inefficiency arisen, calling for more advanced structures to secure the relations and interests. Even though Williamson (1985) argues that a complete vertical integration as the general response to the problems identified above, since it by definition implies inherent safeguarding, adaptation and evaluation possibilities, we regard it important to look at other possible forms of interfirm governance to get a full understanding of the problem.

### ***3.2.2. Forms of interfirm governance***

According to Williamson and Ouchi (1981), governance implies “the mode of organizing transactions”, including the process of structuring and reinforcing relationships between parties. The definition is relying on the transaction cost theory, which is looking at governance through the prism of specific mechanisms that are designed to support economic transactions. Heide (1994) in his work is criticizing this definition as being rather broad. Instead he suggests a more dynamic and embracing definition that we would like to stick to:

*“Governance is a multidimensional phenomenon, encompassing the initiation, termination and ongoing relationship maintenance between a set of parties”* (Heide 1994, 72).

Heide’s (1994) approach to interfirm governance as a dynamic phenomenon is rather constructive, as it allows for analyzing the different types of governance structures along the development of relations between the parties, i.e. relationship initiation, maintenance and termination. Based on the three theoretical approaches (i.e. resource dependence theory (Pfeffer and Salancik 1978), transaction cost theory (Williamson 1985), and relational contracting theory (Macneil 1980)) the author suggests a formal typology of approaches to manage relationships between firms. Namely, the author distinguishes between (1) market and non-market forms of governance, with the latter then divided into (2) unilateral (hierarchical) and (3) bilateral forms of governance (Heide 1994). Market governance can be paralleled with the discrete exchange, when single individual transactions are assumed to be unrelated to any future or past interactions (Dwyer, Schurr and Oh 1987). The unilateral governance is based on the authority structure that has power to develop rules, impose decisions and give instructions (Williamson 1985). Finally the bilateral relations are built on joint action of the parties involved: all the policies and action plans are discussed together with the shared final goal behind (Heide 1994). We will overview all the three types across the three stages of relationship development. Table 3 provides an overview of the three types of governance across the three stages of relationship development. In addition it provides information about what each of the stages involves.

### **(1) Market governance**

Due to the short-term one-time character of market-based exchange, the *initiation* of such relationships is usually not required. The relation is initiated by unsatisfied simple needs of one of the parties.

Though within the *relationship maintenance* stage there are several dimensions to consider, most of them are not applicable to the market governance case or they have a rather specific character. For example, such dimensions, as planning and ongoing adjustments are usually nonexistent. However the former can be present but limited to a single transaction, and the latter can be encountered in the form of immediate compensation or a decision to exit the relation otherwise (Heide 1994).

**Table 3 Forms of interfirm governance across relationship development stages\***

	Description of the stage	Market governance	Nonmarket governance	
			Unilateral	Bilateral
<b>Relationship initiation</b>	Evaluation of potential partners, initial negotiations about future interactions	No specific initiation processes	Selective entry processes, based on skills, qualifications analysis	Selective entry processes, based on skills, qualifications together with values analysis
<b>Relationship maintenance</b>	Ongoing maintenance of interfirm relations			
<i>Roles specification</i>	The way decisions and functions are assigned to parties	Roles depend on individual transactions	Specific roles throughout the entire relationships	Overlapping roles, joint actions
<i>Planning</i>	Processes by which all future contingences & responsibilities are explicit beforehand	If exists, limited to a single transaction	Proactive, initiated and centralized within one party	Proactive, decentralized, flexible plans
<i>Adjustment processes</i>	Mechanisms designed to adapt ongoing relations to changing environment	If exists, results in immediate compensation or exit otherwise	Specific mechanisms formulated beforehand	Negotiable changes through mutual adjustments
<i>Monitoring procedures</i>	Mechanisms to measure the relationship performance	External, reactive, tied to specific actions	External, reactive, tied to output	Internal, proactive, self-control as a foundation
<i>Incentive system</i>	Rewards to the parties, based on a certain level of performance	Short-term, tied to output	Short- and long-term, tied to output and behavior	Long-term, tied to relevance to the system
<i>Enforcement mechanisms</i>	Mechanisms that ensure the fulfillment of contractual obligations	External (legal system, competition)	Internal, legitimate authority	Internal, shared values, mutual interests, future plans
<b>Relationship termination</b>	Process of ending the relationship	Completion of discrete transaction	Explicit mechanisms of termination	Open-ended relationships

\*Based on Heide (1994)

When it comes to role specification within the relationship, it is a matter of a discrete transaction, and the roles are basically unidimensional (Kaufmann and Stern 1989). For realizing monitoring procedures external sources are normally used, and the process itself has a reactive rather than proactive character, meaning the monitoring activities are carried out upon the completion of a specific transaction (Anderson and Oliver 1987). The incentive system is usually tied to the completion of transaction (in forms of resale profits, commission payments, etc.), and such incentives tend to have a short-term effect (John and Weitz 1989). The last dimension of relationship maintenance stage is the enforcement means, and in case of market governance such means usually come in the form of external mechanisms, such as legal system, maintenance of competition, etc. (Heide 1994).

*Relationship termination* stage in case of market governance is rather clear and comes with the completion of transactions. This stage doesn't require any special actions since for market governance interfirm relations are simply a row of single transactions, representing a completed event (Heide 1994).

## **(2) Nonmarket governance: Unilateral**

*Relationship initiation* stage for parties involved in unilateral relations is characterized by selective entry processes. Due to firmer relations within the hierarchy, the selection of parties usually involves assessment if required skills and/or qualifications, and no interest in values is showed (Heide 1994).

*The ongoing maintenance* of interfirm relations is rather different from market governance case, being characterized by a deeper involvement of parties into the relations and their upholding. The roles within the relations are usually assigned by one party on the other using the authority. All the planning processes are as well concentrated in the hands of the the same party, who thus has the authority to make decisions and specify actions (Rubin 1978). For the adjustment processes particular mechanisms are usually designed in advance, specifying how the changes should be made in this or that situation (Williamson 1985). Just as in case of market governance, unilateral governance relies on external mechanisms when it comes to monitoring procedures, and just as well the processes have a more reactive character. The incentive system under hierarchichal governance also resembles that under the market governance in a sense that the system is closely tied to some aspect of



performance. However compared to the market organization, the hierarchical reward system has a longer-term effect, basing the reward on observed behavior (the most common case is salary compensation) (Anderson and Oliver 1987). Finally the enforcement mechanisms, unlike in market governance, rely mostly on the internal sources. Due to the hierarchical structure particularities and authority-based relationships, the enforcement is usually realized through legitimate authority (e.g. employment relation, contractual arrangement, etc.) (Stinchcombe 1985).

Unilateral governance views relations as a more time-dimensional construct, compared to the market governance. Thus it is common for such relations to be open-ended in term of the time horizon of them. However it is often the case for a clear statement of relationship commencement and termination in the contract between the two parties (Dwyer, Schurr and Oh 1987).

### **(3) Nonmarket governance: Bilateral**

Just as unilateral governance, bilateral governance involves in significant selection processes in the *relationship initiation* stage. However, compared to the former, the parties not only evaluate skills and qualifications, but also the values, assessing the possible strategic fit. Such a deep assessment usually implies rather high setup efforts (Grandori 1987).

Assigned roles as part of *relationship maintenance* stage are much more complex and multidimensional, compared to the two other forms of governance. In addition, it is worth mentioning that the roles are more integrated with those of a partner, bringing a more cooperative approach to assigning them (Heide 1994). The planning process is similar to the one in hierarchical structure in a sense that it is proactive in nature. However the difference lies with the perception of the process – planning is more decentralized, and both parties take part in the process, with the exchange of information as an important point (Macneil 1980). The adjustment processes are bilateral and flexible in nature, meaning that both parties are willing to take part in joint negotiations and change implementation in case of environmental events (Dwyer, Schurr and Oh 1987). The distinctive feature of the measurement procedures under bilateral governance is that such procedures are usually proactive in nature, promoting internal control through extensive communication. In that case the need for reactive actions is significantly reduced (Ouchi 1979). The reward and incentive

system is extensively based on the commitment to the system, rather than on specific aspects of performance. Such a basis for incentives makes the reward system much more long term in nature (Heide 1994). When it comes to enforcement mechanisms, the two specific processes are present: first, the need for explicit enforcement is diminished when the common values are established and shared; and second, the expectation of future relations and interactions serve as an enforcement itself (Axelrod 1984).

Since the bilateral governance regards the relationships as entirely open-ended with no finite or foreseeable conclusion, there is no need for any special *relationship termination* processes (Macneil 1980).

### **3.2.3. Governance mechanisms**

Jap and Ganesan (2000) regard governance mechanisms as “safeguards that firms put in place to govern interorganizational exchange”. As an example, they mention “incentive structures, monitoring mechanisms, contractual provisions, reputations, norms, and interpersonal trust” (Anderson and Jap 2003). We will overview governance mechanisms that are most covered by the relational exchange literature, and that are of current project’s interest. These include (a) formal written contracts (Stinchcombe (1985); Lusch and Brown (1996)); (b) specific investments (Heide and John (1990); Gundlach, Achrol and Mentzer (1995)); (c) relational norms (Heide and John (1992); Dant and Schul (1992)); and we have also added (d) trust as additional mechanism. We will overview these with respect to international context of operations.

