

# **When a Relationship is “Transactionalized”: The Introduction of Reverse Auctions in a Key Account Relationship**

**Björn S. Ivens**

Friedrich-Alexander-University, Nürnberg, Marketing department  
Lange Gasse 20, D-90403 Nuremberg,  
phone ++49-911-5302-218, fax: ++49-911-5302-210,  
Germany  
Email: Bjoern.Ivens@wiso.uni-erlangen.de

**Catherine Pardo**

Ecole de Management, Lyon, Marketing department  
23, avenue Guy de Collongues, BP 174, F-69132 Lyon Ecully Cedex  
phone ++33-4-7833-7778, fax: ++33-4-7833-7926  
France  
mail: pardo@em-lyon.com

## **Abstract**

Suppliers and their customers often interact in ongoing relationships for years and years. However, ongoing relationships do not represent safeguards in themselves. Both sides of the dyad may “transactionalize” the relationship at any moment. Often, the other party is highly surprised when such moves occur. This paper first discusses this phenomenon from a conceptual point of view. Subsequently we present a case study which demonstrates reasons and effects of relationship transactionalization. Particularly, it shows how the introduction of reverse auctions by a customer limits all supplier attempts of relationship building. We end by discussing the implications for relationship management.

# **When a Relationship is “Transactionalized”: The Introduction of Reverse Auctions in a Key Account Relationship**

## **Introduction**

For many years, establishing relational exchanges (instead of transactional ones) between firms has been considered a means (not to say a guarantee) for profitability. The IMP group considers three dimensions as being crucial for relationships: actor bonds, activity links and resource ties (Håkansson and Snehota 1995). But what happens when one company suddenly chooses a transactional way of regulating its exchanges with another company? For instance, many suppliers believe that they have a relationship with a customer - particularly in case they define this customer as key account – but, increasingly, however, they are surprised by the introduction of transactional purchasing mechanisms such as reverse auctions by those they were considering their key accounts. What is the theoretical significance of these new movements? How should long-term in-suppliers react? Our work-in-progress paper will try to structure the problem bringing together a case study and certain aspects of recent works we subsume under the label “alter-relationalism”.

The paper will be structured in the following way. First we will present some aspects of what we call “alter-relationalism” with a view to make it clear why and when a relational way of regulating exchanges can be considered a burden for either the supplier or the customer. Then, we will describe the mechanism of reverse auctions. We will then go through a case study describing the relationship between a chemical company CHEMIC and its customer, STEELCO, a steel manufacturer. The customer – a worldwide leader – is considered a key account by its supplier and a long-term mutually profitable relationship has been going on for more than 20 years. But suddenly the customer reorganizes its purchasing and introduces a reverse auction process. We will then confront the CHEMIC-STEELCO story to the main aspects of “alter-relationalism”. It will allow us to formulate several theoretical consequences and propose strategic alternatives for an in-supplier to react when it is asked to submit a proposal for a reverse auction.

### **“Alter-relationalism”: when the relation becomes a burden...**

For over two decades now, different authors have posited a strong correlation between the establishment of customer relationships and business profitability. Recently, however, several voices have questioned this systematic association of relationships and profitability. As Pillai and Sharma (2003) underline: “recent findings have cast doubt on some of the fundamental assumptions of relationship marketing theory. In fact, some research has suggested that transaction-oriented strategy may be more profitable for firms” (p. 643). To understand the meaning of the criticism addressed by more and more authors to the “relational orientation”, we propose to introduce the relationship along three perspectives and then put into evidence how each of these perspectives is criticized.

### **The meaning of “relationships”**

We posit that at least three perspectives can be associated with relationships: 1) long-term orientation ; 2) adaptation ability ; 3) alternative to contractual exchange control mechanism.

#### ***Relationship and long-term orientation***

In this perspective, the term relationship is used to underline the specific duration (long-term) of an exchange between two parties. Several works have associated the relationship duration with the notion of profitability (Bendapudi and Berry 1997; Kalwani and Narayandas, 1995 ; Morgan and Hunt 1994 ; Reicheld and Sasser 1990; Reicheld and Teal 1996; Sheth and Parvatiyar 1995). The central argument for most of these works is that there are supposedly lower costs associated with keeping a customer than winning a new customer from the market. Another argument is that long-term orientation allows supplier and customer to leverage investments they have made in the relationship.

