

The effect of overall strategic approach on perceived value of sub-supplier relationships

Case: The Danish Kitchen Manufacturing Industry

(work-in-progress paper)

Lars Bjerregaard Mikkelsen

Ph.D. Student

Copenhagen Business School

lm.lpf@cbs.dk

Dr. Laurids Hedaa

Professor

Copenhagen Business School

hedaa@cbs.dk

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Abstract

There are significant ongoing structural changes among the brand manufacturers within the Danish kitchen manufacturing industry, and 3 archetypical strategic approaches pursued, have been identified:

- *The consolidation approach*
- *The agility approach, and*
- *The process optimisation approach.*

Perceived value by the kitchen brand manufacturers, of their sub-supplier relationships, differs according to the strategic approach pursued.

A discussion of the concept of value and sub dimensions within this concept is conducted, in order to establish a framework for assessing the Danish kitchen brand manufacturer's perceived value from sub-supplier relationships. Subsequently, empirical findings from the Danish kitchen manufacturing industry are applied to the framework established.

Introduction

In Denmark, the kitchen manufacturing industry is mainly clustered in a limited geographical area in rural Western Jutland¹. Historically, interaction among the companies here has to a large extent been based on personal relations, and trust has traditionally played an important role in co-ordinating inter company activities.

Short social, as well as physical, distance among the actors have induced a distinct development towards specialisation. Many companies have focused on a limited span of competencies within the total value net of the industry. Most kitchen brand manufacturers have outsourced large parts of their production to specialised, and historically with preference for local, sub-suppliers.

¹ See appendix A for an overview of physical location of Danish kitchen brand manufacturers

With ongoing changes in the industry structure, the local sub-suppliers are under increasing pressure from (cost-leading) foreign competitors. Many are struggling to identify valid routes for adding value to their existing customer relations (to the brand manufacturers), ensuring their roles in the emerging new industry structure.

Research objective

Focusing on the inter-company interaction patterns between the Danish kitchen brand manufacturers and their first-tier sub-suppliers, the immediate objective of the project is to describe and understand the nature of these current business relationships, and the reasoning behind the identified patterns.

Subsequently, the question sought answered at this stage of the project (i.e. in this paper) is: What is, by the Danish kitchen brand manufacturers, perceived as being of value in their assessment of the offerings of their first-tier sub-suppliers?

The nature of business relationships

In regards to describing and understanding business relationships, Werani (2001) distinguishes between cooperative business relationships on one side, and “the general understanding of business relationships” (non-cooperative) on the other, with the difference resting in the specific quality of the interaction process, and, Werani argues, this difference can be measured along five dimensions:

<i>Long-term orientation:</i>	The degree of long-term orientation rather than the mere duration of a relationship
<i>Relationship-specific investments:</i>	The existence of mutual adaptations, which can be considered as relationship-specific investments
<i>Contractual safeguarding:</i>	The extent to which interaction is based on implicit agreements and relationship-specific norms developed during the relationship, on account of more formal and contractually fixed agreements
<i>Frequency of interaction:</i>	The intensity of the mutual coordination, i.e. the frequency of interaction among the relationship partners
<i>Change of contact persons:</i>	The presence of relatively stable patterns of social interaction caused by a low degree of fluctuations of interaction partners

which are all indicators of a cooperative rather than a non-cooperative relationship. According to Anderson (1995), the *raison d'être* of such collaborative customer-supplier relationships is value creation and value sharing.

The concept of value

In order to discuss what is perceived as being of value by the Danish kitchen manufacturers, a definition of the term “value” is called for. Value has been the topic of research on numerous occasions, and many authors have each contributed with their definitions of *the value concept* in the industrial market (Ulaga & Chacour, 2001). Despite apparent differences many definitions of value seem to centre on the difference between what the customer receives and what he has to give up, and four recurring characteristics can be identified (Ulaga & Eggert, 2003):

- Value is a subjective concept (Kortge & Okonkwo, 1993),
- it is conceptualized as a trade-off between benefits and sacrifices (Zeithaml, 1988),
- benefits and sacrifices can be multifaceted (Grisaffe & Kumar, 1998), and
- value perceptions are relative to competition (Anderson & Narus, 1999; Gale, 1994).