(a) *Formal written contracts.* Contracts are “legally binding documents in which the parties involved agree on their rights and obligations in the transactions they intend to execute” (Burkert, Ivens and Shan 2012). There has been an extensive amount of research conducted on the topic of contracts and contractual law, showing its importance and “a key governance role in almost all exchanges” (Gundlach 1994).

⇒ Considering the cultural differences and thus differences in the recognition of rights and obligations, contracts play an even bigger role in an international business context (Cavusgil, Deligonul and Zhang

2004). Owing to different standards in home, compared to foreign countries, thorough specifications and the process of evaluating performance and fulfillment of contract terms has proved to be of greater importance in international settings (Burkert, Ivens and Shan 2012).

(b) *Specific investment (or asset specificity)*. As mentioned before, specific investments are those made by a party in transactions with a partner that would have limited value outside this focal relationship (Williamson 1985). Usually such investments are made deliberately, and in most cases by seller/supplier, e.g. a supplier might invest in personnel training to service a particular product. Due to the nature of specific investments and their inapplicability outside of the relationship, they usually create a lock-in situation for the investor, increasing the chance of opportunistic behavior and exploitation by the receiver. However Rokkan, Heide and Wathne (2003) argue that opportunism might not always be the case, creating considerable value to the receiver and thus discouraging unethical behavior. The authors state that the real outcome of specific investments depends on the two factors: relationship extendedness (i.e. significant future time horizon) and the norms that characterize the focal relationship (e.g. solidarity norms, implying that both parties are willing to strive for joint benefits). In addition, in case of mutuality of specific investments, they start to act as safeguards against opportunistic behavior due to appeared balanced obligations between the parties (Rokkan, Heide and Wathne 2003).

⇒ In most cases by making specific investments, one party is encouraging another party to maintain the relationship, which might lead to reciprocal or mutual investments, and as a result, to cooperative instead of competitive relationship (Anderson and Weitz 1992). By investing into the relationship, an actor regards this relationship as important and beneficial, looking forward to a longer-term cooperation. When acting in international environment, higher risk and uncertainty level is implied. Thus companies may be more reluctant in making specific investments, fearing the fact that such a relationships will probably be shorter, compared to one on domestic market (Burkert, Ivens and Shan 2012).

(c) *Relational norms*. Norms are expectations about behavior, shared by parties in a relationship (Heide and John 1992). Control through norms does not imply any sorts of incentives, but moral comound, defining appropriate and deviant behavior. In a way relational norms complete formal contracting. Macneil (1980), for example, suggests ten common norms to consider when being in a relationship (e.g. solidarity, reciprocity, or flexibility). Kaufmann (1987) distinguish two types of norms: value-creating norms (i.e. the ones that help parties in creating value by the exchange) and value-claiming (i.e. the ones that result in distribution of value among all the parties involved in a relationship). As an example of the former, there can be flexibility or mutuality, and of the latter, – cooperative conflict resolution or limitations to the use of power.

⇒ Obviously, for norms to be present in a relationship, previous values and beliefs between parties in a relationship are important. For parties involved in business with an international component such closeness and shareness of common and clear expectations towards each other is much lower. Thus the level of both types of norms is supposed to be lower (Burkert, Ivens and Shan 2012).

(d) *Trust*. In addition or instead of controlling a relationship through deploying specific governance mechanisms (often time- and resource-consuming), parties can rely in mutual trust (Dwyer, Schurr and Oh (1987); Morgan and Hunt (1994)). Doney and Cannon (1997) define trust as the “perceived credibility and benevolence of a target of trust”. Trusting a partner can result in lowered costs on other governance mechanisms, coupled with reduced probability of opportunistic behavior (Bradach and Eccles 1989). To say more, several recent researches prove positive correlation between trust and performance of a company (Sirdeshmukh, Singh and Sabol 2002). However we believe that trust as a safeguard mechanism is possible when the relationship has reached a certain level, and all the parties involved feel comfortable and secure within it.

⇒ There has been revealed a positive correlation between trust and similarity (Doney and Cannon 1997), with “similarity” as interests, lifestyles, cultures, values, goals, commonly shared between people or

organizations (Palmatier, et al. 2006). Obviously, parties involved in international exchange are likely to have less similarities between each other, needing formal contracts to ensure the stability of relations. Given the fact that formal contracts may lower the level of trust between parties (Ghoshal and Moran 1996), international exchange is more unlikely to rely on trust as a governance mechanism (Burkert, Ivens and Shan 2012).

As a matter of fact, building and developing business relationships does not imply usage of all the mechanisms with equal intensities. International business relations, though more complex, do not differ that much from domestic, however they do require some modifications in the approach to managing relations.

### **3.3. Purchasing Portfolio Strategies: Kraljic Matrix**

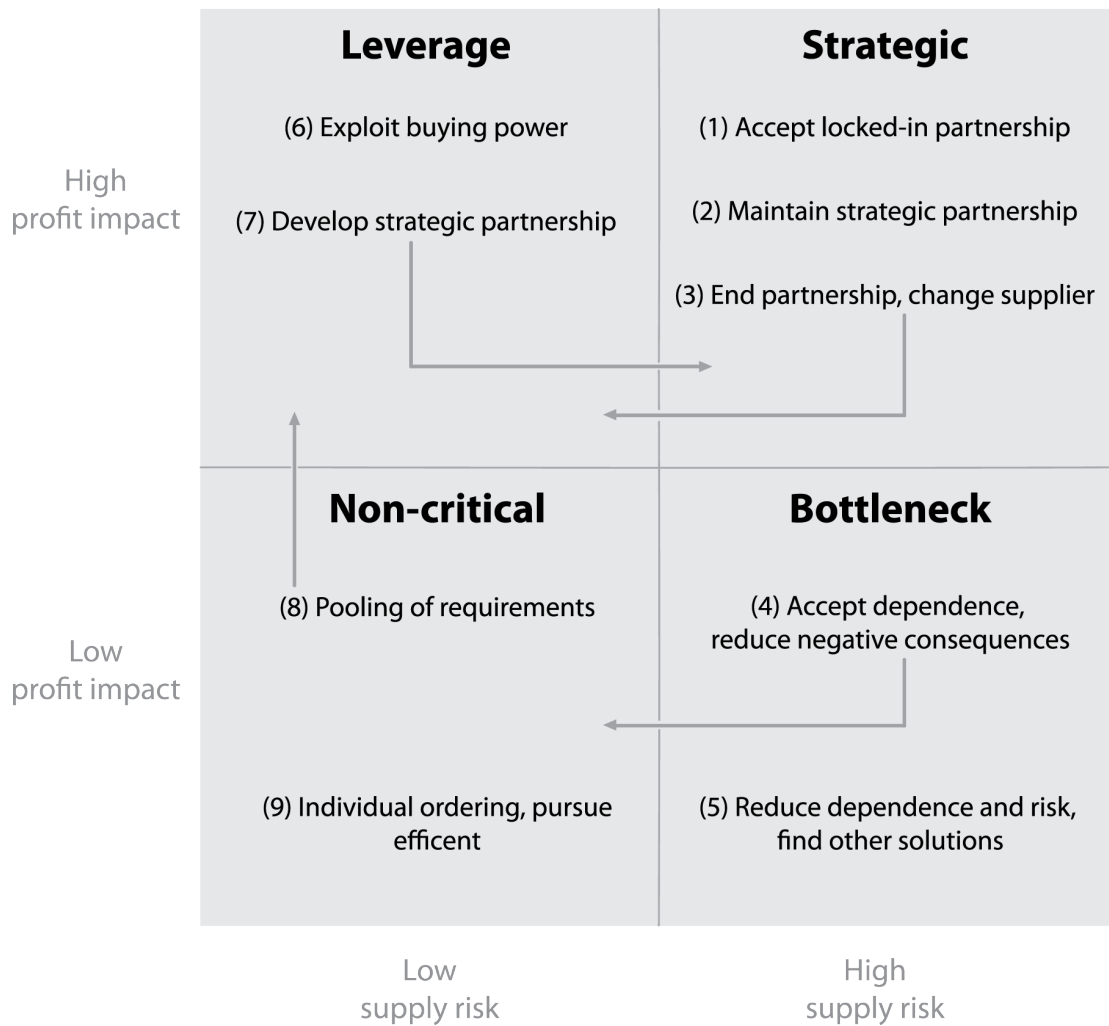
With the increasing internationality of business and the shift from vertical integration to outsourcing, companies (e.g. manufacturers) encounter major challenges connected with risks and complexities of global sourcing, when trying to ensure long-term availability of critical components and materials at competitive costs (Kraljic 1983). In addition environmental uncertainties and price disruptions on an unprecedented scale worsen the situation. The bottom line – with the increase of the level of uncertainty within the buyer-supplier relations, technological uncertainty, physical availability of specific components/materials, increases the importance of supply management.