## ***Relationship and adaptations***

In this second perspective, the term relationship is used to underline the adaptation process exchange parties go through. Adaptations are seen as "modifications [...] carried out by one or both parties [...] in order to suit new needs or conditions, and which are designed initially for the specific relationship" (Canning and Brennan, 2004). Several articles have associated adaptations within the relationship with the notion of a profitability. For instance, Halinen (1994) shows that adaptation makes the relationship more beneficial as the resources are adapted or changed. For Hallen et al. (1991) adaptations (from the supplier) can strengthen the competitive position of a supplier. For Johanson and Mattson (1987), adaptations strengthen bonds between partners.

## ***Relationship as an alternative to contract as exchange control mechanism***

In this perspective – drawing on the general theories of governance and specifically on the Relational Exchange School (Macneil 1985 and 1980) and relational norms (Heide 1994; Dwyer, Schurr and Oh 1987) – the idea is that the term "relationship" is used to designate an alternative (or complementary) mechanism to written contracts to control business exchanges between two organizations. In our perspective, relationships stand for trust as control mechanism for business exchanges. Several authors have associated the notion of trust to the notion of performance (Zaheer et al. 1998); cooperation (Axelrod 1984); commitment (Achrol 1991; Morgan and Hunt 1994), etc.

Of course, the three perspectives described above are not mutually exclusive. They are interconnected, one being alternatively the cause or consequence of the other. Trust can encourage partners to make investments in the relationship, for instance through adaptation ; long-term orientation allows partner to know each other and then allows trust to develop ; etc.

## **When “relationships” become burdens ...**

Håkansson and Shenota (1998) have identified several drawbacks that can be associated with relationships. They have organized them around the ideas of: unruliness or loss of control; undeterminedness ; resource demand ; exclusiveness and stickiness. More specifically, on each of the three perspectives we have identified as being associated with the idea of relationship, we can find voices criticizing either the long-term orientation perspective or the adaptation perspective or the governance alternative perspective. For instance, Uncles and Dowling (1997) question the assumption that long term relationship with customers is either realistic or profitable for all businesses. Reinartz and Kumar (2002) declare "much of the common wisdom about customer retention is bunk" (p. 86). The same authors (2000, 2002) also underline that certain long-term customers can be less profitable than certain short-term customers. Kumar et al. (2003) refer to the cost of maintaining long-term customers.

In the same perspective, several drawbacks of adaptations have also been identified. They have been partly summarized for instance by Hagberg-Andersson (2002). With adaptations, companies become much more dependent (Johanson and Mattson 1987) which can be a problem in certain situations. Tight bonds can limit creativity and innovation (Gadde and Snehota 2000). More globally, investments on which adaptations relied cannot be transferred (Hallen, Johanson and Seyed-Mohamed 1991).

Finally, as regarding relationships as an alternative mode of governance, it is important to notice that under certain circumstances, controlling exchanges through formalized contracts may be preferred to "relational" norms, specifically trust. Macaulay in his classical works (1963a and b) globally underlines that contracts are used primarily when their usefulness overpasses their cost. Roxenthal and Ghauri (2002) referring to the works of Hallen (1982) and Håkansson and Wootz (1975) recall that contracts may be preferred to control an exchange when there is high market or transaction uncertainty..

## **... the actors may “transactionalize” them**

In the early relationship marketing literature, the fundamental distinction made by authors was between the two strategic “meta-orientations” (1) transactional marketing and (2) relationship marketing. The major topic on the relational side was the initiation and ongoing management of a business relationship. Later, a growing number of authors picked up topics such as complaint management, customer regaining or relationship termination. This recognition of the existence of a “dark side” of relationships was a step ahead for the relationship

marketing literature. However, one possible evolution of a business relationship has received little attention: the case where a customer or a supplier does not want to end a relationship but intends to reduce the level of relationality by which exchange is governed. This implies that future transactions are not excluded, but the way they are going to be managed will change.

