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Sunil Gupta, Series Editor

READING

Framework for Marketing Strategy Formation

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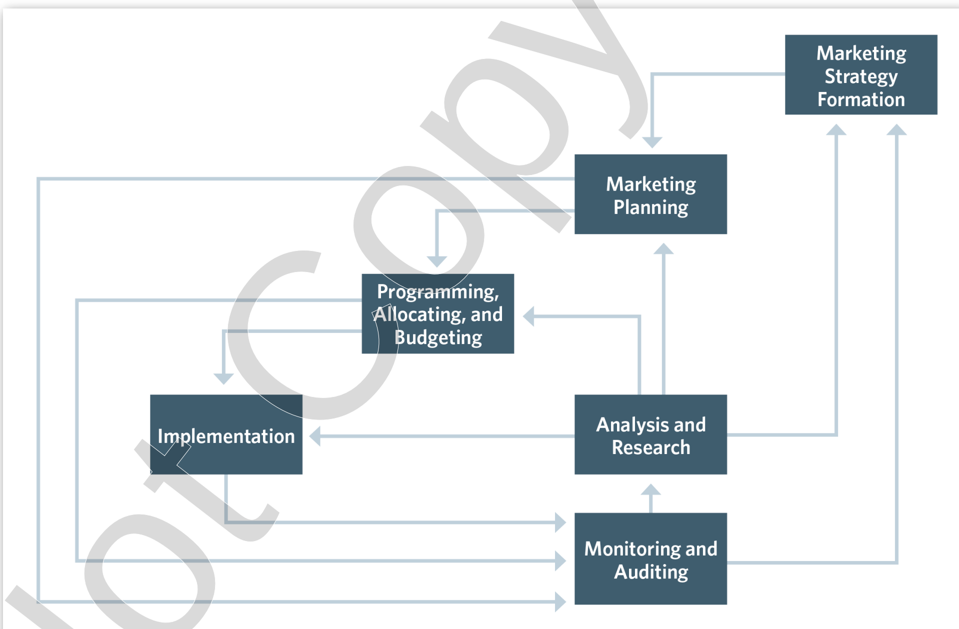
Robert J. Dolan, MBA Class of 1952 Baker Foundation Professor of Business Administration, Harvard Business School, developed this Core Reading.

1 INTRODUCTION

According to Peter Drucker, the renowned management scholar, "the purpose of business is to create a customer."[1] A decade later, Harvard Business School marketing professor Theodore Levitt articulated an important addition to Drucker's statement: "the purpose of a business is to create *and keep* a customer" (emphasis mine).[2] For Levitt, achieving those goals (and, implicitly, the financial goals of the firm) required "differentiating what you do and how you operate."[3]

The contributions of Drucker and Levitt were seminal, and there is now little debate about the value of defining the purpose of business around creating and keeping customers. But how do organizations do that? Benson Shapiro, in "The Marketing Process,"[4] helps answer that question by showing the relationship among the six key elements of a customer-centered marketing process. (See Shapiro's flowchart in **Exhibit 1**.)

EXHIBIT 1 Relationships Among the Six Parts of the Marketing Process



Source: Reprinted from Harvard Business School, "The Marketing Process," HBS No. 584-146 by Benson P. Shapiro. Copyright © 1984 by the President and Fellows of Harvard College; all rights reserved.

Shapiro defined the parts of the process as follows:

1 *Marketing strategy formation.* Set the overall, long-term goals and basic approach to the marketplace. This typically involves making choices about specific customer groups to serve, customer wants to address, and the best way to create value for customers.

2 *Marketing planning.* Depending on the industry, the time horizon for planning can vary. In dynamic situations, for example, in a technology-driven industry, plans need to be reworked regularly. In other, more stable situations, the basics of a plan might extend over two or three years.

3. *Programming, allocating, and budgeting.* Set near-term objectives and detailed plans (typically once a year), including how resources will be allocated to the necessary activities.
4. *Implementation.* Execute the programs specified in step 3.
5. *Monitoring and auditing.* Evaluate results against goals and develop corrective action plans as needed.
6. *Analysis and research.* Gather necessary data from inside and outside the company to support the four action steps (steps 1 to 4 above). This data gathering should occur before executing each of the first four steps and should be ongoing, as depicted in Exhibit 1.

This reading focuses on the top portion of Shapiro's diagram, the market strategy formation stage, in which an organization articulates its overall goals (especially, which kind[s] of customer it will seek to create and keep). We will also outline the basic approach for achieving those goals. A good way to think about marketing strategy is, in Robert Davis's words, as the "blueprint by which the firm plans to compete."[5] In this reading, we will set down the process for developing that blueprint.

Note that while a company is making the all-important choice about the customers it hopes to acquire and retain, other firms are making similar decisions—each attempting to achieve Levitt's "differentiation" among a specific customer set. For example, in 2012, Pebble Technology decided to serve customers wishing to connect with their smartphones via a wrist device. By entering the smart-watch market, Pebble Technology would compete with both small firms, such as Fitbit, with its focus on fitness-related activities, and larger ones with more general-purpose functionality, such as Samsung, with its Galaxy smart watch. For today's highly informed customers, accessing information on the web and staying connected to social media forums is paramount. To succeed in its chosen customer segment, then, Pebble Technology would have to differentiate itself from competitors in the value it could deliver.

Later in this reading, we will examine the story of how Pebble Technology fared. But for now, our point is that winning at this contest in a way that yields revenues to cover costs and contribute to profits is no simple task. Most new products, in fact, do not find a way to do so and thus fail—often before they even get to market.[6] Organizations therefore must recognize that they need not try to create a mass-market product loved by everyone. Rather, a company could focus, for example, on the customer segment looking to trade off frills for a basic product at a low price (e.g., Vizio in televisions, often sold through discount clubs such as Costco) or the price-insensitive group seeking maximum performance (e.g., Bang and Olufsen with its home theater system). Marketing strategy is about the process of selecting these customers, deciding on the competitive point of differentiation to present to them, and developing a plan for accomplishing this.

In this reading, we set out a basic framework for thinking through the decisions to optimize an organization's chance for success. We begin with a description of the classic five Cs analysis for developing a marketing strategy (customer, company, collaborators, competition, and context). We then discuss two sets of decisions every organization needs to make: the aspiration decision (what the company hopes to achieve in the market) and the action plan decision (commonly known as the four Ps of the marketing mix—product, promotion, place, and price). Finally, we briefly set out the different kinds of actions required for customer acquisition versus customer retention. As an overview of marketing strategy, this reading does not provide extensive treatment of each area, but it does offer references throughout to appropriate sources of in-depth coverage.[7]

2 ESSENTIAL READING

There is no one way to market a product or service effectively; indeed, organizations often adopt different strategies for their different offerings.[8] For example, General Electric's approach to selling microwave ovens to millions of households differs, more than a little bit, from how it sells aircraft engines to the handful of firms that buy them. Similarly, different firms within the same industry employ different approaches. Steinway devotes itself to "Making the World's Finest Pianos" (and nothing else) by strictly limiting the types of pianos it manufactures and the types of outlets through which it sells. Competitor Yamaha, on the other hand, offers everything from grands and uprights to digital pianos and portable keyboards. L'Oréal of Paris has a policy that its cosmetics can be found at a wide variety of retail partners in the United States, including department stores, grocery stores, drugstores, and mass merchants, while Mary Kay cosmetics can be purchased only from a certified Mary Kay beauty consultant (including online, telephone, and in-person orders).

A given organization might also change its marketing approach over time. Samsung Electronics, for example, launched in 1969 with a low-cost strategy, and in 1990, the company's marketing head referred to Samsung as a "third-tier commodity brand with very little product differentiation."[9] Shortly thereafter, Samsung focused on developing manufacturing expertise to compete on the basis of the highest quality products. In 2013, it was rated number 8 in Interbrand's "Best Global Brands of 2013" tabulation—the highest rated non-US company on the list. That same polling had rival Sony at number 46, showing the extent of Samsung's transformation from a low-cost player, with a reputation lagging far behind Sony, to a top quality producer.[10]

Customer differences—in what they value in a product or service, how they want to buy, and how they trade off price versus benefits—mean that some customers more naturally fit the capabilities and aspirations of a given company. As companies seek to find and keep different kinds of customers, it logically follows that the market will be populated with products of varied specifications, promoted and distributed in a variety of ways, and priced at different levels. For more detail, see *Core Reading: Segmentation and Targeting* (HBP No. 8219).