Attention to purchasing portfolio and strategies for managing it has been increasing over the last decades. Several purchasing portfolio models have been introduced, but one of the most famous ones was suggested by Kraljic (1983). The matrix helps develop the purchasing strategy for the products a company needs. The ultimate goal can be regarded as removing the supply vulnerability and maximizing the potential buying power of a company. According to Kraljic (1983), the company's supply strategy depends on two criteria: (1) strategic importance of purchasing in terms of its impact on profitability (e.g. the value added by the product line, percentage of raw materials in total costs, etc.), and (2) supply risk and complexity of the supply market (e.g. supply scarcity, technological unpredictability, entry barriers, logistics costs or

complexity, etc.). Using these two criteria the company distinguishes all its purchased items between four types: (1) strategic items (high profit impact, high supply risk), (2) leverage items (high profit impact, low supply risk), (3) bottleneck items (low profit impact, high supply risk), and (4) non-critical items (low profit impact, low supply risk) (Kraljic 1983). For each of the quadrants Kaljic (1983) suggests several recommendations:

- *Strategic items* require most attention and are worth establishing long-term supply relationships or even considering producing the item in-house. Regular analysis and management of risks is important.
- *Leverage items* allow the company to use its full purchasing power. There is also a flexibility in terms of substituting products or suppliers.
- *Bottleneck items* require rather carefull attention due to lack of reliable availability. A useful strategy might be to over-order whenever the item is available and search for ways to control suppliers.
- *Non-critical items* don't need special treatment, and general monitoring coupled with optimizing order volume and inventory levels are the things to be considered. To say it shortly, the reduction of transaction costs should guide the actions and strategies taken in this case..

Several models have been suggested based on the Kraljic matrix, however they don't differ much in terms of employed dimensions. In addition, these matrices result in more or less the same recommendations for each quadrant: for strategic items form partnerships, assure supply in case of bottleneck items, exploit power for leverage products, and safeguard efficient processing in case of non-critical items (Marjolein and Gelderman 2005). A recent study by professional purchasers, however, goes deeper and suggests a clearly distinctive types of strategies within one quadrant: (1) strategies to keep the position in the quadrant and (2) strategies to move to another position (Gelderman and Van Weele 2003). Figure 2 gives an overview of strategic directions for each of the four quadrants. Strategies numbered 3, 4, 7 and 8 aim at moving from one position to another.



**Figure 2 Purchasing strategies (based on Gelderman and Van Weele (2003))**

The obvious advantage of Gelderman and Van Weele's (2003) study is its practical foundation, however there are no mentionings on the conditions in which specific strategies are to be chosen, yet it might be the case of differences in power and dependence positions (Marjolein and Gelderman 2005).

## **4. Methodology**

The main approach of the current paper is to analyze the relational content of B2B relations and mechanisms to govern them within international environment, and then to analyze RRM's strategic orientation and approach to managing relations. Altogether this will create an approach for managing relations with customers on a new market, suitable for specific situation. The character of this study is deductive, which aims at the utilization of pre-existing literature on the topic, which is later entwined with the specific case situation to develop most suitable solutions (Saunders, Lewis and Thornhill 2009).

The theory on managing relations on B2B markets is used as a basis for deriving recommendations for RRM. Analysis of the company, i.e. its strategic orientation, goals, ways of managing operations, strengths and weaknesses, coupled with the deep analysis of the Russian maritime market with its major players, constitutes the core part of the research.

### **4.1. Research Design**

Since the project has a more practical application, the chosen research design is exploratory. The reason for this is that the problem has a real life context for a specific company in a specific situation. Exploratory study is a valuable means of finding out the most important factors that affect the problem, and thus making it clearer (Yin 2009).

The nature of the research is qualitative. For the purpose, interviews are chosen as a way of data collection. The number of people with expertise on the topic is relatively low in RRM therefore this is a suitable path. The research strategy is a case study: it is a particular stage in the business life of RRM when it is facing challenge when operating on the Russian market. Unlike any experimental analysis, a case study is deprived of practically all the possibility for controlling, – it is performed in a natural flow of events.

The research focuses on a single case – an array of options available to RRM regarding managing operations and customer relations on the Russian market. Due to the time and resources limitations, this problem cannot be perceived from the point of



view of the company as a whole. Instead, the research goes deeper inside the structure of RRM, across several departments that play key roles in the interaction on a new market. Therefore the embedded case, where different viewpoints come in layers, is the appropriate design for the research (Saunders, Lewis and Thornhill 2009).

This is a case study for a particular company, although the problem of managing operations on a geographically new market is relevant for other companies in other markets. However, the specificity of the industry, market and company's prerequisites make this study rather narrow-pointed and fine-tuned to the unique problem. Therefore the expected results would be hardly applicable for other companies within the industry or the market.

#### **4.2. Primary Data Collection**

The following tools were used during the research data collection: interviews and documentary analysis. Semi-structured interviews with representatives from different departments engaged in the process of international establishment and will be used for collecting primary data. This type of interview allows for covering of all the topics intended by the research but provides the flexibility within the interview to go with the flow of the conversation (Saunders, Lewis and Thornhill 2009). The main purpose of primary data collection was to gain understanding of the industry, RRM's business model, operations, and service model, as well as company's strategic orientation, values, competitive edge, points of differentiation from competitors as seen by employees, ways of establishing contacts and relations, corporate culture. All this is needed to estimate the company's strengths to stress when marketing its offers to the Russian customers and to find a suitable way of managing relations on a specific market. Personal interviews with semi-structured interview guides were used to deeply understand RRM's strategic characteristics.

Key informants were employees from different departments directly engaged in the relationship. The four departments were chosen (with our reasoning in brackets): commercial/sales (chooses the partner and establishes first contact), contract (responsible for negotiation of conditions), marketing and business development (strategic focus of the company), and engineering (mutual development of a product, quality management and control). There were three interviewees from the sales

department, one from contract and two from marketing departments, and five from engineering, adding up to ten interviewees in total. The reason for such distribution is that the sales department represents the important part when establishing relations with customers, being the first point of contact with the company. Engineering and design are the key departments considering the product and services offered by the company. In addition designers and engineers take a big part in communication with the client in pursuit of developing the appropriate product. The contract department was interesting in terms of the ways for securing RRM's interests, and the marketing and business department is rather small, though represents a relevant informant in terms of RRM's strategic orientation and points of differentiation. The number of respondents, i.e. 11, is acknowledged to be a reasonable number due to time constraints within the given research, analysis and writing. The data achieved from every key department set a basis for evaluation of the company-side opportunities in the Russian market.

Both the interviewer and the interviewee knew subject areas beforehand. For each department separate questions were formulated as the interviewees represented different levels of organization with different areas of expertise (see Appendices A-D). All interviews were conducted by phone through Internet in English. Information from the interviews was recorded together with notes taken, in order to avoid unpredictability of technologies. In order to ensure the ethics, the information was only to be disclosed upon agreement of the respondent, with the anonymity guaranteed. The main results and the overview of the interviews are presented in the table in Appendix E.

For the collection of secondary data, analysis of existing literature was used. Scientific articles and publications as well as books relevant to the topic were reviewed and analyzed. Due to apparent abundance of the available data on the theoretical topic, only the most credible and reliable sources were considered to ensure the quality of the research. These sources were used in order to gain an understanding of the way B2B relations are built and how they are managed. That also helped in defining the frames and dimensions on which to pay attention when collecting primary data.

### **4.3. Secondary Data Collection**

For the purpose of the research it was important to have reliable and sufficient information about the customer side of the situation in order to derive relevant and useful recommendations for RRM on the Russian market. Having identified the potential customer of interest, it was intended to approach him with specific questions regarding the case. However, getting first-hand information from the potentially interested Russian side was unsuccessful due to several reasons. First of all, highly integrated vertical structures of both SCF and USC rendered it important to contact people in charge, who have access to strategic information. In the Russian context, these are typically occupying high corporate positions. No personal information like e-mail or mobile phone is available on the web, and repetitive attempts to connect to both the official accounts of the companies as well as specific people inside via the social media proved ineffective. Getting in touch with someone in possession of relevant information is not impossible, but, given the time constraints of the current project, it was deemed unreachable. Moreover, the Russian cultural context implies severe artificial communication barriers between the members of management and the outsiders. Therefore primary data collection from the side of the customer was regarded impossible. However, we used the available secondary data to fill in this part of the research. Having only used trustworthy resources (official governmental pages, major industry publications with inside knowledge of the situation, official companies' websites, etc.) we consider received information actual and true.

### **4.4. Limitations of the Research**

There are several limitations to the chosen research design. One of the most important ones, as mentioned before, is the lack of primary information from the customer. Such a drawback leads to the research and recommendations having a more one-sided character, and the results subject to change whenever more information about the customer appears. The decision upon qualitative instead of quantitative data collection technique can also be regarded as a limitation to the research (Saunders, Lewis and Thornhill 2009). However the character and specificity of the problem justify the choice, since the topic chosen is very firm and situation-specific, and considering the

scope of the research, it would be difficult to come up with a valid questionnaire that would reflect all the possible sides of the problem.

#### **4.5. Credibility of the Research**

Credibility of the research consists of three constructs: reliability, validity and generalizability. In order to ensure the reliability, the importance of control of such factors as participant and observer errors was considered. To avoid the former, the interviews were conducted in the middle of the week in order to avoid hectic and stressful periods. The latter error implies the way the interviews are interpreted. In the case of current research, since there are two authors, there is a dual point of view on the same question, which by definition decreases the possibility of the observer error occurrence.

Taking measures, which address the interviewees' response clarity, ensured validity of the research. All the interviews were conducted roughly at the same time to facilitate the general time frame of the case, and anonymous to make sure the respondents feel no pressure when answering.