In acceptance of the fact that value assessment is influenced by the degree of “fitness for purpose” (Juran, 1974) or “conformance to requirements” (Crosby, 1979) of the evaluated offering, we can look at the concept of value as based on decision theory. Engels (1962, quote from Werani, 2001) and Roeb (1994, quote from Werani, 2001), argue that the value of a given offering is never of an immanent quality that, like a physical attribute, objectively exists and is independent of the valuing actor. On the other hand, value is also never the result of a purely subjective assessment in the sense of an isolated relation between the valuing person and the offering to be valued.

Rather, the value, as perceived by the valuing actor (the buyer), is assessed against a background of given goals, alternatives and environmental variables. Since alternatives and environmental variables are normally given, or at least outside the scope of direct control of the valuing actor, the goals which are to be reached by means of the respective offering remain as variable determinants of value.

We therefore theorize that an important determinant for assessing the value of a given offering, from the buyer's perspective, lies in the degree of fit of the offering with the specific strategic context for which it is intended. And thus, that the strategic approach chosen by the Danish kitchen brand manufacturers is a strong influential factor in how they perceive value from their sub-supplier's offerings.

Dimensions of the value concept

Though some common dimensions of value have been proposed in literature, a wide variety of value dimensions with varying degrees of overlap exist. Lapierre (2000) identify 13 drivers of value and groups them into 3 benefit dimensions (product, service and relationship benefits) as well as 2 sacrifice dimensions (price and relationship costs). Ulaga & Eggert (2003) extends this to 5 benefit dimensions (product, service, know-how, time-to-market and social benefits) and 2 sacrifice dimensions (price and process costs). Ulaga & Eggert (ibid.) further distinguish between core dimensions (the 7 above mentioned dimensions) and contextual dimensions, which include: Industry, nature of the relationship and product category.

Entering the concept of trust into the equation, Walter, Hölzle & Ritter (2002) identifies 2 overall functions (dimensions), the purchasing function (consisting of 3 sub-functions: The cost reduction, the quality and the volume function) and the network function (also consisting of 3 sub-functions: The market, the scout and the innovation development function) as determinants for relationship value as perceived by the buyer. Purchasing functions are seen to influence the economic goals of the customer directly, whereas network functions are seen to have an indirect effect on these goals. Fulfilment of the different functions is seen to have varying influence on the level of trust in the relationship, which again influences the value of the relationship as perceived by the customer.

Distinguishing between product based value and relationship based value, and further building on the concept of trust, Walter, et al. (2002, p. 5) theorize that relationships are driven by the need to create value (both product and relationship based). They see trust as "the doorway to successful relationships while value creation is the glue that leads to commitment".

A topic of some debate has been whether changes in price affect perceived value by the customer. Anderson & Narus (1998) argue that this is not the case, "rather, change in price changes the customer's incentive to purchase that market offering".

Uлага & Chacour (2001), on the other hand, argue that a customer's perceived value must be seen as a trade off between price and quality. This inclusion of price seems to be in line with our initial empirical findings from the Danish kitchen manufacturing industry, which has indicated a rather narrow "buying focused" purchasing orientation among many of the Danish kitchen brand manufacturers.

Purchasing orientation can be seen as the overall philosophy behind purchasing-related decisions, and according to Anderson & Narus (1998) customer firms commonly adopt one of three purchasing orientations:

<i>Buying</i>	- focus on minimising the price paid in a given transaction
<i>Procurement</i>	- focus on reducing the total cost associated with the use of a product or a service
<i>Supply management</i>	- focus on maximising the benefits relative to costs and price from an offering.

Uлага & Chacour (2001) further refines the quality-part of their definition of perceived value into: Product quality, service quality and promotion quality. The latter including criterion such as personal relations and the trustworthiness of the supplier. Thus, Uлага & Chacour suggest to regard perceived value as a function of Price; product quality; service quality and promotion quality.