Even though there is more than one way to go to market, we can nevertheless articulate a best practice for thinking about how to develop a marketing strategy for a particular circumstance. Such a framework is shown in **Exhibit 2**.

EXHIBIT 2 Schematic of Marketing Strategy Formation Process

2.1 Overview of Marketing Strategy Formation

In Exhibit 2, we see three interrelated elements in the marketing strategy formation process: analysis, decisions, and outcomes. The middle of the diagram depicts the two different sets of decisions an organization needs to make: the aspiration decision and the action plan decision.

The aspiration decision (which we can think about in terms of what value the product will represent to what kind of customer) specifies what the firm hopes to achieve in the market. This involves three steps: (1) ***segmenting*** the market to identify possible groups to serve, (2) selecting or ***targeting*** a specific group or groups to address, and (3) determining the desired ***positioning*** in the mind of the selected customers (that is, what should the customer be thinking about the firm's offering, relative to other options?). The steps in working out the aspiration decision are popularly known as STP (segmenting, targeting, and positioning).

Once the aspiration decision has been made, the firm can begin to work out its action plan, commonly known in marketing as the four Ps of the marketing mix (we use the term *mix* because the elements all need to work together to form a cohesive plan.) Three elements of the plan create value for the customers—the *product* offered, communication to the customer about the product (*promotion*), and mechanisms to distribute the product to the customer (*place*). The final element of the mix is the *price* charged for the product, which generates revenue for the firm. The value created for the customer through the first three Ps is the upper bound on the price the company can charge and still attract a customer. Obviously, organizations aspire to create value, such that the upper bound on price is greater than the unit cost of producing the value.

As shown on the left side of Exhibit 2, an organization needs to analyze the market in order to make good aspiration and action plan decisions. Usually this requires an analysis of the five Cs (customer, company, collaborators, competition, and context). To indicate its primacy for marketing decision making, Exhibit 2 places the first C—customer—in the middle of the circle under analysis. Here we assess who is involved in a purchase decision and how customers approach that process. For example, when purchasing a laptop computer, what criteria does the customer use to make a decision? Does she trade off various attributes against one another (e.g., weight versus screen size versus price) or does she have a set expectation that the product must meet or exceed for each attribute? The customer analysis is followed by close examination of the remaining Cs, which we will explore in the next section of this reading.

A company's choice of actions in the middle of Exhibit 2 then has to be funded and implemented. For example, if part of the chosen marketing mix is promotion via a company-owned sales force, the company must then develop and field such a sales force. The decisions in the middle column thus determine how successful the company will be at acquiring a customer, whether that customer is retained over time, and at what rate of purchase. The decisions made also determine the costs of the product or service and the supporting marketing costs.

As Exhibit 2 illustrates, the actions of the firm create not only short-term financial results but also a franchise, the platform for future marketing efforts such as its brand reputation and customer loyalty. This is not a linear process. Rather, there is a back and forth between analysis and decisions. The need to choose between action alternatives determines the specific analysis the firm should undertake. For example, if a manufacturer decided to distribute its goods through retail channels, rather than just selling on its own website, it would need to drill down further in its analysis to decide between, say, Target and Walmart, or to identify smaller, local firms.

We will keep the interactive process between analysis and decisions in mind while, in the sections that follow, we describe the other concepts shown in Exhibit 2, moving from left to right. Thus, we begin with analysis and a brief discussion of the five Cs.

2.2 Analysis Underlying Marketing Strategy Formation

When developing a marketing strategy, a company should undertake a five Cs analysis, starting with the primary C of (1) *customer* behavior (see Exhibit 2), supported by analysis of the (2) *company* (e.g., what special skills, competencies, and assets does the organization bring to the task of creating and keeping customers?), plus (3) *collaborators* (e.g., which suppliers can partner with the firm in its effort to attract and keep customers, and how they can be enlisted and motivated to participate as desired), (4) *competition* (e.g., who else seeks to create and keep the same customers? What capabilities do firms bring and what are their aspirations? What is their blueprint for competing?), and (5) *context* (e.g., what cultural, technological, and legal factors limit what is possible?).

In the sections that follow, we will look at each of the five Cs in an actual company context—the example of Pebble Technology, which we introduced at the beginning of this reading.

Customer Analysis[11]

In 2013, Pebble Technology shipped its first-generation Pebble smart watch, which sold for $150. By January 2014, at the Consumer Electronics Show (CES) in Las Vegas, Nevada, Pebble Technology's CEO Eric Migicovsky and his creation—the new, improved Pebble Steel smart watch—were among the stars of the show.[12] Of the 18 smart watches on display, Pebble Steel was dubbed "the most generally useful of all the wearable devices at CES 2014."

How did Migicovsky develop his smart watch from an idea to a hit product? Like many entrepreneurs, Migicovsky's initial customer analysis was on himself. An avid cyclist, he wanted a device that would notify him of text or e-mail messages coming to his smartphone while he was cycling. Rather than an "on the wrist" replacement for a cell phone, he preferred a device that would complement his phone—and his instincts told him that other cyclists would want the same.

Pebble Technology's CEO adopted a minimalist approach and developed the Pebble smart watch to work with the Blackberry phone he used at the time. But designing a more mainstream product required broader customer input, and he soon discovered that potential customers most wanted to know whether it would work with their iPhones. Migicovsky's job at this point was to systematically map out the key needs and the *decision-making process (DMP)* of potential customers of smart watches. He found that an appealing Pebble smart watch would work with iPhone and Android, be visible in direct sunlight, operate for a week or more without recharging, and be waterproof.

To market the product effectively, Pebble Technology executives also had to know how customers became aware of and informed about the features of a product like a smart watch. Did they conduct deliberative research on the Internet? Was word of mouth important? Did they need to touch and feel the product before buying? The answer to the first two questions was "generally, yes," and to the third was "some did, some didn't."

In general, the next part of customer analysis involves determining who the decision-making unit (DMU) is—that is, who is involved in the purchase process? In Pebble Technology's case, this was relatively straightforward because the purchase of a $150 smart watch would likely involve only the end users themselves. But particularly in business-to-business (B2B) situations, the DMU can be much more complex. Thus, customer analysis also requires in-depth understanding of customers' purchase and usage patterns.

When trying to ascertain the DMU, the marketer should ask the following question: Who are the participants in the buying process, and what role does each play? In an influential article, Thomas Bonoma set out six major roles generally played across a broad set of buying situations:[13]

- *Initiator(s).* Initiators recognize the value of solving a particular issue so they stimulate the search for a product.
- *Gatekeeper(s).* Gatekeepers act as problem or product experts and control information and access to other members of the DMU.
- *Decider(s).* Deciders make the purchasing choice.
- *Influencer(s).* Although they do not make the final decision, influencers have input in it.
- *Purchaser(s).* Purchasers consummate the transaction.
- *User(s).* Users consume the product.

In his work on capital equipment and service purchasing, Bonoma found an average of seven people involved in the six roles. But often one individual plays all six roles, which was usually the case in Pebble smart watch purchases, as it is with laptop purchases and other personal electronics purchasing decisions. For more involved or expensive purchases, such as a car or a house, married couples frequently make up the DMU, sometimes joined by their parents if financial help is required. The DMU might also include children if the products are home furnishings or a family vacation spot.

After determining the DMU, a marketer must next understand the purchaser's decision-making process, which includes finding responses to questions such as the following: Will there be a search for information, and how will it be conducted? How do the DMU members interact? What criteria will be used in making the decision? What is the relative importance of each? Can one criterion be traded off against another, or is there some minimal level that must be reached on each?

A variety of research methods can be used to answer these questions, ranging from quantitative surveys to qualitative methods such as focus group discussions or customer interviews. (For a survey of these methods, see *Core Reading: Marketing Intelligence* [HBP No. 8191]). Pebble Technology sought input from users via surveys to such an extent that *Wired* magazine called the Pebble smart watch "crowd-designed."[14]

Company Analysis

The second C for Migicovsky to consider in Pebble Technology's marketing strategy was his company's strengths and weaknesses. Through his customer analysis, he attempted to design a product that fit the market; the next requirement was to ensure that his product and approach fit the company.

Generally, assessing product/company fit requires an understanding of the finances, research and development (R&D) capability, manufacturing capability, and other assets of the firm. A highly influential concept, developed by Prahalad and Hamel, is a company's *core competency*. Two key elements of core competency are to (1) make a significant contribution to the creation of perceived customer value in products and (2) be difficult for competitors to imitate.[15] As we will discuss next, the complement to company analysis is collaborator analysis: If the company does not have a requisite skill or capability in-house, can it be obtained from another organization?