Large-scale generalizability of the project is questionable due to two main factors. First, the narrow specificity of the agents that are analyzed is present: the Russian market conditions could be different from most of the rest as well as the fact that shipbuilding industry possesses unique features on its own. And second, we encountered the limited scope of the research due to the company's preferences and limitations. On the other hand, the study relies on the theoretical background, which can be used for analyzing and assessing other specific market conditions.

## **5. Research and Analysis**

### **5.1. RRM Company Analysis**

Primary research was conducted through a company analysis of RRM, i.e. we analyzed RRM's business model, operations, and service model. In addition we tried to look at the values of the company and its corporate culture. The final goal was to realize RRM's competitive edge, points of differentiation and points of inferiority from competitors, as well as ways of establishing contacts and relations. We are further overviewing the results we got based on the qualitative research performed.

#### ***5.1.1. Strategic orientation and value creation of RRM***

Rolls-Royce Marine AS is devoted to upholding its reputation of a trustworthy partner that delivers the full service package specifically tailored to its clients' needs and specification with unparalleled quality and precision. Having analyzed multiple answers we received from within the company, we can underline the importance of continuity of the delivering the level of quality along the whole timeframe of implementation of the project. RRM does not compete on price levels; instead it goes for higher margin operations and more complex projects with higher revenue while relying on its strong side as a technological powerhouse and provider of superb products. The company successfully tries to stay market leader in all the segments that it's present at despite the increasing competition from newly emerged companies. Not the last comes the brand value of Roll-Royce, which is associated with cutting-edge technologies, premium quality, exclusivity and higher prices.

Strategic philosophy behind delivering RRM products is providing a full integration, rather than a simple product. This includes development, customization, production, quality control and assurance, training, after-sale service and any other activities requested by the client. The company is also capable of providing a complete ship package: from hull and engines to propellers/thrusters and deck machinery and everything in between. Apart from designing the ship and outsourcing the parts to suppliers, RRM uses in-house capacities to deliver quality products for its own projects. The company can operate complex project and transfer knowledge from one discipline to another. Having been involved in shipbuilding for over 40 years, RRM

has accumulated the expertise and knowledge that place their products out of the ordinary range. It also continues to expand its knowledge by cooperating with University Technology Centers around the world (Interview with Rolls-Royce Marine, Marketing and Business Development Department 2013).

### ***5.1.2. RRM's approach to managing the clients***

When entering a new market or working with new clients, RRM upholds the same principles. It searches for the opportunities to get into the market that offers opportunities to grow and expand the client network and perform large scale, expensive and preferably long-lasting projects as opposed to single-sale actions. When in contact with the client, RRM engages in uncovering all the needs for project: this involves extensive communication on the part of the company. Meeting between the client's side and designing/sales personnel from RRM are held, when all the crucial details of the project are covered; when necessary Rolls-Royce engages in follow-up procedures in order to get the full understanding of the needs and specifications and ensure that customers understand the offerings and what they entail. At the initial stage it is very important to cover all the aspects of the future vessel, as modifications to the design in later stages of the project could be costly in time and resources.

In order to reduce the possible negative effects of delays or other unforeseen occurrences, RRM normally keeps in close contact with customers, ensuring their full understanding on how the process is handled on the producer's side. This is done in order to uphold the image of RRM as a reliable leader of the industry and evade any client dissatisfaction as that could affect the future of the company in the long run and even spread to other sectors of the head company.

When entering a new project, the most important part of the team is engineering. After the contract about the basic terms of the deal has been signed, the core competence of RRM comes into force. Design and engineering are the processes that require most communication and interaction with the client and the shipyard further in the project fulfillment. When designing the offering it is important to know the usage conditions and all the technical specifications for the vessel. According to the designers at RRM, the company is rather flexible when it comes to introducing

modifications into the original design in the later stages of the project. That way RRM ensures that they meet completely the client's needs, and he gets the design/ship he is satisfied with (Interview with Rolls-Royce Marine 2013).

### ***5.1.3. RRM's approach to managing operations***

One of the strategic choices of RRM is disengagement from investing in capital assets. This means that the company prefers to remain in the roles of design supplier, ship's elements supplier parts and project manager and streamline the production process with the use of other subcontractors. The company does not own any shipyards or production sites but has an extensive network of available subcontractors that are chosen for a specific project with accordance to the capacity of the plant, project characteristics and customer's specific instructions. In addition RRM has docks in 35 countries worldwide in order to provide after-sale services. The "no own production facilities" strategy implies experiencing some difficulties when it comes to country-specific requirements, like production localization requirement in Brazil, for example. According to the Marketing and Sales Department managers, RRM's operations in Brazil are rather expensive due to transportation costs: because of the "local content of the final vessel" requirement, the hulls and non-critical parts are built on Brazilian shipyards, whereas the important outfitting equipment is transported from the European countries, which in the end turns out to be quite costly (Interview with Rolls-Royce Marine 2013).

Since every project is different from one another, rarely does RRM sell a "white-label" design without any alterations to the concept. Given the engineering potential of the company, changes can be made to any part of the vessel and often are completely innovative to the market. This limits the number of available options for actually building a ship to those subcontractors that can withstand the complexity of the project and keep the quality on the high level. Even if a shipyard is not capable of performing the whole operation, RRM does not invest in machinery or other equipment, but continues to outsource it further. In order to avoid situations when a shipyard is incapable of producing a desired design, the Engineering department explains the client the technical limitations and suggests alterations to the project.

These changes are then passed on to the Design department and implemented in the ship's design.

### **The usual process of working with the client**

Usually a customer approaches the company with a set of requirements or a vessel type in mind. In an early stage a sales manager together with the designer assess the requirements and propose a vessel, tailored exactly to the needs of the customer. Again, the key strength is RRM's flexible approach to designing the vessel, instead of selling an "off-the-shelf" project. Often the customer is not sure of the requirements themselves, and in this case it is important to engage clearly with the customer to assist them in defining what is important in the vessel.

After several meetings with the client, the General Arrangement, drawing list and building specifications are made. At a later stage, when the design is agreed upon and is to be realized by the shipyard, it is important for RRM to maintain close relationship with the latter in order to control the quality, possible changes in the original project, and delays (Interview with Rolls-Royce Marine 2013).

The project is completed by a team of engineers, supervised by a Project Leader, who represents the channel and the link for communication with the client and with other departments involved in the order fulfillment.

#### ***5.1.4. Contractual security of RRM's interests***

RRM tries to operate on the frontier of available technology. This means serious investment into R&D. What's more, for each project, a custom design is performed, which also sometimes requires extensive development and creation of new solutions. Different clients have different technical specifications and should be treated accordingly to what they need. The fact that RRM is capable of tailoring its offerings to every client's unique set of restrictions is a part of what makes RRM a great partner and a leader in its segment, therefore protection of intellectual property is paramount. Speaking further about strategic leadership, it requires investment in design and processes that can later be implemented in the works of the company, and legal protection of these investments is necessary in order to keep making profit in the long run.



Contracts as a means are a crucial part in securing RRM's competitive edge. It is important for the company to embrace all the possible sides of the project with the satisfied as result both for RRM and for the client. That results in complex contract negotiation, especially with the new clients, in order to pine all the potential risks.

The Non-Disclosure Agreement (NDA) represents the most important part of the contract, safeguarding against opportunistic behavior and preventing the scenario of losing the competitive edge of being the high-technological player on the market (Interview with Rolls-Royce Marine 2013). Even though the flexible approach of RRM to working with clients (e.g. the possibility to make changes at the later stages of the project), the NDA is non-discussable core guarantee to protect RRM's interests.

## **5.2. Russian Maritime Market Assessment**

Russian Maritime Market, being undeveloped and of particular interest for the government, represents great opportunities for companies offering vessel design services. Coupled with the offshore oil and gas industry, which is strategically important for the Russian economy, this adds up to the market with the high enough potential, especially for companies offering advanced technologies. However there are major risks and challenges to be considered, together with country particularities that might discourage from expansion of operations onto the Russian market.

### ***5.2.1. Russian maritime market potential assessment***

The Russian government identifies shipbuilding and maritime sectors as priority areas of industrial development and modernization of the country. Both industries experience serious difficulties with unacceptably old fleet and underloaded capacities, thus requiring major support, but not only from the government, but also from foreign investors. The fact that up to 25% of the world's hydrocarbons are stored on the Russian shelves, adds up to the importance of the shipbuilding industry development in order to ensure the successful operations of the fields.

Although the country experiences the current investments into upgrading the shipyards and building new ones (e.g. the Kotlin island project), it is not enough for the proper development of the maritime industry, especially offshore sector. With the

substantial amount of hydrocarbons lying in the Arctic waters, it is important to possess advanced equipment due to harsh working conditions. However, Russia lacks the necessary knowledge and experience when it comes to designing and building highly technological, complex vessels. And at this point the situation represents promising opportunities for companies offering design services of advance-technology, state-of-the-art equipment. In addition, experience of working with ice-class vessels is a great advantage, since most of the equipment needed is expected to operate in the Arctic waters. The extensive plans of Russia to build 90 arctic vessels, 140 offshore supply vessels, and more than 40 icebreakers by the year 2030 increase the attractiveness of the market.