Several forms of relationship transactionalization exist. Rather than to provide an exhaustive list, in this work-in-progress paper we would like to give some examples:

- As a consequence of the 1990s relationship orientation, many companies reduced their supplier base, sometimes using a single sourcing paradigm or at least limiting their supplier portfolio two or three in-suppliers per product. Today however, a re-introduction of competition between suppliers is observable through an enlargement of the supplier base. For the in-supplier in a single sourcing relationship, such a return to competition implies a sinking level of exchange relationality.
- Many studies have shown the existence of close personal relationships between buyers and sellers on business markets. Positive effects of such relations were empirically identified. However, in some cases companies observed that close personal relationships did not necessarily optimize the purchasing results. As a consequence, they have introduced policies such as the rotation of their purchasing managers across product ranges on a yearly basis. Again, for the sales manager this represents a transactionalization of the relationship.
- The introduction of e-commerce solutions in B2B exchanges has contributed to a decreasing level of face-to-face interaction between seller and buyer. Particularly in the case of online reverse auctions, this trend has reduced the possibility for suppliers to positively influence their share of the customer through personal contacts.

More ways of relationship transactionalization exist. However, in this paper we would like to provide a closer look at the mechanisms through which even relationships with a long history can become modified within a short laps of time through the presentation of a case study in which an online reverse auction was introduced into a 20 year old key account type of relationship.

## Online reverse auctions

For hundreds of years auctions have been an important mechanism for the fixation of prices. Traditionally, vendors use auctions in order to obtain an optimal price by making the market transparent. Purchasing managers in many industries apply a mechanism that is closely related to auctions to the procurement process: requests for proposals from potential suppliers. In this case, a buyer asks producers to submit proposals for the delivery of a specified good or service or the combination of both. Such mechanisms are also called "reverse auctions" or tenders.

Although the history of reverse auctions can be traced back as long as for classical auctions, the current trend towards a reorganization of many firms' purchasing functions and strategies has led to a "renaissance" of reverse auctions. Reverse auctions are an important tool which aims at increasing purchasing efficiency: An (often powerful) buyer asks competing suppliers to submit offers for a certain range of clearly specified goods or services. The supplier who best meets the criteria specified in the request for proposals will be selected as in-supplier. On business markets, this purchasing technique is increasingly used on the internet in the form of online reverse auctions. Advantages associated with online reverse auctions are

- their high adaptability (new price offers can be taken into account immediately)
- their high transparency (all offers can be displayed to all participants)
- their high objectivity (decisions are only based on pre-specified criteria).

However, current studies (e.g. Jap 2003; Smeltzer and Carr 2003; Daly and Nath 2005) point out that the use of online reverse auctions implies several risks:

- The purchasing decision for a supplier is often exclusively based on price. Since the supplier usually only obtains the "deal" for one transaction, the incentives for him to invest in a customer relationship (e.g. in the form of a key account program, customer-specific R&D budgets or specific logistical solutions) decrease.
- From the supplier's vantage point a second risk lies in the customer's usage of online reverse auctions as a negotiation tool. Customers can quickly gain an overview of the range of prices valid on a market. They can then use this fairly perfect information (in a neoclassical perspective) in order to exert pressure on the existing supplier.

- The exclusive focus on the cost aspect of purchasing transactions prevents the customer from evaluating the other potential (economic and non-economic) benefits a supplier may offer in a relationship. A supplier behavior often observed is the submission of low price bids in order to be selected as in-supplier. Later the customer discovers that the supplier is not able to provide the requested quantity and quality at the right time and place. As a consequence, the customer will face increasing purchasing costs and potentially problems in his production process.
- Finally, reverse auctions represent a threat for the trustful relationships many customers and suppliers have established over the years. Particularly online reverse auctions, an anonymous procedure where the customer often “hides” behind a machine, imply the substitution of face-to-face-negotiations by a mechanism which disregards common values and relationship history.

## **The CHEMIC-STEELCO CASE**

CHEMIC EUROP is the subsidiary of US based CHEMIC INC. This chemical company produces different substances. It is structured according to its customer industries. CHEMICEUROP delivers – among other customers – the steel industry using various chemical products in the production process of high quality steel.

CHEMIC EUROP's largest customer in its European rolling oils business is the STEELCO group. STEELCO has been purchasing from CHEMIC EUROP for over 20 years. In order to maintain and stabilize the relationship, CHEMIC EUROP has attributed STEELCO (as well as certain other important customers) key account status. It has also adapted internal processes as well as their reporting system. The key account manager maintains numerous contacts with people in different functions, hierarchical levels and geographical places at STEELCO.