In Pebble Technology's case, the initial demand for the smart watch indicated the need for large-scale production capability, which the company did not have. The strengths that the company analysis identified, however, were that Pebble Technology was early to the market, and its executives had a native understanding of their potential customers, since they were avid cyclists themselves.

Collaborator Analysis

The C of collaborators involves analyzing the set of external assets that may be accessed to complement those of the company, thus allowing the organization to implement an effective marketing program. Pebble Technology's company analysis identified some significant holes to fill. It had a good smart watch idea, yes, but it still needed money for R&D; the capacity to manufacture at large scale; a distribution system for customers needing to "touch and feel" the product before buying; and applications that would work on the Pebble smart watch, thus increasing its market appeal.

With respect to money, Pebble Technology's collaborator was the website Kickstarter. After failing to acquire venture capital investment on suitable terms, Migicovsky turned to the Kickstarter model, hoping to raise $100,000 from those willing to invest $125 against later delivery of a Pebble smart watch, which was then only in prototype phase. Within 37 days, Pebble Technology found 69,000 such backers and raised $10.3 million. Pebble Technology then engaged a firm with knowledge of Chinese manufacturing options to find the best production sources. Key parts were obtained from STMicroelectronics (the internal microcontroller) and Corning (the glass for the device's cover).

Pebble Technology initially began selling the Pebble smart watch only via its own website in January 2013, when its first product shipped. By July 2013, it signed on with Best Buy as its first and exclusive consumer electronics store distributor. Several months later, it added some AT&T stores and finally, near the end of 2013, Amazon.com became an online seller of Pebble smart watches. Thus, through collaborations, Pebble Technology gained access to many customers, including those wishing to try the product and discuss it with a salesperson at Best Buy.

To provide a wide set of applications, Pebble Technology created an open platform and a software development kit. This led to collaboration with many popular services, including Yelp, Foursquare, and ESPN. Thus, Pebble Technology had upstream collaborators making the product, downstream collaborators making the product easily accessible, and developers of complementary products adding their items to the Pebble platform. Effective management of these business ecosystems requires understanding the goals and capabilities of all partners.

Competitive Analysis

Winning the customer acquisition game requires creating more value (benefits minus costs) for customers than any other options known to them. Thus, a firm must identify who its competitors are now and who they are likely to be in the future.[16]

Pebble Technology demonstrated best practice in this area by defining the competition in an appropriately broad way: Pebble Technology regarded its biggest competitor to be an empty wrist because many of the young people the company targeted normally did not wear any kind of wristwatch. While Pebble Technology was early to market with its prototype, it was clear that it would face major players eyeing the smart-watch market. Competitors and potential competitors were of two types: niche players focusing on specific applications along with telling time (such as Fitbit for fitness customers) and more general-purpose players such as Qualcomm and, most notably, Samsung. By 2014, there were 30 smart watches on the market.[17] (While many rumors about an iWatch from Apple circulated, the company had yet to make a definitive announcement.)

Competitive analysis requires assessing others' offerings, the market they address, how they address it, and how all that will evolve over time. As with company analysis, any realistic assessment of the competition must begin with a fundamental understanding of its strengths and weaknesses. Marketers can gain this information in a number of ways, including analyzing competitors' statements about themselves (for example, 10-K filings for publicly traded companies) and interviews with potential customers about their perceptions of competitors' offerings. Marketers can also observe a competitor's marketing actions, including the product it has on the market and, when possible, reverse-engineer or "tear down" a product to understand its features and likely cost.

Part of competitive analysis is also assessing the extent to which one can influence competitors' actions. For example, Pebble Technology wondered if, by providing an open platform for applications, it would discourage another "fitness-only" potential competitor from entering the market.

Context Analysis

A good marketing strategy takes very little for granted. The context shapes what is possible, and the context is always changing. This point is vividly illustrated by the disruption that the capabilities of the Internet brought to existing business practices. For Pebble Technology, context analysis identified a cultural trend towards crowd participation that it exploited in designing and funding its product.

Like technology itself, a context such as culture can shift and bring surprises unless it is carefully monitored. Many fortunes are made by anticipating cultural trends (e.g., consider the success of McDonald's and Nike). Products and services acquire meaning from their place in a culture, and they acquire economic value from that meaning. Thus, value is vulnerable to shifts in the culture. The systematic analysis of cultural trends (popularized recently as ***coolhunting*** and consumer ethnography) is increasingly an integral part of marketing strategy formation.

Similarly, politics, regulation, law, and social norms are not fixed features of the marketing landscape; rather, they are dynamic factors to consider and monitor for signs of disruption. Markets such as banking, television, and pharmaceuticals operate in particularly unstable settings. It is dangerous to design marketing strategies for such environments without a carefully developed point of view on the regulatory context.

Each of the five Cs we have just examined is critical—but in marketing, none is more important than the C of customers and looking at the world through their eyes. Devising an effective marketing program requires deep analysis to support decision making on a host of interrelated issues. With this preliminary understanding of key analysis types, we will now explore in depth the specific marketing decisions to be made.

2.3 The Aspiration Decision: Segmenting, Targeting, and Positioning

As we've said, the aspiration decision specifies what the firm hopes to achieve in the market. This decision involves three steps: ***segmenting*** the market, ***targeting*** a specific customer group or groups to address, and determining the desired product or service ***positioning*** in the mind of the selected customers (commonly abbreviated as STP).[18]

Examples abound of firms consciously positioning products and services to target a particular set—or segment—of customers. In fact, many companies renounce some potential customers so they can focus exclusively on a select customer group, whose wants their product is particularly well suited to serve. The Coca-Cola Company describes its Coke Zero as being "created with young adults in mind."[19] IKEA particularly wants you as a customer "if you can do simple things like pick up your purchases and assemble them at home."[20] "Bugs" Burger Bug Killers unconditionally guarantees pest elimination, not just pest control, and therefore accepts only customers willing to follow its strict cleanup regimen—and to pay premium prices.[21] Marriott designed its Courtyard hotels for business travelers and its Residence Inns for those on an extended stay. Zipcar's car-sharing service, first operating in Boston, sought to solve the transportation and parking problem of urban dwellers and college students, who were generally neglected by car-rental companies with their "no one under 25" rules. Outotec of Finland offers its gold- and copper-mine design and construction services for the most challenging set of circumstances, because those circumstances play to the firm's distinctive engineering skills.[22]

Looking at customer segments and how the purchase process varies across them allows organizations to fine-tune the marketing mix to meet the particular needs of chosen customers. Indeed, segmenting customers has become a key aspect of marketing today. In the words of Theodore Levitt, "if you're not thinking segments, you're not thinking."[23]

An organization's target market selection decision is critical, because customers ultimately set their own purchase criteria and thus dictate the rules by which the marketing game will be played. Thus the target market selection should consider the firm's corporate goals and the fit of the segment with these goals; it should also consider the firm's comparative strengths and weaknesses vis-à-vis competition, given the target market's purchase criteria.

As the examples listed earlier suggest, and as **Exhibit 3** shows, markets can be segmented in a variety of ways. Note also that segments can be defined by simultaneous use of more than one variable; for example, Zipcar combines age (under 25), geographic location (urban), and psychographic (environmentally concerned) to define its ideal customer.

EXHIBIT 3 Common Segmentation Variables

Variable Type	Example	Segment Defined
Demographic	Coke Zero	Age: young
	Zipcar	Age: under 25
	Marriott Courtyard	Business traveler
Geographic	Zipcar	City dwellers and college students
Psychographic/lifestyle	Zipcar	Environmentally concerned
	Ikea	Value-oriented
Benefit sought	"Bugs" Burger Bug Killers	Pest elimination (not control)
	Outotec	High performance
Usage	Marriott Residence	Long stay

The most widely used segmentation bases are demographic (e.g., age, income, gender, occupation), geographic (e.g., nation, region of country, urban versus rural), and lifestyle (e.g., hedonistic versus value-oriented). An alternative type of segmentation variable is the customer's behavior or relationship to a product: for example, the customer's user status (nonuser versus user), usage rate (light, medium, or heavy user), and loyalty status (none, moderate, strong, or totally loyal). With the widespread use of customer loyalty cards, usage-related customer segments can now be readily identified and targeted. For example, Catalina Marketing maintains three-year purchase histories for over 200 million unique loyalty-card identifiers.[24]

In the segmentation and target market selection process, a company has to play out various scenarios. Consider the positioning part of the aspiration decision: If we pursue this segment, how would we approach it and what would we want segment members to see in us? Positioning answers these questions. The answers should be formalized in a positioning statement. A positioning statement can take many forms, but effective statements specify the following essential elements:

1. The target customer, as defined by the segmentation variables
2. The wants of that customer
3. The product type and category, as seen by the customer
4. The key benefit to be provided to the target customer.