With the recent suspension of the most promising offshore oil & gas field Shtokman in the Arctic waters, the demand for the support vessels for offshore operations has decreased. However it is still on attractive enough level due to several other large offshore projects in operation, that are planning to increase the fleet of large ice-class vessels for maintenance and transportation.

To conclude, Russian maritime market, especially its offshore-related part, opens a rather high potential for establishing and expanding operations. A massive governmental support and the fact, that both shipbuilding and oil & gas industries are regarded as strategically important to the country, underline the priority set to the problem of development of the industry. And for the moment in order to close the technological gap between local shipbuilding and shipbuilding the leading countries, Russia is forced to turn to technologically advanced foreign companies to get the necessary knowledge and expertise.

### ***5.2.2. Risks and challenges for operations on the Russian maritime market***

Russia's specific approach to doing business coupled with its maritime particularities impose certain limitations and risks that might discourage foreign companies from establishing or expanding operations on the market. On the other hand the situation might require careful adaptation of approaches and strategies, or even allowances for compromises in order to ensure stable and successful operations on the Russian market.

The first and foremost concern is the country's orientation and dependency on the fossils extraction, which results in heavy ramification for the balance on the market. Not only does the extraction industry and its affiliates receive preferential treatment from the government, financial organizations and other institutes, but also sometimes it means that in other areas of the economy the infrastructure may be underdeveloped, the workforce less qualified and the financing miniscule, as these spheres do not enjoy enormously large amounts of capital return. Strategic planning is often far from reality or even useless, and business operating in such unstable and unpredictable conditions has to adapt accordingly.

The poorly developed infrastructure and underloaded shipbuilding capacities might force the Russian government to impose the liability for foreign design bureaus to look for subcontracting shipyards in Russia. That way the country is hoping to increase the level of competence and expertise of the Russian workforce involved in the shipbuilding industry. However this implies major difficulties for the companies entering the market, since the lack of knowledge together with old equipment represent a serious challenge. The problem may require investments at least in training of the personnel. Moreover, the process of quality and deadlines control is becoming much more complex and scrupulous, which may result in delays and unmet needs. In addition, low efficiency means poor utilization of existing technology or absence of technology at all, which could result in product qualities inferior to the ones of competitors'.

The country's aiming at upgrading shipbuilding facilities inland and making the maritime industry internationally competitive in terms of technological capabilities represent another possible pitfall for foreign companies with extensive and advanced knowledge in offshore maritime industry. That is the disregard for intellectual property rights from the part of the Russian companies. Putting it simply, at times some companies begin to think that paying for contract is enough and there is no need to pay for licenses; this may result in copyright infringements, which, in turn, undermines trustworthiness and leads to partners falling apart. This situation is obviously representing serious risks for a company with technology orientation, entering the Russian market, in terms of securing its competitive edge. In most cases such a position of the Russian companies becomes an obstacle and prevents foreign design companies from further development of any relations.

Yet another obstacle that some foreign companies may face while doing operations in Russia is the unfamiliar level of bureaucracy that plagues many aspects of regular work, from establishing subsidiaries to obtaining licenses. This further contributes to low efficiency of work as time is essentially wasted on unnecessary paper pushing. This aspect should be taken into consideration when planning for complex projects that involve any state entities either as counterparts or regulators.

To conclude, Russian maritime market, offering increasing and promising opportunities for international companies with advanced knowledge and capabilities at the same time holds serious challenges that need to be met and handled carefully with a specific, tailored to the Russian reality, approach. However once the right solutions are found, the market pays back with promising demand and orders.

### ***5.2.3. Types of customers on the Russian maritime market***

#### **Sovcomflot**

Sovcomflot, being the largest Russian shipowner, is a primary target for any company seeking to secure a contract in the field of providing ship design services within offshore industry. The company includes in its structure ZAO Rosneftflot, which provides services for those interested in the offshore support fleet in Russia. Therefore for the sake of the research these two entities can be viewed as one company-client. Keeping in mind the governmental program for developing shipbuilding and maritime industries, SCF plays the crucial role in implementation of this project, due to its abundant experience and market share. The company works directly with the government therefore it is tightly involved in the decision-making process and can affect the structure and the principles of realization of the program. This connection goes two ways: for example, the choice of counteragents as well as the projects could be affected by politically biased decision-making units.

Despite the possible influence by different decision-making units, SCF is still inclined towards the introduction of a modern technology and improvement of knowledge and expertise in terms of technological capabilities in the shipbuilding sector, minimizing the technological gap between the national maritime industry and the foreign competitors. That makes SCF a product-committed customer, according to the Jackson's (1985a) classification. This means that SCF would search for a company

capable of supplying it with the right product that aligns with its goals and obeys its classifications. This, however, results in a rather broad pool of potential suppliers, capable of meeting the product's minimal requirements that satisfy the set goals.

At the same time, following the Jackson classification and taking into consideration SCF's track record, it can be concluded that the company is also vendor-committed. It means that they prefer working with the limited number of vendors (instead of committing to a specific technology in case of unforeseen changes) with whom the company is acquainted and had previous working experience. SCF has long-lasting relationships across several projects with the industry heavyweights like Aker Attics, and STX. Such commitment has a direct influence on the approach to relationship management the company is following.

Continuing the parallel with Jackson's (1985a) work, SCF possesses the characteristics of an always-a-share type of customer with some attributes of a lost-for-good customer. SCF's commitment to product represents the AAS part, namely the possibility to switch suppliers in search of the most suitable solution, which results in a considerable low risk level due to the number of option available for comparing. Before the introduction of the "Of development of shipbuilding" program, SCF would base its assessment of suppliers on their immediate capabilities and inducements, according to the technical specifications of a particular project. It also would prefer engaging with familiar counteragents based on the previous experience following the path of minimal resistance (i.e. lower costs, shorter completion time, easier negotiations and communication) (Sovcomflot 2013). However, with the introduction of the industry development plan, SCF, being a major participant, is interested in attracting more advanced and contemporary technological solutions to the market (Kuznetsov 2011). Encouraging stiffer competition is a logical solution to the challenge, which results in increasing the number of market players. In turn, this would result in SCF's investing more time and resources when choosing the next contractor. With a large amount of project goals to be completed in the following 20 years, SCF might regard it a good strategy to minimize costs by entering a more prolonged cooperation if the suitable partner is present. According to Jackson (1985a), such behavior depicts a LFG type of customer.

## **United Shipbuilding Corporation**

United Shipbuilding Corporation represents another side of the Russian maritime market and a supplier to the different part of a project value creation chain. USC is characterized by a high level of deterioration of equipment and capital assets. This prevents it from successfully enrolling with the industry development program on a large scale. Even though there exist several relatively advanced installments, capable of meeting minimal requirements for specialized projects (e.g. ice-class vessels of a specified deadweight tonnage), these would not be sufficient for delivering high-technology advanced vessels due to the lack of necessary resources and competence. An example of such shipyards could be Zvyozdochka, Admiralty Shipyards and Caspian Energy Group.

With the introduction of the shipbuilding development program, the government might also impose the requirement for local content of the final vessels, meaning that foreign design companies will be forced to search for subcontractors among the existing Russian shipyards. As a result, the former appear to be in bottleneck situation according to the Kraljic matrix (Kraljic 1983). They would have to choose among the limited number of local shipyards, which lack the desired skills in most cases.

Speaking of the relationship management approach of the USC, it is worth assuming it would be interested in establishing a long-term relationship with foreign design companies in order to secure the optimal load of the existing production power and ensure the knowledge and expertise sharing.

Based on the information, gathered from the interviews with the company and the secondary data analysis of the Russian maritime market, we have come up with the SWOT analysis of RRM with regard to the market situation and company's opportunities in Russia (Table 4).

**Table 4. SWOT matrix for RRM in the Russian market context**

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>– Engineering and design capability</li> <li>– Flexibility: ability to deliver full-package product as well as just supply parts</li> <li>– Ability to create customized projects, completely from scratch</li> <li>– Long experience provides extensive cases base and knowledge of processes/suppliers/materials/technologies</li> <li>– Experience with Arctic region-specific products</li> <li>– High brand equity</li> <li>– Former single operations on the market</li> </ul>	<ul style="list-style-type: none"> <li>– Need for investment</li> <li>– Unwillingness to invest in capital assets</li> <li>– Price</li> <li>– Lack of knowledge of the market</li> <li>– Competitors already present in some large scale projects</li> <li>– Disregard for low-class products</li> </ul>
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>– Russia’s development of Arctic offshore region</li> <li>– Russia’s revitalization of the shipbuilding industry</li> <li>– Emergence of new economically attractive extraction technologies</li> </ul>	<ul style="list-style-type: none"> <li>– Opportunistic behavior on the Russian side</li> <li>– Political ban of British companies due to increased tension</li> <li>– Political shift resulting in reprioritizing and cease of the project</li> <li>– Exclusive domestic companies’ access to resources-related projects</li> <li>– Discovery of new hydrocarbon extraction fields and technologies, leads to offshore operations cease</li> </ul>

## **6. Discussion and Recommendations**

The recommendations were derived based on the theoretical background and the analysis of Rolls-Royce Marine AS as well as the Russian market and industry analysis.

