

Politics, Profits, and Proactive Marketing: Anticipating Spending in the World of B2i

John F. Hood, President
MCH, Inc.

Introduction

“Know your customer!” It’s one of the basic axioms of business. Most business-to-business marketers intuitively understand the motivations of their B2B customers because they’re business people themselves. But what if many of your “business” customers aren’t really businesses? What if they have completely different motivations—completely different reasons that drive their buying decisions?

It’s not a fantasy. The fact is that many of your current “business” customers aren’t businesses at all. They’re institutions. In the world of B2i—the world of purpose-driven institutions—the motivations that affect purchasing aren’t necessarily obvious, and they certainly aren’t the same as in the business realm.

Businesses are fundamentally motivated to maximize profits and grow revenue. Those motives fuel the decisions of business managers to spend money on your products. As a marketer, you appeal to the impulses of business managers by touting the benefits of your products in terms of improved productivity, lower costs, tax advantages, and increased sales.

Institutions, however, are very different. They’re primarily government agencies, government-funded organizations, or not-for-profit organizations. Some others are for-profit organizations like many hospitals and their related clinics. All together they constitute about one-third of the U.S. economy and are big buyers of many of the same products purchased by businesses. What motivates institutional buying behaviors? Not profits or increased sales—they don’t sell anything.

So what is it? It’s their **purpose**. Institutions are purpose-driven. They spend money to provide specialized services to their constituents, and they do it outside the typical business measurement of profitability. For example, fire departments commit massive financial resources to specialized equipment and highly trained 24-hour staff-

ing only for them to sit idle the vast majority of the time. It's no way to run a business, but thank goodness the firefighters and fire trucks are there when needed to prevent loss of life and property.

Hospitals also maintain enormous facilities that are filled with top-dollar professionals and specialized equipment—while every single person in the hospital's service area hopes to *avoid* becoming one of its customers. When there is a life to be saved, the hospital must be ready.

Institutional Missions

Institutional missions are oriented around benefiting individuals.

<p>Protecting Society. Reducing Crime.</p> <p>Federal Bureau of Corrections</p>	<p>Educating all students for success in life</p> <p>Anchorage School District</p>
<p>Exceptional care, close to home.</p> <p>Bothwell Regional Hospital</p>	<p>One in Faith. Strong in Love. Bold in Mission.</p> <p>Trinity Episcopal Church</p>

The story is the same for churches, schools, police departments, libraries, nursing homes, colleges, and the other institutions in our communities. Their purpose is their motivation for purchasing goods and services. Since the purposes of various types of institutions differ, unraveling their motivations is complex. This paper will help you untangle the influences that drive institutional buying behavior. When you are able to align your marketing efforts with the purposes of these organizations, you will maximize your returns from this big and fast-growing market and become a master marketer in the B2i space.

Funding and Accounting

The world of B2i includes about 2.3 million institutions that employ 37 million people. All together, these organizations represent one-third of U.S. gross domestic product. They are a \$4.3 trillion economy in their own right.

The Scope of Institutions			
	Locations	Employees	Employees per location
Businesses	11,162,911	94,900,483	8.5
Institutions	2,244,609	37,384,696	16.7

As we have shown in a previous paper¹, institutions on average are bigger, more stable, and faster growing than businesses, and they carry very little credit risk. They make ideal customers for most B2B marketers. But they are *not* businesses and require a distinct marketing strategy.

¹Beyond B2B – A New View of the Institutional Market, published in January 2007.