For example, Tybout and Sternthal recount the following positioning statement for Zipcar:

> To urban dwelling, educated, techno-savvy consumers who worry about the environment that future generations will inherit, Zipcar is the car sharing service that lets you save money and reduce your carbon footprint, making you feel you have made a smart, responsible choice that demonstrates your commitment to protecting the environment.[25]

The Ross School of Business at the University of Michigan developed this positioning statement for its MBA program:

> For prospective students seeking leadership capability development, Ross is the best MBA program because of the opportunity sensing skills and teamwork capabilities developed through extensive action-learning experiences, complementing classroom learning.[26]

The positioning statement is intended to get the whole organization aligned regarding the aspiration decision. External statements derive from the positioning statement. For example, Zipcar and Ross both had taglines related to, but shorter than, their positioning statements—Zipcar proclaimed "Wheels When You Want Them" and Ross touted itself as "Leading in Thought and Action."

A meaningful target market selection typically provides focus by deliberately excluding some customers from the market served. For example, in its early days, Dell consciously renounced first-time buyers of a personal computer because the buyers lacked the sophistication required to custom-design a machine on the web.[27] The Ross School of Business consciously renounced MBA candidates not interested in developing teamwork skills through action learning. The previous positioning of the school was so general, focusing on the non-differentiating attributes of being collaborative and innovative, that no one was excluded. The new, narrower positioning caused a short-run decline in applications, as the school actively sought to discourage applications from those not sold on action learning. That strategy was validated by the fact that the percentage of accepted MBA students who enrolled increased dramatically because of the superior fit of the service to the selected target.[28]

The goal is to define a target market that can be reached by the firm efficiently, whose members value the firm's comparative advantage, and who are willing and able to pay for it. Kotler articulated the fundamental importance of making the aspiration decision: "The advantage of solving the *positioning problem* is that it enables the company to solve the *marketing mix problem*. The marketing mix—product, price, place, and promotion—is essentially the working out of the tactical details of the positioning strategy."[29] That is the focus of the next section.

2.4 The Action Plan: The Marketing Mix Decision

Once an organization has made the aspiration decision, it needs to address the marketing mix decision (the action plan). Neil Borden of Harvard Business School originated the term *marketing mix* to describe the set of activities composing a firm's marketing program.[30] He noted the ways in which a firm blends mix elements into a program and that competing firms can have dramatically different mixes at work. Borden originally specified 12 distinct mix elements, ranging from product planning to display. Over time, an aggregation of these elements has become popular. As already shown in Exhibit 3, the four 4Ps terminology of product, price, promotion (communications strategy), and place (channels of distribution) is often used to set out the marketing mix in a memorable way. As suggested by Borden's use of the term *mix,* it is important that the various elements blend well.

Benson Shapiro has identified "three degrees of interaction":[31] *consistency* of mix elements—the minimum standard, implying a generally good fit; *integration*—existence of positive, harmonious interaction; and *leverage*—where each element is used to its best advantage to support the value creation/capture of the overall mix. In the sections that follow, we examine some of the major issues involved in setting the four Ps of product, promotion, place, and pricing, in that order.

Product Decisions

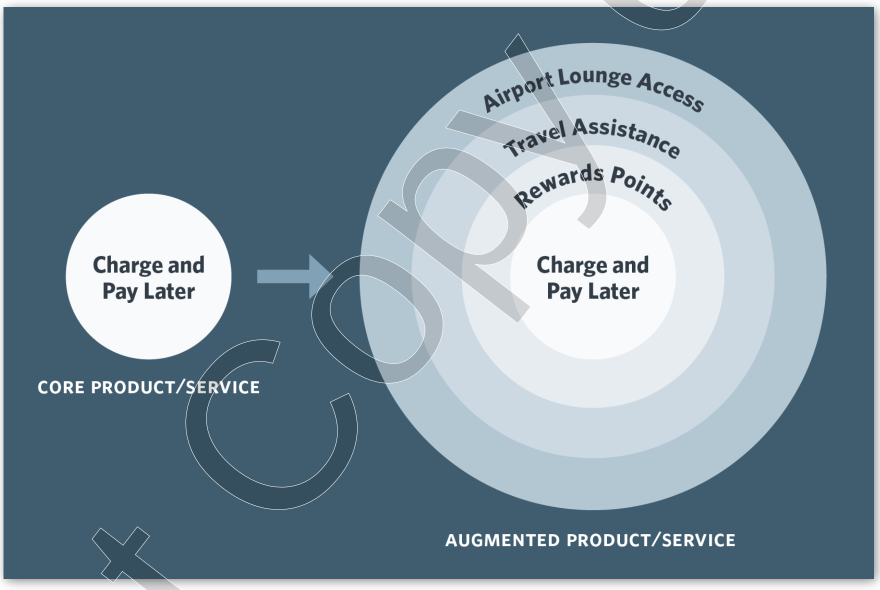
The product (or service offered) is the centerpiece of the marketing mix. It is a complete set of ways that value is delivered to the customer, not just a single core feature. For more detail, see *Core Reading: Product Policy* (HBP No. 8208).

For example, a conventional home thermostat, costing about $25, senses the room temperature and automatically turns on the heat when the room temperature falls below a specified level (or it turns on the air-conditioning if the temperature rises above a specified room level). Programmable versions, costing slightly more, permit the desired temperature setting to vary by time of day and day of the week.

Even though the relatively low-tech thermostats work fine for most customers, the desires of some customers are best met by a thermostat called Nest, the "Learning Thermostat," that costs five times as much as a basic one. Although its core function is the same as that of the $25 model, Nest provides added benefits. First, it is designed to be simple to install, but if help is needed, Nest provides a concierge service. Second, it is easy to use. The customer doesn't have to program anything—just adjust the temperature as desired; Nest learns the desired temperature by the time of day, or the day of the week, and automatically programs itself to accommodate those desires. Third, if a customer is deviating from a usual pattern, such as heading home early from work, Nest can be controlled from a smartphone. Fourth, if a customer is not at home, Nest senses that and adjusts the temperature to conserve energy. Fifth, Nest reminds the customer to change the air filter. Sixth, the customer doesn't have to calculate the savings gained; Nest sends a monthly energy report. Seventh, Nest's design and appearance have been highly praised in product reviews. In short, the Nest product is far more than just a device to turn the heat and air-conditioning on and off; rather, it is a complete bundle of benefits that can be offered to (and appreciated by) a particular segment of customers.

The logic here applies to services as well as products. For example, in 1958, American Express launched its charge card directed to business customers. It provided the basic function, but over time Amex added the Gold and Platinum cards, distinguished not by doing the basic function better but by augmenting it with other benefits such as membership rewards points, concierge services, and for Platinum holders, access to select airport lounges (see **Exhibit 4**).

EXHIBIT 4 Range of Credit Card Benefits for American Express Customers



As these examples illustrate, the core function of a product is not what makes the sale in most situations. That is why, when defining a product or service, marketers need to think of the full set of ways in which value can be created for customers—be it by brand name, company reputation, product/core functionality, ease of installation, ease of use, post-sale assistance, or warranty. This broad conception of a product is the key to seeing possible valuable points of differentiation from competitors. In fact, Theodore Levitt advocated the adoption of a total product view, considering the product as the full set of ways in which an offering can solve a customer's problem.[32]

Based on extensive study of new product launches, Robert G. Cooper has identified key success drivers.[33] While he admits some of these may be fairly obvious, his experience shows that some firms simply neglect them.[34] The key success factor is to have the output of the product design process be "a differentiated product that delivers unique benefits and a compelling value proposition. . . ." That outcome is advanced by "building in the voice of the customer" and by "spiral development," wherein a company first develops a concept and then a prototype, which is put in front of the customer for feedback, and then revised based on the customer's feedback.