The term "quality", however, potentially invokes a problem, since "quality can mean many different things to different customers in different circumstances, and the term therefore is meaningless unless carefully defined in each context" (Ford et al., 2002, p. 10). Adhering to this view on quality, and further building on the thoughts on value influenced by a supplier's problem-solving ability as well as transfer ability (Ford et al., 2003, Håkansson, 1980) and on our earlier argumentation on perceived value of a sub-supplier's offering being influenced by the strategic approach of the valuing (buying) actor, we build our value dimensions around the concept of "fit", distinguishing between:

- Product fit
- Service fit, and
- Relational fit

in the relationship between the Danish kitchen manufacturers and their 1st tier sub-suppliers.

Product fit describes the fit of the actual product, i.e. the ability of the sub-supplier to deliver a product, the characteristics of which target immediate requirements of the end-customer (customer's customer) in terms of functionality, sturdiness/reliability, choice of material, design, colour, etc. This does not necessarily mean that the sub-supplier has to master a wide, and rapidly changing, array of production competencies by himself. Product fit can also hinge on the position of the sub-supplier in the supply network, and thus on ability of the sub-supplier to orchestrate system deliveries through complementary sub-suppliers further upstream, quickly "piecing together" the right offering, at the right time, through external resources.

In other words, product fit depends on the problem-solving abilities of the sub-supplier, and on him, through understanding end-market requirements (customer's customers), always making available to the customer (the kitchen brand manufacturer) an offering that targets current end-market needs.

Service fit describes the fit of the services surrounding the actual product, i.e. the degree of flexibility, speed and timeliness in producing and delivering the actual products. The Service fit dimension includes potentially value enhancing services such as e.g. *just-in-time delivery*, *vendor-managed-inventory* and knowledge trans, and thus also the ability of the sub-suppliers to integrate with the kitchen manufacturers system wise, sharing information and automatically acting on shared information. Market offerings can be seen as falling along a continuum of tangibility (Levitt, 1981). In business markets, suppliers typically provide a blend of tangible products and accompanying services (Hutt & Speh, 1998). It is these accompanying services, ensuring optimal "flow" of the tangible product, in the eyes of the valuing actor (The kitchen brand manufacturers) that is included in the service fit dimension.

Thus, the service fit dimension can be regarded as the degree to which relationship related sacrifices can be minimised through the transfer abilities of the sub-supplier. Williamson would call this a reduction in transaction costs (Williamson, 1981). I.e. how costs that occur in acquiring and storing products; costs incurred in coordination with the supplier's organisation, in order to obtain the tangible product and make it available for the valuing actor's (the kitchen brand manufacturer's) own transformation process, can be kept down.

Relational fit describes the elements of the buyer/supplier relationship that go beyond the exchange of products and services. Even though business relationships are established

between organizations, they are actually managed by individuals within the organizations, and it is these individuals that make a relationship work or fail (Wilson & Jantrania, 1995). The relationship fit dimension therefore describes the social distance between the kitchen manufacturer and the sub-supplier, the extent to which interaction is founded on personal relations, the degree of interpersonal trust in the relationship and the ease of communication and interaction in the relationship in general.

Not disregarding the direct monetary exchange, and in line with Ulaga & Chacour (2001), in addition to the 3 fit dimensions, we also see *price* as a prominent sacrifice, and an important determinator in customer's assessment of perceived value from a sub-supplier's offering.

We therefore see value, perceived by the Danish kitchen brand manufacturers, as a function of price, product fit, service fit and relational fit of the sub-supplier's offering, which can be summarized as:

$$\text{Perceived value} = f(P + pF + sF + rF),$$

where P is price, pF is product fit, sF is service fit and rF is relational fit.

The relative influence on the total perceived value formula, from the individual dimensions (sub-elements) within the definition, is determined by the overall strategic approach chosen by the valuing actor (the buyer) and by the nature of the sub-supplier's offering (product category).

The distribution of relative influence of the individual sub-elements in overall perceived value assessment is also an indicator of the general purchasing orientation of the kitchen brand manufacturers, with a high ranking of P pointing towards a buying biased philosophy, sF indicating procurement orientation, pF pointing more towards a supply management approach, and with a high ranking of rF supporting a procurement as well as a supply management purchasing orientation.