In the past, engineers played a critical and decisive role in the buying centre which conducted the purchasing process for rolling oils at the key account STEELCO. Accordingly, CHEMIC EUROP's key account manager focused strongly on technical decision takers at STEELCO in his customer contact strategy. Inside STEELCO the engineers argued for the purchasing of CHEMIC EUROP's products stressing their outstanding quality which implied remarkably low total cost of ownership. Repeatedly the purchasing department questioned the engineers' arguments but had to accept it due to the purchasing procedures in place. As a consequence, purchasing managers received considerably less attention (in terms of time and other resources) from CHEMIC EUROP's key account manager than engineers.

In the year 2003 a sudden change occurred (see figures 1 and 2). A new top management at STEELCO decided to review and reorganize purchasing activities and to attribute larger competencies to the purchasing department. They also put stronger stress on cost criteria.

Moreover, the presence of a consulting company at STEELCO was used to review the purchasing process. The consultants argued that the introduction of a bidding process would allow the customer to obtain important gains in purchasing. CHEMIC EUROP's sales management received an invitation to submit an offer for future contracts. This invitation contained clear rules for the submission process. These rules' character was strongly transactional (or discrete). Particularly, one single contact person was nominated. Any attempts of gaining information or other advantages through additional contacts with STEELCO employees would lead to the exclusion from the bidding process.