Testing with customers can be done in a number of ways, including surveys, taste tests, simulated test markets (in which mock stores are set up and customers are recruited to shop in the mock store environment), and actual test markets for consumer goods and beta tests for industrial goods.[35] In a beta test, potential later adopters of a technology are recruited to use and evaluate a product as an input to design refinements and the go/no go decision. Testing is appropriate not only for the product itself, but also for the supporting elements of the marketing mix, such as the communication strategy and price.

Once an organization has developed and then launched its product or service, it begins a process of managing the product (or service) life cycle. First, the firm should be continually learning about customers from their reactions to the introduced product. This post-launch learning may suggest product repositioning or marketing mix changes. Second, the marketing environment is always changing; for example, customer wants are not static, market segment sizes change, competitive offerings change, and technology updates affect the firm's capabilities and costs.

Obviously, many firms do not offer just a single product. One decision a firm needs to make concerns the breadth of the ***product line***. (How many different product types will the company offer?) General Electric, for example, has a broad product line, ranging from aviation to appliances to health care. Other firms are more focused, offering a single type of product but perhaps a deep line of multiple, related items. General Motors (GM) is focused on cars and particularly its Buick, Cadillac, Chevrolet, and GMC brands. Its Chevrolet line is deep—comprising 24 different models, including the Spark (a small vehicle for "urban living," starting at $12,170), the Malibu ("where heart and mind just reached an agreement," at $22,140), and the electric Volt ("the best of both worlds," at $26,685). The line also includes the Silverado heavy-duty truck (the "strong just got stronger," at $31,310) and the Camaro ZL1 convertible at $60,155.[36]

Managing at the level of the product line taps possible synergies, for example, in production or R&D, and avoids unwanted competition among line elements. With its 24 Chevrolet automobile models, GM is attempting to serve a variety of different customer segments in a way that benefits from scale and helps build the dealer network.

New products come in many shapes and forms. For example, in pharmaceuticals, it might be a breakthrough blockbuster drug such as SmithKline's Tagamet (the first drug representing an alternative to surgery for ulcer problems) and Pfizer's Lipitor for cholesterol treatment. In the snack-food industry, one might legitimately apply the "new" tag to the latest flavor of Cheez-It crackers, as Kellogg did when it added Cheez-It Provolone Baked Snack Crackers to its line. This line already featured Cheez-It crackers in Big Original, Cheddar Jack, Pepper Jack, and Amazing Spider-Man form, among others.[37]

The most common type of new product is based on an existing product, such as the regular, predictable, "new and improved" models of computers, cars, televisions, golf clubs and balls, and smartphones under the same brand name.[38] Model changes may come at a regular interval (e.g., cars and model years) or as technology development warrants.

A second type of "new" product can be a company's initial entry into a product category that already exists. For example, while SmithKline established the ulcer treatment drug category with Tagamet (a product that was new to the company and to the world), Glaxo later introduced Zantec into the category, which eventually overtook Tagamet. Many new products of this second type are also similar to incumbents. For example, after Minolta introduced a very successful auto-focus camera, the other leading camera manufacturers followed suit.

The third type of new product is an addition to an existing product line—like the Cheez-It example, in which the new product exists alongside the old. Or the "new" product can represent a trade-up of the product line that seeks a higher quality and/or price point. For example, Tanqueray traded up its London Dry Gin, offering Tanqueray No. 10, described as "born in the elegant 10th still" with "small batches and fresh fruit." While some gin drinkers maintained a preference for the original, others were willing to pay the approximate 25% price premium for the No. 10. Alternatively, the newly introduced product can be a trade-down to a lower price point, a move often intended to battle competitors, as Kodak did with its "FunTime film" for "casual picture taking." FunTime film was priced at 20% less than its market-leading Gold Plus film. In such situations, a major concern is cannibalization, in which customers trade down from the higher-priced (and usually higher-margin) offering to the new low-priced product by the same company.

Promotion Decisions

The next element of the marketing mix is promotion—or how organizations communicate with selected customers about the product positioning. Initially, the goal may be to create product awareness, then knowledge about the product's features, then a level of interest in purchasing to the point of making a trial purchase as the product value is communicated. After the customer has tried the product, promotion has a reinforcing role in keeping that customer, per Levitt's specification of the job of marketing. Because of the variety of steps in this process of creating and keeping a customer, an integrated communications plan is key to an effective marketing strategy, which often combines personal selling efforts with nonpersonal ones such as advertising, sales promotion, and public relations. Let's look now at some of the tasks and tools required in promoting a product or service.

Tasks

A useful mnemonic for the tasks in planning communications strategy is the six Ms model:

1. *Market.* To whom is the communication to be addressed?
2. *Mission.* What is the objective of the communication?
3. *Message.* What are the specific points to be communicated?
4. *Media.* Which vehicles will be used to convey the message?
5. *Money.* How much will be spent in the effort?
6. *Measurement.* How will impact be assessed after the campaign?

By formalizing a positioning statement, an organization will be able to answer questions 1 and 2 and provide a foundation for answering question 3. The specific message should consider both the aspiration embodied in the positioning statement and the customer's current state of mind.

With respect to the fourth of the six Ms, a communications program sometimes comprises a wide variety of elements. For example, Sephora, a retailer of specialty beauty products with approximately 450 stores in the United States and Canada, directed traditional marketing out of its New York office and digital media out of Sephora Direct in San Francisco.[39] Together, these two offices put together a communications plan that included many elements, as shown in **Exhibit 5**.

EXHIBIT 5 Sephora Communications Plan

1. Striking store window displays
2. A Sephora website home page "look" consistent with the store window
3. Advertising with specific keywords with Google AdWords to direct online web searches to the Sephora site
4. Print advertisements in leading magazines
5. A loyalty program called "Beauty Insider" in which enrolled customers received
   - E-mails once or twice a week
   - Direct Mail
   - A 32-page print catalog
   - Free gifts/samples
6. A "Very Important Beauty Insider" program for high-spending customers, featuring free gifts and invitations to special store events
7. Highly trained salespeople in stores, referred to as cast members, and attired in Sephora black, white, and red. This personal selling effort was responsible for embodying the Sephora message and providing advice to customers.
8. Facebook advertising
9. YouTube videos (typically directed to product application demonstrations)
10. Mobile applications

Source: Adapted and reprinted from "Sephora Direct: Investing in Social Media, Video and Mobile," HBS No. 511-137 by Elie Ofek and Alison Berkley Wagonfeld. Copyright © 2011 by the President and Fellows of Harvard College; all rights reserved.

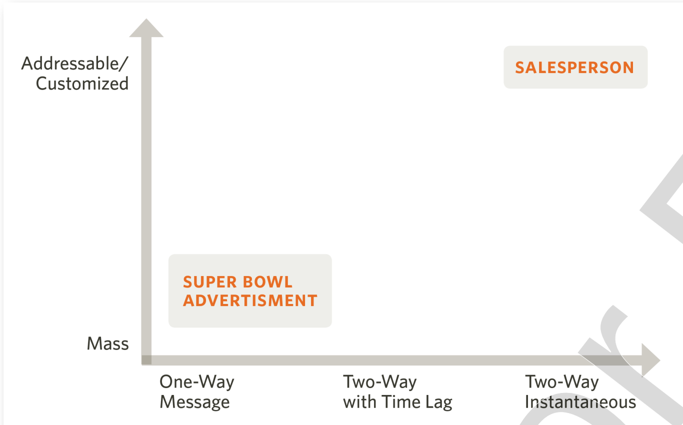
Tools

Exhibit 6 shows two dimensions along which it is useful to contrast communication vehicles: one-way versus two-way, and mass versus addressable/customized.

One-way versus two-way. The horizontal axis (dimension) in Exhibit 6 depicts the distinction between situations in which there is only outbound (one-way) communication and those in which there is two-way communication (an interaction between the initiator and receiver of the initial message). TV advertisements are typical one-way communications to a mass audience. For example, when Volkswagen ran its classic one-minute "pint-sized Darth Vader" ad, a favorite of Super Bowl 2011 (with ad rates running $3 million for a 30-second spot), it sent the same message out over the airwaves to all viewers (more than 110 million) tuned to the US television station Fox TV.

At the other end of the spectrum is the two-way dialogue. For example, when a prospect, perhaps motivated by the "pint-sized Darth Vader" ad, visited a Volkswagen showroom to see the new 2012 Passat featured in the ad, a salesperson was likely to engage that person and thus deliver a message. The prospect responded. An exchange of some duration typically ensued in which the salesperson tailored or customized his or her reply to the prospect's comments. If the salesperson's message was persuasive enough, the prospect's ultimate response may well have been to test-drive and then buy or lease the Passat. Thus, the communication began as a one-way, instantaneous one, but it evolved into a two-way communication.