In turn, this will again indicate the level of commitment, and thus the nature (cooperative vs. non-cooperative) of the relationship.

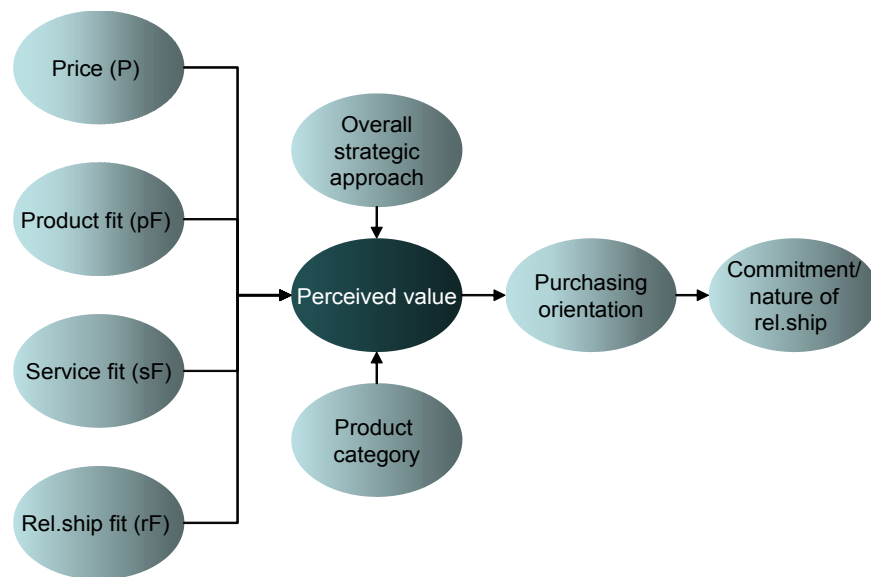


Figure 1: Perceived value drivers

Methodological considerations

Since industrial networks tend to be heterogeneous in nature, it has been difficult to apply a specific best methodological practice to the project at hand.

Therefore, given the special characteristics of the Danish kitchen manufacturing industry, and the so far limited availability of work on inter-company interaction related aspects within this industry, the methodological approach chosen is of a primarily exploratory, inductive and descriptive nature.

Also, because of the fact that industrial relationships, per se, are difficult to study out of context, (Easton, 1995), and because focus here, is on a contemporary phenomenon within some real-life context, the events of which the investigator has little control over (Yin, 1994), research has been based on a descriptive, in-context, qualitative, multiple case study strategy.

In the words of Van Maanen (1983) the primarily qualitative approach chosen will optimally include *“an array of interpretative techniques that seek to describe, decode, translate and otherwise come to terms with the meaning – not the frequency – of certain more or less naturally occurring phenomena in the social world”*.

With the focal area of research, in the current project, being the relationships between the Danish kitchen brand manufacturers (customers) and their 1 tier sub-suppliers (suppliers), and with the experience of it being less problematic to gain access to information on a company's suppliers than it is to gain access to information on a company's customers, the interviews have been structured into two separate "waves".

The first "qualitative and exploratory wave" includes interviews with all relevant Danish kitchen brand manufacturers, with the objective of:

- identifying the parameters for their assessment of perceived value of sub-supplier offerings, according to the definition (Perceived value = $f(P + pF + sF + rF)$ established.
- mapping their current individual supplier networks, as a basis for selecting relevant candidates for wave 2

The influence of the individual elements of this definition on overall perceived value of the Danish kitchen manufacturers differ according to the strategic approach pursued, and is mirrored in the structure of their individual supplier networks.

It is these differences that are of interest to this project, and they will be visualised by means of the perceived value assessment framework illustrated in figure 2.