Sources of Money	
BUSINESSES	INSTITUTIONS
<ul style="list-style-type: none"> ■ Sales of products and services 	<ul style="list-style-type: none"> ■ Taxes & Fees ■ Tuition ■ Intergovernmental Transfers ■ Grants ■ Donations ■ Endowments ■ Bequests

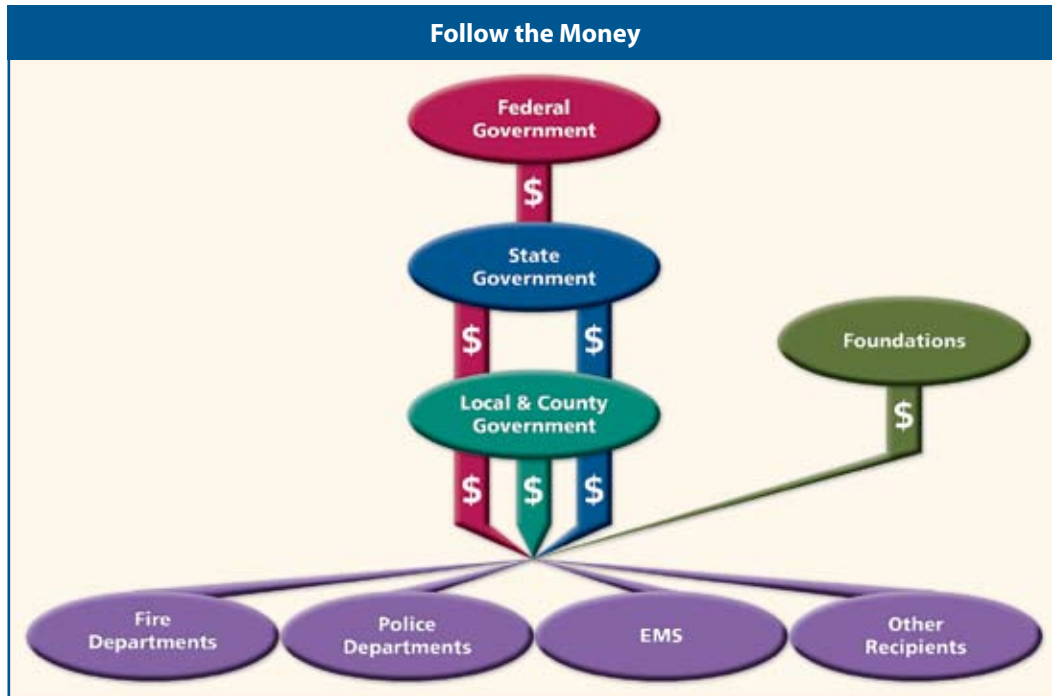
Money management is one of the fundamental distinctions between businesses and institutions. Since institutions don't "sell" and don't make "profits," their accounting is different than that of businesses. Institutions receive funding to advance their purposes. The money may come from taxes, grants, endowments, donations, tuition, fees, or other sources, but it always comes with conditions or strings. The funds are provided with the expectation that they will be spent—in their entirety—for the designated purpose. For example, when a fire department receives a grant to upgrade a fire station to respond to a new type of emergency, the department is expected to spend the money and become fully prepared. Otherwise, it has "failed" its mission. When a library doesn't spend its collection development budget to add to the inventory of books and media, it is failing its purpose. If a church diverts money donated to help the poor to a reserve fund or another purpose, it's likely to face a firestorm of outrage from its donors.

The expectation that an institution will spend *all of its allotted funds* is fundamentally different than in the business world. Business managers' incentives are linked to spending less than budgeted. A business manager is a hero for "coming in under budget" while the administrator of an institutional program may suffer negative consequences for "sitting on resources that could have been put to good use."

Government and non-profit accounting practices reflect this attitude about money. When institutions receive funding, the money typically goes into accounts set up to support purchases for specific purposes. The accounts control the spending process so institutional administrators know which money has been committed and how much is left. When a purchase order is issued, money in the appropriate account is "encumbered" or reserved for that purchase order so it can't be spent elsewhere. Since most institutions only spend money after they have it, they don't carry significant credit risk. This process of committing funds long before they are paid out affects the buying behaviors of the institutions' staff.

Let's say you are the "provider" of a portion of an institution's funds—you're the donor, the city council, or the trustees. How do you get the institution's administrators to do what you want? Through the primary power available to you: by giving them more or less money to spend for a particular purpose. If you want the police department to have bulletproof vests, you provide the money and instruct the police chief to use it to purchase vests. The chief is successful if he spends the money and unsuccessful if he doesn't. These administrators are measured on how effectively they spend the money for the purpose for which it was provided.