EXHIBIT 6 Characteristics of Communication Options



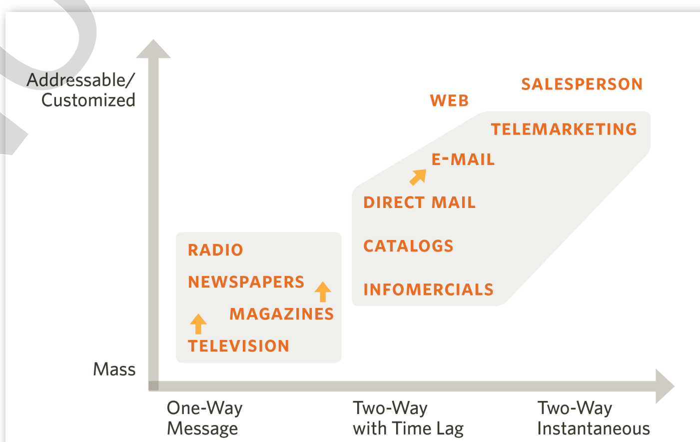
Source: Exhibits 6 and 7 adapted from a set of dimensions originally suggested by Professor John Deighton, Harvard Business School.

As shown in the middle of the horizontal axis of Exhibit 6, other two-way interactions occur with a time lag. For example, a direct mail piece may prompt a reply by the receiver, although that reply may await the receiver's attention or next trip to the post office.

Mass versus addressable or customized. The vertical axis (dimension) of Exhibit 6 describes the extent to which the message can be varied to meet the particular communication needs of the person receiving it. The Volkswagen ad on the Super Bowl was not customized; rather, it was delivered via a mass medium to everyone watching in precisely the same way at the same time. But the car salesperson can and should be customizing his or her message to the particular communication needs of the message recipient. A primary advantage and justification for the typically high cost of personal selling is this ability to adjust the message to the situation. For example, the salesperson might talk about safety features to the family with four children, the cargo-carrying capability to the young couple with ski weekends on their minds, and low initial payment leases to the first-time car buyer with no equity in a trade-in vehicle.

Exhibit 7 depicts some of the other important communication vehicles available. The positions are generally suggestions rather than absolutes for all situations.

EXHIBIT 7 Positions of Major Communication Vehicles



The proliferation of cable TV channels has increased the addressability/customizability options for television, as represented by the upward arrow in Exhibit 7. Obviously, everyone watching a given show sees the same advertisement. But there are now many specialized channels that have specialized audiences. An ad can be customized to the kind of audience typically viewing a certain TV show (or reading a particular magazine), thus matching the message to the audience.

Two types of promotions commonly form part of the communications mix. Customer promotions include free samples, continuity programs, and coupons. Trade promotion includes incentives to retailers, such as free goods or discounted prices if the product is provided in end-of-aisle displays.

Free samples are especially useful in getting customers to try a product. They can be distributed in the mail, passed out at points of purchase, or made available upon request from a potential buyer. For example, in early 2013, the Internet calling service Skype offered one month of the "best of Skype" for free, followed by $9.99/month thereafter. While samples typically prompt an initial use, a *continuity program* rewards customers for continuing the relationship. An example is an airline's frequent flyer program.

How promotion dollars are allocated across media vehicles varies greatly depending on the market situation. A fundamental decision is whether to focus on a push strategy or a pull strategy. In a ***push strategy***, marketers focus on inducing intermediaries, such as a retailer, to play a major role in creating demand for the product. For example, Hart Schaffner Marx may communicate to men via magazines, but Saks Fifth Avenue plays the major role in putting the target customer into one of the clothing manufacturer's suits. In a ***pull strategy***—for example, Levi's attempts to create a jeans brand preference with the customer—the retailer's role is merely to make the product conveniently available.

As the number of feasible communication vehicles has increased (e.g., event sponsorship, telemarketing, product websites, postings on someone else's website, social media, and infomercials), the job of specifying the right communications mix has grown more complex. At the same time, the situation presents the possibility of gaining competitive advantage if a company can leverage these vehicles.

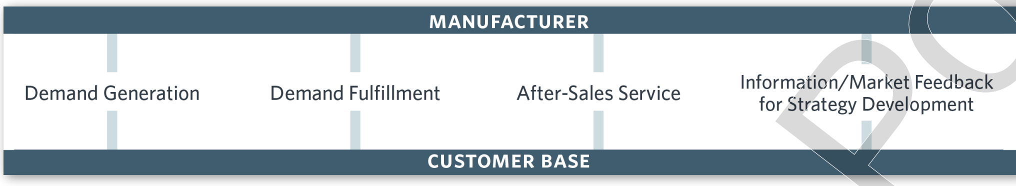
The fifth of the six Ms, money, is best addressed with an objective-and-task approach, first setting out the objective and then defining the best set of tasks to accomplish it. Some iteration between objectives and spending is usually needed to ensure the plan's economic viability. Spending levels vary widely across situations. Some firms spend over $1 billion per year in advertising; for example, in 2012, in the United States, Anheuser-Busch spent $1.5 billon, Target $1.7 billion, and Procter & Gamble, the largest buyer of advertising, spent $4.8 billion. These absolute numbers are obviously large, but viewing them as a percentage of sales puts them in perspective. For example, P&G's $4.9 billion represents only about 10% of its sales in the United States.[40]

The final of the six Ms, measuring results, should be done against the set objective of the communication plan. For example, if the goal is simply to raise product awareness, then the metrics should measure the increase in the level of product awareness. Behavioral measures such as whether customers agree to try the product or buy it again could also be appropriate, depending on the circumstances.

Place Decisions

Place, the third P, refers to ***distribution channels***, or where and how an organization decides to go to market. For more detail, see *Core Reading: Developing and Managing Channels of Distribution* (HBP No. 8149). As shown in **Exhibit 8**, a firm typically has to link (directly or through a partner) with its chosen customers to achieve four major tasks: (1) generate demand for a product or service, (2) fulfill that demand by getting the product to the customer, (3) provide after-sales service, and (4) gather and transmit feedback from the customers to the manufacturer.

EXHIBIT 8 Market Channel Tasks



Depending on customer requirements and their own strategies, different organizations place or distribute their products in fundamentally different ways. These choices determine the specific roles of players, their importance in the overall business, and their power to claim a share of the profits generated. For example,

- Gap, Inc., describes itself as "owning brands, not just stores" and designs all its own products, which it sells through over 3,000 company-owned or franchised retail stores. Its Gap Online store made $2.3 billion in revenue in fiscal 2013, about 14% of the total company revenue.[41] It outsources manufacturing, purchasing from 1,200 suppliers, but manages the entire going-to-market phase itself.
- Avon Products generated approximately $10 billion in sales in 2013 by selling through more than 6 million sales representatives worldwide.[42] Selling mostly cosmetics and fragrances, these representatives are independent agents, not employees of Avon, who work part-time buying product from Avon and then selling to customers directly via customized online stores or at in-person gatherings. Avon assists in the demand-generation task by training sales representatives and producing a sales brochure every two to four weeks. Sales representatives receive products from Avon and deliver them to the customer, collecting payment for their own accounts.
- In the United States, BMW goes to market through partners, with 338 BMW passenger car dealers, 115 MINI dealers, and 32 Rolls Royce dealers selling its automobiles. The dealers and BMW share responsibility for demand generation. BMW designs and implements national advertising. Dealers provide product display and the opportunity for customers to test drive. Dealers fulfill demand by delivering vehicles to customers and providing local after-sales service.
- In 2013, SAP, the software company, served a wide variety of customers—more than 250,000 in 180 countries—both directly and through a variety of collaborators, generating €16 billion in revenues. While most business development was driven by its own direct sales organization, it had 11,000 partners, including original equipment manufacturers, value-added resellers, and distributors.
- Distribution channel assignments can change over time. For example, in 1998, when Starbucks began to market its coffee beans and ground coffee in supermarkets and mass merchants, it entered into a joint venture with Kraft, which assumed the marketing of Starbucks in these stores. After 12 years, citing a desire to better integrate its "at home" and "away from home" target markets, Starbucks terminated its venture with Kraft and undertook the marketing task itself.[a] In 2013, the one-year-old wine company Stack Wines, with its innovative packaging and "Take It With You" trademark, enlisted a large distributor to help it expand nationwide.