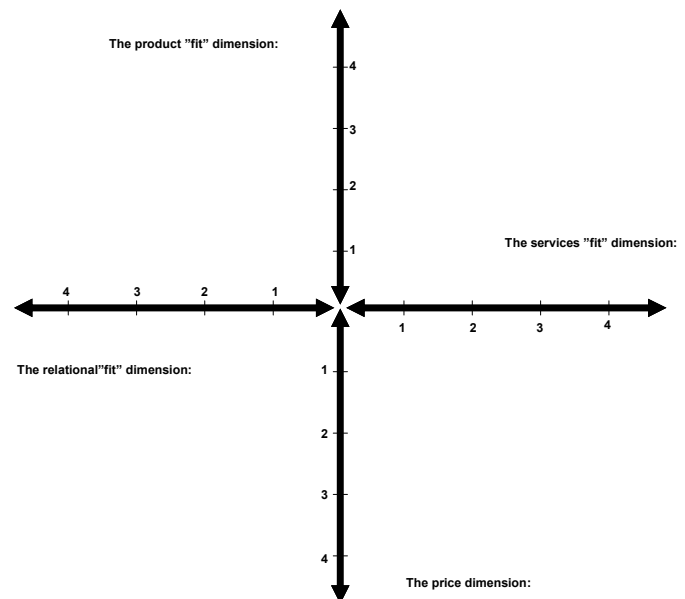


Figure 2: Perceived value assessment framework

Having mapped the sub-supplier networks, this knowledge will be leveraged in order to gain access to relevant sub-suppliers. Subsequently, through an operationalisation of the perceived value assessment parameters of each kitchen brand manufacturer identified through wave 1, wave 2 will be a quantitative (primarily) questionnaire based survey among the chosen sub-

suppliers, identifying their evaluation of their customer's perceived value of the offerings supplied.

At this stage of the project, wave 1 analysis is being conducted. Wave 2 has not yet been initiated. The remaining part of this paper is based on findings from the part of the analysis conducted so far.

The Danish market for kitchens

Over the past decade, the Danish market for kitchen furniture has experienced a strong growth, resulting in a doubling in turnover (for Danish kitchen brand manufacturers) from DKK 1,2 billion in 1992 to DKK 2,5 billion in 2001².

With a favourable development of interest rates, and a continuous rise in the value of real estate in Denmark, this growth really took off around 1993-94 when many people started converting their old high-interest loans with new 30-year low interest loans and thereby freed up a lot of liquidity, which by many was re-invested in their homes, and thus also in new kitchens.

Coupled with a substantial rise in the number of homes sold in Denmark, from 1995-1998, this spurred a significant growth of the Danish kitchen market during that period. Since 1998, however, the number of homes sold has decreased, which has also influenced the Danish kitchen market, experiencing a stagnation around 1999-2000³.

Since the Danish kitchen market, due to the sheer size of the country is quite small, and due to special Scandinavian design requirements, foreign brand manufacturers do not dedicatedly serve the market.

Seen from an overall market perspective, it seems as if a polarisation of the market is taking place, with expected future growth at the top and especially at the bottom, and with the entire middle market stagnating, however, still constituting a large share of the total Danish market for kitchens. Today this figure is app. 70%⁴.

² Data from Statistics Denmark

³ Data from Statistics Denmark

⁴ See Appendix B: Outline of the Danish kitchen market

Ongoing structural changes within the industry

Looking across the span of brand manufacturers occupying the Danish kitchen market, 3 archetypes of strategic approaches have been identified:

- **Approach 1:** Consolidation – strength through scale
- **Approach 2:** Agility – minimise in-house production
- **Approach 3:** Process optimisation – virtually integrate

These archetypes will form the framework in which to structure our empirical findings, even though this may be argued to be a simplification of real life, since, in reality, the strategic approaches of most of the individual kitchen brand manufacturers, incorporates elements of all three.

Approach 1: Consolidation – strength through scale

Several kitchen brands are currently being consolidated horizontally, into large entities spanning more brands and several countries. The identities of the individual kitchen brands are maintained, with the primary objective of the consolidation being to leverage accumulated sourcing demands.