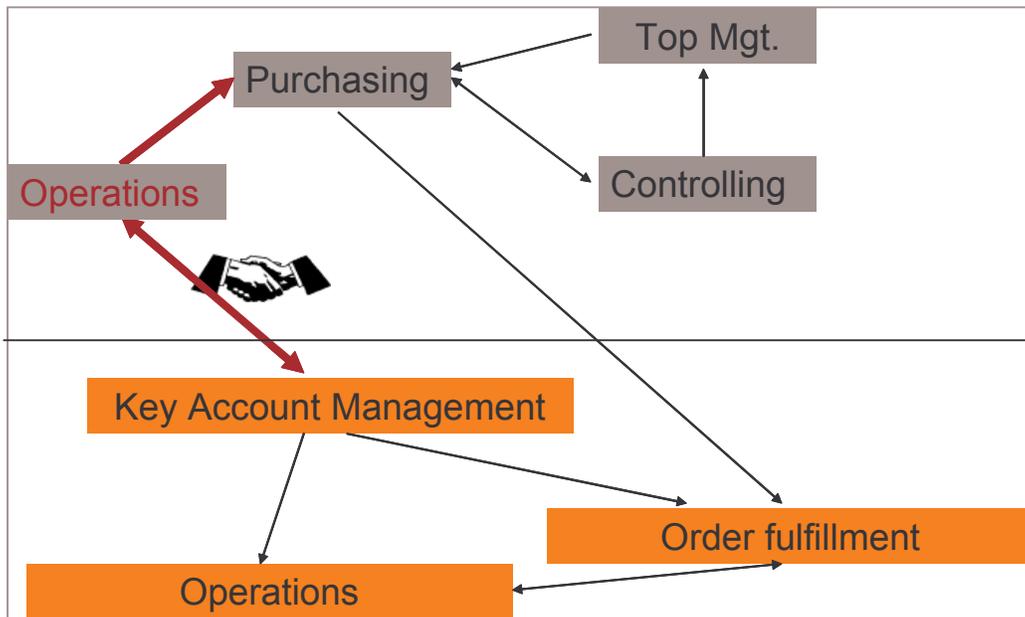


Figure 1: The constellation in the dyad before 2003

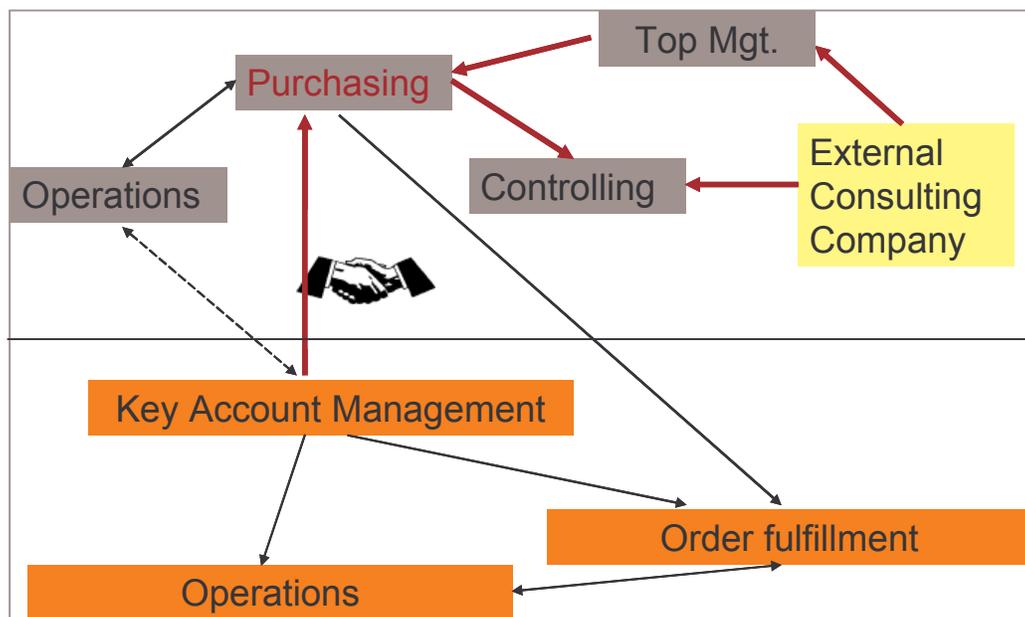


Figure 2: The changes leading to the introduction of online reverse auctions

### How to interpret the case in the light of alter-relationalism

#### Discussion

Based on the theoretical background of relationship marketing we suggest that at least three different interpretations of the CHEMIC EUROP / STEELCO are possible. They open three perspectives:

1. The situation the case describes can be considered as an isolated "transactional" episode in a relational perspective of exchange. In this case this means that the general outline of the exchange will come back to a relational one. No other attempt will be made to "transactionalize" the relationship. The emergence of such an episode can be explained by several factors:

- The tension within the buying centre between purchasers and engineers. Then the reverse auction is a means for the first one to regain power.
  - The presence of a consultant being the "champion" of the "reverse auction" solution. One could suspect that after the consultant mission the solution will lose its importance.
  - A general policy of cost reduction, forcing all the departments within STEELCO to display solutions showing that they commit to this policy
2. The situation the case describes can be considered as a possible "recurrent transactional episode". This means that in the same exchange between two firms "transactional" and "relational episodes" will cohabit.
  3. The situation the case describes can be interpreted as the first signal from the customer's will to move from a relational perspective of exchange to another form of exchange that can be qualified a transactional one.

**Managerial implications**

Given these different potential interpretations, for the supplier it becomes crucial to understand its customer's strategic intentions motivating the introduction of online reverse auction (ORA). We argue that the required analysis will comprise at least the following three phases (figure 3):

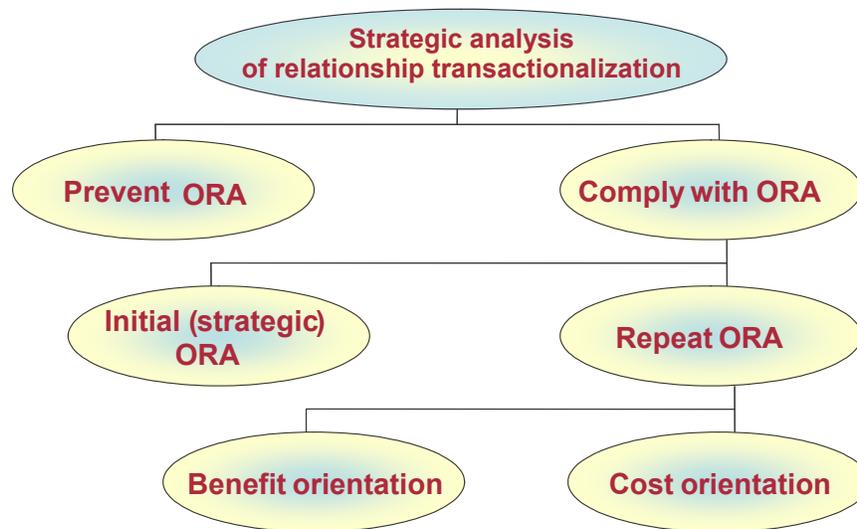


Figure 3: Three steps of analysis for online reverse auctions

In a first step the supplier needs to identify whether it is possible for him to prevent the introduction of an online reverse auction. Reasons allowing ORA prevention might be e.g. a high degree of customer dependency on the supplier (because of e.g. resource ties, activity links or specific investments) or strong personal relationships (actor bonds in the IMP language) between company representatives on higher hierarchical levels (e.g. between supplier and customer CEOs). Prevention may take place in two forms. Either the supplier is exempted from ORA participation but the customer starts an ORA for second-tier suppliers or in order to gain market price information from competing suppliers. Or the customer completely refrains from the use of ORAs.