[a] In an example of how difficult it can be to change a channel relationship, Kraft disputed its termination and eventually won a $2.7 billion arbitration award from Starbucks.

Today it is common for companies to reach different customers through different routes. Recall the example of the Pebble smart watch and its collaborators. Selling directly through its own website enabled Pebble Technology to serve some customers and keep the entire profit. However, other customers wanted the full service afforded by visiting a retail store: that is, the opportunity to see, touch, and discuss the product. Thus, Pebble Technology partnered with the home electronics and appliance retailer Best Buy. Given its 1,056 US stores, 40 million square feet of selling space, and 23 distribution centers, Best Buy had customer access that Pebble Technology could not economically generate for itself.[43] Of course, other kinds of customers want the convenience of *not* having to visit a store; they can still order from the manufacturer's website or an online retailer such as Amazon. Still other customers combine use of both distribution channels: educating themselves at a retail store and then seeking a lower price online.

Note that the economic consequences of a company's choice of place—its distribution channels or partners—can be quite significant. For example, in its fiscal year 2013, Best Buy retained about 24% of the revenues it generated in selling the products of firms ranging from Apple to Pebble Technology, as well as its own private label sales.[44]

Indeed, when setting a go-to-market policy, companies must consider two major areas. The first is the choice of *channel design.* Will the manufacturer pursue a direct or do-it-yourself (DIY) strategy, undertaking all necessary functions? Or will channel partners be involved? If partners are to be involved, what going-to-market role will each one play? The second aspect is *channel management,* which addresses questions such as: What policies and procedures are needed to guide the functions performed by the various channels? A key issue here is where the channel power will reside. A retailer could just be providing convenient local availability of a product (e.g., shaving cream at a drugstore) and so claim only a small percentage of revenues, or the retailer could be highly influential in brand choice (as in the example about Hart Schaffner Marx suits mentioned earlier) and so claim a higher percentage.

A key goal of channel design is to minimize conflicts between partners in a distribution system. Parties' interests can seldom be perfectly aligned—for example, while they all might wish to generate a large "profit pie," each would like a bigger piece for itself. A downstream channel partner, such as a Best Buy, may well carry a broad assortment of competitive products to draw customers to the store. That retailer, while wanting to make a sale, may be somewhat indifferent to the specific brand bought, or it might even be pushing its own private-label products, as the larger grocery chains do. For more detail, see *Core Reading: Developing and Managing Channels of Distribution* (HBP No. 8149).

Pricing Decisions

The three elements of the marketing mix discussed to this point—product, promotion, and place—represent an outlay of money from the firm. Effective execution of these activities creates, communicates, and delivers value to potential customers. Price (the final of the four Ps of the marketing mix) has the role of tapping into that value to create revenues for the firm and thus to cover costs and generate a profit.[45]

Getting pricing right is critical because of the highly leveraged effect it has on the bottom line. Consider what it would mean to be able to improve price realization (the revenue obtained from selling a given bundle of goods) by 1%. Siemens is a large German company with €76 billion in sales, generating €4.2 billion in net income for 2013.[46] A 1% improvement in price realization would result in an 18% improvement in net income. Some industries, such as grocery retailing, operate on razor-thin margins. For example, in the United States, Safeway had $44.2 billion in sales in 2012, generating $566 million in net income. If Safeway improved its price realization by 1%, it would improve net income by 78%.[47] This, of course, may not be possible in such a competitive industry, but even a 0.25% improvement (e.g., increasing the price received by 1% on 25% of the products it sold) would generate a 19.5% improvement in net income. Looking at the *Fortune* 500 firms as a whole, a 1% price realization improvement produces about a 12% bottom-line improvement.

A complete pricing program has many components. The first is the pricing mechanism itself. Auctions, in which the price is determined by potential buyers' expression of their willingness to pay, used to be restricted to a fairly small set of products, such as thoroughbred horses, fine artwork, and distressed real estate. However, information technology advances have made auctions much more widespread. An eBay seller, for example, has to decide between using an auction mechanism and setting a buy-it-now price. Google prices its AdWords via a cost-per-click-based auction, in which a potential advertiser specifies the maximum cost per click it is willing to pay. Google then serves up advertisements considering these bids and the relevance to the customer's search.

Still, the most common pricing mechanism is the posted price, where the supplier of the good states a price. In some cases, it is a take-it-or-leave-it proposition, for example, $6.00 for the *Sunday New York Times* at the newsstand, $750 for the Ferragamo Pellas shoes at Zappos, or $228 for a nonstop JetBlue flight from West Palm Beach, Florida, to Boston at 7 a.m. on an upcoming Sunday morning. Other times, the posted price is the starting place for a negotiation. Posted prices can also be fairly stable (such as the price for the *New York Times*), or they can be dynamic (JetBlue, for example, varies the price for a given flight over time, based on observed bookings).

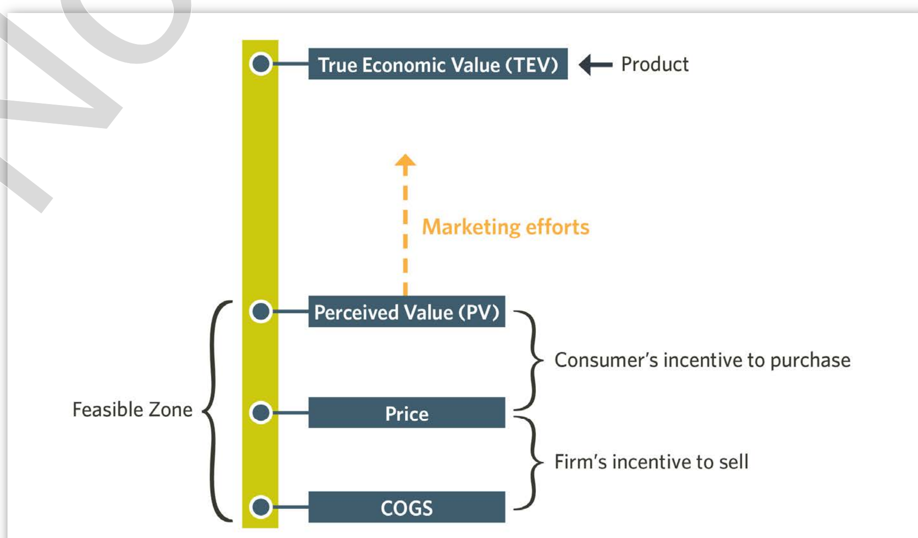
While the price itself is most central, the terms and conditions are also critical. For example, many firms offer quantity discounts where the price varies with the number of units purchased—either in the given order or accumulated over a time period.

The three points to consider for an effective pricing program are (1) the value of the product to the customer (rather than the firm's cost of goods being the major pricing determinant), (2) opportunities to vary price across customers according to the value they individually place on the item, and (3) customers' price sensitivity. We look at each of these next.

The Value-Based Approach

Exhibit 9 summarizes the important inputs to the pricing decision. The key element in the exhibit is the perceived value that the customer places on the item. This establishes an upper bound on what the customer is willing to pay. It is a function of the firm's offering and the price and features of competitors' offerings that are known to the customer.

EXHIBIT 9 Key Inputs to the Pricing Decision



As shown at the bottom of Exhibit 9, the firm cost is generally a lower bound to the price. Sometimes, however, a firm may sell below cost to spur some trial and adoptions, with the belief that this will increase the perceived value and lead to greater pricing flexibility in the future.

Assessing perceived value (PV) can be done in a number of ways. A common and useful approach is to break down the value into its two components, as shown in **Exhibit 10**.

EXHIBIT 10 Calculating True Economic Value

True economic value = price of the next-best alternative + value of the performance differential compared to next-best alternative

The calculation of true economic value (TEV) must take place relative to the next-best alternative as seen by the customer because a sale will be generated only if the product's value outweighs price when compared with all competing products or services. Competing products may be very similar to one another (e.g., golf balls from Bridgestone, Calloway, or Titleist), or they may be quite different, as in the competing services to a Delta Airline shuttle flight from New York to Boston. Such services can include the very similar service from US Airways but also Amtrak's Acela train service, regular train service, a luxury bus coach, a low-cost bus, and a car rental. Particularly in industrial situations, where the buyer's cost structure can be estimated, this economic value equation can be very helpful.

An alternative to this way of assessing perceived value is to conduct market research on potential customers' willingness to pay, using straightforward questioning or more advanced techniques.