### **6.1. Approach to Managing Relations With Counterparts on the Russian Maritime Market for RRM**

Based on the market assessment of the country, it is obvious that it holds a great potential for companies involved in supply of full ship design for offshore supply projects as well as just outfitting equipment (e.g. deck machinery, thrusters/propellers, engines, etc.) However, certain market characteristics and features of Russian business practices pose challenges and risks to foreign companies entering the market. These peculiarities impose certain alterations to the approach of managing the relations.

Given the specifics of the industry and the area of RRM's operations, the company is involved in bilateral relations with its counterparts, following the Heide's (1994) categorization. The relations are built on joined actions of all the parties involved – vessel creation cooperation, thus it is important to secure the continuous communication and information exchange throughout the lifetime of the project. With respect to the Russian maritime industry realities, additional emphasize should be put on this aspect of relationship. Due to fact that RRM has very little experience with the local shipyards as well as the fact that the Russian shipbuilding industry is undeveloped, it becomes even more complicated to control the quality of every stage of development and the final vessel. In addition, language barrier could worsen the situation. Keeping that in mind, it would be vitally important for RRM to increase the quantity and improve the quality of communicational interactions. However, it is worth stating that the relations between RRM and partners on the Russian market specifically are not completely bilateral. The Russian market is characterized by being unstable with short horizon of predictability and the presence of unethical business principles. This results in the lowered trust between the parties and the need of legal third party insurance at least in the first stages of relationship. Therefore such



government mechanisms as relational norms and trust (Jap and Ganesan 2000) will not suffice in securing the interests of RRM and protecting its rights. The appropriate governance mechanism in this case would be formal written contracts with extended detailization and maximal coverage of mutual responsibilities and control mechanisms. It is vitally important to secure the interests of the company in order to capitalize on the opportunity without losing its competitive advantages. Detailed responsibilities coverage also creates a better safeguard for RRM against potential risks connected with involvement on the Russian market. The implications go beyond the project-specific contractual liabilities and cover for unpredictability of the Russian economic context in large.

One-sided specific investments, though a promising option in terms of RRM's involvement in the industry development, represent the major in the Russian market context due to the possibility for opportunistic behavior from the side of the customers. In a close-to-monopolistic market, with sufficient enough number of companies offering vessel design services, Russian shipowners and shipbuilders have a leverage when it comes to losing one partner as they are left with others to choose from. Taking into consideration the important strategic goal of industry development and previously expressed unwillingness to sign the non-disclosure agreement for intellectual property right, the threat of opportunistic behavior is even higher: Russian customers can exploit the technology and investments offered by RRM without any reciprocity. The solution to this is mutuality of specific investments. In our case a possible example of a bilateral specific investment is RRM's involvement in the industry renewal in form of direct financing or technology lease on condition that SCF invests resources into its personnel training. This way the industry receives a superior technology, and RRM develops a long-term client, compatible with RRM's product.

Risks associated with specific investments are most probable in the very beginning of the relationships development between RRM and SCF. At the later stages, in case of success, RRM might encounter the challenges connected with communication and trust between parties, since SCF might be reluctant to provide or share useful information that they regard as strategically important. In addition, short horizon of planning on the Russian market might result in unexpected events unfold, requiring adjustments in the original contract, which might result in further conflicts and

misunderstanding between the parties. Finally, it might be hard to control the quality of the final product and the level of compliance with the terms established in the contract due, again, to communication problems.

In any way, considering the industry development program introduced by the Russian government, we regard it important for RRM to approach the market not with the intention to simply sell the product, but with the intention to take part in the development of the offshore shipbuilding industry, especially keeping in mind the fact that RRM has already had a similar experience. To be more specific, the company has not only extensive experience on the Brazilian offshore market as a supplier of both critical parts and full vessel designs, but it also played an important role in the revival of the industry: RRM's local participation with yards and effective transfer of knowhow, has contributed to the rebirth and growth of the Brazilian naval industry. For example, RRM has plans to invest over \$200 million over next 18 months to build an Energy packaging plant for turbo-generators. Moreover RRM plans to build Marine thrusters assembly and test plant together with a state-of-the-art training center in the country. That way RRM has secured a long-term presence on the market not as a supplier of offshore equipment, but as an important part of the industry with a continuous number of new orders and projects (Interview with Rolls-Royce Marine 2013).

One of the ways for RRM to secure its long-term presence in the newly-developing industry is being present in the Western cluster development, regarded as one of the most prospective in the intended new maritime industry landscapes. It is very important for the Russian part not just buying a product, but driving the development of the industry and therefore RRM cannot be present in the long run by simply trying to sell a product.

Given the specificity of the area of operations and that RRM prefers supplying the full ship package, it is strategically important in the long run to minimize the always-a-share traits of a partner and develop a lost-for-good characteristics. This is done through RRM's ability to deliver highly technological complex systems that are fully customizable and hence reduce the intravendor costs of a customer while increasing the intervendedor costs (according to Jackson (1985a)) In this case the a customer would be locked in with RRM's offerings which ensures the entrance of the Strategic position according to the Kraljik (1983) matrix. As a result it would be difficult for a

customer to leave the relationship due to high switching costs (investment costs as well as a risk of exposure to an unfamiliar partner (according to Jackson (1985b))).

Needless to say that managing operations and upholding relations with the customer would be considerably easier with the subsidiary established in the country. From our point of view, the right place for doing so would be the North-Western region, i.e. St. Petersburg. Such a recommendation is justified by the fact that a new large maritime and shipbuilding cluster is now under development in the region (i.e. the Kotlin island), making it a center for managing operations within the industry. In addition, the proximity to the European borders implies the possibility to take advantage of the development European infrastructure should the need for critical parts deliveries or other cooperation arise.

In conclusion, it is worth saying that even though the Russian market opens up promising opportunities for RRM, it is very much underdeveloped. Hence in order to ensure successful and prolonged operations and presence on the Russian market, it is important that RRM is involved in the development of the industry in one or another way – either by direct investments into the physical assets or at least by taking part in increasing the technological competence and knowledge in the country. That way the company will convince the customer in its true intension of its willingness to be present on the market for a long time period and take part in the industry revitalization rather than simply gain from signing the contract.

## **6.2. Approach to Designing Offers for the Russian Maritime Market for RRM**

For successful operations on the Russian maritime market it is important to pay special attention to designing the right offer for the client, with regard to the specificities of the market needs and orientation. Fortunately RRM has a strong point of being flexible when it comes to shaping the products and services for the market. We have derived several recommendations concerning the possible strategies for marketing the company's offerings, considering client's estimated preferences and expectations.

### ***6.2.2. Full package design services***

The option of offering a full ship design is especially desirable for RRM as it aligns with the strategic positioning of the company, being a service integrator and a supplier of the full package product. In addition RRM is interested more in providing a full ship design services due to scale of the usual projects and hence their outcomes in the future.

By offering a full package design RRM ensures the situation when the customer is to a certain extent locked-in in the relations with the company. In the best-case scenario this might lead to the customer becoming a lost-for-good type (Jackson 1985a), meaning that he/she will be more reluctant to switch between partners and is expected to engage in prolonged relations with the supplier. Keeping in mind the fact that the average length of the project is high, due to its complexity and technological intensity, the situation facilitates the prolonged exposure to communication between the parties involved. This fact, fortified by the scope of the program that is being implemented on the Russian maritime market, this opens up an opportunity for RRM to become a perpetual partner of choice at least for the duration of the program, which is 20 years plus.

Having analyzed the history of SCF's operations together with its future prospects and orientation with regard to the Russian maritime industry development program, we have concluded the company's predisposition to commitment both to the product/service and to the vendor, following Jackson's (1985b) classification.

- SCF's commitment to the product means for RMM that it is important to offer a set of immediate benefits with strategic perspective in order to attract a customer. It is possible through designing offerings that underline RRM's superior set of features and unique technological competences, which other competitors do not possess. Specifically to the SCF's strategic orientation with regard to the company taking part in the development of the industry, RRM's focus on advanced technology and R&D responds to the client's needs and expectation. Taking into consideration the particularities of offshore operations in such a harsh environment as Arctic waters coupled with the infrastructural challenges in Russia, it is beneficial for RRM to offer maximum flexibility and customization when it comes to marketing the offer.

- SCF’s commitment to a vendor implies for RRM the necessity to ensure rather high intervencor costs together with low intravencor costs. One of the ways for RRM to ensure the high level of intervencor costs is to invest in personnel training instead of simply supplying the customer with the specific advanced technology products. This way RRM embraces two goals. First, the company ensures its technology integration into the industry and establishing the entry barrier for competitors via creating company-specific knowledge among the Russian workforce. This limits the applicability of such knowledge to RRM’s products and services, thus increasing the intervencor switching costs. Second, RRM convinces the government in their intension to be a part of the growth of the industry by increasing the technical knowledge and expertise of the Russian workforce involved in the maritime sector.

The option of offering full ship design services coupled with investing in intangible assets requires rather high commitment from RRM. From the other side of transaction, the Russian customer would be interested in receiving a highly advanced technology that can be adapted and customized to Russian conditions and goals, and delivered as a full package – together with knowledge and expertise transfer.

### ***6.2.3. Outfitting equipment delivery***

Due to the existing circumstances on the market and the industry specifications allow for another way of being present on the market by designing anther type of offer, namely the supply of the outfitting equipment to the shipbuilders and shipowners. Such an option involves less risks du to less investment required and a rather vast market for the products. On the other hand the option does not ensure the strategic presence on the market and continuous involvement in the growth of the industry and in the later stages, when the industry is developed sufficiently enough to be able to operate on its own without benchmarking against foreign players.