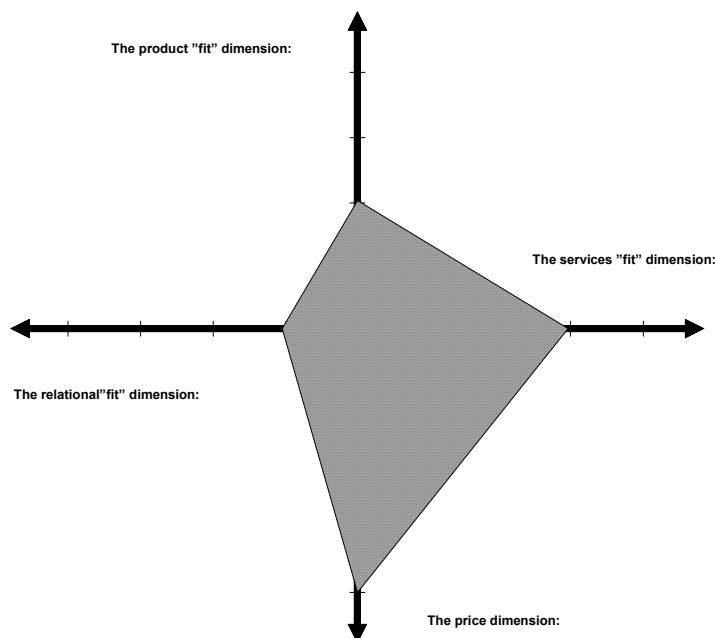
Exemplifying this; 3 individual brand manufacturers (together constituting approximately 50% of the total turnover in the Danish kitchen market) have been bought by the Swedish holding company Nobia, who also owns a large number of Norwegian, Swedish, German and English kitchen brand manufacturers⁵.

Another example of a consolidated entity with ownership interests in the Danish kitchen manufacturing industry is the Ballingslöv Group (also Swedish), which in Denmark has so far bought 2 brand manufacturers (accounting for another approximately 10% of the total Danish kitchen market), adding these to their existing portfolio of Swedish and UK kitchen brands.

⁵ E.g.: HTH, Invita, Unoform, A la Carte, Gold Reif, Marbodal, Myresjökök, Norema, Optifit, Parma Plus, Petra, PoggenPohl, Pronorm, Sigdal, Star-Beka, Yes Box, Magnet.

According to both Ballingslöv and Nobia, the immediate objective of their consolidation efforts is to utilise volume of accumulated sourcing needs to negotiate lower prices upstream in their supply networks. In a somewhat longer perspective, the ambition is to re-structure production and distribution in a way that minimises stocks/cost of capital as well. Applying these findings to the perceived value assessment framework established, it can be argued that:

- Price is ranked as the most influential factor.
- Product fit is ranked rather low. This group of kitchen manufacturers are addressing the main stream market, and have no requirements for being at the forefront of development. Immediate product fit, always immediately targeting new trends in the market, is not critical.
- Service fit is an important but not immediate concern. The accumulated needs of the consolidated entities within this group, facilitates quick consumption of the large batch sizes bought. Automation of processes through increased integration with suppliers, streamlining distribution and logistics is an important, but not immediate, area of concern.
- Relational fit is of low and continuously decreasing concern. With consolidated entities spanning numerous brands and several markets, and with the establishment of professional group wide sourcing teams, short social distance and the existence of personal relations with sub-suppliers become increasingly irrelevant.



Figur 3: Perceived value map – approach 1

Approach 2: Agility – minimise in-house production

There are, however, some obvious disadvantages, e.g. regarding loss of autonomy and control, entering into a large consolidated entity. Recognising this fact, some of the Danish brand manufacturers, seemingly somewhat inspired by the dominant cluster of fashion-driven textile manufacturers in the area, have chosen to redefine how they evaluate themselves, from being traditional “manufacturers of kitchens” towards being “suppliers of interior solutions and life style”.