In case the introduction of ORAs cannot be prevented, the second step consists of understanding how the customer intends to use ORAs in his purchasing policy. Two options exist. On the one hand, ORAs can be used for selective market scanning at specific points in time. In this case the customer selects an in-supplier for a longer period of time which will cover several transactions. The resulting supply agreement from such a "strategic" ORA is the starting point for a new relationship. Adjustments of this agreement may be possible during the relationship. On the other hand, the customer may decide to introduce ORAs as a regular purchasing procedure used in each single purchasing transaction. For the in-supplier, even if he manages to maintain his position over several transactions, such an approach represents a strong form of relationship transactionalization because the customer shows no long-term commitment towards the customer which represents a barrier for the establishment of trust.

In case ORAs are adopted as regular purchasing mode by the customer, the supplier needs to at least identify the set of selection criteria the customer will base his supplier choice on. In pure ORAs, the customer's choice is often based on pure unit costs for the product or service to be purchased. However, due to the shortcomings of ORAs (e.g. Jap 2003; Smeltzer and Carr 2003, cf. above) certain customers develop broader sets of selection criteria in order to capture additional benefits suppliers can offer them beyond the unit cost aspect. The relationship marketing literature (e.g. Gadde and Snehota 2000, Ulaga and Chacour 2001) suggests that the value a customer may draw from a supply relationship cannot only be defined by the unit costs. Rather, a broad range of additional economical and non-economical benefits need to be taken into consideration. Hence, in case the customer intends to limit his choice criteria exclusively to unit price and if the supplier disposes of sufficient influence on the customer (e.g. through actor bonds), the supplier can suggest enlarging his set of selection criteria to the customer. Important customer benefits from a relationship are e.g. supplier reliability, supplier service orientation or supplier flexibility.

Summarizing, suppliers whose customers threaten to transactionalize the relationship by introducing an ORA are not faced with a simple 0/1 decision to either enter the ORA or withdraw. Several shades of gray exist between these extremes and the supplier needs to understand (a) whether the ORA is inevitable and (b) to what extent it will transactionalize the relationship.

More generally, the case study introduced in order to illustrate the phenomenon of relationship transactionalization also hints to several points which may be decisive for the customer's decision to introduce an ORA.

Firstly, the key account manager's strong focus on the engineers and his neglect of the purchasing department were representative of a static perception of the relationship. The later development of the case stressed the necessity for customer managers to anticipate potential evolutions of buying center structures in order to achieve relationship stability.

Secondly, in existing supply relationships it is important for suppliers not only to provide customers relationship benefits which go beyond unit price. These benefits also need to be communicated to the customer. The customer needs to perceive these benefits and be aware of the fact that relationships imply specific material and immaterial benefits (e.g. in the fields of logistics, maintenance or service) difficult to obtain in transactional purchasing modes. In the CHEMIC EUROP case, the key account manager has focused too much on the communication of product specific benefits to the users of the product.

### ***Further research***

Contrary to other aspects of relationship marketing such as customer satisfaction research, complaint behavior or relationship dissolution, relationship transactionalization still constitutes a topic which is largely under-researched.

With the growing body of literature on e-commerce and more particularly on online reverse auctions, evidence increases that interactions on many markets become more anonymous than in the past. The opportunities electronic media offer in terms of collecting reliable and up-to-date market information as well in terms of increasing negotiation speed are a strong driver of relationship transactionalization. However, we still have a lot to learn, on the customer side, about the precise motives, the modes, and the effects of relationship transactionalization. Also, ORAs are only one driver of relationship transactionalization among others. A typology of transactionalization cases might be helpful in order to better understand this phenomenon.

On the supplier side, studies about the perceptions of, reactions to and effects of customer driven "transactionalizations" of relationships will provide valuable insight. From an alter-relationalism perspective it would be interesting to study the positive effects of relationship transactionalization for both sides of the dyad. This work-in-progress paper constitutes a small step into this direction.

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