However we regard the option of supplying the market with self-sufficient products as a viable option at least as a first step of getting familiar with the market and its main players. Complicated by the unstable and unpredictable nature of the Russian market, it is a safer strategy for pulping the market and getting to learn about different procedures, regulations and rules used on the market by getting an inside perspective

of the market, which would further facilitate the process of establishing a foothold in Russia.

Even though at first glance the option represents a more temporary one-time sales approach, RRM should structure the offering in a way that would allow for the further expansion and company's presence on the market. RRM should put long-term relationship building forward by going beyond basic customers' needs, offering a superior product in both the technology and customer service:

- Due to the complexity and specific application of the products offered by RRM, it is important that the company provides decent after-sale services to the buyers. This would imply presence of the RRM's offices in the major regions of Russia with competent specialists, preferably from local professional pool.
- Considering the underdeveloped Russian market with the lack of knowledgeable and experienced workforce, RRM's participation in training of personnel in using its equipment properly would provide the company with competitive edge by supplying the market with both tangible and intangible assets. The complexity of the technological solutions offered by RRM even when it comes to the single products are so immense that coupled with proper customer management and support would these products can win a considerable share of the newly developed market. Such an approach would create the locked-in situation for the customers with the RRM's products, thus increasing the costs of switching between suppliers on the market.

The necessity of establishing the long-term continuous relations with the customers even when it concerns just the outfitting equipment is aligned with the theoretical framework suggested by Kraljic (1983). For the moment, the current forces allocation and structure of the Russian maritime market represents the Leverage situation from the position of SCF as a customer. That implies that SCF has a sufficient enough number of potential suppliers of critical parts for the vessels, which might result in the choice of price as decision criteria. This puts RRM in an unpleasant position of being one of the many on a competitive market with the strategy that does not align with the customers committed to the price, according to Jackson (1985b). For RRM to escape such situation would require convincing SCF in benefits from working with RRM in the long run, thus eventually squeezing other competitors from the market and take a

Strategic position for SCF (Kraljic 1983). However at the same time RRM might be the Bottleneck supplier for SCF in case the former offers products and services of limited availability on the market. To be more specific, if RRM supplies SCF with the technologically advanced critical parts for the vessels, that very little or no competitors can offer, that puts SCF in the situation when it is dependent on RRM and its products. Needless to say that such a state of affairs will only favor RRM's operations on the Russian market.

## **Conclusion**

The objective of this research was defined as suggesting the ways for Rolls-Royce Marine AS to approach managing B2B relations on the Russian maritime market, given the industry and country context.

The research question was formulated as follows: “How should the company manage its customer relations and how it should design its offerings given the market characteristics, company’s strategy and resources?”

The theoretical basement for approaching the first part of the question was derived from the literature on relationship types, governance mechanisms, transaction cost analysis and relationship management. Different interviews were created for employees in different departments of RRM, engaged in the relationship with a client. The data about the company’s goals, strengths, expectations and processes were received through interviews with RRM employees. Secondary data about the actual and prospective market conditions were found in reliable sources.

Theoretical basement combined with the information about RRM and the Russian industry was used to formulate different suggestions for the company to guide it through the process of managing its relations on the Russian maritime market, while minimizing possible risks and avoiding potential threats. The major challenge for RRM is a likely opportunistic behavior that could threaten long-term goals. This problem along with others, such as lack of trust, small planning horizon and understanding issues should be tackled with increased quality and quantity of communication interactions along with increased legal protection. Also, bilateral involvement should be in place for RRM to ensure its market integration in the long run. This would nurture mutual dependency between the industry and RRM and create a safeguard against opportunism. This is a desirable option for the company given the amount of governmental initiative taken for the revival and modernization of the industry.

As a result of this research, suggestions for designing RRM’s offerings were also derived. These were divided into two groups, one of which was especially aligned with RRM’s strategic positioning (full-package) and the other taking into additional consideration the specificity of the local industry and the market (supplying



equipment). By offering a full-package product, RRM would work towards raising SCF into a lost-for-good customer. Also, given the customer's commitment to product, RRM should provide the customer with superior technological products while accenting its experience and competence in the Arctic offshore operations. Speaking about commitment to vendor, RRM has to ensure high intervencor costs and low intravencor costs in order to attain the client for at least the duration of the national revitalization program.

As of equipment supplying, it could be considered a safer option, given the market unpredictability and lack of a strong foothold in the industry. This option would allow for a slow and safe entry on an already developing market with customer service and after-sale activity being a measure to warrant more-than-one-time deal. Also, stressing the advancement of offered solutions on the underdeveloped and obsolete Russian maritime market, RRM could win its share by locking the customer personnel on the complex supplied equipment, creating insurance for being present in the picture for the long term.

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### **Interview with Rolls-Royce Marine AS**

Interview with Rolls-Royce Marine, AS, interview by Danil Naumov and Yulia Ivanova. *Contract Department* (May 28, 2013).

Interview with Rolls-Royce Marine, AS, interview by Danil Naumov and Yulia Ivanova. *Engineering Department* (May 30, 2013).

Interview with Rolls-Royce Marine, AS, interview by Yulia Ivanova and Danil Naumov. *Marketing and Business Development Department* (February 28, 2013).

Interview with Rolls-Royce Marine, AS, interview by Danil Naumov and Yulia Ivanova. *Sales Department* (May 29, 2013).

# Appendices

## Appendix A. Sales Department Interview Guide

Dear Sir/Madam,

We are two master students at Norges Handelshøyskolen in Bergen in the Marketing and Brand Management program. We are currently writing a thesis on the topic of Rolls-Royce Marine managing its operations on the Russian market. For our project to have value and relevance both for the company and us we need to get a better insight into company's operations, values and ways of doing business. Thus we would be really grateful if you could spend some time to answer the following questions as fully as possible. Should you require any help or further clarification of a question, feel free to write or call us back.

Thank you very much in advance! We really appreciate your help and contribution to our project.

NB: As researchers, we guarantee complete anonymity of the interviewees, and the interview will not be published without your consent. We would appreciate it if you could answer the questions to the best of your ability.

*Yulia Ivanova*

*Danil Naumov*

### **Part 1. General aspects**

- a. What role does the sales department have in the company? Could you describe the importance of the department and its usual activities?
- b. In what do you believe RRM is different from its competitors at this stage? Are RRM's projects usually completed on time?

### **Part 2. Marketing and sales activities**

- a. What are marketing and sales tools that RRM usually uses when communicating with existing/potential clients? Are these tools and activities tailored to different

markets or stay the same? Do you believe these can be employed when operating on the Russian market?

b. What are the elements of client research activities? What do you think the company does that is different from its competitors at this stage?

What characteristics are you usually looking in a client (if that is the case with the company)?

c. How do you usually establish the first contact? How do you maintain the contact with the customer after fulfilling the order (if you do maintain it)?

d. How long are the relationships between a client and a sales manager? Does the relation end with the client's agreement to sign the contract or you are responsible for the whole process until the order is fulfilled?

### **Question 3. Operations on the Russian market**

a. Could you explain the motivation for increasing operations on the Russian market?

b. What do you believe are most important aspects to consider when acting on the Russian market? What risks do you think the company might experience?

## **Appendix B. Marketing & Business Development Department Interview Guide**

Dear Sir/Madam,

We are two master students at Norges Handelshøyskolen in Bergen in the Marketing and Brand Management program. We are currently writing a thesis on the topic of Rolls-Royce Marine managing its operations on the Russian market. For our project to have value and relevance both for the company and us we need to get a better insight into company's operations, values and ways of doing business. Thus we would be really grateful if you could spend some time to answer the following questions as fully as possible. Should you require any help or further clarification of a question, feel free to write or call us back.

Thank you in advance! We really appreciate your help and contribution to our project.

NB: As researchers, we guarantee complete anonymity of the interviewees, and the interview will not be published without your consent. We would appreciate it if you could answer the questions to the best of your ability.

*Yulia Ivanova*

*Danil Naumov*

### **Part 1. General aspects**

- a. What role does the marketing department have in the company? Could you describe the importance of the department and its usual activities?
- b. In what do you believe RRM is different from its competitors? What are its points of differentiation and points of inferiority compared to its customers? How would you describe the competition intensity on the market today?
- c. What kind of strategy RRM uses? Has it proven to be effective: to what extent have the desired goals been achieved?

### **Part 2. Marketing and sales activities**

- a. What are marketing and sales tools that RRM usually uses when communicating with existing/potential clients? Are these tools and activities tailored to different

markets or stay the same? Do you believe these can be employed when operating on the Russian market?

b. What are the elements of client research activities? What do you think the company does that is different from its competitors at this stage?

c. What characteristics are you usually looking in a client (if that is the case with the company)?

d. How does the company usually establish the first contact? Is the contact with the customer maintained after fulfilling the order? If it is, how?

### **Part 3. Operations on the Russian market**

a. What kind of strategy RRM generally uses when entering a new market? Is the strategy tailored to every country? If not, what factors determine the choice?

b. Could you explain the motivation for increasing operations on the Russian market?

c. What do you believe are most important aspects to consider when acting on the Russian market? What risks do you think the company might experience?