Conversely, if you want an institution to stop doing something, you stop providing it funds for that purpose. In this environment, the entity that controls the money controls the institution by providing more or less money. For just this reason, federal, state, and local politicians spend countless hours battling over how and where to allocate tax receipts.



The entity providing the funds and the one spending the funds are commonly departments or divisions of the same organization, but money can travel through many other channels such as intergovernmental transfers. In this scenario, higher levels of government (federal, state) provide funds to lower levels of government (county, city)—generally with “strings attached.” The funds are provided on the condition that they are spent solely for the intended purpose. Institutional accounting systems are in place to ensure that the money has been spent as the controlling party directed.

Grants provide an even more dramatic picture of the funding relationship between institutions. Grants allow an institution—such as a foundation or government agency—to achieve a purpose beyond its own direct capabilities. The organization accomplishes its objectives by transferring funds under restricted terms to the parties who have the proper legal authority, specialized skills, or other key resources.

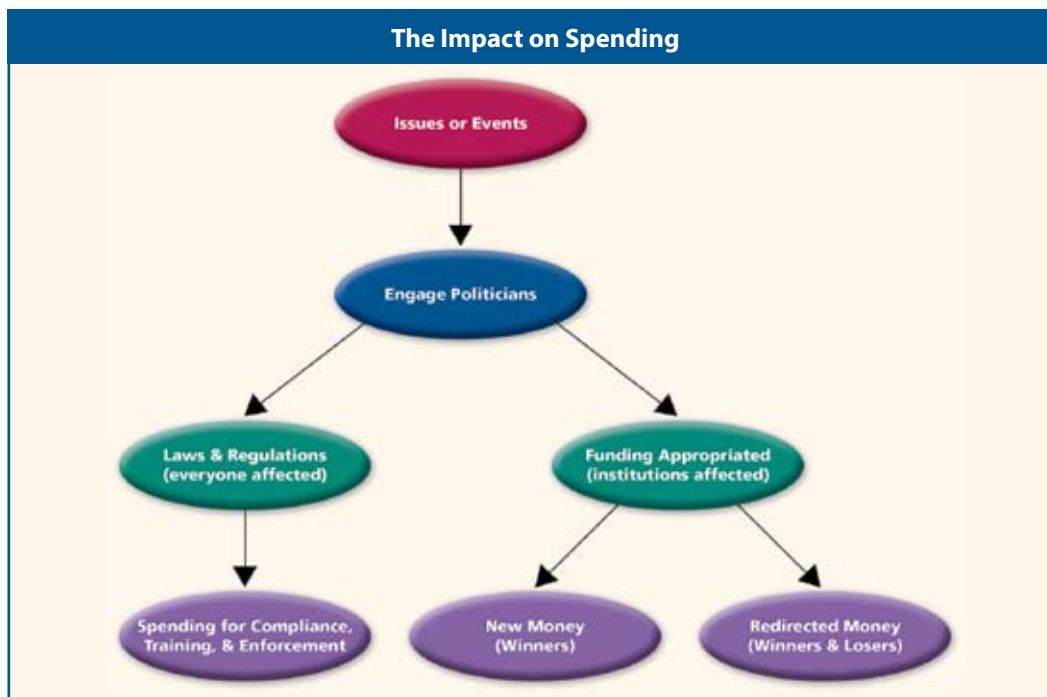
For example, a private foundation established to support and preserve works of art might set aside \$2 million in grants designated for the restoration of Renaissance paintings owned by small museums. The foundation doesn’t own paintings or employ experts to perform the restoration, but it ensures that its mission is accomplished by making money available to qualified organizations. Likewise, a government agency might offer \$10 million in grants for the prevention of teenage tobacco use. The grants are publicized, anti-smoking organizations apply, applications are accepted, and the granting organization writes the check. The grant recipient spends the money in accordance with the rules and restrictions of the grant. The impact of grants is far from trivial. According to The Foundation Center, foundations made 150,392 grants totaling \$21.6 billion in 2007 – and that excludes government grants.