Price Customization[48]

Price customization seeks to recognize and capitalize on the fact that different customers place different values on the same product. Let's return to the example of airline prices. As already mentioned, JetBlue recently posted a price of $228 for a Sunday 7 a.m. departure, nonstop, from West Palm Beach, Florida, to Boston. But what if you want one more day in the sun before returning to Boston to work on Monday morning? There is a departure at 6:45 p.m. Sunday, but the ticket price is $648. If you really want that last day in the sun, you will be willing to pay the extra $420. (Note that the same 6:45 p.m. departure was priced at $408 on Monday evening and $258 on Tuesday evening.) Therefore, when pricing a product or service, you should ask the following questions:

- Do customers vary in their intensity of use? Heavy users generally value a product more than light users do, especially when it comes to durable products—for example, golf clubs, televisions, cameras, and the like. Heavy users may also be interested in added features or complementary products, so a company can use ancillary products as a mechanism for differential pricing.
- Do customers use the product differently? Some customers use a product differently than other customers do, with a consequent difference in perceived value.
- Does product performance matter more to some customers, even if the application is the same? "Bugs" Burger Bug Killers guarantees total pest elimination and commands a

price ten times the industry norm because it focuses on customers such as hotels and hospitals, for whom the cost of failure is extreme. "Bugs" Burger's guarantee of zero pests has much more perceived value for those customers than it does for other potential customers.

- Do customers vary in their ability to pay? For example, senior citizens on fixed incomes might have limited means and be willing to pay only smaller amounts. Price customization is the common practice of aligning prices to the value of a particular segment.

Price Sensitivity

A third factor in setting prices is determining just how price-sensitive a customer is in a given circumstance. One way to do this is with market research, but a business can also use the guidelines that follow to make handy predictions about the price sensitivity of its customers. A customer's price sensitivity increases (and a business's pricing latitude decreases) in the following circumstances:

1. When the end user, rather than a third party, bears the cost (for example, until recently, pharmaceutical manufacturers have had greater pricing latitude, because neither the prescriber nor the patient bore most of the costs);
2. When the cost of the item represents a substantial percentage of a customer's total expenditure;
3. When the buyer is not the end user but rather sells his or her end product in a competitive market. It is worth noting that price pressure from further down a distribution channel ripples back through the chain. For example, one steel producer was able to obtain better margins by selling a component to buyers who produced specialty items, rather than to those who sold to commodity markets: the latter was much more price sensitive;
4. When buyers are able to judge quality without using price as an indicator. However, in some product categories, such as perfume, where judging quality is subjective, price sometimes has little impact because customers often use price as an indicator of quality;
5. When customers can easily shop around and assess the relative performance and price of alternative products. Today, advances in information technology have enabled customers to increase their awareness of prices and their access to alternative options through comparison-shopping engines such as Google Shopping, Nextag, and PriceGrabber;
6. When there is no urgency to make a decision and thus the customer can take the time to locate and assess alternatives;
7. When buyers can switch from one supplier to another without incurring additional costs. In January 2014, T-Mobile, which confronted ***buyer stickiness*** due to termination fees from other cell phone service providers, offered to pay up to $350 per line for termination fees when a customer switched from other cell phone service providers.[49]

Finally, regarding the competitive situation, a company's pricing latitude decreases to the degree that (1) there is limited difference between the performance of its product and others in the category, and (2) a long-term relationship with the company and its reputation are not important, so the customer's focus is on minimizing the cost of this particular transaction.

In addition to these customer issues, effective pricing considers competitors' potential reactions. As shown earlier in Exhibit 10, the true economic value that a customer ascribes to a firm's offering is a function of the competitor's price. Thus, considered pricing actions need to take into account competitive reactions.

2.5 Conclusion

At the beginning of this reading, we mentioned management guru Peter Drucker's view that the only valid purpose of a business was to create a customer—and Theodore Levitt's point about the importance of *keeping* the customer as well. Acquiring a customer means that she or he has chosen to engage in an exchange with the company—usually an exchange of products or services for money. How the company interacts (or not) with the customer thereafter often depends on the nature of the product or service. For instance, a company might focus simply on successfully completing that transaction and the profit it generates. In other cases, the focus is on the customer relationship over time. Some customer purchases, for example, are of items needed only once in a lifetime (one hopes); a customer replacing a home hot-water heater likely hopes not to have to repeat that purchase. In other product categories, retention of an acquired or created customer seems almost inherent. For example, many homeowners never make a claim on their insurance policies. Years go by, the policy renews automatically, and a bill arrives. Lacking real experience with the product unless spurred to action by a change in price or terms, the household automatically repeats the purchase by having the amount regularly deducted from a bank account.

For many kinds of businesses, in fact, the long-term health of the company depends not on acquiring a customer but almost entirely on retaining that customer.[50] While, in general, there may be some stickiness to customers' purchase behavior, customer ***churn*** and defections are not uncommon. Recent research by Catalina Marketing, based on its vast database of household purchase behavior, shows precisely this type of behavior. In its study "The Top 100 Brands," Catalina Marketing defined "high loyals" as households devoting 70% or more of the purchases in a year within a category to a single brand.[51] Catalina Marketing's research showed that for the subsequent year, 25% of the "high loyals" reduced their loyalty to an extent they no longer met the "high loyal" definition and, in fact, an additional 20% defected from the brand completely.

Levitt presents the customer-retention challenge in this way:

> The fact of buying changes the buyer. He expects the seller to remember the purchase as having been a favor bestowed on him by the buyer, not as something earned by the seller. Hence, it is wrong to assume that to have gained an account gives you an advantage by virtue of having gotten "a foot in the door." The opposite is increasingly the case. . . . The natural tendency of relationships, whether in marriage or in business, is entropy—the erosion or deterioration of sensitivity and attentiveness. . . . A healthy relationship requires a conscious and constant fight against the forces of entropy.[52]

Thus, the same marketing actions that *create* a customer might not necessarily help to *keep* that customer. Consider a study at Wachovia Bank (now Wells Fargo).[53] Wachovia was interested in three related points: (1) customer acquisition, (2) customer retention, and (3) upselling or cross-selling the customer. The study hypothesized that advertising would help acquire customers, expanding the branch network or customer service would likely help to retain them, and new-product development would allow cross-selling to current customers. But the analytically rigorous study showed that these goals were not mutually compatible: "[A] marketing mix designed to maximize new-customer acquisition in the short term would differ significantly from a mix designed to maximize customer equity [the long-term value of the customer]."

And yet some firms have distinguished themselves in their superior ability to retain loyal customers. The Walt Disney Company has fostered relationships to create loyalty so well that it is able to offer a course for other companies entitled "The Disney Approach to Brand Loyalty." While Disney "repeaters" may go years between purchases, other companies would prefer that the time between purchases be a matter of hours. For example, Starbucks has enacted a promotion program directed to visitors during the busy morning hours to encourage them to return in the midafternoon for a discounted cold drink. These are just some of the strategies that successful organizations depend on to retain the customers they have worked so hard to get.

Acquiring customers and retaining them in the ways we have just described require a cohesive marketing plan based on proven analytical approaches for decision making. In this overview of the marketing process, we have set out a comprehensive framework for understanding the major marketing challenges that organizations must address in order to craft such a marketing strategy.

3 KEY TERMS

buyer stickiness Resistance of customers to switching easily between one supplier of a good or service to another.

churn One hundred percent (100%) minus the customer retention percentage rate.

coolhunting Observing and predicting the emergence of and changes in cultural trends, visible in clothing fashions, popular music, urban lifestyles, uses of technology, etc.

distribution channels The network of individuals and organizations involved in the process of moving a product or service from the producer to the end user.

positioning (1) Defining a value proposition for the target segments. (2) Differentiating a product or service (or its brand) from others in the perception of customers.

product line Group of products manufactured by a firm that are closely related in use and in production and marketing requirements.

pull strategy A pull strategy involves motivating customers to seek out your brand in an active process, via tactics such as advertising, customer relationship management (CRM), and sales promotions.

push strategy A push strategy involves ensuring the customer is aware of your brand at the point of purchase, via tactics such as direct selling to customers in showrooms, packaging designs, or point-of-sale displays.

segmentation A marketing planning process that involves dividing a broad target market into subsets or groups of customers who have common needs or characteristics.

targeting Selecting the potential customer segments to whom a company wishes to sell products or services, after an analysis of each segment's attractiveness.

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