## **Appendix C. Contract Department Interview Guide**

Dear Sir/Madam,

We are two master students at Norges Handelshøyskolen in Bergen in the Marketing and Brand Management program. We are currently writing a thesis on the topic of Rolls-Royce Marine managing its operations on the Russian market. For our project to have value and relevance both for the company and us we need to get a better insight into company's operations, values and ways of doing business. Thus we would be really grateful if you could spend some time to answer the following questions as fully as possible. Should you require any help or further clarification of a question, feel free to write or call us back.

Thank you very much in advance! We really appreciate your help and contribution to our project.

NB: As researchers, we guarantee complete anonymity of the interviewees, and the interview will not be published without your consent. We would appreciate it if you could answer the questions to the best of your ability.

*Yulia Ivanova*

*Danil Naumov*

### **Part 1. General aspects**

- a. What role does the contract department have in the company? Could you describe the importance of the department and its usual activities?
- b. In what do you believe RRM is different from its competitors in terms of legal project handling?

### **Part 2. Contractual and legal activities**

- a. How does RRM ensure the integrity of its technological solutions and know-hows that are used in the process?
- b. How broad is the contractual liability of RRM? Does it cover all the stages of development, including the after-sales service and maintenance? For what period of time?

- c. Does contract come in installments, conditions of which can be negotiated and tailored "on the go"? How flexible are the contracts in terms of budget, deadlines and products?
- d. What kind of insurance is provided for the client? What kind of insurance are you using for own protection against different scenarios?
- e. How do you approach the intellectual property protection? Can sensitive information be shared with your partners and under what conditions?

**Part 3. Operations on the Russian market**

- a. Could you explain the motivation for increasing operations on the Russian market?
- b. What do you believe are most important aspects to consider when acting on the Russian market? What risks do you think the company might experience?

## **Appendix D. Engineering Department Interview Guide**

Dear Sir/Madam,

We are two master students at Norges Handelshøyskolen in Bergen in the Marketing and Brand Management program. We are currently writing a thesis on the topic of Rolls-Royce Marine managing its operations on the Russian market. For our project to have value and relevance both for the company and us we need to get a better insight into company's operations, values and ways of doing business. Thus we would be really grateful if you could spend some time to answer the following questions as fully as possible. Should you require any help or further clarification of a question, feel free to write or call us back.

Thank you very much in advance! We really appreciate your help and contribution to our project.

NB: As researchers, we guarantee complete anonymity of the interviewees, and the interview will not be published without your consent. We would appreciate it if you could answer the questions to the best of your ability.

*Yulia Ivanova*

*Danil Naumov*

### **Part 1. General aspects**

- a. What role does engineering have in the company? Could you describe the importance of the department and its usual activities?
- b. In what do you believe RRM is different from its competitors? What are the points of difference from the engineering and designs approaches and perspectives?

### **Part 2. Design and engineering activities**

- a. Could you please describe how the design process is handled (e.g. in terms of communication with the client, in terms of flexibility of the standard package, etc.)?
- b. What information do you need from clients? How close are communications between you and the client/shipyard? Is collaboration possible?



- c. Are you taking part in searching for a contractor/shipyard to complete the project?
- d. Are there any technological limitations that can prevent the company from achieving the technical specifications provided by the client?
- e. Are RRM's projects usually completed on time (compared to competitors)?

**Part 3. Operations on the Russian market**

- a. Have you ever had experience with eastern clients? What difficulties do you think you might encounter?
- b. What do you believe are most important aspects to consider when acting on the Russian market? What risks do you think the company might experience?

## Appendix E. Interviews Results

Interviewee's Name	Interview Date	Department	Position	Age	Interview Duration	Main Ideas
Yrjar Garshol	28 <sup>th</sup> May 2013	Marketing & Business Development	VP Marketing – Offshore	Not given	36 minutes	<ul style="list-style-type: none"> <li>▪ The main competitive edge is the ability to design integrated systems and technologically advanced solutions to customers</li> <li>▪ Absence of own production sites is a part of RRM's strategy as a way to achieve high quality via increased competition</li> <li>▪ Russian market can offer great opportunities if the right approach is found</li> </ul>
Runar Haddal	28 <sup>th</sup> May 2013	Marketing & Business Development	VP Business Intelligence	Not given	42 minutes	<ul style="list-style-type: none"> <li>▪ Russian market hold major challenges in terms of securing the Intellectual Property Rights</li> <li>▪ Main strategy for RRM is differentiation, and not price, with focus on high-end of the market</li> <li>▪ Main characteristics RRM is looking for when searching for a partner/customer: strategic fit, growth opportunities, credibility, financial strength, opportunities for development (innovation, product development, etc.)</li> </ul>
Rolf-Petter Almli	28 <sup>th</sup> May 2013	Contract	General Manager – Contract	Not given	22 minutes	<ul style="list-style-type: none"> <li>▪ Contracts are usually fixed, but can be discussed at a later stage in regards to commitment. In this case an amendment to contract should be issued</li> <li>▪ Non-Disclosure Agreement plays an important role in securing RRM's interests</li> </ul>

Per Ståle Nykrem	29 <sup>th</sup> May 2013	Sales	Area Sales Manager	Not given	31 minutes	<ul style="list-style-type: none"> <li>▪ Longer building time than estimated on the Russian shipyards may lead to delays in deliveries, which might increase the final costs</li> <li>▪ When entering a market, RRM usually analyzes potential customers and creates their profiles with regard to CRM approach</li> </ul>
Hans Robert Almestad	29 <sup>th</sup> May 2013	Sales	VP Sales & Contract	Not given	36 minutes	<ul style="list-style-type: none"> <li>▪ After the fulfillment of the order the contact with the customer is maintained: RRM needs to know the customer, sell to him and serve him (aftersales)</li> <li>▪ Russia's production localization requirement might create a great challenge for RRM in terms of delivering high quality vessels due to lack of facilities and manpower competence needed; harder to control quality</li> </ul>
Magne Hjelle	29 <sup>th</sup> May 2013	Sales	Sales Coordinator	Not given	33 minutes	<ul style="list-style-type: none"> <li>▪ It is worth attempting to enter a new market as long as it is accessible and sufficiently big</li> <li>▪ An important point to consider is the importance of adaptation to the country's culture as much as possible</li> <li>▪ Exhibitions and tenders represent the most common ways for getting to know potential customers</li> </ul>
Rory Williams	30 <sup>th</sup> May 2013	Engineering & Design	Designer	26	47 minutes	<ul style="list-style-type: none"> <li>▪ The role of the engineering department now is to develop new products that will enable RRM to stay ahead of its competitors while simultaneously supporting the service and aftermarket departments and engaging in continuous development of existing products to enhance the company's competitiveness</li> </ul>

						<ul style="list-style-type: none"> <li>▪ RRM is rather flexible when it comes to vessel design – almost any part can be tailored exactly to customer’s needs, even if it means creating something absolutely new</li> <li>▪ Length of the design stage depends on the customer’s need and time availability – it can last for a month or less or for more than a year</li> <li>▪ Collaboration is required in every project during both the design stage, build and delivery stages to ensure a successful project</li> </ul>
Torgeir Torgersen	30 <sup>th</sup> May 2013	Engineering & Design	Designer, Principal Designer AHTS	29	38 minutes	<ul style="list-style-type: none"> <li>▪ The contact level between RRM and the customer depends on the latter: it can be very close with day to day engagements of the client or it communication only via brokers with no extra information</li> <li>▪ RRM sometime gives recommendation for shipyards/contractors, mostly in less developed areas (e.g. RRM was very heavily involved in the forming of the Brazil offshore ship building industry)</li> </ul>
Carl Arthur Sunde	30 <sup>th</sup> May 2013	Engineering & Design	Project Engineer, Hydrodynamics & Stability	29	37 minutes	<ul style="list-style-type: none"> <li>▪ RRM has a long history (over 40 years) and experience in both design and engineering, fortified by the strong brand name connected to quality and exclusivity</li> <li>▪ Information that is needed from the shipowner is where the ship will operate, if there are any tender requirements it has to fulfill. RRM needs this to</li> </ul>

						determine how powerful thrusters and engines the ship has to be equipped with, in addition to any requirements for cargo volume
Erlend Hagen	30 <sup>th</sup> May 2013	Engineering & Design	Not given	Not given	27 minutes	<ul style="list-style-type: none"> <li>▪ Rolls-Royce can offer anything from single components or systems to entire design packages with complete and fully integrated main system package</li> <li>▪ When working on a new market challenges mostly rise when the shipyard is used to build entirely different ships and applies an entirely different perspective to building</li> </ul>
Anna Swider	30 <sup>th</sup> May 2013	Engineering & Design	Project Engineer – Structure	31	41 minutes	<ul style="list-style-type: none"> <li>▪ Each team in the department is making one ship and works with the Project Leader who is "communication person" between other departments, class and shipyard. The Project Leader is the person who is giving the term of the delivery drawings and calculations</li> <li>▪ When the contract details are being discussed, a person with engineering knowledge is always present in order to correctly specify and reply to particular customer's wishes</li> <li>▪ Different class/market requirements, business culture differences, language difficulties, access to reliable information represent possible pitfalls on the Russian market</li> </ul>