In effect, the funding agency says: “I have money to spend for mission X. Will someone please spend it for me?” Business doesn’t work this way.

Politics and Purpose

It is easy to mischaracterize the B2i world as serene and unchanging. Institutions are certainly much more stable than businesses. About 11% of businesses cease to exist each year while institutions are much more long-lived. Look at the dates on the cornerstones of many institutional buildings and the founding dates of churches and colleges. Can you think of any city or county governments that have shut their doors? Or their police departments, fire departments, libraries, or school systems? That stability, however, masks dramatic changes in purchasing trends within the institutions.

Changes in institutional behavior tend to happen in great sweeping movements that take years to fully manifest themselves. For example, computer technology and the Internet have transformed businesses, schools, colleges, and libraries. These institutions were early computer adopters, but for very different reasons than businesses which want to improve employee efficiency for higher profits. To the contrary, educational institutions embraced computer technology as part of their core mission – to ensure that their students are qualified for the workforce upon graduation.



But the biggest changes to institutions happen as a response to sudden external shocks (9/11) or growing societal pressures (healthcare or education reform). When the political world responds, institutional spending priorities are often dramatically affected, changing the way that billions of dollars are spent. The politicians direct the money to different institutions for different purposes, and it is spent on different products and services. These scenarios create both winners and losers. Being a winner means more money for your business; being a loser means just the opposite.

Here is a small (approximately \$42 billion) example. The Health Insurance Portability and Accountability Act, a federal law, was enacted in August 1996. The law required the Secretary of the Department of Health and Human Services (DHHS) to issue privacy regulations protecting individual health information in 3 years if Congress didn't.

Congress didn't, so DHHS proposed a Privacy Rule in November 1999 and the final rule was issued in December 2000. The Privacy Rule applies to nearly all doctors, nurses, pharmacies, hospitals, clinics, nursing homes, health insurance companies, HMO's, employer group health plans, Medicare, Medicaid, and other providers—millions of professional people, institutions, and businesses on the healthcare provider side. The regulation is very far reaching. It is also technical and complicated.

Attentive businesses studied this law and its implications. When DHHS released the final Privacy Rule, these companies were ready to provide seminars, software, business forms, and training manuals to the millions of people who had to comply with the new requirements or risk civil liability. Although the rule itself provided no funding, organizations spent billions of dollars to comply with it. The BlueCross BlueShield Association estimated the full cost of HIPAA compliance at more than \$42 billion over five years. Members of the training, business forms, and software industries reaped the rewards of this regulation—if they were paying attention and were prepared.

There are many similar examples of sweeping institutional changes driven by political forces. Below, we will examine four major recent and emerging changes that and show how they are affecting or may affect various markets. No Child Left Behind (education reform), the response to 9/11, healthcare reform, and Democratic control of Congress are each causing the redirection of many billions of dollars. "Redirection" has both a "from" component and a "to" component. If you find yourself on the "from" side, you're at risk of losing lots of revenue. If you are on the "to" side, you may benefit from large quantities of new revenue. You need to pay attention to politics and societal trends affecting institutions so you can redirect your own efforts—including products, positioning, and promotions—and stay on the lucrative "to" side of the equation.

The Response to 9/11

After the September 2001 terrorist attacks in New York and Washington, Americans reeled in outrage and fear. Congress responded with billions of dollars in funding. The U.S. government went from budget surpluses to record budget deficits, essentially borrowing from the rest of the world to plow billions of additional dollars into an economy suffering a tremendous shock.

Direct governmental response created business opportunities in industries including security systems, public health supplies, communication systems, and emergency medical equipment. This money poured through both federal government expenditures and transfers to state and local governments. Homeland Security funding affected every level of government. Of course the advent of wars in Afghanistan and Iraq created spending for a whole array of military contractors.