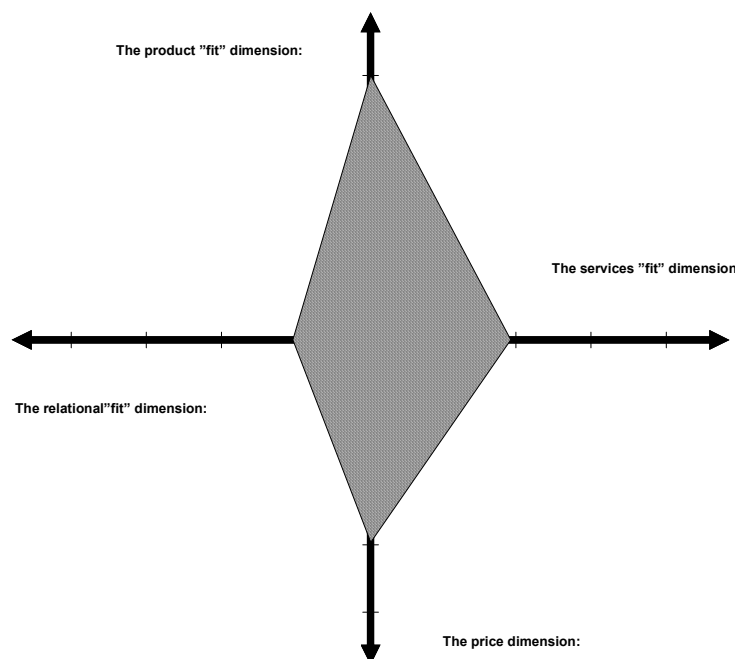
They evaluate the future kitchen market as being fashion driven and continuously changing, to an extent that there will be no reasoning in maintaining any significant production facilities in-house. Design, choice of material, requirements for accessories, embedded technology, etc. will develop and change at a rate that will make ownership of specific production facilities/technologies a costly hindrance in meeting the ever changing market requirements.

The argumentation for pursuing this strategic approach is that the real value adding activities will not be realised in the actual production stages. Focus therefore, must be on the stages prior to production (the design stage), i.e. trend spotting, design and r&d; and on the stages after the production (the marketing stage), i.e. positioning/branding, retail and after sales service.

Therefore, concerning the actual production stages, it is argued, that focus must be on building superb competences in orchestrating production up-stream with whatever sub-supplier that may have the solution that suits immediate market requirements, and on being able to handle the increasing logistics requirements this approach calls for.

Applying these findings to the perceived value assessment framework established, it can be argued that:

- Price is still an important factor, but of less importance than in approach 1.
- Product fit is the most influential factor since the success of the kitchen manufacturers pursuing this strategy, relies on their ability to be at the forefront of development, continuously targeting (and shaping) the immediate and constantly shifting market trends.
- Service fit, and thus integration with the suppliers, is important, keeping down inventories and ensuring flexible supply. But only to the extent that it does not compromise the ability of the kitchen manufacturers to quickly switch to another supplier, responding to the shifts in market requirements.
- Relational fit is not important. Supplies are bought wherever the right (market targeted) product is available.



Figur 4: Perceived value map – approach 2

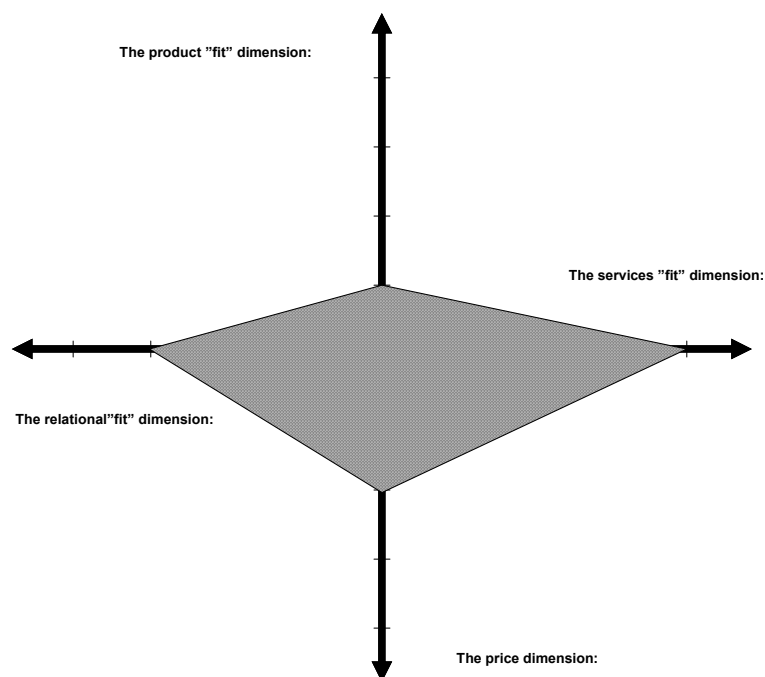
Approach 3: Process optimisation – virtually integrate

The process optimisation (virtual integration) approach is rooted in the belief that responsiveness and short delivery times towards the end-market will be the crucial sales parameters in future, and in the ambition of meeting these requirements without the need to accumulate and carry large quantities of stock.

The idea being that as soon as the end-customer has placed an order at retail level, detailed information of the order is broken down and immediately made available for both the brand manufacturer and all relevant sub-suppliers for that specific order, for them to act on. For any items/sub-assemblies not in stock anywhere in the supply network (stocks are kept at a minimum) production can be initiated immediately.

Applying these findings to the definition and value assessment framework established, it can be argued that:

- Price is important, but not the dominant factor.
- Product fit is not that important. Most of the kitchen brand manufacturers pursuing this strategy have a relatively narrow span of products addressing the main stream market.
- Service fit, and the ability to virtually integrate with suppliers, continuously and immediately sharing and acting on information on orders and inventories with suppliers, is the number one criteria for success, and rated very high.
- Relational fit is also rated high, primarily due to the fact that opening up IT-systems towards other companies seems to call for some level of inter company trust. Also, because of the extreme speed and flexibility required to support this strategic approach, some level of personal interaction to “back-up” and continuously refine the virtual integration attempts, and lean manufacturing and distribution scenarios pursued, is rated as being of importance.



Figur 5: Perceived value map – approach 3

Foundation for further research

The perceived value scenarios of the Danish kitchen brand manufacturers, outlined in this paper is based on the initial empirical findings of a current Ph.D. research project. Next phases of the project will include:

- Mapping of customer networks of selected sub-suppliers. This phase will be initiated after the supplier networks of all relevant kitchen brand manufacturers have been mapped, basing selection of sub-suppliers on these data.
- Identifying the sub-supplier's perception of perceived value assessment of their customers (the kitchen brand manufacturers they serve)
- Analysing and evaluating consistency between actual perceived value of the kitchen brand manufacturers and the perception of this value assessment, held by the sub-suppliers.

Based on this work, it is the ambition of the research project, to be able to provide the sub-suppliers to the Danish kitchen manufacturing industry, as well as the kitchen brand manufacturers, with a better overview, than currently seems to be present, of the value creation potential to be derived from customer-supplier relationships, and of the competencies necessary at “both ends” of the relationship, in order to realise this potential.

I invite everyone to contribute with insights from similar or related areas in their own research, in order to initiate a (hopefully) mutually beneficial debate.

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Bo Geisler	CEO, Geisler Bordplader	(www.geisler.dk)
Bjarne Henriksen	CEO, Compo Tech	(www.compotech.dk)
Henrik H. Hansen	CEO, Tvimo	(www.tvvis.dk and www.modulia.dk)
Jens Berthelsen	CEO, AUBO Køkkenet	(www.aubo.dk)
Knud Troelsen	CEO, Kvik Køkkenet	(www.kvik.dk)
Leif Glintborg	CEO, Multiform Køkkener	(www.multiform.dk)
Leif Nygaard	CEO, Invita Køkkener	(www.invita.dk)

Poul Kongsgaard	CEO, Hanstholm Inventar	(www.hanstholm.com)
Preben Bager	CEO, HTH Køkkener	(www.hth.dk)
Villy Jæger	CEO, NettoLine	(www.nettoline.dk)

Appendix A: Location overview of the Danish kitchen brand manufacturers



Appendix B: Outline of the Danish kitchen market