No Child Left Behind

In January 2001, a new president, George W. Bush, came to Washington touting his success at education reform as Texas governor. In Texas, Bush had worked with politicians from both parties to improve the results of public schools. The Bush administration quickly set to work in Washington to repeat those efforts on a national scale. The result was the No Child Left Behind (NCLB) reform of federal educational funding.

Only about 10% of the nation's education spending comes from the federal level, but NCLB was crafted to shape the overall goals of American schools – especially those with the greatest number of struggling students. The law changed the rules for spending Title I funds which are targeted at struggling students from underprivileged backgrounds. The restrictions on each school's Title I funding are now directly tied to the results of standardized testing on core subjects. Any school that fails to meet annual goals faces consequences that increase in severity each year. Using this leverage, the U.S. Department of Education effectively grabbed the reigns of nearly all public education decision making, including the 90% of expenditures that are funded by state and local taxes. In fact, NCLB has affected every public school district and school building, even the ones that don't receive a single cent of federal funding.

NCLB, in fact, has had its biggest impact by redirecting the funds that schools were already collecting. Certain education specialty marketers were clear winners. For example, companies that develop standardized tests and the ones that publish elementary reading and math curriculum materials were perfectly positioned to serve the new directives to test, teach, and test again. Likewise, tutoring services for struggling students and continuing educational programs for educators have blossomed in this new environment.

On the other hand, this political trend has not been kind to companies that produce educational products outside the NCLB nexus. Until recently, science and social studies were not a significant part of the testing regimes and have taken a back seat to math and reading instruction. In many schools, funding has also shifted away from art, music, and physical education programs in favor of more teaching that will measure on the standardized tests.

For general marketers, it's important to understand which schools and districts are under the most stress from NCLB requirements. The vast majority of federal funding is geared to struggling students in underprivileged communities. These districts—typically with low property values and tax bases—are heavily dependent on federal funding. Their administrators are single-minded in their spending; their funds go to improving results on standardized test. In wealthier areas, however, school budgets benefit from high property values and the schools rarely have to struggle to maintain adequate yearly progress. These districts typically have much more discretion to spend additional monies on a wide variety of products and services.

Healthcare Reform

Unlike many European nations, the U.S. does not provide universal socialized medical care. In fact, corporations operate a significant portion of America's healthcare institutions on a for-profit basis. Political decisions, however, exert tremendous influence over American healthcare organizations and drive marketing opportunities. If a program for universal healthcare is enacted, political influence over healthcare expenditures would multiply.

Currently, political influence comes in a variety of forms:

- U.S. government programs such as Medicare and Medicaid pay for a significant portion of the services performed by hospitals and long-term care facilities. By setting the reimbursement amounts for various procedures, the government dictates the revenue potential for organizations.
- The growing expense of the Medicare and Medicaid programs, which are administered at the state level, are squeezing state budgets. Many states have had to cut other programs to fund healthcare for the poor and elderly.
- Federal and state governments legislate restrictions on insurance coverage. In some cases they dictate which medical procedures and services the providers must cover.

The development of specialty hospitals that focus on high-profit surgical procedures is on the rise. These organizations avoid offering services that are poorly reimbursed or must be provided without compensation to the poor and indigent. As a result these institutions are financially strong. However, that strength comes at a cost to competing general hospitals that are losing lucrative procedures but must continue to provide a broader array of low-income services.

Conclusion

Are you a proactive marketer?

Are you watching other big issues that are being debated now?

Are you thinking about how your products and services should be aligned to capitalize on new opportunities?

Here are seven proactive steps you can take to achieve success in the institutional market:

1. Recognize the size, growth, and potential of the institutional market.
2. Understand the purpose-driven nature of institutions.
3. Appreciate the different frame of reference within which institutions operate.
4. Time your promotions to take advantage of their funding and budget cycles.
5. Follow the money: track issues to appropriations to likely recipient institutions.
6. Align your marketing message with their objectives.
7. Target multiple contacts within institutions when needed.

Recognizing your institutional customers and understanding that their motivations are driven by purpose can be the keys to maximizing your returns in the big and fast-growing institutional market.